Sylvamo Corporation

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Gabe Hajde: Thank you all for being in attendance here. Gabe Hajde, Wells Fargo key paper and packaging analyst. I'm joined by my colleague, Alex Yi, back there. We're welcoming for the first meeting for us, at least, Sylvamo. Thanks for being here. Representing the company will be John Sims, Senior Vice President, CFO. And then other, I'll call them Sylvamo ambassadors, we have Matt Barron, I think the Chief Legal Officer, in the back; Hans Bjorkman, Vice President of Investor Relations. So thank you all again for attending. Many or all are familiar, this should be conducted as interactive, so if you have questions, please don't hesitate to ask.

And with that, John, I'd like to hear about Sylvamo, and I think you have a few opening remarks and some slides.

John Sims: I do, Gabe, and thanks. Thanks to everybody for being here. I've got a couple of slides I want to go through, and let me flip to them. And I also want to thank those that may be joining us via the Web.

So good morning. I'm going to start by discussing the basis of our strategy, Sylvamo's strategy. Our strategy is to be singly focused on uncoated freesheet, and that's a product that we produce and sell. Because we believe in uncoated freesheet, it's going to be around for a long, long time. It's the largest and most resilient graphic paper grade, as this chart shows. It has the highest number of end use applications, so you think across banking, finance, government, education, real estate, manufacturing, distribution--all those vertical channels use uncoated freesheet. It's used across all sectors of the economy in every region where we operate. This is why the total demand of uncoated freesheet, as you can see from this chart, exceeds the sum, the total of all the other printing and writing grades combined. It's sustainable, it's affordable and functional, and we believe paper will remain an effective vehicle for education, communication, and entertainment well into the future.

For example, paper plays a critical role in education. Studies continue to show students at all ages absorb more when reading on paper versus reading on digital screens. Just last year in Sweden, they reversed their decision made in 2019 to move all their education to digital and now are moving students back to books.

So as I said earlier, our strategy is to be singly focused on uncoated freesheet. Since we operate in attractive markets for uncoated freesheet and because we have an inherent competitive advantage, this provides us the opportunity to create long-term value for our shareowners. Our capital allocation strategy is to maintain a strong financial position, reinvest in our business to improve our competitive advantages, and that's reinvesting back into uncoated freesheet, and continue to return substantial cash to shareowners. So

I'm going to provide some additional color on each of these three uses of cash in the next couple of slides.

Slide 6, this one, shows our commitment to maintaining a strong financial position that allows us to operate and invest through the cycle. But since we've spun from International Paper, we've reduced our gross debt by $580 million, almost 40% since the spinoff, and remain below our $1 billion target. This is a healthy position. It allows us to retain flexibility to address macro conditions, downside risk, and to invest in high-return opportunities across the cycle.

Let's look at cash returns to shareowners, the next slide, Slide 7. We will continue to return substantial cash to shareowners via dividends and share repurchases. As this graph shows, we initiated a regular dividend with the first year of our spinoff. And after paying down significant debt and strengthening our financial position, we've more than doubled our regular dividend to kick off 2023 and then raised it again $0.30 per share in the fourth quarter of 2023. We also issued a special dividend of $0.30 per share in the fourth quarter last year. Just a few weeks ago, we announced that we are raising our regular dividend by 50%, up to $0.45 per share in the third quarter. And I'll move to the next slide.

On slide 8, since 2022 we've returned $170 million in cash via opportunistic share repurchases. We have repurchased almost 3.5 million shares, or 8% of our initial shares outstanding, at average price of $49.00. These repurchases have shown a return of 45% based on a share price of $70.00. We'll continue to look for opportunities to repurchase shares at attractive prices and to also return cash via regular and special dividends. We remain committed to return at least 40% of our free cash flow to shareowners this year in 2024.

