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CPB - Q2 2015 Campbell Soup Co Earnings Call

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OVERVIEW:

CPB reported 2Q15 as reported net sales of $2.234b. 1H15 adjusted EPS was $1.40 and 2Q15 adjusted EPS was $0.66. Expects 2015 net sales to be negative 1% to plus 1% and adjusted EPS to be $2.32-2.38.

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David Driscoll *Citi Research - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Campbell's Soup second-quarter 2015 earnings conference call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference, Jennifer Driscoll, Vice President of Investor Relations. Please go ahead.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Thanks, Kate. Good morning, everyone. Welcome to the second-quarter earnings call for Campbell's Soup's fiscal 2015. With me here in New Jersey are Denise Morrison, President and CEO; Anthony DiSilvestro, CFO; and Anna Choi, Senior Manager of Investor Relations.

As usual, we have created slides to accompany our earnings presentation. You will find the slides posted on our website this morning at investor. CampbellSoupCompany.com. This call is open to the media who participate in listen-only mode.

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 our slide or to our SEC filings for a list of factors that could cause our actual results to vary materially from those anticipated in any forward-looking statements.

While in the current quarter we had no items affecting comparability, our comparisons of fiscal 2015 with fiscal 2014 will exclude previously announced items. Also, our fiscal 2015 guidance is on a 52-week to 52-week adjusted basis. There were 53 weeks last year.

Because we use non-GAAP measures, we have provided in our appendix a reconciliation of these measures to the most directly comparable GAAP measure.

And with that, let me turn the call over to Denise Morrison.

Denise Morrison - *Campbell Soup Company - President & CEO*

Thank you, Jennifer, and good morning, everyone. Today I will share my perspective on our second-quarter and first-half performance, our plans for the remainder of the year, and finally our initiative to create a new enterprise structure, while driving significant cost savings over the next three years. Our CFO, Anthony DiSilvestro, will discuss our financial performance and segment results in greater detail and then we will have time for your questions.

My perspective about the second quarter is highly influenced by some of the factors we shared with you during our first-quarter call. As a reminder, we had strong first quarter with organic net sales up 5%, adjusted EBIT up 9%, and adjusted EPS up 12%. Recall that in quarter one we experienced higher input costs than expected and this situation continued into quarter two.

We started the year with a stronger seasonal sell-in. We also had more holiday promotion activities ship in quarter one because of the timing of our quarter end relative to Thanksgiving. This shift drove sales growth in Campbell's condensed soups, Swanson broth, and our Pepperidge Farm stuffing businesses ahead of consumption.

The strong first quarter put pressure on our supply chain to maintain acceptable customer service levels. To serve our customers, we ran our plants overtime and shipped product from all over our network to meet the increased demand. We also increased our use of spot market transportation, which resulted in higher rates in a constrained market and fueled additional cost.

These supply chain issues continued into the second quarter as we made the decision to incur additional expenses to improve our customer service levels.

With this as background, let me now offer my perspective on our second-quarter results. Our organic sales performance was comparable to year ago. In the quarter, declines in US soup were impacted by quarter one sales growth, which benefited from movements in retailer inventory levels and the timing of quarter end relative to the Thanksgiving holiday. This had an expected adverse impact on Q2 soup sales.

In the quarter, we delivered positive sales growth in our large US sauce brands, Prego and Pace, as well as in Plum Organics baby food, in the CPG portion of Bolthouse Farms beverages and salad dressings, and in our Foodservice business. I was pleased with our Global Baking and Snacking business, which delivered solid organic top-line growth as well as strong bottom-line growth with contributions from both Arnott's and Pepperidge Farm.

I was not satisfied with the performance of the US beverage business. Sales of our V8 V-Fusion franchise declined, while V8 Splash and V8 + Energy performed well in the quarter. In January, we started shipping our new V8 Veggie Blends, which have been well received by our customers.

Our biggest disappointment in the quarter was our gross margin performance. As I mentioned previously, we continue to face persistent challenges with increased inflation and cost pressure and logistics, including higher transportation and warehousing costs and the impact of a stronger US dollar on the input costs of our international businesses.

Despite our efforts to reduce expenses, we posted a double-digit EBIT decline greater than we anticipated. Anthony will discuss our gross margin performance and outlook in much greater detail in a few minutes.

As a reminder, at the close of our first quarter, we told you that we didn't expect our performance in fiscal 2015 to be evenly distributed across quarters. As a result, we said at that time that evaluating our business performance on a first-half basis, rather than a quarterly basis, would be more meaningful. We still believe a first-half view gives the most informative picture of the business.

Turning to our first-half performance, organic sales increased plus 2%. For the half, four of our five reporting segments achieved organic sales growth, with gains in US Simple Meals including steady sales in US soup. We posted positive organic sales in Global Baking and Snacking, Bolthouse Farms and Foodservice, and International Simple Meals. Sales of US Beverages declined.

It is important to note that our recent acquisitions, Plum and the CPG portion of Bolthouse Farms, posted double-digit sales gains for the half and Kelsen biscuit sales increased as well. For the half, our gross margin was under pressure with the continuation of the input costs that were higher than anticipated and the supply chain issues that I previously discussed.

Turning now to the back half, we plan to focus on fewer, bigger innovation platforms across our portfolio. As discussed at CAGNY last week, we believe this approach will have a more significant impact on the top line and reduce complexity in our supply chain. In the back half, we will continue to ramp up our health and well-being platform across our business.

Our health and well-being platform includes new Campbell's Organic soup and the continued expansion of our Healthy Request line of soups. We are increasing the distribution of new V8 Veggie Blend juices for affordable mainstream juicing and V8 protein bars and shakes, which are expanding the brand into adult on-the-go nutrition.

In the packaged fresh category, this spring we are launching 1915 by Bolthouse Farms, a new cold-pressed ultra-premium organic juice. We will continue to expand Bolthouse Farms Kids fresh beverages, veggie and fruit snack tubes, and carrot veggie snackers in the produce section. And we also have spring flavor innovations in place for super premium fresh beverages, including an on-trend blueberry banana almond milk variety and new varieties of salad dressings.

