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# Reynolds Consumer Products, Inc. (REYN)

## Q2 2022 Earnings Call

# CORPORATE PARTICIPANTS

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Greetings and welcome to Reynolds Consumer Products, Inc. Second Quarter 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Mark Swartzberg, Investor Relations. Please go ahead, sir.

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

Good morning and thank you for joining us for Reynolds Consumer Products Second Quarter 2022 Earnings Conference Call. On the call today are Lance Mitchell, President and Chief Executive Officer; and Michael Graham, Chief Financial Officer. For our agenda today, Lance will focus on market conditions and our fundamentals, and Michael will review our quarter and outlook. Together, our remarks will be approximately 20 minutes. Then we will open it up for your questions.

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 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 risk 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 measures 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. While we would like to answer all 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.*

Thank you, Mark. We delivered another quarter in line with our earnings expectations and what continues to be a very dynamic environment. First half and second quarter highlights include continued share strength across our business, share gains in branded waste bags, branded disposable tableware, and multiple cooking and baking categories. A return to shipments aligned with consumption. Further narrowing of the price to cost gap across most of our business, including a further improvement in waste bag profitability.

Delivery and expansion of Reyvolution savings. A substantial slowdown in foil consumption has been challenging. However, category declines have been moderating since late June. Our branded volume share is growing again and a number of corrective actions are underway to address this issue. In addition, lower cost inventory has a positive impact on foil margins, as we head into the holiday season, I will go into our foil plans and other revenue drivers in a moment.

But before I do, I want to highlight a few things about the environment and our unique advantages and position within it. Our category advisors are diligently working with our retail partners to support our categories and drive traffic. And as you would expect, consumer behavior during these dynamic times is top of mind. That means we are having numerous discussions about the optimum balance of brands and private label, promotions, pack sizes and features and displays.

I also want to point out that our price leadership and the cumulative value of our pricing actions, together with declines in aluminum and polyethylene rates are producing a closer alignment between price and cost, which we have been pursuing since late 2020. This translates into an anticipated margin expansion and earnings growth in the fourth quarter and a significant increase and flexibility to invest in trade, advertising and other category drivers as we plan for the holidays in next year. Michael will operate on that shortly.

Now, let's talk about our main drivers of growth, pricing, consumer demand and innovation and manufacturing and supply chain capabilities. In the area of pricing, we began increasing foil promotions in June, motivated by the historically strong impact of promotions and we are encouraged by the consumer and retail response. We are implementing additional promotional activity over the balance of the year, including a substantial step-up in October in order to drive holiday related demand. We've announced another round of pricing for our tableware products to offset the additional cost increases for polystyrene resin and an additional increase for Hefty brand waste bags.

In terms of elasticity, the foil category is demonstrating the largest increase in elasticity prompting many of our actions. Our other categories are also seeing increased elasticity by comparison to what we were seeing earlier in the year and we are watching them all closely. Changes in consumer consumption in our categories has been more dynamic than we have seen historically. We will continue to respond with corrective measures.

Turning to consumer demand, as you know our products are in 95% of US households and we have benefited from the changes in habits triggered by the pandemic. We've been meeting these changes in habits and as I said earlier, we are uniquely positioned to respond to new opportunities as economic conditions change. We rely on consumer market research, which allows us to better understand who is driving our categories and their needs. We stepped up at these capabilities during the pandemic and made a number of discoveries.

For example, an increased portion of men and younger consumers are more active in the kitchen at home than they were prior to the pandemic. That's a major opportunity in any economic environment. But here are a few examples of how we're responding to it in this environment. In foil, as I said, we're stepping up promotions, allowing us to hit lower retail price points and increase purchase frequency. We're also increasing features and displays to drive usage and targeting advertising to reach younger consumers.

In Waste & Storage, we're seeing strong back-to-school demand in branded and private label products and driving the Hefty brand through innovation, larger pack sizes, distribution gains and additional advertising. In disposable tableware, we're driving party cups with a particular emphasis on the club channel.

