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Sealed Air (SEE)-9/18 Quarter Update
Maintain HOLD

Sealed Air (SEE) confirmed nearly all of our areas for concern when it reported preliminary 3Q18 results and reduced its full-year outlook on October 17. The full results will not be released until November 1. Sales growth before FX has been cut from 7% to 6%. EPS is now expected to be $2.40-$2.35 down from $2.45-$2.55. EBITDA of $870-$880 million Is expected vs. $890-$910 million. Much of this is FX related, but we see more reasons for concern. Our August 23, 2018 report gives more background into these issues:

- **We were concerned that if the end markets for e-commerce, fresh food, and protein were growing so strongly, why wasn't SEE reporting better sales volume growth?** We estimated that volumes should be rising about 4% per year. Instead, sales volume was running less than 2%. In the preliminary 3Q results, SEE reported only "a slight increase in volume." It expected lower global volumes at a division that is 30% of sales in 4Q too. The biggest source of growth in 3Q is an acquisition that accounts for about half the constant currency growth.

- **Rising raw material prices were crimping margins and cash flow.** According to SEE, that is continuing and is resulting in it lowering its outlook. "Our third quarter profitability was adversely affected by currency headwinds and higher than expected raw material and freight costs." Continuing in the press release, the company expects higher input costs to continue in the 4Q. Rising working capital was already hurting cash flow and we questioned how much more the company could stretch payables. That remains an issue in our view.

- **FX is becoming a bigger headwind as we predicted too.** SEE lowered guidance from 2Q's outlook based on a forecast of currency hurting sales by $40 million up from $20 million and EBITDA by $10 million up from $5 million. SEE started the year with FX as a tailwind helping sales and EBITDA. This has changed in a big way for them.

- **We continue to question how much Sealed Air can boost prices to drive growth.** Already volumes are weak. More importantly, **a strong dollar effectively boosts prices for foreign buyers. This is actually a larger part of the FX problem that is tough to quantify.** SEE is having trouble with earnings based on foreign sales being translated back on a discounted rate. What investors are not seeing is how many foreign sales are not happening at all because SEE is priced above local competitors? In the first half of 2018, pricing was a big part of overall 6.6% sales growth: 2.7% from price, 2.1% from FX, and 1.8% from volume. They are guiding to negative FX and soft/negative volume. It sounds like pricing was the only organic source of sales growth in 3Q, "This [8% constant currency] growth was attributable to favorable pricing, a slight increase in volumes, and $44 million in acquisitions (4% of sales)." **It sounds to us that SEE is becoming more dependent on pricing at the same time it sees a lack of volume.** As the FX becomes a bigger headwind, pricing should become more difficult to take.

We're not convinced these headwinds are over with the cut in guidance on Wednesday.

Explanation of EQ Rating Scale

6- "Exceptionally Strong"	Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises
5- "Strong"	Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.
4- "Acceptable"	Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement
3- "Minor Concern"	Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.
2- "Weak"	Indicates the company's recent reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.
1- "Strong Concerns"	Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely.

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

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The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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