

Lark Research

P.O. Box 768, Norwood, MA 02062
www.larkresearch.com

Stephen P. Percoco

(781) 762-1476

spercoco@larkresearch.com

Campbell Soup Company

Executive Summary

August 6, 2014

In response to stagnating sales and profits, Campbell Soup Company adopted a dual mandate in February 2013 under which it would seek to (1) stabilize and strengthen its core businesses and (2) build new avenues for growth in products, consumer niches or geographies. Although the company reported good progress on this mandate in fiscal 2013, it has not achieved a successful follow-through in fiscal 2014. Management attributes disappointing performance to sluggish consumer spending associated with slow income growth and uncertainty about the future.

Management says that this disappointing financial performance will continue in fiscal 2015. Its preliminary guidance for fiscal 2015 is below long-term targets. Although it plans to launch another 200 products in the coming year, it says that more significant changes to the company's product portfolio may be necessary to get back on track. Given this sentiment, its guidance for the fiscal 2014 fourth quarter looks aggressive, but management has also set a low bar for fiscal 2015.

Although the recent acquisitions of Bolthouse Farms, Plum Organics and Kelsen appear to be good growth platforms, many aspects of Campbell's growth initiatives seem out of step with the "new normal" in consumer spending. In this environment, it would be more appropriate for the company to reduce cost and operational complexity by trimming many product line extensions and shifting the weighting of its product portfolio more in favor of products that deliver better value to the consumer, through a combination of lower prices and higher product quality (e.g. more nutritious products). The company should also improve its disclosures in several ways, for example, by providing a review of its product innovation efforts in the MD&A section of its financial statements that includes summary performance figures.

In this tougher consumer environment, Campbell should focus on improving its financial flexibility by paring fixed costs, rather than adopting a 5-year sales target of \$10 billion. It should reduce its current heavy reliance on short-term financing. Instead of stock buybacks, the company should concentrate on raising its dividend and using excess free cash flow to reduce debt. All of this would enhance its ability to respond both to future challenges and opportunities, if conditions in its core business deteriorate further.

Common Stock Performance Rating: 3; Safety Rating: C-
S&P 500: 1920.21

Amt Outst (\$m)	CUSIP	Type	Recent Price	Coupon	Maturity	Yield	Spread	Call Date	Call Price	Credit Ratings
400.0	134429AV1	Senior Notes	104.94	3.050%	7/15/17	1.33%	43 bp	Now	MW	A2/BBB+
300.0	134429AT6	Senior Notes	110.18	4.500%	2/15/19	2.13%	58 bp	Now	MW	A2/BBB+
500.0	134429AW9	Senior Notes	107.90	4.250%	4/15/21	2.94%	74 bp	Now	MW	A2/BBB+
200.0	134429AG4	Senior Notes ^a	131.98	8.875%	5/01/21	3.50%	140 bp	None	N/C	A2/BBB+
450.0	134429AY5	Senior Notes	95.56	2.500%	8/02/22	3.13%	84 bp	Now	MW	A2/BBB+
400.0	134429AZ2	Senior Notes	88.07	3.800%	8/02/42	4.56%	129 bp	Now	MW	A2/BBB+

(a) The 8 7/8% Senior Notes trade less frequently than other Campbell debt issues. N/C = non-call; MW = make whole

Shares Outst. (mil.)	Common Stock	8/5/14 Price	Div. per Share	Div. Yield	Tangible Book Val.	Proj '14 EPS	2014 P/E	Proj. '15 EPS	2015 P/E
313.9	Campbell Soup Co. (N:CPB)	\$41.81	\$1.25	3.0%	(\$6.72)	\$2.53	16.5	\$2.61	16.0

Positive Investment Considerations

U.S. market leader in soups with an estimated 60% market share. Campbell has a formidable position in soups with leading positions in condensed (eating and cooking), ready-to-serve (Campbell's HomeStyle and Chunky), premium (Habitan and Wolfgang Puck) and broths (Swanson). Its long-standing market leadership gives it key advantages, such as high profit margins and strong, relatively stable cash flows. Its recent product innovations have reinforced its market leadership and put competitors on the defensive; but its ability to grow the category and raise market share beyond 60% appear to be limited. With tough competition from Progresso in ready-to-serve and the receptivity of budget-minded consumers to store brands, growing sales and profits in soups is a challenge for Campbell.

Well-recognized brands in a range of product categories. Besides soups, Campbell's is among the market leaders in shelf stable beverages (V8, Campbell's Tomato Juice), pasta sauces (Prego), Mexican sauces (Pace) and premium bakery products, including breads, cookies and Goldfish crackers (Pepperidge Farm). In Australia, Arnott's is a recognized leader in biscuits and snacks. Several of these brands, including Campbell's, Prego and Pace, fall into a key product category called Simple Meals, a strategic priority for the company, with greater potential for synergistic growth. Besides their inherent value, Campbell's strong brands can also facilitate the success of new products in related categories and product line extensions.

New growth platforms. Over the past couple of years, Campbell has made three acquisitions to expand its growth opportunities: Bolthouse Farms, a producer of carrots (and related products) and premium fresh beverages and salad dressings; Plum Organics, a producer of organic food for babies, toddlers and small children; and Kelsen Group, a maker of premium butter cookies with well-established positions in Asian growth markets, especially China. The company intends to grow each of these businesses by increasing distribution and ramping up product development.

Sophisticated and knowledgeable consumer marketer. Campbell's understands consumers and has strong relationships in all distribution channels. It regularly tracks who is using its products, how they are using them and what motivates purchase decisions. Thus, it is adept at devising advertising and marketing campaigns to reach consumers to exploit sales opportunities. This also gives it the ability to spot new trends and adjust its advertising, promotion and distribution strategies as required.

Strong balance sheet. Campbell's ratio of debt-to-total market capitalization is only 23%. Its publicly-traded debt is solidly investment grade, with ratings of A2 by Moody's and BBB+ by Standard & Poor's. At April 27, 2014, it had \$222 million of cash on the balance sheet and more than \$500 million in excess availability (over and above the outstanding amount of commercial paper) under a \$2.2 billion bank revolving credit facility.

Consistent generator of free cash flow. Campbell's cash flow from operating activities has averaged more than \$1.0 billion annually for the past six fiscal years. During this period, annual capital expenditures have averaged \$315 million and dividends \$360 million. Except for recent acquisitions, the company has used its free cash flow mostly to buy back debt.

Growth Opportunities in Asia and Latin America. Although it has had mixed success in its international expansion efforts, Campbell still sees opportunities to grow, particularly in Asia and Latin America. In Asia, the company is growing by expanding its Arnott's biscuits and snacks businesses and Kimball sauce brand to boost sales in Indonesia, Malaysia and other parts of Southeast Asia. It is leveraging its recent acquisition of Kelsen to pursue growth in China. In Mexico, Campbell has transferred its existing operations to joint ventures with Jumex and La Costena, which it believes will facilitate greater penetration of local and regional markets. It is also looking to enter into similar arrangements in other Latin American and Asian markets.

Key Concerns

Difficult market environment for branded food companies. After an encouraging rebound in fiscal 2013, led by 9% growth in ready-to-serve soup, Campbell has experienced disappointing sales growth in fiscal 2014. Much of the softness in sales is due to weak consumer spending. Slow income growth and continuing economic uncertainty probably represent a "new normal" for consumers. If so, branded food companies will have to adjust their product strategies to emphasize price and value in order to sustain sales.

Many of its new product launches seem inconsistent with current market conditions and challenges facing consumers. If a new normal for the consumer is at hand, the company's continuing emphasis on new product introductions seems misplaced, especially for those products that are premium-priced, discretionary purchases. In this environment, the company should place greater emphasis on products that offer greater value, including those that meet its sustainability goals for health and nutrition.

The company has had only limited success with new product launches in recent years. Many of Campbell's new products have not found permanent space on grocers' shelves. In most cases, I believe that the quality of Campbell's new products has been excellent; but it is difficult to get customers to incorporate new products into their eating routines within the timeframes normally allotted by grocers and other retailers to demonstrate adequate sales levels.

Campbell's innovation effort is too broad. Given the challenges facing consumers and the difficulty of creating successful new products, Campbell's decisions to (1) establish three new growth platforms through acquisitions (with possibly more to come) and (2) introduce 200 new products each year (in the current and upcoming fiscal years) seems like an overreach. It is hard to imagine that the company will be able to devote the necessary resources in both manpower and especially investment to ensure the success of this far-reaching and ambitious innovation effort.

Inadequate financial reporting on new product initiatives. Given the growing importance of product innovation in recent years, Campbell should incorporate a discussion of and summary performance figures for its new product development efforts into its public financial reporting framework. Although distinguishing between costs in the core business and new product initiatives may be subjective, management should be able to adapt reports that are used internally for this purpose at little or no additional cost.

Although management says that fiscal 2014 profits will be at the low end of its guidance range, the implied guidance for the fourth quarter looks aggressive. At its recent analyst meeting, management said that it expects that EPS for fiscal 2014 (which ended on August 2, will likely be at the low end of its previous guidance ranges of 2%-4% growth (\$2.53-\$2.58). However, the implied guidance for the fourth quarter looks aggressive, with revenue growth of more than 8% and adjusted EPS growth of nearly 14%.

Management's preliminary guidance for fiscal 2015 indicates that the company's performance will fall short of long-term targets. It said that it is taking longer than anticipated to meet the goals of the dual mandate. A further reconfiguration of the product portfolio may be required to get Campbell's financial performance back on track. Management will offer detailed guidance on Monday, September 8, when it reports fiscal 2014 fourth quarter results.

Campbell currently has too much short-term debt. At April 27, 2014, total debt was \$3.91 billion, including \$1.66 billion of short-term debt. Short-term debt consisted of \$915 million of commercial paper and \$700 million of publicly-traded debt maturing in August. The company will apparently fund this maturing debt by issuing more commercial paper. It is overdue for another public debt offering which would reduce short-term and lengthen maturities at fixed interest rates. (Its last debt issuance was in July 2012.) Although Campbell has hedged some of its interest rate exposure in the past, it would be better served, given the risk of rising interest rates and its aggressive growth agenda, by issuing more fixed-rate debt, refraining from ramping up share buybacks or both.

Business

Campbell Soup Company is one of the world's leading consumer branded foods companies. Although it manages its operations through 10 operating segments (based upon product type and geographic location), it reports its performance in five segments:¹

U.S. Simple Meals (37.8% of YTD FY 14 Net Sales; 62.6% of YTD FY 14 EBIT), a single operating segment that combines the U.S. Soup and U.S. Sauces businesses and manufactures the following branded products: *Campbell's* soups (condensed and ready-to-serve) *Swanson's* broths and stocks, *Prego* pasta sauces, *Pace* Mexican sauces, other *Campbell's* products (pasta, baked beans, gravies and dinner sauces), *Swanson's* canned poultry and *Plum Organics* food and snacks (for children)

Table 1
Campbell Soup Company
 Business Segment Net Sales and EBIT: Fiscal 2011 to Fiscal 2014
 (\$ millions)

	52 Weeks 31-Jul-11	52 Weeks 29-Jul-12	52 Weeks 28-Jul-13	39 Weeks 28-Apr-13	39 Weeks 27-Apr-14
NET SALES					
U.S. Simple Meals	2,751	2,726	2,849	2,356	2,426
Global Baking and Snacking	2,156	2,193	2,273	1,703	1,812
International Simple Meals and Beverages	887	872	869	682	592
U.S. Beverages	759	774	742	569	539
Bolthouse and Foodservice	590	610	1,319	1,019	1,047
Total	7,143	7,175	8,052	6,329	6,416
EBIT					
U.S. Simple Meals	657	658	731	621	600
Global Baking and Snacking	355	315	316	232	234
International Simple Meals and Beverages	128	106	108	94	85
U.S. Beverages	182	134	120	100	84
Bolthouse and Foodservice	82	85	116	91	88
Corporate	(132)	(136)	(260)	(205)	(98)
Restructuring charges and related costs	(60)	(7)	(51)	(31)	(35)
Total	1,212	1,155	1,080	902	958

Global Baking and Snacking (28.2%; 24.4%) includes the Pepperidge Farm operating segment, which makes cookies, crackers and fresh and frozen bakery products, the Arnott's operating segment, which makes biscuits for the Australia and Asia Pacific geographic markets and the Kelsen segment, which makes cookies globally.

International Simple Meals and Beverages segment (9.2%; 8.9%) includes two operating segments: the Canadian retail business and the simple meals and beverages business in Asia Pacific, Latin America and China.

U.S. Beverages segment (8.4%, 8.8%) includes *V8* juices and beverages and *Campbell's* tomato juice.

¹ This description of business segments is taken primarily from Campbell's fiscal 2014 third quarter 10-Q.

