Sylvamo

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Gabe Hajde: Gabe Hajde here, Packaging Analyst for Wells Fargo. Today, one of our last meetings, we have Sylvamo. Representing the company is going to be Senior Vice President John Sims. I think Senior Vice President of Corporate Affairs, Tom Cleves. And Hans Bjorkman, Vice President of Investor Relations. Thank you, gentlemen, for being here.

I think you had a couple of prepared remarks that you'd like to go through, a presentation that went out on the web for those that listening on the webcast. If you'd like to go through that first, John?

John Sims: I would. Thanks, Gabe, and just thanks for the opportunity to be here at this conference and speak to you. And as Gabe said, we posted this presentation I'm going to refer to on our website, so please, that's what I'm going to be referring to. I'm going to be on I guess Slide 4 of the presentation. And there, I just want to briefly recap we're a relatively new company, 20 months since we spun from International Paper in October of 2021. Although we've got a lot of experience in the uncoated free sheet business.

When we spun, our primary focus was to get off the TSA if you will, separate from International Paper, and also to deleverage and strengthen our balance sheet. Unexpectedly, we didn't plan on it, the Ukrainian invasion, but we decided on principle that we needed to exit the Russian business. And we made that decision relatively quickly. And it worked to our benefit because we were able to exit that business and get hard currency out of Russia which few have been able to do. We got 420 million euros out of Russia. And we were able to use that to deleverage and reduce our debt. And that would increase earnings and cash flow. We reduced debt by almost $470 million, so reduced our leverage ratio from 3x to 1.3x. And core to our plan was to get our debt and deleverage so that we had a strong balance sheet.

You also take a look at 2022, we generated high margins, nearly 20%, and also, 30% return on invested capital. This was not unique to this business. We generally have earned well above cost of capital returns, north of 20%, even as part of International Paper Company.

We also were able to seize on the opportunity to acquire the Nymolla Mill in Sweden at a very attractive purchase price of a multiple of 2.5x adjusted EBITDA. And we have high return projects that we're investing in.

To go onto the next slide, I'll talk briefly about our investment thesis. What's I think the key part here is our strategy is really based on the belief that uncoated free sheet demand, uncoated free sheet demand will be around for a long time. And people will continue to need uncoated free sheets in the markets we serve to educate, communicate and entertain themselves. That's why we're singularly focused on uncoated free sheet, and we believe that the regions we operate have the characteristics that are favorable for companies such as Sylvamo that have a competitive advantage, that generate well above cost of capital returns, increase our cash, and increase our earnings going forward. We plan to leverage our strengths to drive high returns on invested capital and generate cash and we're going to allocate the capital to maximize shareholder value.

Increasing cash returns to shareowners is one of our key objectives. With that in mind, I'm going to talk a little bit about our principles for capital allocation on the next couple of slides. Turning to the next slide, core to our capital allocation is maintaining a strong financial position. We've targeted $1 billion in debt. We believe that $1 billion, in approximately that range, will allow us to invest through the cycle. That's important for us. In a declining industry, we want to continue to raise stakes for those that stay. And we believe that by investing in high return, low risk projects, we can continue to strengthen our competitive position in the markets that we serve.

Going to the next slide, our principles of returning cash to shareowners. We're a cash flow story, so we strive to increase cash returns consistently over time. We believe that a dividend is core to our cash return principles and strategies. We want a dividend that's sustainable and one that we can increase over time and it does not restrict our strategic flexibility.

Also, we will opportunistically repurchase shares when the price is less than 80% of intrinsic value. We'll prioritize that. Share repurchases when the share price is less than 80% of the intrinsic value. Otherwise, we'll also consider either increasing cash or paying a special dividend or variable dividends in the future.

And finally, the third leg of our capital allocation strategy is creating long term value for our shareholders, increasing our earnings, increasing our cash flow by making smart investments in our business. Again, fundamental to this, our capital allocation framework and the belief that the uncoated free sheet markets in which we operate provide the opportunity to invest in high return projects that deliver returns well above cost of capital and increases our ability to generate cash and earnings. We believe when we operate in the U.S. and the uncoated free sheet regions, that will provide us this opportunity and that we believe that in the future, naturally these regions will get even more favorable going forward.

