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Reynolds Consumer Products, Inc. (REYN)

Q3 2021 Earnings Call

CORPORATE PARTICIPANTS

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

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

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

OTHER PARTICIPANTS

Nik Modi
Analyst, RBC Capital Markets LLC

Robert Ottenstein
Analyst, Evercore ISI

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

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

William B. Chappell
Analyst, Truist Securities, Inc.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Wendy C. Nicholson
Analyst, Citigroup Global Markets, Inc. (Broker)

Peter K. Grom
Analyst, UBS Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Greetings. Welcome to the Reynolds Consumer Products Inc., Third Quarter 2021 Earnings Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] Please note this conference is being recorded.

I will now turn the conference over to your host, Mark Swartzberg, Vice President of Investor Relations Thank you. You may begin.

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' Third Quarter 2021 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 15 minutes, then we will open 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 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. 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 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.

Thank you, Mark. We delivered another quarter in line with our expectations in spite of additional cost and supply chain challenges, thanks to the hard work and dedication of our team. We grew revenue 10% on top of last year's record third quarter net revenues, including an approximate 2-percentage-point benefit from a one-time sale of excess raw materials in the quarter. We did so in spite of production disruptions at third-party suppliers and continued import delays.

Our market share has remained strong across most of our products and we achieved our earnings forecast in the face of additional material, labor and logistics costs and a more challenging environment for staffing and logistics services.

We are narrowing our earnings guide within our previous range to reflect additional staffing and supply chain pressure as well as higher rates for key commodities versus July levels. Michael will walk through those drivers of this pressure and the pricing actions we are taking to offset material cost increases. I remain firmly committed to implementing price increases to offset material cost increases at a pace and amount appropriate to market conditions.

Michael will also talk through Reyvolution cost savings, which are tracking ahead of plan and remain a significant source of margin recovery. Increased investment in automation is a major contributor to Reyvolution cost savings.

Now, let's return to the top line. We expect four factors to drive accelerating revenue growth for RCP in the fourth quarter. They are consumer demand, price increases, innovation and expanded manufacturing and supply chain capabilities. Together with our market share performance, we expect these drivers to remain a sustained source of long-term growth.

First, consumer demand. Household use of our products remained elevated versus pre-pandemic levels. According to our latest Harris Poll, which we conducted again in September, everyday use of foil is up more than fourfold versus pre-pandemic levels and weekly use of waste bags and food bags is up more than 30% versus pre-pandemic levels.

In addition, according to our fourth numerator poll, the overwhelming majority of respondents continue to expect to maintain or increase their foil, waste bag and food bag use beyond 2021. Our household penetration has increased from pre-pandemic levels with 24 to 25 households now having one or more of our products.

This sets up our categories, our brands and our product portfolio for continued strong performance. And that's what we're seeing. On an omni-channel basis through October 10, branded dollar share is foil, waste bags and disposable cups and dishes is up versus year-ago levels and improving sequentially. These figures include e-commerce and [indiscernible] (00:05:52) same trend.

Brand dollars [indiscernible] (00:05:57) foil, waste bags and disposable cups and dishes higher than year ago levels and improving, sequentially. We're also building on our e-commerce momentum. E-commerce related sales are growing strong double digits. Growth is broad-based across RCP and major e-commerce retailers and we continue to expand participating in third-party marketplaces while also testing and launching direct-to-consumer initiatives.

The next driver of our revenue growth is price. Our third round of pricing actions was implemented as planned and a fourth round goes into effect during the first quarter of next year. We expect sequential improvement in profitability in the fourth quarter and a pronounced improvement in profitability by the end of the first quarter of 2022 as a result of these increases. This assumes key commodity rates stabilize.

Michael will speak more to the timing and results of our pricing actions in a moment. I know that elasticity is also a topic of interest to all of you. We're watching that closely given the amount of pricing across retail. As you know, historically, our categories have demonstrated low elasticity by comparison to many consumer staple categories. That remains the case and we factored our latest research on elasticity into our guide.

The third driver of our strong growth is innovation. Hefty Fabuloso continues to exceed our expectations and drive volume thanks to Hefty's quality, consumer preference for Colgate-Palmolive Fabuloso scent and our sales and category management teams' effectiveness partnering with our retail customers. In fact, Hefty Fabuloso helped drive Hefty Waste & Storage pass $1 billion in annual retail sales for the first time in the quarter.