The third driver of our growth is innovation. Our standout innovations continued to be Hefty Fabuloso and Hefty ECOSAVE. Each of which continues to demonstrate high velocity, while also gaining distribution. Other notable contributors in the quarter and year-to-date include new Hefty Fabuloso 4 and 8 gallon waste bags for use in additional rooms of the house and private label waste bags with odor control. Hefty Fabuloso and Hefty ECOSAVE are delivering as major platforms for innovation and we plan to expand them. And in terms of new innovation, we just introduced Hefty Compostable Printed Paper Plates, Reynolds Kitchen Compostable Wax Paper and other Reynolds innovations are in the pipeline and we plan to introduce a wide range of branded and private label products offering sustainable solutions that are wins for consumers, retailers and RCP alike.

Our fourth driver is manufacturing and supply chain capabilities. Staffing and supply chain conditions continue to be challenging, but they are stabilizing and much improved versus late 2020 and 2021 levels. Before I pass the call to Michael, I'd like to leave you with the following. We're well-positioned for changing economic conditions and we're responding with promotions, pack sizes, advertising and other pieces of the marketing mix to meet our consumers increased emphasis on affordability.

The gap between our pricing and material manufacturing and logistics cost increases is nearly closed, and we are on course for margin expansion and earnings growth in the fourth quarter and 2023. This means not only a return to earnings growth, but also increased flexibility to invest in our categories and drive future innovation and consumption.

We are executing with excellence in our mission to simplify daily life. So consumers can enjoy what matters most. I'm extremely proud of the RCP team as we navigate through these dynamic times. We are well-positioned to realize the benefits of the actions we've taken over the last two years.

With that, over to you, Michael.

## Michael Graham

*Chief Financial Officer, Reynolds Consumer Products, Inc.*

Thanks, Lance. And good morning, everyone. I'll briefly review our second quarter results, then I'll turn to our guide and why we are well-positioned for margin expansion in the fourth quarter and 2023. Net revenues in second quarter were $917 million, an increase of 5% over second quarter net revenues of $873 million in 2021, primarily driven by price increases and partially offset by a decline in volume.

Adjusted EBITDA for the second quarter was $118 million, down 20% versus last year's second quarter of $148 million, driven by lower volume, primarily due to declines in foil consumption as well as higher materials, manufacturing, logistics and advertising costs. Significant price increases across our entire portfolio offset all material cost increases and a large portion of increases in manufacturing and logistics costs. We expect to close the remaining gap between price and materials manufacturing and logistic cost increases in third quarter and to see an additional margin benefit in the fourth quarter driven by anticipated progressive easing in aluminum cost and implementation of additional pricing. Adjusted earnings per share for the quarter was $0.26.

Turning to our segment performance, details are in our press release and 10-Q. So let me give you the highlights. The 5% increase in net revenues was driven by low to mid-teen increases in pricing in each of our business segments, which was partially offset by a 9% volume decline driven by Reynolds Cooking & Baking and to a lesser extent declines in two other segments. Our overall price increase of 14% is consistent with the year to-date increase of 13% and reflects our effectiveness in recovering on material cost increases and a large portion of increases in our manufacturing and logistics cost in the second quarter.

As you know, in May we expected a mid-to-high single-digit volume decline in the second quarter and as Lance reviewed, slowing foil consumption was a substantial headwind in the quarter. The 19% decline in Reynolds Cooking & Baking volume also reflected a decline in low margin reroll volume and an additional headwind from timing of retailer replenishment early in the quarter, whereas volume declined 3% in Hefty Waste & Storage driven by lower waste and food bag usage as consumers are spending less time in their homes and as Lance mentioned, branded waste bag volume and dollar shares are up in the first half. Volume was flat in Hefty Tableware as gains for Hefty disposable plates and private label party cups were offset by declines in other disposable tableware and Presto products volume declined 7%, driven by lower waste in food bag usage.

Turning to our outlook for the third quarter of fiscal 2022, we expect net revenues to grow 8% to 12% on $905 million in prior year, driven by price increases and a low to mid-single-digit volume decline. Adjusted EBITDA of $110 million to $120 million and adjusted EPS to be in the range of $0.21 to $0.25 per share. For the fourth quarter of fiscal 2022, we expect net revenues to grow 9% to 17%, on $1,021 million in the prior year, driven by price increases and flat to slightly down volume. Adjusted EBITDA of $220 million to $240 million and adjusted EPS to be in the range of $0.59 to $0.66 per share.

