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Reynolds Consumer Products, Inc. (REYN)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Reynolds Consumer Products Second Quarter 2020 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker 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. Good morning and thank you for joining us on Reynolds Consumer Products second quarter 2020 earnings conference call. On the call today are Lance Mitchell, President and Chief Executive Officer; and Michael Graham, Chief Financial Officer. Nathan Lowe, Senior Finance Director; and Chris Mayrhofer, Vice President, Corporate Controller and Principal Accounting Officer, will also be available for Q&A.

During the course of this call, management may make forward-looking statements within the meaning of the federal securities laws. These statements are based on management's current expectations and involve risks and uncertainties that could cause actual results and outcomes to differ materially from those described in these forward-looking statements.

Please refer to the Reynolds Consumer Products Annual Report on Form 10-K and other reports filed from time to time with the Securities and Exchange Commission and its press release issued this morning for a detailed discussion of the risks that could cause actual results to differ materially from those expressed or implied in any forward-looking statements made today.

Please note management's remarks today will focus on non-GAAP or adjusted financial measures. A reconciliation of GAAP results to non-GAAP financial measures is available in the earnings release posted under the Investor Relations heading on our website at reynoldsconsumerproducts.com. The company has also prepared a few presentation slides and additional supplemental financial information, which are posted on Reynolds website under the Investor Relations heading. This call is being webcast and an archive of it will also be available on the website.

I'd also like to note that we are conducting our call today from our respective remote locations. As such, there may be brief delays, crosstalk or other minor technical issues during this call. We thank you in advance for your patience and understanding. While we would like to answer all of your questions during the question-and-answer session, in the interest of time, we ask that you ask one question and a follow-up and rejoin the queue if you have additional questions.

And now, I'd like to turn the call over to Lance Mitchell.

V. Lance Mitchell

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

Thanks, Mark. Good morning, everyone. Today, I would like to start by recognizing and thanking essential frontline workers, especially the work of healthcare professionals caring firsthand for those who are sick. Employees at our retail partners have also stepped up to continue to supply people with essential products on an ongoing basis. We are pleased to be able to support them, and I am incredibly proud of how the entire team at Reynolds has come together as we emerged from this quarter a stronger and more agile company.

The pandemic continues to present immense challenges for people everywhere, and there are five areas where I believe we've learned, grew and demonstrated new and better capabilities in the quarter. I will review each of them, including the challenges we face and high level comments on our second quarter financial results. Then, speak to our second half priorities and how we are pivoting from managing the crisis to leading and working our plans to become a stronger company and partner.

Safety, our safety first culture has served us well, as the pandemic developed in March and was fully underway throughout the second quarter. We implemented unprecedented safety protocols ahead of CDC guidance with urgency. These included safe distancing, barriers, shift separation, mandatory mask usage, temperature testing, hand-washing and increased cleaning. It's one thing to develop policies and procedures. It's yet another to ensure that they are implemented on a day-in and day-out basis. Our safety culture has ensured we successfully continue to follow all the guidelines we established at the outset of the COVID-19 pandemic.

Supply chain, we moved rapidly to expand capacity for products that continue to be in higher than planned demand, and we were creative in unlocking capacity. We worked with our retail partners to pause low-volume SKUs in favor of priority items, shifted innovation emphasis from on-the-go to stay-at-home products, centralized a portion of inventory management to improve replenishment and accuracy, re-commissioned mothballed capacity in our Cooking & Baking segment, accelerated line additions, added plant staff, and undertook other measures to deliver against the increase in demand.

As a result, our capacity continues to increase, contributing to retailer in-stock rate well above levels early in the quarter in many of our categories. However, we are not operating full utilization rates, reflecting challenges fully staffing existing and new capacity and contributing to out-of-stocks in certain product categories. Staffing challenges reflect multiple factors, including absences in local hotspots, employees' childcare needs and hiring conditions in certain local economies. We're making progress here, but we have more to do. Overcoming this is a top priority of our leadership team.

Category management, we strengthened the competitive advantage by spending more on proprietary research, developing new consumer insights, and implementing new analytical tools to support our retailer partners and future product development. For example, we conducted three successive waves of research to identify progressive changes in shopping behavior since the start of the pandemic, allowing us to see new normals of growth and share by product segment.