Cooking & Baking results are also seeing a substantial benefit from new products, strengthening our market position, bringing us to the new adjacencies and expanding the scope of our sustainable offerings. Notable Reynolds innovations include Reynolds Wrap Everyday Non-Stick Foil, Reynolds Wrap 100% Recycled Foil and Reynolds KITCHENS unbleached and compostable parchment paper.

In tableware, ECOSAVE is now the number one sustainable brand in disposable tableware according to IRI. And innovation in store brands also contributed to our strong performance across RCP categories, including share gains for our Presto unit and private label food bags.

I also hope that you saw the recent release of our ESG scorecard. The scorecard provides baseline metrics for evaluating our performance against the goals we announced in April. Development and expansion of sustainable products is integral to our business. We've introduced numerous sustainable product solutions and have more in the pipeline for introduction in 2022. We're also on track to achieve our goal of a sustainable option in all product lines by 2025.

Our fourth growth driver is expanded manufacturing and supply chain capabilities. The capacity additions we undertook last year have allowed us to maintain strong market shares and retailer in stocks for most of our products remained well above pandemic related lows. These and other improvements to our manufacturing, and supply chain capabilities position us well in our categories.

Having said that, we're not immune to the staffing and logistics related pressures across the economy, and we're actively working to minimize related disruptions to production and shipment of our products.

Before I pass the call over to Michael, I'd like to leave you with the following: Our business remained strong and we have a history of dependable volume, earnings and cash flow. We have the brands, the product portfolio, the category management team, the manufacturing and supply capabilities, the pricing actions, the cost savings, and most of all, the people to position us for substantial improvement in earnings growth when inflation moderates and over the long term. I look forward to our future growth and success for our company, our partners, and our shareholders.

With that, over to you, Michael.

Michael Graham

Chief Financial Officer, Reynolds Consumer Products, Inc.

Thanks, Lance, and good morning, everyone. I will briefly review the third quarter results then turn to our outlook and capital allocation priorities. Revenues increased 10% on top of the record third quarter revenues in 2020, reflecting pricing to recover increased costs, strong underlying demand across our business, and approximately 2 percentage points from a one-time sale of excess raw materials. Adjusted EBITDA was $132 million, down 31% to prior year as price increases lag increases in material, labor and logistics costs, which was partially offset by lower SG&A. Adjusted earnings per share for the quarter was $0.33.

Turning to our segment results for the third quarter, there are three main drivers of our year-on-year performance, strong underlying demand for our categories and product portfolio, price increases, which lagged further commodity cost increases and higher labor and logistics costs along with increased staffing and logistics challenges.

In Reynolds Cooking & Baking, net revenues grew 15%, with 11 percentage points coming from price increases, with the remainder driven by a one-time sale of excess raw materials. Adjusted EBITDA decreased 11% as price increases lagged the pace of commodity cost increases. Excluding the benefit of the one-time raw material sale, the underlying volume was down 2% due to the lapping of last year's increased consumption.

For Hefty Waste & Storage, net revenues grew 13%, driven by price increases and a 2% volume increase. Adjusted EBITDA decreased 43% as increases in material and labor cost outpaced price increases, partially offset by higher volume. Volume was up as household demand remained strong and our waste bag business continued to benefit from innovation.

For Hefty Tableware, net revenues increased 2%, driven by price increases, partially offset by a volume decline of 4%. Adjusted EBITDA decreased 42% as price increases lagged increases in material, labor and logistics costs. We also saw labor shortages at third-party suppliers continue to adversely impact volume, which more than offset the continued strength from higher everyday usage, social gatherings and innovation.

Finally, for Presto Products, net revenues grew 11% driven by price increases, slightly offset by a 1% volume decline. Adjusted EBITDA decreased 50% as price increases lagged increases in material, labor and logistics costs. Presto volume was down 1%, reflecting import delays and lower business-to-business product sales for the quarter, partially offset by improving food bag category trends and improved Presto private label food bag share.

Now to our guidance, which we've updated versus our previously disclosed guidance, followed by a few additional comments on our outlook. We continue to expect high-single-digit revenue growth for the fiscal 2021, underpinned by pricing, at-home consumption, increases in social gatherings, innovation and retail replenishment. We estimate 2021 cost pressures to be in excess of $450 million and have updated our outlook to reflect these pressures. Rates for resins have not eased since July, as previously forecasted and aluminum rates are higher versus July levels as well. Labor and logistics costs have also exceeded forecasts since July.

