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Reynolds Consumer Products, Inc. (REYN)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greeting, and welcome to the Reynolds Consumer Products Fourth Quarter and Full Year 2020 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Mark Swartzberg, Vice President of Investor Relations. Thank you, Mark. You may begin.

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

Thank you. Good afternoon and thank you for joining us on Reynolds Consumer Products fourth quarter and fiscal year 2020 earnings conference call. On the call today are Lance Mitchell, President and Chief Executive Officer; and Michael Graham, Chief Financial Officer.

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 afternoon for a detailed discussion of the risks that could cause actual results to differ materially from those expressed or implied in any forward-looking statements made today. Please note management's remarks today will focus on non-GAAP or adjusted financial measures.

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

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

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

V. Lance Mitchell

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

Thanks, Mark. Thank you for joining us today. First off, I'd like to thank our employees for continuing to follow prevention measures and putting safety first always, both for the ongoing COVID-19 pandemic and for overall injury prevention. So, our agenda today: Michael will review our quarter and outlook; I will cover our first year as a public company, our business performance and 2021 priorities. Together, our remarks will be approximately 20 minutes and then we'll open it up for questions.

We've reported record performance in 2020; our first year as a public company, delivering strong results because of the hard work, dedication and commitment of our more than 5,000 employees in a very difficult environment. Revenue was up 8%, driven by growth of our categories, new products and marketplace wins. We increased brand support double digits and developed a strong new product pipeline.

EBITDA and cash flow grew significantly, even with the increase in standalone costs. We paid down more debt than expected at the start of this year, and we responded to the sustained and favorable shift in demand for our products, by expanding capacity without adding roofs. This sets us up for more growth in a year that will be every beat as dynamic as 2020. Michael will speak to what that means for quarterly phasing. First, I'll set the stage by reviewing the consumer landscape and our business performance.

Consumer demand for our categories remains elevated, higher than we'd anticipated at the time of the IPO. We're seeing a sustained and favorable shift in demand for our products supported by the data. 80% of families are cooking more meals at home, 60% of families say that cooking has become a social activity in their household, and 60% of families are storing more leftovers and freezing more food. This goes hand in hand with trends in small kitchen appliances, where purchases are up double digits since the start of the pandemic. And among active users of our categories, over 88% say that they intend to maintain or increase elevated consumption of oil, waste bags, food bags and disposable tableware beyond 2021.

Turning now to our business performance in Cooking & Baking. The Reynolds brand family became $1 billion brand at retail in 2020, driven by growth across its portfolio. We see more strong growth ahead for Reynolds products and have expanded capacity accordingly. This will allow us to improve in-stock performance and execute against a substantial pipeline of innovation. It is also worth noting that service for this unit was impacted by staffing challenges in the fourth quarter, and service has been improving since year end.

Hefty Waste & Storage also has momentum. The waste bag and food bag categories are large and growing, and the Hefty brand continues to do very well. Innovation will pick up here too, including the introduction of Hefty waste bags scented with Fabuloso licensed from Colgate Palmolive. Hefty Tableware showed resilience last year, growing low single digits in spite of fewer and smaller holiday related gathering and a fall-off in demand for business and restaurant items.

The Hefty Eco Save rollout continues to go well and we expect innovation to be an even larger contributor for the tableware growth this year. Presto also enters 2021 with a substantial increase in capacity and produced solid growth despite the exit of low margin business in the fall of 2019. We posted excellent e-commerce growth for the year and again in the quarter, continuing our robust performance in this channel. Our analysis indicates our e-commerce shares are equal to or better than brick-and-mortar shares depending on the category.

As I said, 2021 offers no lack of challenges, and we expect comparisons to contribute to uneven quarterly performance. We're confident we're entering the year stronger because of our commitment to our retail partners, our unrelenting focus on safety and the diversity and can-do spirit of our people. Our 2021 priorities are: safety, service, profitability, and business transformation. We put safety first always and improved upon our impressive record in 2020. We can get even better when we intend to do so. This means a lower reportable injury rate and more emphasis on wellness amidst the pandemic.