We undertook a state-by-state analysis of restaurant and dining-out trends in relation to reopening orders, discovering patterns that are helping us predict localized trends for our Tableware business. We adopted a new analytical tool to predict growth of our most important product categories, factoring the latest trends into predictions and continually backtesting for accuracy. And in terms of e-commerce, we conducted research identifying that an average of 26% of US shoppers now look to e-commerce to fulfill their purchase needs in our categories.

All of this tells us we're seeing a sustained shift in behavior that benefits our categories and our ability to serve our retail partners. In terms of consumer behavior, our July Harris Poll finds that heightened nesting continues and that a significant majority of consumers expect to continue the increase in cooking, baking, cleaning and organizing in which they are engaged today. Consequently, we're planning and operating on the expectation that these shifts benefit the majority of our categories not only in 2020, but over the long-term too.

Leadership is our fourth area of growth. We developed tools, policies and training that allow us to lead and manage remotely. We've also increased communications to promote alignment, increased investment in cybersecurity training for our distributed workforce, and adapted in order to remain on track with our plans to exit transition service agreements.

Our financial results, we reported strong revenue performance in the second quarter in spite of last year's exit of certain low-margin store brand business, lapping a price point investments in Reynolds Wrap foil, lower related party revenues and decreased demand for our Tableware business. Our e-commerce retail sales were also strong in the quarter, as we continue to capture elevated participation in the e-commerce platforms. And adjusted EBITDA grew double-digits, driven by our top line and gross margin expansion of 200 basis points, primarily from lower material and manufacturing cost, in spite of incremental COVID-19-related operating costs.

When we formed Reynolds Consumer Products in 2011, we had the opportunity to create a new company, build on well-known brands from solid legacy companies. We used that opportunity to create a culture that prioritizes safety, families, ethics and achievement of our financial and strategic goals. Nine years later, we entered the IPO process, a successful company, partner and competitor benefiting from the requirements of going public. Today, our leadership team leads an even stronger and more agile company, and I could not be more proud of our team and employees for their resilience and success responding to the challenges and opportunities presented by the COVID-19 pandemic.

As we move into the second half, our priorities are: one, additional spending and work to better understand changing consumer preferences, behaviors and shopping patterns; two, advertising levels to support momentum into next year and readying of innovations with continued focus on at least 20% of net revenues from products launched in the last three years; three, build out, staffing and right-sizing of capacity; four, additional automation of production and processes; and five, delivery of [indiscernible] (11:07) new revolution business transformation initiatives.

I would like to conclude by reiterating that we continue to make safety our top priority, striving for zero accidents. I'm happy to tell you that we have experienced a record low number of incidents year-to-date. Even with the challenges of a pandemic and projects to increase our capacity, that's a continuation of our safety culture journey. Over the last seven years, we have reduced our injury rate by 30%.

I will now turn it over to Michael to discuss our results for the quarter and our outlook.

Michael Graham

Chief Financial Officer, Reynolds Consumer Products, Inc.

Thanks, Lance, and good morning everyone. I'd like to echo Lance's comments in thanking our employees whose dedication has been crucial to navigating our company through the implications of this pandemic. And I'm extremely proud to be part of the Reynolds team.

With that said, I now will spend a few minutes reviewing the financial results for the quarter. Total net revenues in the second quarter of 2020 were $822 million, compared to $791 million in the prior year. The increase was primarily driven by stronger volume stemming from the consumer response to the pandemic. We saw increased demand across our Reynolds Cooking & Baking, Hefty Waste & Storage, and Presto Products segments, whereas our Hefty Tableware segment was negatively impacted by the pandemic.

We'll go into the details of the segments shortly. Net income for the second quarter was $112 million compared to $55 million in the second quarter of last year, and adjusted net income was $115 million for the second quarter of 2020. The increase was primarily driven by the aforementioned stronger volume, as well as lower interest expense, reflecting the capital structure that went into effect with the IPO.

Adjusted EPS for the quarter was $0.55. Adjusted EBITDA for the second quarter was $193 million, compared to $169 million in the prior year. The increase was primarily due to the previously noted volume increases.