Bolthouse and Foodservice segment (16.3%, 9.2%) comprises the Bolthouse Farms carrot products operating segment, the Bolthouse Farms super-premium refrigerated beverages and refrigerated salad dressings operating segment and the North America Foodservice operating segment.

Besides segment earnings, consolidated EBIT includes corporate expenses and restructuring charges (and related costs), which are not allocated to the individual reporting segments. Collectively, these amounted to -13.9% of consolidated EBIT in the fiscal 2014 year-to-date period.

Strategy

Under President and CEO Denise Morrison, who is beginning her fourth year at the helm, Campbell's has adopted a "dual mandate": It is seeking both to strengthen its core business and expand into higher growth spaces.

Strengthening the Core. Campbell's aims to strengthen its core businesses by focusing on three key tactics:

- 1) Growing its brands
- 2) Reinforcing its relationships with consumers; and
- 3) Enhancing the appeal of its products.

A key guideline for its efforts to strengthen the core is to approach consumers as they are living now (and presumably not to try to change the way that they live or predict how they might live in the future).

A large part of "Strengthening the Core" might simply be described as attending to the day-to-day "blocking and tackling" that is necessary to preserve and enhance the core franchises. The three tactics are mutually reinforcing. Brands can be strengthened through improved advertising and promotion, but also by reinforcing consumer relationships and enhancing product appeal. Product line extensions and new varieties can play a key role in strengthening and growing brands. Ms. Morrison and her management team have undertaken a number of initiatives to this end:

In U.S. Soup, Campbell's has refreshed its product line to offer more varieties that appeal to key customer segments, such as millennials and Hispanics. It has converted its "Select" ready-to-serve soups to "Homestyle," using wholesome ingredients and no added preservatives. It has added new varieties to its condensed soup line, including more flavors for children. It has expanded its "Healthy Request" line, which is certified by the American Heart Association as being low in saturated fat and cholesterol. It has focused its Chunky advertising on its core customer: soup-loving, (male) football fans. It has also updated its advertising, reduced its emphasis on promotions and discounting and consolidated manufacturing operations to improve efficiency.

Although Campbell's led "the veggie craze" in beverages, its U.S. Beverages business suffered a 34% decline in profits from fiscal 2011 to fiscal 2013 and another 16% decline so far in fiscal 2014. This has occurred even though more people are juicing vegetables these days. Both V8 and Campbell's Tomato Juice have been among the leaders in the shelf-stable 100% vegetable juice for decades. Campbell's scored big wins with V8 Splash (a fruit and vegetable juice drink) and V8-Fusion (made 100% with juice), especially among children and young adults; but consumer enthusiasm seems to have waned and competition has stiffened. Its efforts have been designed to make vegetable and fruit juice combinations more appealing to consumers, especially children. This may be an attractive proposition to parents who would prefer to see their children drink juice rather than sugar-sweetened soda, but it carries less weight with truly health conscious consumers. Campbell's hopes to reinvigorate the business by 1) making V8 the "go-to" beverage for health focused adults, 2) building V8 Splash into a powerhouse brand for kids and 3) broadening the distribution of its beverages (in suitable sizes) to discount stores, wholesale clubs, drug stores and convenience stores.

With three new distinctive tomato varieties, its first line of white pasta sauces and a new advertising campaign, Campbell's Prego pasta sauce (#2 in the U.S. market behind Unilever's Ragu) increased sales by 8.7% to \$427 million in North America in the 52-weeks through June 2014, despite a modest decline in global sales for the category.

Campbell's Pace Mexican sauces have also gotten a sales boost from new products including super hot salsas and new dip varieties.

In Australia, where Arnott's and its other product offerings have suffered declines in market share and profits, management is seeking to step up its marketing efforts and boosting advertising spending to re-invigorate many of its iconic brands. In the past year, it has streamlined and strengthened its organizational structure and leadership. It has also upgraded its manufacturing capabilities to promote greater efficiency, including the installation of automated packaging equipment, which will allow it to produce a range of package sizes efficiently and thereby appeal to the desires of more consumers.

Expanding Into Higher Growth Spaces. The second part of Campbell's dual mandate involves reshaping its product portfolio by adding new product and business lines that it believes have greater growth potential. Under Ms. Morrison, the company has effectively launched three new product platforms through acquisitions.

In August 2012, the company acquired Bolthouse Farms, a California-based vertically-integrated producer of carrot products (carrots, juice concentrate and fiber) and super premium refrigerated juices, drinks and salad dressings, for \$1.55 billion. Besides expanding Bolthouse's product line, package sizes and product distribution, Campbell's is also seeking to use the Bolthouse platform to launch a new line of V8 super-premium refrigerated beverages. The V8 brand may be better suited for distribution in venues where the Bolthouse brand is less well known, such as convenience stores, smaller supermarkets or perhaps less affluent markets. Since management has said nothing to the contrary, it does appear that it intends to keep and build both brands, at least for the time being.

In June 2013, Campbell's acquired Plum Organics, a maker of premium-priced organic food and snacks for babies, toddlers and children, for \$249 million. Plum Organics is the second largest producer in this segment. (I believe that Earth's Best is number one.) As with Bolthouse, Campbell's intends to scale the business by broadening its product line and increasing its distribution.

In August 2013, Campbell's acquired Kelsen AG, a Danish producer of premium-priced cookies and snacks under the brand names of Royal Dansk and Kjeldsen's, for \$325 million. Kelsen sells its products in 85 countries, but Campbell was interested in Kelsen was primarily because of its market position in China, which it intends to expand over time. Kelsen should also help Campbell's to achieve greater distribution of Arnott's product line in China.

The acquisitions of Bolthouse and Plum Organics provide new platforms upon which Campbell can grow its product offerings primarily to higher income consumers. Although consumers of all income classes can afford to make individual purchases of these products, the heaviest and most frequent users will probably be consumers with higher levels of discretionary income. This could address one of the challenges currently facing the company: Its traditional product lines serve mostly low- and middle-income consumers whose budgets remain tight, even after six years of economic recovery. As noted, Campbell's believes that this represents a "new normal" for its core customers. So new product platforms that target higher income consumers should allow it to continue utilizing its brand management skills and assets.

Besides these acquisitions, Campbell's can also create new growth platforms internally, through extensions of existing brands or product lines or launching new brands or product lines. This is most readily evident from the development and growth of its Simple Meals platform.

Simple Meals. Campbell was among the first to recognize and respond to rising consumer demand for "simple meals." While many of its products, such as Prego pasta sauces, Pace Mexican sauces, Swanson's broths and Campbell's condensed cooking soups, were designed for convenience, the growth of simple meals – which use convenience foods in combination with traditionally-prepared ingredients or side dishes to create "home cooked" meals cheaply and in 30 minutes or less – really took off with the growth in two wage earner households and tight family budgets. This trend helped launch the career of television personality Rachael Ray, whose "30-Minute Meals" on the Food Network became a big hit.

Campbell noticed early on that consumers were creating meals by augmenting its products. For example, some consumers were adding rice and steamed vegetables to its ready-to-serve soups. The company helped to promote the trend by posting recipes on product labels and on its various product websites.

Meeting the demand for simple meals tackles both sides of the dual mandate. It strengthens the core, raising consumer demand by promoting new uses for its products. In this way, it builds brand value and reinforces the company's relationships with consumers.

The concept of simple meals also addresses the second part of the dual mandate: finding and developing new, higher growth spaces. Those spaces can be found within existing product lines, such as soups, broths and stocks, or entirely new product lines. The company now offers Campbell's Skillet Sauces, which are used in combination with browned meat and rice to make meals in just fifteen minutes. It also offers Slow-Cooker Sauces, which facilitate and enhance the preparation of meat dishes, such as Sweet Korean Barbeque and Tavern-Style Pot Roast, in slow cookers, such as crock pots. Both Skillet Sauces and Slow-Cooker Sauces are typically located in a separate section of the grocery store center aisle, with other simple meal components, like chili, baked beans and dinner sauces, often near the soup section. Both are logical additions to Campbell's "simple meal" product line, but require new advertising and promotion campaigns in order to build customer awareness. It is still not clear whether Campbell will be able to make this a permanent addition to its product line-up at an acceptable return on investment.

Innovation Return on Investment. Campbell's has pursued innovation through much of its recent history, but it is difficult to gauge its overall success. The company has not published return on investment figures for its innovation efforts.

Nevertheless, I believe that the company's track record on new product innovation is mixed. I have reached that conclusion by watching grocery store shelves over the years and seeing whether new products earn a permanent place on them or how long they last. New Campbell products routinely come and go. Many have not stayed for long.

Campbell's lack of consistent success is not, in my opinion, because of poor product quality. Indeed, I think that the quality of most of its new products has been quite good; but product quality alone is apparently not enough to ensure success.

So why do most new products fail? Each product has its own story; but the simple answer is that it is often tough to get consumers to change habits (i.e. to incorporate new products into their daily routines). By virtue of its strong relationships with retail store chains, Campbell's can muscle most new products onto store shelves, but unless those products are able to demonstrate a minimum level of sales and profitability, retailers will eventually discontinue them. Keeping slow-selling products on the shelves (in order to give them more time to succeed) probably requires a level of investment – in advertising, promotion and distribution – that Campbell has so far been unwilling to make, in most instances.

Examples of discontinued products include Campbell's Chunky Chili (which apparently is still around, but not in any of my local stores), Campbell's Supper Bakes and Campbell's Gourmet Bisques (in aseptic packages). Innovation also extends to product packaging and distribution, including gravity-feed shelving, which has been scaled back (or even discontinued) by most grocers, and microwaveable bowls,

whose popularity has probably been waning (as evidenced by Campbell's decision to consolidate production for this type of packaging in fewer thermal plants).

To its credit, Campbell has not given up on some of its innovations. For example, it has relaunched the Gourmet Bisques line over the past couple of years, with new package designs and some flavor reformulations. I thought the product was great the first time around (five years or so ago); but it was obvious that it did not sell well. This time around, the company appears to have achieved broader distribution; but already I see that it has been discontinued by one of the major local chains.

A similar experience may await Campbell's GO soups, a new line of exotically-flavored soups in innovative, stand-up, microwaveable, heavy plastic containers. With flavors like Creamy Red Pepper with Smoked Gouda, Moroccan Style Chicken with Chick Peas and Golden Lentil with Madras Curry, and pictures of happy and surprised twenty-somethings on the packages, GO soups are clearly targeted to millennials who crave exotic and bold flavors. I think that the product is great; but I first tried it a little over a year ago after purchasing it from the bargain bin (for \$1) at a local supermarket, after it had already been discontinued. Campbell's has obviously remain committed to the success of its GO soups. In fact, I recently saw that the product was back on the shelves at that same local supermarket. It is also carried now by all of the major supermarket chains in my area; but it is still too early to call it a success.

The cost of innovation can vary widely among products. Product line extensions are typically less costly and can be pursued more aggressively because the consequence of failure is low. On the other hand, expansion into adjacent product lines or especially into altogether new product categories is more costly and therefore much more risky.

Adding another flavor of Chunky ready-to-serve soup may require some market research, a new recipe and a new label design. Existing equipment and administrative infrastructure can be used to roll out the new flavor. This type of innovation is relatively cheap and can serve to keep the product line fresh and relevant in the minds of consumers.

Innovations such as Campbell's Skillet Sauces and Slow-Cooker Sauces, on the other hand, are more costly, because they require new recipes, new forms of packaging, securing new space on retail shelves and the creation of new marketing campaigns. It may still make sense for Campbell to pursue this more costly form of product innovation, but it must also be able to gauge the effort required to ensure success and an acceptable return on investment.

Innovation into new product categories represents an even higher hurdle. The cost of this type of innovation is usually quite high and the chances of success are often quite low. Pursuit of this type of innovation must, as a consequence, be more selective and as a rule, undertaken only for products that have strategic significance, especially in the current operating environment.



Campbell's new products for fiscal 2015 include V8 Protein Shakes and Protein Bars. Both are new entries into product categories in which the company does not currently compete. Both are an attempt to extend the V8 brand to a new product category. In my view, this type of innovation is costly and has a very low probability of success. If, in fact, the V8 brand is strong enough to elicit sufficiently high consumer trials, the concept of the product appears to be weak.

In my opinion, these shakes and protein bar products convey dubious health benefits. Campbell is seeking to move into an already crowded field, straddling the space between breakfast cereal bars and natural food (or organic) bars. Unless this product has strategic significance – either the company has determined that there is significant growth potential or it plans to acquire a firm already in the space, this product seems to make little sense and would probably be a drag, even if a small one, on its profitability.

The cost of product innovation may not be a problem, if the entire innovation effort is more keenly focused. However, Campbell launched 200 new products in fiscal 2014 and is gearing up to launch another 200 products in fiscal 2015. Even though many of these are product line extensions, it is not clear how much the overall effort is costing the company, including both the costs of continuing to support the 2014 product launches or to initiate and support the 2015 new ones. Given the company's mixed track record (and the still uncertain economic environment), there is a significant risk that the majority of these new product launches may prove to be losers.

