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Q1 2021 Campbell Soup Co Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Campbell's First Quarter Fiscal 2021 Earnings Presentation. (Operator Instructions) Please be advised that today's conference may be recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Ms. Rebecca Gardy, Vice President, Investor Relations. Ma'am, you may begin.

Rebecca Gardy *Campbell Soup Company - VP of IR*

Good morning, and welcome to Campbell's First Quarter Fiscal 2021 Earnings Presentation. I'm Rebecca Gardy, Vice President of Investor Relations.

Following the completion of this call, a copy of the presentation and a replay of the webcast will be available at investor.campbellsoupcompany.com. A transcript of this earnings conference call will be available within 24 hours at investor.campbellsoupcompany.com.

Turning to Slide 3. Today, we will make forward-looking statements which reflect our current expectations. These statements rely on assumptions and estimates which could be inaccurate and are subject to risk. Please refer to Slide 3 or our SEC filings for a list of factors that could cause our actual results to vary materially from those anticipated in forward-looking statements.

Because we use non-GAAP measures, we have included in the Appendix of this presentation a reconciliation of these measures to the most directly comparable GAAP measures.

On Slide 4, you will see our agenda. With us on the call today are Mark Clouse, Campbell's President and CEO; and our Chief Financial Officer, Mick Beekhuizen. Mark will share his thoughts on our overall first quarter performance and in-market performance by division. Mick will discuss the financial results of the quarter in more detail and review our guidance for the second quarter. We will close the call with an analyst Q&A.

And with that, I'll turn the call over to Mark. Mark?

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

Thanks, Rebecca. Good morning, and welcome to our first quarter earnings call for fiscal year 2021.

I'd first like to wish everyone all the best as we head into the rest of the holiday season. I know I am grateful this year for the entire Campbell organization, especially our colleagues in the manufacturing plants and our distribution teams, who have been producing and shipping to meet the higher demand the pandemic has brought while prioritizing the safety of our people and following our heightened

in-plant protocols.

Turning to the results. As you saw in our press release, we reported another strong quarter from both a sales and profitability perspective, with growth across all our key metrics as we continue to execute in a volatile environment and against our strategic plan. Our strong top line growth, combined with gross margin expansion and value capture synergies, despite the impact of ongoing COVID-19-related costs, led to better-than-expected adjusted EBIT growth, up 18%, and a 31% increase in adjusted EPS to \$1.02 per share.

It also was a strong executional quarter where we were able to strengthen supply levels to allow our retailers to improve inventory going into the crucial soup and holiday season. In addition, we announced that our Board approved a 6% increase in our quarterly dividend, reflecting the company's strong earnings performance, cash flows and increasing confidence in our long-term growth prospects as well as our continued commitment to shareholder returns.

Organic sales in the first quarter increased 8%, led by 12% organic sales growth in Meals and Beverages, reflecting our continued investment in our brands to attract and retain new households as retailers also rebuilt inventory levels. Turning to our Snacks division, we drove solid growth with organic sales up 4%, reflecting sales increases across the majority of our 9 power brands. Our portfolio of unique and differentiated snacks remained in high demand as in-home consumption rapidly expanded.

We did make some selective strategic decisions to shift promotions from the first quarter to the balance of the year to help ease supply constraints, particularly in the Meals and Beverages division. While these decisions did generate mixed share results as expected, we exited the first quarter in a much better position on retailer inventories and are seeing accelerating in-market performance as programming is ramping up into our key holiday season. We expect that, that pressure of elevated demand on supply will continue in the near term, but we are building supply chain capacity and capabilities to help us better navigate this pressure and maximize availability while protecting and growing share.

For the sixth consecutive quarter, our total company in-market dollar performance grew in measured channels, increasing 7%, with growth across almost the entire portfolio. Continuing the momentum from the back half of fiscal 2020, October was the ninth consecutive month in which we grew household penetration versus prior year.

In our first quarter, we attracted millions of new households, with the most notable increase coming from younger consumers. We also continued to see elevated repeat rates with over 70% of household gained since the beginning of the pandemic purchasing our products again. As we have said on previous calls, we consider this to be an enduring change in behavior. And given strengthening consumer trends, like quick scratch cooking and at-home eating and snacking, we remain confident that we will retain a meaningful number of these households beyond the pandemic.

Within the Meals and Beverages division, soup net sales increased 21% with growth in all segments. This reflects retailer inventory recovery, in-market gains and moderated promotional activity. We grew our household penetration in overall soup by 1.3 points. In addition to gaining new buyers, we are retaining these new buyers as reflected by higher repeat rates. And among millennials, we grew share for total U.S. soup by nearly 1 point, including significant growth of 2.7 points on condensed and over 1 point on ready-to-serve, demonstrating the sustained relevance of our core businesses with younger consumers.

Our condensed soups were the highlight of the quarter with double-digit net sales growth, gains in share led by cooking SKUs and 4 million new households purchasing this quarter versus prior year. We continue to bring new ideas and recipes to consumers who are cooking more frequently at home. As these first-time cooks gain more confidence, we believe they will likely continue to use these skills to prepare more meals at home well beyond the pandemic. Our recipe solutions continue to resonate with consumers as we saw a 20% increase in overall recipe-related page views in the first quarter compared to the prior year.

Within ready-to-serve, we saw solid consumption growth, but supply pressure and our decision to moderate promotions, as previously mentioned, resulted in some short-term share loss. However, as supply has improved, we are seeing improved trends, supported by our Chunky NFL sponsorship activation, our Slow Kettle Crunch innovation and our Well Yes! relaunch. We expect all these factors to have a

very positive impact in the second quarter.

Our Pacific Foods growth engine performed well as we continued to build scale with nearly 22% dollar consumption growth in soup and broth in the quarter. Pacific soup and broth grew share for the fourth consecutive quarter, including strong gains with millennials. Pacific has also increased points of distribution and grew household penetration as we launched our first-ever national advertising campaign.

