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EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

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Campbell Soup (CPB) EQ Review Update-10/18 Quarter

Current EQ Rating*	Previous EQ Rating
3-	3+

*For an explanation of the EQ Review Rating scale, please refer to the end of this report

We are lowering our rating on Campbell Soup (CPB) from a 3+ (Minor Concern) to a 3- (Minor Concern).

CPB reported adjusted EPS of $0.79 per share, down 14% from a year ago but 10 cps better than what analysts were expecting. The $0.79 was also penalized by 4 cps from a change in revenue recognition accounting which accelerated the recognition of promotional expense. This is expected to penalize profits in the first half of the fiscal year but turn positive in the back half with an immaterial impact on the full fiscal year. The quarter was also hit by 3 cps in higher costs from production issues at its Findlay plant. Still, management affirmed its full-year guidance.

We note that CPB is a turnaround story and for the immediate future its stock price has been and will likely continue to be driven more by headlines about its relationship with activist investor Third Point and the planned divestiture of its international business. Large structural transactions will make the company's reported earnings volatile and difficult to analyze the impact of quality of earnings issues. With that in mind, we note the following observations about the quarter:

- While clouded by recent acquisitions, working capital trends remain positive with no obvious concerns regarding receivables, inventories and payables.

- CPB recorded an increase of $140 million of goodwill related to the 3/28/18 Snyder's-Lance acquisition to offset, among other things, a $134 million decline in the estimated value of trademarks and $52 million in customer relationships. This represents over 2% of the acquisition price and we wonder if this is foreshadowing a future write-down of this goodwill.

- The restructuring charges are expanding. CPB has undergone several phases of restructurings over the years which continually get extended and expanded. The estimate for total costs stated in the 7/18 10-K was $570-$605 million. This was increased to $640-$685 in the 10/18 10-Q. Large, expanding charges always cast doubt on the quality of adjusted EPS numbers as ongoing operating expenses can be shuffled into the charges and dismissed.

Explanation of EQ Rating Scale

6- "Exceptionally Strong"	Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises
5- "Strong"	Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.
4- "Acceptable"	Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement
3- "Minor Concern"	Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.
2- "Weak"	Indicates the company's recent reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.
1- "Strong Concerns"	Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely.

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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