Transcript

SYLVAMO: 1st Quarter Earnings Call
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SPEAKERS

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

ANALYSTS

George Staphos – Bank of America
Matthew McKellar – RBC Capital Markets

PRESENTATION

Moderator	Welcome to Sylvamo's First Quarter 2024 Earnings Call. All lines have been placed on mute to prevent any background noise. As a reminder, your conference is being recorded. I'd now like to turn the call over to Hans Bjorkman, Vice President, Investor Relations.
H. Bjorkman	Good morning, and thank you for joining our First Quarter 2024 Earnings Call. Our speakers this morning are Jean-Michel Ribiéras, 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 earnings release, as well as today's presentation. With that, I'll turn the call over to Jean-Michel.
J. Ribiéras	Thanks, Hans. Good morning and thank you for joining our call. Let's turn to Slide 4, please.

As anticipated, we experienced improving uncoated freesheet and pulp condition in the first quarter, which resulted in improved order book. Our mill system ran near full capacity and our earnings reflect much less economic downtime. We are making good progress with Project Horizon, our program to streamline overhead, manufacturing and supply chain costs. We are on track to meet our year-end run rate target of $110 million in savings.

We also continue to return substantial cash to shareowners. We distributed $12 million via the first quarter dividend. As of today, we've repurchased $20 million in shares this year. Let's move to the next slide.

Slide 5 shows our key financial metrics. We generated adjusted EBITDA of $118 million with a margin of 13%. As expected, free cash flow was lower than the fourth quarter due to the timing of year-end payments and non-repeat of the fourth quarter inventory reduction benefit and the payment of annual incentive compensation in the first quarter.

Keep in mind that our free cash flow is heavily weighted in the second half. In 2023, we generated almost 90% of free cash flow in the second half, and in 2022 about 75% in the second half. We generated adjusted operating earnings of $1.07 per share.

Now, John will review our first quarter performance in more detail.

J. Sims

Thank you, Jean-Michel and good morning, everyone. I'm on Slide 6, which contains our first quarter earnings bridge.

The $118 million of adjusted EBITDA we earned was within our outlook of $105 million to $125 million. Price and mix were better than projected. This reflects the implementation of pulp and paper price increases that we had communicated late in the fourth quarter and early in the first quarter in all regions.

Volume decreased by $12 million driven by the normal seasonally weaker demand in Latin America. Volume trends in Europe and North America were favorable as we projected.

Operations and other cost improved by $19 million, primarily reflecting lower economic downtime across all regions. Planned maintenance outage costs decreased by $3 million and input and transportation costs increased by $9 million.

Let's move to Slide 7. This graph shows our economic downtime over the last five quarters. In the first quarter this year, we took 11,000 tons of economic downtime, which was an 80% decrease from the first quarter of 2023 and nearly a 95% reduction from the peak in the third quarter of last year.

Let’s move to Slide 8. Uncoated freesheet conditions continue to improve. Our order books have strengthened across all regions versus 2023 levels. We implemented previously communicated price increases in both paper and pulp at all regions as well. We are also experiencing a stabilization of input costs.

Let’s move to Slide 9. We expect to deliver second quarter adjusted EBITDA of $145 million to $160 million. We project price and mix to improve by $15 million to $20 million primarily reflecting price increase realizations across all regions. We are also expecting a favorable mix impact in Latin America. We expect volume to improve by $5 million to $10 million driven by seasonally stronger demand in Latin America, plus continued momentum in Europe and North America.

Operations and other costs are projected to improve by $5 million to $10 million primarily due to lower operating costs in Europe and North America, as well as lower economic downtime in North America. We expect input and transportation costs to improve by up to $5 million due to better transportation and energy costs in North America, partially offset by unfavorable fiber costs in Latin America. Planned maintenance outages projected to increase by $3 million.

Let's go to Slide 10. In order to remain a low-cost producer of commodity products sold in mature demand, cyclical markets, we must become a leaner and stronger company. That's why we initiated Project Horizon to streamline our organization and improve our cost structures.

