BEHIND
THE NUMBERS
Quality of Earnings Analysis
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Sealed Air Corporation (SEE)
Earnings Quality Update- 12/21 Qtr.

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

We are maintaining our earnings quality rating of SEE of 2- (Weak) and maintaining our Top Sell rating.

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

Summary

SEE finally missed forecasts for the first time in years as 4Q21 was light by 1-cent. That was actually a bigger shock than the market realizes as after beating 3Q21 by 4-cents, SEE didn't boost guidance and gave an outlook for 4Q that included lower interest expense, lower depreciation, and a lower share count – all of which should have helped 4Q. Also ignored was the fact that free cash flow of $496 million missed the guided range of $520-$540 million which had already been lowered from $520-570 million after 3Q. Guidance for 2022 was set at $510-$555 million.

The market fell in love with SEE realizing $296 million of price increases vs. forecasts of $275 million (worth 10 cents in EPS in a quarter SEE still missed) and its 2022 guidance that revenue would grow organically by 7%-11%. It also claimed it would offset $200 million in raw material cost inflation and $100 million of labor/production costs with more price hikes in 2022.

- Forecasts for revenue growth are largely focused on pricing. It mentioned on the call that maybe it can get to 2%-3% volume gains. That is only $110-$165 million in revenue growth. Forecasts are calling for $400-$600 million of revenue gains. That means $300-$400 has to come from pricing.

- Is that much volume even realistic? Look at the comps they are coming up against:

	4Q21	3Q21	2Q21	1Q21	4Q20	3Q20	2Q20	1Q20
Food Vol.	6.2%	5.7%	4.2%	-0.4%	0.3%	-1.8%	-1.9%	4.6%
Protective Vol.	0.9%	3.8%	15.2%	13.0%	7.4%	21.4%	-35.9%	-2.3%

We noted last quarter that SEE still had two easy quarters to go on food volumes but the easy comps were gone for packaging. In fact, we thought the packaging price increases at the end of 3Q21 would pull sales into that quarter at the expense of 4Q21- which is what appeared to happen. Now, Packaging has a 13% and 15% comp to start 2022. Also, for all the new automation sales SEE is touting – their forecast is for $50 million of growth in that area for 2022. That is basically 10% of expected revenue growth and to reach their goals by 2025 they need to make acquisitions that will become one-quarter of that business.

- Shouldn't FIFO accounting be helping more? This is inflation we're looking at and yet gross margin is falling noticeably:

	4Q21	3Q21	2Q21	1Q21	4Q20	3Q20	2Q20	1Q20
Pricing	12.0%	7.8%	2.6%	0.7%	-0.2%	0.0%	2.6%	-0.5%
Gross Margin	31.0%	28.7%	30.2%	31.7%	31.7%	32.7%	33.9%	33.3%
y/y chg GM bp	-70	-300	-250	-220	-140	50	130	50

SEE is selling the cheapest stuff first and raising prices. Its inventory is in line with past quarters. There is some seasonality as DSIs are generally about 70 days in 1Q, over 70 in 2Q, high 60s in 3Q, and 60 days for 4Q. That is where results were for 2021: 69 days, 72 days, 67 days, and 63 days for first-fourth quarters. They turn inventory about 5.3-5.5x a year. Shouldn't investors be expecting margin gains? We're not seeing gross margin improve and SEE has been restructuring for years.

- Price hikes should leverage operating margin too. Adjusted EBITDA margin in 2021 was 20.4%, down 100bp from 2020. Guidance calls for margin to be about 21.0% which is still below 2020. SEE expects higher R&D of about $45 million or 75bp of headwind, but it

also expects more productivity gains to drive the margin higher. FIFO should be helping too – yet it only sees 60 bps of gain in EBITDA margin in 2022. SEE is guiding to 11%-17% EPS growth. 60bp of margin is worth 5.0% and a lower share count should add 1.5%. The rest all has to come from pricing.

- South America growth looks unlikely to repeat in 2022 and could become a drag on results. We think this can explain the entire pricing beat SEE posted in 4Q21 when pricing for the year came in at $296 million instead of forecasts for $275 million. We have discussed the unrealistic results from South America due to hyperinflation vs. huge FX hits in the past. 2021 looks like a one-time event where this region really boosted results.

- South America used to be reported as a separate unit in 2019 and 2020. It alone was inflating SEE's results due to massive pricing gains. Normally all those gains were lost through FX losses. Meanwhile, North America was posting negative pricing:

South America 2020	**4Q**	**3Q**	**2Q**	**1Q**
Pricing	9.4%	16.0%	18.8%	9.0%
Volume	3.6%	-3.1%	-0.7%	3.9%
Org Growth	13.0%	12.9%	18.1%	12.9%
FX	-24.2%	-28.9%	-33.3%	-14.5%

South American 2019	**4Q**	**3Q**	**2Q**	**1Q**
Pricing	18.3%	17.9%	24.8%	25.1%
Volume	12.3%	2.7%	5.2%	-0.1%
Org Growth	30.6%	20.6%	30.0%	25.0%
FX	-22.2%	-16.3%	-28.4%	-32.0%

- In 2019, South America was only 4.9% of total sales at $233.8 million. It was $49.4 million of the total company's pricing gain which amounted to 116% of the total (that is not a typo.)

