BEHIND
THE NUMBERS
Quality of Earnings Analysis

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Sealed Air Corporation (SEE)
Earnings Quality Update- 9/21 Qtr.

6- Exceptionally Strong
5- Strong
4- Acceptable
3- Minor Concern
2- Weak
1- Strong Concern
+ quality improving
- quality deteriorating

We are cutting our earnings quality rating of SEE to a 2- (Weak) and maintain our Top Sell rating.

For an explanation of the EQ Review Rating scale, please refer to the end of this report.

Summary

SEE reported 3Q21 non-GAAP EPS of $0.86, which beat forecasts by 4-cents. Much of this is due to price hikes SEE announced. More interesting to us is SEE reduced its forecast for Free Cash Flow ($520-$540 million vs. $520-$570 million) and Adjusted EBITDA ($1.12-$1.14 billion vs. $1.12-$1.15 billion) for 2021 and did not raise revenue guidance from $5.5 billion.

Even more surprising, SEE did not raise the top-end of EPS forecasts from $3.60 despite a 4-cent beat. They also added a new forecast for share count to fall from 154 million after 2Q to $152.5 million after 3Q which should add 3.5 cents. SEE is now saying it will see $3 million in lower interest expense for 2021, which should add 1.5-cents, The company cut its depreciation/amortization forecast by $5 million, which would add another 2.4 cents. It also changed its forecast to a lower tax rate that could add up to 5.0-cents too. Those are as much as 12.4-cents of tailwinds from changes in EPS guidance on top of a 4-cent beat and SEE didn't raise forecasts.

As far as the 4-cent beat in 3Q21, we saw SEE note it had a $5 million Brazilian benefit in the quarter that helped Adjusted EBITDA – (and seems likely to have helped adjusted EPS too).

- The Brazilian item would be 2.5-cents of EPS in 3Q21.

- SEE cut stock compensation and profit-sharing by $4 million – that's another 2.0 cents.

- After putting the South American FX games into the full America's division, we are going to highlight the full FX benefit from the Americas of $1.9 million – which is up to 0.9-cents more of non-quality EPS.

- SEE of course added back more third-party consulting fees for another 2.5-cents.

- The tax rate was up from 3Q20, but still below guidance. At best that that had no impact on EPS growth or was a small help of up to another 1.3-cents.

We think SEE's EPS beat is an illusion and the fact that they cut other metrics and didn't boost the outlook for EPS seems to indicate that too.

What to Watch?

- We believe that SEE may have seen some volume gains in 3Q from customers ordering ahead of the announced price increase in September. Total pricing was up 9.5% in 3Q21 for packaging. We know the company benefited from easy comps and an unexpected source of business for packaging Covid shots from 4Q20-2Q21. The volume in the protective unit backed off considerably in 3Q against a modest comp – now here comes a tough comp of 7.4% for 4Q21 and that should be the case well into 2022:

	3Q21	3Q20	2Q21	2Q20	1Q21	1Q20	4Q20	4Q19
Protect Vol y/y	3.8%	4.4%	15.2%	-8.0%	13.0%	-2.3%	**7.4%**	-3.8%

SEE is saying that much of the volume deceleration came from its customers lacking parts and labor to complete their orders which included delivery problems in addition to parts. This may need to change in the next few weeks for 4Q volumes not to suffer from disruption again based on other calls we have heard.

- Food volumes are bouncing off four ugly quarters when demand was very poor. 4Q21 should be an easy comp again. We would not rule out some demand coming in before price hikes here either as prices rose 6.6% in 3Q21 vs. almost nothing in pricing for a year.

	3Q21	2Q21	1Q21	4Q20	3Q20	2Q20	1Q20
Food Vol y/y	5.7%	4.2%	-0.4%	0.3%	-1.8%	-1.9%	4.6%

- Reinvent-SEE, the company's restructuring plan has been ongoing since 2018. The sizes of the gains from this plan have grown weaker as the heavy lifting was completed. Improvements in costs have been declining since 2019, yet SEE's 4Q anticipates them to accelerate again- that is worth watching:

(y/y gains)	4Q21e	3Q21	2Q21	1Q21	2020	'19/18
Reinvent benefit	$22	$15	$14	$14	$118	$173

SEE expects a total of $65 million in 2021, it will need to pick up the pace in 4Q by $7 million (this is almost 3.5 cents of EPS, SEE is counting on for 4Q estimates).

- SEE continues to cut its forecasted operating margin for 2021. It started the year at 21.4%, was cut to 20.8% after 2Q, and now cut again to 20.5% after 3Q. The reason behind that is largely cost inflation. We warned after last quarter that we did not think SEE's price increase in mid-September would be able to offset all the cost increases it was experiencing. They admitted that on the call and is likely why they cut the margin forecast with only 4Q to go:

(y/y change	3Q21	2Q21	1Q21	4Q20
Price/Cost	-$18	-$36	-$18	-$7

Remember two things. First, its customers are willing to take price hikes from SEE that are commodity price related. However, while there are leads and lags where at times SEE is ahead of cost inflation and other times behind it – customers expect this to net out to zero over time. As much as SEE is pointing out this headwind, when it works against them, they are still far ahead of where they should be after having this as a positive figure for 10-straight quarters.

Second, SEE just posted a quarter where it took 7.8% in higher pricing. That likely understates the amount of actual price increase as much of it came in September. Management noted on the call that Price/Cost turned slightly positive in September and they expect a positive figure for 4Q21. Later, they highlighted that they expect a $40-50 million positive Price/Cost figure for 4Q. That sounds very high to us. After 2Q, SEE was at -$55 million in this area and guiding to -$25 to -$30 million for the year. After 2Q, management talked favorably about its 3Q price hikes and did not indicate it would continue to see Price/Cost as a sizeable headwind in 3Q. After 3Q, SEE hit -$72 million YTD and needs to get every dollar of the $40-$50 positive change to hit forecasts now. If SEE misses, this will likely be a key reason.

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 recently 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 Concern)- 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 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 upcoming quarters. 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.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

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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