We are on track to deliver $30 million overhead cost reductions and to reduce our manufacturing and supply chain cost by $80 million before inflation. We have communicated about 150 position eliminations globally. Approximately one-third of these have already occurred and nearly all the rest will be completed by the end of the third quarter. We are on track to meet our run rate savings targets by the end of this year.

Let's move to Slide 11. We spent $25 million on planned maintenance outages in the first quarter and expect to spend $28 million in the second quarter. By mid-year, we'll have spent about three-quarters of the total annual planned maintenance outages costs for this year. In the second quarter, we will conduct outages in Latin America and North America. We have no planned maintenance outages scheduled for our European mills in 2024.

Let’s move to Slide 12. We are focused on uncoated freesheet and will continue to create long-term value through our talented teams, iconic brands and low-cost mills in favorable locations. Our capital allocation strategy is to maintain a strong financial position, reinvest in our business to improve our competitive advantages and continue to return substantial cash to shareowners.

Let’s look at the next few slides for some additional color on each of these three uses of cash. Slide 13 shows our commitment to maintaining a strong financial position to allow us to operate and invest throughout the cycle. We have reduced our gross debt by $580 million, almost 40% since the spin-off and remain below our $1 billion target. This healthy position 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 the cash returns to shareowners on Slide 14. We will continue to return substantial cash to shareowners via dividends and share repurchases. As this graph shows, since 2022, we have 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 an average price of just over $49 per share. These repurchases show a return of 35% based on a share price of $65. We will continue to look for opportunities to repurchase shares at attractive prices and to also return cash via regular and special dividends.

Let's shift gears and discuss reinvesting in our business on Slide 15. We will continue to invest in high-return projects to strengthen our business and increase our cash flow. At the time of our spin-off, 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 another $200 million of high-return capital projects, which will allow us to grow our earnings and cash flow in the

future. We expect such investments to generate well above cost of capital returns.

This slide highlights three specific projects, two at Eastover that we're already ramping up and one at Luis Antonio that will start up later this year. In Eastover, we had the opportunity to take advantage of a new supply of low-cost wood chips. This project started up in the first quarter and we project annual savings of $0.5 million with an IRR of 35%.

We also started up the evaporator heat recovery system in Eastover. This project will allow us to capture and reuse evaporator heat. We expect annual savings of $1 million with a return of 33%.

The third example is the new turbine generator in Luis Antonio. This will increase our self-generated power and reduce annual maintenance expenses. We expect annual savings of $2 million with a return of 24%.

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

J. Ribiéras — Thanks, John. We are strengthening our ability to create shareowner value throughout the cycle. Sylvamo is a cash flow story and continues to deliver against our investment thesis. Uncoated freesheet conditions are strengthening across all regions. Our system is still running near full capacity and our price and mix continues to improve.

As a result, our earnings are improving from the bottom of the cycle. Financial discipline is a key component of our strategy. We continue to leverage our strength to drive high returns on invested capital, generate free cash flow and use that cash to increase shareowner value.

As John discussed, we are reducing our cost structure and we see opportunities to grow earnings and free cash flow. We are confident in our future and motivated by the opportunities that lie ahead.

With that, I will turn the call back to Hans.

H. Bjorkman — Thanks, Jean-Michel and thank you, John. Leah, we are now ready to take questions.

Moderator — Our first question is from George Staphos with Bank of America.

G. Staphos — I want to go to Slide 6 where you have the waterfall and look, at the end of the day, your performance was in line with your expectations. The guidance looks at least in line for 2Q with where The Street is. So congratulations on all that, but on ops and other costs, there was a slight sort of miss, if you will, versus the midpoint of the range and just because of the performance being in line or better elsewhere, just curious what was driving that?

Then if you could maybe to start off and warm up, across the regions, how was performance relative to your expectations across North America, Europe, Latin America? Anything to call out either positive or negative?

J. Sims — We were slightly below our range in ops and we had a couple of things that were not planned or not forecasted. One was a tax item down in Brazil and then we had an inventory revaluation that occurred in Europe. So those two things were roughly about $4 million that would have put us closer into our range.

