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Campbell Soup Co. (CPB)

Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, ladies and gentlemen, and welcome to the Campbell Soup Company Third Quarter Fiscal 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] As a reminder, this conference call is being recorded.

It is now my pleasure to introduce your host, Rebecca Gardy, Chief Investor Relations Officer. Please go ahead.

Rebecca Gardy

Senior Vice President & Chief Investor Relations Officer, Campbell Soup Co.

Good morning, and welcome to Campbell's Third Quarter Fiscal 2023 Earnings Conference Call. I'm Rebecca Gardy, Chief Investor Relations Officer at Campbell. And joining me today are Mark Clouse, President and Chief Executive Officer; and Carrie Anderson, Chief Financial Officer. Today's remarks have been prerecorded and reflect an effort to better accommodate more time for Q&A. Once we conclude the prepared remarks, we will transition to a live webcast Q&A session. For us to give as many participants as possible the opportunity to ask questions, we ask that you limit yourself to two questions. The slide deck and today's earnings press release have been posted to the Investor Relations section on our website, campbellsoupcompany.com. Following the conclusion of the Q&A session, a replay of the webcast will be available at the same location, followed by a transcript of the call within 24 hours.

On our call 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 of our presentation 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 provided a reconciliation of each of these measures to the most directly comparable GAAP measure in the appendix of this presentation. On slide 4, you'll see today's agenda. Mark will share his overall thoughts on our third quarter performance as well as in-market performance by division. Carrie will discuss the financial results of the quarter in more detail and review our guidance for the full-year fiscal 2023.

And with that, I'm pleased to turn the call over to Mark.

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

Thanks, Rebecca. Good morning, everyone, and thank you for joining our third quarter fiscal 2023 earnings call. As you read in our press release this morning, we delivered our third quarter very much in line with our expectations with strong mid-single digit net sales growth, led by favorable net price realization, partially mitigated by the comparison to year ago retailer inventory rebuild. We also experienced planned low-single digit declines in adjusted EBIT and adjusted EPS year-over-year, primarily due to higher non-operating items. Overall, it was another quarter of consistent strong results, fueled by in-market performance, best-in-class service levels driven by our sustained supply chain recovery, and favorable inflation-driven net price realization. All of these have and continue to be key areas of focus for our company.

Our performance was led by another tremendous quarter in Snacks, where we continue to build broad-based momentum on both growth and share and made a meaningful step change on margins. In Meals & Beverages, our brands continue to benefit from the strong value and convenience they provide consumers. We did experience some expected volume mix pressure as we cycled prior year retailer inventory rebuild. It's worth noting that we are fully back to pre-COVID service levels in the mid-to-high 90s, which is currently best-in-class as we continue to turn our supply chain operations into a competitive advantage. In addition, we don't expect further significant inventory-driven volatility as retailers have returned to targeted inventory levels, taking advantage of these improvements in our service levels.

As we look to close out another strong fiscal year, we are reaffirming our full-year fiscal 2023 financial guidance ranges for net sales and adjusted EBIT, and we are currently tracking to the upper end of our adjusted EPS outlook range. Our guidance appropriately considers the current environment, prior year comparisons, normalized investment levels, and absorbs the divestiture of the Emerald nuts business, which was announced on May 30. Now, I'll turn to a quick discussion of our divisional results, starting with Meals & Beverages. Organic net sales decreased 1%, while in-market dollar consumption grew 2% with the variance primarily driven by the cycling of significant retailer inventory rebuild in Q3 fiscal 2022, which was more pronounced in the Meals & Beverages division.

Our supply chain recovery has been best-in-class and our top-tier execution led to significantly improved customer service levels, up approximately 25 points in the third quarter versus prior year, enabling retailers to return to pre-pandemic inventory levels. Volume in the quarter was impacted by the same inventory dynamic, as well as below historical norm price elasticities and some increased competitive activity as other supply also improved. Once we cycle the tough prior year comparisons, we expect volume trends to improve sequentially. We have made considerable progress in creating sustainable momentum and relevance across the Meals & Beverages business over the last several years and remain confident in the continued growth potential of our iconic brands.

Turning to our soup portfolio on slide 8, dollar consumption was essentially flat versus prior year, reflecting inflation-driven pricing mitigated by below historical norm elasticities and some increasing share pressure. As

competitors improve supply, we are seeing some increased promotional activity. On a net sales basis, soup was down 11%, primarily reflecting the disproportionate impact of cycling the inventory recovery from a year ago, which accounts for the majority of this decline. Strategically, we continue to believe strongly in our ability to grow the soup business and are pleased with the progress we've made in leading the renewed relevance of the category over the last four years. For example, the improved relevance of condensed soup, especially cooking, where we have supported the growth of in-home meals. Importantly, this has attracted new younger consumers to Campbell's.

In addition to cooking, our condensed eating icons, including Chicken Noodle and Tomato, are also up significantly from pre-COVID levels, providing a strong foundation for our business. However, some flankers like healthy requests in our kids' flavors, which have been key drivers of recent share softness, remain an area of opportunity. Next is the complete restage and growth of Chunky soup. This brand has been fundamentally transformed from a product purchase primarily on deep discount promotion to a great everyday value with a compelling position that focuses on protein and quick in-home lunches. This positioning has been particularly relevant with younger consumers, especially given the current economic climate and in contrast to higher-priced frozen food or away-from-home options.

