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Campbell Soup Company in 2004 (A)

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This case was prepared from various referenced sources and was developed solely for classroom discussion; the case is not intended to serve as an endorsement, source of primary data or an illustration of either effective or ineffective handling of a business situation. The author gratefully acknowledges information and insights provided by Mr. Len Griehs, Vice President of Investor Relations for Campbell Soup and Dr. Thomas Myers of the University of Richmond.

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CAMPBELL SOUP COMPANY - 2004

As fiscal 2004[1] began, Doug Conant, the President and CEO of the Campbell Soup Company could take pride in the results of his 3-year transformation plan instituted in fiscal 2001 to revitalize the company. The key initiatives of the plan were to restore revenue and profitability growth and stimulate shareholder wealth.

Conant, who became President and CEO in January of 2001, called the plan, "the single most comprehensive commitment to revitalization ever undertaken in the 132-year history of Campbell Soup Company."[2]

The financial results achieved in fiscal 2002, the first year of the plan, were a mixed bag. Although net sales grew 6% to $6.1 billion, net earnings declined 19% to $525 million. This decline was driven by a 21% ($183 million) increase in marketing and sales spending to revitalize Campbell's strong brands.

However, in fiscal 2003, net sales grew 9% to $6.7 billion (currency and acquisitions accounted for 5% of the increase, 3% of the increase came from mix and volume and 1% from higher selling prices.) Net earnings grew 14% to $595 million.

The transformation plan also impacted Campbell performance on Wall Street. From June 2001, to July 2003, the stock price had risen from $22 to $26/share. In 1997, the stock had traded at a high of $67/share.

Fiscal 2004 presented many challenges for Conant relative to the continued success of the turnaround plan

1.) Sustained revenue and profitability growth in spite of a sluggish U.S. packaged food industry.
2.) Ability to stem the decline of the condensed soup business.
3.) How aggressive could Campbell be with pricing especially in its canned soup business.
4.) Shift of power in the buyer chain from manufacturers like Campbell to grocery retailers such as Kroger and Wal Mart.
5.) Slow development of becoming a truly global competitor.
6.) Role Campbell should play in the merger/acquisition game.

U.S. PACKAGED FOOD INDUSTRY

The U.S. Packaged Food Industry includes large companies such as Campbell Soup, Conagra Foods, General Mills, H.J. Heinz, Kellogg, and Kraft. In 2003, total industry net sales were $355 billion, up 1.7% from 2002. From 1993 to 2003, net sales exhibited an average growth of only 1.5% per year.

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[1] Fiscal year runs from August 1 to July 31st

[2] 2001 Annual Report

Factors contributing to this sluggish growth included:

1.) Declining Pricing Power of Companies – During the late 80's and into the early 90's, food companies were able to price products in excess of inflation, especially those with strong brands. For many years, this pricing occurred without improvement in product quality

2.) Growth of Private Label Market Share – During this period, the quality of private label (store brands) improved. As the price of branded products increased, the spread in pricing between branded and private label approached 30% in many food categories. This combined effect resulted in the average market share of all private label food categories grew to 14.9% in 2002.

3.) Lack of New Product Innovation – Many new products introduced in the 90's were low fat or no fat versions of existing products. Several of these products failed because of a lack of flavor/taste. During this low fat/no fat trend, new product introductions declined 10 to 20% per year for five consecutive years, before increasing slightly in 2001.

4.) Shift in Buyer Chain Power to Food Retailers – The major food manufacturers dominated the buyer chain in the 80's and early 90's. Large retail chains such as Kroger, Giant, Albertson's and Food Lion relied on the manufacturers for logistics and merchandising services. This resulted in the manufacturers controlling the shelf space in stores; however in the early 90's, power in the buy chain shifted to retailers, driven in part by consolidation (merger/acquisition activity). This shift allowed retailers to impose slotting fees on manufacturers for shelf placement of new product introductions. Such fees approximated $5,000 - $10,000 per item, per store. In 2002, slotting fees averaged approximately 2% of manufacturer sales, 6% of marketing spending and 13% of total trade spending.