In terms of expectations by regions, we were close to where we thought we were, across all the regions. A little bit better maybe in Europe and also in North America. A little bit less in Brazil mostly because of a mix issue. We ended up selling more into export markets and less into Brazil than we expected, but in general, pretty much in-line with what we expected.

J. Ribiéras — In terms of outlook, you were asking, I think we have a continuing momentum of what we have seen in first quarter, which is improvement in every one of the regions. Latin America, the first quarter is seasonally always the weakest one, so it should come up. The rest is just continuing to progress and you can see it in our outlook.

Moderator — Next, we go to the line of Matthew McKellar with RBC Capital Markets.

M. McKellar — First, could you provide a little bit more color on the $200 million of high-return capital projects you've identified? Is there anything you can share over what time frame you'd expect to invest in these projects? What share of the project set would maybe be associated with each geographic segment? Then if there is anything you can share around weighted average IRRs across the pipeline of projects, that would be helpful.

J. Sims — Sure, Matthew. I think we said on the call that by the end of this year, we will have invested in about $70 million. If you look at next year, we

probably will spend about $115 million on high-return projects. If you look at the weighted average returns across those projects, it's almost greater than 35% or even higher than what we're showing in return on our share repurchases. But I think the— if you think about in terms of what we're spending on an annual basis, it's about that trajectory.

So it took us about 3 years to go through $100 million return projects. Now we have identified another $200 million. We will probably be generally— continue with that rate.

Most of these projects when you look at them on average is about $2 million of capital project on average, returning well above 20% internal rates of returns. There are several projects that we need to continue to evaluate and of course get board approval that may be above $15 million to $20 million, but those are things that we are still looking at.

M. McKellar — As a follow-up, would that $70 million for this year be encompassed within Project Horizon? Then just on Project Horizon, more generally, could you maybe talk about how much you may be achieved on an annualized run rate basis in Q1 and how much incremental benefit you might expect in Q2?

J. Sims — Yes, some of these high-return projects are driving cost reductions that we're seeing, particularly in our manufacturing. So they are incorporated into our targets for Horizon and also will be part of our strategy going forward. As we say, we're doing this to strengthen our competitive positions in our core assets across the regions.

In terms of the benefit of what we saw in the first quarter, remember, we shared this last time, we only expect about bottom line, $10 million to $15 million this year because of $50 million roughly of inflation. So we said Horizon, we're going to deliver $110 million of run rate. By the end of this year, we'll be at that run rate, $50 million of inflation will have to be netted against that. So, we expect $10 million to $15 million this year and most of that is back-end loaded towards the second half of the year as we implement these projects and also reduce position.

So the bottom answer is that we probably didn't see much in the first nor the second quarter. It will be back-end loaded.

Moderator — We have a follow-up from George Staphos with Bank of America.

G. Staphos — I know it's a little difficult to talk about this sort of thing live mic, but some of the other producers in North America have either scaled back and/or we've heard from our trade contacts, had some operating issues in the first quarter where they had outages perhaps not planned.

Has that been a material driver of your business? If so, should we be, to the extent possible, maybe trying to build in some cushion should that business leave that entered earlier in the year, leave you later in the year and into 2025? How would you have us think about that conceptually?

Then a second question I had and then I'll turn it over. I know you're not guiding on third quarter yet. We do know what the maintenance guide is. Are there any other significant bridge items that you would have us at least conceptually think about as we think about 2Q to 3Q?

J. Ribiéras — George, if you don't mind, I'll ask you to repeat your first question because I think I didn't get the first question. I can answer the second question on a high level.

So the main thing is the maintenance as you said. The other thing as we always say is the second half is a much better seasonality in Latin America than the first half. So, if I had to guide on two things, which may be is important are those two. Then, of course, the continuation of the improvement that we've seen in the first half— first quarter of this year.