The details of our guide for fiscal year 2021 are as follows: Net revenues to grow in the high-single digits; adjusted net income to be in the range of $321 million to $336 million; adjusted EBITDA to be in the range of $590 million to $610 million; adjusted EPS to be in the range of $1.53 to $1.60; capital spending of approximately $145 million, which includes $25 million for the completed purchase of a manufacturing facility we previously leased and net debt to be approximately $1.9 million at December 31, 2021.

For the fourth quarter, we expect revenue growth in the mid- to-high teens, driven primarily by recent price increases and anticipated volume above Q4 2020 levels. And we expect sequential margin improvement, but with continued short-term earnings pressure, primarily driven by price increases implemented during the third quarter, lagging increases in commodity, labor and logistics costs.

We also assume progress mitigating staffing, third-party manufacturing and logistics-related disruptions. The details of our fourth quarter guide are as follows: Net revenues to grow in the mid- to high-teens on $888 million in the prior year; adjusted net income to be in the range of $93 million to $108 million; adjusted EBITDA to be in the range of $170 million to $190 million and adjusted EPS to be in the range of $0.44 to $0.51.

We plan to provide our guidance for 2022 with the announcement of fourth quarter results in February. Nonetheless, I thought it would be helpful to provide an update on some of the items we reviewed last quarter.

In the area of pricing, as Lance said, our fourth round of pricing to offset additional cost increases is being implemented across RCP. The majority of the increases have been announced and go into effect in January. Assuming current rates of resin and aluminum hold, we will fully recover these higher commodity costs through pricing actions for Reynolds Cooking & Baking; Hefty Tableware and Presto by the end of the first quarter of 2022.

We could also see ongoing unfavorable gap between commodity costs and pricing for Hefty Waste & Storage moderate if we announce additional waste bag pricing or resin rates are lower than we are forecasting. We're planning to return to a more typical level of trade promotion and advertising in 2022.

Investing in Reyvolution cost savings programs is being accelerated, and it remains a major source of our funding for growth. We continue to expect more than 200 basis points of EBITDA margin from Reyvolution of cost savings in 2021 and expect to grow Reyvolution dollar cost savings again in 2022. We're investing approximately $25 million in automation-related projects in 2021, and plan to invest more than double that in 2022.

We expect spooling automation in our Louisville operations to contribute significantly to the increase at a total of nearly $50 million in spending over three years of 2021 through 2023.

This project is typical automation-related projects providing an estimated payback of less than three years. Numerous additional automation and intelligent factory projects are also underway across RCP, including the installation of a high-speed cutting equipment for cooking and baking, line upgrades for Hefty Waste & Storage, and Presto, robotics and related line expansions for Hefty Tableware and other improvements in equipment and line efficiency throughout our operations.

Now, before I turn the call back over to Mark and your questions, I'd like to leave you with the following: As Lance reviewed, our business remain strong. Demand for our products is up. Our market shares are strong and our manufacturing and supply chain capabilities are strong and we are investing to strengthen them further. Nonetheless, it is important to remember that the environment for staffing and logistics related services has become more challenging and material cost increases have been difficult to predict with accuracy.

We consider this year's profit pressures temporary and expect sequential improvement in profitability in the fourth quarter. We also expect to return to pre-pandemic levels of profitability when inflation moderates. As I previously said, we will fully recover these higher commodity costs through our pricing actions for Reynolds Cooking & Baking, Hefty Tableware and Presto, by the end of the first quarter of 2022, assuming current rates for resin and aluminum hold.

And we remain committed to strong cash generation and disciplined capital allocation. Investment and internal growth and upgrades to our cost structure will remain our top priority. We continue to focus on deleveraging with a target ratio of 2 times to 2.5 times EBITDA. We plan to continue returning excess cash flow to shareholders through dividends. And we recently announced a quarterly dividend of $0.23, payable November 30, 2021. And we continue to opportunistically pursue bolt-on M&A in our categories and adjacencies domestically and internationally.

With that, I'll hand the call back over to you, 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 asked 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: Thank you. At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of Nik Modi with RBC Capital Markets. Please proceed with your question.

Nik Modi
Analyst, RBC Capital Markets LLC Q

Yeah. Thank you. Good morning, everyone. I just had a quick clarification question just on the raw material sale, if you could just provide some details around that. And then the broader question is, just on the price elasticity, you talked about, I haven't done a study yet. I would be curious to hear kind of what the conclusion was of that. And how do you see the consumer and as they kind of draw down all the cash that they've been sitting on given all the stimulus as we kind of move into 2022? How do you think that's going to manifest and just the receptivity of pricing generally because it's not just in your categories, it's basically every category. Thanks.