For the fiscal year 2022, we now expect net revenues to be up 8% to 11% on $3,556 million in 2021, driven by price increases and a mid-single-digit volume decline including the impact from timing of retailer inventory replenishment, primarily in the first quarter of this year. Adjusted EBITDA of $560 million to $590 million, adjusted EPS to be in the range of $1.32 to $1.43 per share and net debt to be $1.9 billion to $2 billion at December 31, 2022 and as a reminder, our capital allocation priorities are unchanged.

As Lance said, elasticities have picked up, particularly in our foil business. And so those assumptions are reflected in our guide, we continue to closely monitor elasticities and how they may change in other categories given the inflationary environment.

In terms of other key assumptions, we assume rates for key commodities are stable-to-easing by comparison to end of July levels and estimate incremental cost pressures of approximately $525 million for the year, which is a $75 million increase by comparison to our expectations, we reported in the first quarter results.

We estimate depreciation and amortization of $120 million for the year, interest expense of $70 million and an effective tax rate of 25% and a capital spending of $135 million to $145 million, down from our previous estimate of $150 million to $170 million, driven by extensions and timing of select capacity and other investments. In terms of phasing, our incremental pricing and costs comparisons have us positioned for substantial margin expansion that we expect in the fourth quarter. As I just reviewed, first-half results reflect a narrowing of the gap between pricing and cost increases. We expect that trend to continue in the third quarter and for our implemented pricing to fully offset increases in materials, manufacturing and logistics costs. We also expect SG&A to be up in the third quarter versus prior year due to increases in variable compensation and advertising costs. As we enter the fourth quarter, we expect to see progressive easing of aluminum costs driven by existing inventory positions and fourth quarter gross margin is expected to also benefit from the implementation of recently announced pricing.

Now before I hand the call back over to Mark and your questions, I want to leave you with a few thoughts on recovery of pre-pandemic profitability. We anticipate achieving pre-pandemic levels of profitability in 2023. We estimate this to be in the mid $900 million, when adjusting to current volume levels compared to pre-pandemic gross profit of $880 million. We expect closing of the gap between pricing and cost increases, as I discussed when reviewing the guide, to be a major catalyst. In addition, as Lance mentioned, the cumulative value of our price increases is significant. Together with our category leadership position and the anticipated easing of commodity costs, we expect this will allow us to increase category investment, while also gaining additional margin. And we are expanding Reyvolution cost savings based on a comprehensive business review, identifying and targeting additional procurement, manufacturing and logistics savings, giving us added scope for investment in margin growth.

In closing, we continue to manage through a very challenging environment. I'm encouraged about the actions we've taken as well as the implications for the future results.

And with that, I'll hand the call back over to you, Mark.

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## Mark David Swartzberg

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

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

# QUESTION AND ANSWER SECTION

**Operator**: At this time, we will be conducting a question and answer session. [Operator Instructions] Our first question comes from Kaumil Gajrawala with Credit Suisse. Please proceed with your question.

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**Theo Brito**
*Analyst, Credit Suisse Securities (USA) LLC (Broker)*

Q

Hi, this is Theo Brito for Kaumil. So you're now guiding to volumes to be down mid-single-digits this year. Can you maybe just remind us what was your expectation before and more importantly, what gives you confidence in the new volume outlook, please? Thank you.

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

A

So the answer to the first question was down low-single-digits. And what gives us confidence in our new volume guide is, this is a very dynamic environment. And as I mentioned in the prepared remarks, elasticities have picked up in much of our business, particularly foil. But as I also said, in our remarks, our category advisors are actively addressing changing consumer needs with our retail partners and we're seeing an encouraging response to corrective actions in the foil category.

Specifically, we have maintained all points of distribution that have historical share position. Our category declines have begun moderating and we're regaining volume share as we've picked up these promotions. The EQ volume for 12 weeks ending June 26 for Q2 essentially, the category was down 12.2% and Reynolds Wrap was down 15.6%. The EQ volume for the four weeks ending July 31, the category is down 5.6% and Reynolds Wrap down 4.4%. We plan to continue increasing foil promotions, features and displays through year-end, including a substantial pickup in October to take advantage of lower foil costs and holiday related demand.

