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Reynolds Consumer Products, Inc. (REYN)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to Reynolds Consumer Products Fourth Quarter 2022 Earnings Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's call is being recorded.

I would now like to hand the conference over to your speaker today, Mark Swartzberg. Thank you. Please go ahead.

Mark David Swartzberg
Vice President-Investor Relations, Reynolds Consumer Products, Inc.

Thank you, operator. Good morning, everyone, and thank you for joining us on Reynolds Consumer Products fourth quarter and fiscal year 2022 earnings conference call. Please note that this call is being simultaneously webcast on the Investor Relations section of the company's corporate website at reynoldsconsumerproducts.com. Our earnings press release and accompanying presentation slides are also available on the website. With me on the call today are Lance Mitchell, our President and Chief Executive Officer; and Michael Graham, our Chief Financial Officer.

For our agenda this morning, Lance will focus his remarks on fourth quarter performance and the Reynolds Cooking & Baking recovery plan, as well as discussion of our performance drivers, while Michael will review our fourth quarter and full year financials, as well as our 2023 outlook. Following prepared remarks, we will open the call for questions.

Before we begin, I would like to provide a few reminders. First, this morning's discussion may contain forward-looking statements based on current expectations and beliefs. These statements are subject to risks, uncertainties and changes in circumstances that could cause actual results and outcomes to differ materially from those described today. Please refer to our Risk Factors section in our SEC filings, including our annual report on Form 10-K and our quarterly report on Form 10-Q. Please note the company does not intend to update or alter these forward-looking statements to reflect events or circumstances arising after the call.

Second, during today's call, we will refer to certain non-GAAP or adjusted financial measures. Reconciliations of these GAAP to non-GAAP financial measures are available in our earnings press release, investor presentation deck and Form 10-K. Copies of which can be found on the Investor Relations section of our website.

Now I'd like to turn the call over to Lance Mitchell.

V. Lance Mitchell

President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

Thank you, Mark. Thanks to our people, our integrated brand and store brand business model, and our unwavering commitment to category leadership, we made strong progress on our key initiatives in 2022. We entered 2023 with increased market share in our largest categories. Service returned to pre-pandemic levels and profitability restored in three of our four business segments. However, as you can see from our fourth quarter results, the Reynolds Cooking & Baking business segment performance fell short of our expectations.

On our earnings call in November, we reported that the Reynolds Cooking & Baking business segment entered the fourth quarter having experienced periods of unplanned equipment downtime, resulting in additional manufacturing costs and impacting our ability to adequately supply customers. Equipment reliability remained challenging in the fourth quarter, driving inefficiencies and manufacturing costs higher than expected, while also driving continued higher aluminum costs. These factors drove the EBITDA shortfall versus the expectations we shared with you in November.

In addition, while we were successful driving Reynolds Wrap share to the highest quarterly level for the year, household foil consumption was weaker than expected, also contributing to lower than anticipated net revenues for the quarter.

Now, let's turn to our plan to return Reynolds Cooking & Baking to historical levels of profitability. And as I do so, I want you to know that we entered 2023 with a thorough understanding of what has been impeding Reynolds Cooking & Baking's margin recovery, as well as the team and resources in place working to correct the issues impacting that business segment.

Key actions underpinning the Reynolds recovery plan include the following: management changes, including several key operational leadership roles; redesign of equipment reliability processes and practices, incorporating benchmarks and input from experts in operational excellence; return to pre-pandemic preventive maintenance disciplines; and new initiatives focused on improving operational excellence, including implementation of condition-based monitoring and predictive maintenance, cross-functional teams focused on critical asset efficiencies, investments aimed at improving equipment reliability and performance and increased technical expertise alongside key production assets. We believe that these and all the improvements we are making to the Reynolds Cooking & Baking operations will not only drive a major improvement in manufacturing efficiencies, but also a decline in our use of the higher cost supplemental purchases of milled aluminum that I mentioned previously.

Michael will speak more to our expectations we're facing at Reynolds Cooking & Baking business segment earnings recovery.

Now let's review key drivers of our performance overall: pricing, consumer demand, innovation and manufacturing and supply chain capabilities. First, pricing. We continue to selectively increase trade promotions, which are expected to be up in 2023 versus 2022 levels. We also remain watchful of commodity trends and the cost of aluminum and resin is up versus end of December levels. On balance, I would describe the pricing environment as far more stable than it was either last year or in 2021.