Now, we'll discuss the results of each of our segments. Reynolds Cooking & Baking net revenues in the second quarter were $295 million compared to $275 million in the same period of last year. The increase was primarily driven by increased demand due to consumer response to the COVID-19 pandemic. The increase was partially offset by lower-related party sales and lower pricing from actions largely taken in the prior year as we supported our customers in achieving key price points, and as a result of lower material costs.

Adjusted EBITDA in the quarter was $66 million compared to the prior year $49 million as the impact of higher revenue along with lower material and manufacturing costs was partially offset by the impact of lower pricing.

For Hefty Waste & Storage, net revenues in the second quarter were $203 million, compared to $183 million in the prior year. The increase was primarily driven by the increased demand due to the consumer response to the COVID-19 pandemic. Adjusted EBITDA in the quarter was $63 million compared to $52 million in the prior year primarily driven by the increased revenue.

Now moving on to the Hefty Tableware. Net revenues for this segment were $186 million, compared to $207 million in the prior year. This segment was negatively impacted during the quarter because of fewer social gatherings particularly around end-of-school year and summer events. Additionally, lower demand from food service businesses serviced by our retail partners contributed to the decline. Adjusted EBITDA in the quarter was $43 million compared to $51 million in the prior year, primarily due to the decreased revenue as well as increased material and manufacturing costs resulting from our transition to a standalone entity.

Finally, the Presto Products segment. Net revenues were $138 million, compared to $131 million in the prior year. The increase was primarily driven by increased demand due to consumer response to the COVID-19 pandemic, partially offset by exit of certain low margin store branded businesses in the prior year. Adjusted EBITDA in the second quarter was $28 million, compared to $24 million in the prior year primarily driven by the increased revenue.

Now, moving to our capital structure. As of June 30, 2020, we had a cash balance of $392 million, a total debt outstanding of $2.44 billion. Adjusted net cash from operations was $263 million for the quarter, compared to adjusted net cash from operations of $165 million in the prior year. CapEx was $29 million for the quarter compared to $26 million in the prior year.

I'm pleased to announce that our Board has approved a quarterly dividend of $0.22 per common share, which is expected to be paid on August 31 to shareholders of record as of August 17. Additionally, subsequent to the quarter-end, we made a voluntary $100 million principal payment against the balance on our senior secured term loan facility.

I would now like to comment on our guidance for the fiscal year ending December 31, 2020. The following guidance is what we previously provided for fiscal 2020; net income to be in the range of $335 million to $355 million. Earnings per share to be in the range of $1.60 to $1.69 per share. Adjusted EBITDA to be in the range of $695 million to $715 million. Adjusted net income to be in the range of $388 million to $403 million, and adjusted earnings per share to be in the range of $1.85 to $1.92 per share. Net debt to be in the range of $1.9 billion to $2.1 billion.

We expect higher than previously planned demand for many of our products to continue over the balance of the year. And as a result, now expect 2020 results to be at the upper end of the previously provided ranges for net income, earnings per share, adjusted EBITDA, adjusted net income and adjusted earnings per share. We're also confirming our previous guidance for net debt. This is a positive outlook on our guidance we communicated in May and provided in the context of our business facing a high degree of uncertainty going forward. It also reflects a number of headwinds limiting our expectations for the third and fourth quarter, particularly the fourth quarter.

We are on track to completing our capacity objectives by early 2021. However, the additions of capacity in this environment involve added cost, and the staffing challenges on existing lines are compounded as we add capacity, reflecting the factors Lance noted earlier. Our research and trends indicate fewer and smaller social gatherings are an offset to higher rates of everyday consumption for many of our products, leading us to expect less from holiday-related sales.

Also, while our Tableware business is expected to see moderation of Q2's headwinds as foodservice and dining out trends improve from the pandemic lows, we expect continued pressure from this business over the balance of the year. We have also seen increases in all of our key commodities in recent months, and the outlook is worse than our expectations when we reported Q1 earnings in May.

We have seen COVID-related costs rise. In the quarter, [ph] discreet costs (19:08) for cleaning, safety and related items were in the range of $5 million to $10 million. In addition, we are experiencing our operational and supply chain inefficiencies rising from the operating in a high-demand environment, delays in certain cost savings programs and other factors.