All of us are members of families and our products are integral to family life. Safety will always come first. Service improved for all but Reynolds Wrap in Q4, and we're committed to further improvements. Staffing continues to present challenges, especially given our commitment to safety, but we're managing through that and entered 2021 with more capacity. We're seeing further in-stock improvements and expect our capacity increases to also support our growth.

Commodity, packaging, and logistics costs are rising, and we're committed to minimizing the gross margin impact. We are doing this through a combination of price, trade spend management, procurement initiatives, SKU rationalization and innovation. We're monitoring top trends daily and pivoting to protect margins and grow our business. Revolution is our business transformation program. We're doing more here too, improving the way we do business, our manufacturing cost structure, and our potential for growth.

As I said in my opening remarks, we accomplished a lot in our first year as a public company and we have more to do. Our value proposition includes both branded and store brand products, and we continue to provide valuable expertise to our retail partners. I'm confident our people, culture, and priorities will allow us to continue simplifying daily life for consumers, while also delivering another year of impressive financial performance.

I'll now turn it over to Michael to discuss our results and our outlook.

Michael Graham

Chief Financial Officer, Reynolds Consumer Products, Inc.

Thanks, Lance, and good afternoon, everyone. I'll briefly walk you through our results, then speak to our outlook. For the fiscal year 2020, net revenues were a record at $3.3 billion, up 8% over the $3 billion we had in 2019.

Growth was driven by a fundamental shift to more at-home use of our products, as well as the introduction of several new products.

Net income increased to $363 million compared to $225 million in the prior year, with adjusted net income at $413 million for the year. The increase was primarily driven by higher revenue, operating leverage, and lower interest expense. Adjusted earnings per share was $1.97. Adjusted EBITDA was $717 million, which also was a record, compared to $655 million in the prior year. The increase was primarily due to net revenue increases along with lower material and manufacturing costs, partially offset by higher personnel, advertising and logistics costs.

Now, turning to the quarter, net revenues in the fourth quarter were $888 million, an increase of 6% over the prior year net revenues of $835 million. Growth was driven by strong demand, most significantly in the Hefty Waste & Storage segment and the introduction of new products. Adjusted EBITDA for the fourth quarter was $198 million compared to $214 million in the prior year. The decrease was primarily due to increased material and manufacturing, logistics, advertising, and personnel costs, which were partially offset by increased revenue. Adjusted earnings per share for the quarter was $0.57.

Turning to our segment results, Reynolds Cooking & Baking net revenues increased 8% for the year, driven by consumer demand and growth across the portfolio. In the fourth quarter, net revenues increased, but were constrained by lower inventory levels entering the quarter, as well as COVID related staffing challenges encountered during the quarter. The decrease in adjusted EBITDA in the fourth quarter was driven by higher logistics and advertising costs.

For Hefty Waste & Storage, net revenues increased by 15% for the year, driven by consumer demand and the continued strength within the Hefty brand and portfolio. In the fourth quarter, net revenues also grew double-digits, driven by increased consumer demand, higher pricing and fewer trade promotions than in the prior year. The increase in adjusted EBITDA in the fourth quarter was due to revenue growth, partially offset by increased material and manufacturing costs.

For Hefty Tableware, net revenues increased 2% for the year, driven by the introduction of several new products and the recovery from an initial falloff in demand for business and restaurant items shortly after the start of the COVID-19 pandemic. In the fourth quarter, net revenues were up slightly, driven by the impact of new products and higher pricing, mostly offset by softness from business and restaurant items serviced by certain retail partners as well as fewer holiday related social gatherings. The decrease in adjusted EBITDA in the fourth quarter was primarily due to increased advertising and material and manufacturing cost.