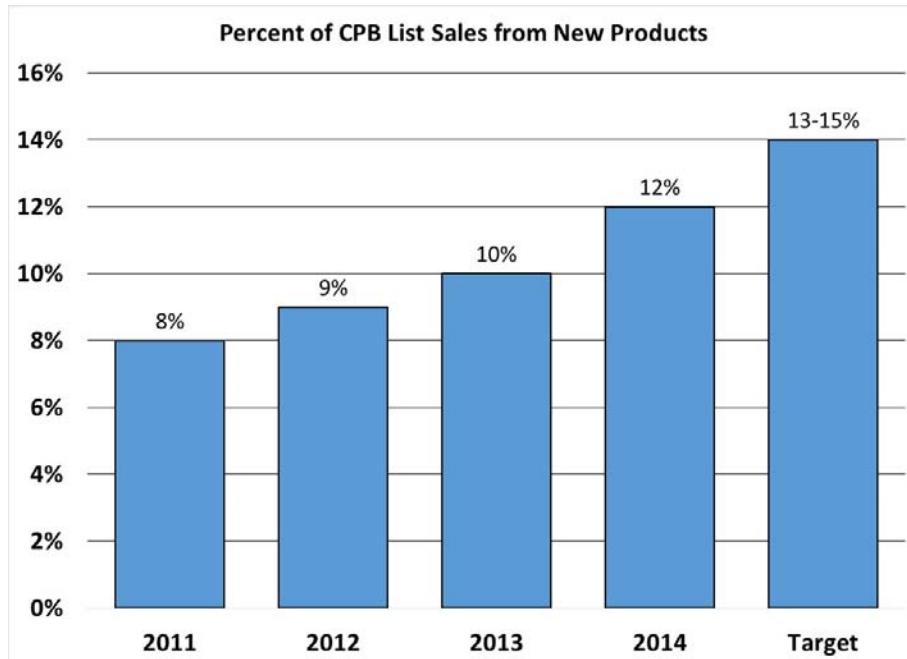
Impact of Innovation on Historical Financial Performance. These questions might not arise, if Campbell's was showing clear signs of improvement in its financial results or if it routinely included a report on its new product development efforts in its financial statements. Except by looking at Campbell's consolidated results, investors currently have very little information with which to gauge the success of management's new product development efforts.

Table 2
Campbell Soup Company
 Consolidated Net Sales and EBIT: Fiscal 2008 to Fiscal 2014
 (\$ millions)

	52 Weeks 2-Aug-09	52 Weeks 1-Aug-10	52 Weeks 31-Jul-11	52 Weeks 29-Jul-12	52 Weeks 28-Jul-13	39 Weeks 28-Apr-13	39 Weeks 27-Apr-14
Net sales	6,988	7,085	7,143	7,175	8,052	6,329	6,416
EBIT	1,187	1,272	1,212	1,155	1,080	902	958
EBIT margin	17.0%	18.0%	17.0%	16.1%	13.4%	14.3%	14.9%

The table above shows that Campbell's consolidated net sales and earnings before interest and taxes have been stagnant since fiscal 2008. The boost in sales from fiscal 2012 to fiscal 2013 was due mostly to the acquisition of Bolthouse Farms. The lower profitability recorded in 2013 was also due in part to restructuring and other costs associated with the acquisition of Bolthouse and effort to improve Campbell's overall operating efficiency.

If new products are contributing positively to the company's performance, it is nearly impossible to tell from the reported results. Campbell's has disclosed the percent of its list sales (before discounts and allowances) attributed to new products (on a three-year rolling basis), as shown in the chart on the next page:



The percentage of list sales attributable to new products has been rising steadily over the past four years. (The figure for fiscal 2014 was an estimate from the beginning of the year, but it is in line with recent company disclosures.) Campbell's has set a target of deriving 13%-15% of its list sales from new products.

Without knowing how list sales compare with net sales, it is difficult to gauge the actual sales impact of new products. The company also does not disclose any profit or investment figures associated with new products.

Given the importance of Campbell's product innovation efforts, the company should at least disclose summary figures in its financial reports for them. This reporting should be consistent with the ways that management evaluates new product development programs internally. Campbell's should also discuss the performance of its new product development efforts in the MD&A section of its financial statements at least on an annual basis, providing a review of the overall results of its innovation programs, including both successes and failures.

Although any breakout of innovation costs will be subjective (because the effort uses people, services and capital equipment also employed by the core business), it should still help stakeholders see whether innovation is delivering acceptable returns on investment. It should also shed some light on the rate of decline, if any, in the core business. In this way, it should provide a better starting point for further discussions with stakeholders as well as another important way to evaluate management's performance.

The Future of Branded Products. If, indeed, Campbell's is facing a "new normal" in its customers' ability and willingness to spend, then a broad-based innovation effort may be a waste of both time and money. This new normal could eventually call into question the future of premium-priced branded products.

When the economic pie is expanding, more consumers are willing to pay a premium for branded products because they provide greater tangible and intangible benefits than store brands. These benefits might include higher product quality (e.g. taste, nutrition and other health benefits) or the status associated with using a premium or luxury product. In tough times, more consumers willingly forego these benefits to conserve disposable income.

Under this new normal, however, the financial status and behavior of consumers is not easily categorized; first, because there is great diversity among consumers with respect to nationality, race, age and family status and second, because even low income consumers are able to afford (albeit with the aid of some forms of assistance, such as food stamps and disability payments) many goods and services (like cell phones, internet access and cable television) that should be considered luxuries.

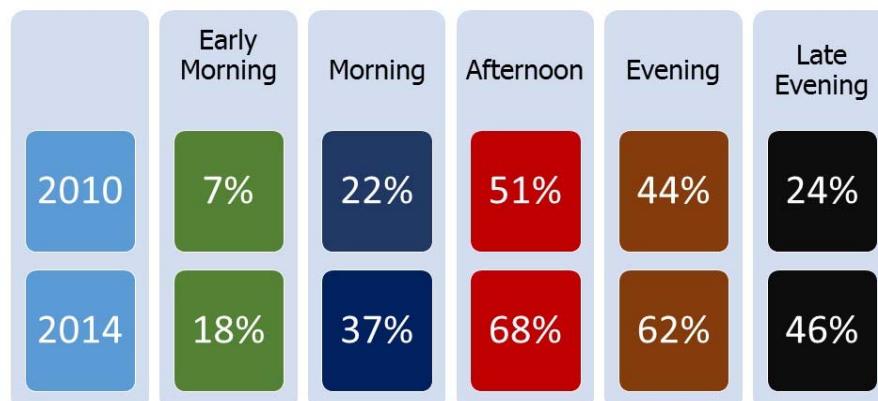
It is also true that obesity is a problem in all income cohorts, especially in lower and middle income households. Consumer eating and cooking behaviors have changed markedly, even over the past few years. More people are snacking between meals. Under the new normal, therefore, household incomes may be under pressure, but many people still suffer from poor eating habits and being overweight.

If income pressures were making it more difficult for consumers to buy enough food to eat, then the strategy choices for Campbell might be simpler and clearer. In that case, it would make more sense for Campbell (and other branded food products companies) to cut back on efforts to create new, premium-priced branded products and focus more either on reducing the cost of their products to consumers or increasing quality. Increasing quality would mean raising nutritional value to help consumers get more for their money. Raising product quality might also involve ensuring product safety.

This issue has precedence. During the 1930s, during a period of depressed economic conditions and fierce competition, Campbell's President, Arthur Dorrance, who took the reins after his brother John passed away, raised product quality and held prices steady. (Campbell's Corporate Archivist Jonathan Thorn also says, in the company's 2014 Corporate Sustainability Report, that Mr. Dorrance likewise began innovating with new products, but it would be interesting and instructive, I think, to compare the company's 1930s product innovation efforts with today's.)

While there are clearly parallels to present times, it is also important to note that in many ways, the 1930s were simpler and more tolerant times. If today's consumers are better off (financially speaking), should the company raise product quality and hold prices steady? What about consumers that are over-eating? Should Campbell's try to help them out? Should its duty to shareholders to maximize sales take precedence? Would the company be violating its duty to shareholders by helping consumers use their products more appropriately?

Problem or Opportunity? The Growth of Snacks and Mini-Meals Continues



The percentage of consumers snacking almost daily by day part: 2010 vs. 2014

Source: IRI 2014 Snacking Survey (from Campbell's Analyst Day Slide Deck, July 21, 2014)

Consider, for a moment, the Pepperidge Farm Goldfish franchise. Launched in 1961, Goldfish is among the most lucrative of Campbell's franchises. Today, Goldfish is in the cupboards of more than one-half of all U.S. households with children. Pepperidge Farm says that Goldfish is popular with "kids-of-all-ages." It still working hard to continue expanding that franchise by deepening its connection with parents, many of whom have a strong emotional connection to the product, enhancing brand love with children and driving incremental growth through product innovation.

A Pepperidge Farm Goldfish is essentially a Cheez-It cracker shaped into a fish. The product has greater nutritional value than Cheez-Its, because it is made with vitamin-enriched flour; but most nutritionists would probably say that the caloric content is what's most important. Like any snack, Goldfish are fine if eaten in moderation. Kids can and regularly do eat things that are a lot worse for them than Goldfish.

In recent years, however, product innovation has resulted in an expansion of Goldfish varieties. Today, Goldfish come in many flavors: like Xtra Cheddar, Xplosive Pizza, Slammin' Sour Cream & Onion and Flavor-Blasted White Cheddar. The Goldfish Grahams line includes French Toast, Strawberry, Honey Bun Vanilla Cupcake, Fudge Brownie, Cookies & Cream, S'mores and Cocoa Adventures. You can also buy Goldfish in bags, boxes, cartons, multipacks, 100 calorie pouches and Grab & Go containers. A new product, Goldfish Puffs, is designed to appeal to teenagers.

Clearly, with such variety, Goldfish are not being marketed solely to children. But where is the line drawn? What might have been recognized years ago as a cute snack for children is now much more today. Goldfish's product innovation encourages overconsumption and unhealthy eating.

The profusion in product SKUs and efforts to promote greater consumption through advertising raise a number of questions. Among them: Is Campbell's serving its customers best in the long-run with this approach? Isn't the company contributing to the problems of both childhood and adult obesity by pursuing its current Goldfish marketing strategy? Is the drive to "enhance brand love" among children (primarily through advertising) appropriate? Does this effort meet standards of corporate social responsibility and sustainability? (Campbell's has won numerous awards for CSR and is included in several CSR indices.) Is CSR mainly about reduction of greenhouse gas emissions? Is this profusion of flavors and packaging profitable and is it likely to generate an acceptable return on investment in the long-run? Would Campbell's serve both its customers and its shareholders better by harvesting the Goldfish brand? (i.e. scaling back advertising, marketing and product innovation, cutting back operating expenses as much as possible and letting the brand carry itself without any further marketing efforts?)

In the short-term, this is primarily a question of where Campbell's should draw the line in its marketing efforts. Importantly, the company has already determined where it aims to draw the line. This is given, as discussed above, as one of its guidelines under the dual mandate for strengthening the core: to approach consumers as they are living now.

I believe that there is much wisdom in this approach. It is risky to change business practices today in anticipation of what Campbell might think consumer wants and needs might be in the future or what Campbell might determine that their wants and needs should be. Consumers may not respond to Campbell's predictions about their future wants and needs. Many, for example, are likely to maintain their bad habits no matter what products are available or marketing messages they see. In that case, foregoing profit opportunities now would be a disservice to shareholders. The future may turn out different from what any of us might imagine.

On the other hand, there is also a risk to approaching consumers only as they are living now. Meeting current consumer needs may put the company at a disadvantage, if and when those needs change, especially if the change is sudden. Just as the best chess players anticipate their opponents' moves, it would be best for Campbell to anticipate consumer moves and make changes at the appropriate times to ensure

that it can continue to serve them effectively. But, of course, this requires anticipating changes in consumer behavior correctly. Without a clear and well-functioning crystal ball, Campbell's may be best served by focusing on the here and now.

Under these circumstances, it may be appropriate for the company to adjust certain of its policies. With Goldfish, for example, a case can be made that most of the marketing is targeted to adults, who rightfully should bear responsibility for their actions, including the actions that they take with respect to their children. Personally, however, I think that the company should stop advertising Goldfish directly to children on television (and probably elsewhere). Some might disagree and say that parents are responsible for what their children watch; but as a parent, I know that it is impossible to control everything that a child experiences. In my opinion, children already face significant challenges in this environment. Campbell can and should take steps to avoid making it more challenging for them.