Second, consumer demand. Our categories have settled into a new normal. And in 2023, we expect a return to household formation as our main driver of growth, offset by inflation's continued impact on consumption and lapping of elevated demand in the first several months of 2022. We also entered 2023 in a position of strong category leadership. Consumption in many of our categories is up 5% or more since 2019, and we have built market share in our largest categories and in multiple adjacencies over this period. We've also gained additional share in these categories in 2022.

Reynolds Wrap's market share gains accelerated in the second half of 2022, driven by promotions to key price points, narrowing price gaps to private label and consumers' appreciation of Reynolds Wrap performance advantages by comparison to private label foil. In waste bags, Hefty's household penetration increased in 2022. Hefty waste bag brand increased buyers in almost every generational group, especially among millennials. And in disposable tableware, Hefty again gained share in 2022, driven by disposable plates, including a rapidly growing Hefty ECOSAVE line.

Our third performance driver is innovation. Innovation remained a major source of volume in 2022. In 2023, we plan to continue leaning into this success by expanding distribution across a number of high-velocity products while also introducing multiple major new products and increasing our emphasis on sustainable solutions.

In Reynolds Cooking & Baking, we plan to increase distribution of Reynolds Wrap Pitmaster foil and Reynolds Kitchens Air Fryer liners, among others, while also introducing Reynolds Kitchens Stay Flat Parchment and other products designed to meet the increase in cooking and baking among young adults and other major segments of the population.

In waste and storage, we plan further distribution gains for our portfolio of Hefty Fabuloso products, including new Hefty 4- and 8-gallon drawstring trash bags. And we're excited to announce that Hefty trash bags is launching the new Fabuloso Refreshing Lemon scent in the first quarter. In dollar sales, Refreshing Lemon is the number two scent of Fabuloso multiple-purpose cleaners and lemon citrus-scented waste bags are growing at two times the rate of the larger waste bag category.

We're also doing a lot in the area of sustainable solutions. Reynolds Kitchen Butcher Paper and Wax Paper are now compostable. Hefty ECOSAVE continues to grow rapidly, with additional strong growth expected, driven by SKU expansion, further distribution gains and continuing strong consumer demand.

Early results for the Hefty compostable printed paper plates also gives us confidence in our expansion plans for this new solution. And in waste and storage, a wide range of sustainable products are lined up for commercialization. For example, our recently launched private label food bag made from 20% renewable plant and ocean materials is off to a strong start.

Manufacturing and supply chain is our fourth driver of performance. Our entire organization is focused on the execution of the Reynolds Cooking & Baking business segment recovery plan. In addition, we've expanded the scope of Reyvolution cost savings, giving us confidence in another year of at least 200 basis points of incremental margin as a source of funds for reinvestment and margin expansion. Legacy Reyvolution programs still have considerable runway and we are undertaking new procurement and operations-related programs in 2023 as well.

Before I turn the call over to Michael and your questions, I'd like to leave you with the following. Our people have responded to the many opportunities and challenges of the last three years with exceptional resilience and resolve to serve our customers, combat inflation, and leverage our integrated brand and store brand business model to help consumers simplify their daily lives and make our business stronger.

Our market share, our category consumption levels and full recovery of pre-pandemic profitability in three of our four business segments are proof points of our success. Looking forward, the Reynolds recovery plan is in place and I have the utmost confidence in our plan and our ability to deliver a strong recovery of that segment's profitability.

I'm extremely proud of the entire RCP team and we look forward to earnings growth in 2023 and the years to come.

With that, over to you, Michael.

Michael Graham

Chief Financial Officer, Reynolds Consumer Products, Inc.

Thank you, Lance, and good morning, everyone. I'll start with a review of full year 2022 and fourth quarter financial results before turning to our 2023 outlook and the actions we're taking to return to pre-pandemic profitability this year.

For the fiscal year 2022, net revenues were a record $3.8 billion, up 7% from $3.6 billion in the prior year. This growth was driven by pricing up 13%, taken in response to increased material, manufacturing and logistics costs, and partially offset by lower volume. Volume was lower driven by price elasticity and the increased activity outside the home, which was partially offset by share gains in household foil, waste bags, disposable tableware and other categories.

Adjusted EBITDA was $546 million, down 9% from $601 million in the prior year due to lower volume and higher advertising costs, partially offset by the timing of pricing actions to recover increased material, manufacturing and logistics costs. Operational inefficiencies in the Reynolds Cooking & Baking segment and continued supplemental purchases of milled aluminum at a premium to our costs drove the EBITDA disappointment versus our previously provided outlook.