Turn to Slide 9. We will continue to invest in high-return projects to strengthen our business while increasing earnings and cash flow. On this slide you can see how we ramped up our spending in these high-return capital projects since our spinoff. At the time of our spinoff, we projected at least $100 million of high-return projects, about $70 million of which we will have funded by the end of this year. We have now identified over $200 million of additional high-return capital projects to invest in the coming years. That's going to provide us opportunities to grow our earnings and our cash flow in the future. We expect such investments to generate well above cost of capital returns. And again, all these investments are in the business that we know; that's uncoated freesheet.

I'm going to wrap up by the last slide, Slide 10. We're strengthening our ability to create shareowner value throughout the cycle. Sylvamo is a cash flow story that continues to deliver against our investment thesis. Our earnings are improving from the bottom of the cycle. Last year we achieved 16% EBITDA margins and earned over $600 million adjusted EBITDA and generated significant free cash flow. We achieved this while continuing to reinvest in our business and strengthen our competitive advantages. We're reducing our cost structure, as I discussed earlier. We see several opportunities to invest and grow our earnings and cash flow.

Financial discipline is a key component of our strategy. We'll continue to leverage our strength to drive high return on invested capital and generate free cash flow and use that

cash flow to increase shareowner value. We're confident in our future and motivated by the opportunities that lie ahead.

That concludes my remarks, Gabe. Thanks for letting me share them.

Gabe Hajde: Thank you, John. So the first question, you talked about being pretty much a honed hedgehog focused on one product line specifically. Can you give us maybe just a lay of the land, geographically speaking? And a little bit off-script, maybe talk about some of your competitors and what they do. Because one of the things that stands out to me is your ability to identify some of these projects as an independent company and deploy that capital internally versus maybe what you were able to do in the past and maybe how some of your competitors are hindered in that regard.

John Sims: Yes, I think the--and that's the key thing with us in terms of our strategy of being focused on uncoated freesheet. So we get up every day thinking about how we can create value, increase our competitive positions. But one of the things, I think, that we need to understand with the uncoated freesheet market is we believe that we operate in very hospitable markets, very conducive to earning high return on capital that we reinvest back into the industry.

And because the industry over time is declining in some of our markets, particularly in Western Europe and North America, that market naturally has players exit, and we're seeing players exit today. So we've had players exit from Europe, players that are exiting from North America, and also even in Latin America. We, on the other hand, are reinvesting back in the business, strengthening our competitive positions and strengthening our ability to grow, actually grow our earnings in these markets.

It is different than our competitors. Our competitors, we've seen other competitors that have diversified into product lines, into different product lines, different investments. What we tell investors is that we believe that there's a lot of opportunity to increase our earnings, increase our cash flow, by staying true and focused on uncoated freesheet. We're going to generate a lot of cash, and if you want to invest in a different business, we're going to give you the dividends to be able to do that. But we're going to stay in our home markets. We're going to stay with what we know and where we feel that we have a competitive advantage and that we can generate a lot of earnings from.

Gabe Hajde: Well, it's served investors well, I think, over the past 12 months, stock up 80% or so, so it seems like a fine strategy. Three years post-spin, maybe some of the key highlights, key learnings and any challenges that you all have faced?

John Sims: Yes, I think when you think about--you said 3 years, we have about 2.5 years. But we faced some significant challenges if you think about it. Not only did we spin from International Paper, and you have to deal with standing up and your own company getting off the IT systems. But within 2 quarters of the spin, we were faced with the Russian invasion of Ukraine. One of our largest, most profitable businesses was in Russia. We decided that we had to exit that business.

But we also then took an opportunity that same year to acquire a mill in Sweden that fit strategically very well. Then the next year, even in the face of high inflationary markets

back in 2022 and then 2023, we had to deal with probably the biggest downturn that we've seen in uncoated freesheet because of inventory corrections. Apparent demand, not the underlying demand, but the apparent demand was a lot lower, more dramatic decrease in Western Europe and North America than even in COVID.