The company faces a similar issue with its V8 Splash product line. That product offers a splash of juice, 5%-10% of total content, and is sweetened with high fructose corn syrup. Yet, it is also vitamin C-fortified and provides refreshment at only 80 calories per eight ounce serving. Some parents may see this as a better alternative than soda or even fruit juices with a higher caloric content. Nevertheless, Campbell has set its sights on turning V8 Splash into a powerful brand for kids. Even so, it is unclear (in my mind, at least) whether the company can at the same time, extend the V8 brand into the premium, fresh packaged category. (What, then, does the V8 brand really represent to the consumer?) I think that the company would be better served under the circumstances to forego its brand building initiatives for V8 Splash with children.

In summary, based upon my analysis, there is a strong likelihood that a meaningful portion of Campbell's current product innovation expenditures is wasteful and so should be adjusted and probably scaled back. The company should improve its financial reporting practices by providing a review and assessment of its product innovation efforts at the very least on an annual basis. It should take steps to ensure that its marketing and product development efforts generate a satisfactory return on investment and discontinue programs that are either too risky (because they are both costly and outside of its current asset base and expertise) or have little chance of success. It should take steps to ensure that it is serving its consumers effectively now, while retaining both the operating and financial flexibility to serve them well in the future. It should include a specific discussion of its product marketing and innovation efforts in its corporate social responsibility and sustainability reporting. Finally, Campbell's should take steps now to eliminate direct advertising to children and scale back other marketing efforts to adult consumers of products that have few or no nutritional benefits, as warranted by business and economic conditions.

Historical Consolidated and Segment Financial Performance

Net Sales. Consolidated net sales increased 12.2% in fiscal 2013 to \$8.05 billion, due mostly to the acquisition of Bolthouse Farms. A gain of 5% in ***U.S. Simple Meals*** was driven primarily by increased soup sales and primarily a 9% surge in Campbell's Chunky canned soups. ***Global Baking and Snacking*** sales increased 4% due to gains at both Pepperidge Farms and Arnott's. Pepperidge Farms sales increased across all product lines, but were also helped by the bankruptcy of Hostess Brands. Arnott's sales benefited from gains in Indonesia. Sales of ***International Simple Meals and Beverages*** were flat. ***U.S. Beverages*** reported a 4% decline in sales as a result of lower sales of V8 vegetable juice and V8 V-Fusion beverages. Excluding the acquisition of Bolthouse, net sales in the Bolthouse and Foodservice segment declined 8%, due to the loss of a major customer and higher levels of trade spending.

Across all business segments, volume and mix increased net sales by 1%. Higher prices and lower sales allowances raised net sales by 2%. Increased promotional spending reduced sales by 1%. The acquisitions of Bolthouse and Plum Organics increased sales by 11%.

For the 39 week period (nine months) ended April 27, 2014, consolidated net sales increased 1.4%. ***U.S. Simple Meals*** posted a sales gain of 3%, as a 1% decline in U.S. soups was more than offset by the Plum acquisition and gains in Prego and Campbell's Slow Cooker sauces. Net sales in ***Global Baking and Snacking*** increased 6%, due entirely to the Kelsen acquisition. It appears that overall sales at Pepperidge Farms were essentially flat, while Arnott's sales declined due to currency, increased trade spending and lower biscuit sales. In ***International Simple Meals and Beverages***, net sales declined 13%, with lower sales across all regions (Canada, Mexico and Asia Pacific). The decline in Mexico was due to a shift to reporting sales on a net basis. ***U.S. Beverages*** net sales dropped 5%, due to a drop in unit volume, mostly sales of V8 V-Fusion beverages. Net sales in the ***Bolthouse and Foodservice*** segment increased 3%, due to an extra week of sales at Bolthouse and double-digit growth in premium refrigerated beverages and salad dressings, partially offset by another sales decline in Foodservice.

In summary, without the benefit of acquisitions, net sales across all of Campbell's business have been flat to down slightly over the past seven quarters, when compared against prior year periods. This has happened despite the launch of 200 new products in fiscal 2014.

Table 3
Campbell Soup Company

Consolidated Sales, EBIT, Depreciation and Capital Expenditures: Fiscal 2011 to Fiscal 2014
(\$ millions)

Consolidated	52 Weeks 31-Jul-11	52 Weeks 29-Jul-12	52 Weeks 28-Jul-13		39 Weeks 28-Apr-13	39 Weeks 27-Apr-14
Net sales	7,143	7,175	8,052		6,329	6,416
Sales growth	NA	0.4%	12.2%		11.9%	1.4%
Adjusted EBIT	1,251	1,167	1,232		1,024	1,022
Adjusted EBIT margin	17.5%	16.3%	15.3%		16.2%	15.9%
Restructuring costs	39	7	142		112	37
Acquisition costs and other (1)		5	10		10	27
EBIT	1,212	1,155	1,080		902	958
EBIT margin	17.0%	16.1%	13.4%		14.3%	14.9%
Depreciation & amortization	268	262	407			
Capital expenditures	272	323	336			
Components of sales growth						
Volume and mix	NA	-2%	1%		2%	0%
Price and sales allowances	NA	3%	2%		1%	2%
Promotional spending	NA	-1%	-1%		-1%	-2%
Currency						
Acquisitions	NA		11%		9%	4%
Other						-2%

(1) In the 39 weeks ended April 27, 2014, Acquisition costs and other included an \$18 million pension settlement charge (associated with the closure of a facility in Sacramento CA and a \$9 million loss on foreign exchange forward contracts).

Table 4 also shows that, after adjusting for restructuring and acquisition costs, Campbell's profitability (i.e. earnings before interest and taxes or EBIT) was essentially flat from fiscal 2011 to fiscal 2013 and also for the 39 week periods from fiscal 2013 to fiscal 2014.

Table 4
Campbell Soup Company
Consolidated Financial Results: Fiscal 2011 to Fiscal 2014
(\$ millions)

	52 Weeks 31-Jul-11	52 Weeks 29-Jul-12	52 Weeks 28-Jul-13		39 Weeks 28-Apr-13	39 Weeks 27-Apr-14
Net sales	7,143	7,175	8,052		6,329	6,416
Sales growth	NA	0.4%	12.2%		11.9%	1.4%
Cost of products sold	4,255	4,365	5,140		4,040	4,149
as % of revenues	59.6%	60.8%	63.8%		63.8%	64.7%
Marketing and selling expenses	909	941	947		756	746
as % of revenues	12.7%	13.1%	11.8%		11.9%	11.6%
Administrative expenses	577	580	677		482	424
as % of revenues	8.1%	8.1%	8.4%		7.6%	6.6%
Research and development expenses	120	116	128		94	88
as % of revenues	1.7%	1.6%	1.6%		1.5%	1.4%
Other expenses	10	11	29		24	16
Restructuring expenses	60	7	51		31	35
Total operating expenses	5,931	6,020	6,972		5,427	5,458
Earnings before interest & taxes	1,212	1,155	1,080		902	958
as % of revenues	17.0%	16.1%	13.4%		14.3%	14.9%
Interest expense	122	114	135		102	91
Interest income	10	8	10		7	2
Earnings before taxes	1,100	1,049	955		807	869
as % of revenues	15.4%	14.6%	11.9%		12.8%	13.5%
Taxes on earnings	351	325	275		242	278
Income tax rate	31.9%	31.0%	28.8%		30.0%	32.0%
Earnings from cont ops & other items	749	724	680		565	591
as % of revenues	10.5%	10.1%	8.4%		8.9%	9.2%
Earnings from discontinued operations	53	40	(231)		44	81
less earnings attrib. to noncontrol. int.	3	10	9		7	9
Net earnings	799	754	440		602	663
EPS - basic						
From continuing operations	\$ 2.28	\$ 2.30	\$ 2.19		\$ 1.82	\$ 1.91
From discontinued operations	\$ 0.16	\$ 0.12	\$ (0.74)		\$ 0.14	\$ 0.26
Total EPS	\$ 2.44	\$ 2.43	\$ 1.46		\$ 1.96	\$ 2.17
EPS - diluted						
From continuing operations	\$ 2.26	\$ 2.29	\$ 2.17		\$ 1.80	\$ 1.90
From discontinued operations	\$ 0.16	\$ 0.12	\$ (0.73)		\$ 0.14	\$ 0.26
Total EPS	\$ 2.42	\$ 2.41	\$ 1.44		\$ 1.94	\$ 2.16
Non-GAAP EPS from cont. operations	\$ 2.54	\$ 2.32	\$ 2.48		\$ 2.05	\$ 2.04
Wtd. avg. shares						
Basic	326	317	314		314	314
Diluted	329	319	317		317	316
Dividends	\$ 1.15	\$ 1.16	\$ 1.16		\$ 0.87	\$ 0.94

Campbell's gross margin declined by 120 basis points from 40.4% in fiscal 2011 to 39.2% in fiscal 2011 and then by 300 basis points to 36.2% in fiscal 2011. Cost inflation and other (related) factors have been a primary driver. This has been mostly offset by higher selling prices and productivity improvements. In fiscal 2013, 270 basis points of the decline was due to the impact of acquisitions and restructuring costs. (Unfortunately, the company does not describe exactly what the impact of acquisitions or whether this negative impact is expected to continue. Some of the decline may be due to one-time, purchase accounting adjustments, but Bolthouse's gross margin are also lower than the company average.)

Year-to-date in fiscal 2014, Campbell's gross margin has slipped another 90 basis points to 35.3%. Here again, cost inflation was mostly offset by higher selling prices and productivity improvements. This year, the company has incurred a higher level (110 bp) of promotional spending. The continuing negative impact on gross margins from acquisitions (including a product recall by Plum Organics) and the pension settlement charge, was essentially offset by lower restructuring related costs.

Marketing and selling expenses as a percent of net sales have declined steadily in recent years – by 130 bp in fiscal 2013 to 11.8% - and by another 30 bp vs. the prior year to 11.6% year-to-date in fiscal 2014. In general, higher administrative expenses associated with recent acquisitions and higher selling and marketing expenses associated with new product rollouts have been offset by lower advertising and consumer promotion expenses. Marketing and selling spending has still increased, but at a slower pace than net sales.

Administrative expense as a percent of sales increased by 30 bp to 8.4% in fiscal 2013, but decreased by 100 bp to 6.6% year-to-date fiscal 2014. The 2013 increase was due to acquisition costs, higher compensation and benefit costs, and higher administrative costs and inflation, offset partially by restructuring initiatives. This year's decline was driven mostly by a big drop in incentive compensation (i.e. stock-based compensation). Management has indicated that stock-based compensation will be higher next year, providing a modest headwind for the company's administrative expense ratio.

U.S. Simple Meals Segment: Stabilization of this most important piece of the core business remains a work in progress. After enduring a period of sliding sales and profits in the aftermath of the recession, as consumers maintained a firm grip on their wallets, the company began trying to reshape the business, by weaning customers off of discount-driven stock-up purchases, reducing what it perceived as wasteful trade spending and upgrading its product portfolio by improving taste. With the focus on taste, Campbell

Table 5
Campbell Soup Company
 U.S. Simple Meals Segment Results: Fiscal 2011 to Fiscal 2014
 (\$ millions)

U.S. Simple Meals	52 Weeks 31-Jul-11	52 Weeks 29-Jul-12	52 Weeks 28-Jul-13		39 Weeks 28-Apr-13	39 Weeks 27-Apr-14
Net sales	2,751	2,726	2,849		2,356	2,426
Sales growth	-6.4%	-0.9%	4.5%		4.0%	3.0%
EBIT	657	658	731		621	600
EBIT margin	23.9%	24.1%	25.7%		26.4%	24.7%
Depreciation & amortization	93	92	146			
Capital expenditures	126	97	82			
Components of sales growth						
Volume and mix	-5%	-4%	3%		2%	1%
Price		3%	2%		2%	2%
Promotional spending	-1%		-1%			-2%
Acquisitions			1%			2%

began to address the perception among many consumers that Progresso soups have better taste, which was undoubtedly a major source of irritation to Campbell's management. The strategy was also designed to appeal to important emerging consumer segments, like millennials and Hispanics. In U.S. Sauces, the goal was to introduce new cooking sauces, such as Campbell's Skillet Sauces and Slow-Cooker Sauces, to meet the growing demand for quick, home-cooked meals.

The segment showed good progress in fiscal 2013, with a 4.5% increase in sales and an 11.1% increase in profits. Higher sales volume and prices more than offset the pick-up in promotional spending that supported the company's marketing efforts. One key driver of performance was the 9% jump in Campbell's Chunky soup sales, which resulted from the introduction of new varieties, higher promotional spending and a return to the NFL mama's boy-themed advertising. Sales of both condensed soups and broths were also up, by 2% and 4%, respectively. Campbell introduced 38 new soups in fiscal 2013. U.S. Sauces sales increased 5%, due to the acquisition of Plum Organics, growth in Prego pasta sauces and Pace Mexican sauces and the launch of Skillet Sauces.