Finally, Presto Products, net revenues increased 4% for the year, driven by consumer demand despite the exit of low margin business in the fall of 2019. In the fourth quarter, net revenues increased 6%, driven by consumer demand. The decrease in adjusted EBITDA in the fourth quarter was primarily due to increased material and manufacturing costs.

Moving to our capital structure and cash returns, we continue to be very pleased with the cash-generating ability of our business. We reduced our leverage in 2020, and as of December 31, 2020, we had a cash balance of $312 million and a total debt outstanding of $2.2 billion. We paid another quarterly dividend of $0.22 per share in the fourth quarter and announced a 5% increase in the quarterly dividend to $0.23 per share payable on March 9, 2021. After year-end, we made an additional voluntary debt payment of $100 million.

Now to our guidance, I will review the expectations for the year and first quarter, then I'll speak to our underlying expectations in quarterly phasing. For the fiscal year 2021, we expect net revenues to grow in the low single digits, adjusted net income to be in the range of $412 million to $427 million, adjusted EPS to be in the range of $1.96 to $2.03 per share, adjusted EBITDA to be in the range of $710 million to $730 million and capital spending of approximately $155 million, which includes approximately $25 million for the potential purchase of a manufacturing facility that we currently lease. Net debt to be approximately $1.7 billion to $1.8 billion at December 31, 2021. For the first quarter of 2021, we expect net revenues to be up mid-single digits, adjusted net income to be in the range of $73 million to $77 million, adjusted EPS to be in the range of $0.35 to $0.37 per share and adjusted EBITDA to be in the range of a $138 million to $143 million.

As you can see, we expect another record year of net revenues. We also anticipate a strong start to the year, but expect uneven quarterly profit growth due to volume and cost comparisons, especially in the second and third quarters. As you revisit your models, you should keep this in mind. We are operating in much larger categories than at the start of the pandemic and see this as evidence of a sustained and fundamental shift in demand for our products. Comparisons, nonetheless, will be challenging, especially in March and in the second and third quarters. Commodity, packaging and logistics costs have increased significantly and market trends indicate potential for further increases.

We are committed to minimizing the profit impact of cost increases in a timely way through price and other measures. Remember, year-over-year commodities were a tailwind in Q2 and Q3 of 2020 and flipped to a headwind in the fourth quarter. Labor shortages remain at watch out. However, we will not risk employee safety to address them. We have been mitigating this risk through modified plant processes and targeted recruiting and training and we will remain vigilant in this area.

From a full year perspective, we expect slight decline in gross margins and an increase in SG&A, reflecting A&P spending and wraparound of standalone public company cost.

In wrapping up, there are a few things worth repeating. We are pleased to be operating in categories that are larger than anticipated at the time of the IPO. We remain committed to strong cash generation and cash returns. And this includes further deleverage of net debt between 2 times and 2.5 times EBITDA and continued growth of dividends over time.

Thank you. And with that, I'll turn it back over to you, Mark.

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 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. We will now be conducting a question-and-answer session. [Operator Instructions] Our first question comes from Andrea Teixeira with JPMorgan. Please proceed with your question.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Hi. Thank you and good evening. So I was hoping if you can comment on demand against inventory at the trade. I'm assuming you still similar to have done in previous calls where you talked about what you hear from your retail partners and also if you can comment a little bit on what is embedded in terms of commodity cost pressures into 2021? Thank you.

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

A

Hi, Andrea. Thank you. This is Lance and I'll talk about the fundamental shift in consumer behavior and demand versus retailer inventories, and I'll turn the commodity question over to Michael Graham. As I indicated in my opening remarks, consumer behavior in our research indicates a strong and sustained fundamental shift in demand for our products and our research indicates that that's going to continue for the longer period of time.

When we look at in-stocks, in-stocks inventory throughout the supply chain is low. But we've seen improvements in-stocks across most of our products and retail partners in the fourth quarter. We do expect retailer inventory in in-stocks to continue to improve gradually as we take advantage of the capacity we've added, managed staffing and leverage supply chain improvements, the top priority of our organization in 2021, but the replenishment enhancement will occur. Most of our high velocity products, we are still at very low inventory levels throughout the supply chain. Michael?