But in all of that, the company performed extremely well because we were focused, because we had a team that can react quickly, make decisions quickly. And even in light of the challenges that we had, we were able to exit Russia, we were able to acquire Nymolla, and we were able to generate 16% EBITDA margins last year, probably in the worst down cycle we've seen in uncoated freesheet, generate $600 million of adjusted EBITDA, and return $125 million back to cash, back to the shareowners, and increase our investments internally, even in the worst downturn that we've had. So I think it just speaks to the advantage of being a focused company on a market that we understand.

Gabe Hajde: Okay, makes sense. Again, go back to the share price. You've articulated being a cash flow story and then giving shareholders the option, either through share repurchases or dividends. What's the feedback been from investors in terms of your strategy or the investment thesis that you are putting out there?

John Sims: Thanks for asking that question, because we've heard from our shareholders. They're very pleased with the balanced approach that we've taken. And as I said, our first priority was to make sure that our balance sheet is strong. We've set a $1 billion target, and we were able to achieve that really relatively quickly. And we want to keep a strong balance sheet so that we have the strategic flexibility to take advantage of any opportunities that may arise--for example, with Nymolla.

But after that, then the cash that we will retain, we want to reinvest back in our business that are high-return projects, that can grow our earnings going forward. And this is important because most people believe and have a bias toward companies that are in declining industries, the belief is that you can't grow your earnings. That's not true. There are so many opportunities as we said, over $300 million in investments, and we have the ability to do that.

But at the same time, we also said that hey, we're going to balance those investment opportunities with also balance in buying back our shares. If the value of the company is significantly below its intrinsic values that we're seeing, that's going to be a hurdle that we're going to look at before we even reinvest back in the business. And that's what we've been doing. We've been buying back our shares because we believe we've been undervalued, and so we've been able to do that.

And then I think the other thing that's important is the foundation for our capital allocation is a dividend that we believe that we can sustain for a long time. And so it's core to our strategy to return cash to shareowners, but we want to make it so that the dividend doesn't constrain us strategically, but also it's optimum in terms of returning cash steadily back to the shareowners. And that's why we raised the dividend. We're really comfortable with the level that we're at that meets that hurdle.

Gabe Hajde: And there's a shareholder base out there that embraces that?

John Sims: So they do. And I think what they've--to answer your question that you asked is what they like is our balanced approach. But the priority, I think, is that make sure your balance sheet is strong and then deploy capital where you're going to get the highest return.

Gabe Hajde: Okay. Sometimes we use these events to communicate to the market anything on the demand side or pricing, what-have-you. There's a current price initiative out there we could talk about in a minute. But on the demand side, it's been tricky, so there's been a lot of volatility around destocking, restocking, and things like that. Any updates that you'd give us? Do we think that 2024 can contract what a normalized year should look like, appreciating down in Brazil it's a little bit, they're going into their winter months right now, so it's Southern Hemisphere business. So just anything that you could point out to us that you're seeing in the business today from a demand standpoint?

John Sims: Well, you raised a good point, and that was really one of the key drivers last year was this inventory restocking. But when you look at the past several years, even through COVID and stuff, the underlying demand decline between Western Europe and North America has been pretty consistent with what we've seen. So we still believe that because of electronic substitution, we're seeing about maybe a 3% to 5% decline in those markets, where Latin America remains steady. And nothing's really changed our view on that going forward.

Gabe Hajde: All right. Shifting gears to pulp, we're reading a lot about pulp price increases. The pulp market is a little bit of a different animal, but you guys operate vertically, integrating those so you don't necessarily have to substitute. But just maybe talk about that dynamic again relative to your competitors and how it serves as a strategic advantage for you.

