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Campbell Soup (CPB)-EQ Review

Our review of CPB's recent results turned up a few minor points of concern. While the company struggles with all the fundamental problems faced by the packaged food group, overall, we consider the company's earnings to be of relatively high quality compared to its peers.

On the surface, CPB's receivables and inventory accounts jumped noticeably in the 4/18 quarter, but this was all due to the 3/26/18 acquisition of Snyder's-Lance. The company gives a detailed breakdown not only of the value of the accounts at the time of the Snyder's deal, but also the amount of sales generated by the acquisition in the quarter. This allows us to make adjustments to facilitate the analysis of working capital accounts. While the company did acquire Pacific Foods on 12/12/17, this did not have a material impact on the 4/29 quarter's working capital ratios.

After adjustment for the Snyder's acquisition, accounts receivable days of sales (DSOs) were roughly in line with the year-ago period

	4/29/2018	1/28/2018	10/29/2017	7/30/2017	4/30/2017
Accounts Receivable DSOs	31.1*	30.9	32.3	33.2	30.4

**Adjusted for Snyder's Lance acquisition.*

The average DSO of the packaged food group (KHC, MDLZ, HSY, CAG, K, CPB, GIS, SJM) was approximately 34 using the most recently reported quarters. As such, CPB appears to have very strong receivables management and thus relatively little room to boost cash flow from collections.

Inventories adjusted for the Snyder's deal declined about 3 days from last year's quarter

	4/29/2018	1/28/2018	10/29/2017	7/30/2017	4/30/2017
Inventory DSIs	56.6*	56.1	66.3	79.8*	60.8

**Adjusted for Snyder's Lance acquisition (assuming 40% gross margins)*
***Adjusted for large pension mark-to-market in COGS*

The group average DSI using the most recently reported quarter is approximately 65, implying CPB has efficient inventory management and therefore little room to boost cash flow from improvement in that area.

Accounts payable days-of-sales (DSPs) rose approximately 4 days over the year-ago quarter after our adjustment for the Snyder's deal

	4/29/2018	1/28/2018	10/29/2017	7/30/2017	4/30/2017
Accounts Payable DSPs	47.8*	45.6	47.2	58.9**	43.6

**Adjusted for Snyder's Lance acquisition (assuming 40% gross margins)*
***Adjusted for large pension mark-to-market in COGS*

This continues a multi-quarter trend of meaningful increases in DSPs which is consistent with all the other companies in the group. Our medium-term concern for the group is the impact to cash flow growth when the trend of rising payables reverses. However, we note that CPB's DSP is well below the industry average of over 75. In addition, its approximate 4-day increase in payables versus the year-ago quarter is roughly half the average increase in DSPs for the group. This implies CPB has not leaned as hard on its suppliers as most of its peers.

The company wrote off the final $540 million in goodwill associated with the Campbell Fresh unit

The write-off was a result of several factors, including certain private label customers informing the company that they would begin in-sourcing production, reduced forecasts at the Garden Fresh Gourmet business, and below-expected performance of the Bolthouse Farms business unit. An additional $143 of intangible assets related to these units was also

written off. In light of these write-offs, we found the following downbeat commentary in the 4/18 10-Q to be notable:

> *"Through the third quarter of 2018, our performance has been below our expectations. This lower-than-expected performance was driven by increased cost inflation, primarily higher than anticipated increases in transportation and logistics costs, as well as increased costs in Campbell Fresh, under performance with a key customer, and slightly higher promotional spending. We expect these factors to continue through the remainder of 2018. We also expect margin performance to decline in 2019 due in part to the anticipated impact of import tariffs and the ongoing increases in transportation and logistics costs."*

Acre limited partnership

We note that in February of 2016, CPB made a capital commitment of up to $125 million to form a limited partnership known as Acre. The purpose of the partnership is to make capital investments in "innovative" new food-related companies. However, CPB is the sole limited partner of Acre, it owns a 99.8% interest, and it has been deemed the primary beneficiary - hardly an "arms-length" deal. Acre is considered a variable interest entity (VIE) and is consolidated on CPB's financial statements. So far, CPB has funded $74 million of its $125 million commitment which Acre has used to make investments. It is unclear what the ultimate goal of these investments is but on the surface, this deal reminds us of a common practice used by many pharmaceutical companies of setting up research partnerships with capital contributions which are later bought back when the new technology is fully-developed. This has the effect of keeping research spending off the income statement. We are not sure if something similar is going on with Acre, but we consider the deal to be unusual.

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