And after many months, lagging Reynolds Wrap price increases, we've seen private labels begun taking prices up. And some of the other drivers in our other three business units, we expect our performance in the club channel, which is strong to continue and that's particularly important for tableware. Hefty Fabuloso continues to gain momentum with new distribution and introduction of multiple new pack sizes. We are stepping up advertising across our portfolio of Hefty Waste & Storage products and evaluating increases in promotions and we're also introducing new low-price-point pack for above sizes and additional value-pack sizes. The changes in consumer consumption in our categories has been more dynamic than we've seen historically and we're continuing to watch it very closely and we will continue to respond with corrective measures.

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**Operator**: Our next question comes from Lauren Lieberman with Barclays. Please proceed with your question.

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**Lauren R. Lieberman**
*Analyst, Barclays Investment Bank*

Q

Great. Thanks. Good morning, everybody. I still just wanted to go back to the reason for the lowered EBITDA and earnings outlook for the year because the conversation on, yes, the volume declines in foil are worse. But we've talked about this before and that you would turn the promotion on and then you called out the higher cost basket. I'm just curious the sources of that big change because it just feels like 3Q is a little bit of a shock and I frankly thought there was maybe a little bit more visibility, inherent in the business model. So I'm curious mostly about 3Q? Thanks.

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

A

Yeah. So the main driver of our guide down is lower volume expectations as we are in a more inflationary environment and therefore elasticities have gone up. We estimate approximately 3 points less volume than we previously expected. Those 3 points represent about $40 million of loss contribution margin, that's all the $40 million decline in adjusted EBITDA and when you look at the lower-end of our guide of $615 million and the midpoint of our current guide of $575 million. So in terms of the third quarter EBITDA, in terms of volume as Lance said we're in a dynamic environment. Elasticities have picked up in all of our categories, particularly in foil, but as we look at the commodity curve, the value of the pricing we've implemented and we are expecting a significant increase in earnings in Q4 relative to Q3 as a result.

Specific to Q3, in aggregate, the year-over-year benefit of pricing in Reyvolution is fully neutralized, cost increases year-over-year. With the other segment compensating for Reynolds business, where we are still working through some of the higher cost aluminum. So that has to be worked through in subsequent quarters. So this leaves volume in SG&A. We expect volume declines in the range of low to mid-single digits, which is a headwind, but there are some offsetting margin benefits from improved innovation. As an example, Hefty waste bags, Fabuloso. We've also have the Reynolds Kitchens have performed very well and we're expecting the same moving forward.

So year-on-year the decline really boils down to higher SG&A with most of our total year-over-year increases falling in the back half. The key drivers are increased advertising and market research and higher compensation costs, some of which is timing related.

**Lauren R. Lieberman**
*Analyst, Barclays Investment Bank*

Q

Okay. So just step back for a sec, volumes in foil or in cooking and baking being worse than expected in 2Q created a delay in the timeline for what you previously expected for moving through some of that higher cost inventory through the P&L, so that...

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

A

... you got it.

**Lauren R. Lieberman**
*Analyst, Barclays Investment Bank*

Q

Okay. Okay. And then the SG&A piece that you were saying, Michael, I'm sorry. I was still my brain was spinning on the inventory piece. So there's also some higher SG&A that you've built-in, because you're investing more than you've maybe previously planned?

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

A

Yeah.

[indiscernible] (00:24:29)

**Lauren R. Lieberman**
*Analyst, Barclays Investment Bank*

Q

Yeah. Okay. Okay, great. And then for 4Q then you get the margin expansion because the timing is back to as planned in terms of moving to that lower cost inventory and then the incremental pricing?

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

A

So let's just go back to the SG&A point.

**Lauren R. Lieberman**
*Analyst, Barclays Investment Bank*

Q

Sure.

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

A

The year-over-year decline was down to higher SG&A with most of that total year-over-year increase falling in the back half, right. The key drivers are increased advertising and market research and higher compensation costs.

**Lauren R. Lieberman**
*Analyst, Barclays Investment Bank*

Q

Okay. All right. Great. Okay. I'll leave it there, pass it on. Thank you. I'm fine. We can follow up offline too, thanks, guys.