Lower household foil consumption, together with higher-cost aluminum, also contributed to the earnings decrease. Adjusted earnings per share for the year was $1.28 versus $1.59 in the prior year.

Turning to our fourth quarter results. We delivered a record net revenue of $1.1 billion during the fourth quarter, up 7% from the prior year's Q4 of $1 billion. And in terms of profitability, each of Hefty Waste & Storage, Hefty Tableware and Presto segments fully recovered to pre-pandemic profitability while also reporting record earnings, with improvement driving a 10% increase in adjusted EBITDA to $200 million by comparison to $181 million in the prior year.

Operational inefficiencies in the Reynolds Cooking & Baking segment and continued supplemental purchases of milled aluminum at a premium to our costs drove the EBITDA disappointment versus our previously provided outlook. Lower household foil consumption, together with higher-cost aluminum, also contributed to the earnings decrease.

Adjusted earnings per share for the quarter increased 4% to $0.53 compared to $0.51 in the prior year period.

Unpacking our volume performance. Elasticity and increased consumer activity outside of the home drove a 4% volume decline, driven by a 10% decrease in Reynolds Cooking & Baking volume. However, all four segments did gain volume share in their largest categories in tracked channels, driven by innovation, strong retail partnership and service. Hefty Tableware and Presto delivered volume increases in the quarter driven by innovation and share gains.

Looking ahead, I'll start with the summary of our earnings outlook for the full year 2023, followed by our expectations for the first quarter. I will then turn to the topics we're all keen to discuss in more detail, our key performance drivers, our expectations for Reynolds Cooking & Baking, and more information on the first quarter guide and post first quarter expectations.

For the full year 2023, we expect continued pressure from elasticities and our net revenues to be flat plus or minus 1%, with pricing flat to slightly up on net revenues of $3.8 billion in 2022. We expect rates for key commodities to be relatively stable by comparison to the levels that we saw at the end of January. We expect SG&A to increase to approximately $420 million, driven by compensation-related comparisons and increased investments in advertising and market research.

We expect Reyvolution-related cost savings to be a source of approximately 200 basis points of incremental margin for reinvestment and potential contribution to margin expansion. In 2022, Reyvolution growth initiatives were a source of approximately 2 percentage points of revenue and we expect a similar contribution from Reyvolution growth initiatives in 2023.

Adjusted EBITDA to be in the range of $605 million to $635 million, which is a low-double-digit to mid-teen increase by comparison to results in the prior year and EPS to be in the range of $1.30 to $1.41 per share.

Other key assumptions for the year include depreciation and amortization of approximately $120 million, interest expense of approximately $120 million as well, and an effective tax rate of approximately 25% and capital spending of approximately $120 million to $130 million.

For the first quarter, we expect net revenues to be flat, plus or minus 1%, with pricing up mid-single digit on net revenues of $845 million in the prior year period. Adjusted EBITDA to be in the range of $75 million to $85 million, down by comparison to adjusted EBITDA of $112 million in the prior year period, and EPS to be in the range of $0.06 to $0.09 per share.

Now let's talk about the performance drivers and phasing, including the first quarter guide. We entered 2023 with margins benefiting from pricing alignment to the current cost environment and expect the significant improvement which is evident in the fourth quarter results to drive adjusted EBITDA growth and margin expansion on an annual basis as well. In terms of segment performance, we expect 2023 results to be driven by continued solid performance for Hefty Waste & Storage, Hefty Tableware and Presto, and improving performance for Reynolds Cooking & Baking as we move through the year.

Focusing on the first quarter, while volume comparisons are more challenging in the quarter and expected to be a drag on year-on-year EBITDA growth, the major driver of the expected decline in year-on-year adjusted EBITDA is Reynolds Cooking & Baking performance. Between Reynolds Cooking & Baking's fourth quarter operational inefficiencies and continued supplemental purchase of milled aluminum at a premium to our costs, we expect limited, if any, EBITDA, for Reynolds Cooking & Baking in the quarter. Obviously, our first quarter expectations are far short of what we normally expect for Reynolds Cooking & Baking profitability. And with that in mind, I thought it would be helpful to elaborate on the factors driving our confidence in earnings growth after the first quarter.

Each of our business segments is winning at retail and entered 2023 with increased share in our largest categories. We have the in-store display, promotions and advertising plans in place to reinforce and build category leadership and profitability in all of our business segments. Pre-pandemic profitability has already recovered in three business segments and the level of pricing and margin achieved in the fourth quarter translates into margin expansion for these businesses in 2023. After the first quarter, we expect to see a lot less reliance upon supplemental milled aluminum, in turn, resulting in a sizable improvement in average product costs.