Overall, we continue to feel great about the progress we've made against our Win in Soup strategy as evidenced by our success expanding into millions of new households, attracting younger consumers and growing all of our core brands.

Turning now to the performance of our Snacks power brands, which grew dollar consumption by 6% in the quarter. The most notable being Late July, which grew consumption sales by 26% and share by nearly 2 points. We continued to run the brand's first national ad campaign throughout the quarter. Late July is a great example of how our power brands are helping consumers make the most of their snacking moments. We take a mainstream segment like tortilla chips and offer a product with higher quality, including organic product credentials, highly relevant innovation and world-class marketing to better engage consumers, allowing them to trade up into a better snacking experience. We have successfully applied this model to other brands as well, such as Kettle brand chips and Snack Factory Pretzel Crisps, which also had double-digit dollar consumption growth in the quarter.

We also made significant progress on Goldfish in the quarter, with both supply and service levels improving. We have also redirected marketing aimed towards snacking options at home and restored promotional spending toward the end of the quarter. This is resulting in improved consumption and share in the most recent periods. We feel very good about our snacks performance and the steady growth it delivers, supported by a very healthy base business. In addition, we continue to remain on plan to deliver the value capture synergies that we initially outlined as part of our acquisition of Snyder's-Lance. Our investment in capacity expansion in both Goldfish and our chips demonstrate our conviction in the long-term growth potential of our brands.

We are still working through some supply constraints, including a challenge in cookies, where the combination of demand and labor impacted by COVID-19 has had some negative impact on supply. Despite these isolated challenges, we feel very confident in our ability to meet the long-term demand, driven by the expected sustained growth of consumer snacking behavior.

Given the rapid growth of the e-commerce channel across foods, I want to touch on our enterprise performance in the quarter. Our e-commerce in-market dollar consumption results were once again impressive, growing 85% over prior year. Consumers' use of e-commerce, and particularly click and collect for groceries, has increased by a considerable amount these past several months, and we believe this trend will continue. Accordingly, we are investing to strengthen our capabilities and in our support of key partnerships to serve the millions of consumers who are shopping online.

Given our overall financial results and the actions we've taken to start the year, we are well positioned across our entire portfolio heading into Q2 and the key soup and holiday season.

With that, let me turn it over to Mick for a deep dive into our financial results.

Mick J. Beekhuizen *Campbell Soup Company - Executive VP & CFO*

Thanks, Mark. Good morning, everyone. As Mark just shared, we had a strong start to fiscal 2021 with another quarter of strong sales growth driven by elevated consumer demand, gross margin expansion despite the COVID-19 cost headwinds, and robust adjusted EBIT and adjusted EPS growth ahead of expectations.

I'll now review our first quarter results in more detail and provide guidance for the second quarter. For the first quarter, reported net sales increased 7% to \$2.3 billion. Organic net sales increased 8% in the quarter, which excludes the impact of the sale of the European chips business. Adjusted EBIT increased 18% to \$463 million as higher sales volumes, improved adjusted gross margin performance and lower selling expenses were partially offset by increased marketing and slightly higher adjusted administrative expenses. Adjusted EPS from continuing operations increased by 31% or \$0.24 to \$1.02 per share, reflecting an increase in adjusted EBIT as well as lower net interest expense.

Breaking down our net sales performance for the quarter. Organic net sales increased 8% from the prior year. This performance was driven by a 6-point gain in volume across the majority of our retail brands, offset partially by declines in foodservice. Lower levels of promotional spending in both segments drove a 2-point gain. The divestiture of the European chips business negatively impacted net sales in the quarter by 1 point. And the impact from currency translation in the quarter was neutral. All in, our reported net sales were up 7% from the prior year.

Our adjusted gross margin increased by 100 basis points in the quarter to 34.8%. Favorable product mix, which drove a 30 basis point improvement in our adjusted gross margin, was largely driven by the increased contribution from our soup products within our Meals and Beverages segment. Separately, we are estimating a 60 basis point gross margin improvement from better operating leverage within our supply chain network as we significantly increased our overall production, primarily within Meals and Beverages. Net pricing drove 120 basis point improvement due to lower levels of promotional spending in the quarter.

Inflation and other factors had a negative impact of 270 basis points, driven by cost inflation as overall input prices on a rate basis increased approximately 2%, as well as other operational costs and continued COVID-19-related costs. This was partially offset by our ongoing supply chain productivity program which contributed 150 basis point improvement, and includes, among others, initiatives within procurement and logistics optimization. Our cost-savings program, which is incremental to our ongoing supply chain productivity program, added 10 basis points to our gross margin expansion.

Moving on to other operating items. Marketing and selling expenses increased 1% in the quarter to \$208 million. This increase was driven primarily by our planned increased investment in advertising and consumer promotion expenses, which is up 17% versus a year ago. These investments primarily reflect higher levels of support behind soup to continue to drive usage, inspire meal solutions, build brand awareness among younger households and support innovation. These investments were partially offset by the benefits of our cost-savings initiatives, lower marketing overhead and lower selling expenses.

Adjusted administrative expenses increased \$11 million or 9% to \$137 million, driven by higher benefit costs and general administrative costs, including incremental consulting charges related to supply chain optimization as well as inflation, partially offset by the benefits from our cost-savings initiatives.

Moving to the next slide. We have continued to successfully deliver against our multiyear enterprise cost-savings initiatives. This quarter, we achieved \$15 million in incremental year-over-year savings, inclusive of Snyder's-Lance synergies. To date, that brings our savings for the overall program to \$740 million. We expect an additional \$60 million to \$70 million in the balance of fiscal 2021, and we remain on track to deliver our cumulative savings target of \$850 million by the end of fiscal 2022.