The impressive four-year growth in dollar consumption up 31% and share up 2 points has been fueled by great marketing, effective inflation-driven pricing, and innovation like our spicy line. We did experience a step-up in some competitive pressure in Q3, but we're already seeing the return to share growth, up 1 point in the latest four weeks. Finally, the performance of Pacific as a growth engine. This organic premium line has proven to be a fantastic acquisition, driving incremental consumers to our portfolio. Its results over the last four years have been impressive, up 56% in dollar consumption and 0.9 share points. With offerings across broth and ready-to-serve soup, Pacific gives us a high-growth premium platform to keep expanding the category and our soup business. These three areas of strength, paired with a robust pipeline for the future, solidifies our confidence that soup will be a steady contributor as we cycle through some of the tough comparisons and return to a level playing field.

Turning to slide 9, our Snacks business delivered its third consecutive quarter of double-digit net sales growth, continuing the strong momentum of this business. Our 12% net sales growth was fueled by our eight power brands, reflecting the benefit of net pricing and below historical norm elasticities, which resulted in a slight decline in volume and mix. In-market dollar consumption in our total Snacks business grew 15% over the prior year and 32% compared to four years ago, also driven by our power brands. Although not as significant as in Meals & Beverages, we were also lapping some of the inventory recovery from a year ago. In fact, with our significant supply chain recovery, our customer service levels are now averaging 95%.

Drilling into our power brands on slide 10, dollar consumption increased 18% with strong dollar and volume share growth, which was driven by impactful marketing and a steady drumbeat of innovation. On a four-year basis, dollar consumption was up 40% with all eight brands growing double digits in the quarter. For six of our eight power brands, our dollar consumption growth is outpacing their respective categories, highlighting the outsized consumer demand for our unique and differentiated Snacks portfolio that spans both cookie cracker and salty categories. With increased service levels, contributions from new product and packaging innovations and planned investments, the share trajectory of our power brands shows a significant improvement over the prior year, systematically rising for each of the last four consecutive quarters. Our marketing efforts also continue to win, as we focus on engaging consumers where and when we can have the greatest impact.

Goldfish, which is on pace to approach \$1 billion brand, is a great example being named teens' most preferred snack brand for the fourth time in a row according to Piper Sandler's Spring 2023, taking stock with teens survey. Building on the success of our Goldfish innovation model, with LTOs such as Frank's RedHot and Old Bay

Goldfish, we are now driving increased innovation on other brands in our snacking portfolio, such as the Kettle brand. Our new kettle-cook and air-finish potato chips have performed extremely well in market. We've also released two LTOs with strong results, taking a page out of the successful Goldfish playbook. We're adding innovation on brands like Late July that has also fully recovered now on supply. As we continue to build momentum across the portfolio, we'll step up investment behind this innovation and brand building, which will continue in the fourth quarter.

Our Snacks business has grown steadily these past two years, and we're now starting to see progress on our profit and margin roadmap. Over the same period, we have seen operating earnings growth average 13%, and even with the strength of our top line, we've also seen margins expand. In fact, Q3 year-to-date, we are up 130 basis points versus two years ago and pacing to an absolute operating margin for the year of over 14%. We remain confident that we'll continue to show steady improvement in fiscal 2024 while also remaining on track for our longer-term Snacks operating margin goal. In summary, although Q3 was a tougher comparison to cycle from a year ago, our results were in line with our expectations.

We remain right on track for the full year. And more importantly, we're showing fantastic progress in many critical strategic areas such as momentum in every facet of our Snacks business, including margins; strong sustained execution across our supply chain; and momentum and continued relevance of our Meals & Beverages business. Overall, we continue to be pleased with the consistency and performance of the business, leading to another strong year for Campbell.

With that, I'll turn it over to Carrie.

Carrie L. Anderson

Executive Vice President & Chief Financial Officer, Campbell Soup Co.

Thanks, Mark, and good morning, everyone. I'll begin with an overview of our third quarter results which came in as expected, reflecting the benefit of prior waves of pricing and ongoing supply chain momentum as well as the in-market environment and retailer inventory dynamics which Mark discussed earlier. Third quarter organic net sales increased 5% versus prior year, reflecting favorable inflation-driven net price realization partially offset by volume and mix declines. Adjusted EBIT decreased 2% primarily driven by higher adjusted other expenses related to lower pension and post-retirement benefit income this year. Higher adjusted gross profit more than offset higher adjusted administrative expenses and higher marketing and selling expenses.

Adjusted EBIT margin declined by 110 basis points versus prior year to 14%. Adjusted EPS decreased 3% to \$0.68 driven by lower adjusted EBIT and a higher adjusted effective tax rate. The impact of lower pension and post-retirement benefit income reduced adjusted EBIT margin by 50 basis points and EPS by \$0.03 in the quarter. Turning to a year-to-date view, top line and adjusted EPS were both up double digits compared to the period last year and adjusted EBIT was up 9%. The impact of lower pension and post-retirement benefit income reduced year-to-date adjusted EBIT by \$37 million and adjusted EPS by \$0.09. Of note, our Q3 year-to-date adjusted EBIT margin was relatively stable at 15.4% when compared to 15.6% for the nine-month period last year.