Let's turn to the next slide. It's going to talk briefly about how we are applying these principles to 2023. First, we do intend to continue to reduce debt through normal amortization payments. And then second, we intend to return $125 million of cash to shareholders. In order to do that, once we approach the $90 million limit restriction that we have from our debt covenants, we will make a $60 million payment into escrow. And provided we maintaining $225 million of liquidity, we'll be able to increase cash returned to shareholders. Our restrictions of cash will be unlimited at that point.

Again, we intend to return $125 million this year in the form of both dividends and share repurchases, 40% more than what we did last year. If you remember, we returned $90 million last year.

Also, to remind you that we doubled our dividend this first quarter to $0.25 a share. So far, through Friday, June 9, we returned $56 million between our quarterly dividends and share repurchases.

Another question we've gotten that I'd like to address from our first quarter earnings call was around the second half earnings relative to first half. Looking at our outlook, you'll note that the second half, would be something between $80 million to $100 million more than the first half. And earnings, if you take our first quarter and our second quarter outlook. There are 3 main drivers that went into our full year outlook which will drive the second half stronger performance. First of all, $28 million less planned maintenance outage expenses. The second one is increased volume. We're picking up additional volume in North America from the closure of the mill in North Carolina. We'll also have

seasonally stronger volume in LatAm. And also, the fact that the school publication, the book publication program, was not initiated in the first quarter like it typically is, it will come in the third quarter on LatAm. Will mean the second half of the year will actually be much stronger than typically in Latin America. And inventory corrections that are occurring both in North America and in Europe will work themselves out by the third quarter. That will translate into stronger volumes.

Secondly, input costs, chemicals, energy, freight costs, are all going down and that's worked into our outlook and we'll be more positive in the second half. And just a reminder that in our outlook we took in account already previously announced decreases in pulp prices and our best view of uncoated free sheets.

Just wrapping up the final comments, we remain confident in our ability to create shareowner value and remain committed to our investment thesis. We'll continue to leverage our strengths to drive high returns on invested capital and generate cash. And we'll use that cash to maximize shareowner value. We think we have a unique combination of low-cost mills in attractive regions with strong supply positions, iconic brands, strategic channel partners, and best in class commercial operating teams that give us competitive advantages in the regions we operate in.

Our 3-pronged strategy of commercial excellence, operational excellence and financial discipline will enable us to continue creating long term value for our shareowners. Gabe, that concludes my remarks and I appreciate you giving me a chance to do that.

Gabe Hajde: Thank you very much. We've got a couple lists of questions here, but first one I want to start off with, you talked about 20 months sort of being independent and working off the transition service group, etc. Can you talk about some of highlights and challenges that you guys have faced? It's been pretty volatile I think for most companies. But I think it's pretty impressive to obviously navigate the Russian divestiture piece, clearly unexpected I'm assuming from your perspective, and then being able to find an asset that you were able to redeploy that capital pretty quickly. Those are maybe the highlights, but --

John Sim: Yeah, and I would start off first with one of the things that we did find when we spun off with International Paper, it helps tremendously when the management team and everybody is singly focused on one product line. The alignment that we've gotten and the direction and the focus allow us, one, to make decisions quicker and to react quickly to the changes and challenge that we had. I mean one of the biggest challenges we did have was just exiting the TSA from International Paper, because it was very complex. You can imagine, across 3 continents that we had to do that. And on top of that, we had to exit the Russian business which also meant getting off that, getting that system off, getting that mill and that whole business out of our system. Being able to do that in an expeditious manner, just because of some of the risks that it posed with being in Russia. And then being able to take advantage of a unique opportunity to purchase the Nymolla mill. I think that we were able to do all of that because of the tremendous focus that we have on the business itself. I think that was the advantage and why we are able to move quickly.

Gabe Hajde: I think the tagline, I might have to write this down, or I did write it down, educate, communicate, entertain folks. A quick overview sort of just for those maybe aren't familiar. You guys are relatively new as public company as you were talking about. Primary products that you produce and markets that you serve, things like that. And maybe different by geography.

John Sims: Yeah, we call it uncoated free sheet, but it's white papers business. It's bleached. It's not brown, it's white paper. And generally, 2 categories. It's copy paper, so that's the paper that everybody uses in their offices and across the printers. And that's really what drives

demand for that is office use. And then we have book, that we go into commercial printing. In commercial printing, you can think of that anything from direct mail to mailers to menus that you have, promotional pieces. Generally, we make the envelopes that drive into the mail. Well, we make the paper that other, our customers, then turn into envelopes. But also, the inserts that go in that. That's really the big categories of products.