In Simple Meals, we will introduce a range of premium and convenience platforms, including the expansion of our Dinner Sauces line with the addition of Grilling Sauces. We are also preparing for the launch of Campbell's Fresh Brewed Soup in K-Cups, our joint development project with Keurig Green Mountain. And, finally, we will introduce Prego and Pace ready meals in convenient, on-the-go microwavable pouches.

We have also taken actions to address the supply chain issues that are within our control. For instance, we are making significant improvements to our freight and transportation management while our service level to customers and cost management is improving.

We are taking steps to increase net price realization on our core business. We believe that these steps will help our gross margin performance improve, starting in the third quarter. And, finally, we are managing SG&A and other costs aggressively across a number of areas such as travel and hiring.

Even with these efforts, we don't expect to offset the full impact of the margin pressures that we experienced in the first half. We recognize the challenging environment that we and our peers are operating in, particularly in center store categories. Consumer behavior and their preferences with respect to food are changing.

There are many seismic shifts impacting our industry, which I discussed last week at CAGNY. We are taking these shifts into consideration as we pursue our dual mandate to strengthen our core business, while at the same time to expand into faster-growing spaces. We recently announced a new enterprise structure to better align our organization to deliver on our strategy.

After considerable thought and planning, we are reorganizing our company to unlock greater value from our people, brands, and assets. This work is underway and will ramp up in the back half. We expect the creation of our three new divisions -- Americas Simple Meals and Beverages, Global Biscuits and Snacks, and Packaged Fresh -- coupled with our efforts to simplify our organization structure, will result in streamlined operations, better execution, and improved financial results over time, all while delivering fewer, bigger product innovations that will delight consumers.

As we implement this leaner and flatter organization structure, we are also adopting zero-based budgeting in fiscal 2016 to drive cost savings and to instill new cost discipline at Campbell. Together, we expect these initiatives to ramp up to annual cost savings of $200 million-plus over a three-year period.

This is a difficult time across the food industry. While we have made solid progress at Campbell's over the past three-and-a-half years to reshape our portfolio, it has not been enough. We are making necessary changes at our company, changes to the way we organize and manage our business, and changes to the way we allocate resources and assets, while managing costs to fund our growth.

Simply put, we are taking more aggressive action on multiple fronts, while staying resolutely focused on the consumer to change the growth trajectory of our business.

Thank you and now I will turn the call over to Anthony DiSilvestro.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Thanks, Denise, and good morning. Before getting into the details, I wanted to give my perspective on our second-quarter performance and revised 2015 guidance.

First, we are pleased with our overall sales performance. Organic sales following 5% growth in the first quarter were flat in the second quarter with a first-half now at plus 2%. Our updated sales guidance reflects an increased headwind from currency. Excluding currency, our sales outlook remains unchanged from our previous 2015 guidance.

However, reflecting disappointing gross margin performance, second-quarter EBIT was down 17% and below our expectations. I will discuss the details of our gross margin performance shortly.

Importantly, for the balance of the year, we expect to see improved gross margin performance as inflation and supply chain headwinds moderate and we take actions to improve our net price realization. As we announced on February 12, given our second-quarter performance and revised outlook for the balance of the year, including the impact of currency translation, we lowered our full-year guidance.

Now I will take you through our second-quarter results segment highlights and then review the guidance.

For the second quarter, net sales on an as-reported basis declined by 2% to $2.234 billion due to the negative impact of currency translation. Organic net sales were comparable to the prior year as gains in both our Global Baking and Snacking and our Bolthouse Farms and Foodservice segments were primarily offset by declines in US Simple Meals and US Beverages. Following a strong first quarter, sales in the second quarter were negatively impacted by movements in retailer inventory levels, including earlier holiday shipments that benefited the prior quarter.

With these timing-related items now behind us, first-half reported sales increased 1% with organic sales gaining 2%. Adjusted EBIT in the quarter fell 17% due to a lower gross margin percentage and unfavorable currency, partly offset by reductions in marketing spending. For the first half, adjusted EBIT declined 4% as the negative impact of a lower gross margin percentage and currency were partly offset by volume gains and lower marketing and administrative expenses.

Reflecting lower interest expense and a lower tax rate, adjusted earnings per share decreased 13% to $0.66 in the quarter. At $1.40 for the first half, adjusted EPS is down 1%.

Decomposing our sales performance, favorable volume mix contributed 1 point to sales growth. Gains in volume mix in the Global Baking and Snacking and Bolthouse and Foodservice segments were partly offset by declines in US Simple Meals, the segment most impacted by the inventory and holiday shipment timing between the first and second quarters. Higher selling prices, primarily in Global Baking and Snacking, added 1 point of growth.

Overall, increased promotional spending lowered sales by 2 percentage points. The pressure came largely from the Global Baking and Snacking and US Simple Meals segments. Currency reduced sales by 2 points as our two primary foreign currencies, the Australian dollar and Canadian dollar, both weakened further against the US dollar.

Here is our gross margin bridge for the second quarter. Our gross margin declined by about 3 points in the quarter compared to the prior year.

First, cost inflation and other factors had a negative margin impact of 3.6 points. About two-thirds of this was cost inflation, which as a rate increased by approximately 4%, reflecting continuing increases in meat, tomatoes, dairy, steel cans, and chocolate, and includes the negative impact of mark-to-market losses on open commodity hedging contracts. While inflation was slightly higher in the quarter than anticipated, we expect inflation to moderate in the back half.

The remaining third came from our supply chain, where we experienced increases in manufacturing costs, in freight and distribution, and from the impact of a stronger US dollar on the input costs of our international businesses. I will comment further on the first two.

Our manufacturing costs are higher as we have temporarily increased the use of co-packers to meet short-term demand and from an equipment outage in one of our major plants. On freight and distribution, to meet our customer service levels we have incurred higher transportation costs based both on our usage and rates, the impact of which we've seen moderate during the quarter. Looking ahead to next year, our investments in soup common platform, broth capacity, and changes in our committed freight capacity should mitigate the impact of these factors.