As reflected on slide 17, third quarter dollar consumption growth in measured channels of 8% outpaced net sales growth of 5% driven largely by the expected lapping of retailer inventory rebuild in the prior year period when our service levels were recovering. This was partially offset by net sales growth in non-measured channels which we estimate contributed approximately 2 percentage points in the bridge between dollar consumption growth and organic net sales growth in this quarter. Slide 18 summarizes the drivers of our net sales growth of 5% in the third quarter. We generated 12 percentage points of growth from inflation-driven net price realization. Volume and mix

declined 7 percentage points, reflecting both the cycling of retailer inventory rebuild in Q3 of fiscal 2022 as well as lower volume consumption due to higher elasticities.

Excluding the impact of the cycling of retailer inventory, the underlying volume and mix decline was approximately mid-single digits, consistent with the implied run rate we expect for the balance of fiscal 2023. We expect volume trends to improve into fiscal 2024 as we fully cycle pricing. Price elasticities remain below historical levels, illustrating the continued underlying strength of our brands. Our third quarter adjusted gross profit margin was generally as expected, declining 60 basis points to 30.9% this year from 31.5% last year driven primarily by unfavorable volume and mix. As shown on the bridge, favorable net price realization and productivity improvements more than offset cost inflation and other supply chain costs.

Within other supply chain costs, we are lapping a one-time insurance benefit of 50 basis points in Q3 fiscal 2022 related to a temporary disruption in our Meals & Beverages supply chain operations caused by a Texas storm in 2021. The next page highlights the steps we have taken to mitigate core inflation which was approximately 8% on a rate basis in the third quarter compared to 15% in the third quarter of fiscal 2022. Our actions include targeted pricing and trade optimization. For the third quarter, net pricing was 12% and reflected the impact of pricing waves three and four. As a reminder, wave three pricing went into effect at the start of July of 2022 and wave four pricing, which was more selective compared to other rounds, was in place at the beginning of the third quarter of fiscal 2023.

We continue to deploy a range of other levers to mitigate inflation, including supply chain productivity improvements and broader margin-enhancing initiatives, including a focus on discretionary spending across the organization. In terms of commodity exposure, all of our raw materials are essentially covered for the balance of the fiscal year and we continue to closely monitor the overall commodity markets. Moving on to other operating items. Marketing and selling expenses increased \$6 million or 3% in the quarter on a year-over-year basis. This increase was driven by higher selling expenses partially offset by increased benefits from cost savings initiatives. Overall, our marketing and selling expenses represented approximately 9% of net sales for the quarter, and we continue to expect marketing and selling expenses to be at the low end of our targeted range of 9% to 10% of net sales for the full fiscal year.

Within marketing and selling, advertising and consumer promotion or A&C was down 2% versus prior year driven by a mix of investments to focus on prioritizing value-driven programs to match the current consumer landscape. Adjusted administrative expenses increased by \$8 million or 5% to \$154 million due to higher general administrative cost and inflation, higher incentive compensation, and higher benefit-related costs, partially offset by lower expenses related to the settlement of certain legal claims. As a percentage of net sales, adjusted administrative expenses were 6.9% in line with prior year.

As shown on slide 22, adjusted EBIT decreased 2%, more than explained by the \$12 million increase in adjusted other expenses related to lower pension and postretirement benefit income this year. Higher adjusted gross profit more than offset the combination of higher adjusted administrative expenses and higher marketing and selling expenses. Overall, our adjusted EBIT margin decreased 110 basis points to 14% in the quarter, primarily driven by a lower adjusted gross profit margin and the expected 50 basis point impact of lower pension and postretirement benefit income year-over-year. The impact of higher marketing and selling expenses and higher adjusted administrative and R&D expenses was fairly neutral on margin in the quarter as net sales growth was higher than expense growth.

Turning to slide 23, adjusted EPS of \$0.68 was down 3% or \$0.02 per share compared to the prior year. This was driven by the lower pension and postretirement benefit income we just discussed, which was a \$0.03 impact to

adjusted EPS, along with a slightly higher adjusted effective tax rate in the quarter. Turning to the segments, in Meals & Beverages, third quarter reported net sales decreased 2%. Organic net sales decreased 1%, primarily due to inventory and elasticity-driven volume and mix declines, partially offset by gains in foodservice and net price realization. Third quarter operating earnings for Meals & Beverages decreased 17% due to lower gross profit, with nearly 30% of the decline due to lapping the insurance settlement in the prior year.

Third quarter operating margin in the segment decreased to 16.4%, driven by lower gross profit margin, which was due in part to an unfavorable mix shift between foodservice and retail and the 100 basis point impact of lapping the insurance settlement. Favorable net price realization and supply chain productivity improvements largely offset cost inflation and other supply chain costs. On a third quarter year-to-date basis, segment operating margin stayed relatively stable at 19.2% compared to 19.4% in the comparable year ago period. For Snacks, third quarter net sales, both reported and organic, increased 12%, driven by sales of power brands, which were up 16% and reflected favorable net price realization, which was partially offset by modest declines in volume and mix. This is the third consecutive quarter of double-digit net sales growth for our Snacks business.