5.) Decreased Advertising Spending – From 1996 to 2002, the major food companies reduced advertising spending from an average of 5.0% of net sales to 4.7%. In essence, the companies reduced efforts to communicate product benefits directly to consumers. This reduction in part was caused by increased trade spending.

6.) Growth of Food Service Channel (Away from Home Dining) – The food service channel consists of food that is eaten away from home; specifically in restaurants and cafeterias. Over the past 20 years, growth in this channel increased because of an increase in dual income families and the proliferation of casual dining and quick service restaurants. From 1990 to 2001 the number of casual dining and quick service restaurants grew 21% to approximately 400,000 units.

Wal Mart Factor

A major factor that has and will impact net sales growth in the food industry is the emergence of Wal Mart as a power food retailer. In the 90's, Wal Mart introduced its supercenter strategy, which involved the building of huge stores selling groceries as well as traditional products. From 1994 to 2003, Wal Mart's total food sales grew from approximately $10 billion to $45 billion and represented in 2003 approximately 12% of all food industry sales. By 2006, this total is projected to be approximately 20%, driven by the opening of an additional 865 supercenters and 120 new all-food format stores.

This growth occurred because Wal Mart sells its products at a 10 to 20% discount versus traditional grocery stores. They can do this because of huge supply chain cost advantages (logistics and operations). Also, Wal Mart does not charge slotting allowances and dictates that manufacturer's promotional dollars be directed toward the end consumer.

The emergence of Wal Mart as a power food retailer has drastically impacted the growth of major food manufacturers. Wal Mart usually carries only the market share leader or #2 brand in each product category. Therefore, manufacturers with lower market shares will lose overall share as Wal Mart grows. Wal Mart also imposes tight supply chain restrictions forcing inventories to reach only 1 to 2 weeks.

Merger/Acquisition Activity

Similar to other industries, the food industry witnessed an increased level of consolidation in the 1990's that carried over into the 21st century. Since many of the large companies compete in several food categories, acquisitions that were niche focused or targeted to fill specific areas of portfolios were common. An example was the Heinz purchase of Vlasic Foods in 2001 to compliment its condiment business.

There has also been a significant number of divested businesses and spin-offs of non-strategic businesses. The strategy here was to focus on core brands that enjoy both higher margins and market share positions.

Food companies benefit from acquisitions in that both revenue and earnings can increase. Earnings growth flows from synergies between the combined businesses, such as the consolidation of supply chains and sales forces, closing of plants and lower selling, general and administrative expenses (SG&A). For example, General Mills was expected to derive 15% of its total net income in 2002 as the result of synergies rising from its acquisition of Pillsbury in 2000. Additional consolidation in the food industry is likely to occur in 2004 and 2005, as companies will have reduced debt on their balance sheets. Also, if the stock market continues its strong 2003 growth, more acquisitions will occur using stock as a payment method instead of cash/debt.

Several companies including Heinz, Campbell Soup and Kellogg are considered to be acquisition targets. Heinz is one of the few companies with strong market share positions in most of its categories without a large family or trust ownership to preclude a sale. Campbell Soup, on the other hand, has a large family/trust ownership.

FOOD INDUSTRY COMPETITORS

Most large U.S. food companies manufacture and market products in several segments or categories including candy, baking, canned, frozen, dairy, cereal, meats and pasta. Each category or segment is measured separately in terms of revenue, profitability and market share, although companies in most cases do not provide a full financial breakout for each segment.

1.) General Mills

General Mills competes in several segments/categories including cereal, yogurt, pasta, snacks, baking supplies and canned soup. Total net sales in 2002 were $8.36 billion up 2.5% from 2001. Sales have nearly doubled as a result of the acquisition of Pillsbury in 2000.

The General Mills portfolio of brands includes Cheerios, Yoplait, Betty Crocker, Pillsbury, Green Giant and Progresso. In 2002, 67% of its products held the #1 market share position in their respective categories trailing only Hershey and Kraft.

