Transcript

SYLVAMO: Sylvamo's Second Quarter 2023 Earnings

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SPEAKERS

Hans Bjorkman – Vice President of Investor Relations
Jean-Michel Ribieras - Chairman and Chief Executive Officer
John Sims – Senior Vice President and Chief Financial Officer

ANALYSTS

George Staphos - Bank of America
Paul Quinn - RBC Capital Markets

PRESENTATION

Moderator	Good morning. Thank you for standing by. Welcome to Sylvamo's Second Quarter 2023 Earnings Call. [Operator instructions]. As a reminder, your conference is being recorded. I'd now like to turn the call over to Hans Bjorkman, Vice President of Investor Relations. Sir, the floor is yours.
H. Bjorkman	Thanks, Leah. Good morning, and thank you for joining our call today. Our speakers this morning are Jean-Michel Ribieras, Chairman and Chief Executive Officer; and John Sims, Senior Vice President and Chief Financial Officer. Slides 2 and 3 contain important information, including certain legal disclaimers. For example, during this call we will make forward-looking statements that are subject to risks and uncertainties. We will also present certain non-US GAAP financial information. Reconciliations of those figures to US GAAP financial measures are available in the appendix. Our website also contains copies of the second quarter 2023 earnings press release as well as today's presentation. With that, I'll turn the call over to Jean-Michel.
JM. Ribieras	Thanks, Hans. Good morning and thank you for joining our call.

Let's turn to slide 4, please. In the second quarter, we generated adjusted operating earnings of $1.14 per share and we achieved $124 million in adjusted EBITDA, both at the high end of our guidance range. We generated $33 million of free cash flow and returned $41 million in cash to shareholders via dividends and share repurchases in the second quarter.

Price, mix, operation and input and transportation costs were all favorable to the outlook we provided in our first quarter call. Our second quarter volume was short of our expectations, reflecting continued channel inventory correction and weaker than projected demand. John will discuss the industry demand in more detail.

Slide 5 compares our second quarter key financial metrics versus prior periods. In the second quarter, we had $124 million in adjusted EBITDA, after $58 million in planned maintenance outages expenses. Our operating teams matched our production to our customer demand, while executing two third of our total planned maintenance outages for 2023. I'm proud of our teams that completed these outages safely and efficiently. If we normalize planned maintenance outages expense, our second quarter adjusted EBITDA margin would have been 17%.

Now, John will discuss our second quarter performance in more detail. John?

J. Sims

Thank you, Jean-Michel. And good morning everyone, and thank you for joining our call.

Slide 6 shows our second quarter earnings bridge. As Jean-Michel stated, we earned $124 million of adjusted EBITDA in the quarter, which was in line with our guidance of $115 million to $125 million.

Let's discuss the changes versus the first quarter adjusted EBITDA. Price and mix decreased by $38 million due to lower paper prices in Europe, less favorable mix in Latin America and North America and lower global pulp prices. Volume was the one area that was significantly different than our outlook, and I will discuss more about this on the next few slides.

Operations and other costs increased by $10 million, primarily driven by $15 million in higher unabsorbed fixed cost due to increased economic downtime. Planned maintenance outages costs increased by $58 million, as we conducted four major outages versus no outages in the first quarter.

Input and transportation costs improved by $24 million, driven by favorable energy, chemical and transportation costs.

Over the next few slides, I'll discuss industry demand and our volume projections, which are central to our revised outlook. So it's worth spending a few minutes on them.

Let's move to slide 7. In the first half of this year, apparent demand for all printing and writing papers, including uncoated freesheet, declined significantly, especially in Europe and North America. The dark bars on this slide show the demand for the first half of 2023 versus demand for the first half of 2022. The lighter bar shows the demand over the last 12 months versus demand over the prior 12-month period. We regard the lighter bars to be more representative of apparent demand.

In the second half of 2022, Europe and North America experienced surges in uncoated freesheet imports and customers built inventories well above normal levels. At the same time, uncoated freesheet demand began to slow down, as some European economies entered recessions and North America companies pulled back on advertising, some in anticipation of a recession. This impacted direct mail and commercial printing, which contributed to reduced orders for uncoated freesheet in the first half of this year.