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

A

Yeah. As it relates to commodities, we are very focused in our efforts to minimize the impact of higher commodity costs, packaging and logistics costs. We plan to recover the overwhelming majority of our added costs through increased prices, adjustments to level of promotions and/or other actions, including things like SKU rationalization. We've talked about this in the past. We do recognize that there is always a lag as it relates to pricing. So we're always cautious about making sure that we are seeing the level of endurance from a commodity standpoint before we make a decision. But overall, we think we have a good process that's very tight and have served us well in the past and I'm sure it's going to serve us well going forward.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

And just a follow-up, Michael, that's an interesting point about pricing because we heard from one of your key competitors on pricing and they spoke about not increasing prices during the pandemic. Are you talking about aluminum foil related or you're talking about bags?

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

A

Yeah, Andrea, let me take that question. First of all, it does, our pricing strategies do vary across the different products and categories and we are taking pricing on all of those products where they are impacted by commodities, including waste bags. Our waste bags business has been a path of strong growth for us for over five years and that's attributable to our products performance, our advertising and the value we offer to consumers. That combination resonates with consumers. As they're spending more time at home, they're using our products more and we'll continue to focus on superior value proposition, which is delivered by our great spokesperson in John Cena. I'm absolutely aware of our competitors' pricing and we've modeled elasticity impacts across our business. We'll continue to focus on our core mission of serving retailer partners and consumers, innovating, protecting profitability and delivering growth, and we have already implemented one price increase in that product line.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Okay. That's helpful. Thank you. [ph] I'll pass it along (00:22:05).

Operator: Thank you. Our next question comes from Bill Chappell with SunTrust. Please proceed with your question.

William B. Chappell
Analyst, Truist Securities, Inc.

Q

Thanks. Good afternoon.

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

A

Hi, Bill.

William B. Chappell
Analyst, Truist Securities, Inc.

Q

I guess, first, if we take a look back on the Tableware business, I mean up 2% for a year where there weren't a whole lot of outdoor or picnic gatherings. Is there a way to kind of quantify or gauge what that would have been in a normal year or how far – how much you could actually make up in a reopening environment?

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

A

Yeah, that would be a very complicated math exercise that I don't know how I would be able to answer that. I can say this. The Tableware business is really a tale of two cities. There are items that we sell that are primarily for restaurant items and small businesses that go through certain retailers and you would expect those product lines saw significant decline through most of the year. We saw a slight rebound in Q3. But those product items we expect to gradually rebound in 2021, that's factored into our guide, but not return over to the prior level we were at prior to the pandemic. Our consumer items are driven by two things: one, our holiday gatherings, where we saw fewer holiday occasions, particularly like in Q4 where there were less holiday parties and those holiday parties impacted the use occasions towards the Tableware products.

However, on the flip side of that, we had new product introductions, which included our EcoSafe paper, fully compostable, disposable paper products, as well as everyday use occasions for disposable Tableware as consumers got tired of washing dishes every day. So that's why I say there's a lot of moving parts, very complicated math to try and figure out what that growth would be otherwise. But I think a growth year with all of those factors working against that business is an excellent outcome. It speaks well to the future potential for our Tableware business.

William B. Chappell
Analyst, Truist Securities, Inc.

Q

Got it. No, thanks for the color. I know it's a tough to gauge. Switching over, just a follow-up on Presto. I guess in most categories or CPG categories, you saw the trade up to more premium, more trusted brands or what have you that affected both private label and store brands and even value brands. Are you seeing that start to wane and I guess consumers get back to more normal purchasing, or is it still having any drag on Presto and do you expect that to kind of continue in the first half of this year?