General Mills through its Progresso brand held a 12.9% market share position in the canned soup category in 2002, compared to 12.3% in 2001 and 11.9% in 2000. (Exhibit 4) This gain reflected an aggressive T.V. advertising campaign depicting Progresso as a superior product versus Campbell. Also impacting this gain was the heavy promotional dollars spent by Progresso. In 2002, 38% of its soups were sold on promotion, compared to 31% in 2000. It should be noted that Progresso competes only in the RTS (Ready to Serve) soup segment.

In 2002 the net sales split for General Mills was 70% U.S. retail, 20% food service and 10% international. The food service business, which is comprised primarily of restaurant sales, offers some risk in times of economic downturn as consumers eat more meals at home. General Mills has a relatively small international presence, thereby negating the effects of currency translation on financial performance.

2.) Con Agra

Con Agra is a highly diversified company with operations in packaged foods, meat processing and agricultural products (feeds/grains). Brands include Hunts, Chef Boy R Dee, Banquet and Butterball.

Total net sales in 2002 were $28 billion, up 3% from 2001. However net margins have averaged only 2.7% from 1997 to 2002, which is drastically lower than the other major food companies. The net margin performance is reflective of the commodity status of its meat processing and agricultural products; in addition Con Agra's packaged foods brands hold mostly the #2 or #3 market share positions in their respective categories.

One of these brands, Healthy Choice, holds a strong #2 position (20.5% market share) in the prepared frozen foods segment. In the early 90's, in an attempt to extend the Healthy Choice brand, Con Agra introduced a line of canned RTS (Ready to Serve) soups. This line, which is targeted towards a health/wellness consumer, was developed with lower levels of sodium and fat than competitive products. Sales of this product line have grown very slowly to $75 million in 2002, representing a market share of 2.5% (Exhibit 4).

Very little of Con Agra's net sales are derived outside the U.S. (less that 5%); however, through its meat processing and agricultural operations, the company generated food service sales of 37% in 2002, again representing some risk during an economic downturn.

3.) <u>H.J. Heinz</u>

In 2002, Heinz generated net sales of $7.6 billion, down 14.1% from 2001. The sharp decrease resulted in part from the spin off of its U.S. tuna (Starkist), pet food, baby food and private label soup businesses to Del Monte in 2002. Heinz brands include Ore Ida, Rosetto, Weight Watchers, Classico and Bagel Bites.

The Heinz business mix is unique in that 55% of its net sales in 2002 were from international markets where it sells soups, beans and sauces. It enjoys the #1 market share position in the U.K. canned soup segment, far outdistancing Campbell. Heinz European net sales were $3.6 billion in 2002, with $1.5 billion coming from the U.K.

In 2002, 23% of Heinz net sales ($1.4 billion) were in food service, where it sells condiments such as ketchup, mustard and pickles to restaurant chains such as McDonalds, Burger King and Olive Garden.

Until the spin off of its canned soup business to Del Monte, Heinz was the leading manufacturer of private label canned soups in the U.S. Typically, it would contract with large grocery chains such as Kroger to manufacture canned soups using the chain's label. In 2002, it was estimated that private label sales in the canned soup segment represented approximately $400 million or a market share of 13.5%. Private label holds #2 market share position in the canned soup category. (Exhibit 4)

CAMPBELL SOUP COMPANY

History

Campbell was founded in 1869 by Joseph Campbell and was originally a jam and jelly company. In 1897, a Campbell chemist, John T. Dorrance, developed a process for canning soup in condensed form (water removed). This resulted in lower production and distribution costs.

Dorrance purchased the company in 1900 and by 1905, soup sales totaled 40,000 cases per week. Ownership of the company was solely held by the Dorrance family until 1954, when the company went public. In 2004, the Dorrance family through various trust agreements still holds majority control of the company.

Management of the company shifted from the Dorrance family to outsiders beginning in the 1950's. Campbell's first outside CEO, William Murphy was instrumental in diversifying the company via acquisitions including Swanson frozen foods, V-8 Vegetable Juice, Pepperidge Farm bakery products and Godiva chocolate. These acquisitions, combined with Campbell's domination of the U.S. condensed soup market, made it a formidable growth company in the 1960's.