Promotional spending negatively impacted gross margins by 100 basis points, primarily due to higher spending in the Baking and Snacking segment. And, while volumes increased in the segment, trade had a negative impact on margin. Higher selling prices, primarily in Baking and Snacking, added 40 basis points.

Lastly, we've continued to drive meaningful productivity gains in our supply chain, which contributed 130 basis points of an improvement. As I will discuss in connection with the guidance, we expect that our gross margins will expand slightly in the second half.

Marketing and selling expenses decreased 10% in the quarter, reflecting reductions in advertising in US Simple Meals and Pepperidge Farms, helping to offset some of the gross margin pressure. Administrative expenses were down 1% as lower benefit costs, cost savings from prior restructuring initiatives, and the impact of currency were mostly offset by increased long-term incentive compensation costs compared to the prior year, which benefited from reductions in estimated payouts.

On the topic of incentive compensation more broadly, we now expect a full-year 2015 headwind on incentive compensation costs of approximately $0.06 per share, compared to our original estimate of $0.09 per share, as we have lowered our assumption for estimated payouts on long-term and annual bonuses.

For additional perspective on our performance, this chart breaks down our EPS growth between our operating performance and below-the-line items. As you can see, adjusted EPS declined by $0.10 per share, $0.12 of which was attributable to the decline in EBIT. Net interest expense declined $4 million versus a year ago, as we reduced our debt level, and this contributed $0.01 to EPS growth in the quarter.

Our cash rate for the quarter was 27.9%, down 310 basis points versus the prior-year adjusted rate, due to the favorable resolution of an intercompany pricing agreement between the US and Canada. The lower tax rate in the quarter added $0.03 to EPS. We now expect the tax rate for fiscal 2015 in the range of 30% to 31% versus our previous guidance of 31% to 32%.

Under our strategic share repurchase program, we repurchased $50 million in the quarter, bringing the year-to-date total to $100 million. With rounding, you don't see an EPS impact on the quarter.

Currency had a $0.02 impact on EPS. For the full year and based on current spot rates, we estimate currency will have a 2 point, or $0.05 per share, negative impact.

Now turning to our segment results. Sales declined in US Simple Meals by 3%, primarily driven by volume declines and higher promotional spending. US soup sales decreased 6% following a 6 point gain in Q1 as the timing between quarters was impacted by movements in retailer inventory levels and the timing of our quarters relative to the Thanksgiving holiday.

Sales of other Simple Meals increased 6%, driven by growth in Plum, Prego, and our dinner sauce platform. Operating earnings for US Simple Meals declined, primarily due to higher inflation and the supply chain costs I discussed earlier.

In Global Baking and Snacking, 4% organic sales growth was driven by the strong performance of Arnott's. We achieved consumption and share gains in the Australian biscuit category and Indonesia delivered another quarter of double-digit sales gains.

Within Pepperidge Farm, Goldfish Crackers delivered strong sales gains, which were partly offset by softness in frozen products. Kelsen sales declined slightly, reflecting the shift of the Chinese New Year further into our third quarter. Global Baking and Snacking posted strong operating earnings, driven by the organic sales growth and lower marketing spend.

In the Bolthouse and Foodservice segment, organic growth was driven by sales gains in Foodservice and in Bolthouse premium beverages and salad dressings, while Bolthouse Farms carrot and natural ingredient sales declined. The decline in operating earnings was primarily driven by a lower gross margin percentage and higher administrative expenses as the prior year benefited from a reduction in long-term incentive compensation accruals. The decline in gross margin percentage reflects higher carrot costs, including the impact of adverse weather.

International Simple Meals and Beverages organic sales declined 2%, with lower sales in Latin America and the Asia-Pacific region. Sales in Canada were comparable to the prior year, following a very strong first quarter. Declines in operating earnings were due to cost inflation, the adverse impact of currency on input costs, and the negative impacts in currency translation.

US Beverage sales fell 4% as declines in V8 V-Fusion more than offset gains in V8 Splash. Operating earnings declined primarily due to higher promotional spending, including new item introduction costs, cost inflation, and increased supply chain costs.

For the first half, I want to focus your attention specifically on the performance of the US Simple Meals segment. With the timing shift in Q1 and Q2 now behind us, US Simple Meals sales increased 2% for the half, driven by volume gains in the segment. US soup sales were comparable to the prior year, while sales of other Simple Meals increased 10%, driven by growth in Plum, Prego, and our dinner sauce platform.

Operating earnings declined 3%, reflecting cost inflation and higher supply chain costs, partly offset by productivity improvements, lower marketing expenses, sales gains, and the benefit of lapping the Plum recall in the prior year. For the remaining segments, the results for the half were similar to those of the second quarter.

Within US soup, 6% lower sales in the second quarter was due to declines in condensed and Swanson broth, which were impacted by the timing of shipments between the first and second quarters, while ready-to-serve soup sales were comparable to the prior year. While our soup sales decreased 6%, consumer takeaway in measured channels for the comparable 13-week period ending February 1 declined 1%.

For the first half, as shown at the bottom of the chart, soup sales in aggregate were comparable to the prior year as a 3% decline in condensed was offset by 7% growth in broth, with ready-to-serve sales comparable to the prior year. We ended the quarter with retailer inventory positions comparable to the prior year.

Here is a look at US wet soup category performance and our share results as measured by IRI. For the 52-week period ending February 1, 2015, the category as a whole declined 1.2%. Our sales in measured channels declined 1.9% with weakness in condensed and ready-to-serve partly offset by strength in broth.

Our share declined 50 basis points in the last 52 weeks and has been relatively stable over the past two years. All other branded players collectively had a share of 28%, with gains driven by smaller players. Private-label also grew share, finishing at 13%.

We had strong cash flow performance in the first half as cash from operations increased by $221 million to $584 million as we wrap the taxes paid in 2014 on the divestiture of the European Simple Meals business and due to lower working capital requirements and pension contributions in 2015.

Capital expenditures increased to $143 million. We continue to expect capital expenditures of about $400 million for the year as we increased capacity to support growth in our faster-growing businesses. We pay dividends totaling $199 million, reflecting our current quarterly dividend rate of $0.312 per share.