Segment operating earnings in the quarter increased 41%, primarily due to higher gross profit, partially offset by slightly higher marketing and selling expenses. Gross profit margin increased due to favorable net price realization and supply chain productivity improvements more than offsetting cost inflation and other supply chain costs. Overall, within our Snacks division, third quarter operating margin increased year-over-year by 330 basis points to 16%. On a third quarter year-to-date basis, operating margin increased 150 basis points to 14.5% versus 13% in the comparable year ago period. This year-to-date margin is more indicative of the Snack margin we expect for the full year, as we continue to invest in the momentum of the business.

I'll now turn to our cash flow and liquidity. Our cash generation remains strong with cash flow from operations of \$918 million through the end of the third quarter. In line with our commitment to return value to shareholders, year-to-date we have returned over \$475 million through dividends and share repurchases. Cash flow from operations was lower than the prior year, primarily due to changes in working capital, partially offset by higher cash earnings. Our year-to-date cash outflows from investing activities were reflective of capital expenditures of \$257 million, up from \$179 million in the previous year. Our year-to-date cash outflows from financing activities were \$535 million, including \$336 million of dividends paid and \$141 million of share repurchases.

At the end of the quarter, we had approximately \$301 million remaining under the current \$500 million strategic share repurchase program and approximately \$104 million remaining under our \$250 million anti-dilutive share repurchase program. We ended the quarter with cash and cash equivalents of \$223 million. Turning to slide 27, we are reaffirming our net sales, adjusted EBIT and adjusted EPS outlook, provided on our second quarter earnings call. Given our year-to-date performance, we are tracking to the upper end of our full-year fiscal 2023 adjusted EPS guidance. And given the momentum of our core brands, we anticipate that the recent divestiture of the Emerald nuts business, which closed on May 30 will not have a material impact on our fiscal year adjusted 2023 results. And accordingly, our full-year guidance is inclusive of the lost sales and profits of that business for the remaining two months of the fiscal year.

Our reaffirmed adjusted EBIT and adjusted EPS guidance reflects planned fourth quarter investments in sales and marketing, especially in our Snacks business as we drive continued momentum and value for consumers into these important summer months. Additionally, we are now expecting full-year capital expenditures of \$360 million for fiscal 2023, up from our previous guidance of \$325 million as we look to accelerate key manufacturing capacity investments in our Snacks business. Our full-year guidance for all other items remain unchanged, including the full-year pre-tax pension and postretirement benefit income, which is expected to be lower by

approximately \$45 million or \$0.12 per share compared to the prior year. This represents approximately 3.5% of adjusted EBIT growth and approximately 4% of adjusted EPS growth.

To wrap up, our third quarter tracked to our expectations, driven by strong price realization and operational execution, including in our supply chain. While we did see volume and mix decline in the quarter, it was largely a function of year-over-year comparisons, which masked base volume trends. We are meeting consumer needs for value, quality, and convenience while managing private label and competitive activity, particularly in our Meals & Beverage business, while our Snacks business continues to demonstrate accelerated growth and steady year-to-date margin progression. Our capital allocation priorities are well-defined and consistent, and we look forward to deploying our strong cash flow against the highest ROI opportunities.

And with that, let me turn the call over to the operator to begin Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of Andrew Lazar from Barclays. Your line is open.

Andrew Lazar

Analyst, Barclays Capital, Inc.

Hey, thanks so much. Good morning, everyone.

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

Hey, Andrew.

Andrew Lazar

Analyst, Barclays Capital, Inc.

Mark, you mentioned that results were in line with your expectations. But we've seen some sizable upsides to results on both organic sales growth and gross margin for really a bunch of packaged food peers recently. And maybe it's not fair to compare and some, I suppose, could be timing related. But I'm curious how we should think about that as it relates to Campbell's results this quarter. And then maybe more important, as the group starts to approach a more normal operating environment, do you see Campbell as being able to manage through this sort of transition period in, let's say, a relatively even keeled way or should we expect some volatility as the benefit from pricing starts to wane and sort of volume needs to ultimately sort of pick up the slack? So, just sort of a two-part question. Thank you.

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

Sure, sure. Yeah. Thanks, Andrew. I think it's always when we're cycling a quarter like we had in the third quarter last year, where we had such a dramatic step-up in our supply chain that enabled us to catch up what had been essentially two years of kind of hand-to-mouth service levels and kind of hovering in the 70s and low 80s for quite a while. It's always a little tough to help people see through all those variables as we set up what that lap will look like. But maybe if I can try to still down why I do not think Q3 of this year optically is necessarily an indicator or

harbinger of things to come, there are a few pieces that I think are quite unique. So, if you look at the top line, we delivered 5% net sales growth with about a 7% negative on vol/mix.

We know that when we cycle the inventory replenishment from a year ago, it was worth about 5 points, right, which is going to impact dramatically or directly net sales, but also significantly on the vol/mix side. And so if you kind of back that out and although look, I don't know where other players are in their returns to inventory levels with retail or how supply chains have recovered, but I would make the case that our supply chain for perhaps a lot of good reasons that we needed to do it recovered at a faster pace than many. And in fact, if you look at our service levels right now in the marketplace, they would absolutely be best-in-class. We're essentially fully back to pre-COVID levels of service. And so, arguably, our supply chain probably gave us a benefit a little bit faster than it might have in some other places.