When Murphy retired in the early 1970's, Harold Schaub, whose reputation was that of an operations guru, succeeded him. During Schaub's tenure, considerable capital resources were spent on building new plants and updating older facilities. The company also spent considerable R & D dollars on the continued development of RTS (ready to serve) soups culminating in the introduction of the Chunky Soup line.

The Chunky Soup introduction was important for Campbell in that RTS soups provided a strong compliment to its condensed soup varieties. The main benefit of RTS soups was convenience in that the consumer did not have to add water. Also an added benefit was its product positioning – "soup as a meal, soup so thick, you can eat it with a fork."

CAMPBELL IN THE 1980's (GORDON MCGOVERN)

Gordon McGovern became President and CEO of Campbell in 1980, after having served as President of its Pepperidge Farm subsidiary. McGovern's background was that of a risk taker who encouraged creativity and a willingness to innovate. His emphasis was on new product development, marketing and a strong focus on the consumer.

Under McGovern's leadership, the company was organized into several strategic business units with a clear shift from an operations to a marketing orientation. In addition, significant resources were allocated to R & D in order to promote a steady flow of new products.

By 1985, McGovern's strategy resulted in Campbell becoming the U.S. leader in new product introductions in the food industry. Among the products introduced were Le Menu frozen dinners, Prego spaghetti sauce, Great Starts breakfasts, and Home Cooking soups. Campbell's marketing budget grew from $250 million in 1981 to $550 million in 1989, with a corresponding increase in advertising spending. McGovern was named Advertising Age's Adman of the year in 1982.

In addition to internal growth via new products, McGovern's strategy was to acquire small, fast growing food companies in areas where synergies could be developed. His goal was to add $200 million in sales every 2 years via acquisitions.

During McGovern's tenure, Mrs Paul's Kitchens, a manufacturer of frozen prepared seafood, Juice Bowl Products, a producer of fruit juices and a 20% interest in Arnott's LTD, an Australian manufacturer of bakery products, were acquired.

McGovern's leadership and strategy produced varying results. By 1985, net sales had increased 31% to $3.7 billion and net earnings by 47% to $191 million. However from 1985 to 1989, Campbell's earnings fell short of McGovern's 15% targeted growth objectives. This caused speculation that Campbell had become so focused on new product introductions, that cost control had become neglected. As a result, Wall Street was not enamored with the financial performance of Campbell.

CAMPBELL IN THE 1990's (DAVID JOHNSON/DALE MORRISON)

After the retirement of Gordon McGovern, David Johnson became the President and CEO of Campbell in 1990. Johnson, a turnaround specialist, had come from Gerber Foods where he orchestrated spectacular growth in shareholder value, with stock price tripling during his 27-month tenure.

Johnson came to Campbell with the prime purpose of building shareholder wealth; specifically providing dividend growth and long-term stock appreciation. To accomplish this, Johnson acted quickly to cut costs and divest underperforming business.

During his first 18 months, Johnson directed the sale of 8 plants, the shutdown of 12 plants worldwide and a workforce reduction of 8000 people. In 1993 and 1996, additional restructuring plans were implemented by Johnson, which resulted in more plant closures.

Johnson also acted quickly to divest a total of 26 businesses with below average profit margins. These divestitures included many of the businesses acquired in the 1980’s under the direction of McGovern.

With the turnaround well in progress, Johnson began an acquisition program targeted toward businesses with higher profit margins. Many of the acquisitions were intended to grow Campbell’s international business. Specifically the acquisition of the Erasco Group, the largest soup brand in Germany, was made in 1997 to strengthen the overall soup business in Europe. Also Campbell purchased a larger interest (70%) in Arnott’s.

Johnson’s biggest and somewhat controversial acquisition occurred in 1995 when Campbell purchased Pace Foods for $1.12 billion. Pace was the leading U.S. manufacturer of Mexican style sauces (salsa). The acquisition was controversial because Campbell paid a multiple of 20 times earnings and 5 times sales, thereby adding a significant amount of goodwill to its balance sheet. Campbell felt that the salsa category, which grew at approximately 15% from 1988 to 1993 represented an opportunity to help balance the slow growth of its soup business.