Now, we also make pulp and we do sell about 400,000 tons of market pulp and we make some specialty products such as file folders, as one example. We make the tape that goes on wallboard that you use for drywall to put up. Stick paper. There's some other specialty grades that we make. But the really core of the business is in the uncoated free sheet, it's copy paper and it's a commercial paper.

Gabe Hajde: Okay. I'm going to go off a little bit here just because something you said in the prepared remarks. Have you guys talked about or communicated -- you said toggling on the repo when things are sort of at 80% of intrinsic value. I'm just curious if you guys run an internal DCF for sort of what the Mendoza or trigger line trigger is. And if you're committed to returning the capital, it sort of implies that you're looking at it but it may not be a hard fast line.

John Sims: Well, you're right, we do calculate our intrinsic value using discount cash flow model. We also look at a range of possibilities, so we don't just come up with one number. We'll look at a range and it can be driven by different economic cycles or whatnot. We get a view of what the bottom range may be, what the upper range may be. And that's why we said -- now we've said we would prioritize share repurchases if the share price is less than 80% to give a margin of error. Not to say that if get to 90% we wouldn't buy our shares. But generally, we're going to prioritize it if it's below 80%, and so there's a margin of error.

And simply, we're thinking that at 80% for example, your simple return is at least 20% and you're at the bottom of your intrinsic value range. And that's what we're really about. Even the investments that we retain and put back into the business, either in high return capital projects cost reductions, and we're looking at hurdle rates that are above 20%.

Gabe Hajde: Okay, I was actually going to go there next. Again, intuitively listening and knowing what I do about the business, it's relatively mature, these are pretty old assets, and I would expect that you would have, over time, you would invest in those assets and done a lot of these cost project initiatives. But it sounds like maybe, I may have put words in your mouth, but maybe they were neglected a little bit or overlooked.

John Sims: No, I wouldn't --

Gabe Hajde: Not neglected, that's the wrong word. It seems like there's a good pipeline of projects that you've got high return, cost reduction. Can you talk about pipeline?

John Sims: Yeah, and I would think the way to think about is not that the products or the mills -- the mills are old, but technology also moves forward. And so, it's really capturing the technologies that our suppliers are developing that allows us to -- like when we talked about, highlighted at Eastover, we're able to reclaim, with an investment we're making there, reclaim more chemicals. It reduces our chemical consumption. That technology wasn't available several years ago. We're now deploying it now. Same thing.

It's really just a matter of taking advantage of advances that are being made. But it's important for us to do that because we believe that one, we want to be able to grow our earnings and grow our cash flow. We believe that's possible even if we're only going to be focused on uncoated free sheet. And we believe it's possible even if we have to reduce

our capacity going forward. We still believe that we can generate higher earnings than we're doing today going forward. Because the industry that we operate in the and regions we operate, we believe become more favorable over time.

And let me -- I hate to digress from this, but I think there's a lack of understanding about declining industries versus growth industries. In growth industry, typically you have to, companies have to pay a lot of money and premium to change the structure of the industry, right? And declining industry happens naturally. You don't have to do anything. People exit because they are not willing to invest in it or they want to shut down.

When they do exit, I think Nymolla Mill is a good example of that, they have to exit at a discount. They sell at a discount. We were able to buy the Nymolla Mill at 2.5x multiple. The risk to us is a lot less. Not only did we buy it at a discount, but we can generate $20 million in synergies. That's the opportunity we have going forward. And that's I think some people miss that. We actually believe that over time, the industry will continue to consolidate as people exit. And it will be an opportunity for us to increase our earnings.

Gabe Hajde: Understood. I think last year, probably one of the best performing stocks, at least in my screen. How do you think investors are sort of responding to the strategy and the investment piece you guys have laid out? It sounds like there's still a disconnect. Trying to chop wood there, but anything in that regard?

John Sims: Well, you know, I think you have to say, given where we're trading at in terms of the multiple, that there is a disconnect. And I think it's a matter of us, and this is great to be able to speak at this conference to be able to talk about our investment thesis, to talk about what the earnings potential that this company can generate and how we're going to return cash to shareowners. Those that are long-term owners of Sylvamo will be rewarded for that. It's just a matter I think for us -- we're a small cap company, we're not covered broadly. It's a matter of us getting out and making sure that people understand our strategy. But then we also have to deliver. We have to show that over time.