And our other big headwind in Reynolds Cooking & Baking is operational inefficiencies. We expect operational efficiencies to improve over the course of the first quarter and continue to improve during the second quarter, driving a significant increase in earnings by comparison to the first quarter results, and to return to pre-pandemic profitability as we enter the third quarter.

Now before I turn the call back over to Mark and your questions, I'd like to leave you with the following few thoughts on cash flow. We remain committed to leading our categories and driving progress towards recovering pre-pandemic profitability across our business, leading to stronger cash flows. Our increased emphasis on cash conversion benefited fourth quarter results, and we expect further cash flow gains in 2023 as we grow earnings, further emphasize balance sheet efficiency and maintain capital spending discipline. All of this is expected to drive return to debt paydown this year. And finally, our capital allocation priorities are unchanged.

With that, I'll hand the call back over to Mark.

Mark David Swartzberg

Vice President-Investor Relations, Reynolds Consumer Products, Inc.

Thank you, Michael. As I turn the call over to the operator for your questions, in the interest of time, we ask that you please ask one question and a follow-up and then rejoin the queue if you have additional questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from Lauren Lieberman with Barclays. Please proceed.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Thanks so much. Good morning. I guess to start it at kind of high level and appreciating you went through kind of key bullets on this plan to recover in the Cooking & Baking business. I guess upon first getting to know the company, my assumption was this is going to be a great manufacturing operation, like Reynolds comes out of packaging background, that this is a manufacturing company, and then my positive surprise was how great marketers the company is.

But now, what we're finding is where there seem to be cracks is in that what I thought was core, right, the manufacturing. So I just – knowing you've offered words already on the plan to repair, I just need to go back and understand a little bit better what's going on in terms of "equipment reliability," is it a matter of underinvestment in capital? I'm struggling with kind of what's broken down operationally, because last quarter when you had this downtime, you discussed it was temporary in nature. And so, there's something here that wasn't temporary, was a misunderstanding of the issues that began in the third quarter. So just a little bit more color on all that would really be great. Thanks.

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

Lauren, that's a very fair question and very accurate. We are a great manufacturing company and the cause really goes back to the pandemic. Our focus during that period of time, really strong demand from consumers, particularly for Reynolds Wrap, included some swings in production rates we'd never seen historically. And it compromised our maintenance programs and therefore our equipment reliability.

In addition, we paid heavy attention to restoring the element of production to – on preventive maintenance. So the resolution of that is to return to historically effective preventive maintenance disciplines while also implementing multiple new initiatives, including the ones I mentioned in my prepared remarks. I think it's also worth reminding that we have a very strong team, and along with the input of some outside expertise that we brought on board, it gives us a high degree of confidence in the effectiveness of our plan.

The key here is the improvement in operational efficiencies as that reduces the manufacturing costs while also decreasing our reliance on supplemental purchases of milled aluminum. And we expect to proceed along the lines that Michael reviewed in his prepared remarks. Our plan is very detailed and it has multiple elements to it. I think that ultimately the key assumptions are that, one, we have a very firm grasp on the causes of the downtime; two, a prescription matched to the causes; and three, a team to apply that prescription. I mentioned the confidence in our team and I'm equally confident in our understanding of the loss of efficiencies and our plan for fully reversing them.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Okay. That's great. Thank you for that. And then just in follow-up, in the release, it was specifically said that you're not going to offer non-GAAP or adjusted net income and EPS and sticking with EBITDA. So that's fine. EBITDA's cash, it's closer to cash. But any sort of perspective you can offer on some of those non-GAAP adjustments or just maybe even why, right? Is it because you don't yet know the cost of restructuring and sort of remedying the plan that you're detailing and you don't want to put a number out there for the cost of the plan? Is that the key reason we're moving away from adjusted EPS?

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc. A

Look, the reason we're moving away from adjusted EPS, and I'll let Michael elaborate on this, is there's no transaction costs anymore. And so, we don't expect there to be any adjustments to any of the GAAP measurements three years after the IPO. And as a matter of fact, our compensation is based on EBIT, and not EBITDA based on the incentive plan. So that comment in the release was primarily just to say there's not going to be an adjustment, period. [indiscernible] (00:26:00)

Lauren R. Lieberman
Analyst, Barclays Capital, Inc. Q

Okay. That's great. Okay, great. That was a misunderstanding, cause I was reading it and thinking, is this about there being restructuring costs that can't be quantified, but it's rather that there's – that the adjustments post IPO that's in the past. That's great.