Unfortunately, the improvement in performance at U.S. Simple Meals has not continued in fiscal 2014. Year-to-date, sales were up 3%, due mostly to the acquisition of Plum. Small gains in sales volume and price were mostly offset by promotional spending. U.S. Soup sales decreased 1%, with modest declines in condensed and ready-to-serve only partially offset by an 11% jump in broth sales. Admittedly, the company faced tough comparisons against last year's very strong results, but it had expected to do better. Excluding the Plum acquisition, U.S. Sauces sales increased 4% with the aid of further gains in Prego sales and the introduction of Campbell's Slow Cooker sauces.

Despite ongoing innovation, the company has been unable to drive category growth in fiscal 2014. Management points to the challenges still facing consumers as the primary cause of this disappointment. Yet, it will continue rolling out new products in fiscal 2015, including a line of organic soups in aseptic packaging and a line of Campbell's Oven Sauces (for oven-cooked meat dishes). A key test will be whether it is able to keep shelf space for products introduced over the past two years, including GO soups, Gourmet Bisques and Slow Kettle-Style soups in the soup section and Campbell's Skillet Sauces and Campbell's Slow Cooker Sauces in the simple meals section.

The company remains optimistic. In sauces, for example, stores representing 60% of all-commodity volume now have dedicated dinner sauce sections. Management says that its new products are winning trial and repeat purchase rates above its competitive benchmark; but it remains to be seen whether these purchase rates are enough to keep retailers (and ultimately Campbell) happy.

To its credit, Campbell has positively changed its profile in the soup and dinner sauce aisles. It has clearly been the leader in innovation in recent years and based upon my personal experience, the quality of its products is good. Progresso has been a quick imitator, following Campbell in most new niches with copycat products; but it seems to have lost mind share (if not market share) and remains somewhat committed to its long standing practice of driving sales of ready-to-serve soups through discounting. I have been surprised on some busy supermarket days to see the shelves that hold Campbell's new soup and sauce offerings roughed-up with empty spaces, a sure sign of good sales; but it does seem (from my admittedly limited observations) that both trial and repeat purchases are on the whole not as strong as they need to be with many of these new products. Hopefully, if the economy holds up and job growth remains robust, consumers will become a little less cautious and fall in love with soup and sauces again.

Global Baking and Snacking. Although this segment now includes three very different businesses – Pepperidge Farm, Arnott's and Kelsen – with virtually no overlap or synergies, recent results have unfortunately been similar (except for the recently-acquired Kelsen, which has not been in the fold long enough to exhibit a trend)

In fiscal 2013, segment sales were up 3.6% to \$2.27 billion, but EBIT was flat. Pepperidge Farms saw sales gains in fresh bakery, Goldfish crackers and cookies, but not in frozen products, which seem to be in a sustained rate of decline. (Pepperidge Farms' frozen products, which include cakes, turnovers, pastry sheets, garlic breads, rolls and Texas toast are terrific, but other than loyal customers, few people seem to know about them, especially the desserts.) PF's bread business got a boost from the Hostess bankruptcy, increasing promotional spending to secure more shelf space. Arnott's benefited from improving sales in Indonesia, offset partially by currency. It too boosted promotional spending, in Australia, in order to remain competitive. Segment EBIT increased by only \$1 million, as a modest gain at PF was mostly offset by lower profits at Arnott's.

YTD 2014, segment sales were up 6.4% to \$1.81 billion. All of the increase was due to the Kelsen acquisition. PF's sales gains in fresh bakery, crackers and Goldfish were partially offset once again by a decline in frozen. Arnott's sales declined due to the impact of currency and declines in Australia (mostly in savory chocolate biscuits), offset partially by continued strong growth in biscuit sales in Indonesia.

Once again, despite relatively strong revenue growth and the benefit of the Kelsen acquisition, segment profit was largely flat. Besides the contribution from Kelsen, profits increased from lower marketing and administrative costs, partially offset by lower gross margins.

Table 6
Campbell Soup Company
 Global Baking and Snacking Segment Results: Fiscal 2011 to Fiscal 2014
 (\$ millions)

Global Baking and Snacking	52 Weeks 31-Jul-11	52 Weeks 29-Jul-12	52 Weeks 28-Jul-13		39 Weeks 28-Apr-13	39 Weeks 27-Apr-14
Net sales	2,156	2,193	2,273		1,703	1,812
Sales growth	9.2%	1.7%	3.6%		4.0%	6.4%
EBIT	355	315	316		232	234
EBIT margin	16.5%	14.4%	13.9%		13.6%	12.9%
Depreciation & amortization	84	83	83			
Capital expenditures	73	126	112			
Components of sales growth						
Volume and mix	3%	-1%	4%		4%	1%
Price and sales allowances	2%	5%	2%		1%	3%
Promotional spending	-1%	-3%	-2%			-3%
Currency		1%			-1%	-4%
Acquisitions	5%					9%

Although GBS may benefit in the short-run from improving economic conditions, I am concerned about its ability to perform in the longer-term. PF's product line consists mostly of premium-priced baked goods. These are cheap indulgences, but many consumers will cut back their regular purchases of them, when budgets are tight. As already noted, I believe that its strategy to expand Goldfish into agencies that cater to teens and adult snackers, is ill-advised. These niches are shallow. (You can get a sense of this by taking a look at your local grocers Goldfish display in the late afternoon on a Saturday and Sunday. My observations showed relatively few takers for the Goldfish Grahams and Flavor-Blasted varieties.)

For Goldfish, expanding into adjacencies in this way is a strategy that seems past its prime. This might have worked well in the years before the financial crisis, but now it seems like there is a high probability of failure. PF's sales will get a boost as it rolls these products into stores. Consumers may warm up to them, if the economy gains steam. But in the current environment, with the risk of another economic

setback within the next few years looming large, I think that PF would better serve Campbell's shareholders by milking the Goldfish business for profits and keeping its fixed costs as low and its financial flexibility as high as possible. To compete more effectively over the long haul, PF might even consider acquisitions in fresh bakery or cookies that would raise its market share across the country and help lower its per unit marketing costs.

Arnott's, the Australian biscuit and snack maker, appears to face similar challenges in its home market. After several years of expanding its product line before the financial crisis and a recent manufacturing capacity expansion, the business has hit a rough patch due to weakness in the local economy, tightness in consumer spending and heightened competition. However, growth in Indonesia, in part due to increased penetration of the retail trade, has been a bright spot. The company has met its domestic challenges by raising promotional spending. It has also further upgraded its manufacturing (and also its marketing) capabilities by adding automated flexible packaging to its Virginia, Australia plant.

With its \$325 million purchase of Kelsen Group in August 2013, Campbell's acquired a leading producer of premium butter cookies, marketed under the Kjeldsen's and Royal Dansk brand names. The business has a strong position in China, where its cookie tins are regularly given as gifts. Kelsen's brands enjoy strong consumer awareness – in excess of 90% - in Hong Kong and Shanghai. Campbell International will seek to expand its distribution into adjacent geographic markets within China and hopes to use this ultimately as a platform to introduce other products into the Chinese market.

International Simple Meals and Beverages. Besides Arnott's and the Kelsen Group, which are included in the GBS segment, Campbell International offers soups, sauces and beverages that are similar to or the same as those offered in the U.S. In some cases, the products may be adapted to local market tastes. In Canada, which offers the full complement of products offered in the U.S., the company also markets the Habitant line of soups (known mostly for its pea soup). In Malaysia, which has been a good growth story, the company produces and markets a line of tomato-based sauces (like ketchup and chili), mayonnaise and beans under the Kimball brand.

Table 7
Campbell Soup Company

International Simple Meals and Beverages Segment Results: Fiscal 2011 to Fiscal 2014
(\$ millions)

Int'l Simple Meals and Beverages	52 Weeks 31-Jul-11	52 Weeks 29-Jul-12	52 Weeks 28-Jul-13		39 Weeks 28-Apr-13	39 Weeks 27-Apr-14
Net sales	887	872	869		682	592
Sales growth	NA	-1.7%	-0.3%		1.5%	-13.2%
EBIT	128	106	108		94	85
EBIT margin	14.4%	12.2%	12.4%		13.8%	14.4%
Depreciation & amortization	24	22	23			
Capital expenditures	25	32	19			
Components of sales growth						
Volume and mix	NA	-1%			2%	-2%
Price and sales allowances	NA	3%	2%		2%	-2%
Promotional spending	NA	-3%	-2%		-2%	
Currency		-1%			-1%	-7%
Other						-2%

In October 2013, Campbell sold its European simple meals business, which consisted of a portfolio of national brands of soups, sauces and simple meals, to CVC Partners for €400 million. The results for that

business have been excluded from continuing operations for both the ISMB segment and on a consolidated basis and now appear in discontinued operations. In conjunction with the sale, Campbell wrote down the carrying value of its goodwill by \$396 million (\$263 million after-tax or \$0.83 per share). It also recorded tax expense of \$0.06 per share, reflecting the difference between the carrying value and taxable basis of its assets.

In Mexico, Campbell forged new partnerships in early 2013 with local food producers, Grupo Jumex and Conservas la Costena, to manufacture and distribute its entire Mexican product line. The agreements expanded Campbell's manufacturing and its distribution capabilities. Grupo Jumex will produce V8. La Costena will be responsible for soups, broths and Italian sauces. Both partners will also be responsible for consumer marketing and R&D. In conjunction with the move, Campbell closed its Villagran manufacturing plant and laid off its 260 workers. The remaining 70 employees, who work in general management, sales, marketing, R&D and supply chain management, were retained. Two percentage points of the year-to-date decline in fiscal 2014 sales in the ISMB segment came as a result of a switch in reporting from gross to net sales in Mexico.

In fiscal 2013, ISMB sales of \$869 million were down slightly, as declines in Asia Pacific were mostly offset by increases in China, Latin America and Canada. Segment profits rose 2%, mostly as a result of reduced losses in China.

So far in fiscal 2014, ISMB sales have fallen 13.2% to \$592 million. Sales fell in all three regions: in Canada, due to the negative impact of currency and lower soup and beverage sales; in Asia Pacific, also due to currency and lower soup sales in Australia; and in Mexico, due to the aforementioned transition to net sales and lower product prices. Segment EBIT fell 9.6% to \$85 million, due to the drop in sales volume and prices and also to the unfavorable impact of currency.

Despite the weak year-to-date results, Campbell International is upbeat about its future prospects. It has recently streamlined and strengthened its management team. It expects to stabilize performance in Australia and eventually restore growth. It sees good prospects continuing in Malaysia, with Kimball as its anchor, and also in Indonesia, where it expects to achieve double-digit growth in biscuits. It anticipates good growth in China from Kelsen and eventually from introducing some of Arnott's biscuits into select markets. It expects improved performance in Mexico, especially near-term in beverages. It also intends to pursue more development deals (i.e. joint venture arrangements) in other regions, especially Asia Pacific. An eventual moderation in dollar strength should turn a significant headwind into a tailwind.

U.S. Beverages. The U.S. Beverage segment has suffered an extended decline in its operating and financial performance. Although revenues have hovered around the \$750 million level for the past five fiscal years, segment profit peaked at \$206 million in fiscal 2010 and have fallen by 16% per year on average since then. In fiscal 2013, profits declined 10.5% to \$120 million. So far in fiscal 2014, EBIT is down another 16% to \$84 million.

The U.S. Beverage business originally consisted of V8 vegetable juice, purchased by Campbell in 1948, and Campbell's tomato juice. In the late 1990s, the company created the V8 Splash line, which has only a "splash" of juice, 5%-10%, and is sweetened with high fructose corn syrup and sucralose. V8 Splash became a big hit, fueling the segment's growth in sales and profitability. Eventually, Campbell added V-8 V-Fusion, a 100% fruit-vegetable juice blend. It broadened the product line with versions that included tea and energy drinks. In 2013, the company added V8 Refreshers, which contain 20%-25% juice.

The weakness in U.S. Beverage's performance is due to several factors: First, sales of V8 have mostly declined steadily for several years. The popularity of vegetable-juice combination drinks appears to have peaked several years ago. Greater attention to ingredients, especially in sweetened drinks, may also have prompted consumers (and especially parents) to seek alternatives. Competition has also been on the rise. Campbell has had to offer increasing sales discounts and promotions in order to keep sales flat.