In aggregate, we repurchased $133 million of shares in the half, $100 million of which were under our strategic share repurchase program. The balance of the repurchases were made to offset dilution from equity-based compensation. Based on our current plans, we anticipate making strategic share repurchases at this pace on average for the balance of the year.

Net debt declined by approximately $200 million to $3.7 billion.

Now I will step through our 2015 guidance, which is consistent with our news release on February 12. As a reminder, growth rates are based off a 52-week adjusted fiscal 2014 base.

Beginning with net sales, we expect changes in net sales to be in the range of minus 1% to plus 1%, including a currency headwind of 2 points. Excluding currency, our sales outlook is unchanged from our previous guidance.

We expect adjusted EBIT to decline between minus 7% and minus 5%, reflecting weaker than anticipated gross margin performance. While first-half performance has been impacted by inflation, supply chain costs, and currency, we expect improved year-on-year performance in the back half as inflation and the supply chain impacts moderate as we exit the season and we realize the benefit of several list price increases and promotional spending reductions which are now in the marketplace.

For the full year we forecast that our gross margin percentage will decline by approximately 1 point. In EPS and reflecting a tax rate in the range of 30% to 31% and interest expense slightly below the prior year, we expect adjusted EPS to decline between minus 5% and minus 3%, a range of $2.32 to $2.38.

In terms of quarters, directionally we expect a relatively weak third quarter followed by a stronger Q4.

As we discussed at the CAGNY conference last week, we have launched a major cost reduction initiative targeting a $200 million-plus annual cost opportunity by adopting a zero-based budgeting approach. While we expect to deliver savings beginning in our fiscal 2016, we do not anticipate a material impact on our 2015 results. As we said last week, we are in the early stages and will have more to say about the initiative and the impact on our performance as we make progress.

That concludes my remarks and now I will turn it back to Jennifer for Q&A.

Denise Morrison - *Campbell Soup Company - President & CEO*

Thank you, Anthony. Kate, we will now start our Q&A session. Our audience, we would ask you that since we have limited time, please ask only one question at a time.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Chris Growe, Stifel.

Chris Growe - *Stifel Nicolaus - Analyst*

Good morning. I just have two quick questions. I'm sorry; you said keep it to one. Let me just do it in one then and really just focus on the gross margin.

Anthony, can you give more color around the increase in transportation costs? Like some of the unique factors that led to the weaker gross margin performance in the quarter. I know you talked about these in some overall detail, but I'm just curious how much incremental, say, transportation costs were. Is that one of the big drivers of the weaker gross margin performance?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Sure. As I said my remarks, if you look at the gross margin bridge, we have cost and inflation and other factors of 3.6 points. About a third of that is the supply chain issues and the largest single one within there is freight and distribution.

And as Denise mentioned, we have prioritized maintaining our customer service levels over some incremental costs. So what that has resulted in is some more inter-plant shipments, less use of intermodal, and a higher utilization of the spot market at a time when carrier capacity has been constrained and the rates have been higher. So those three things are really the primary drivers of the costs in freight distribution, those which are a pretty significant part of the supply chain costs we've been talking about.

Chris Growe - *Stifel Nicolaus - Analyst*

Then would input costs be the remainder or the vast majority of the remainder of the incremental gross margin weakness in the quarter?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

When you talk about year-over-year performance, inflation is the single largest factor, so two-thirds of that 3.6 decline is inflation. Things like meats and tomatoes and chocolate and dairy are all increasing double digits. Steel cans counts is single digits, and made worse by mark-to-market on some diesel hedges that we had that were underwater in the quarter.

Chris Growe - *Stifel Nicolaus - Analyst*

Okay, thank you for your time.

Operator

Jason English, Goldman Sachs.

Jason English - *Goldman Sachs - Analyst*

Good morning, folks. I guess I will ask more of a philosophical question on marketing. It's sort of surprising to see your marketing spend continue to shrink. I was just looking through it in the first half; it's now down to 25% from where it was 10 years ago. And your sales continue to suffer.

How should we think about marketing on a go-forward? Are we in an environment or a world now where advertising spend, the deflationary pressure on the efficiency of digital has enabled us to be at a point where we can continue to trim it? Or do you still believe that marketing is a very important driver of top-line growth?

And as we think about the go-forward at Campbell, should we be expecting and modeling for a degree of reinvestment in marketing on a go-forward?

Denise Morrison - *Campbell Soup Company - President & CEO*

Jason, we do try and keep total advertising consumer and trade at about 25% of sales. In the first half, our soup advertising was not cut. What we are lapping is the launch of Prego white sauces and dinner sauces, so the advertising spend in the Simple Meals portion was down. And also lower advertising on US Beverages, as we chose to spend more on that in the back half against introduction of the V8 Veggie Blends.

The other thing that we did was in the biscuit business we did have a higher trade on Pepperidge Farm as we drove more merchandising in particularly the second quarter. And in Arnott's we had a price increase and we did spend trade to make sure we protected promoted prices in the marketplace.

The other thing that affected trade was soup, the launch of new organic soup, and also the launch of veggie blends where we put new distribution funds in place on those two businesses. Going forward, we absolutely believe that advertising is a solid grower of top line, as is consumer. And as we work through our new divisions and their portfolio roles, we will be making sure that we are allocating those investments to the places that have the greatest profitable growth opportunity for us.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Just to add to Denise's comments, as we look to the $200 million cost opportunity, we believe some of that can come from our non-working or discretionary marketing expense. So we will be looking at that area pretty closely.

Denise Morrison - *Campbell Soup Company - President & CEO*

And we will be able to make that distinction.

Jason English - *Goldman Sachs - Analyst*

Okay. I'm going to try to cheat and squeeze in one quick follow-up.

You talked on looking at spend as an entire bucket, inclusive of trade spend. Your promo line has been moving higher; I should say as a contra-revenue indicator moving lower for eight years. And you're now citing gross margin disappointment on the net price utilization.

So clearly it's a problem, the degree of trade spend and the lack of efficiency on it. How do you address that? And after eight years of putting more money in, is it really feasible to imagine you'd be able to pull money out and get a net benefit on that in the go-forward?