But nonetheless, if you kind of put that into context with the 5% growth rate for the quarter, especially given that you've got the underpinning consumption in market of 8%, you're feeling much better about what I would tell you is kind of the underlying, let's call it, run rate. Although we do expect pricing to begin to come down and volumes to improve, that's important to kind of look at it through that lens. What may not have been as immediately clear is then as you kind of ripple down into the margin. So, we were off about 60 bps on gross margin and about 110 bps on EBIT margin. But there's three really important factors that you have to build into that. First, as frustrating as it is for me to share this each quarter, there was about 60 bps of the pension income headwind that we've had all year and we'll expect that to continue into Q4.

There was also about 50 bps of the insurance settlement related to the storm. And perhaps, the less obvious one and as you really see this on the Meals & Beverage business, is the impact of the mix dynamic of that inventory cycling. And so, a lot of the benefit a year ago was in soup. So, what you see, especially in Meals & Beverage, is a lower soup number, better away from home number and the mix impact of that was well over 100 basis points. So, when you kind of put those pieces together relative to where the EBIT margin and EBIT came in, you see a pretty different picture. And in fact, when we say it's in line with our expectations, that was how we were planning it. And if you think about why we're also saying hey, we're kind of right on track for guidance for the year, those elements were contemplated as we laid out the year.

Now, we're always going to want to make sure as we look into Q4 that we've got the room to invest. And it is true that as others are recovering in supply competition, I expect to continue to be stepping up a bit but nothing that I see that's dysfunctional or out of line with historical levels. So we're going to keep ourselves in a position to be able to invest. But really from my standpoint, when you peel that back and you look at what's going on underlying in the business, and this is a little bit of a lead into your second part, I feel great about where we are. I mean, there's no question the Snack business is really just on fire; I mean, it's hitting on all cylinders. We're seeing the broad-based growth, significant share improvement, strong and improving vol/mix.

And for the first time, really starting to see the traction on margin as we're now above 14%, about 150 basis points up for the year which is kind of a [ph] run rate (00:31:14). This quarter might be a little better than what we'll see next quarter. But in essence, we're going to be delivering, I think, a really meaningful step forward for the business in the year. And so, as I look forward, again, notwithstanding a full outlook or guidance for 2024, I feel very good. It is going to be a different dynamic as price does come down and volume improves. But I see very strong potential to continue to make progress across all fronts, and that's including margins and profit and being able to sustain growth.

So, I think although this quarter we have to unpack a few of those variables, at the end very much in line with what we expected. And I do not think this is a bellwether necessarily for us or the industry for that matter as far as the way the world will unfold over the quarters ahead.

Andrew Lazar

Analyst, Barclays Capital, Inc.

Thanks so much. Really appreciate that detail.

Q

Operator: And your next question comes from the line of Ken Goldman from JPMorgan. Your line is open.

Kenneth Goldman

Analyst, JPMorgan Securities LLC

Hi. Good morning.

Q

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

Hey, Ken.

A

Kenneth Goldman

Analyst, JPMorgan Securities LLC

Hi. I wanted to ask about what you're seeing in the marketplace for soup. And you touched on some of this, but it looks like unit share losses for Campbell are decelerating in condensed but maybe it's requiring a little bit of a heavier price investment and then RTS, your primary competitor, is investing a little more in price. So I don't want to overstate what's in the scanner; you're clearly getting a benefit from non-measured channels. But one of the questions that we're getting is hey, is there a risk that soup is starting another race to the bottom, right? It's been a long time since we've seen that kind of dynamic in this category.

Q

It's been much more rational than it used to be, but those of us who are a little longer in the tooth kind of remember when those price competitions, for lack of a better phrase, were not really uncommon. So just curious on your thoughts about direction the category is heading.

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

Yeah. No, it's a good question because we tend to talk about soup and the macro and there are, as you begin to point out, a variety of different variables underneath it. I would tell you that we do not see that dynamic that you're describing. I do think the fights are kind of by different segments. So if you think about what we've set up previously, for us, as we look about long-term health and sustainability of soup, we're really focused in three big areas. The first is the relevance question around condensed which, arguably, over the longer horizon has perhaps been the biggest question that certainly I've gotten over the years here, is are we able to continue to drive that relevancy that we saw picking up through COVID.

A

And really, for the last four years, soup has been growing at a CAGR of about 4% a year. I don't remember any time that in history we may have seen it. A lot of factors why but nonetheless, a pretty steady performance. Can we sustain it? But I think that as condensed, we look at it, there are two areas that we're really dialed in on. The first is making sure that that core set of icons continues to be a solid foundation. And I get asked a lot are you better off versus pre-COVID? How does it look? Those icons have grown 5 share points in condensed. And that's

a good thing for us because those are really where we have strong competitive differentiation, Chicken Noodle, Tomato, Cream of Mushroom, Cream of Chicken; very, very compelling and strong.

I think the most exciting part of condensed, which was the other big strategic focus, was to drive the versatility of the category and see it more relevant with cooking. And if you look at the last quarter, we were up 0.6 point on condensed even in a world where we were seeing some pressure overall from private label. But within the cooking area, we continue to grow and that's a great signal for the future. In particular, a lot of that growth is coming from younger households where I think there was a lot of questions on can you attract people into the condensed business that are millennials, and I think the answer is a clear yes. In fact, if you go back pre-COVID to now, we're up about 3 share points in cooking as we've continued to see a little bit of distortion based on our focus and the versatility of that segment.