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

A

Well, broadly speaking, our brands have outperformed private label and store brand businesses since the pandemic. And looking forward, our commitment as you know is to grow our categories. That means providing a balance of brands and store brands to ensure that consumers have choices that expand the category. We've invested significant resources over the years as part of our strategy to differentiate ourselves from other suppliers by providing both brands and store brands and supporting that with the best in industry category management teams. We distinguish ourselves with our retail partners as a result.

It's been a winning formula since day one when we formed the company in 2011 and we expect it to be a winning formula going forward. But I'll remind you that what I said since the roadshow is the balance between brand and private label in these categories has been very stable over the years. And I attribute some of that to the private label already representing a significant portion of this category. There has not been a significant shift during a pandemic nor would we expect one after.

William B. Chappell
Analyst, Truist Securities, Inc.

Q

Great. Thanks so much.

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

A

Thank you, Bill.

Operator: Thank you. Our next question comes from Kaumil Gajrawala with Credit Suisse. Please proceed with your question.

Kaumil Gajrawala
Analyst, Credit Suisse Securities (USA) LLC

Q

Hello.

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

A

Kaumil, you might be on mute.

Kaumil Gajrawala
Analyst, Credit Suisse Securities (USA) LLC

Q

Sorry guys, I was. My mistake. I think I do that once a day. Michael, I wanted to ask about CapEx and hurdle rates and such. I have to imagine that at the time of IPO or the years prior, you probably had some pretty specific hurdle rates, but now you're putting in capital to catch up with capacity, which is something that maybe given how the outlooks or the categories have changed quite materially, maybe you're just looking at it differently. So can you maybe just talk a bit about how you think about returns on capital, that sort of thing?

And if I could just ask my follow-up now because it's related to this is what sort of protections do you feel like you have in place in case your research isn't accurate, in case we do end up reversing or the categories don't grow at the rate that the research right now indicates that they should grow? Do you have some sort of safeguards on what you'll do with the capacity that you have on hand?

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

A

Yeah. So talking to capital and the hurdle rates, what we basically look for is a payback that's somewhere in the range of 2.7 to 3 years, right. And so we're pretty diligent about that overall process. Both Lance and I are very involved in the capital approval process. We review all the capital projects before they go forward. And so we've been pretty successful at that. We also have a very rigorous post project review process on the back end of this that we go back and evaluate how did it perform against our expectations. And if there was something that was slightly off, how do we correct that going forward. So our process is pretty tight and our expectations from a payback standpoint, I think, are reasonable.

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

A

And I guess I'll answer the follow-up part of that, Kaumil. We did establish very significant and robust contingency plans in the event that our forecast is off and we shared that during our board of directors meeting recently. And it essentially boils down to two things. One, our capacity did not involve adding additional routes and the capacity we added is lower cost than our existing capacity. So we will be able to utilize that lower cost capacity in the event that we don't have as much demand.

Secondly, we still use third party suppliers for some of our products and we would be able to repatriate some significant part of that volume back into our own capacity as a safeguard. So I think our contingency plan is very robust and provides us with a solid safeguard in the event the forecast that we've established which we believe are strong and solid based are off.

Kaumil Gajrawala
Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. Thank you very much.

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

A

Thank you, Kaumil.

Operator: Thank you. Our next question comes from Nik Modi RBC Capital Markets. Please proceed with your question.

Nik Modi
Analyst, RBC Capital Markets LLC

Q

Yes. Thank you. Good evening, everyone. So Lance, I just wanted to ask about your comment about private label on how you haven't really seen things change over the years. But one thing that's becoming clear to us in discussions with retailers is they are looking to expand private label and leading brands on kind of all that middle that has always been speculated to kind of shrink is actually finally being put into practice. Do I have that right and can you just kind of talk around your very unique position and having both sides of that equation?

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

A

Well, in our categories, these categories are already highly penetrated with store brands. So some of the categories you may be hearing from retailers are categories that don't have that significant penetration that we see across most of our product portfolio. So it's a different situation perhaps in other categories. We as the category captains have significant insight into trends that are occurring. And as you pointed out, we are on both sides of that equation. So our focus is on growing the total category and we win as long as the category is growing.