Denise Morrison - *Campbell Soup Company - President & CEO*

Yes, we have been doing quite a bit of analytics on our trade performance in the marketplace and on the appropriate pricing, so we have been able to really understand with a new level of granularity where we have invested and the return on that investment. And we will be reducing less profitable or less ROI trade in the marketplace. That is our approach.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Just to add to that, in terms of our back half net price realization efforts, we have announced pricing on our Simple Meals segment across 30% of the portfolio at an average of 5.7%. So we are taking pricing on some of our red and white SKUs. We are taking pricing on Prego. We are taking pricing on Campbell gravy.

And we're also reducing our promotional spending in a couple of our key businesses. I won't name those for competitive reasons, but we should be seeing some moderation on trade in the back half here.

Jason English - *Goldman Sachs - Analyst*

Great. Thanks a lot, guys. I will pass it on.

Operator

Alexia Howard, Bernstein.

Alexia Howard - *Sanford C. Bernstein & Company - Analyst*

I know we focused a little bit at the conference on the overall trajectory on margins, but can I just focus specifically on the soup segment? Just from looking at what's going on in the grocery stores, there seems to be a shift into newer products that are in cartons and other new packaging formats, not necessarily the cans.

And Campbell's is obviously joining this trend with the organic soups and so on. How does that affect your margins over the long-term?

In the near term, I imagine using co-packers reduces the margins. Longer-term if you were able to scale those and bring them back in house, would the gross margins be comparable? And is there also margin pressure across the US Simple Meals category, if the new pouched skillet and dinner sources are replacing sales of condensed soup for cooking? Thank you very much.

Denise Morrison - *Campbell Soup Company - President & CEO*

Alexia, I do think that the major shift for us in terms of out-of-the-can packaging has been in the area of premium soup, which has been a place where we've expanded our Campbell Slow Kettle in tubs, our bisques in boxes, and now our new organic soups, which are also going into that segment. And that segment is growing.

And that segment also commands a higher price point, so we are very pleased with the margins that are in that particular segment. That said, the canned soup business is still several billion dollars and very profitable, and so bringing news to the core business is also an important part of our program here.

I think the best example I can give you in terms of margins is on the broth business. Recall once upon a time, Swanson broth was 100% in cans and over time, after the introduction of the aseptic Swanson broth at a higher retail and very solid margins, we have been able to manage that conversion at the pace that the consumer has taken us there. And so we now have two very profitable offerings in that particular space.

So I hope that answers your question.

Alexia Howard - *Sanford C. Bernstein & Company - Analyst*

Is that a model that you can use directly in the canned soup business to migrate it over to those aseptic cartons, or does the FDA prevent that?

Denise Morrison - *Campbell Soup Company - President & CEO*

I think that -- again there are many consumers that are -- that continue to buy canned soup and there are some that choose to buy soup in other packages. And we believe we are bringing the consumer a choice model, depending upon what their preference is, and we make sure that our margins are acceptable.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

This is Jennifer. I was just going to add, you probably noticed that our new organic soups in the cartons do have garnish.

Alexia Howard - *Sanford C. Bernstein & Company - Analyst*

Yes, it would be great to see more of that. Thank you very much, I will pass it on.

Operator

Diane Geissler, CLSA.

Diane Geissler - *CLSA Limited - Analyst*

Good morning. I wanted to ask about your comment on reducing the amount of innovation, but making -- sort of scaling it and making it more impactful.

So last summer when we came to your analyst day obviously had a lot of innovation you showed us. It seems like there's a little shift in strategy there given what's going on in the center of the store.

Can you just talk about what you envision in terms of like platform innovation? How many will we see per year? What is the bogey in terms of sales that you have to hit in order for it to be considered successful? I just want to understand a little bit better the strategic thinking behind that and how you will assess it going forward.

Denise Morrison - *Campbell Soup Company - President & CEO*

Let me take you back three-and-a-half years, where we had no innovation pipeline on our soup and Simple Meals business and our sustainable innovation was driving about 5% of sales from new products on a rolling [3%]. Fast forward to today where we have built a pretty robust innovation pipeline in that business and our sales from -- in the new products introduced in the last three years now are about 11%.

We would like to get them to between 13% to 15%, so we still have more work to do, but we are totally in a different place. That said, we have been able to go back and look at, literally, the plethora of activity in that space. And what we have realized is, if we can cluster our innovation into fewer bigger platforms that have scale in the marketplace and can have a bigger impact, that would be a better program that we are now prepared to run.

And so, for example, if you look at health and wellness, innovation in the organic space, innovation in the fresh space, and innovation in vegetable nutrition are three big platforms that we think we can build out. In Simple Meals our whole dinner sauces with skillets, oven, slow cooker, and now grilling can be a platform that will have a meaningful difference in the category. And so those are two examples of how we are starting to look at it.

Diane Geissler - *CLSA Limited - Analyst*

So is the Company scaled for larger innovation platforms in fiscal 2016, or is it more fiscal 2017 where we should look for larger impactful platforms?

Denise Morrison - *Campbell Soup Company - President & CEO*

I believe what you will see is us building on to the platforms that we have already initiated and coming out with new bigger ones over the next couple years, because we still are very committed to brand building and innovation as a way to drive sustainable, profitable growth.

Diane Geissler - *CLSA Limited - Analyst*

Okay, great. Thank you.

Operator

Robert Moskow, Credit Suisse.

Robert Moskow - *Credit Suisse - Analyst*

Thank you. Anthony, I was listening to the reconciliation of gross margin and it seemed like a lot of these issues were things that you had mentioned on the first-quarter call already. So I guess I wanted to know what was the major surprise. Since you were already talking about spot rates and intermodal traffic in first quarter, what made it worse in second quarter that you didn't expect?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

I would break it down into three areas. The first was cost inflation, so I quoted some numbers on categories earlier. Those numbers were a little higher, frankly, than we anticipated and the mark-to-market on diesel was a little higher than we anticipated.

The second is in this area of freight and distribution. We talked about in the first quarter that we got a little bit behind, given an early spike in demand, and that continued further into the second quarter than we anticipated, quite frankly, as we decided to prioritize keeping up on customer service over some of these incremental cost issues. So I think it's the same factors that have just pushed into the second quarter a little bit further than we have anticipated.