The next few slides show uncoated freesheet demand data by region and provide context to the recent regional demand trends. In summary, we believe that in 2022 customers were buying more paper than they were using and in 2023 they're using more paper than they're buying, in other words, reducing their inventory significantly.

Let's move to slide 8. Let's look at Europe first. On average, industry demand declined 5% annually over the last four years. Despite the significant swing, the full-year trend is similar to the long-term demand trend. We now expect channel inventory corrections in Europe to be completed by the end of the year, as many of our customers are targeting lower inventory levels than historical averages. For the balance of the year, we expect the demand to remain weak due to the slower European economies. This will continue to put pressure on our volume and price and mix in Europe.

With respect to changes in supply, recently one producer permanently shut down a 175,000-ton uncoated freesheet machine in Austria and another

producer announced the start of a process that may lead to the permanent shutdown of a 220,000-ton paper mill in Germany.

Let's turn to slide 9 to discuss the North America uncoated freesheet demand picture. Over the past four years, on average North America industry demand declined at 3% per year, which is also close to the long-term demand trend. We expect North America channel inventory corrections to be largely completed by the end of the third quarter.

The US economy appears more resilient than many were expecting and US advertising spend recently grew for the first time in nearly a year. Assuming this trend continues, we would expect paper demand to improve in the second half of the year.

With respect to changes in supply, one competitor shut down a 240,000-ton uncoated freesheet mill in May. We have started to supply the new business we gained as a result of that permanent shutdown.

Let's turn to slide 10 to discuss Latin America. Over the past four years, on average Latin American industry uncoated freesheet demand was up 3%, which is slightly better than the long-term demand trend. As you can see on this slide, Latin America has a very strong seasonality pattern, with the second half being stronger than the first half. First half 2023 demand was a bit lower than we expected, as customers were also adjusting their inventories throughout Latin America.

Let's turn to slide 11 to summarize our views on uncoated freesheet demand trends. The European and North America first-half demand declines were driven by four factors.

Number one, the 2023 surge in imports. And as you may know, imports returned to normal levels by the first quarter in the United States and in the second quarter in Europe.

Number two, significant channel inventory corrections. We now expect these corrections to be completed in the third quarter in North America and the fourth quarter in Europe.

Number three, reduced advertising in the US, some in anticipation of a recession, as the recession has not occurred and the economy continues to be more resilient than many expected.

And finally number four, the slowing economic growth in Europe. We expect continued low economic growth in Europe.

Now let's turn to slide 12 to review our third quarter outlook. We expect to deliver third quarter adjusted EBITDA of $130 million to $150 million. We project price and mix to decrease by $60 million to $65 million, primarily reflecting paper price decreases in Europe and the realization of prior price decreases for pulp across the globe.

We expect volume to improve by $15 million to $20 million, reflecting seasonally stronger volume in Latin America and North America and the recent new business we've gained in North America.

Operations and other costs are projected to increase by $5 million to $10 million, primarily due to higher unabsorbed fixed cost, as we continued to match supply to our customers' demand. We expect input and transportation costs to improve by $15 million to $20 million, with favorable trends in fiber and chemicals. Planned maintenance outages are projected to decrease by $54 million. We project adjusted operating earnings of $1.20 to $1.55 per share.

Let's turn to slide 13 to review our revised 2023 annual outlook. Based on the slower than expected demand recovery, we now project adjusted EBITDA of $560 million to $600 million for the full year. This revised outlook reflects lower volume and higher unabsorbed fixed cost from economic downtime in Europe and North America, less favorable price and mix in Europe and in Latin America, favorable input in transportation cost and favorable operations and other costs. We now project free cash flow of $220 million to $250 million. This revised estimate reflects lower adjusted EBITDA, offset by lower cash taxes and a significant reduction in working capital.

We continue to focus on generating cash flow and remain a cash flow story. Our revised outlook indicates continued strong free cash flow of about $5 to $6 per share, and importantly, we remain committed to returning $125 million in cash to our shareowners this year.

Let's turn to slide 14, please. We will continue to maintain a strong balance sheet, return substantial cash to shareowners and create value by reinvesting in our business. We will continue to reduce debt through required amortization. We plan to deposit $60 million in escrow, which will allow us to return more than the $90 million limit in our credit

agreement. $125 million in dividends and share repurchases will be an increase of about 40% versus the $90 million we returned in 2022. In the first half of this year, we have already returned $61 million to shareowners.