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc. A

Right.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc. Q

Okay. Thanks. I'll pass it on and get back in the queue if there's time. Thank you.

Operator: Our next question is from Jason English with Goldman Sachs. Please proceed.

Jason English
Analyst, Goldman Sachs & Co. LLC Q

Hey. Hey, folks, thank you for slotting me in. A couple of questions. First, you hinted that the issues you're seeing in first quarter are going to bleed into 2Q, with comments like lapping elevated consumption through the first half, comments like you're still going to be working through the inefficiencies through the second quarter, et cetera. Can we just put a finer point on that and can you unpack what really are your expectations through the first half of the year with the implicit second quarter?

Michael Graham
Chief Financial Officer, Reynolds Consumer Products, Inc. A

Yeah. So as I said in my prepared remarks, after Q1, we have significantly less reliance on supplemental milled aluminum, resulting in lower average cost. Operational efficiencies improved over the course of first quarter, improved further in Q2 followed by a return to pre-pandemic profitability in the second half. A bit more color on this, you will see carryover of Q4's additional purchases for supplemental – supplemented by milled aluminum into

Q1. Also, since Q1 is seasonally a smaller quarter, the profit impact will be more pronounced in the second quarter, which is a larger quarter.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Okay. So let's switch gears and back to sort of Lauren's angle of questioning there. If we go back to your pre-IPO days and I remember all the hype about your shake and bake technique of – taken and this is starting to kind of form your own stuff so you don't have to go out there in the open market and buy this. And I recall it being kind of new. It's not like you've been doing this for a decade. It's something that you began to implement really just a few years ago. And it sounds like, given that you're now going back out to the market to buy this, it sounds like that's the issue. Like this new approach that's still relatively young isn't working for you.

So do you have to kind of revisit that whole model, this whole shake and bake approach in milling [indiscernible] (00:28:31) and why should we have confidence that it's just a couple of tweaks on the preventative measures and you'll be back to bright.

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

Shake and bake is about melting aluminum. It's about melting scrap aluminum. It's – that production process is in Hot Springs, Arkansas, as part of our aluminum melting facility and it's 100% operational. What we're talking about here is the milling operations in Louisville. That is the area where we have the challenges in that we're addressing. So we're able to melt more aluminum than we can mill. And so we have to buy milled aluminum from a third party. That's the significant issue here that we're addressing. They're two different manufacturing processes that you're addressing.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

That's helpful. Thank you. I'll pass it on and, like Lauren, get back in if there's time.

Operator: Our next question is from Kaumil Gajrawala with Credit Suisse. Please proceed.

Kaumil Gajrawala
Analyst, Credit Suisse Securities (USA) LLC

Q

Hey, everybody. Good morning. So clearly, something didn't go, I guess, according to plan in Cooking & Baking. It sounds like you have a grasp on what occurred. Is there – are you able to put some – perhaps some numbers around precisely what it costs? Obviously, your guidance for 1Q EBITDA for the segment gives us a sense. But did it cost $20 million of EBITDA or $40 million or can you just give a little bit of a read on what it might have – what the expense might have been that's a little more one time?

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

Yeah. We've missed the guide by, let's call it, $20 million. $10 million of that was volume. Approximately $5 million of was the metal purchases and the other $5 million was the operations disruptions.

Kaumil Gajrawala
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you. Thank you for being so clear. And typically we don't ask for a guide by segment or anything. But I think in this instance, it might be helpful to just get a sense for the full year as Cooking & Baking has made between $200 million and $250 million of EBITDA, as we're thinking about the full year for 2023 or if you can at least give us a sense of where you expect it to end up once we get past 1Q.

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.
A

Yeah, you're right, we don't give guidance on individual segments. We did try to be very clear about the cadence of the earnings recovery in the Cooking & Baking segment. And Michael in his prepared remarks talked about Q1 being breakeven-type EBITDA and then recovering the full profitability by the second half with good progress in Q2. For the full year, that business segment will be better than it was in 2022. It is a back half loaded. But specific numbers, we're not going to guide specific numbers on segments.

Kaumil Gajrawala
Analyst, Credit Suisse Securities (USA) LLC
Q

Got it. Thank you. I had to try.

Operator: Our next question is from Tristen Chau with Stifel. Please proceed.