Nik Modi
Analyst, RBC Capital Markets LLC

Q

Great. That's a good point. Just a real quick follow up is, any changes in the new product kind of introduction cycle or resets, are things back to normal? I know 2020 was kind of a weird year for obvious reasons. But is 2021 going to kind of take the normal shape of resets and innovation curves?

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

A

We actually saw a resurgence of retailers looking for new product innovation as we entered the latter part of the third quarter going into fourth quarter. Approximately 160 basis points of our revenue growth in the fourth quarter and 2020 came from new products and approximately 22% of our net revenues came from products that are less than three years old. We expect a significant benefit from innovation again this year. We've got a long list of new products that we're introducing. I highlighted one in my opening remarks. But we've got several new products in the Reynolds family, including 100% recycled aluminum foil and a change in the way that we're positioning our nonstick foil, grill bags, perforated plastic wrap, stainless steel crusted clothes food bags amongst many others that we're very excited about the new product pipeline that we'll be launching in 2021.

Nik Modi
Analyst, RBC Capital Markets LLC

Q

Excellent. Thank you. I'll pass it on.

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

A

Thank you.

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

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Great. Thanks so much. I know, Lance, you just mentioned a few new products in the food bag side of the business. But I was curious even before those mentions. When we talk about the Hefty business, usually it's focused on trash, obviously, it's the relative size of the business. But when you talk a lot about some of the consumer trends that are at play, it has a lot to do with more of the food storage side of the business. So I was just curious about if you're willing to think about relative growth rates of those two, even if it's from a sort of high level and thinking about the balance of those two portions of the business going forward?

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

A

Within the Hefty portfolio or you mean overall?

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Within Hefty, within Hefty.

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

A

Yeah. Within Hefty, our challenge there is continues to be we are making and selling as much as we can. We've been challenged with the continued demand and what you're seeing in the scanner data reflects the outpaced continued use of storage bags, particularly quart and gallon sliders, because consumers are storing more food, leftovers and freezing more leftovers and it's – we're not seeing that kind of growth yet in sandwich bags, but there's significant double-digit growth continuing in food storage bags in the quart and gallon size. In waste bags, that category continues to grow significantly year-over-year, because of families spending more time at home. And as a result, they're generating more use of [ph] small (00:34:32) kitchen as well as large black bags. Hello?

A

Paul?

Operator: Yes. One moment. [Operator Instructions] Our next question comes from Mark Astrachan with Stifel. Please proceed with your question.

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

Q

Hey, and thanks and good afternoon, everyone. I guess, Lance, I wanted to start with the quote in the press release and kind of understand it a little bit better. So, what is sustained and fundamental shift in consumer demand mean to you all? And how do we think about what would be baked into your view or expectations for whatever reopening – whenever reopening looks like and consumers are spending less time at home?

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

A

Well, as we've said, what our research shows is at-home activity is going to continue to be up significantly before it was in the pre-pandemic, which translates into new and favorable habits for us. Families are cooking more meals at home, millennials and Gen Zs are adding to that because they're growing and using our products more often. 50% of families are saying, they discover that cooking has become a social activity and something that they intend to continue for the long term post 2021. And small kitchen appliances are up, so they're going to continue to use those.

We do recognize, of course, that when the re-openings gradually occur throughout 2021 that it won't return to levels that we saw in the March and April timeframes, and we've factored that into our forecasts. But the combination of continued stay at home more frequently, cooking more frequently at home and driving use of our products, means that our categories will have consumer demand higher than they were at the time of the IPO. Time of the IPO, we were expecting these categories to grow at 2% to 3%. We are now looking at those categories from our research to grow about twice that.