Now, what that does imply is that some of our more higher-priced flankers, we're going to have to get a little bit sharper at that value proposition and make sure not on price but on benefit. So, I do not see this as a race to the bottom at all. Although we do experience some pressure on private label, we're being very thoughtful about the longer-term strategic game in condensed. So I think this is a different day, Ken, and I get it and I know that people are going to want to really probe on that to understand it, but I really do see it in a very different space than it was in the past. On ready-to-serve, you're right. I think some people have come back into supply and we're seeing a little bit more competition, but nothing dysfunctional. And in fact, the game there is really Chunky which has just been an unbelievable transformation as I said in my comments.

Repositioning it from this kind of low-cost, value, on-promotion item to something that's delivering value, protein, and convenience has really proven to be successful, especially when you pair it with some of the innovation. Although we saw a little bit of share pressure in the quarter, overall, in the last four weeks we're up 1 share point again. And if you go back in time, we've grown this business 2 points since COVID and I just feel great about where it's at and where it's headed. I think perhaps a little bit of the sleeper in the ready-to-serve category has been our Pacific business. Interestingly enough in this world of concern of trading down, our Pacific brand was the fastest-growing ready-to-serve brand in the quarter. That's faster than some other jarred premium soups that are out there really kind of debunking this whole myth of whether cans or jars.

If it's good food, people are going to buy it, especially if it's a great value. And I think Pacific has done extremely well in setting that combination with Chunky. And perhaps something you don't see in the numbers is that some of our value elements within ready-to-serve like Home Style, which is a little bit lower priced, but high quality was up 10% and growing share in the quarter. So, you may see us distort a little bit more between not just Chunky, but adding Home Style and Pacific to the ready-to-serve story. So, as I look forward, I think we're really well-positioned to benefit from this kind of resurgence in the category overall. And I feel like that in contrast to some of the places where we're feeling pressure is a great sign for things to come, even though in some of these flanker or more premium spaces within the categories, we've got to keep working there.

I don't want to see any share loss. But generally speaking, we're right in line with where we expected to be and I talked about Pacific. The third area, of course, is Pacific, more broadly to include broth. But that's just been a great acquisition for us. It's been up almost 60% since the beginning of COVID. And as I said, it's been growing share rapidly, especially in ready-to-serve, where we launched the new line of canned products. So, probably a little bit longer on soup, but I know that's a big question. I'm just not at all convinced that there's a return to history. I really think this is a different day, different portfolio, and certainly a different level of commitment.

Kenneth Goldman
Analyst, JPMorgan Securities LLC

Q

Great. Thank you so much.

Operator: Your next question comes from the line of Peter Galbo from Bank of America Merrill Lynch. Your line is open.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Hey, Mark and Carrie, good morning.

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

Hi, guys.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Mark, I know we've spent a lot of time on soup, maybe just to put a little bit finer point on maybe the marketing side. You talked a bit about ramping the marketing spend, I think, on Snacks in the fourth quarter. But just as we get into next year, as part of that strategy to get sharper value positions, again, maybe not wanting to get competitive on price. But is it more marketing in soup as you get into soup season in fiscal 2024? Just kind of help us understand the lever to pull to eventually kind of drive the volume.

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

Yeah. Well, I think, as we said, we've been pretty consistent through the year as we start to cycle a little bit of this kind of return to supply, let's call it a little more of a level or equalized playing field. I think it's going to be, again, this balancing act or combination of ensuring that we've got the right price points, promotion frequency, but also the equity has really been at the end of the day, what's driven a significant amount of the benefit on the business, right? So, the idea that we've been able to position cooking and condensed as a quick great value tool for solving this dilemma, whether it's in the economic backdrop we're in right now or just the dilemma of what I'm eating for dinner, that work will continue into next year.

And again, you pair that with Chunky, some great innovation there, the runway for Pacific. As I said, I do think you might see us, Peter, dial up a little bit of some of our flankers. One of the things that's interesting more broadly in Meals & Beverages, some of the businesses that are not insignificant, but perhaps we don't talk as much about, like SpaghettiOs or Swanson Chicken or Home Style ready-to-serve. These are all really well-positioned. In fact, in the third quarter, all three of the businesses I just named were up 10% and growing share. And so, we've got quite a few tools in the bag, if you will, that can complement our core businesses.

The goal in mind here is not to chase price down, right? That's not what we need to do. I think the good news for us is these four years have given us an opportunity to really strengthen the brand and equity. And so, our goal here is going to be a balanced attack, right? We've got to get pricing right and promotion right, but we also want to really drive it on the basis of differentiation. And as I said, I think, although we can always point to, well, why was – it's been four years, but there's always a reason why it's better or good. At the end of the day, our soup category growing at the rate that it's grown consistently over the four years gives us a lot of conviction and confidence in the future.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Q

Got it. Thanks for that, Mark, and then, Carrie, maybe just a real quick one. In the gross margin bridge, I think this quarter the spread kind of between the core market inflation rate, whatever you want to call it and kind of what came through the P&L was a bit wider than last quarter and I think that's just hedging. But wondering if you can unpack that quickly and just when we might start to see that gap start to shrink between the two kind of numbers that you reported? Thanks very much.

Carrie L. Anderson

Executive Vice President & Chief Financial Officer, Campbell Soup Co.