And the third impact I would point out is the dollar continuing to strengthen has had a larger impact on input costs of some of our international businesses than we anticipated.

Robert Moskow - *Credit Suisse - Analyst*

Campbell has done a lot of work to make the supply chain more efficient. Productivity pops up all the time as a benefit. Are you at all concerned that maybe, as you've changed your supply chain footprint, that you have reduced the flexibility in the footprint at the same time and that could've led to some of these issues? Or am I just jumping to a conclusion?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

We've talked about that. We look back at some of the actions we have taken, primarily the closure of the Sacramento plant; we achieved very significant savings from that initiative and I think in comparison these costs that we are seeing here are relatively minor compared to that.

We believe we understand the causes of them. We believe we are addressing them. We're starting to see them moderate and we expect the worst is behind us from here going forward.

Denise Morrison - *Campbell Soup Company - President & CEO*

Our supply chain continues to deliver about 3% in productivity every year. And with the soup common platform and plant of the future it actually is introducing much more flexibility into the footprint to be able to manufacture products beyond the can.

Robert Moskow - *Credit Suisse - Analyst*

Thank you, Denise.

Operator

David Palmer, RBC.

David Palmer - *RBC Capital Markets - Analyst*

Good morning. You mentioned condensed is down a few percent. If you break down condensed between eating soups and cooking soups, what are the trends in each? And if you want to extend it back a couple quarters to make it even, please go for it.

And what is the percentage of the breakdown between eating and cooking soups currently in condensed? Thanks.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

They are about equal weight. I think the way to answer the question is longer term we have seen relatively better performance out of cooking soups than eating soups. Cooking soups being more on-trend with consumer behaviors around obviously cooking and recipes, while the eating soups, given all the activity in ready-to-serve, there has been some migration from eating soups to ready-to-serve soups. And I think that has been the primary factor over the longer term negatively impacting condensed eating varieties.

Denise Morrison - *Campbell Soup Company - President & CEO*

I would just add that the three icons still remain very strong in condensed soup and where we have seen the impact is in the other eating with the interaction with ready-to-serve.

David Palmer - *RBC Capital Markets - Analyst*

That really is the nature of the question is that you wonder if there might be a time one, two, three years down the road where your sauces, your broths, and then your cooking condensed varieties together get to a scale and they are on trend with the Millennial eating patterns that that could be a high-margin sort of savior to your growth, whereas some of your other growth areas are lower margin in nature.

I wonder if that -- if you see that getting to critical scale within some time horizon. Is that a fair question?

Denise Morrison - *Campbell Soup Company - President & CEO*

We tend to view the business that way. In fact, it comes together really nicely on CampbellKitchen.com, where we are able to suggest many recipes using both broth and also our cooking soups to make fresh food taste great. And so we do see a scale play in terms of our cooking varieties.

That said, we still have a very nice business in our other eating condensed as well.

David Palmer - *RBC Capital Markets - Analyst*

Okay, thank you.

Operator

Erin Lash, Morningstar.

Erin Lash - *Morningstar - Analyst*

Thank you. I was hoping you could just kind of address, in line with the discussions, regarding some of the innovation.

You've been quite upfront about the fact that center of the store has been struggling. We've seen that in the numbers. Kind of the positioning of those new products, whether you think that they will drive traffic in the center of the store, or positioning within the perimeter, and how those discussions with retailers are going.

Denise Morrison - *Campbell Soup Company - President & CEO*

Well, I think it's important that when you run an innovation program there has to be an acceptance that some of the innovations are going to hit and some of them are not. The trick is to figure out which ones are the winners and put your money and investment behind those and figure out which ones are not and pull them away. And I believe we have been running that kind of program.

But we have seen some very important innovation to our core business. For example, in pub-inspired chunky soup, which has introduced a whole new line of innovation to that particular franchise. We've also -- we are very pleased with the building of the dinner sauce platform that I talked about earlier. Those are two examples where we have really hit the mark.

The other place, too, is in the premium soup. We have been able to get four feet extra for premium soup in the stores, which has enabled us to expand Slow Kettle and the boxed soup and also provide a home for our new Campbell Organic soup. Again, as I mentioned, that segment is growing nicely.

We've introduced Goldfish Puffs in the Pepperidge Farm franchise, which are gluten-free. We also introduced Jingos! a couple years back that didn't work. So there is always going to be a mix and what we are pleased with is that we are hitting more than we are missing.

Erin Lash - *Morningstar - Analyst*

So suffice it to say, most of the innovation will be -- continued to be I guess positioned within that center of the store as opposed to the perimeter?

Denise Morrison - *Campbell Soup Company - President & CEO*

I'm sorry if I gave you that impression. We have a very robust innovation pipeline in the perimeter with our Bolthouse Farms business. In Beverages, we are introducing new blueberry banana almond milk and a couple new salad dressings, in addition to 1915, which is the ultra-premium cold-pressed juice.

And we also have an innovation pipeline that is looking at other categories in the perimeter where we can bring Campbell's capabilities, so there's a lot of activity going on in that space.

Erin Lash - *Morningstar - Analyst*

Thank you.

Operator

John Baumgartner, Wells Fargo.

John Baumgartner - *Wells Fargo Securities - Analyst*

Good morning. Thanks for the question. Denise, just wanted to address US Beverages for a minute.

Performance is pretty weak there and I guess it's clearly not from a lack of effort. But at this point you've already pushed through new packaging, new advertising, new flavors; you've renovated with corn syrup removal and yet it seems price reductions are more of an everyday lever, and without a volume response.

So what comes next? Is this just an example of a category moving away from you structurally with V-8? Do you have to look outside at maybe different brands or segments at this point? Just your thoughts there.

Denise Morrison - *Campbell Soup Company - President & CEO*

The shelf-stable juice category has been really sluggish for a couple years and I think that one of the big drivers is most of the juice in that category contains sugar and there's been a movement on the part of consumers to really pay attention to that. That said, we are pretty well positioned, having vegetable-based beverages, and we decided a year ago to really rethink that whole offering from V-8, which is why we spent a great deal of time developing the V8 Veggie Blends, gaining some expertise from our part of the business at Bolthouse Farms.