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

Yeah. I'll take the first part of that on the raw material. So, we thought ourselves long on raw materials and we really don't speculate in this space. And so we decided to sell of those raw materials, so we got market prices at that. It was a nominal increase from a margin, I mean, for nominal level from a margin perspective. But, overall, it was the best thing to do and it's a prudent thing to do at that point in time.

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

And I'll take the elasticity question, Nik. We've done elasticity studies over the course of the history of our company and they've always come back as these categories have relatively low elasticity. There's no question we're in a dynamic environment now that's different than we've seen historically and it did come back again with low elasticity. But as I said, it's dynamic. So, we're going to watch it very closely and we'll course correct and adjust as necessary. But stimulus packages and consumer spending while it's factored into that study, it's not necessarily able to predict it any better than any of us. So, we'll have to course correct if necessary as we go forward.

Nik Modi
Analyst, RBC Capital Markets LLC Q

And Lance if I could just follow-up. Do you see the competitive situation playing out as you would have hoped or is there still some disconnect in terms of you guys moving versus some of your competitors across your categories?

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

Well, we've taken pricing across 85% of our products as Michael indicated. So, as Michael also said, the recovery in waste bags will be dependent upon the easing of commodity grades, additional pricing or both. There is numerous factors we're going to consider in making those decisions. Consumer demand, category strength, retail price points. And, of course, working with our retail partners in the competitive environment. Right now, our focus on waste bags is – demand is exceeding our increased waste bag capacity currently. So, as a result, our focus is on improving case [indiscernible] (00:23:56) service to our retail partners.

Nik Modi
Analyst, RBC Capital Markets LLC

Q

Great. Thanks.

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. Just first a point of clarification. Did I hear you say that you expect to get back to kind of normal margins at the end of Q1 2022, assuming that no further cost increases? And I suspect its market share gains that is driving that conviction. So that's just kind of the follow up question. And if we stand back and think longer term, once we get into a normal environment, given all the gains that you've gotten from Reyvolution, given your market share trends, given what looks like sustainably higher consumer demand, is there any reason why you won't be able to earn materially more than what you did in 2019 when you get to a more stable environment? Thank you.

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

A

Yeah. So just to clarify, when we were talking about recovery, our overall intent is that we feel by the end of Q1 that we'll have full recovery from – on the commodity increases that we've seen. So that was it. It was not intended to be margin related. It was full recovery from a commodity cost standpoint. Obviously, labor and logistics continues to be a bit of a challenge and we're still working through that. But we think we have a good plan to address that as well.

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

A

And, Mike. Robert, this is Mark. Just to add to what Michael said that full recovery comment pertained to Reynolds Cooking & Baking, to Tableware, and to Presto.

Robert Ottenstein
Analyst, Evercore ISI

Q

And what's going on with the rest of the business?

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

A

Well, the rest of business is the Hefty, and I think we've talked about that quite a bit and that Hefty portfolio. We have to be very mindful of what competition is doing from a pricing standpoint. And so at this point in time there's no further actions that were taken around pricing.

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

A

Just to add to that, we've implemented mid-single-digits in the first quarter on Hefty Waste bag, a 9% increase in August, together, representing a 14% increase in those products.

Robert Ottenstein
Analyst, Evercore ISI

Q

And the competition's lagging?

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

A

Yes.

Robert Ottenstein
Analyst, Evercore ISI

Q

Great. Thank you very much.

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. I was curious about private label. And given the breadth of your portfolio, how you are thinking about or actually already communicating with retailers about if there's an inevitability that the pinch on the consumer wallet from such widespread inflation does cause some trade down. I just would love to hear how if it's in prior cycles, but what you can offer in terms of how your portfolio can fare given the private label participation that you have.

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

A

Yeah. As we've talked about on numerous occasions, Lauren, over the last couple of years since we went public, these categories through these cycles have remained very stable from a percentage of brands and store brands. And part of that because it's already highly penetrated. Of course, we closely watch this and manage price gaps. But our studies show as part of the elasticity models that in the current environment that that should hold going forward as well.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Okay. That's great. And then my follow-up was I do recall having – you guys having spoken in the past about there being like a magic price point in foil. It was $4.99, maybe. But there actually was an element, at least, in the foil business of there being a magic price point that elasticity kind of kicks in above that level. There's incredibly increased demand in that category. So I'm just curious if you think that magic price point conversation goes out the window because of the greater usage and household penetration you've had in that category through the pandemic.