Tristen Chau
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Thanks and good morning, everyone. This is Tristen on for Mark. I just have two questions. First, just on cash flow, as I saw that working capital was dragged down by increased inventories. So what gives you confidence that working capital or inventories can improve to get net debt to $1.8 billion to $1.9 billion as forecasted in your guidance? And what's a reasonable expectation for cash flows from operations? And I have a second question after that.

Michael Graham
Chief Financial Officer, Reynolds Consumer Products, Inc.
A

Yeah. Big driver is – obviously, a big part of is a return to profitability within our Cooking & Baking. We also see commodities as being stable. We have a number of Reyvolution initiatives that we've talked about before, and we've had a great track record in terms of driving that and that materializing in bottom line results. Beyond that, we also have a number of working capital initiatives that we continue to push. Inclusive in that obviously is just making sure that we manage our CapEx spending. But that's going to be supplemented by a very high focus on accounts payables, as well as managing inventory levels.

Tristen Chau
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Great. Thanks. And my second is just you mentioned an increase in A&P spend in 2023. And so how does that compare to pre-pandemic levels as there are certain threshold where volumes respond? Thanks.

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.
A

Yeah. This brings us back to historical levels of advertising spending, it'll be approximately $20 million higher than it was in 2022.

Tristen Chau
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thanks.

Operator: Our next question is from Andrea Teixeira with JPMorgan. Please proceed.

Shovana Chowdhury
Analyst, JPMorgan Securities LLC

Q

Hi. This is Shovana on for Andrea. You did mention that you are expecting to see improvement of profitability by Q3, end of Q2, progressing and laid out all the foundational, but can you please go over the specific reasons, like, is it the timing of the commodities, the addressing the inefficiencies and/or promotions? And if you could please give us a sense of the kind of numbers you're allocating to each of these reasons. Thank you.

Michael Graham
Chief Financial Officer, Reynolds Consumer Products, Inc.

A

Yeah. I did say that – in my prepared remarks that we do expect that we're going to see increased operational efficiencies throughout the quarter. And obviously, a big part of that is going to be the timing of the actions we've put in place. We still also see commodities. As I mentioned earlier, commodities not being as much of a drag on overall business. And we see the lower – Cooking & Baking having a better performance as we've mentioned earlier. Those are the key drivers.

Shovana Chowdhury
Analyst, JPMorgan Securities LLC

Q

Thank you. And promotions would not play a factor at all or...

Michael Graham
Chief Financial Officer, Reynolds Consumer Products, Inc.

A

Well, it's minor in terms of the overall impact to overall results. I don't think that is a big factor.

Shovana Chowdhury
Analyst, JPMorgan Securities LLC

Q

Thank you for clarifying. I'll pass it on.

Operator: Our next question is from Peter Grom with UBS. Please proceed.

Peter Grom
Analyst, UBS Securities LLC

Q

Thanks, operator. And good morning, everyone. Hope you're doing well. So I wanted to ask about the profit outlook, but more just kind of what's embedded in terms of the commodity cost. I think the release states that you're expecting spot rates from the end of January to hold. Is that simply just being conservative or is there something that you're seeing that would kind of actually drive these spot rates to hold at current levels? And then maybe just a follow-up on that. I mean, a lot of news around potential tariffs on Russian aluminum. Any thoughts on how this may or may not impact your profit targets?

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

Let me answer the last question first. We don't buy metal from Russia, so it will not have any impact to us either way. The first question – remind me, the first question again was...

Peter Grom
Analyst, UBS Securities LLC

Q

Yeah. Just more around why are you assuming spot rates kind of hold. I mean, I think most people are more of the view that you can see some moderation in commodity costs from here. So just any thoughts on...

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

Yeah. Aluminum prices closed out – the LME plus Midwest premium closed out December at $1.29. It's now trading at a high $1.40s to $1.50. So we've seen some – already some increases on aluminum costs from where they closed out the year. And polyethylene recently went up $0.03 a pound as it closed out January. So we do see stability compared to what we saw in 2021 and 2022 in these commodity costs. But I think further declines plus other inflationary costs are factored into our guide.

Peter Grom
Analyst, UBS Securities LLC

Q

That's super helpful. And then I guess I just want to go back to the commentary around gross profit and return to pre-pandemic profitability in terms of gross profit dollars. Michael, I think, back in July, it was kind of this $950 million number. In November, the change – elasticity kind of shifted that number lower. So just – I know it's kind of – the gross profit recovery is more of a back half dynamic now, but just how should we be thinking about gross profit recovery for the full year just in the context of what you've outlined previously?