We are just getting those vegetable blends in the marketplace today, but what we believe is that that will offer consumers great-tasting vegetable juice alternatives that are mainstream-priced and we believe will add a jump start to our V8 business. In addition, we only have 10% of our business in single-serve, whereas most beverages have about 50%.

So we are still very committed to increasing our V8 business in single-serve, immediate consumption. And with the Veggie Blends we will have more of a breadth of line to offer our distribution the marketplace.

John Baumgartner - *Wells Fargo Securities - Analyst*

Outside of the Veggie Blends, what are your thoughts on just the core tomato franchise? Has that weakened at all at the consumer in terms of change in preferences?

Denise Morrison - *Campbell Soup Company - President & CEO*

The core tomato franchise has always been polarizing. There are people who either like tomato or who don't like tomato, and we haven't been able to offer the people that don't like tomato-base a different alternative. So we believe that tomato will still be an important part of our franchise for those who love it, and we will be able to offer other things as well.

John Baumgartner - *Wells Fargo Securities - Analyst*

Thanks, Denise.

Operator

Akshay Jagdale, KeyBanc.

Lubi Kutua - *KeyBanc Capital Markets - Analyst*

This is actually Lubi on for Akshay. I just wanted to ask about performance in Bolthouse in general.

It seems that top-line performance and maybe profitability as well in that segment has been trending somewhat below your original expectations when you first entered the sort of faster-growing packaged fresh category. So, first, is that a fair characterization? And then, if that is the case, can you talk a little bit about what's driving the relative underperformance and how you are thinking about growth in Bolthouse longer term? Thank you.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

I can take that. I would split the business into two parts. Think about the CPG, beverages, and salad dressings -- those businesses we are very pleased with the performance of those business both top and bottom line.

Where the issue in the short term has been, and I think most of this is now behind us, has been on natural ingredients and carrot costs. As you know, we went from a very unique drought situation and that raised our costs in terms of water costs, water extracting costs, land costs. And then we went from that to four rain events within a 10-day period, which also cost us on the carrot cost side. Both of those situations have impacted our business.

The reason I said I believe it's behind us is now we have shifted our harvesting to the more southern region where they don't have the same kind of situation. We saw improved performance in the back end of our quarter, so we feel pretty good about the outlook.

The other issue we've had a little bit on the top line is we export some natural ingredients and concentrates to Japan, and that business has been under pressure. But the core business, the CPG beverages and salad dressing, continues to perform very, very well.

Lubi Kutua - *KeyBanc Capital Markets - Analyst*

Thank you, that's helpful. I'll pass it on.

Operator

Andrew Lazar, Barclays.

Andrew Lazar - *Barclays Capital - Analyst*

Good morning, everyone. If we look at, I guess, gross margins today versus even a couple years ago, obviously we've seen some pretty significant erosion for various reasons that you have discussed over time.

I am just trying to get a sense of whether you view the current level of gross margins as maybe somewhat artificially low or as really a new, more reasonable base from which you try and improve going forward in light of the various reinvestment needs. You've got the gross margin mix of some of the faster growth areas put against the ZBB actions you are going to take.

And then just secondly, you are taking some pricing actions, even in soup you talked about it. I had always thought it was tough to take pricing sort of intra soup season. And is it just more on the versions that you know are very elastic that allow you to do that?

Just trying to get a sense of what's changed there. Thank you.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

In terms of the first part of the question, I really believe we have opportunities to improve our gross margin performance over time. And I think when you think about the new organizational structure, coupled with the portfolio of roles that we've assigned to each of those businesses, we really do have an opportunity to improve gross margin performance, both from net price realization, both from a more modest inflation outlook, continuing productivity improvement, and the cost savings we expect to garner through our new $200 million program. So I think there are opportunities to expand margin over time.

In terms of the pricing question, certainly in terms of benefit we get more benefit by enacting a pricing action ahead of the soup season, but there's nothing that really prevents us from doing it at any point. The key is to work through the timing and the impact on the promotional activity with our retailers. But this was well planned out and is now in the marketplace.

Andrew Lazar - *Barclays Capital - Analyst*

Thank you.

Operator

Jonathan Feeney, Athlos Research.

Jonathan Feeney - *Athlos Research - Analyst*

Good morning, thanks. I guess this is for Anthony.

Looking at the volume declines, particularly in Simple Meals over the past few years, and you mentioning your use of increased co-packing in some of the new products, what would you say that maintenance capital expenditure is for this business? And maybe as part of that, as we look at this new sort of segment structure and maybe some different kind of streamlining and cost savings that might allow, what sort of returns on capital do you typically look at for amounts over and above that maintenance capital expenditure in your annual regular budgeting process? Thanks.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

I think maybe the best way to answer the question is we expected to spend about $400 million this year on capital, 60% of which is on projects that have an economic return. And those are split between capacity-adding projects and cost reduction projects.

On the capacity-adding project, we typically see pretty significant and attractive IRRs, I would say 20%-plus kind of levels. On the cost reduction ones, I'd say we do see returns certainly above the cost of capital. It's kind of hard to come up with one kind of IRR from any kind of range, but I think we have a very successful track record of achieving good returns on those cost reduction projects.

Jonathan Feeney - *Athlos Research - Analyst*

I got you, but about -- if your business, just in a weird alternate universe, didn't grow volume at all and everything stayed exactly the same from year to year, you are saying about 40% of your capital expenditure would be required to sort of just -- doesn't have an economic return, just sort of maintains economic returns where they are. Did I hear that right?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Yes, you did.

Jonathan Feeney - *Athlos Research - Analyst*

Great. Thanks very much.

Operator

Eric Katzman, Deutsche Bank.

Eric Katzman - *Deutsche Bank - Analyst*

Good morning, everybody. I guess maybe I will follow up on Andrew's question around pricing. Is this kind of a signal of, for lack of a better phrase, treating some of the Simple Meals in the new division and maybe the relative share targets? Is one way to interpret this that it is, again kind of lack of a better term, but a cash cow?