To help tie this all together, we are providing an adjusted EBIT bridge to highlight the key drivers of performance this quarter. As discussed, adjusted EBIT grew by 18%. This was largely driven by the increase in demand for our products, with sales gains contributing \$53 million of EBIT growth. The overall adjusted gross margin expansion of 100 basis points contributed \$23 million of EBIT growth which more than offset higher marketing and selling expenses of \$2 million, reflecting our investments in A&C, partially offset by lower selling expenses. The remaining impact of all other items, consisting of adjusted administrative expenses, R&D and adjusted other income, in aggregate, was nominal. Our adjusted EBIT margin increased year-over-year by 180 basis points to 19.8%.

The following chart breaks down our adjusted EPS growth between our operating performance and below the line items. Adjusted EPS increased \$0.24 from \$0.78 in the prior year quarter to \$1.02 per share. Adjusted EBIT had a positive \$0.18 impact on adjusted EPS. Net interest expense declined year-over-year with \$25 million, delivering a \$0.06 positive impact to adjusted EPS, as we have used proceeds from completed divestitures and our strong cash flow to reduce debt. The impact from the adjusted tax rate was nominal, completing the bridge to \$1.02 per share.

In Meals and Beverages, organic net sales increased 12% to \$1.3 billion, reflecting double-digit increases across most of our U.S. retail products, including gains in U.S. soups, inclusive of Pacific Food soups and broth, Prego pasta sauces, V8 beverages, Campbell's pasta and Pace Mexican sauces as well as gains in Canada, partially offset by declines in foodservice. Volume was favorable in U.S. retail and

Canada, driven by increased demand of food purchases for at-home consumption, offset partially by the negative impact on foodservice as a result of shifts in consumer behavior and continued COVID-19-related restrictions. Net sales of U.S. soup, including Pacific, increased 21% compared to the prior year due to retailers' rebuilding inventory for the upcoming soup season, in-market gains in condensed soups and broth and moderating promotional spending.

Operating earnings for Meals and Beverages increased 18% to \$333 million. The increase was primarily driven by sales volume growth and improved gross margin, offset partially by increased marketing investment. The gross margin performance was impacted by the lower levels of promotional spending and favorable mix as productivity improvements and improved operating leverage were offset by other operational costs, cost inflation and COVID-19-related costs.

Within Snacks, organic sales increased 4%, driven primarily by lower levels of promotional spending as well as healthy velocity on the majority of the base business. We saw volume gains in fresh bakery products, Late July snacks, Pop Secret popcorn, Pepperidge Farm cookies, Snack Factory Pretzel Crisps as well as Kettle brand potato chips, which partially offset declines in Lance sandwich crackers. Sales of Goldfish crackers were relatively flat in the quarter as increased demand for family-sized products were offset by reduced away-from-home consumption.

Operating earnings for Snacks increased 11%, driven by lower selling expenses, lower marketing overhead and sales volume gains partially offset by higher administrative expenses. Gross margin performance was consistent with prior year as lower levels of promotional spending were offset by higher net supply chain costs as productivity improvements, cost-savings initiatives and improved operating leverage were more than offset by cost inflation and COVID-19-related costs.

I'll now turn to our cash flow and liquidity. Cash flow from operations was \$180 million, comparable to the prior year, as changes in working capital were basically offset by higher cash earnings and lower other cash payments. Cash from investing activities decreased by \$341 million, driven by lapping the net proceeds from our divested businesses in the prior year. The cash outlay for capital expenditures was \$74 million, \$24 million lower than the prior year, driven by discontinued operations and in line with our previously communicated full year expectation. Cash outflows for financing activities were \$245 million compared to \$453 million 1 year ago. The reduced cash outflow reflects lower debt repayments. Dividends paid in the amount of \$108 million were comparable to the prior year, reflecting our current quarterly dividend of \$0.35 per share. We ended the quarter with cash and cash equivalents of \$722 million.

I'll now turn to guidance. As I've reviewed, the company's strong first quarter fiscal 2021 results were impacted by increased demand stemming from the COVID-19 pandemic. The impact of the continuing pandemic on the company's fiscal 2021 results is uncertain and makes it difficult to provide a full year outlook at this time. Based on our expectation of a continued elevated demand landscape and increased investment in our brands, we are providing the following guidance for the second quarter of fiscal '21.

We expect year-over-year growth in net sales of 5% to 7% as growth more closely aligns with consumption, reflecting better inventory, strong programming and improving share positions. We expect adjusted EBIT growth to be in line with year-over-year sales growth for the quarter as we invest to win the season and keep fueling the retention of new households behind key consumer trends. We expect the combination of healthy EBIT growth and the benefit of significantly reduced interest expense year-over-year to result in adjusted EPS growth of 12% to 15% or \$0.81 to \$0.83 per share. While it remains very difficult to provide any more direction for the balance of the year, as time has progressed, our outlook does continue to strengthen.

In closing, our first quarter results were a strong start to the year. I am proud of the continued strong execution by our teams throughout the organization.

And with that, operator, let's open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Andrew Lazar from Barclays.

Andrew Lazar Barclays Bank PLC, Research Division - MD & Senior Research Analyst

Maybe to start with Mark. In the vein of exiting the pandemic in a stronger position than the company entered it, and you've talked about a number of compelling metrics, such as household penetration and repeat and buy rate and as well as habit changes, right, by consumers. I'm curious really more of what you're hearing from your key retail partners around how they view relevance of key categories. And not so much in today's crisis per se, but what they're telling you about once things normalize and how that compares to maybe 1 year or so ago. And then I've just got a quick follow-up.

Mark A. Clouse Campbell Soup Company - President, CEO & Director

Yes. Thanks, Andrew. Yes. I think the -- if you look at how we're viewing the indicators as we kind of come through the pandemic and why we're continuing to see a growing level of confidence kind of with each month and with each quarter, I think that's very consistent with what retailers are experiencing as well. If you look at kind of the macro trends that we point to, they recognize like we do, this kind of infusion of millions of new households that are now cooking at home, that are building confidence in that area, becoming more efficient and looking for meal solutions, has become very, very prevalent. And so that's one example of a macro that we're trying now to work together to bring to life, whether it's in the retail environment or the online environment, which we did a lot of work on around Thanksgiving. And I'm sure we can talk about that a little later.