A

Yeah. I think, overall, let's start with the fact that core inflation came in at 8% in the quarter, which is trending in the right direction. Last quarter, it was 14%. So, definitely, we're still in an inflationary environment, but it's going in the right direction. And certainly, price was still a healthy contributor for us in the quarter as well. And so, when you look at that bridge on a dollar basis, if you look at net price realization and inflation and other recovered are essentially our inflation coming through the bridge there. And then you combine that with the productivity improvement, I think we're doing a really nice job of showing that core improvement in the business.

But going back to what Mark said earlier, what you've got there is a little bit of unpack on the fact that you've got some unfavorable volume and mix with some of this inventory cycling impact that you talked about, as well as the 50 bps of favorability we had last year in this insurance storm settlement that we didn't have this year. So, those are the two items that I think make the bridge a little bit more challenging. But the core inflation is going in the right direction. We've got some still healthy price there that is offsetting those items.

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

A

And remember, too, Peter, you had what, about 50 bps there that was the insurance that we were cycling that shows up in that bucket as well.

Operator: And your next question comes from the line of Michael Lavery from Piper Sandler. Your line is open.

Michael S. Lavery

Analyst, Piper Sandler & Co.

Q

Thank you and good morning.

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Hey, Michael.

Michael S. Lavery

Analyst, Piper Sandler & Co.

Q

You had mentioned that A&C was down a couple of percentage points in the quarter. And just to attribute that to some version of – I'm trying to be mindful of the value consumer and just can you unpack some of those adjustments and how you think about it? And what the shifts look like? And if at a point in time where you're mindful of consumer switching, you would actually maybe spending down a little bit? That was a little bit of a surprise.

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Yeah. I think a little bit of – so if you look at marketing and selling overall, we were up. It was a little bit of relatively very small number in the reduction. What I would say is most of our investment and we're trying to get this balance right between what we would call traditional A&C and then in-market marketing and support. One of the things that we did and that difference, by the way, was primarily in our Meals & Beverage business. And one of the tactics that is working extremely well for us right now, it's going to sound a little bit like a throwback to days gone by, but the whole meal solution platform in store is a really effective tool where we're helping people through the lens of value, how do you put together a simple meal for a low price.

I think what we're seeing with consumers is this ever-growing desire to really stretch their dollar as you would expect. And so, trying to gear our marketing, especially on categories like soup or Prego, where we could even pace for that matter, which had a really good quarter, up double digits and upward share. These are very effective in that context. So, it's a little bit of the mix of the spending that might make the A&C a little bit more stable. I do think as we go into Q4 you're going to see us continuing to invest. Remember, we've talked about this before that the goal in mind for marketing and selling is to get to kind of that 9% to 10% range for the company. In this quarter, we were at about 8.7%, so just under 9%. If you go back to the first quarter, we were just under 8%.

So, we have been creeping that up. I think in Q4 we're going to try to do better. I'd like to see us getting pretty close to 10% in Q4 really with the thought in mind of fueling the momentum on Snacks and continuing to provide that good underpinning value equity message on our Meals & Beverage business. And so, although it shows a little bit on A&C down, it really wasn't a big number and where we did focus a little bit more than where we would have been a year ago was more in store.

Michael S. Lavery

Analyst, Piper Sandler & Co.

Q

Okay, that's helpful. And just shifting gears a little bit, going back to the Investor Day about a year and a half ago. Can you just update us on the \$1 billion sauces plan? And maybe specifically, it looks like 15-ish or so percent of that target was meant to come from premium brand extensions and M&A, a little bit of your kind of white space opportunities. Any progress there or anything we should be thinking about in terms of if those plans might have changed or what's the latest?

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

A

No. I think that we still see sauce as a great kind of second punch, if you will, in the Meals & Beverage business, right? When you think about what the consumer dynamic is right now and where the muscle really is in center of store of the grocery, we feel this area around cooking and quick meals is really the sweet spot that we want to be in, where we think there's truly momentum, high consumer relevance, and an opportunity to win. I love the brands we have. And I think that between Prego and Pace, we've got a great mainstream foundation that gives us a lot of runway. But it is fair to say that there's also a lot of growth that's happening in the more premium segments of some of these spaces.

And so, I think in some combination of the brands that we already have in the portfolio while continuing to think about M&A, our balance sheet is in a great position. I mean, nothing on the swing for the fence there. I'd say more tuck-in and strategically-aligned M&A makes sense for us in our endeavor to continue to drive. So I think our vision has not changed at all and I feel like we're in great spot. I mean, remember, we've got brands like Pacific and brands like Late July even on our Snacks business that we think also could play a contributing role. So I think

very consistent to what we said in Investor Day; we really see that sauces area as a great complement to a rejuvenated and sustainable soup business.

Operator: Your next question comes from the line of David Palmer from Evercore ISI. Your line is open.

David Palmer

Analyst, Evercore ISI

Q

Thanks. First, a question on Snacks. That segment margin already at 16% this quarter was a strong step-up. I wonder how you're thinking about that. Is that sustainable? You just mentioned that A&C, that stepdown was more on the Meals & Beverage side. So I'm wondering if you're sort of ahead of that journey on segment margin.