Johnson set very aggressive financial objectives for Campbell in order to effectuate a rapid turnaround. The objectives included a 20% annual increase in earnings, return on equity and cash return on assets. Absent from these objectives was targeted revenue increases which was difficult to achieve because of the slow growth of the soup business.

In order for Johnson to accomplish the 20-20-20 objectives on an annual basis, the following action was taken:

1.) Aggressive cost reduction both in COPS (cost of product sold) and SG & A (selling, general and administrative) expenses
2.) Reduction of assets via sale and closure of plants
3.) Share repurchases to drive a higher return on earnings per share (EPS) and return on equity (ROE)
4.) Raising prices across the product portfolio especially in the slow growth, canned soup category

The financial performance of Campbell Soup during Johnson's 1990 to 1997 tenure is illustrated in Exhibit 2. Net earnings grew from $402 million in 1991 to $713 million in 1997, peaking at $802 million in 1996. Net earnings per share grew from $1.58 in 1991 to $3.22 in 1996 and net earnings as a percent of net sales more than doubled from 1991 to 1997.

As a result of this impressive financial growth, Wall Street became very bullish regarding Campbell stock. During fiscal '96 alone, the share price rose 43% to a record $67/share. From 1990 to 1997, Campbell significantly outperformed both the S&P 500 and all other food companies in total return to its shareholders.

DALE MORRISON (1997-2000)

David Johnson retired from his President and CEO positions in July 1997 but remained as chairman of Campbell's board of directors. He was succeeded by Dale Morrison, who had been President of the Pepperidge Farm subsidiary. Morrison had engineered a turnaround at Pepperidge, resulting in double-digit gains in net sales and earnings during his 2-year tenure.

Morrison's strategies were in many respects a continuation of Johnson's. However, unlike Johnson, he targeted a very aggressive objective of increasing net sales from 8 to 10 percent on an annual basis. To accomplish this, he sought to focus growth on Campbell's more differentiated brands including RTS Soups, Pepperidge Farm goldfish and Milano cookies, and Prego/Pace sauces. He wanted growth to come from unit volume increases rather than from pricing. His plan also included a significant increase in advertising spending.

Morrison continued Johnson's strategy of restructuring Campbell's business portfolio. In late 1997, Campbell's spun off seven (7) low growth businesses with combined sales of $1.4 billion. The spin-off businesses were rolled into one stand-alone publicly traded company, Vlasic Foods International. Among the businesses were Campbell's frozen food operations (Swanson), its condiment business (Vlasic) and the Swift Armour meat operation in Argentina. Swift Armour was the major supplier of the beef used in Campbell's canned soup products. The strategy behind the spin off was to allow Campbell to focus on its most profitable businesses, while shedding low margin contributors.

The Vlasic spin-off achieved the desired financial results for Campbell; however the stand-alone Vlasic business performed poorly with its share price declining from a high of $22.75 at the inception of the spin-off to as low as $2 in fiscal 2000.

In 1998 and 1999 Morrison sold other Campbell businesses including Delacre, its European biscuit business. He also divested the company's can making assets, realizing approximately $125 million in the sale. These divestitures and the Vlasic spin-off allowed Campbell to implement a share buyback program to repurchase 8% of the company's stock between 1999 and 2001. This strategy, which originated in the Johnson era, was designed to boost both earnings per share (EPS) and return on equity (ROE).

Morrison's biggest challenge was to grow a rapidly declining condensed soup segment that had decreased in market share from 80 percent in 1993 to 74 percent in 1997; the share loss was to lower priced, private label brands. To regain market share, Morrison decided not to increase prices in 1998 and 1999. During Johnson's tenure, pricing was increased 3 to 7 percent annually. He also eliminated the practice of quarter end promotions to retailers to stimulate sales. To counter these moves, he significantly increased advertising spending.