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

A

Well, we've gone far enough past that price point now with the two price increases that we've already announced and implemented at Reynolds Wrap. And that price point was $3.99. We've long surpassed that in the last couple of months. And you can see from the category in our shared data that it's continued to be very strong. So out the window, I think, is a great comment. It's a very inflationary environment now, and that was different when we crossed that price point previously.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Okay. That's great. Thanks so much.

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

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

Q

Yeah. Hey. Thanks and good morning, everyone. I guess just to start as a follow-up, could you maybe comment on where price gaps are today and whether private label is moving generally in unison with the multiple rounds of price that you've taken across relevant categories?

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

A

Yes. So, as you know, we have a large percentage of our business is also store brands and the pricing that we've taken on ours, as well as competitor store brands have been consistent with the brands. So in most categories, there has been a consistent price gap maintained in most of these categories. But the exception maybe waste bags and we're watching that closely. We have taken up as well as we've seen competition in store brand waste bags, say price increases, more than the brands.

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

Q

Got it. Okay. That's helpful. And then broadly speaking and maybe some of this is A is unknown; B is a bit optimistic. But if we kind of look forward to next year and say in a perfect world, the spot rates for key inputs either stay where they are or even come down. Could you just remind how to think about this – how much of the pricing if there'll be four rounds, I guess by beginning of next year, in key categories? How much of that sustains, retains versus how much is given back in just reductions of price increase promotions, et cetera?

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

A

Yeah. That's a very, it's a very dynamic question because it really depends on where commodities are at that point. But as we've said historically, the price increases that we take if commodities stabilize or retreat modestly, we don't reflect that in price decreases. And in this environment, there are other offsets that we've got to consider. We have higher labor costs, we have higher logistics costs. We have higher input costs, including energy and packaging. And all of those have got to be considered as part of the pricing equation as we go forward even if commodities retreat.

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

Q

Got it. Okay. Thank you.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of Bill Chappell with Truist Securities. Please proceed with your question.

William B. Chappell
Analyst, Truist Securities, Inc.

Q

Thanks. Good morning. Just as expected, another question on commodities and input inflation. Just trying to understand how much of it right now is, I guess, specific to the company, thinking more like aluminum. And how much of it is also more what you would view as transitory? We heard some other companies talk about kind of Hurricane Ida, affecting resin prices and that would – and shortages and stuff like that, I don't think you really alluded to that. But just kind of maybe as you look at your basket, how do you feel that does probably start to ease versus some of it being more, I guess, longer lasting than anything else.

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

A

I think it's very, very difficult historically to accurately predict forward commodity costs. If we were able to do so, we'd price to that forecast versus the actual costs and that's what we're doing across the vast majority of our product portfolio.

One thing's pretty certain. Resin is not going to retreat back to pre-pandemic levels. We do see the modernization and stabilization occurring in resin, but we're not predicting a big pullback. We'll watch it closely, of course, and I've talked to all the major resin suppliers personally and they're not predicting a major pullback either. On aluminum, it's been very dynamic and volatile. It is almost doubled at one point versus prior year. It's retreated modestly in the last week, but it's up substantially versus 2020 levels.

William B. Chappell
Analyst, Truist Securities, Inc.

Q

Okay. Great. And then, just follow-up kind of on the upcoming holiday season, I feel like a year ago you felt like the fewer family outings would − I think it was would − maybe have a benefit just because fewer big get together and lots of smaller family outings would be a lift for your products. So, how does that we characterize that coming to this holiday season, I mean, should there be this greater occasion usage or just how you're looking at that from a volumes perspective? Thanks.

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

A

Yeah. You're correct. We did predict that and our prediction turned out to be incorrect. We did not see the kind of holiday gatherings we historically seen particularly for the cooking and baking products in 2020. And so, what we're seeing in 2021 is a return to the more normal holiday gatherings in 2021.

William B. Chappell
Analyst, Truist Securities, Inc.

Q

Great. Thank you.