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

A

Okay. Thanks, Lauren.

**Operator**: Our next question comes from Robert Ottenstein with Evercore. Please proceed with your question.

**Robert Ottenstein**
*Analyst, Evercore ISI*

Q

Great. Thank you very much. Can you talk a little bit about the competitive environment for trash bags, what you see your competition doing, how the promotional feel looks like and what you need to do to kind of get that business on a better path?

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

A

Yeah. Robert, thank you for the question. We have seen a much more constructive environment in the competitive dynamics in the waste bag category. As you heard in my prepared remarks, we are announcing another price increase on Hefty waste bags. And so when that is completed, we will be recovering almost all of our costs, including labor and logistics, as well as resin, assuming the resin curve holds in that category. So we've seen at a very much more positive environment as it relates to the pricing dynamics across the category. And that is going to come down to how the consumer consumption plays out as we go forward.

**Robert Ottenstein** Q
*Analyst, Evercore ISI*

How do you feel about your share trends?

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

The share trends in the first half were positive, in the last four weeks it's been pretty flat.

**Robert Ottenstein** Q
*Analyst, Evercore ISI*

Okay. And going over on the aluminum foil side, how do you see that category playing out in terms of consumer choices between private label and branded? And do you see a path for consumers going back more heavily to branded?

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

Yeah as I mentioned in the prepared remarks, we have seen pricing of private label increasing. And so to put specific numbers on it, the last 12 weeks, private label increased 2.5 share points. But in the last four weeks, it's been flat. So as we've put these promotions in place, which has gotten our price points lower and as we've seen private label prices increasing. We've seen that the price gaps narrow. And we've seen that shift back to a more stable position between brand and private label in the category.

**Robert Ottenstein** Q
*Analyst, Evercore ISI*

Okay. And then if I can just sneak one more in. Given this dynamic environment, right, which you say that the, it's you've never seen or that it's at least more dynamic than in the past, a lot of elasticity. Is your – are your conversations with the retailers different in the past, the retailers looking at the category in any way more differently than they had in the past?

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

I think what we're looking at with the retailers is making sure that we get the price points correct, right. And what happened in foil, when you see a category that declined 15 points in a quarter, that's historically something we've never seen a double-digit decline in the category. So our discussions with them has been about how do we get the price points right in this inflationary environment.

Reynolds Wrap, 75 foot pre-pandemic traded below $4 on a unit basis, the 75 square foot flagship product. As we've taken pricing to compensate for very high costs aluminum, it went up to almost $2 a pound. The price points went above $5. So we're now promoting well below that. Looking to get below $5 and into the mid-4s as we get into Q4. And that will be driven by the investments we will make with lower aluminum costs, as we go through that inventory, but we'll do that on a sequential basis to ensure that we also have the opportunity to ensure our margins stay strong.

**Robert Ottenstein** A
*Analyst, Evercore ISI*

Got it. Thank you very much.

**Operator**: Our next question comes from Andrea Teixeira with JPMorgan. Please proceed with your question.

**Andrea Teixeira**
*Analyst, JPMorgan Securities LLC*

Q

Thank you. Good morning. Lance, I wanted to go back to your comments on private label. Has your mix moved back to that portion of the business and your price in private label has improved to your point about pricing moving up? Do you see that as an improvement on a sequential basis for your margin? And then a follow-up on the Cooking & Baking given the mid-teen, I believe you said mid-teen consumption decline in the quarter, do you have a sense that obviously inventory levels in retail build up and then if you see that, what is baked in your guidance into the fourth quarter, you did say in October you're going to be pushing more pricing and promo. Anything you can inform us also in terms of pantry de-stocking, if you see folks, especially at Costco where you have a big presentation there or a big pack if things have improved sequentially? Thank you so much.

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

A

Well, there's three questions in there. I want to make sure I understood the first one, which was about private label shift, you speaking about foil or are you looking at all of our categories and are you asking about are we margining up our private label, I didn't quite understand what you wanted the question about...