Denise Morrison - *Campbell Soup Company - President & CEO*

Not intended to be, Eric. When you take a step back, the pricing action was only on 25% of our US retail portfolio based on gross sales, but across our entire portfolio it equates to about 1.4%. And we were very surgical about where we priced and so it was predominantly on red and white condensed, on Prego, and on Campbell gravy.

The other place where we are constantly looking to is where we've spent promotional activity and didn't get the returns on that activity. We don't read any more into it than that.

Eric Katzman - *Deutsche Bank - Analyst*

Okay. Then just as a follow-up, Anthony. I remember there was a lot of confusion in the first quarter about how you account for fixed cost absorption and I'm kind of asking that question with regard to the second quarter and the gross margin weakness. And kind of these third -- it's not like your volume was really all that bad in the scheme of things.

So I guess were you actually looking for volume in the quarter to be down, and then volume was better than you thought and then you had to go out into the market to buy the spot freight rates and --? Or was it, again, having to do something with how you account for those fixed costs as you go through the year?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Trying not to complicate this too much, but it's actually a little bit of both. The whole area of inventory and inventory management gets really complex when you think about SKU and location and our multiple distribution points and the fact that we got a little bit behind and had to catch up. And that takes a little bit of time in season when you are running pretty close to flat-out inside of these plants.

We had to run a little more overtime. We had to use co-packers more. That's more of a broth idea than a can idea.

Separate from that in this whole area of fixed costs, it's not the major impact but our sales came down a little bit inside our own range. And that had a slight negative impact on fixed cost absorption, both in the quarter and in our outlook for the year, but it wasn't a significant impact.

Eric Katzman - *Deutsche Bank - Analyst*

Okay. Thanks, I'll pass it on.

Operator

David Driscoll, Citi Research.

David Driscoll - *Citi Research - Analyst*

Good morning and thanks for getting me in. Two points that I just wanted to clear up and then a very short question; the first one is just on the guidance.

If I understand it right, the previous gross margin guidance was minus 50 to minus 100 basis points. Today you are guiding to down 100 basis points, so at the low end of the previously-discussed guidance on gross margins. Tax rate is lower.

So, Anthony, what is the change in the guidance then on EPS? It looks like it's all between gross profits and EBIT, everything in the SG&A line. What's changing there if I've said everything correctly?

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

Between EBIT and EPS a couple of changes. One is we took the tax rate down a bit. We also expect interest expense to be favorable to our original assumption, so down slightly year-on-year.

And then within EBIT I would say there's three things happening. The primary issue is the gross margin performance, and that's a combination of the freight and distribution that we have been talking about, the manufacturing costs that we've been talking about, the use of co-packers. We had a slight impact from an equipment outage at one of our plants. And from a stronger US dollar, that impact on the input costs of some of our international businesses.

The second area is currency translation, so we went from about 1 point of negative impact to 2 points and about $0.05 impact at EPS now for the year. The third I mentioned a moment ago; is a slight sales reduction within our range, which had some impact on gross margin dollars, more so than percentage. So I would say those are the three primary things above EBIT and then below EBIT the tax rate and interest expense.

David Driscoll - *Citi Research - Analyst*

Just to be super clear on this, because I think there's -- I'm not saying it or you're not saying it the same way. Gross margins were previously forecasted down 50 to 100 basis points and today you are saying down 100 basis points, so it's still within the range that you said last call, yet your EPS guidance is down $0.10 to $0.12. It doesn't make sense to me when you say all these factors, because that would be inclusive of what you said three months ago.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

I'd say in hindsight that gross margin range of 50 to 100 basis points was probably a bit too wide and we were closer to the 50 than the 100 basis points.

David Driscoll - *Citi Research - Analyst*

All right, that's what I was looking for.

On the service issues, Denise, just a question here to follow-up on what Moskow said earlier. It does seem like all of this is related to just planning issues. Intermodal transport, everything just seems to be related to forecasting out what you had to ship in this period of time. And that forecasting doesn't go well and, hence, it causes a domino effect across your supply chain that increases costs.

Is that just kind of fundamentally the root cause analysis as to what happened?

Denise Morrison - *Campbell Soup Company - President & CEO*

I think that's part of it, David, but literally, having one less plant in our system, having a much more expensive spot market and making sure that we were -- we got out of the gate with a huge back-to-school program that put some pressure on our forecast. It was above what we had anticipated.

So there was a combination of a lot of things coming together and we got behind. And then we made the conscious decision to make sure that we were delivering for our customers and I still would've made that same decision.

David Driscoll - *Citi Research - Analyst*

Okay. Last little thing for me was just on winter temperatures and soup sales.

In our latest 12 weeks of Nielsen retail data, which I think is easier to understand than maybe your shipment patterns this year, the retail data looks pretty soft in soup and yet the winter temperatures have been pretty cold. So I was just curious if you had a thought as to kind of why that's happening, what's driving the reduction in consumption. Because I think it's both a sales and a volume issue according to our Nielsen data.

Denise Morrison - *Campbell Soup Company - President & CEO*

Our consumption is down about 1% and it's pretty much in line with center store categories.

Anthony DiSilvestro - *Campbell Soup Company - SVP & CFO*

It's really difficult for us to tease out the temperature and the winter impact from our overall performance.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

And it was cold last year, too.

David Driscoll - *Citi Research - Analyst*

Okay, I just wanted to get your sense of it. Thank you so much.

Jennifer Driscoll - *Campbell Soup Company - VP, IR*

Thanks, everyone, for joining us for our second-quarter earnings call and webcast. A full replay will be available about two hours after our call concludes here by going online or call 1-703-925-2533. The access code is 1650012.

You have until March 11 at midnight, at which point we move our earnings strictly to the website, investor.campbellsoupcompany.com, under news and events. Just click on recent webcasts and presentations.

We hope you can join us for our next earnings call on Friday, May 22, 2015. If you have further questions, please call me, Jennifer Driscoll, at 856-342-6081. If you are a reporter, please call Carla Burigatto, Director of External Communications, at 856-342-3737.

Our call has now ended. You may now disconnect.