

Transcript

SYLVAMO: 2nd Quarter 2024 Earnings Release

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SPEAKERS

Hans Bjorkman – Vice President, Investor Relations

Jean-Michel Ribieras - Chairman and CEO

John Sims – Senior Vice President and CFO

ANALYSTS

Cole Hathorn – Jefferies

Matthew McKellar – RBC Capital Markets

George Staphos – Bank of America

PRESENTATION

Moderator Welcome to Sylvamo's Second Quarter 2024 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers remarks you will have an opportunity to ask questions. 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 Sylvamo Corporation Second Quarter 2024 Earnings Call. 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 also available in the appendix. Our website contains copies of the earnings release as well as today's presentation.

With that, I'll turn the call over to you, Jean-Michel.

J. Ribieras

Thanks, Hans. Good morning and thank you for joining our call. I'll begin with our sustainability highlights on Slide 4. Our first and greatest responsibility is to ensure the safety and well-being of our team members. We do this by putting people before paper, always. We're also committed to operating as a sustainable corporation that creates profits for our shareowners while protecting the environment and improving the lives of those with whom we interact.

Continuing Sylvamo commitment for transparent reporting, in the second quarter, we published our sustainability report in a new, streamlined format. We also expanded the sustainability hub on sylvamo.com to communicate sustainable news, regional content, certification and more. I encourage you to visit our website and learn about our sustainability effort.

Let's go to Slide 5. Now, let me go into some highlights of the quarter. We experienced improved uncoated freesheet and pulp conditions. Our mill system ran well as we successfully completed our heaviest planned maintenance outage quarter. We now have almost 75% of our planned maintenance outage for the year behind us.

We generated strong cash flow. In May, we announced a 50% increase to our quarterly dividend from \$0.30 to \$0.45 per share that paid out at the end of July.

Let's move to the next slide. Slide 6 shows our key financial metrics. We earned adjusted EBITDA of \$164 million with a margin of 18%. Free cash flow generation was \$62 million and we generated adjusted operating earnings of \$1.98 per share. I'm proud of how our teams delivered impressive results while taking care of our customers and successfully executing several planned maintenance outages across our system.

Now, John will review our performance in more detail.

J. Sims

Thank you, Jean-Michel and good morning, everyone. I'm on Slide 7. Over the first half of the year, uncoated freesheet conditions improved from last year. Looking at industry demand across our regions, Europe was up 14%. North America was up 3%. However, Latin America decreased 1%, but this was influenced by a significant drop in Argentina.

Industry operating rates improved in North America when a supplier permanently converted approximately 4% of uncoated freesheet capacity

to pulp at the end of June. A European competitor announced in May they would close a machine in Germany by the end of the year. This closure will reduce European supply by about 5%.

Pulp and paper prices have moved up across our regions over the first half of the year, as well. Excluding pulp, we also saw the stabilization of most input costs, although at a high level.

Let's move to the next slide. Slide 8 contains our second quarter earnings bridge. The \$164 million of adjusted EBITDA was better than our outlook of \$145 million to \$160 million. Price and mix improved by \$26 million, reflecting the implementation of pulp and paper price increases previously communicated in all regions, as well as better mix in Latin America.

Volume increased by \$8 million, primarily driven by seasonally stronger demand in Latin America. Operations and other costs improved by \$10 million, primarily reflecting a solid operations and seasonally lower cost in Europe and North America. Planned maintenance outage costs increased by \$4 million and input and transportation costs decreased by \$6 million.

Let's move to Slide 9. We expect to deliver third quarter adjusted EBITDA of \$170 million and \$185 million. We project price and mix to be slightly unfavorable, primarily due to mix. We expect volume to improve by \$10 million to \$15 million, driven by Latin America and North America.

Operations and other costs are projected to increase by \$10 million to \$15 million, primarily driven by higher unabsorbed fixed costs from economic downtime in North America and Europe as we continue to manage our production to our customers' demand. We expect input and transportation cost to increase by \$5 million to \$10 million due to unfavorable fiber in Latin America and energy in North America.