But also, the dynamics -- the other macro dynamics that we look at that are continuing, like I said, to build confidence, is, almost regardless of the timing or the sequence of events relative to vaccines or how the pandemic unfolds over the months ahead, we do expect, and I think retailers would agree, that a sustained view of in-home eating, whether that is because people just more slowly returning to normal life; or the fact that more people are going to be working from home; or this dynamic of more in-home socialization, which has been driving certain segments of snacking at a very aggressive rate. All of these dynamics, as we continue to go forward, we expect to be maintained.

And I think the other element that's very relevant in the planning with customers right now is that we recognize the economic strain across the country and the impact that, that has on people making decisions relative to value, which has resulted in a much higher sourcing -- obviously through the pandemic, but even projected ahead, of people sourcing meals from grocery stores, where we see a terrific opportunity to build upon the behaviors that have been created in the near-term as we think about building momentum out of it.

So I would say, Andrew, for us, and I think for most retailers, we do not see this as a kind of episodic moment. And I think as time has gone on, you see more and more in the numbers. I talked about the repeat, but one of the things that's most significant in our numbers is the dramatic nature of the return to our brands from younger households and millennials specifically. They have the highest increase in buy rates and the highest increase in repeat rates of any of the consumer demographics that we see. And I think that, again, bodes very well for our ability to retain a meaningful number of these households going forward.

Andrew Lazar Barclays Bank PLC, Research Division - MD & Senior Research Analyst

Great. And then just a quick one. Within the 5% to 7% sales growth forecast for fiscal 2Q, could you put a little bit of perspective or color around that? And kind of how soup might fit into that? Or what the expectation around soup is within that 5% to 7%? It sounded like you're now in a place where retailers have rebuilt inventories for the coming sort of few winter months and such. But just want to get some perspective there.

Mark A. Clouse Campbell Soup Company - President, CEO & Director

Yes. Sure, Andrew. I think that as you look at Q2 and as you look at inventory in particular, I am very happy with where we have been able to get to as we go into Q2. The honest answer is we've made some thoughtful and, I think, appropriate decisions in Q1 that may have had a little bit of a short-term headwind on share in some cases as we moderated some promotions. But the goal in mind was that in the most critical part of our soup season, which is really in the second quarter period as well as going into the holiday period, that we were in a much better position. And I think we achieved that.

Now again, I would say that we're continuing to watch demand. And as we project these numbers, it is difficult to anticipate what demand is going to look like as it goes forward, but I think we continue to expect demand to be elevated. And I think in Q2, we would

expect, at least on the Meals and Beverage side, to have our sales -- our net sales a little bit more in line with consumption as we did a lot of that heavy lift on inventory in the first quarter.

Now I think on Snacks, the story is a little bit different. As we've said before, we thought it would take us really through the entire second quarter into the first half to get inventory fully back on some of those businesses.

It's an interesting dynamic in snacking, because if you look at the total 4% or 5% in-market growth rate, which looks a little lower than relative food dynamics in the industry. But when you start to pull it apart, what you see is those segments that have been more impacted by COVID, like salty snacks, where for the quarter, our business was up 11% in-market; or our more indulgent products like cookies, where we were up 8% in Q1; offset of course a little bit by those away-from-home stacks that have been a little bit more softer than the impact of those that are more relevant in the moment, we've got some pressure on supply there that we're rebuilding. The good news is we've added capacity in many of our facilities, we've done a good job navigating, but I would expect there to be some inventory rebuilding, continuing on snacking as we go into the second quarter.

So I think let's call the 5% to 7% a prudent view of a variety of different variables. But of course, the good news is I think we're in a much stronger supply position, so we can adjust to a higher end of demand if we see it. We're ready for that. And I think, again, feel very good about some of the trade-offs we made in Q1 to get us to this position in Q2.

Operator

Our next question comes from Ken Goldman from JPMorgan.

Thomas Hinsdale Palmer *JPMorgan Chase & Co, Research Division - Analyst*

It's Tom Palmer on for Ken. First, just wanted to ask on guidance. You suggest a relatively flat margin year-over-year, just given you've got EBIT growing comparably to sales. Would have expected maybe a bit more of a flow-through given mid-single-digit sales growth. So maybe give some color on what might limit margin expansion next quarter. For instance, are we looking at a big step-up in marketing and promos? Is cost inflation becoming more of a headwind?

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

Yes. So thanks, Tom. I'll start it and then let Mick give you a little bit more of the ticks and ties for the numbers. But I would say that although -- we made, as I said in Q1, some choices from a promotional standpoint to enable us to kind of be ready for the key part of the year as we think of when promotion activity is very important. So as we go into Q2, I would expect us to be in a position where we're with a fully loaded promotional calendar that is really designed to be competitive, that's back to kind of fully supporting the brands that we need to. So although in Q1, I think you see some uptick relative to -- in gross margin relative to the reduction in promotion, I think that will go away a bit in Q2.

I think underlying, all of our fundamentals on the business, though, remains very strong. So on top of our cost savings initiatives, we feel very good about our productivity, our ability to navigate and balance COVID costs. We're continuing to feel very much in control of that situation. And so really, the headwind, if you will, on margin is much more related to the investments we're going to make.

Mick J. Beekhuizen *Campbell Soup Company - Executive VP & CFO*

Yes. Maybe have a little bit add to that is on the one end, as Mark also mentioned, with regard to the promotional spending. And then the second piece is also kind of further down in the P&L more with regard to the marketing. And we will continue to support, obviously, our brands. You saw that -- in Q1, you saw that we had a 1% increase in marketing and selling expenses. That was really kind of underlying within that was 17% increases on advertising and consumer promo. But then within that, there were offsets from a cost-savings perspective. If I look more at Q2, I probably expect a little bit more of an increase on the marketing and selling side.