Logistic units costs have increased as a result of higher fuel cost and lower distribution [ph] inefficiencies (19:32). We expect SG&A increases to be elevated, reflecting A&P increases that are skewed heavily to the second half, driven by our plans to build additional portfolio momentum as well as pandemic-related delays and A&PS originally scheduled for the first half. Thus the amounts planned for Q4 are well above fourth quarter levels of 2019. Finally, it's important to note that we assume no significant disruption to our operations, supply chain or retail partners for the remainder of 2020.

On the topic of [indiscernible] (20:08), as many of you know the 180-day lock-up on the sales of the shares by directors, executive officers, and packaging finance limited recently expired. Our largest shareholder is not advised of any intended change in its position, and is very pleased with the performance and outlook for the company.

As we look ahead, we continue to believe that our business model is well positioned to drive attractive returns in the long term. Our expectations and focus areas continue to be average annual volume growth in the low-single digits, continued investment to support margin expansion, average annual adjusted EBITDA growth of low to mid-single digits, average annual net income growth in the mid-single digits and a dividend payout ratio of approximately 50% of net income.

With that, we'll turn it back over to Mark. Thank you.

Mark David Swartzberg

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

Thanks, Michael. As I turn it over to the operator for the questions, I'd like to remind you that we ask that you ask one question and if you have a follow up, and then rejoin the queue if you have additional questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Thank you. Our first question comes from the line of Bill Chappell with [ph] SunTrust (21:57). Please proceed with your question.

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Hey, thanks. Good morning.

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

A

Good morning, Bill.

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.

Q

I guess, just on – certainly your portfolio is well-positioned with your store brand private label portfolio. Just trying to understand if you're starting to see consumer trade down or if your kind of expectations for the remainder of the year kind of consumer trade down and kind of related impact to margins?

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

A

If – Bill, this is Lance Mitchell, if you mean by trade down...

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Good morning.

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

A

... [indiscernible] (22:30) from brand to store brands...

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Correct.

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

A

...we have seen just the opposite continuing. You could see that in the [indiscernible] (22:37) even through July that shares across our categories have remained strong for the branded businesses. And in fact, they've continued to grow in some cases.

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Got it. And do you expect that to continue as we kind of move forward for the rest of the year in a recession?

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

A

Well, as we've talked to previously, this company has not gone through a recession as Reynolds Consumer Products, but the legacy companies have, and the historical look back indicates that there was no meaningful difference in shares changing during the last recession for the majority of the products.

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.

(

Got it. And then one follow up, just on the capacity additions, is there – is there a need for these additions? I mean are you expecting demand to continue well past COVID and into 2021 or is this just things are being pulled forward but you were planning to do it down the road anyways?

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

A

It is a combination of both. We did pull forward some planned capacity additions, but we've also increased our capacity because our outlook for consumer demand based on the research I talked about in my opening remarks indicates that this is a more permanent type of demand pattern for consumers for our categories. So we're adding additional capacity for the long term.

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.

(

Got it. Thanks so much.

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

A

Thank you.

Operator: Our next question comes from the line of Rob Ottenstein with Evercore. Please proceed with your question.

Robert Ottenstein
Analyst, Evercore ISI

Q

Great. Thank you very much. So I'm wondering how the dialogue with retailers has progressed, given your important role as the category captain through, let's say, March through June? And given what you're saying that you think there's a more permanent demand pattern here. Is that something that retailers agree with, and are they going to, therefore, give more shelf space? And then related to that, how is the whole discussion going with retailers in terms of e-commerce, and how do you see the development of e-commerce as the crisis continues? Thank you.

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

A

Okay. I guess – yeah there's two questions there. And the first one regarding our relationship with retail partners, I think our relationship has emerged from the pandemic in the last quarter stronger than it was before. We've been very transparent with them about our capabilities, our capacity additions, and we've talked about our [ph] SKUs (25:36) that we're going to pause and come to a collaborative agreement on that. So our – they are in agreement that the categories are going to grow and a demand permanently stronger than we had originally anticipated before the pandemic because consumer behaviors are changing.