So the momentum, LatAm and the outage is probably a good way to look at it. And I'm sure—

G. Staphos — Jean-Michel, momentum, LatAm and what was the other thing you said?

J. Ribiéras — Momentum in general in the three regions and the outage as you mentioned—

G. Staphos — No. My first point, we had heard some of the other freesheet producers had some operating issues in the first portion of the year. I think there was one that was in the press with, I think, an unplanned outage. Did any of that business accrue to you and if it did, does it go away once those producers are back running more normally, I guess, is the substance of the question.

J. Ribiéras — Yes, we heard about it too and we just saw the first estimate of operating rate for the month of April and that statistic is saying it was 96%, which is

very high, but I don't think we can put a direct relation between our order book and what happens to our competitors. I think those two are independent.

Moderator — We go back to a follow-up with Matthew McKellar with RBC Capital Markets.

M. McKellar — I think you talked about upward pressure on the cost of your wood fiber in Sweden in 2023. I think you also mentioned expecting continued headwinds on the cost of fiber in Latin America, at least in the near term here. Can you talk about what the latest trends are in each country and maybe talk about whether you expect any moderation in wood fiber cost as '24 progresses?

J. Sims — Yes, Matt, the situation in Sweden, the wood cost continues to be elevated. Remember, we said that the reason for that is higher demand for wood for bioenergy and also the Russian situation and a lack of exports of wood. It has stabilized, but it stabilized at the higher levels. So we are not seeing increases in Sweden, but we're not seeing— nor are we seeing decreases. So it's pretty much stabilized there.

Same thing in Brazil. Brazil where prices have certainly increased on the open market side. That also is stabilized but it was at the higher rate.

M. McKellar — If I could sneak one more in. Are you seeing new opportunities in Mexico that you could serve from either the US or Brazil with Mexico imposing import duties on uncoated freesheet from China and Indonesia?

J. Ribiéras — So the Mexico side is a balance for us because we had some export from Brazil, which is going to be taxed and it created opportunity from North America. So net-net, I think when we looked at it, it’s more opportunities than anything, but it’s been a balance between the two. But yes, you are correct. That is probably an opportunity which we are seeing to export more from North America to Mexico.

Moderator — We do have another follow-up from George Staphos.

G. Staphos — Just last one for me. Just number one, if possible could you give us a quick snapshot on capacities by region— paper versus pulp? If it is in the deck or in the coming Q, we'll wait and/or look, but if you had that quickly, that would be great.

Then what did you say the headcount reduction is with Horizon for this year in total? I recognize a third is already done from what you said, but what was the number that you cited for the year?

J. Sims — I'll answer the Horizon question first— 150 positions and that is across globally.

On the capacity perspective, what we have it by region is for uncoated— so, I will give these numbers to you. So for uncoated papers in Europe, it is 765,000. For market pulp in Europe, it's 130,000.

In Latin America, it's 1.1 million for uncoated freesheet and 165,000 for market pulp.

In North America, for our facilities, it is 975,000 for uncoated freesheet and 115,000 for market pulp, but remember, we have a supply agreement with International Paper. So the supply agreements for both Georgetown and Riverdale, it's 655,000 of uncoated freesheet. That is in the appendix.

Moderator — We have no other questions. I'll now turn the call back over to Hans Bjorkman for closing comments.

H. Bjorkman — Thanks, Leah. Before we wrap up the call, Jean-Michel, any closing thoughts?

J. Ribiéras — Just a few. So first of all, thank you for joining the call. As we've demonstrated since the spin-off, we maintained a balance between a healthy financial position, returning cash to shareowners and reinvesting in our business. We continue to go to the same direction.

Core to our strategy is reinvesting in our business to increase our competitive advantages. We are confident in our ability to generate strong earnings and cash flow throughout the cycle and looking forward for the second quarter and this year. Thank you very much.

H. Bjorkman — Thanks for joining us today. We appreciate your interest in Sylvamo and we look forward to continued conversations in the coming weeks and months.

Moderator — Once again, we'd like to thank you for your participating in Sylvamo's First Quarter 2024 Earnings Call. You may now disconnect.