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

Yes. And Tom, just as a point of reference to that, that's really already started. And I think the good news is that what should come along with that is the improvement on the share position, which was a bit more mixed in Q1. But as we exited the quarter, and even into the more latest IRI data, as you look at November, you see some pretty significant pivots. Like for example, one of the places that we made a

lot of tough calls was on our ready-to-serve, and in particular, our Chunky business where we did see some softness on share. Through the latest 4 weeks, we're up over a share point of growth on our ready-to-serve, even stronger on our Chunky business, where we've kind of got all of the cylinders firing now from a promotion, marketing, all of the above.

You see similar sustained momentum on Pacific, on condensed. And even on the Snacks businesses, as we mentioned in our comments, we're seeing improving trends as it relates to Goldfish, which obviously has been a little bit of a trickier one as the consumer dynamics have impacted that one a little differently than they have some of our other businesses that we've had to adjust for. But I think the good news is there's great evidence that, that's already driving the kind of impact that we want in market, and I think that was the game plan. So so far, so good.

Thomas Hinsdale Palmer JPMorgan Chase & Co, Research Division - Analyst

Great. And just a quick follow-up, actually, to Andrew's question. So you're guiding to slightly lower organic sales growth in the second quarter, you characterized it as prudent. Maybe I can just ask this explicitly. To what extent does your guidance assume that underlying take away decelerates relative to last quarter versus less help from timing items, like inventory build or Thanksgiving compares?

Mark A. Clouse Campbell Soup Company - President, CEO & Director

Yes. I think we expect Q2 to continue to be an elevated level of consumption. I think what you see us probably planning or kind of adjusting a little bit is a more consistent run rate on consumption going forward with a little less contribution potentially from inventory. But I will tell you, again, if you look at the more recent trends, we're feeling very good about performance through Thanksgiving, and we'll continue to watch that unfold as we go.

And like I said, the good news is, in this quarter -- or in second quarter, I think we're going to be in a very good position to kind of adjust to higher demand levels if necessary. And again, as you can appreciate in this moment, it's a lot of uncharted water, so we're trying to get the balance right. But I think the idea that you should definitely take away from us that, as we've continued to progress through the year, we're growing in our level of confidence and belief in ability to continue momentum going forward.

Operator

Our next question comes from Jason English from Goldman Sachs.

Jason M. English Goldman Sachs Group, Inc., Research Division - VP

Congrats on another strong quarter. Just a couple of questions, clarification, kind of what's already been said.

First, I want to make sure I heard you right on some of the comments to Andrew's last question. Promotions, net price benefit of promotions added 125 bps to GMs this quarter. You said that benefit goes away next quarter. GMs were up 100 bps. So my interpretation is you're effectively suggesting that gross margins will be flat to down modestly going forward. Did I hear that right?

Mark A. Clouse Campbell Soup Company - President, CEO & Director

Yes. I'd say closer to more flat is kind of where we're expecting. Obviously, we don't guide directly to gross margin. There's a couple of variables in there that are tough to pin. I do expect, though, that what I would say broadly is where we did make some of those decisions to moderate promotions in Q1, we will not be making those decisions in Q2 as we're now more kind of in a stronger position for inventory. So I would expect to see a more historically robust level of promotions in Q2.

Jason M. English Goldman Sachs Group, Inc., Research Division - VP

And building on that promotion comment, do you think we're at a point where you can operate consistently with a lower level of promotion than maybe you did pre-COVID? Or should we expect that promo line to flip to a deflationary headwind later this year or next year?

Mark A. Clouse Campbell Soup Company - President, CEO & Director

I don't think that we -- I think we'll continue to evaluate. And I think I talked about this at the year-end period, where as we were exiting 2020 and certainly as we've navigated the first quarter of Q1, what we've tried to do is be as thoughtful and surgical as possible in

balancing both the marketing expenses and the promotional lines. And where we felt like there were opportunities to perhaps drive a little bit more on the marketing side, a little less on the promotional side, certainly, in Q1, where we made a little bit more of a decision on a couple of businesses, all right, we need to get back to strength going into a more important part of the year. And of course, doing all of this very much in conjunction with our retail partners.

I think what you'll see is a total investment line for the company that remains very consistent. And I think that's -- we're spending at a level that I believe we feel good. About -- whether or not you'll see some balancing between lines as we continue to work through, okay, where is the best ROIs? What's the dynamic in the marketplace competitively? All of those elements, I think, will influence it. But I would not expect you to see radical changes in investment for us going forward, other than the continued sustaining spend that we've kind of put into our base now.

Does that make sense, Jason?

Jason M. English *Goldman Sachs Group, Inc., Research Division - VP*

Yes. I mean, to my ears, I heard that there's a likelihood that promotions come back, price goes negative and you cut A&P to offset that. I mean, I don't want to put words in your mouth, but that's kind of what I'm hearing.

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

Yes. I mean, I don't think we'll -- yes, I think there may be some balancing on certain businesses, but I also think that our total A&C level, as we look at it, is in -- from a full year perspective, is in a pretty good level. So I do think there may be some calibration there, but I wouldn't expect it to be significant.

Operator

Our next question comes from Bryan Spillane from Bank of America.

Bryan Douglass Spillane *BofA Merrill Lynch, Research Division - MD of Equity Research*

Maybe just to follow up on Jason's question on that last point around A&C and maybe just tie this also into e-commerce. Just Mark, you've done a good job capturing millennials and incremental household penetration with millennials. How is the advertising mix? How have you adjusted the advertising? And what you're -- how are you spending on advertising to affect that? I guess, what underneath the question is just, is it less traditional TV, more digital, more social media? And if that's the case, does that sort of imply that you don't necessarily need to spend in A&C at absolute levels that you did in the past?