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

Q

Got it. Wow, I'm still digesting that last point which looks interesting. I guess, sort of related to that, how do you think about the spend that you want to invest, reinvest on advertising, media, et cetera, given the change in the consumer, right? So it's obviously been a consumer pulling as opposed to you kind of pushing. How do you think about that and how has pandemic kind of changed that, and how does it change the way that you approach selling your products?

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

A

Well, our advertising has changed fundamentally to focus on two things. One, millennials and Gen Zs and ensuring that since they've come into the category that we retain and keep them in the category, which includes tips and tricks on how to use the products. It also changes the approach to the advertising and that it's more digital to reach them. And we're focusing on less trade, because trade is not required at this point in time to be able to promote our products. So the combination of how we invested advertising trade is something that we evaluate literally on a very frequently basis, but those are the primary goalposts we're using as we look at the approach.

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

Q

Got it. Thank you, all.

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

A

Thank you, Mark.

Operator: Thank you. Our next question comes from Cody Ross with Goldman Sachs. Please proceed with your question.

Cody Ross
Analyst, Goldman Sachs & Co. LLC

Q

Hey. Good afternoon, everybody. Thank you for taking our questions. Just wanted to talk a little bit about your gross margin outlook. I believe you said down a little bit. However, we are seeing meaningful increases in commodity costs. How do you expect to achieve it down a little bit when if I look back to 2017 and 2018 which is where commodities are now, your gross margin declined about 100 to 200 basis points? And then I have a follow-up.

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

A

Yeah. Well, first of all, I think when you think about our margins, you need to look at it from a perspective of from a volume perspective. And when you account for the fact that our volume is in line with overall margin increases, we're pretty pleased with that overall process. So, I think what you may be looking at is a slight decline in overall margins, but when you look at it from a volume perspective, it equates – the impact of pricing is actually up slightly.

Cody Ross
Analyst, Goldman Sachs & Co. LLC

Q

Okay. So despite the commodity costs moving back to 2017 and 2018 levels, you don't think you would see at least 100 basis points decline because of the higher volume?

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

A

Cody, I think there's two things to consider here. One is, we are factoring pricing including trade into our forward plan, meaning reducing trade. So it's important that we are saying very clearly here, we are going to take price to offset commodity costs. The timing of that could have some impacts, right. There's always a lag between the time we get a cost increase from our suppliers to the time that we are able to fully pass that on to the market but we will take price.

We also have other levers that we're employing to ensure that we protect our profitability in addition to price. That includes cost reduction initiatives that we have in revolution, manufacturing productivity initiatives and other actions that we can take from a cost standpoint, which we will also be employing those levers. What Mike is saying is, look at the numerator; the numerator will be going higher. So, that alone can impact your percentage of your gross margin. The total margin dollars are what is most important that we protect, while we're growing volume.

Cody Ross
Analyst, Goldman Sachs & Co. LLC

Q

That makes sense. And then, I just wanted to touch real quick on your Q1 guidance for sales being up mid-single digits. Any color you can provide on each of the segments would be greatly appreciated. Thank you.

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

A

Well, I'd say, first of all, in all of the segments we have fairly easy comps in January and February because of the pandemic impact to our categories this year versus last year. And then March, as Michael pointed out in his opening remarks, that was a stock up period for consumers across some of our products which is going to be partially offset by the fact that we are going to need to replenish inventory levels at retailers in order to get our in-stock performance and our service levels back to our retailers' expectations and our expectations.

Of course, Tableware will be the challenge because that's the one segment, whereas I've talked about earlier in today's call and other forums, we've got a lot of dynamics there relative to year-over-year changes with business items, as well as gatherings, Easter, and Memorial Day and so forth.

Cody Ross
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you very much. I appreciate it.

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

A

Thank you, Cody.

Operator: Thank you. Our next question comes from Rob Ottenstein with Evercore. Please proceed with your question.