Operator: Our next question comes from the line of Andrea Teixeira with JPMorgan. Please proceed with your question.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Good morning. So, you lowered the EPS for the fourth quarter, but your top line came in well ahead in the mid-to-high teens. So, can you breakdown a bit between volumes and pricing? I saw the increase of the inventory, so it seems that you are prepared to meet the higher demand. But given the puts and takes of each of the divisions, I think Tableware has this comps and Cooking & Baking as well in terms of volumes, but you have tough comparisons in the Hefty Waste & Storage. So how can we think about added to the price increase that you took in that division and how to think, as you just discussed with Bill now, from a holiday perspective, how to think about the puts and takes? Thank you.

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

A

Yeah. So, I would – you'd probably recall I did say that about $450 million – we've seen a $450 million increase in material, logistics and related cost. Now, $50 million of that is higher than what we anticipated in early August. And so that $50 million is really driven by additional labor and additional aluminum cost and logistics costs. If I broke that out, so about $30 million of that $50 is materials, and the rest of it is labor and logistics. So, that's really the driver of why that's challenging us further.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Right. Yeah. No, that's helpful, Michael. But then in terms of the top line, kind of the mid-teens and high-teens, I think came in way ahead of consensus in our numbers. So what informs you in terms of demand or the top line growth? Are you seeing early signs from your retailers that they're taking in way more inventory for cooking and for tableware normalizing, how we should be thinking to get to that number for the fourth quarter?

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

A

Yeah. Before he answers that, Andrea, could I just clarify? Are you asking about Q4?

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Yes, Q4.

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

A

Okay. All right. Go ahead, M.G.

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

A

Oh, I thought you were talking about the top line for Q3, where a lot of that was driven by the excess aluminum sale.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Oh, yeah. No worries. Sorry if I wasn't clear. It's more about like the forward-looking the fourth quarter. It came in ahead, of course, you have the pressure that led to your EPS being lowered. But on the top line what is your view...

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

A

Yes. Yes. Yeah. So, bottom line, I think it's timing, right? So, there's no real change in a full-year right? So, it's basically just about a matter of timing a shift between Q3 and Q4.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Okay. And in terms of demand you're not saying while you just discussed that holiday season or inventory levels at the retail. How we should be thinking of that?

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

A

It's still early in the quarter but our guide holds that we're seeing strong demand in the quarter compared to prior year, particularly in cooking and baking. But what Michael is saying is the headwinds on higher commodity costs and logistics cost is approximately $50 million more than we'd seen in early August.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

That's fair. I'll pass it on. Thank you.

Operator: Our next question comes from the line of Wendy Nicholson with Citi. Please proceed with your question.

Wendy C. Nicholson
Analyst, Citigroup Global Markets, Inc. (Broker)

Q

Hi. Good morning. My first question has to do with a comment about the sale of the excess raw materials. I don't know if I've ever heard that before and it just strikes me as sort of a strange thing given the scarcity of raw materials and whatnot. So, can you just give us a little bit more color of what that was? Was it a mismatch in terms of raw materials you had on hand versus what you were selling or how did that come about?

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

A

Yeah. Well, it was primarily in aluminum space and over a period of time we accumulated more inventory in that overall space than we anticipated, right? And so, typically when we have a situation where we have excess amounts. If the market conditions are at such that we could sell it are at a margin, even if it's a low margin we'll exit that, because we don't want to get in a practice of speculating and holding on excess levels of inventor that can't be used in a reasonable amount of time.

Wendy C. Nicholson
Analyst, Citigroup Global Markets, Inc. (Broker)

Q

Got it. Okay, fair enough. And, I guess, just longer term and I apologize for the second question, but I think I'm near the end of the queue, so hopefully that's okay. Just Michael, what you said about sort of a commodity environment and resin prices aren't coming down anytime soon and how you're not taking pricing in Hefty sort of given the competitive environment, I'm just curious if you take a step back for Reynolds in particular just specifically you. How long do you think it will take or is it even in the cards for you guys to get back to kind of a high 20s gross margin? Has something structurally changed? Do you think – I mean I don't – I can't imagine you or any of your competitors want to be structurally lower gross margin going forward, but if you're not taking enough pricing to insulate margins of Hefty, what does it take for you to get back to that high 20s gross margin? Is that a two-year event, three-year event or has something just changed? Thanks.

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

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Before Michael answers that, one thing I will just say is the math is going to change with these numerator and denominators moving around so much. So when we talk about high 20s, we need to calibrate less on percentages and more on actual dollars. Michael?