Regarding shelf-space, that's premature. We haven't had those discussions. We are discussing new product introductions. But regarding the shelf-space that's not something that's been on the agenda as of yet. The second question, remind me again please.

Robert Ottenstein
Analyst, Evercore ISI

Q

Just you had mentioned that I think 26% – based on your research, 26% of the population was looking towards e-commerce as a channel for your products. So I'm trying to understand what that means in terms of how you're going to adapt to that and what that means in terms of your discussions with your brick-and-mortar retailers?

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

A

Well, I'd say first of all, our brick-and-mortar retailers we included e-commerce, so curbside pickup and the programs that the brick-and-mortar retailers are participating in is included in the way that we look at e-commerce. It's not just home delivery but it's all aspects of e-commerce. And we are very pleased with our results in e-commerce through the second quarter and as we look forward because in those categories we are growing, in fact growing from a share standpoint most of our products faster than we've grown traditional brick-and-mortar channels.

Robert Ottenstein
Analyst, Evercore ISI

Q

Are you able to give us a sense of what percentage of your sales were e-commerce and a sense of what your share in e-commerce looks like?

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

A

Yeah. I can't share that number at this point partially because the data is still murky. Some retailers are sharing very detailed numbers and some are not. So we get directional data there, but we're not getting clean data. That is going to improve over time as more and more retailers provide specific information.

Robert Ottenstein
Analyst, Evercore ISI

Q

Great. Thank you very much.

Operator: Our next question comes from the line of Jason English with Goldman Sachs. Please proceed with your question.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Hey. Good morning, folks. Glad to hear you all are doing well.

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

A

Hi, Jason. It's good to hear your voice again.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. Thanks, Lance. You too. I was a little surprised by the revenue you posted this quarter. In light of the data we're all looking at in Nielsen or IRI, I think many of us expected to see a more robust figure. Can you walk us through what the disconnect is? As we look at these numbers, why they [indiscernible] (28:32) What are some of the offsets?

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

A

In our quiet period, I really want to reach out and talk about this and so did Mark. We attribute this mainly the decline in related party revenue and a straight focus on scanner data at the macro category level that also mistakes the net of our branded and private label performance. So, let me try and break it down for the quarter. Our related party net revenues were down $14 million for the quarter, and the related parties just primarily into foodservice and restaurants, foodservice foil and bakeware, aluminum pans.

Our reported net revenue is excluding related net revenue – related party net revenues were up 6% for the quarter. That's still well below the rates I know many of you cited from the scanner data. And I said it's important to go deep into the category and accurately net our branded and private label performance to see how we perform at scanned channels. For example, in Tableware, our [ph] Hefty cup performance (29:37) was more than offset by our private label [ph] cup performance (29:40). Whereas, our private label performance in the foam plate segment outgrew the branded.

In Tableware, it's also important to note that paper is a significant part of disposable dishes segment and we're introducing new products in that area, but we don't yet participate in that segment in a meaningful way from a paper standpoint.

In addition, some of our revenue from the Tableware business is sold in certain channels for foodservice applications. So, a combination of all those events, you can't look at our business just on the scanner data across – and apply that across our entire company.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

That's really helpful. I appreciate – oh, sorry, go ahead.

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

A

And Jason, I'll add – all I'll add to that, Jason – this is Mark speaking, nothing substantive because Lance covered the substantive points. But we get that you're tracking the data and trying to get it at the most granular level you can. So definitely look for Nathan and I to help you just follow it because as Lance said, the number was – the underlying number was a plus 6 and you obviously want to be able to see that – try to get closer to that as you go through the given set of months intra-quarter.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Absolutely. You're still a new company and we're all trying to learn here. So we'll lean on you going forward a little more heavily. Second question, Michael, in the tail end of your prepared remarks, you ran through a lot of headwinds in the fourth quarter from logistics cost, from commodities moving to incremental COVID cost to heavy op on SG&A ad spend in the fourth quarter. Can you give us any sort of quantum of investment, any way to contextualize the level of expenses and headwinds that you're talking about there?