Robert Ottenstein
Analyst, Evercore Group LLC

Q

Great. Thank you very much and congratulations on a great start as a public company. Apologies to go back to the pricing question, but we get a lot of incoming queries on this from investors, so it's important. Can you give us some sort of sense of the consumer and customer reaction to your price increases on Hefty, given the fact that your main competitor doesn't appear to be following yet? And kind of how the consumer has reacted? You talked about elasticity. What's going on there and maybe perhaps differentiate between branded and private label?

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

A

Well, first of all, our retail customers are our partners and any price changes that we take is an established pattern of increased costs. We share the data with them. It's a collaborative process and we have a strong understanding of the elasticities in our categories. They change product by product. The models are not the only thing we do, we do it category by category.

Being a supplier of branded and private label products gives us an advantage by making pricing decisions that are wins for both retailers and consumers and helping grow the total categories. The additional pricing we've announced since the fall has generally been accepted and implemented according to plan, and that includes both brand and store brands.

Robert Ottenstein
Analyst, Evercore Group LLC

Q

Terrific. And then, just pivoting over to the aluminum business. What is the outlook there on commodities? And do you feel that you can reduce the number of sheets, I think that's something we talked about in the past, if needed, to avoid sticker shock?

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

A

Well, it's certainly something we can do. It does take longer to implement that strategy. And the reality is that we are running a different elasticity model now, because in that particular category, post pandemic, we believe the elasticity model has changed. So before we take a pricing action that is either fewer feet or crossing a price threshold, we're going to complete that analysis and then make a decision.

Robert Ottenstein
Analyst, Evercore Group LLC

Q

And can you elaborate on how the models change, please?

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

A

Yeah. The consumer demand fundamentally for the category is significantly higher, and there's been less concern about specific price points during the pandemic. There has been almost no promotion in this category in the back half of the year, including during critical holiday period of Q4 and yet demand remained strong through that period of time, because consumers are just fundamentally using the product more.

Robert Ottenstein
Analyst, Evercore Group LLC

Q

So the business has just fundamentally become more valuable and you have more pricing power?

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

A

I'd say that the consumer has valued the product more. As they're staying at home and cooking more, they value the product more. And therefore, the fundamental demand has increased.

Robert Ottenstein
Analyst, Evercore Group LLC

Q

Terrific. Thank you very much. That's very helpful.

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

A

Thank you.

Operator: Thank you. Our next question comes from Kaumil Gajrawala with Credit Suisse. Please proceed with your question.

Kaumil Gajrawala
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Thanks, guys, for taking another one. I wanted to see if you can dissect the revenue outlook a little bit in that. It looks like you have more demand for your categories. You've inventory that you need to replenish at retail, and there'll be some pricing in that figure. So can you maybe try to break down, is it a third, a third, a third or half and two-quarters? Maybe just kind of breaking down the guide for the full year, not for the quarter, what you expect for the full of 2021?

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

A

Yeah. Yeah, so the lion's share of that is pricing. So when I think about – I don't know if I can give you the exact percentages, but greater than 60% of that is in the overall pricing.

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

A

And particularly in Q1.

Kaumil Gajrawala
Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. And then when I think about the revenue growth versus EBITDA, it looks like you're taking a whole series of measures including pricing to manage inflation on raw materials. But it does look like you're looking at EBITDA, maybe closer to flat for the full year, but revenue is up for the full year. So, is that just you're taking as much as you can but you expect some contraction or is there something else going on between those two line items?

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

A

No, it's a couple of variables in there. Obviously, there's the impact of timing. And Lance has talked about the overall lag that we sometimes have on pricing. So, that's a big variable in that overall change that you're looking at.

Kaumil Gajrawala
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay, guys. Thank you.

Operator: Thank you. There are no further questions at this time. I would like to turn the floor back over to Lance Mitchell for any closing comments.

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

I would like to thank all of you for your questions. We value your perspectives and we appreciate the time you've taken to be with us this evening. Please stay safe. Thank you.

Operator: This concludes today's call. You may disconnect your lines at this time. Thank you for your participation and have a wonderful evening.