And then maybe tied to that also, in terms of e-commerce, if this has become kind of a platform -- or I'm sorry, a level that's higher than it would have been previously, how does that factor in, how you're thinking about how you spend promotional dollars going forward? Meaning, is it less end caps and more in support of the click and collect?

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

Yes. That's great question. The short answer is, it's been a pretty meaningful shift as we think about where -- and not just purely because of e-commerce, but also because of just simply how millennials shop and how they view the world of engagement with brands. So even if they're still shopping traditional retail, the ability for us to be more effective with our spend in digital is significant.

So if you take Q1 as an example, from 1 year ago, we doubled our investment in digital spending, and it now represents over 50% of the total spend in A&C. So that's a pretty dramatic shift for us from where we would have been historically. And the great news is, given a lot of the work that we've done in the last 2 quarters, we feel like our understanding of the ROIs and the impact that it's having is giving us great confidence that we can drive tremendous efficiency within this line item. And as you point out, one of the things that's always been great about digital is if you can unlock the right content, the right placement, you can tend to drive some impact or more impact on an investment level that may be a little more modest than what traditional TV campaigns cost.

And if you translate that to really how it's working, we've made pretty significant investment, too, in a lot of partnerships where our dollars go further. So you might have seen, over the holiday, we had a great program with Instacart, which has been one of the faster

growing third-party shoppers, where we had a -- their homepage was basically a Campbell's page on -- if you spend \$25 on all of our kind of holiday products, you got free delivery for the trip. And those kinds of activities where we're getting front and center or top of mind for consumers is really important in making it effective. And so as you point out, what I just described, feels a little bit more like something you might have seen in a store or a retail that's now becoming a digital marketing platform.

So the blending of dollars between shopper and traditional advertising, and even trade and promotion, when you get into the digital world, it gives you a lot of options to be able to drive impact. And like I said, if you look across our businesses, up 85% in the quarter, we grew share in both of our businesses pretty significantly. And in particular, we grew dramatic share in the areas we were really targeting, which was in the click and collect space as well as the retail-delivered and third-party areas, all of those were very significant growth engine for us and where we spent a lot of time investing behind it.

So we're feeling good. Now the -- now what we're doing is making sure our assortments online are right. We're getting the right team in place, the right capabilities. But as we think going forward, we really do see e-commerce and the digital spend together being a major influence of performance going forward. And I would say as we watch kind of the marketplace, we feel very good about the position that we're in. And I think really benefited from some of that spending in Q4, we were talking about last time, is a great source of learning for us.

Bryan Douglass Spillane *BofA Merrill Lynch, Research Division - MD of Equity Research*

And if I could just slip one in for Mick. Just CapEx. I'm not -- I didn't -- I don't know if I missed it, but did you give an outlook on capital spending for the year?

Mick J. Beekhuizen *Campbell Soup Company - Executive VP & CFO*

I didn't, but we did that last time around. And I am still. Based on Q1 spending, that was pretty much in line with our original expectations.

Operator

Our next question comes from Chris Growe from Stifel.

Christopher Robert Growe *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Analyst*

I just had 2 questions for you. The first one -- and it's a bit a follow-on from earlier questions. As I think about this rebuilding of inventory that's occurred at retail, that's obviously availability of product. Have you also been able to increase your SKUs, those got paired back during the height of the pandemic? Are you back to what you'd call a normal sort of shelf set? Or maybe where you want the shelf set to be sort of going forward.

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

I'd say we're probably 75% of the way back, right? We have made up a lot of ground in the first quarter, which is what we expected. And again, I think a lot of different metrics to measure how we feel about Q1. But perhaps one of the ones that's most significant to me was our ability to execute in a very complex environment at a very high level, where we were rebuilding inventory, bringing back SKUs that we had pruned or put on hold during the heart of the pandemic. And so although you still see a TDP decline head-over-head, you see that improving with kind of each month. And that is representative of us coming back with the SKUs as well as some innovation that's kind of intermingled there.

But I'd say we're still -- there's probably about 1/4 of items that we're working on. But some of the really important ones, for example, on Prego, one of our most unique and differentiated products that were back fully in business is our alfredo or our white sauce within Prego. It makes a huge difference for us on share, and you see that in the numbers as we've been able to come back. But there's a variety of examples like that, where we've been able to improve supply and/or create enough room that we can bring some of the meaningful complexity back.

As I've said before, I do think there is a percentage of those TDPs that we probably, in the end, will -- if we're going to replace it, we'd rather do it with innovation. So I'd say a big step forward in Q1, but still with a little bit of room to go.

Christopher Robert Growe *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Analyst*

Okay. That was helpful. And then just a second question. In the gross margin bridge, you outlined this net pricing benefit, 120 basis points. Does that quantify -- does that incorporate the benefit of lower promotional spending? For example, is that one of the factors within that? So -- because that was about a 2% benefit overall. I'm just trying to get a sense of like, is this -- is there an underlying net pricing increase in your business, and then promotion is separate to that? If that makes sense.

Mick J. Beekhuizen *Campbell Soup Company - Executive VP & CFO*

Yes. No, it's a really good question. I mean, the -- basically, just think about that 120 basis points net pricing increase as lower promotional spending. There's no underlying price movement there.

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

Yes. I mean, sometimes you see movement between promotion to EDLP in some places. So you see -- if you look at any given moment on pricing in the quarter, you'd see some numbers that might define what we're describing. But if you net out the total impact to the business on the places where we had backed off on some promotional spend, you see that in the pricing numbers. And that also, of course, translated into the margin as well.

Operator

Our next question comes from Steve Powers from Deutsche Bank.