Table 8
Campbell Soup Company
U.S. Beverage Segment Results: Fiscal 2011 to Fiscal 2014
(\$ millions)

U.S. Beverages	52 Weeks 31-Jul-11	52 Weeks 29-Jul-12	52 Weeks 28-Jul-13		39 Weeks 28-Apr-13	39 Weeks 27-Apr-14
Net sales	759	774	742		569	539
Sales growth	-0.4%	2.0%	-4.1%		-4.0%	-5.3%
EBIT	182	134	120		100	84
EBIT margin	24.0%	17.3%	16.2%		17.6%	15.6%
Depreciation & amortization	22	22	39			
Capital expenditures (*)						
Components of sales growth						
Volume and mix	2%	3%	-3%		-3%	-5%
Price and sales allowances						
Promotional spending	-2%	-1%	-1%		-1%	
Currency						
Acquisitions						

Management was somewhat reticent about its intentions for the U.S. Beverage business at its recent analyst meeting on July 21. Although it acknowledged the pressures on the shelf stable juice category and presented a strategies for strengthening the V8 and V8 Splash brands and increasing distribution, it did not put forth any plans or strategies that would appear to have a high probability of turning around the business segment's performance.

Its plans to reinvigorate the V8-Splash brand face at least one challenge: In June, CEO Diane Morrison received a letter from the Center for Science in the Public Interest, a non-profit advocacy group for nutrition and food safety, which threatened to take legal action, unless the company agrees to change what it characterizes as misleading statements about the juice content, overall healthfulness and nutritional value of V-8 Splash and V-8 Refreshers.

Campbell will probably have little trouble in addressing this threat; but the incident does highlight questions about the V8 brand. What exactly does Campbell want the V8 brand to convey to consumers? Does it believe that the brand can have a unified image in the minds of consumers when applied to products ranging from V8 Splash (with 5% juice and high fructose corn syrup) to premium-priced refrigerated fresh packaged fruit and vegetable juices?

Apparently so. As already noted, Campbell intends to build V8 Splash into a powerhouse brand for kids. It plans to offer the product in new flavors and new sizes and adopt new multicultural marketing campaigns to broaden the brand's reach. At the other end of the spectrum, it has created new fresh-packaged formulations of V8, developed with on the Bolthouse platform. V8 Bloody Mary mix is a hit.

But just how strong is the V8 brand? It is certainly not Tiffany or Rolex, but rather a good quality, mid-tier brand. V8 has better name recognition than Bolthouse, perhaps making it a better brand choice for expanding the distribution of fresh packaged juices to additional outlets, like convenience stores, drug stores and even big box retailers. It remains to be seen whether Campbell can stretch the image of V8 across a disparate portfolio of products, as currently envisioned.

It may also be expensive to support both the V8 and the Bolthouse brand names for what is obviously the same product.

As noted above, if Campbell's follows through on its plan to extend the V8 brand to protein bars and shakes, it will, I believe, eventually run up against the V8 brand's limits. Stretching the V8 brand further in this way will likely require a significant investment in order to carve out a meaningful stake in this competitive product niche.

Bolthouse and Foodservice. Sales of this segment more than doubled in fiscal 2013, due to the acquisition of Bolthouse. However, the North American Foodservice business posted a decrease of 9% in sales, due to the loss of a major restaurant customer and higher levels of promotional spending to sustain sales in a competitive environment.

Fiscal 2013 segment earnings increased 36.5% to \$116 million. Excluding the profit contribution from Bolthouse of \$63 million, profit in Foodservice fell 37.7% to \$53 million.

Year-to-date, segment sales increased 2.7% to \$1.05 billion, but profits slipped 3.3% to \$88 million. Sales benefited from an extra week sales from Bolthouse this year. (Bolthouse was acquired one week into fiscal 2013, on August 6, 2013.) Apart from that, higher sales volume and prices were partially offset by higher promotional spending. On the cost side, despite the increase in sales, the drag from higher cost inflation exceeded the benefit of lower administrative costs.

Campbell is concentrating on driving growth in Bolthouse both in its premium refrigerated drinks (in partnership with V8) and in its refrigerated salad dressings businesses. But progress to date has been relatively slow. I expect to see more significant movement at Bolthouse in fiscal 2015.

Management is not really saying much about North American Foodservice, except that it is working on fixing its problems.

Table 9
Campbell Soup Company
 Bolthouse and Foodservice Segment Results: Fiscal 2011 to Fiscal 2014
 (\$ millions)

Bolthouse and Foodservice	52 Weeks 31-Jul-11	52 Weeks 29-Jul-12	52 Weeks 28-Jul-13		39 Weeks 28-Apr-13	39 Weeks 27-Apr-14
Net sales	590	610	1,319		1,019	1,047
Sales growth	2.1%	3.4%	116.2%		108.4%	2.7%
EBIT	82	85	116		91	88
EBIT margin	13.9%	13.9%	8.8%		8.9%	8.4%
Depreciation & amortization	14	14	90			
Capital expenditures	3	9	83			
Components of sales growth						
Volume and mix	-1%	2%	-6%		-6%	2%
Price and sales allowances		2%				1%
Promotional spending	2%	-1%	-2%		-3%	-1%
Currency	1%		124%		117%	1%
Acquisitions						

Corporate Expenses and Restructuring Charges. Unallocated corporate expenses nearly doubled in fiscal 2013 to \$260 million, due to the inclusion of \$91 million of restructuring costs (which were nevertheless included in cost of sales) and \$10 million of transaction costs associated with the acquisition of Bolthouse Farms. These costs primarily consisted of accelerated depreciation and other exit costs associated with ongoing restructuring efforts as discussed in greater detail below. Excluding these unallocated restructuring and transaction costs, corporate expenses increased by 16.9% to \$159 million.

In addition, the company recorded \$50 million of restructuring charges not assigned to corporate expenses or any of the business segments.

Table 10
Campbell Soup Company

Consolidated Net Sales, Corporate Expenses and Restructuring Charges: Fiscal 2011 to Fiscal 2014
(\$ millions)

Sales, corporate & restructuring	52 Weeks 31-Jul-11	52 Weeks 29-Jul-12	52 Weeks 28-Jul-13		39 Weeks 28-Apr-13	39 Weeks 27-Apr-14
Net sales	7,143	7,175	8,052		6,329	6,416
Sales growth	NA	0.4%	12.2%		11.9%	1.4%
Corporate expenses	132	136	260		205	98
as % of net sales	1.8%	1.9%	3.2%		3.2%	1.5%
Restructuring charges	30	7	51		31	35
as % of net sales	0.4%	0.1%	0.6%		0.5%	0.5%

Year-to-date in fiscal 2014, the company has incurred \$98 million of unallocated corporate expenses, down from \$205 million last year. This year's corporate expenses include a pension settlement charge of \$18 million associated with the closure of the Sacramento manufacturing plant (discussed in greater detail below). They also include a \$9 million loss on foreign exchange forward contracts attributable to Campbell's recently sold European simple meals business. Last year's results included \$81 million of restructuring expenses and \$10 million of transaction costs. Excluding special items from both years, unallocated corporate expenses declined 37.7% from \$114 million to \$71 million.

Year-to-date restructuring expenses totaled \$35 million, up nearly 11% from \$31 million last year. This year's charges included a \$14 million charge attributable to the restructuring of the ISMB segment's soup and broth business in China. This was equivalent to \$0.02 per share and will result in estimated annual savings of \$6 million.

In addition, the company streamlined its North American and Asia Pacific workforces in the first quarter of fiscal 2014, eliminating 250 positions. This streamlining resulted in a restructuring charge of \$20 million pre-tax, equivalent to \$0.04 per share after-tax.

Restructuring Initiatives. Campbell continues to implement initiatives designed to improve its supply chain cost structure by maximizing asset utilization across its U.S. thermal plant network. In fiscal 2014, it completed the shutdown and closure of its Sacramento thermal plant, eliminating 700 full-time positions and transferred its production of soups, sauces and beverages to the Maxton NC, Napoleon OH and Paris TX plants. It also closed its spice plant in South Plainfield NJ and consolidated spice production in its Milwaukee WI plant.

This fiscal year, the company also closed its PF bakery plant in Aiken SC and shifted the majority of its bread production to its Lakeland FL bakery plant, eliminating 110 positions.

The closing of its manufacturing plant in Villagran, Mexico and transfer of responsibilities for production, marketing, distribution and product development to Jumex and La Costena is also included as part of Campbell's 2013 restructuring initiatives.

In August 2013, Campbell North America completed a reduction its salaried workforce by 70 positions. In its interim fiscal 2014 reporting, the company said, as noted above, that it had streamlined its North American and Asia Pacific workforces in the first quarter of fiscal 2014, eliminating 250 positions. I assume that the 70 are included in the total of 250.

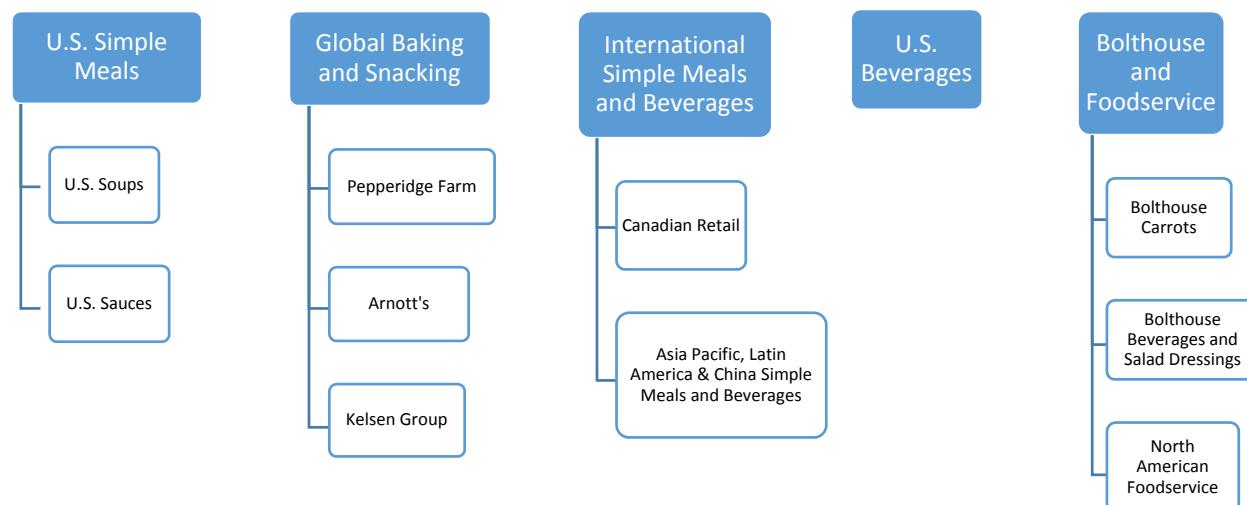
Although the company's fiscal 2013 and first quarter fiscal 2014 disclosures are not clear, I am assuming that the fiscal 2013 and fiscal 2014 restructuring initiatives are expected to result in total combined annual pre-tax savings of \$40 million beginning in fiscal 2015, with a \$26 million benefit in fiscal 2014.

Accounting and Financial Reporting Issues.

Trade and consumer promotion programs. Given the importance of trade promotions and discounts, including couponing, to the company's overall sales, it should disclose both the impact of such programs on sales (i.e. the difference between gross sales and net sales). It should also disclose the carrying amount, if any, of any promotion programs which have not been fully utilized, including the difference between estimated and actual promotion costs.

Business segment reporting. Campbell manages its operations through 10 operating segments (based upon product type and geographic location), but reports its performance in five segments. A diagram of operating and reporting segments is provided below. Reporting segments are listed at the top (in the dark boxes), while operating segments within those reporting segments are listed below the reporting segments. Please note that the U.S. Beverage is both a reporting segment and an operating segment.

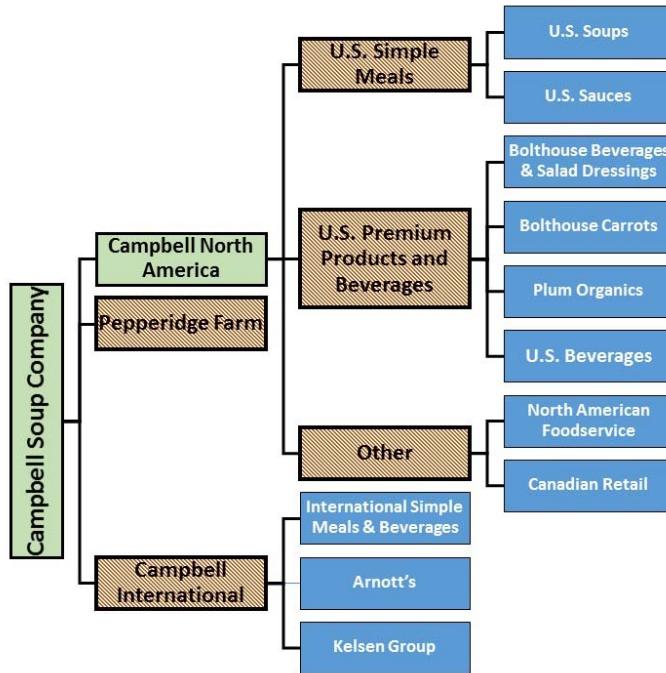
Chart 1
Campbell Soup Company
 Current Reporting and Operating Segments



The current configuration of reporting segments does not align with the way the businesses are managed. Arnott's and Kelsen Group, which are included in GBS, are managed by Luca Mignini, the President of Campbell International. Both of these businesses have little to do with Pepperidge Farm. Bolthouse's beverage and salad dressings business may be more appropriately grouped with the U.S. Beverage business, especially given the expected growth in fresh-packaged varieties of V8 vegetable juice. Plum Organics, which does not appear on the above chart because it is not considered an operating segment, seems out of place in U.S. Simple Meals. It seems better suited for the Bolthouse/U.S. Beverages combination, since it is a premium-priced, organic product. Finally, North American Foodservice, which mainly provides soups to restaurants and institutions, should probably be grouped with U.S. Simple Meals, even though its distribution channel is quite different from the rest of USSM.