Michael Graham
Chief Financial Officer, Reynolds Consumer Products, Inc.

A

Yeah. So I think the context you provide is accurate. Drivers – we see gross profit being around $920 million now. We did previously give indication around $950 million, which we later lowered to around $930 million. It's lower for Reynolds Cooking & Baking and higher for the other business segments. But net down, Reynolds for – we've reviewed operational efficiencies and the purchases of supplemental milled aluminum at a premium. Those are big drivers of that. And in the other business segments – the other businesses as we enter 2023, they have healthy shares across the businesses. They demonstrate a strong performance and this is going to be a bit of a offset there. So the confidence is high as we move forward. But clearly, it's been a drag, primarily driven by the Cooking & Baking business.

Peter Grom
Analyst, UBS Securities LLC

Q

Got it. Thanks so much. I'll pass it on.

Operator: [Operator Instructions] Our next question is from Rob Ottenstein with Evercore ISI. Please proceed.

Robert Ottenstein
Analyst, Evercore Group LLC

Q

Great. Thank you very much. Maybe if you could talk a little bit about, you had some initial comments that you expect trade promos to be up in 2023. How should we think about that in the context of still an inflationary environment, still a lot of room to recover on the margins. You guys are the category captains. So, how should we think about that statement? And maybe if you can reference percent of volume or sales that were sold on trade promos kind of pre-pandemic, at the bottom and kind of where we are now. Thank you.

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

Yeah. Robert, we're talking about a 1% increase in trade year-over-year. And most of that being in the segments that are performing at historical plus levels from a margin standpoint. The trade promotions that we took in Reynolds were completed in Q4 and probably maintain those levels, but we may have to revisit that based on the fact that aluminum's gone up. We may have to reduce some trade and move some price points around. But I think we've had a great track record of demonstrating across our business over the years evidence recently by how we've managed share with Reynolds Wrap that we can manage trade to ensure that we get the right price points and ensure that we get growth and share as a result. But we're not talking about a significant – it's one point of revenue that we're talking about.

Robert Ottenstein
Analyst, Evercore Group LLC

Q

Great. That's very helpful and clear. Thank you.

Operator: Our next question is a follow-up from Lauren Lieberman with Barclays. Please proceed.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Great. Thanks. First thing was just on that detail you offered earlier on the drivers of the EBITDA miss, the $10 million from volume. I was curious, how much of that would you – not to ask for more detail, that's really a great detail, but conceptually, was the result of the lower consumption in terms of consumer takeaway or was some of that related to the production challenges in the foil business?

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

It was – yeah, it was almost exclusively consumer consumption related. And a lot of it occurred in December time period from a retailer replenishment from Thanksgiving and then the December holidays. It just did not play out from a consumption standpoint the way that we had forecasted. Our share actually went up in Q4. So we had – it was not a share issue, it was a category consumption issue that occurred from a consumer standpoint. And we have factored that into our guide as part of 2023.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Okay. Okay. And assuming that consumption remains lower than historic trend or what you'd previously might have expected, with that slightly softer volume.

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

Yeah. It's driven by elasticities primarily.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Yeah. Okay, great. And then – so Hefty, so profitability kind of off the charts – sorry, Waste & Storage, I should be more specific. Profitability sort of unbelievably strong this quarter, right, both in in dollar terms in terms of EBITDA and then also on margin. So maybe any update on kind of, A, the competitive environment and, B, separate from the comments you've made on a little bit more trade promotion. I think we've spoken previously about just whether or not pricing would prove so sticky with easing in the raw material cost basket.

So yeah, just any kind of thoughts there as we think maybe towards – as we move into next year? I'm going to assume this kind of $70 million EBITDA isn't a run rate for the business. So just kind of any thoughts there would be helpful to make sure we don't get ahead of ourselves on that business.

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

Well, that category has grown significantly since the pandemic, right? So it's not as high as it was during the peak of the pandemic. But pre-pandemic, this category is up. And the pricing has been stable. And I think all of us in the category have been focused on ensuring that we maintain profitability and that with a lot of – not a lot of promotions, but ensuring that we get the right price points to ensure consumers continue to have high takeaway. So things are relatively stable in that category and there's no reason to believe that these profit levels can't continue.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Okay. Because it was a huge I mean, you've got to look sequentially, right, it's a very material step-up. So would you say what we're seeing there is a combination of better resin costs flowing through, plus the higher pricing that's been enacted over the last – the prior 18 months or so.