Gabe Hajde: Going back, I forget which slide it was, where you referenced the 60,000 tons of incremental demand. That wouldn't have been know kind of come into the year. An announcement came pretty recently in terms of the closure there. I'm assuming those customers kind of were racing to figure out, okay, who is going to be my supplier? And that's a function of I guess proximity to a supplier and the person that can service that business. Is there anything else that kind of plays into that decision making? And what's the visibility on, what was it, a long-term contract that you guys were able to get?

John Sims: Yeah, I think -- so we are also, our business team will be selective too in terms of the customers. They have to have to be customers that want to do business with us, but also we want to do business with them. We're somewhat selective in that regard too because we also want to make sure that we can continue to supply our other customers going forward. But with regards to that, yeah, it wasn't planned, and those customers, some of them were scrambling. Some of these that we're growing with are existing customers that were being supplied by that mill, so we were able to ramp them up with that.

Gabe Hajde: Okay. And then I guess the visibility on the book order, this sound like, again, somewhat of a political hot potato I'm sure in terms of how that plays out. But maybe for those again on the webcast, when you might have confidence or conviction. Or is that something that you feel pretty good about today, have visibility into that kind of playing out in the back half of the year?

John Sims: I think we are -- one thing that we have, that is planned out and we do see it, is imports have returned back to normal levels. We are at about, this is in North America, also

somewhat in Europe, we're back to about 10% of demand. The imports were at about 17% in the fourth quarter, they're down to about 10%, both in Europe and in North America. The inventory is taking longer to correct. One of the reasons that we're being told is that the higher cost to hold inventory, because of interest rates going up, is causing customers to want to target a lower level than they were prior to that, so it's taking a little bit longer for that to work out. And then this is the part we don't have a crystal ball on is some of the pullbacks we've seen is due to the uncertainty around the economy. And we're seeing that mostly in direct mail.

On the positive side, we do see more returning back to the office, particularly in the large office, which is driving copy paper demand increases. And in LatAm, Latin America, we've got positive growth. We've got demand in the positive range there.

Gabe Hajde: There is a book order that you're referencing in Brazil?

John Sims: Yes. Each year, and education drives 30% of uncoated free sheet demand, so a big piece of that is the national program that prints textbooks. And the government will typically release those purchase orders if you will to the printers to get the textbooks printed in the first quarter. They didn't do that this year and we believe it's because of the change in the government. Because they were putting in new directors if you will of education. Those are now being released, but they were just starting. They're just starting to be released and printers, schoolbook printers are starting to order the paper. We really don't expect to see that until the third quarter.

Gabe Hajde: Okay. I think it's on the slide deck, the world's paper company. Is your strategy the same across the 3 kind of key geographies that you participate in? Or does it vary? I think being low cost is central to what you guys are doing, but anything you'd call out on the strategy front, again, from a geographic perspective?

John Sims: No. I think the strategy is pretty consistent across each of the regions. We want to be the low-cost producer. We want to have the best relationships with the top merchants, top customers, top channels, and access to the markets. We want to have the leading brands. And we also put a lot into investing in terms of talent and people that we have. That's pretty consistent across the board.

Now, the execution of the strategy, the brands have different, are different in each of the regions. Where most of our business in Brazil is branded, in North America still a strategy to grow our brand, but there's a lot more private label. That's probably the only difference.

Gabe Hajde: You mentioned the acquisition of Nymolla in Sweden. And I'm trying to think of the last time I heard of 2.5x multiple. It might have been maybe a bankruptcy situation or something like that. I think cost to replace is I'm sure more than that, than what the implied value would be. Can you just talk about the integration process, line of sight to the $20 million in synergies? And then maybe if there's potential upside, I'm sure every investor wants so say, oh yeah, we tell them it's 20, but we're really going to get 30.

John Sims: Yeah, I think we've owned the mill since January of this year and we've been very pleased with it. It wasn't a surprise from that perspective. The -- I want to remember, but the previous owner Stora, made a $40 million investment in the pulp mill. They completed that project in the fourth quarter. And so, we're starting to ramp that up here now this year and it's running ahead of plan. We're seeing already savings in chemicals better than what we expected. That's running extremely well.