John Sims: Well, the pulp market, so about 10% of our volume that we sell, we do sell as market pulp. And it does impact us, not to the extent from as pulp goes up, then we're going to earn more on the market that we sell. And most of the market pulp we sell is in Europe and North America. It also is a big driver of our competitive advantage, particularly in Europe. About 25% of uncoated freesheet capacity in Europe is non-integrated, so they're buying market pulp, purchase pulp. And so when the pulp prices go up, the cost curve steepens pretty significantly. And so that helps with raising prices in Europe. So we're seeing that. In Europe, though, with the pulp prices going up, we're essentially moving to the lower end of the cost curve, and our competitors and non-integrated players are moving up to the right. Less of an impact in North America because most of the--predominantly all the players are integrated, and the same thing down in Brazil that's integrated. But most of the impact you'll see is in Europe.

Gabe Hajde: Okay. But domestically, there is a price increase initiative at the moment that the industry is pushing through.

John Sims: Yes, in our outlook we've shown that we've got price increases going across all regions, both in paper and in pulp. I believe our outlook, we showed that we expected $20 million to $25 million higher price mix than first quarter. And that's across all the regions.

Gabe Hajde: Sticking with pulp prices and specifically in Europe, changing to a regulatory backdrop, I'm not an expert on this, but the European Union regarding some deforestation. I think

generally speaking, North American producers adhere to a pretty strict, if you will, sustainably forest process and things like that. As it relates to Sylvamo, is that a strategic advantage? Is that a risk to the business model over time? What does it mean as it sits today, as the regulation is in its current form?

John Sims: Well, in terms of the European regulation that they proposed in terms of tracking?

Gabe Hajde: Yes.

John Sims: Yes. So first of all recognize that Sylvamo, our name comes from the two Latin words, "love of trees," so we know that forestry and sustainable forestry is very important to our business. And we actually support the EU. We know that they're trying to do is ensure that all products that are sold--not just paper, but anything that's made--is sustainably produced and being able to track that. So we believe and support that initiative. We don't see that as an issue, because we ensure that the fiber that we source is sustainably produced.

The difficulty in the legislation is the practicality of the implementation, because when you think about it, what they're asking us to do is be able to tell them what tree was produced and used to produce this ream of paper. And if you've ever been to a paper mill and look at the wood yard and look at the chips pile and try to say, "Well, we can tell that chip went into this piece of paper," how difficult that is. But it's not just a Sylvamo issue. It's every paper producer will have that difficulty. So we're trying to work with the EU, work with them to find a reasonable solution to meet what they're trying to do but make it practical so that we can actually abide by it.

Gabe Hajde: Sounds like things are getting more complex, not easier.

John Sims: Well, that's true of the world, true of many things.

Gabe Hajde: So switching gears a little bit, we had dinner last night with a fiber-based packaging company, a couple here today. It seems to me there's interest from European buyers buying domestic assets. There's news articles talking about a potential Brazilian buyer of pulp assets here in North America. Just when we zoom out a little bit, how should investors, do you think, view the risks or opportunities and maybe scarcity value of assets in the context of maybe what some other foreign buyers might see in North American assets, or global assets, for that matter?

John Sims: Okay, Gabe, you have to help me with that.

Gabe Hajde: Just from what we've heard in North America is that there probably will never be a virgin pulping mill permitted, and then construction costs have really escalated. So maybe just--this isn't the right way to think about it--we value things, we tend to, on cash flow. But just replacement costs and construction costs and different perspective and maybe what those other foreign buyers might see in having that footprint in North America.

John Sims: Well, let me answer it this way. When we think about the uncoated freesheet market, this is--and so because it's declining, what we see is everybody generally is moving to exit uncoated freesheet. And this is actually a good thing for us, because we're actually

running in. I tell investors, I say we're like the Marines. When everybody else is running out, we're running in because we really believe with our competitive advantages, the long-term sustainability of uncoated freesheet, is that this gives us advantages.

So players are, when you look at assets, you're right. Nobody's really building an uncoated freesheet when you think about our markets. However, a lot of our uncoated freesheet assets are low cost and can be converted into other assets--producing containerboard, for example, or other grades. And what's attractive to us, and this is going to be true. It's been true in the past and been true in the future is it's the low-cost assets that are converted. Nobody's going to take an uncoated freesheet high-cost asset, convert it and try to compete against a very competitive packaging market. So they're going to take the low-cost assets, and those low-cost assets then steepen the cost curve for the field that we continue to play in. And because we have the low-cost assets positioned well on the cost curve, that's why we believe that over time, even with that declining market, margins can improve and our earnings and cash flow can improve.