- In 2019, South America was $56.9 million or 41% of the total company's FX loss.

- In 2020, South America was only 4.2% of total sales at $207.5 million. While total company pricing gains were -$0.8 million, South America added $35.0 million.

- In 2020, South America's FX loss of $65.9 million was 80% of the company's total.

North America 2020	4Q	3Q	2Q	1Q
Pricing	-1.4%	-1.5%	-0.2%	-2.0%
Volume	4.2%	1.8%	-6.2%	3.0%
Org Growth	2.8%	0.3%	-6.4%	1.0%
FX	-0.3%	-0.7%	-1.3%	-0.3%

North American 2019	4Q	3Q	2Q	1Q
Pricing	-1.0%	-0.8%	-0.4%	1.4%
Volume	-3.7%	-1.8%	1.6%	-2.2%
Org Growth	-4.7%	-2.6%	1.2%	-0.8%
FX	0.1%	-0.2%	-0.2%	-0.5%

North American operations were seeing very benign FX issues and no pricing growth during the same time South America's 5% of total sales was driving SEE's non-GAAP results. In 2021, SEE put the South American operations in the same unit as North America. Investors may remember that until 2018, SEE had a unit called Latin America that was about 9% of total sales and was made up of Central and South America. In 2019, South America became its own unit with the rest of Latin America joining North America. We always consider changing the makeup of divisions to be a red flag as the overriding reason seems to be to remove comparability from year to year of results. SEE has a long way to go in overtaking Newell Brands as the poster child of this which has combined and separated operating units numerous times.

- In 2021, South America and North America were combined into one unit. We went back and combined them for 2019 and 2021 as well. Notice how moving the South American inflation into the North American segment suddenly offsets the pricing decay of North America. North America had negative pricing for 7 out of 8 quarters. After the change in reporting segments, it's now positive for 6 out of 8. Also, notice the negative FX overwhelms the reported organic growth for the combined unit:

Americas Combined 2020	4Q	3Q	2Q	1Q
Pricing	-0.6%	-0.2%	1.2%	0.5%
Volume	4.2%	1.4%	-5.8%	3.7%
Org Growth	3.6%	1.2%	-4.6%	4.2%
FX	-2.2%	-2.8%	-3.8%	-4.0%

Americas Combined 2019	4Q	3Q	2Q	1Q
Pricing	0.4%	0.6%	1.5%	3.4%
Volume	-2.5%	-1.5%	1.9%	-2.0%
Org Growth	-2.1%	-0.9%	3.5%	1.4%
FX	-1.5%	-1.4%	-2.3%	-3.1%

- So what happened for 2021? We can't see SEE's South American unit separately anymore, but we can see what Mondelez and Coca Cola reported for that region and we can see what SEE reported for the Americas:

Coca Cola Latin Am	2021	2020	2019	2018
Pricing	12.0%	2.0%	13.0%	10.0%
FX hit	0.0%	-14.0%	-10.0%	-9.0%
Mondelez Latin Am				
Pricing	13.6%	7.7%	9.9%	6.2%
FX hit	-7.5%	-17.7%	-13.5%	-13.8%

Both of these companies showed similar results to SEE's South American operation – strong price hikes each year that were largely wiped out by FX losses. In 2020, they didn't get as much pricing and had the worst FX hit yet. So 2020 was a one-time extra horrible year. For 2021, they both had super-sized price hikes in the region and their lowest loss on FX yet – a one-time great bounce year. They kept a huge part of the price hikes and Coke reported that FX was a 1% positive on results and MDLZ said FX helped total results in 2021 by 2.8%. Coke told investors to expect a 2-3% drag on sales from FX in 2022 and MDLZ said the drag would be 2.5%. What did SEE report:

SEE Americas	4Q21	3Q21	2Q21	1Q21
Pricing	17.0%	10.9%	3.3%	1.2%
Volume	2.9%	3.1%	9.3%	2.9%
Organic	19.9%	14.0%	12.6%	4.1%
FX hit	-0.6%	0.3%	0.7%	-1.3%

FX practically didn't impact results at all – it was only an $8.2 million drag or 0.2% of sales in 2021. So just like Coke and Mondelez, SEE saw the FX drag vanish after a horrendous 2020. Also, SEE took pricing of 8.4% for the year. Some of that was the planned price increases that hit in September and the Americas would have seen much of that in 3Q and 4Q. **However, we also believe that South America saw a typical year of about 20% pricing gains too. Based on 2020 sales, that would have been $41.5 million of total Americas pricing of $262.4 and would have cut pricing of the unit to only 7.0% for the year with only 0.2% being lost to FX**. Plus, SEE guided to FX being a 2% headwind for 2021 – again just like Coke and Mondelez. 4Q21 already saw FX turn into a headwind everywhere for SEE and it offset about half the pricing in the other segments:

SEE 4Q21 segments	Americas	EMEA	APAC
Pricing	17.0%	4.7%	2.6%
FX hit	-0.6%	-2.6%	-1.2%

We think it is important to recognize that SEE saw very little pricing power overseas in 2021: EMEA is 21.7% of total sales and only saw 2.6% growth in pricing. APAC is 14.7% of sales and only grew pricing by 1.0%.

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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