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

A

Sure. I would attribute a big or large part of that headwinds and I did comment on that is related to our A&P spending. So, a couple of things contributed to that A&P spending. Some of it was related to the COVID but also a large part of that is – that as we start to build momentum for our franchise, we want to make sure you're supported with appropriate levels of A&P spending. So, a big chunk of that additional cost that you are seeing directly relates to A&P spending.

The other part of it is – that I would say from an overall standpoint is that we do have a larger – larger increases in commodity costs that are rising in the second quarter and we see that both from the aluminum side as well as on the resin side.

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

A

I'd also say from a volume standpoint, Jason, we are expecting the holidays to be different this year. That is – that is traditionally our largest quarter from a seasonality standpoint as Thanksgiving and the December holidays, and we don't expect those to drive the same kind of volume as they have in the past partially because consumers already have on hand many of our products and partially because the gatherings are going to be different.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. It'll be interesting to see how that plays out. Thank you all for your time and I'll pass it on.

Operator: Our next question comes from the line of Lauren Lieberman with Barclays. Please proceed with your question.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Great. Thanks. Good morning.

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

A

Good morning.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

I just wanted to – [ph] good morning, I wanted to follow up again (33:05). I know you just ran through some details on again helping us to how we should be looking from going forward and we'll pick that up further offline. But I wanted to also just clarify the comments on in-stock versus out-of-stock. So right now, would you say that [indiscernible] (33:28) as of July? That your shipments are now back in line with takeaway and at retail inventory levels are kind of where they need to be?

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

A

Let me answer that in a couple of different ways. First of all, our in-stock levels have improved from where they were in April. So as we saw the out-of-stock increase until an inflection point at the end of April with a combination of demand easing and capacity increases that we've put in place. Capacity is coming closer to matching demand due to our rapid planning, our creative solutions that I talked about in my opening remarks, as well as adding staff.

So yes, we are – we are seeing improvements, but we still have many of our products on allocation with our retail partners. And we have – we are continuing to add capacity and staffing although not at the rate as I indicated that we would like because our case flow levels are not at the 98.5% that we target for ourselves. But the in-stock levels have returned and it varies by product to the – the low 90s. It's not like you go into a retail partner and see the shelves wiped out in our categories [indiscernible] (34:48) and others. And our retail partners tell us we're doing better than a lot of other companies in keeping the in-stocks. But it's not to the level that we hold ourselves to. And we're continuing to work to improve that as I said in my opening remarks.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Okay.

[indiscernible] (35:05)

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

A

Go ahead. I'm sorry.

[indiscernible] (35:11)

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

A

Essentially in a lot of our products, that are on high demand, we are shipping everything we are making. And so what you're seeing in the scanner data is the shipments. Retailers are not sitting on inventory. In fact, they depleted a lot of their inventories.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Okay. Because the reason I wanted to also touch on this is if I think back to some of the conversations that we've had about pre-COVID, you can remember that time, some of your market share gains for Hefty came – they were – very strong performance on innovation, right. The part of the story was that you were already capacityconstrained and that was beginning to be alleviated. But now when we look at the Nielsen data, we continue to see shares under pressure. And so, just thinking ahead to retailers needing to prioritize with manufacturers that can deliver in-stock levels, is there a worry that some of this continued market share pressure because of the stock issues kind of persists and requires greater investment outside of CapEx, but to kind of build back that market share on the superior products that you've got?

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

Yeah. Across those categories that are in high demand, which includes waste bags, we have significant capacity increases underway, and we expect to be able to be at the [ph] restored case full (00:36:46) levels that I talked about by the end of the year. So, we can talk through the waste bag business directly. I think our shares have held up very strongly during this period of time, and I attribute any change there primarily to some minor out-of-stock at a few retail partners, but those are rebounding this month and will continue to rebound.

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

Yeah. And hey, Lauren. I would like to just add to what Lance was saying. I am confident that after a little more time, the market is going to be just simply more accurate at reading what we actually did in scanned channels and in terms of absolute performance, because you can see in the scanned channels that our share trends are good. So, you're concerned about in-stock, where I understand from the perspective you're looking at and the way you're looking at the data. I hear where you're coming from. But as Lance said, the share performance, pick your channel – or not pick your channel, pick your category – there are a few exceptions, but the dominant trend is on a very healthy share performance. So, I think it really just boils down to really making sure you're getting at the proper granular level of what's happening in our business. And that's not unique to Barclays' comments.