But it also speaks to the enduring value of our assets in uncoated freesheet. And this, I think, investors miss, is the underlying value of our assets have a lot of value. For example, our flagship mill in North America, the Eastover Mill, would make a great containerboard mill--very low cost, integrated containerboard. So there's a lot of value in that. And that's the other thing that some investors--that's why we continue to believe that we're undervalued, because people don't understand that the market's going to be increasingly more attractive going forward and that we have enduring underlying value in our assets, both the mills that we operate because they're low cost, and we talked about--we announced this Brazilian forestry asset that we have that was valued over $1 billion on a recent appraisal. That also is an important part of our enduring value.

Gabe Hajde: You bring it up. I think that came up from $400 million previously, and it's "phantom value," if you will, that unless you sell it, you may not necessarily be able to monetize or recognize the value today. But was that something you prepared independently, or just given, again, knowing what we know about eucalyptus and the trees down there and silviculture? How do we think about that in the context of the Sylvamo story? Does that give you balance sheet strength or what?

John Sims: So a couple of things that will answer that. First of all, we believe that we're capturing that value today. We're capturing that in the integrated value that we have in our assets down there. So every day, that's one of the advantages that we have by being down in Latin America and in Brazil is the very low-cost fiber being integrated and having that. Also, how you're going to think about that in the future is that that enduring value exists there. So it gives us, there's always potential options down the road. We don't know how things will be played out, but that value, we believe, will continue to increase.

And the reason why--you asked the question, why did we do that appraisal, it was really because some public announcements from some of our competitors or players down in Brazil had publicly announced the purchases of land very close to where our plantations are, and we recognized just simple math when we did it, we said, wow, the value of our land is much higher than even what we had appraised it when we spun from International Paper. So we hired the same appraiser that International Paper had hired, redid the appraisal, and it came to about what we expected it to be in terms of that. But that just

shows the value of that land. And also the forestry asset, the pulp wood, has increased pretty dramatically over the last 3 years.

Gabe Hajde: Out of curiosity, there's a North American company that comes to mind that has some timberlands. Are you able to leverage that into maybe better terms or lending terms with the banks?

John Sims: It's possible. We haven't done that because we don't need to do that.

Gabe Hajde: Okay. Switching gears, Project Horizon, that was an initiative you guys put out there pretty recently. I think you talked about $110 million of potential for this year. Specifically, if you dive into that, what is Sylvamo doing, and what do you expect to get out of it?

John Sims: So we did that, the backup, and just to put it into context, is we knew that when we spun that we were going to have additional costs, being an independent company. And we knew that once we got up and running fully, we needed to start working on becoming more streamlined, more efficient. So it was always the plan. And we decided to do this in a very short timeframe, so we did target $110 million of run rate. So by the end of this year, we would get $110 million run rate savings, $30 million of that in SG&A, overhead; $70 million of it in manufacturing and supply chain.

So we've already announced the SG&A part, 150 people globally. That's being executed. The supply chain and the manufacturing is a lot of different initiatives that we're doing. Now we expect to realize probably about $10 million to $15 million of it to bottom line this year because there's $50 million of inflation, so about $60 million or $70 million we'll actually get this year, minus the inflation, so we'll see about $10 million. But we'll be at a run rate at the end of the year of about $110 million.

Gabe Hajde: Okay. As we think about productivity in this again in at least my sector--I don't know about other sectors--but I call it the inflation treadmill. You mentioned $50 million. Sometimes you're able to get a little bit of commercial initiatives to offset that. Customers aren't knocking down doors to pay higher prices, but do you feel like it's incumbent upon you all to have a program like that in place all the time and drive productivity?