The decisions regarding pricing and quarter end promotions would negatively impact Campbell's financial performance. Net sales decreased approximately 5% from fiscal 1998 to 1999. More dramatically, the stock price plunged from $62 per share in early 1998 to below $30 per share in late 1999. However, a majority of this decline mirrored overall S&P performance during this period.

In March of 2000, Morrison resigned and was replaced by Johnson, who agreed to run the company until a permanent successor could be found.

ENTER DOUG CONANT – CAMPBELL IN THE 2000's

Doug Conant became President and CEO of Campbell in January 2001. He had been president of Nabisco Foods where he had revived businesses such as Planters and Lifesavers through product reformulation and packaging innovation.

Conant's prime challenge was to set new direction for Campbell and restore shareholder wealth. To accomplish this, he conducted a comprehensive study of the company and developed a transformation plan (Exhibit 1), which was approved by the Campbell board in July 2001. The goal of the plan was "to re-energize a great company, its brands and its people."[3] The transformation plan was modified slightly in fiscal 2003. (Exhibit 1)

CONANT'S MAIN STRATEGIC INITIATIVE – REVITALIZE U.S. SOUP

Campbell has dominated market share in the canned soup category since the company was founded. However, market share declined from 70.8% in 2000 to 68.6% in 2002 as both private label and Progresso shares have grown (Exhibit 4).

Campbell competes in two (2) canned soup segments, condensed and RTS (ready to serve). The condensed segment is Campbell's biggest and remains its most profitable product line. Market share of this line peaked in 1970 and has declined since. Part of the decline was a cannibalization factor, i.e. – the introduction by Campbell of its Chunky Soup, RTS line. Other factors include a changing consumer, convenience (having to add water), and higher prices.

[3] 2001 Annual Report

While condensed soups declined, RTS soups have exhibited strong growth since the 1970's. From an industry perspective, sales of RTS soups exceeded condensed soup beginning in 1999. In 2002, RTS sales approximated $1.7 billion versus $1.36 billion for condensed.

To revitalize U.S. Soup sales, Conant initiated the following programs.

1.) Quality Improvements – Cold blending technology was implemented which enhanced both flavor and texture; also provided a source of competitive advantage.
2.) Reformulation - Upgrades to more than 80% of condensed soup varieties
3.) New Product Introductions – New varieties of Campbell's Select RTS brand, targeted versus Progresso; also the Soup At Hand line which offers microwave ability and portability
4.) Increased Advertising – A substantial increase especially in the Chunky Soup line
5.) Easy Open Cans – Convenience via non-use of a can opener

During fiscal 2002, the first year of the transformation plan, condensed soup net sales in the U.S. declined 5%; however, RTS sales improved by 9%. During fiscal 2003, condensed net sales declined 6%, while RTS increased by 8%. With 2 years of declining condensed soup sales, fiscal 2004 promised to be a key year in the implementation of Conant's transformation plan.

EXHIBIT 1

Key Strategic Initiatives of Campbell Soup Transformation Plan*

FISCAL 2001

1.) REVITALIZE U.S. SOUP
2.) STRENGTHEN THE BROADER PORTFOLIO FOR PREDICTABLE VOLUME AND PROFIT GROWTH
3.) BEGIN TO BUILD NEW GROWTH AVENUES
4.) DRIVE A QUALITY AGENDA WHILE CONTINUING TO DRIVE PRODUCTIVITY
5.) SUBSTANTIALLY IMPROVE ORGANIZATIONAL EXCELLENCE AND VITALITY

From fiscal 2001 to fiscal 2003, the plan was modified slightly

FISCAL 2003

1.) REVITALIZE CORE NORTH AMERICAN THERMAL BUSINESS
    a. U.S. SOUPS
    b. BEVERAGES, SAUCES AND SIMPLE MEALS
2.) STRENGTHEN THE BROADER PORTFOLIO FOR CONSISTENT SALES AND EARNINGS GROWTH
3.) CONTINUALLY IMPROVE PRODUCT AND PACKAGE QUALITY
4.) DRIVE TOTAL SYSTEM PRODUCTIVITY
5.) BUILD ORGANIZATIONAL EXCELLENCE AND VITALITY

* source – Company Annual Reports