**Andrea Teixeira**
*Analyst, JPMorgan Securities LLC*

Q

Yeah. Sorry let me parse out. I think, if you could focus on foil and trash bags, I guess those are the most important ones, if you can – because I did see the commentary about Presto not performing that well. So I guess probably what you're seeing is that the store brands have taken a little bit of share at that point, as you mentioned. But just to tack on the price gap commentary that you gave just before.

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

A

So on foil. Yes, we did see a shift to private label in the second quarter as we had pricing that was significantly moving faster up than the private label, I quoted the last 12 weeks, it was up 2.5 points in private label share versus us. But in the last quarter, it's flat. So as we put the promotions in place and got below the $5 price points in across all of our sizes. We have been able to – at this point see that flattening and no longer shifting to private label.

In waste bags, it's actually the other direction, if you look at the last 12 weeks, branded share in waste bags has improved one point and in the last four it's 24. So there's not been a shift in the waste bags to private label in our current outlook or in the current history I should say. So does that, gets to your question on the private label shifts?

**Andrea Teixeira**
*Analyst, JPMorgan Securities LLC*

Q

Yeah, Lance. The one thing on the private label share that you mention on aluminum foil, did you capture that because you obviously put this around 40% of your sales in private label, did that shift more favorable to you or it's mostly your competitors?

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

A

I see. Okay. So in foil, that is one of the categories that we don't have a very strong position on private label. We've got some capacity constraints and we have chosen to really focus on the brand in that particular category. So, no we did not pick that up.

**Andrea Teixeira**
*Analyst, JPMorgan Securities LLC*

Q

Okay. And then on the – that's fair. And then on the Cooking & Baking inventory levels both at retail and pantry. I know you have prepared us that this was an issue back in the first quarter. Just wondering how that evolved into the second and as you exit the quarter into the third quarter?

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

A

Yeah. Well, we continue to monitor our retailers' inventories through direct access or a number of inventory tracking tools. And we did see the retail [ph] de-load (00:34:08) the foil and other products as we had anticipated in Q2. But for the last two months, we've been shipping in line with consumer demand. We do know that retailers are of course continuing to evaluate their own inventory levels and we're watching that closely.

**Andrea Teixeira**
*Analyst, JPMorgan Securities LLC*

Q

Right. But then when you say you're shipping according to demand, the demand is still down?

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

A

Yes, but it's moderate, as I mentioned it's 4%. Right. So it's significantly different than it was in Q2. And we have factored...

**Andrea Teixeira**
*Analyst, JPMorgan Securities LLC*

Q

... that's fair. All right. Okay.

**Operator**: Our next question is from Mark Astrachan with Stifel. Please proceed with your question.

**Mark S. Astrachan**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Yeah. Thanks and good morning, everyone. So I want to maybe come at some of the previous questions in a slightly different way. So back to your commentary about achieving pre-pandemic profit levels next year. I guess maybe think to about it, how should we model, the retention of pricing, if inputs come down either in line with expectations or more and relative to what you all have said from a historical standpoint, which I think was maybe just under 40% retention of pricing, if you go back to 2018, 2019. How does that play out going forward and sort of related to that, if I'm doing the math right, for your guidance pricing still has to pretty meaningfully accelerate on a two year basis over the balance of the year. So how does that factor in and could potentially elasticity which is worsening, get worse even than expectation? Thank you.

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

A

Well, I'll answer the first part of the question and then I'll let Michael explain a little bit more about 2023 and our outlook for 2023. But we have historically been able to maintain and improve our margins and keep pricing as commodity costs go down and we believe that we will be able to do that in 2023 and in Q4.

In total, when you look at the price increases that we've taken over a two year period of time. It's almost $1 billion. So there's a lot of opportunity to be able to margin up within that $1 billion and at the same time, invest in our categories to maximize promotions and advertising. Mike, you want to talk about 2023?

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

A

Yeah. And specifically around the gross profit. So we anticipate achieving pre-pandemic levels of profitability in 2023. We estimate this to be around in the mid $900 million when adjusting to our current volume levels compared to pre-pandemic gross profit of about $880 million. We expect closing the gap between pricing and cost increases and as I discussed in reviewing the guide to be a major catalyst. In addition, as Lance mentioned, the cumulative level of our price increases is pretty significant together with our category leadership positions and easing of commodity costs, we expect this will allow us to increase category investment, while also gaining additional margin.