A more logical grouping of reporting and operating segments is provided below:

Chart 2
Campbell Soup Company
 Proposed Reporting and Operating Segment Grouping



The segment grouping in Chart 2 aligns more closely with Campbell's management structure. Under this model, Campbell North America would house three reporting segments: U.S. Simple Meals, U.S. Premium Products and Beverages, and Other. The remaining two segments would be Pepperidge Farm and Campbell International.

U.S. Premium Products and Beverages would hold the U.S. Beverage segment, the two Bolthouse operating segments (Bolthouse Carrots and Bolthouse Beverages & Salad Dressings) and Plum Organics. The grouping makes sense, given the current plan to develop a new line of premium refrigerated beverages under the V8 brand. However, if the overlap between the two does not turn out to be significant, the Bolthouse businesses and Plum could be grouped into a separate segment called U.S. Premium Products that would be outside the Campbell North America umbrella, reporting directly to CEO Diane Morrison. It would not be best to move U.S. Beverage out from under Campbell North America, in my opinion, because this segment shares manufacturing facilities with USSM.

The Other segment would hold North American Foodservice and Canadian Retail. North American Foodservice is currently grouped with Bolthouse, while Canadian Retail is included in International Soups & Simple Meals. However, both are currently part of Campbell North America. Even though they are very different businesses, grouping them together would be more consistent with the way that the business is currently managed.

As shown here, Pepperidge Farm would be a separate reporting segment and continue as a separate operating segment.

Under this framework, Campbell International would include International Simple Meals & Beverages, Arnott's and Kelsen Group. Although these are very different businesses, this grouping is consistent with the way the business is managed. The company could conceivably provide additional disclosures in the MD&A section to address questions about the performance of each individual business. This classification is not perfect, because a significant portion of ISMB's products are manufactured in Campbell's U.S. thermal plants; but it is probably the cleanest achievable, considering both the way the businesses are managed and the information wants and needs of investors.

One of the potential advantages of this proposed segment reporting structure is that the company could in theory allocate corporate expenses between Campbell North America and the holding company. Conceivably, management could use a consolidating framework for reporting segment results that would also show summary performance figures for Campbell North America, as a whole. This, I believe, would provide information that would be useful to many of Campbell's stakeholders.

Given the acquisitions of the past few years, Campbell's organization chart and business segment groupings have changed markedly. While some of the decisions to include recent acquisitions in certain business groups may have been done for the sake of expediency, as management takes the time to learn about the new businesses and resets strategies and operating plans, I believe that the company needs to change its reporting structure again. A new framework based more closely upon the way that the company is currently managed and organized would probably minimize the need for changes in the future.

Pepperidge Farm Distributor Metrics. Pepperidge Farm distributes most of its products to retail stores through independent sales distributors who own their own trucks and the routes that they serve. It employs separate distributors for fresh bakery products and cookies (i.e. cookies, crackers and Goldfish). Frozen products are typically shipped directly to food wholesalers or retail chain distribution centers.

PF guarantees the loans that its independent distributors take out to finance their businesses. This presumably includes borrowings to purchase routes and trucks as well as working capital. I do not know exactly how the distributors are paid: whether they receive payments directly from retailers or from PF.

Campbell reports its total maximum exposure to banks for its guarantees of distributors' loans each year in its annual financial statements. In its fiscal 2013 report, it said that it had guaranteed the loans of 2,000 distributors and its maximum total exposure was \$165 million (up from \$161 million, three years ago). It also says that it is secured indirectly by its distributors' routes and also that it does not believe that it is probable that it will be required to make any payments to banks to satisfy those guarantees.

Even so, I think that the company's disclosure should be expanded to include the total amount of the guarantee as well as performance data for its independent distributors. It is not clear (to me at least) whether this maximum total exposure is equivalent to the total amount of its guarantees. (If it were, the company could easily say so.). It is entirely possible that PF could have negotiated a maximum exposure that is smaller than the total guarantee, because the banks have the ability to obtain collateral from the distributors (in the form of trucks and routes and even inventory and receivables). In that case, the banks would only require a guarantee equal to the total amount of their estimated loss exposure across the entire loan portfolio.

Since it is apparent that PF has a significant amount of control over its independent sales distributors, it should disclose more information about their financial performance in the footnotes of its financial statements, including basic summary income statements and balance sheets and the total amount of its guarantee (if it does exceed the maximum total exposure).

Capitalization

Table 11
Campbell Soup Company
 Consolidated Capitalization at April 27, 2014
 (\$ millions)

	Book Value	Market Value
Cash	222	222
Short-term Debt		
Commercial Paper	915	915
Current Maturities	700	700
Other Variable Rate	47	47
Total Short-term Debt	1,662	1,662
Long-term Debt	2,247	2,336
Total Debt	3,909	3,998
Common Equity	1,602	13,125
Total Capitalization	5,511	17,123
Debt-to-Total Capitalization	70.9%	23.4%

Campbell's ratio of debt-to-market capitalization of 23.4%, highlights the strength of its capital structure. The company's debt is rated A2 by Moody's and BBB+ by Standard and Poor's. At April 27, 2014, it had \$0.9 billion of commercial paper outstanding. It also had two maturing debt issues: \$400 million of Floating-Rate Notes on August 1, 2014 and \$300 million of 4 7/8% Senior Notes due August 15, 2014. During fiscal 2014, Campbell redeemed \$300 million of 3 3/8% Senior Notes due 2015 with part of the proceeds from the sale of its European simple meals business. Since it has not yet announced any new debt offerings, I presume that it has (or will) either issue more commercial paper or borrow under its existing bank credit facilities to meet its August debt maturities.

In December 2013, Campbell entered into a new \$2.2 billion credit facility, replacing two separate facilities that previously totaled \$2.0 billion. There were no amounts outstanding under this new credit facility on April 27, 2014, except for \$3 million of standby letters of credit that were issued on the company's behalf. The credit facility matures in December 2018. It is available to support the company's issuance of commercial paper. With the agreement of the lenders or by obtaining new participants, the company has the ability to expand the credit facility by \$500 million.

Campbell is exposed to interest rate increases on the \$915 million of commercial paper and the \$700 million of debt maturing in August 2014. This represents about 42% of its total debt outstanding. Although it has used swaps to hedge some of its rising interest rate exposure, it had no such hedges outstanding at April 27, 2014. Swaps are only a temporary benefit, since they must be rolled over. It would be better for the company to reduce interest rate exposure by issuing fixed rate debt.

The company did have \$250 million notional amount of forward starting interest rate swaps outstanding as of April 27, 2014. These are used to hedge interest rates on future debt issues.

Campbell's lease obligations appear to be modest. It paid \$54 million under operating leases in fiscal 2013. This would equate to roughly \$400-\$450 million of debt, at an assumed multiple of eight times lease payments.

At the end of fiscal 2013, the company's pension plan had a projected benefit obligation of \$2.48 billion and total plan assets of \$2.275 billion. It was therefore 91% funded. Liabilities related to the pension underfunding and its postretirement benefits obligation totaled \$604 million at July 26, 2014, most of which was included in other liabilities.

Financial Projections

Table 12
Campbell Soup Company
 Long-Term Organic Growth Targets

Metric	Target
Net Sales	3%-4%
Adjusted EBIT	4%-6%
Adjusted EPS	5%-7%

Adjusted EBIT equals earnings before interest and taxes (EBIT), adjusted for one-time items. Most recently, these one-time items have consisted of restructuring and acquisition-related costs. The exclusion of restructuring costs is controversial because such costs are typically considered a normal cost of doing business, even if they are lumpy. When such costs are lumpy, they should be averaged over a multi-year period. Judgment should be used, in any event, to determine whether the magnitude of restructuring costs is unusual, in cases where unadjusted EBIT might not be representative of the company's ongoing performance. Campbell's fiscal 2013 restructuring costs were higher than normal, but the company has recorded restructuring costs in each of the past five fiscal years. The company also says that it intends to continue to pursue cost reduction efforts in fiscal 2015, so it is likely that more restructuring is on the way. For purposes of this report, I value the company on both adjusted and unadjusted profit figures.

For fiscal 2014, the company's guidance still calls for net sales growth of 3%, off of a fiscal 2013 sales base of \$8.05 billion, adjusted EBIT growth at the low end of its 4%-6% target range off of a base of \$1.23 billion and adjusted EPS growth at the low end of its revised guidance range of 2%-4% (from last year's base of \$2.48). This implies adjusted EPS of \$2.53-\$2.58 for fiscal 2014.

The target ranges for fiscal 2014 results were set last November, after the company reported disappointing first quarter results. At that time, management said that fiscal 2014 net sales and adjusted EBIT would be at the low end of its long-term growth targets, but adjusted EPS would grow only 2%-4%, well below the long-term target of 5%-7%. As the year has progressed, management has guided to the low end of its revised guidance range. The lower adjusted EPS target is due to at least three factors: (1) Campbell suspended its share buyback program temporarily because of the debt that it has incurred from recent acquisitions. (It now plans to resume share buybacks in fiscal 2015.); (2) the company's fiscal year-to-date income tax rate is two percentage points higher than fiscal 2013; and (3) the company incurred an after-tax charge of \$11 million or \$0.03 per share for a voluntary product recall at Plum Organics, which has not been added back to adjusted (non-GAAP) earnings.

As already noted, Campbell's year-to-date adjusted EBIT and adjusted EPS for the 9 months (39 weeks) ended April 27, 2014 were essentially flat compared with the prior year. It is apparent, therefore, that the company's current fiscal 2014 earnings guidance implies a very strong fourth quarter. My full year projections, anticipate full year revenues of \$8.23 billion and adjusted EPS of \$2.53 per share. I am below the consensus range on revenues, but in line (on the low end of the range) on adjusted EPS.

My projection implies fourth quarter revenues of \$1.81 billion, up 5.0% from \$1.72 billion last year. (Campbell's historical results were restated to reflect the sale of its European simple meals business in October 2013.) My projection implies adjusted fourth quarter EPS of \$0.49, up 14.0% from \$0.43 last year. Campbell will get a lift from an extra week in this fiscal year's fourth quarter; but management's guidance implies a fourth quarter revenue growth rate of 8.5%, which looks quite aggressive and is probably not achievable. The implied adjusted EPS, though also aggressive, is more within reach; but it would not be much of a surprise, if the company fell short of consensus EPS expectations.