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

I think it's primarily been pricing that have been implemented across the category over the last three quarters.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Okay. Okay. Because there was a final increase that went in September, October. But again, just that sequential jump in...

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

Right.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

...profit would suggest it was much more sizable than prior rounds or, again, getting back to better coverage on stable resin cost.

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

Resin costs came down some and then the pricing went up. So we've crossed that threshold where we're back to higher profitability.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Okay. Okay. All right. Thank you.

Operator: Our next question is a follow-up from Kaumil Gajrawala with Credit Suisse. Please proceed.

Kaumil Gajrawala
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you. Thanks for taking a second. I think you guys are in a better position than most on having a sense of the consumer and any shifting between private label and branded. Can you just give a sense of what you're seeing from a consumer perspective, is there any trading down? There is reduced consumption, but are decisions being made to save dollars at the shelf? Any insight there would be useful.

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

Look, in our categories, private label share was actually down in a number of our categories last year and in the fourth quarter. Private label share is down in foil, it's down in food bags, it's down in slow cooker liner and oven bags for both the year and the quarter, Q4. And private label share in waste bags was down for the full year, was up slightly in Q4. But the Hefty brand was also up slightly in Q4. We are seeing higher private label in party cups, plastic wrap and parchment paper, and all of those except parchment paper, we have a very strong private label position. So those three segments, we are seeing some trade down. We've also seen some trade down in some channels to lower pack sizes, but not a shift from brand to private label.

Operator: [Operator Instructions] Our next question is a follow-up from Jason English with Goldman Sachs. Please proceed.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys, thanks. Let me double dip. Michael, you said your guidance is now predicated at $920 million of gross profit. You had previously said you expected SG&A of $400 million. That gets you to a $640 million EBITDA figure, about $20 million ahead of what you're actually guiding to. So implicitly, you're now expecting higher SG&A. What's driving the higher SG&A outlook?

Michael Graham
Chief Financial Officer, Reynolds Consumer Products, Inc.

A

Yeah. The significant driver of the SG&A increases is the higher variable comp and increased advertising, as you noted, as well as a lot of market research. But just as a reminder from a variable comp standpoint, our variable comp is linked to our year-over-year earnings growth and is such as we expect to increase in earnings over the year with that will come higher SG&A expense. That is a big driver of it.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

So you're cutting your earnings outlook and raising your incentive comp outlook versus where you were in 3Q?

Michael Graham
Chief Financial Officer, Reynolds Consumer Products, Inc.

A

No, I'm telling you that our incentive comp is linked to earnings progression, right? And our forecast has that going up.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And that's the reason SG&A is going from $400 million to $420 million?

Michael Graham
Chief Financial Officer, Reynolds Consumer Products, Inc.

A

That's a big – that's the largest driver.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then on the volume outlook for sort of flattish on the year and you're coming in down mid-singles, what gives you confidence in the inflection to growth later in the year? And is there any, like, reroll or anything that we're not going to be able to see in the consumer-linked data that would drive that?

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

A

As a company, our volumes are up roughly 4% versus 2019. Of course, pricing that we've taken over this period has been significant and implying some elasticities for a sustained period of time. At different points in 2022, our categories did return to pre-pandemic elasticities and we're using those elasticities I have mentioned in a previous question as part of our guide.

Our confidence and our assumptions on elasticity is based on a number of factors. Price increases are largely complete when assuming a more stable and easy commodity environment. Consumer activity outside of the home is increasing versus the pandemic rates, continuing at a relatively stable level in recent months. Our categories and our portfolio's response to trade and other forms of promotion has proven to be very effective and our plan levels of trade and advertising that we've talked about we expect to have that impact.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Okay. Thank you.

Operator: We have reached the end of our question-and-answer session. I would like to turn the conference back over to Lance for closing comments.

V. Lance Mitchell
President, Chief Executive Officer & Director, Reynolds Consumer Products, Inc.

Thank you all for your questions and we do appreciate your time this morning. We have strengthened our competitive position over the last three years. We've recovered to pre-pandemic profitability in three of our four business segments and we entered 2023 with a strong team and a robust plan for recovering Reynolds Cooking & Baking profitability, will translate to even stronger performance for us overall. I want to also thank our employees and our retail partners for their dedication and contributions during these challenging and dynamic times. Thank you.

Operator: Thank you. This does conclude today's conference. You may disconnect your lines at this time, and thank you for your participation.