**Mark S. Astrachan**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Okay. I've got it. Just one other follow-up on that last point, one last piece in that last point, Michael. So you said volume still being off, where I guess the 2023 comments are contingent on volumes still being up versus pre-pandemic levels. I guess you are all surprised at the volume degradation that we've seen in 2022 and kind of the world continues to normalize. How do you think about the likelihood that you retain those incremental volumes?

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

A

Yeah. So we've done some extensive studies with a IRI consumption forecast projection model to look at the effect of this volume, how much of it is impacted by pricing and how much of its impacted by reopening. And in most of the categories, it's 60% elasticity and 40% reopening. In foil, it's 76% elasticity and only 24% reopening. So we believe there's been a fundamental shift in the pandemic and the use of our categories and we get the pricing right on elasticity that volume will continue to be above pre-pandemic levels.

**Mark S. Astrachan**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Got it. Okay. Thank you.

**Operator**: Our next question comes from Bill Chappell with Truist Securities. Please proceed with your question.

**William B. Chappell**
*Analyst, Truist Securities, Inc.*

Q

Thanks. Good morning.

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

A

Good morning.

**William B. Chappell**
*Analyst, Truist Securities, Inc.*

Q

Hey I'm sorry to keep going to hammering on the same issue on foil. But I mean, on that last kind of comment of 76% of the business is elasticity or the issue is elasticity. I mean, it's hard to kind of buy into that number. I mean, I just trying to think fundamentally about the foil category. There's not really a substitute for the category. I mean if prices are high and you're still cooking or using foil, you still need to use a cook foil and it doesn't seem like, all of your business has gone to private label. So I'm just trying to understand how that, how that works out and how you haven't had demand destruction. And I guess the question is, do you think, you've made a mistake of pricing too far, too fast versus just kind of riding out a short-term rise in aluminum costs?

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

A

Well, on the second part of the question on aluminum more than doubled during 2022. It went up to over $2 a pound. So if you did the math on that, the earnings destruction by not taking our price up would have been significant, like $75 million. And so we had really no choice but to follow that pricing up. Yeah, it's just an unfortunate consequence of the commodity drive up that we had to do that from a pricing standpoint, what gives us confidence is both the last four weeks as well as back in 2018, when we crossed a price point, when aluminum spiked at that point, it went above at another price point and when we got it back lower, we got the demand back.

We do know from our research that consumers are not leaving the category. They are stretching out their purchase cycle by de-loading and having less use occasions. In some cases, they're buying the lower pack sizes and in some cases, the more affluent consumers are buying larger pack sizes. And the conditions vary by consumer, but they're not leaving the category. To your point, we've done a lot of study on that. It's not – there's not a real substitute there. So getting the price points back will get the purchase frequency back more normalized.

**William B. Chappell**
*Analyst, Truist Securities, Inc.*

Q

Okay. And I guess on that same, I don't fully understand why private label has taken so long to price. I mean you would assume they have worse purchasing power of aluminum than you do and would want to maintain their price gaps and margins as much as they could. So any color as to why they've taken so long, it's been a weak point for you?

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

A

That is a question that we have asked ourselves over the last year, and it remains a mystery to us. I don't have any answer to that question. I can only speculate that we believe that some retailers were comping off of each other on their store brands and they ate some margin, waiting for the others to move. And that was part of the equation, the other part of the equation may have been the amount of lower cost aluminum that they had in inventory during the run up. So they felt that the producers felt like they could wait before they took the pricing. We have got no confirmation, though that anybody's hedging. So that is not a scenario that we've believed could have impacted the timing for the private label producers.

**William B. Chappell**
*Analyst, Truist Securities, Inc.*

Q

Okay, great. I'll turn it over. Thanks.

**Operator**: [Operator Instructions] Our next question comes from Jason English with Goldman Sachs. Please proceed with your question.

**Jason English**
*Analyst, Goldman Sachs & Co. LLC*

Q

Hey, folks. Thanks for letting me in. I got three kind of rapid fire questions, I guess. So thank you for the mid-$900s number on gross profit. I think we're all going to step back say mid-$900s gross profit, put $350 million or so on SG&A, a $110 million as D&A and walk away saying that you're expecting somewhere in the low $700s from an EBITDA perspective, is that meaningfully off base?

