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Jupiter Market Comment by James Clunie, Head of Strategy, Absolute Return

Mind the Moat! Campbell soup revisited

We started shorting Campbell Soup in the strategy back in 2013 and I wrote about our short position during 2014. Since then, the size of our short position has waxed and waned with our response to newsflow and the movement of the share price. We're still modestly short the stock as I write, but the share price is much lower than before.

When we initiated our short position, the general reaction was pretty much as follows: "Guys, you must be crazy! Don't you know that food stocks like Campbell are 'growth compounders' with strong brands that serve as defensive 'moats'?". To me, though, Campbell simply looked like an expensive stock with unconservative accounting and decelerating sales growth. Effectively, there were two competing narratives around Campbell Soup, and its ilk.

Soon after shorting, the stock price rose, even as the company declared sales growth that was below expectations. This was interesting. Our thesis seemed right (sales growth was disappointing) but the market didn't seem to care and we were losing money for our clients.

Now, many short sellers respond to a rising share price by placing orders to cover their positions (i.e. they apply a price-based stop loss). This approach is designed to limit large losses at the individual stock level. We prefer to use newsflow based stop losses, rather than price-based stop losses, so that our risk management process is less rigid and so less subject to attack by predators. As a result, we held on to our short position in Campbell Soup. In fact, as the disconnect between the share price and the newsflow widened, we actually added to our short position until it became one of our largest portfolio positions.

The firm reacted to its weak underlying business in classic fashion: it launched a series of acquisitions designed to boost sales and, through the miracle of leverage and cheap debt, to boost earnings per share too. One such acquisition was Garden Fresh Gourmet, acquired in 2015. This produced inorganic sales growth (of course!) and shifted the firm's image away from older brands which were associated with fat, salt and sugar, towards a fresher, healthier, more modern food lifestyle. In general, such deals pile more debt onto a firm while failing to counteract the decay in the original business.

When Campbell's organic sales growth figures went negative, most market participants began to see the full extent of the firm's problems.

James Clunie, Head of Strategy, Absolute Return

James Clunie joined Jupiter in 2013. He is currently Head of Strategy, Absolute Return and manages the Jupiter Absolute Return Fund (Unit Trust) as well as the Jupiter Global Absolute Return fund (SICAV).

Before joining Jupiter, James worked at Scottish Widows Investment Partnership as an Investment Director of equities, and managed a long/short equity fund and UK long-only funds.

James was a senior lecturer in finance at the University of Edinburgh between 2003 and 2007, prior to which he worked as Head of Global Equities at Aberdeen Asset Management and Director and Head of Asset Allocation at Murray Johnstone International.

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The dominant narrative in the market started to shift towards our understanding of reality, and the share price fell.

On the 18th of May, 2018, Campbell announced its third-quarter results and they were, in our view, a true shocker. The firm revealed an impairment charge of $619 million in the Campbell Fresh division, where many of those growth acquisitions had taken place. They also warned that earnings per share would be below expectations and that organic sales were shrinking even faster than had been feared. Unsurprisingly, the CEO resigned. The shares fell 12% on the day.

When we get a batch of new forecasts for a stock, we usually try to put them into our reverse discounted cash flow model, to see if the share price now accords roughly with the new expectations. In Campbell's case, the stock began to seem sensibly priced for the first time in years: the share price had fallen by even more than the deterioration in fundamentals, so that the shares had moved from being overtly expensive to roughly fair (in our opinion). We reacted to this change by part covering our short position. From its peak in 2016 to its trough in 2018, shares in Campbell Soup halved. This is really quite remarkable. Who would imagine that a stock perceived as having a strong, defensive "moat" could halve, imposing swingeing losses on shareholders? Markets can be amazing.

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