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Yeah. I would say for the Snacks margin, it was great to see this quarter and it continues to kind of support what I would describe as the overall thesis of the Snyder's-Lance acquisition where we imagined a world where we could take some really, really unique and differentiated brands, infuse our marketing and innovation muscle from Pepperidge Farm and drive those results. And in fact, if you look at those Snyder's-Lance brands from kind of four years ago pre-COVID to now, Kettle and Cape are up 4 share points, Late July up 3. Snack Factory, right, which is in the deli, our pretzel crisps business is up 5 share points. Goldfish even on the Pepperidge side up 1 share point and Lance sandwich crackers are up 6 points of share.

So an evidence of the thesis of what we can do with these brands, I really feel like we're demonstrating now exactly what that proposition was. I think in fairness, what we've been waiting to see a little bit is the translation of all of the synergy that we've driven from the acquisition and the benefit of scale for Snyder's-Lance has the ability to step up our margins. And so, I think when you look at us year-to-date where we're up about 150 basis points, that's probably a better indicator of how we're expecting the year to finish. And if you think about us being a little bit stuck at 13% the last couple of years, although I'll just point out that that was also in a period where there was a lot of external pressure at the same time, but to see us up over 14%, on track for that for this year I think is a great step forward.

And, again, I think as we look forward, we see that trajectory continuing and feel like in many ways we're going to hit a run here where we're really able to live into that vision that we talked about at Investor Day and at the point of acquisition. So I think a lot to believe in right now in Snacks and feeling quite good about the evidence, if you will, that we're putting on the board relative to what we believe was possible.

David Palmer

Analyst, Evercore ISI

Q

Thank you. That's helpful. And you mentioned in your prepared remarks about supply chain, trying to make that a competitive advantage. I know you've had some change in leadership there. Could you just talk about sort of what that journey has been like? What that ultimately will mean for results heading into fiscal 2024? Thanks.

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

A

Yeah, it's a great question. In fairness, and I think we've been pretty open about this, if I turn back the clock two years, I would argue that probably our supply chain was probably average if I was kind of being a bit optimistic in that view. I think the good news about that starting point was it did not give us the luxury of waiting through COVID in this kind of volatile environment to really attack the supply chain and making improvements. And so, we

did that, had to do that really during that period, and I think what we found is that now, several years later, where it may have been a challenge or even a liability, it's now really emerged as a strength.

Our service levels are operating at pre-COVID levels, and that is pretty unique in this environment right now and puts us really in a best-in-class position. And as you know all too well that when that supply chain is running efficiently, there's also additional opportunity as you think about driving productivity going forward. So as we imagine the world in the future, we really do see supply chain as an opportunity to be a contributor and a proof point to why we think we can keep the momentum going. I would also just say that as you think about that in the world of snacks in particular, I do see us as one of the unique businesses that has a truly credible self-help story on margin where we still have opportunity, I think, to create organically opportunity and outsized growth on the margin and earnings side to help fuel that momentum as we come out of this period and into the next chapter.

It's perhaps one of the reasons, to Andrew's first question today, why I feel very good about our ability to navigate through this environment and why I think in many ways, albeit a lot to work through in the quarter, that the underlying elements that are in our business right now give us great conviction and confidence that we feel that we're advantaged and positioned well going into this next chapter.

Operator: And your final question comes from the line of Pamela Kaufman from Morgan Stanley. Your line is open.

Pamela Kaufman

Analyst, Morgan Stanley & Co. LLC

Q

Hi, good morning. Mark, I just wanted to take a step back and see how you would characterize the current consumer and operating backdrop. How are you thinking about elasticities going forward? Do you think that we're at a point where we're likely to see accelerating trade down? And then from a retailer perspective, do you anticipate more leading into price and private label?

Mark A. Clouse

President, Chief Executive Officer & Director, Campbell Soup Co.

A

So I think first, on the overall consumer perspective, I think the consumer has continued and proven to be – I think the word of the day is probably resilient. But I do find that as time goes on there is no question that consumers are beginning to feel that pressure. Whether it's through the lens of what categories they're buying, what we're seeing relative to share of the grocery store and migration to things like shelf stable away from more expensive perimeter items. When they're buying, we've seen a migration to a greater amount of purchase at the beginning of the month, as you can imagine, people trying to stretch paychecks as long as they can. But I also think that that in, in itself creates really the opportunity to both, as I said, focus on value within our messaging without necessarily having to chase pricing all the way down.

No question that it's important that we protect affordability and that we make that relevant in the categories that we're in. But I also think there's a lot of ways to frame value in different ways, right? We gave the example earlier of the comparison of a meal cooked with condensed soup versus something that you may be buying in the frozen section or something that you're ordering from away from home or even within our portfolio focusing on different brands that may not always be the primary focus, but that can be highly relevant in the moment we're in as it relates to value. And then, I think a lot of what will determine success of the operating environment or customer relationships, a lot of this is going to be about who's bringing real solutions to customers that are helping address what the consumers need.

And so, how we execute our marketing plans, how we're bringing innovation, how we're thinking about the timing and sequence of our promotions, all of those things will, I think, play very much into the environment we're in. And that's why also, I think, feeling like that the supply chain being in a strong position is going to be very, very important, as I do think we're heading into a period where those that are able to execute well and outperform, if you will, competition, whether that be private label or other competitors, is going to be a real hallmark of those that are winning in the market that we're in.

Operator: Ladies and gentlemen, this concludes today's conference call. We thank you for your participation. You may now disconnect.

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