Jean-Michel, I'll turn it back to you.

JM. Ribieras — Thanks, John. Let's put all of this into perspective, I'm on slide 15. Remaining the supplier of choice is paramount to our success in the second half. We will continue to supply the products our customers need when and where they need them. We're also committing to managing our production to our customer demand, which will help us reduce working capital and we will continue our efforts to reduce operating cost and selling and administrative expenses. We expect European earnings to remain under pressure, while our Latin America and North American results continue to be resilient.

I'll conclude our prepared remarks on slide 16. Despite the difficult industry demand environment in Europe and North America, we are confident in our ability to create shareowner value throughout the cycle. We have reduced debt significantly since the spinoff and our financial position is robust, at 1.2 times net debt to adjusted EBITDA.

Our free cash flow generation is strong and we plan to return $125 million to shareowners this year. We are also reinvesting in our business to reduce cost, strengthening our low-cost position so that we can exit the downturn in an even stronger competitive position.

With that, I'll turn the call back to Hans.

H. Bjorkman — Thanks, Jean-Michel, and thank you, John. Okay, Leah, we're ready to take questions.

Moderator — Thank you. [Operator instructions]. And we go to a question from George Staphos with Bank of America. Please go ahead.

G. Staphos — Hi, thank you very much. Hi, everyone. Good morning. Thanks for the details.

I wanted to start, Jean-Michel, John, Hans, if you could have us think about how you think what the demand trajectory will be once we're through this weak period. I know that's to some degree up there with

world peace, but do you think there is a demand snapback after we are through this, let's call it recessionary period, destocking period? Or do you think the trajectory on demand goes back to what had been the CAGR for North America, for Europe, for South America? What is your expectation? What would you at least try to convince us of from your vantage point in terms of the long-term demand trajectory after this period, or the intermediate period I should say? Thank you.

JM. Ribieras — Yes. Morning, George, thanks for joining the call. We really believe we're going to go [audio drops] Latin and North America and Europe, sorry, to return to long-term trends. The difficulty we have is to put a time back, but demand will come back. Our inventory correction is at the end. So as you can see on the long term, we've had a lot of ups and down and it's more brutal sometimes than we expect, including COVID, but the trend has not changed. The trend actually, if we take the last four years, it's a little bit better than we expected.

So to answer your question, we are expecting to go back to longer trends, the same we had in the past.

G. Staphos — I guess maybe relatedly, and you don't show this here on the slide and I'd have to go back and look at my numbers, but I seem to remember after the financial crisis, and here I'm just thinking about North America, uncoated freesheet demand really didn't snap back. It didn't decline at the rate that had been experienced during that recession, so that was an improvement, but it didn't really snap back. So if you agree with that premise, and maybe you don't, why should it go back to more of a trend this time around?

JM. Ribieras — Yes, so I think there's two comments in that one, and I don't want to be wrong in my comments. Snap back to prior level, I'm not sure we're going to get there. I think we'll have some snapback because we will have the inventory correction behind us, but the trend will be the same.

G. Staphos — Okay.

J. Sims — Yes, I think one thing, George, I would say also, just remember, we're looking at apparent demand. And sometimes apparent demand gives not an accurate view because apparent demand is calculated by domestic shipments minus exports plus imports. So I think, and we tried to say this little earlier, is that we think in 2022 actually demand, which grew in the north and US based on those that report it, but that was probably overstated. And today, if you look at what's being reported year-to-date,

demand is down almost 17% in the US, but that is probably overstating the decline, and that's being driven because of the inventory corrections. We do believe that there is some pullback, we've seen that.

So I guess what I'm trying to say is that when you're thinking about where is it going to bounce back to, I think the 17% decline number is too low, given where we think because of the way it's calculated with apparent demand.

G. Staphos — Okay. Maybe one last question for me and I'll turn it over. I realize you're not guiding on the fourth quarter, though, implicitly you are because of the full year and the third quarter, and when we just do the simple algebra, it's not even analysis, you wind up with a relatively wide range for what's implied for EBITDA for fourth quarter. And, yes, it's going to be driven by volume, by pricing and so on, we get that, but what specifically, if you could be somewhat granular here about either end market regions pricing, would be the key factors in terms of whether you wind up towards the higher end of your guidance range implied, both third quarter for sure and then fourth quarter, or at the lower end? Again, as we get to the fourth quarter, that range is between $70 million, I think, and $140 million in terms of EBITDA. Thank you, guys.