The integration is running well. And one is, our European team, this wasn't the first

integration that they've had to do. This is a team in Europe that managed the divestiture of the Kwidzyn mill, they managed of course the TSA exit for IP. They managed a TSA, the exit from Russia. But they were also part of the team that when IP did some acquisitions in Europe, the Madrid Mill, the box plant, they were part of that. Our leader over there, Oliver Taudien, was very integral into that. He and that team over there understand and know how to integrate businesses. And they are also very -- there's always the cultural integration is also important. And he made that front and center. The team is doing an excellent job on that.

I think, is there upside to that? I think it's still too early to say. We're committed to the $20 million and we believe that that's -- we've got line of sight on that. We know we can achieve that. We're finding out there's some best practices, there always is, in the acquisitions that we make, and so there's things that we've got to say that maybe we can implement some of that and get some more than what we committed to.

Gabe Hajde: Okay. During the pandemic, I think we talked earlier about 20% of demand, or excuse me, supplies has come offline permanently. And to your point before, gently declining, whatever that number looks like. I think historically speaking it was down 3 to 5, maybe it's down 2 to 4 as we kind of get into a bottom if you will.

Where are we in terms of back to school, back to office? I mean I suspect you guys are probably more proponents of being in the office than some folks might me. But are you able to see maybe step function changes in monthly order patterns or anything like that when you see some of these big announcements from folks saying, hey, we're pushing out from 3 to 5 days or 3 to 4 days or something like that? And where we're in that evolution?

John Sims: Yeah, I think back to school, we're seeing that. Everybody is back to school. We've seen the benefit of that. And the back to office, Latin America, everybody is back in office, small, medium and large. As I said earlier, in LatAm we're seeing 1% growth this year. And demand is above 2019 levels. That's come back in.

In the U.S. though, small and medium offices, they're back. It's the large offices that are still running about 50% returned. And that's some upside if we ever see some increase. We do see some announcements, but we don't see that -- we just won't see that for -- it will trans -- we'll see that over time. And also in Europe, a little bit more, better, back to office than in the U.S. Just because mostly people there have less space to have a home office. It's more convenient to them to go to the office. We're seeing a little bit more return to the office.

Gabe Hajde: That makes a lot of sense. All right. As a matter of practice, you talked about embedding I think what had already transpired and received on both the pulp side and including free sheet in terms of pricing. Your parent co or however you want to say it that you spun out of, they never commented on forward pricing because there was a preexisting litigation, etc. Just lack of understanding, so I apologize here. Do you guys typically, again, I'm assuming embed a range in there in terms of what you're thinking normal or reasonable outcome might look like? Or do you just kind of flatline out current pricing and known changes?

John Sims: No, it's in our outlook. We don't take the exit rate and hold it flat. We take in our best view of price. We believe that if prices have gone down or gone up, we're going to insert that into our forecast.

Gabe Hajde: Okay. And so, I guess that plays into -- I think we're coming up on time shortly here, but assumptions for second half. And then maybe how that leads into your conviction level of

wanting to achieve full year guidance.

John Sims: Well, I can't talk about pricing assumptions, in uncoated free sheet.

Gabe Hajde: I'm sorry, just assumptions, any -- not pricing, but just assumptions that maybe get you to -- makes you feel better or worse about the full year guidance.

John Sim: Yeah, let me -- I'm glad to because again, the assumptions we have is more volume in the second half than first half. We do assume that we'll have less lack or order downtime. And that's really driven by the inventory correction finally working itself out. We're now saying it's going to be probably the end of third quarter to fully -- so it's going to be a full year into that, but that's consistent with what we're seeing in other industries like the packaging industry. The second thing is that we see input costs coming down. And that's across the board. We've seen freight costs come down and gas prices come down, but now we're starting to see chemicals come down and energy coming down. We'll see that, that will play out. Of course, we have less maintenance outage, so that's $28 million that will play out. Those are probably the biggest chunks going forward.

Gabe Hajde: Anything else? Closing remarks or things you'd like to leave us with?

John Sims: No. Again, I'd just reiterate, we're singularly focused on uncoated free sheet. We believe that the industries, the markets that we're in, are conducive to us being able to generate high returns and making cash that we can return back to shareholders. And we also believe that over time, that will actually get better. Thank you.

Gabe Hajde: Thank you.