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

Right. Okay, awesome. Thank you. I'll follow up on that offline. Thanks so much, guys.

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

Yeah.

Operator: [Operator Instructions] Our next question comes from the line of Mark Astrachan with Stifel. Please proceed with your question

Mark Astrachan Q
Analyst, Stifel Financial Corp.

Yeah. Thanks, and good morning, everybody. I wanted to ask two kind of related questions, one just on the cost outlook. So, I appreciate the commentary there about levels increasing. But if we look at just oil for resin, look at aluminum, they're still below where they would have been at the beginning of the year presumably relating to your initial outlook. So, I guess what has changed maybe relative to that? What are you anticipating within your guidance for those metrics over the balance of the year in terms of commodities? And then related to that, you didn't have the same commentary in the press release, maybe I'm overanalyzing this, around being more challenged to show year-on-year improvement in adjusted EBITDA in 2021. So, maybe if you could just touch on that too, that'd be helpful.

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

A

Nathan, can you take the commodity question? And Michael, you can take the 2021 question.

Nathan Lowe
Senior Director-Finance, Reynolds Consumer Products, Inc.

A

Yeah, no worries. Thanks, Lance. So, I'll just pick on one of our commodities there. So, as an example, our polyethylene prices, which is our largest spend, were up in June and slightly above where we started the year and certainly worse than our expectations as we entered the year. More recently, if I – just as a reminder, materials are 60% of our COGS and about 45% of those points are commodities. Within that, polyethylene is the largest, followed by aluminum, and then polystyrene resin. All three of those commodities that I've just mentioned increased in June and now again in July, which are contributing to worsening of our commodity outlook, and suppliers frankly are signaling additional increases in the back half.

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

A

As far as 2021 is concerned, look, there's a lot of uncertainty we have still yet and we're still figuring out, and we're not quite ready to talk about 2021 yet as it relates to our expectations around that. But as the year goes on and we get a little bit more visibility, it'll be clear to give you a little bit more insight into that.

Mark Astrachan
Analyst, Stifel Financial Corp.

Q

Okay. Thank you.

Operator: Our next question comes from the line of Andrea Teixeira with RJ Commodities (sic) [JPMorgan Securities LLC] (00:40:59). Please proceed with your question.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Hi. It's with JPMorgan. So, thanks, and good morning, everyone. So, I'm happy to hear you're all well. My question is on the consumer – the consumption dynamics, and I appreciate all the color you gave in the earlier questions. So – but can you give us an idea of the pantry destocking and do you think customers are still working off their inventories? And also can you please comment on your exit rate for shipments growth in particular for Cooking and Tableware? I think you talked about the level of shipments against retail inventory. So, I was hoping to see if you can give us an idea of the exit rates in particular for those two. Basically, I'm trying to figure out if Cooking has accelerated, while Tableware became less negative as you progressed in the quarter with the reopening? And also a follow-up on the additional distribution for innovation, have you already benefited from that or the bulk of it has yet to come for the balance of the year? Thank you.

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

A

Thanks, Andrea. For the – the RCP categories are experiencing elevated in-home usage and they're continuing to grow. I think the scanner data that you're seeing is representative of takeaway. As mentioned a moment ago, there's really no retailers replenishing inventory at this point, because they're on allocations on most of our high-demand products. We are seeing Tableware start to recover in those – particularly in those states that have reopened more than others, but we're tracking that state by state, in fact, actually geography by geography within those states. And overall, we are seeing stronger demand in those Tableware items. So, from an overall demand standpoint and shipments, I think the scanner data reflects the shipment data as well, and I really can't comment on Q3 any further than that. So, could you remind me of the other two questions that you asked?

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Oh, yeah. Sorry, Lance. Yeah, and I appreciate that color. But I think more on the consumption habits, I know you try to run a lot of kind of Nielsen or surveys, do you think that consumption of your products, meaning the foil – aluminum foil and all of the baking products and obviously trash bags, are you tracking to meet demand? [indiscernible] (00:43:33) and clean out these shelves, like are they probably through that inventory and they are now – what we see in Nielsen is [indiscernible] (00:43:43) you think they're still pantry stocking at this point?