J. Sims — Yes, George, it's John. Thanks for that question. I think we gave the revised range of $560 million to $600 million, which is a $40 million range. And then if you look at our range for the third quarter, it's a $20 million range, $130 million to $150 million. You subtract what we earned in the first half, which is $332 million, you really get a range for the fourth quarter of about $20 million, $100 million to $120 million.

And what's driving our revised outlook, both in the third quarter and the full year, I think we talked about it, but it's really demand-driven, mostly in Europe, because of the slower economic conditions that we're seeing in Europe. And that's also having implications in terms of our views about pricing in the second half of uncoated freesheet in Europe. And it also incorporates our views on pulp pricing, which we've already seen, but we're going to see the full impact of that in the second half. And it also reflects, as we talked about, a little bit lower view demand view in North America. I will say for the year right now, through the first half of the year pricing has been relatively stable in North America. And Latin America, we do see a seasonal increase in volume, and that reflects also our views on pricings in the export markets.

G. Staphos — Okay, thank you so much. I'll turn it over.

Moderator — [Operator instructions]. And we have a question from Paul Quinn with RBC Capital Markets. Please go ahead.

P. Quinn — Yes, thanks very much. Morning, guys. Thanks for the color on the machine shuts that you noticed in North America and Europe. Maybe the question I got is, what kind of volume needs to come out to stabilize pricing, in your opinion, in both those markets?

JM. Ribieras — Hi, Paul, Jean-Michel speaking. I would just start by saying in North America we've seen prices stable. But we don't have the calculation on what kind of volume has to be taken off, I don't have a number to give you.

What is true, which is very volatile in Europe in terms of volume, is the non-integrated producers. In Europe, they are much more important than they might be in Latin America or North America, and right now with the very low cost of pulp and very low cost of gas, those producers who sometimes are in the market, sometimes are not in the market, are much more competitive. So we see them, which sometimes you don't. So there is a variable here which is very difficult to answer your question because it depends on raw materials.

P. Quinn — Okay, that's fair. And then maybe the second question I had. You've stated $125 million return of cash to shareholders. What do you think about that level going forward? And what's your ability to increase that?

J. Sims — Thanks, Paul. We said that core to our capital allocation strategy and goal is to continuously increase cash returns to shareholders, so core to that is our dividend. And what we want to do is be able to provide a stable dividend that grows over time, the balance of it in terms of share buybacks is going to be really based on an opportunistic view. But our first priority, I should say, is maintain a strong balance sheet so that we can invest in the cycle and provide a stable growing dividend in the long term.

So I think the short answer to your question, to what you're trying to get at, it really takes a sense of where we think each year in terms of the free cash flow that we generate in terms of whether we can increase it above the $125 million or not going forward.

P. Quinn — Okay. That's all I had. Thanks, guys.

JM. Ribieras Thank you.

Moderator And we go back to the line of George Staphos with Bank of America. Please go ahead.

JM. Ribieras George?

Moderator Mr. Staphos, you have your phone muted. We don't hear you at this point. Mr. Staphos, if you can hear us, we are unable to hear you.

With the inability to hear Mr. Staphos at this point in time, we don't have any further questions in queue. You may continue.

H. Bjorkman All right. Thanks, Leah. George, we'll follow up with you after the call. But before I wrap up, Jean-Michel, any closing comments?

JM. Ribieras Thank you, Hans. And thanks, everybody, for joining the call. We remain a cash flow story and we remain committed to returning $125 million via dividend and share repurchases in 2023. We remain confident in our ability to generate strong EBITDA and free cash flows through the cycle, re-allocate capital to increase shareowner value, we'll use cash to maintain a strong balance sheet, return cash to shareowners, and reinvest to strengthen our business. In short, we are still very confident through the cycle about Sylvamo.

H. Bjorkman Thank you, Jean-Michel. And thanks, everyone, for joining us today. We appreciate your interest in Sylvamo and we look forward to continuing our discussions in the days and weeks ahead. That concludes our call for today. Thank you.

Moderator Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation. You may now disconnect.