Table 13
Campbell Soup Company
 Historical and Projected Income Statement: Fiscal 2011 to Fiscal 2015
 (\$ millions)

	Actual 52 Weeks 31-Jul-11	Actual 52 Weeks 29-Jul-12	Actual 52 Weeks 28-Jul-13	Projected 53 Weeks 2-Aug-14	Projected 52 Weeks 1-Aug-15
Net sales	7,143	7,175	8,052	8,225	8,400
Net sales growth	-6.9%	0.4%	12.2%	2.1%	2.1%
Cost of products sold	4,255	4,365	5,140	5,338	5,477
as % of revenues	59.6%	60.8%	63.8%	64.9%	65.2%
Marketing and selling expenses	909	941	947	946	941
as % of revenues	12.7%	13.1%	11.8%	11.5%	11.2%
Administrative expenses	577	580	677	559	563
as % of revenues	8.1%	8.1%	8.4%	6.8%	6.7%
Research and development expenses	120	116	128	123	126
as % of revenues	1.7%	1.6%	1.6%	1.5%	1.5%
Other expenses	10	11	29	30	30
Restructuring expenses	60	7	51	50	50
Total operating expenses	5,931	6,020	6,972	7,047	7,186
Earnings before interest & taxes	1,212	1,155	1,080	1,178	1,214
as % of revenues	17.0%	16.1%	13.4%	14.6%	14.4%
Interest expense	122	114	135	125	120
Interest income	10	8	10	8	6
Earnings before taxes	1,100	1,049	955	1,061	1,100
as % of revenues	15.4%	14.6%	11.9%	13.2%	13.1%
Taxes on earnings	351	325	275	308	330
Income tax rate	31.9%	31.0%	28.8%	29.0%	30.0%
Earnings from continuing operations	749	724	680	754	770
as % of revenues	10.5%	10.1%	8.4%	9.3%	9.2%
Earnings from discontinued operations	53	40	(231)	85	-
less earnings attrib. to noncontrol. interests	3	10	9	10	10
Net earnings attrib. to CPB shareowners	799	754	440	829	760
EPS - basic					
From continuing operations	\$ 2.28	\$ 2.30	\$ 2.19	\$ 2.43	\$ 2.52
From discontinued operations	\$ 0.16	\$ 0.12	\$ (0.74)	\$ 0.27	\$ -
Total EPS	\$ 2.44	\$ 2.43	\$ 1.46	\$ 2.70	\$ 2.52
EPS - diluted					
From continuing operations	\$ 2.26	\$ 2.29	\$ 2.17	\$ 2.41	\$ 2.49
From discontinued operations	\$ 0.16	\$ 0.12	\$ (0.73)	\$ 0.27	\$ -
Total EPS	\$ 2.42	\$ 2.41	\$ 1.44	\$ 2.68	\$ 2.49
Non-GAAP EPS	\$ 2.54	\$ 2.32	\$ 2.48	\$ 2.53	\$ 2.61
Wtd. avg. shares					
Basic	326	317	314	314	310
Diluted	329	319	317	317	313
Dividends	\$ 1.15	\$ 1.16	\$ 1.16	\$ 1.25	\$ 1.30

Table 14
Campbell Soup Company

Historical and Projected EBITDA, Cash Flow, Balance Sheet and Key Ratios: Fiscal 2011 to Fiscal 2015
 (\$ millions)

	Actual 52 Weeks 31-Jul-11	Actual 52 Weeks 29-Jul-12	Actual 52 Weeks 28-Jul-13	Projected 53 Weeks 2-Aug-14	Projected 52 Weeks 1-Aug-15
EBIT	1,212	1,155	1,080	1,178	1,214
Depreciation and amortization	268	262	407	350	370
EBITDA	1,480	1,417	1,487	1,528	1,584
Capital expenditures	(272)	(323)	(336)	(320)	(350)
Sale of assets	9	1	5	10	10
Acquisitions	-	-	(1,806)	(350)	
Sales of businesses	-	-	-	520	
Other	2	(1)	(17)	(10)	(10)
EBITDA after capital exp.	1,219	1,094	(667)	1,378	1,234
Cash paid for interest	(131)	(107)	(114)	(115)	(115)
Cash paid for taxes	(304)	(300)	(345)	(308)	(330)
Discontinued operations	53	40	(231)	85	-
Restructuring and impairment charges	63	10	447	50	50
Stock based compensation	98	87	125	90	125
Other items	(94)	(32)	16	(83)	(149)
Change in working capital	(36)	(8)	(258)	(300)	7
Exchange rates	49	(26)	(36)	(30)	(30)
Noncontrolling interests	10	2	3	5	5
Cash flow before dividends and other fin.	927	760	(1,060)	772	797
Dividends Paid	(378)	(373)	(367)	(393)	(403)
Change in debt	295	(257)	1,675	(513)	(94)
Treasury stock	(632)	(300)	(70)	-	(300)
Net cash flow	212	(170)	178	(133)	-
Interest expense	122	116	138	125	120
Interest coverage	9.9	10.0	7.8	13.1	12.0
Cash flows					
Operating activities	1,142	1,120	1,019	952	1,177
Investing activities	(261)	(323)	(2,154)	(150)	(350)
Financing activities	(700)	(920)	1,237	(905)	(797)
Effect of exchange rate	49	(26)	(36)	(30)	(30)
	230	(149)	66	(133)	-

Table 15
Campbell Soup Company

Historical and Projected Balance Sheet and Key Ratios: Fiscal 2011 to Fiscal 2015
 (\$ millions)

	Actual 52 Weeks 31-Jul-11	Actual 52 Weeks 29-Jul-12	Actual 52 Weeks 28-Jul-13	Projected 52 Weeks 2-Aug-14	Projected 52 Weeks 1-Aug-15
Balance sheet					
Cash and cash equivalents	484	335	333	200	200
Accounts receivable	560	553	635	676	690
Inventories	767	714	925	951	975
Net PP&E	2,103	2,127	2,260	2,250	2,220
Goodwill	2,133	2,013	2,297	2,300	2,300
Other intangibles	527	496	1,021	1,200	1,200
Assets held for sale	-	-	586	-	-
Other assets	288	292	266	300	300
TOTAL ASSETS	6,862	6,530	8,323	7,877	7,886
Other liabilities	2,690	2,842	2,524	2,290	2,336
Liabilities held for sale	-	-	136	-	-
Total debt	3,084	2,790	4,453	3,940	3,832
Common equity	1,088	898	1,210	1,646	1,717
TOTAL LIABILITIES AND EQUITY	6,862	6,530	8,323	7,877	7,886
KEY RATIOS					
NI from cont operations/net sales	10.5%	10.1%	8.4%	9.2%	9.2%
Net sales/average assets	1.09	1.07	1.08	1.02	1.07
Average assets/average equity	6.52	6.74	7.05	5.67	4.71
Return on average equity (cont.operations)	74.4%	72.9%	64.5%	52.8%	46.0%
Days receivable		28.2	30.4	30.0	30.0
Days inventories		60.5	71.0	65.0	65.0
Days other liabilities		174.9	142.9	120.0	120.0

My projections for fiscal 2015 assume only modest revenue growth of 2.1%, lower gross margin, but also lower marketing, selling and administrative expenses as a percent of revenue. Management expects that cost of sales inflation of 3%-4% will not be fully offset by ongoing expense reduction efforts, which are expected to reduce product costs by 3%. Thus, it anticipates a headwind of up to 1% in gross margin. My model assumes only a 30 basis point reduction in gross margin for fiscal 2015.

My assumption for administrative expenses as a percent of sales – a decline of 10 basis points to 6.7% – may also be optimistic, since the company says that stock-based compensation was unusually low this year and will likely rise in fiscal 2015.

I also assume flat restructuring expenses, a slight decline in interest expense (in line with the assumed reduction in debt) and a slightly higher tax rate (30% vs. 29%). All of this translates into adjusted earnings per share of \$2.61, which is up 3.2% from projected fiscal 2014 adjusted EPS of \$2.53. That growth rate is below the company's long-term target of 5%-7% adjusted EPS growth, but consistent with management's current thinking.

At the analyst meeting, management said that it expects that the company's performance in fiscal 2015 will be below its long-term targets. It also said that additional portfolio reconfiguration may be required

in order to get performance back on track. If so, it is conceivable that Campbell will make one or more major announcements in fiscal 2015, including an additional acquisition, a new restructuring initiative or the sale of one or more of its product or business lines. If it does, my fiscal 2015 projections could end up in the waste basket. So stay tuned.

Valuation

Table 16
Campbell Soup Company
 Valuation Metrics (based upon August 5, 2014 closing share price)

Recent price	\$ 41.81	
52-week range	\$ 38.30	- \$ 48.08
Dividend	\$ 1.25	
Yield	3.0%	
Dividend payout	55.1%	
Shares outstanding	314	million
Market cap.	13,125	million
	EPS	PE
ttm (GAAP)	2.27	18.4
ttm (non-GAAP)	2.47	16.9
2014E	2.53	16.5
2015E	2.61	16.0
	Per Share	Multiple
Free cash flow	\$ 5.60	7.5
Book value	\$ 3.85	10.8
Tangible book	\$ (6.72)	NM
Sales (ttm)	\$ 31.14	1.3

Campbell's shares are currently valued at 18.4 times GAAP earnings per share and 16.9 times adjusted or non-GAAP EPS. On a free cash flow basis, the stock looks cheap at a multiple of 7.5. (I define free cash flow as net income from continuing operations plus depreciation minus capital expenditures.) Both book value and tangible book value per share are less meaningful for Campbell than for most other companies, primarily because the company has bought back shares consistently for more than two decades. Its equity book value is low because its assets and liabilities are carried at historical book values, while shares are bought back at market value. The same is true for tangible book value per share, which in Campbell's case is negative.

Table 17
Campbell Soup Company
 Comparable Valuation Metrics for Peers

Ticker	Company Name	Latest Price	TTM EPS	TTM P/E	Div. Share	Div. Yield	Market Cap (\$B)	Book Val /Share	Price-to -Book	2014 EPS	2014 P/E	2015 EPS	2015 P/E
ADM	Archer-Daniels-Midland	48.56	2.02	24.0	0.96	2.0%	31.8	30.57	1.6	3.00	16.2	3.45	14.1
CAG	ConAgra Foods	30.50	0.70	43.6	1.00	3.3%	12.9	12.46	2.4	2.25	13.6	2.40	12.7
CPB	Campbell Soup	41.81	2.27	18.4	1.25	3.0%	13.1	5.10	8.2	2.53	16.5	2.61	16.0
DF	Dean Foods)	15.51	3.50	4.4	0.28	1.8%	1.4	7.24	2.1	0.55	28.2	1.05	14.8
FDP	Fresh Del Monte Prod.	30.11	(0.26)	NM	0.50	1.7%	1.7	32.49	0.9	2.55	11.8	2.75	10.9
GIS	General Mills	50.88	2.83	18.0	1.64	3.2%	31.2	10.67	4.8	3.00	17.0	3.25	15.7
HAIN	Hain Celestial Group	83.06	2.67	31.1	0.00	0.0%	4.2	31.00	2.7	3.15	26.4	3.70	22.4
HRL	Hormel Foods Corp.	45.32	2.09	21.7	0.80	1.8%	12.0	13.28	3.4	2.10	21.6	2.55	17.8
HSY	The Hershey Company	88.52	3.71	23.9	1.94	2.2%	19.6	6.97	12.7	4.05	21.9	4.50	19.7
K	Kellogg Company	61.40	5.08	12.1	1.84	3.0%	22.1	10.42	5.9	4.00	15.4	4.20	14.6
KRFT	Kraft Foods Group Inc.	54.21	4.04	13.4	0.56	1.0%	32.2	18.66	2.9	3.15	17.2	3.45	15.7
MKC	McCormick & Company	66.39	2.84	23.3	1.48	2.2%	8.6	15.12	4.4	3.30	20.1	3.55	18.7
SAFM	Sanderson Farms	92.79	8.62	10.8	0.80	0.9%	2.1	32.43	2.9	10.25	9.1	8.30	11.2
SJM	Smucker (J.M.)	99.37	5.46	18.2	2.32	2.3%	10.1	49.46	2.0	6.00	16.6	6.40	15.5
TR	Tootsie Roll Industries	26.89	1.00	26.8	0.32	1.2%	1.6	11.13	2.4	1.10	24.4	1.20	22.4
TSN	Tyson Foods	36.74	2.71	13.6	0.30	0.8%	12.8	17.82	2.1	2.85	12.9	3.25	11.3
UN	Unilever	40.76	1.80	22.7	1.58	3.9%	123.3	6.54	6.2	2.20	18.5	2.40	17.0
				20.4		2.0%	20.0		4.0		18.1		15.9

Data obtained from MSN, Yahoo! Finance, Barron's and Lark Research estimates. All security prices in this report are as of the close of trading on August 5, 2104

Campbell's stock trades at comparable earnings multiple to its peers. Its trailing twelve month GAAP earnings multiple of 18.4 is below the industry average of 20.4. Its forward non-GAAP earnings multiples of 16.5 for projected 2014 earnings and 16.0 for projected 2015 earnings compares with the peer group averages of 18.1 and 15.9, respectively, as shown in Table 17 on the next page.

Campbell pays a \$1.25 annual dividend, which equates to a 3.0% dividend yield at the current quote. This is modestly more attractive than the peer group average of 2.0%. That extra yield helps compensate for a projected earnings growth rate that is below its peer group (3.2% for Campbell vs. the peer group average of 13.2%).



From a technical perspective, as shown in the weekly stock price chart for Campbell on the previous page (courtesy of StockCharts.com), Campbell's stock has recently dropped below both its 10 week (50 day) and 40 week (200 day) moving averages. The stock is therefore looking for support. As long as it does not break below the most recent low of \$37.50 (established in mid-November 2013, after it reported disappointing fiscal 2014 first quarter results), the uptrend would still be considered intact. If it breaks below \$37.50, traders will be hoping that the stock finds support in the low \$30s or (most likely) around \$30.

Over the chart's time frame (since April 2011), Campbell has moderately underperformed the S&P 500 (by about 10 percentage points), but it has slightly outperformed the Dow Jones Food Products Industry Group. Both of these relative price performance relationships are shown in the bottom two panels of the chart above.

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