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

A

Our data shows that the pantry stocking is no longer occurring and that the destocking is already over, and that occurred in the April-May timeframe, but these are now use occasions. The products tracked via our survey, well over half of our consumers are cleaning, cooking, baking, doing yard work and organizing more often than they did three months ago. And 80% of customers say they're cooking more meals. The majority, over 64%, say they're generating more trash and using more disposable dishes to ease the burden of cleaning. And in foil, for example, our research indicates that usage is steady over the past few months and about one-third of our consumers are using foil at least once per day, up from a pre-COVID benchmark of 6%. So, this is sticky behavior that we expect to really continue for the long-term.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

That's super helpful. Thank you so much. I'll pass it on.

Operator: [Operator Instructions] Our next question comes from the line of Wendy Nicholson with Citigroup. Please proceed with your question.

Wendy C. Nicholson
Analyst, Citigroup Global Markets, Inc.

Q

Hi. Good morning. Two just housekeeping things. Number one, the expense of $5 million to $10 million related to the COVID expenses, is that a permanent number that you expect will be with you going forward or is there – they're particularly large as you've got those new protocols put in place? That's question one. Question two, Michael, can you remind us, this $16 million headwind that you had on revenues from the exit of low-margin business last year, how many more quarters do we have that as a headwind? When does that lap?

And then – I hope it's okay. My real question is just with regard to capacity constraints. Just, Lance, like how do you manage capacity constraints when you have a – you have demand from your private label contracts and you have obviously demand for your branded goods. Is there a choice that you have to make sometimes, how you prioritize we're going to meet the demand for the private label versus the brand or what's the decision process like if you've got demand on both sides that you can't meet? I hope that makes sense. Thank you so much.

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

A

It makes great sense. Michael, why don't you answer the first two questions, and I'll take the last question?

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

Sure. So, our COVID costs, the range I that gave you $5 million to $10 million, these are discrete type of costs that are on PP&E, extra labor and cleaning costs and things that we experienced – we've been experiencing thus far. It's hard to peg on what that will be, because obviously depending upon what happens in overall – in the country as it relates to COVID, and we're seeing some ramped up and elevated cases, that has an impact on our locations. So, that could vary. I think the – that $5 million to $10 million is a reasonable range to assume going forward, somewhere in there. But it's really hard to peg the specific number. So, as it relates to the lapping of the exit of low-margin business, we expect that to be behind us in September. So, as of September, we'll be on a normal pace as it relates to those losses of business.

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

And I'll just add to that. [ph] It's gradual through the Q3 too (00:47:29), right?

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

Yeah.

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

So, a vast majority of it was through Q2 and then the final part of it will be in Q3, right?

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

Correct.

Wendy C. Nicholson
Analyst, Citigroup Global Markets, Inc. Q

Got it.

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

So, on that question of how do you balance the capacity constraints for demand on high volume items between store brands and RCP brands, the answer is, customer by customer, product by product collaboration. And as we're adding capacity that we are managing that balance to provide in-stocks for both and pausing items in both that are on the lower velocity SKUs. So, it really is in partnership communications and decision-making with our retail partners because they want both products on the shelves.

Now, in the case of one case where we had some severe capacity constraints on foam plates, we made the decision to really stop production of Hefty brand and went 100% store brand on foam for a period of time. And you probably saw that in the scanner data in Q3 until we were able to get the in-stocks back in demand. But for the most part, it's been very balanced and we have not had to make significant decisions one way or the other. It's been a balancing act of both.

Wendy C. Nicholson
Analyst, Citigroup Global Markets, Inc.

Q

Fair enough. Well, well-done. Thank you so much.

Operator: We have no further questions at this time. Mr. Mitchell, I would now like to turn the floor back over to you for closing comments.

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

Well, thank you everyone for your participation and interest in Reynolds Consumer Products. We're becoming a stronger and more agile company, and I am privileged to lead this great team with discipline and vigilance on safety and a focus on strong performance and an even more attractive environment for our products. Please take care of yourselves, your families and your friends. Stay safe and healthy. Goodbye.

Operator: Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.