John Sims: I think so. And because inflation has gotten significantly higher, so it's a bigger challenge for business. So this really is motivating us in terms of the high-return investments that we're putting back into the company. There was a period of time before we spun that we were underinvested, both in terms of maintenance, which then affects reliability, productivity, our forestry down in Brazil, which affects the cycle time of the trees. So the longer we can wait to harvest the eucalyptus, the higher the yields, the less energy, the less chemicals. And so we've been reinvesting back into our plantations to increase the yield. Unfortunately, you won't see that until about 6 years, but we started it last year. But that's going to drive cost reduction in our facilities down there. Improving the maintenance reliability also improves--but all these things need to overcome some inflation. And that's what our drive is, is to increase our ability to reduce costs at greater rates to inflation so that our margins can increase. It's another way to grow our earnings and cash going forward.

Gabe Hajde: Probably should have done this before. I don't know if anyone in the audience has anything. Let me make an analogy about making the investment. You're like well, unfortunately, it won't be for 6 years. But loblolly pine trees or hardwood trees in North America roll off slower, so maybe the stock price will grow with your eucalyptus trees instead of the North American hardwood.

There's a chart, I can't recall which one it is, I think it was 7, $200 million of high-return projects that you've identified. You talked a little bit about being underinvested or maybe certain projects overlooked because they were comped against a bigger enterprise before. Just maybe talk about what you're doing today in terms of these projects, returns associated with them to the extent you can. And then maybe the runway, because I think that's what can get folks excited, is you guys have taken a 5- to 7-year strategic look at the business and saying, "We've identified a series of these projects."

John Sims: Yes, I'm glad you asked that, because I wanted to clarify. Initially, when we spun, we said we had $100 million of high-return capital projects. And we said that if you look at it today--I'll get to the graph, but we're going to spend about $70 million of it by the end of this year. And then if you look at the carryover, even into next year, that $100 million will have been spent. So it took us a little over 3 years to spend the $100 million of high-return capital projects. Now we've identified and have been working, even since the spin, to identify more opportunities to invest.

But if you look at those projects--I'll give you an example. So if you averaged the projects of the $100 million that we have really committed to spend, it's an average of $2 million a project. Now there are some that are $6 million, there are some that are $12 million, and there are some that are less than $1 million. But the returns on those projects are very similar to the returns we've had on the share buybacks. So they're significant in terms of what they yield.

We believe, and this is what's consistent with our strategy being focused on uncoated freesheet, is that we're investing in our assets, our brand, our people, our teams. We think these are low-risk investments. Why? Because we know these markets, we know these mills, and we fully have high confidence in the ability to generate the returns that we're talking about. So we target north of 20%. In some projects it will be 20%. There will be some projects that have 60% returns.

But when you think about the $200 million that we've identified going forward, I think you can think about essentially the same sort of rate in terms of how we will spend that, and the returns are very similar to that.

Gabe Hajde: Maybe one last one on cash flow, and might be close to out of time, is to your point, maybe, as some competitors de-emphasize uncoated freesheet, do you see opportunity for M&A for you all to further consolidate any markets? Not saying today or tomorrow, just conceptually how investors could think about that.

John Sims: We've always said that M&A is not core to our strategy. However, just like we did with Nymolla, if there are uncoated freesheet assets that are low cost in the markets that we are focused on, that being North America, Europe and LatAm, we're going to be interested in looking in that. And I think there potentially could be. I think that players

that we're seeing, like I said, we have some players are exiting uncoated freesheet in Europe as we speak. Now they're doing some of it through capacity closures and some of it they're doing through sell, like we did when we bought the Nymolla mill. But I think that there could be potential opportunities going forward, and we will certainly evaluate those. Again, it has to fit our strategy, and we have to be sure that we're going to believe that those assets are going to be around for long term and that it's going to be accretive and return to our investors.

Gabe Hajde: Excellent. Well, with that, I think we're out of time. Thank you, John.

John Sims: Thank you. Appreciate the time.