Stephen Robert R. Powers *Deutsche Bank AG, Research Division - Research Analyst*

I guess, 2 questions. Maybe the first, just to circle back on [segments] on the second quarter guidance. In the first quarter, Meals and Beverages showed that it's capable of doing \$1.3 billion-plus in revenue when everything comes together. As we look forward, given the accelerating demand this winter and supply capabilities you've built over the past 9 months or so, I guess, is there any reason to think that, that absolute dollars -- dollar level of sales in the segment won't be higher in 2Q versus the first quarter?

And assuming there's not, I guess, the second kind of the parallel question I'm relating here is that implies only very modest growth in Snacks in the second quarter, if any at all, if my math is correct. So would just love your thoughts there because it sounded like you thought Snacks actually grew [along in-market consumption], but it seems out of sync with at least how I'm thinking about the second quarter numbers. So any help there would be great.

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

Yes. So you sound a little choppy live, but I think I got it. If you kind of hold the pieces of the business apart, and you look at kind of what the underlying assumptions are in Q2, if you look at our overall enterprise in-market consumption for the quarter, we've been in that 7% to 8% range.

I think as we look forward, and again, always the benefit of seeing time pass from month-to-month, depending on where the elevated level of demand stays and whether it's consistent with that, obviously, we'd be at the higher end of our guidance range. I think what we're suggesting is that you may see a little bit less of an incremental contribution from inventory rebuilding in Q2.

But conversely, I think on the Snacks business, you will likely see some very, I think, improving and strengthening numbers, as well as the fact that you'll have some inventory recovery that's going on in the Snacks business in Q2, a little more so than the Meals and Beverage side.

So take those 2 together and try to average them out. There's -- depending on where you peg that overall demand level, you'd be more toward the higher end. Anything else, kind of within that range. So we're providing kind of a perspective. And like I said, I think we're certainly trying to be pragmatic. But at the same time, I do think there is that notable difference of pivot between the 2 divisions.

And again, just to reiterate what I said earlier on snacking, I think sometimes in the COVID world, where you see kind of this consistent high single-digit to double-digit numbers, snacking is a little different. And as I said, within the segments, you have some segments like salty stacks which are saving that way, where we see double-digit growth kind of quarter in, quarter out. Our more indulgent products,

although we are facing a little bit of headwind on supply as it relates to cookies, have performed in the high single-digit ranges.

And then Goldfish, remember, our partner brands remain a point of a headwind as we continue to moderate those down. I think those are the things that are moderating the overall total number in Snacks a little bit lower than what it might feel like as we kind of described the performance. But I think the balancing act between that kind of revolves around this underlying in-market growth rate of in the higher single-digit range. And I think we'll watch that very closely as we go through the quarter. And I would imagine that would be a pretty good proxy for investors to kind of anticipate where we are in the business as well.

Stephen Robert R. Powers *Deutsche Bank AG, Research Division - Research Analyst*

Can you -- hopefully, you can hear me okay. I guess the second question I had was, as we look forward 1 year from now, we're all hopefully going to be operating in an environment with a relatively full vaccine distribution, significantly improved social mobility. And I'm curious whether you can expand what you're doing now to ensure that when that day comes, you've been able to retain as much of the expected demand you've gained in 2020 as possible.

I mean, are there specific initiatives you can point to? And I guess, are you able to -- are you finding yourself actually able to do everything you'd ideally want to, just given the ongoing supply constraints, demand volatility, just the other potential distractions that you're facing right now?

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

Yes. No. I know that is a major question for a lot of investors. And I would just tell you guys, I -- as we've continued to move forward, I absolutely am building a higher degree of confidence in our ability to retain households. And I'll point to kind of 3 big areas.

The first is these macro trends that, whether it is cooking or quick scratch cooking as we call it, in-home eating, just imagine the number of businesses and how slow the return may be to an office environment, regardless of the timing of when a vaccine may be here and the number of millions of incremental lunches and in-home snacking occasions that we're going to be able to be very well positioned to meet. I think there will be pressure economically, however you want to describe it, that's going to create a value proposition where shopping for your meals from the grocery store continues to be a very attractive and affordable way to eat.

I also think we can't underestimate the migration that has happened back to traditional brands in the grocery so I know there's a lot of speculation on whether private label availability is the bigger hindrance. But I can tell you that as we look at every metric of sentiment with our core brands, where consumers have come back or new consumers have come in, sentiment is quite positive. This does not in any way strike me as a moment where they're buying us because something else is not available.

And so I think it's then switching to the second big reason to believe is all of the actions that we're taking right now. Our increase in marketing, our shift to digital, our understanding of what's working. If you look at this soup season, it is the most robust marketing period that we've ever had. If you looked at the great work we did around save a snow day or dinner insurance around Thanksgiving; our advertising, our new campaign around snow buddies, our new campaigns that we have on Late July, on Pacific; the fact that we're doing great work in partnership with our customers as well as our -- as well as some of the online third-party players. All of this, I think, lines up to a world where we can expect to have a much stronger footing with millennials coming in.

We're growing share across all of our businesses with this important target. And I think that even as we think about innovation, a lot of what we're launching, whether it's Pacific condensed, which really targets those millennials in the cooking behavior; or some of our in-home meal occasion moments like the crunch add-ins on Slow Kettle cups; or even the work we're doing on Chunky, where we're heightening our protein content into messaging and then delivering it through Madden partnerships and our NFL relationship, I think all relates very well to our ability to connect with these.

And then the last point I would just make is that, as a reminder, before we came into the pandemic, right, before pandemic ever influenced our results, we had cleaned up the balance sheet, our debt level's down, our ability to use cash flow to help grow and support the business, along with the fact that now 50% of our business is in a growing Snack business that we're growing before, that's been growing through, and I expect to grow after; and a Meals and Beverage business that a lot of questions on relevancy were there initially,

that I feel like now you've got a much stronger case.

So I put those 3 things together, and I feel very good about the idea that we're going to come out of this in a much stronger position than we went in. And I think it's giving us great confidence in our ability to sustain, going forward, a meaningful impact and positive outlook.