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

A

Yeah. So overall, I believe we're taking all the right actions to return to pre-pandemic profitability, right? We've talked about the fact that, our pricing actions are in place to recover by the end of first quarter assuming that we don't see further increases in material costs. We're also we're also taking great – extensive cost reductions across our portfolio and we're managing within our existing footprint, which is pretty critical, right. And that's underpinned by automation, innovation and continued – as well as continued demand.

Currently there are three notable headwinds that we have to overcome. Waste and storage, resin costs in excess of current levels of pricing, we've talked about that. The labor market remains tight and then there's tight logistics conditions driving inefficiencies and rate increases. So, we have to overcome those. But overall, I think we're well-positioned and we're taking all the right steps.

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

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And so just to put a fine point on that, when inflation stabilizes and the commodity costs stabilize, we will return to the dollar gross margins because of the actions we've taken in prices and increases and cost reductions.

Wendy C. Nicholson
Analyst, Citigroup Global Markets, Inc. (Broker)

Q

Terrific. Thanks so much.

Operator: [Operator Instructions] Our next question comes from the line of Peter Grom with UBS. Please proceed with your question.

Peter K. Grom
Analyst, UBS Securities LLC

Q

Hey, good morning, everyone. I hope you are doing well. So, maybe just following up on Wendy's question regarding the margin recovery. I know you mentioned in 4Q margins should improve sequentially, but coming from down 1,200 basis points that's a pretty wide range. So, can you maybe help us understand the magnitude of the improvement? And looking out the 2022, so when do you actually anticipate gross margin expansion given the comments you made around pricing offsetting commodities for three of the four divisions?

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

A

Yeah. I want to go back to what Lance said around gross margins, right? So, overall, you got to factor in the fact that there's a math equation, right, in all the pricing that we've taken. So, that's going to continue to challenge us from a gross margin perspective, right? So, I just can't overemphasize that if you guys are building your models purely on the margin perspective, you have to be cognizant of that.

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

A

And I'll just add that all through fiscal 2021, we've been taking price increases sufficient to recover commodity increases, but it's been on a lag. And assuming, the current commodity cost hold where they are right now, our Q1 2022 pricing actions will see us fully recovered on 85% of our business in a similar statement could have been made in August with regard to Q3 pricing actions. But, obviously, commodities moved up from that point. So, when they stabilized, as I said a moment ago, we will have recovered.

Peter K. Grom
Analyst, UBS Securities LLC

Q

Got it. And then, maybe just asking on margins more around SG&A, it's clearly been a nice tailwind this year. So, just in theory, like as – if gross margin showed improvement, how should we think about some of the between the line spending coming back or do you think you kind of have – you have found some efficiency that should gross margin improve or gross profit dollars improve that you would actually see that flow-through with your earnings?

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

A

No. I would say that 2021 was primarily a lot of belt tightening that we did in. And it's not necessarily something repeat in 2022. And, of course, we'll provide that in more detail with our guide in 2022.

Peter K. Grom
Analyst, UBS Securities LLC

Q

Great. Thank you so much.

Operator: Our next question is a follow-up from Rob 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 dynamics on the waste bag side? And compare that of how it's been over the prior years? It seems that there's a little bit of a change in that dynamic. I don't know if whether it's around competitors looking to gain share, keep share, differences in what's going on in the channels or innovation. But it just – it kind of feels like there's something a little bit different going on. So maybe you can kind of help us understand that a little bit better and why that part of your business should be lagging in terms of margin recovery.

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

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Well, as I've said, we implemented two price increases that added up to 14% in the Hefty waste bags. And as a result, the price gaps, while they vary by channel, in most channels, they've narrowed. We continue to watch this category very closely. And as I also said, where demand is exceeding, our increased waste bag capacity. So our focus right now in Hefty waste bags is improving [indiscernible] (00:46:20) service to our retail partners.

Robert Ottenstein
Analyst, Evercore ISI

Q

Great. Thank you.

Operator: Thank you. Ladies and gentlemen, we have reached the end of the question-and-answer session. I will now turn the call over to Lance Mitchell for closing remarks.

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

Thank you for your questions. We appreciate your time this morning. Our revenue is growing and we expect accelerating revenue growth and sequentially improving margins in the fourth quarter, driven by consumer demand pricing and innovation and our expanded manufacturing and supply chain capabilities. I want to particularly thank our employees for continuing to follow prevention measures and putting safety first as we grow our business in this exceptional time. Thank you and stay safe.

Operator: This concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation. And have a wonderful day.