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

A

The SG&A number is a bit low as we will have more advertising than that. So I'd say closer to $400 million.

**Jason English**
*Analyst, Goldman Sachs & Co. LLC*

Q

Okay, that's helpful. And then in terms of the fourth quarter, you put a sales range out there that's really wide, but you put a volume number at least the comment suggests that you've got a pretty tight expectation on volume. I think you said sort of flat to down slightly, yet total sales plus 9% to 17%, suggesting you see at least probably a 500 basis point range on price, which is sort of unusual. Usually price you got better visibility in volumes, where the uncertainty lies. What's going on there, what drives the exceptionally wide range?

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

A

Yeah. The overall revenue range takes into consideration of potential on volume fluctuation. The indicated volume guide is the midpoint of the expected volume performance. So in order to hit the 17% revenue growth, volume will need to be up. And on the flip side, if we do a 9%, volume would need to be down.

**Jason English**
*Analyst, Goldman Sachs & Co. LLC*

Q

Okay. That's helpful. And in terms of volume, if I do a three-year CAGR on Q2, which is effectively like, if I do it versus 2019, your volume is down 6% versus 2019. So the whole notion that, you're like you're going to be able to have profit off a higher volume base in this quarter, certainly calls that into question, is there something unique sort of timing wise that would, why this quarter is not reflective of sort of a roundtrip back to not only pre-COVID but actually below pre-COVID levels?

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

A

No, I don't see that. We – the 6% I haven't done the math on that. So we're going to have to go back and look at, it's down 50 basis points, right.

**Jason English**
*Analyst, Goldman Sachs & Co. LLC*

Q

Yeah with 2Q 2020, you're up 3% on volume, but 2Q 2021, you're up 1%, now you're down quite a bit, like you compound those and it's not positive. It's a negative number. But sounds like we can follow-up offline?

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

A

We'll need to, we'll do some math.

**Jason English**
*Analyst, Goldman Sachs & Co. LLC*

Q

Yeah. Good stuff. I'll pass it on. Thank you.

**Operator**: Our next question comes from Peter Grom with UBS. Please proceed with your question.

**Peter Grom**
*Analyst, UBS Securities LLC*

Q

Hey. Good morning, everyone. I hope you're doing well. So I guess I wanted to follow-up on Jason's question in terms of the 2023 guidance. I mean, Lance, you mentioned kind of the flexibility, the pricing actions you will provide looking out to 2023, you mentioned promotion decrease ad spend, but I guess, how do you really think about the preference from here because it seems like you're – if you just assume $400 million in SG&A, you're flowing through a lot of upside to earnings growth of – if you're taking the $950 million of gross profit or so, is that the right way to think about it, that you're kind of really expecting potentially north of 20% EPS growth looking at the next year?

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

A

Yeah, I think you're in the ballpark here.

**Peter Grom**
*Analyst, UBS Securities LLC*

Q

Okay. That's helpful. And then I guess I just want to follow-up on Lauren's question regarding the gap between price and cost pressures and thinking through the 3Q earnings guidance. I mean, can you maybe just break out more specifically what you're expecting in terms of gross margin versus higher SG&A that would drive EPS and adjusted EBITDA to be down strong double digits. I know you mentioned the higher incentive comp and ad spend. but just any commentary specifically around those two items, would be really helpful.

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

A

Yeah. So I think the reference is that overall our SG&A is going to be up.

**Peter Grom**
*Analyst, UBS Securities LLC*

Q

Okay. All right.

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

With the primary driver of that is being overall compensation.

**Peter Grom**
*Analyst, UBS Securities LLC*
Q

Okay. Thank you so much.

**Operator**: Ladies and gentlemen, we have reached the end of the question and answer session. And I would now like to turn the call back over to Lance Mitchell for closing remarks.

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

Thank you, everybody, for your questions. We appreciate your time this morning. Our business is well positioned for any economic environment and we anticipate earnings growth in the fourth quarter. I want to thank our employees and our retail partners for their dedication and their contributions during these challenging and dynamic times. Thank you.

**Operator**: This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.