So a little bit of a longer answer, but clearly, a conversation, topic of the day for sure.

Operator

Thank you. Our next question comes from David Palmer from Evercore ISI.

David Sterling Palmer *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

Great conversation so far on that advertising/consumer promotion piece. I just wanted to follow-up on that. Just big picture for Campbell, your A&C spending will be probably highest levels in 8 or 9 years. If we take the increases here in the first part of this fiscal year, it's a bit of a reversal for not just Campbell, but for the food space overall. And Mark, you've seen this in several seats now, where food companies were taking down advertising spending for most of that decade, 2014 to 2019. And I guess to some degree, that reflected the lack of confidence that advertising and consumer promotions were working. And you mentioned the shift to digital. Is it as simple as that channel perhaps versus TV? Could you speak to that? And why the ROI would be better today and why you have confidence in that? And then I have a quick follow-up.

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

Yes. No. I mean, look, this is a -- that's a great question and a fairly healthy conversation on its own. But I will tell you that, no, the answer is not just move the money to digital, and therefore, it's going to work better or you're going to be successful. What is so important in this is really understanding the intersection of content, placements and then how you're linking it with the shopping behavior. Those 3 things, to me, are the big insights on how you make the digital spend more efficient and improve the ROI.

And a lot of times, I think people felt that it was as simple as, well, maybe I should just put my TV ad on Facebook. Or I should just -- if I'm there where consumers are, it's going to work. And the answer is, that does not work. It requires all 3 of those things to come together to really have the impact that we're seeing now.

And even for us, I think, as I've said many times, where we may have been asked a couple of questions on why do you continue to spend A&C into some supply issues? Part of the reason was that we really felt we needed to continue to be out there and making sure that we fine-tune what's working so that when we find ourselves in the position we're in today, where supply is back in place, we are loaded and ready to go as it relates to really understanding it.

And I think condensed soup is probably the single biggest example of that in the portfolio right now, where you see dramatic sustained growth. You see it in millennial targets. Our ROIs in our investments and the creativity of the activity that we have out there is just terrific.

So I'm -- again, you learn all the time. And the one thing I'll say about digital, too. The minute you think you've got it all figured out, you got to stay nimble and moving an agile with where consumers are going. But I think we're in a very good position, and I feel good about the impact we're having.

David Sterling Palmer *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

And just a follow-up, I think in your question and answer with Jason touched on this. There's going to be -- there would probably some room that you need to have on promotion spending coming out of this period on the back end on the bricks-and-mortar side of things, at least. You had some plans in terms of merchandising and organizing the shelf that probably were delayed. So not only would you get back to maybe a run rate that would be more pre-COVID level in terms of bricks-and-mortar merchandising, but you had some bigger plans, too. Could you give us a sense of that? And how much room you have to create for promotions for that?

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

Yes. No. I think the answer is we will continue and are working very closely with our retail partners to really figure out shelf sets for the future. And that's with the mindset that these categories are going to be quite important and highly relevant.

And so yes, you're right. There were a lot of things that we were in the midst of working on that we want to make sure that we incorporate the consumer learnings from this period. But yes, I would expect that as you see us come forward in the next year or so, we're going to be working quite hard on ensuring that we are setting the shelf for the future and that we're creating enough room within both our portfolio and our promotional calendar to really address that in the most consumer-focused way.

Operator

And our next question comes...

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

Yes, we'll do what -- yes, I know we're a little over, but we'll take one more.

Operator

Our last question comes from Rob Dickerson from Jefferies.

Robert Frederick Dickerson *Jefferies LLC, Research Division - MD & Senior Research Analyst*

Mark, I just had kind of a larger, longer-term strategic question just around the Snacks business. I know last quarter, where you had alluded to improved learnings, right, in terms of efficiency in the supply chain over the past, call it, 7 or 8 months. Obviously, you still have some cost savings coming through to the end of next fiscal year. And then at the same time, I think last quarter, you had mentioned maybe some potential visibility on further efficiencies within Snacks, call it distribution hubs, what have you.

So you kind of -- just generally speaking, kind of given the margin profile of the snacks business, but the attraction, so to speak, of that business as well for consumers, maybe even as they shift to more on-the-go and volumes could improve. Like how do you view the incremental potential efficiency gains on that business to hopefully be able to margin-up that business over time? Kind of vis-à-vis a lot of other snacks business that may be able to, or already are, generating a higher profitability profile? That's it.

Mark A. Clouse *Campbell Soup Company - President, CEO & Director*

Yes, no, thanks for the question, Rob. Yes. I mean, I think in its most simplest form, if you think about the strategic runway for the company, I think there are a couple of big things that we believe will be fuel and enable us to continue to deliver against our expectations. And one of those we've talked a lot about today, which is our ability to retain households, really solidify the Meals and Beverage portion of our business, is a steady contributor within the portfolio, which we believe very strongly that we can accomplish. I think the other area of opportunity is for us to continue to sustain and hopefully accelerate growth on our Snacks business while we continue to improve the margin.

If you look at the margin of our Snack business, even after all of the -- I've said this from the very beginning when I got here and was asked, "How do you feel about the synergies?" My answer was, "I feel pretty good." Because even at the end of the synergies, you've got a margin structure that looks lower than what I would expect for Snacks businesses.

And we know there's reasons why, and there's some structural elements there that are not insignificant. But the idea that we can continue to accelerate growth on that business, while we also improve the margin, is very much our focus going forward. And I think there will be a variety of things that we'll continue to look at and do. But we do feel good that there is drill sites and opportunities. And I think as time unfolds, we'll talk more about that. But I think for right now, I would agree with you, we kind of see the same thing. And as I think about big next-chapter elements for the company, I think those are the areas where we're going to want to continue to focus.

Operator

Thank you. And that does conclude our question-and-answer session for today's conference.

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation, and you may now disconnect. Everyone, have a wonderful day.

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