Planned maintenance outages are projected to improve by \$28 million, as we have no major planned outages this quarter. We're making good progress on Project Horizon, our program to streamline overhead, manufacturing and supply chain costs. We're on track to achieve our year-end run rate target of \$110 million in savings.

Let's go to Slide 10. 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 and talk through each of these uses of cash. Last week, we announced the refinancing of our long-term debt to extend our maturity profile. Details are in the 8-K we filed on August 1st and also included in the appendix.

Here on Slide 11, you can see the before and after picture of our maturity profile after we redeem all outstanding 7% notes on September 1st. A strong balance sheet provides us the flexibility to address macro-conditions, downside risk and to invest in high return opportunities throughout the cycle.

Let's move to Slide 12. We will continue to return substantial cash to shareowners via dividends and share repurchases. As this graph shows, we initiated a dividend within the first year of our spin-off, after paying down significant debt and strengthening our financial position.

In 2023, we more than doubled our regular dividend and then raised it again to \$0.30 per share in the fourth quarter. We also issued a special dividend of \$0.30 per share.

This year, we raised our regular dividend by 50% to \$0.45 per share. Thus far in 2024, we have distributed \$43 million via the three quarterly dividends and have repurchased \$30 million in shares.

Let's move to Slide 13. We 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 have ramped up our spending in maintenance, reforestation and high return of capital projects since our spin-off. At the time of our spin-off, we had line of sight on 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 and starting to develop another \$200 million of high return capital projects to invest in the coming years. These projects are of varying sizes and are largely focused on our flagship mills providing us with opportunities to grow our earnings and cash flow. We expect such investments to generate well above cost of capital return.

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

- J. Ribiéras Thanks, John. I'll conclude my comments on Slide 14. Sylvamo is a cash flow story and we continue to deliver against our investment thesis. We will leverage our strengths to drive high returns on invested capital, generate free cash flow and use that cash to increase shareowner value.
- Financial discipline is a key component of our strategy. As John discussed, we have refinanced our long-term debt to extend our maturity profile. We are committed to return at least 40% of our free cash flow to shareowners this year. We are reducing our cost structure and have a great pipeline of high return capital projects, which will enable us to grow earnings and cash flow in the coming years. We are confident in our future and motivated by the opportunities that lie ahead.
- With that, I'll turn the call back to Hans.
- H. Bjorkman Thanks, Jean-Michel and thank you, John. Okay, Colin, we are ready to take questions.
- Moderator Our first question is from Cole Hathorn with Jefferies.
- C. Hathorn Two from my side. The first one's on wood costs. You called out a bit of cost inflation in Latin America, but in the Nordics, we've seen higher wood contractually, I'm just wondering what you're seeing in your other markets within Europe, in your French mill. Are you seeing a more stable wood basket and just any color you can talk about on wood cost because I think that gives you a relative advantage versus some of the others?
- Then sticking with Europe, we've seen some changes in market structure with various paper distributors having financial issues and going bankrupt. Is that a positive or a negative for Sylvamo going forward from here? Effectively, are you able to cut out a middleman in that? I'd love your thoughts there.
- J. Ribiéras Let me start by the wood cost. The wood cost increase in Brazil, starting by Brazil, is due to all the wood we buy. First, for two to three years we need to buy more wood because when we got Sylvamo there had been years where the investment in the forestry was not sufficient. So we made up for this investment and we caught up. So now we need to buy a little bit more price— wood, sorry and on top of that, it's a little bit more expensive.

In Europe we've seen, as you mentioned, the wood cost of Scandinavia increase. There is some overall wood demand increase, which has impact. Russian and Belarus stopped exporting wood chips, which has reduced the overall wood supply in Scandinavia.

So increase in Sweden, some increase in Brazil, which we will make up for it. Saillat is roughly stable and the US is roughly stable on a high level. So that's for the wood side. But I agree with you. We have an advantage with our forestry in Brazil and we have very good wood cost in the US.

In the merchant side, in Europe, I would say it's neutral to us. We have great partners in Europe and we're glad to have these customers. We're ready if there is some more changes in the merchant area or in the channels. If it has to be more direct, we will be, but I would call it neutral for us one way or another.

C. Hathorn Then if I could have a follow-up, which is just around the demand trends. We saw a lot of restocking across various end markets and graphic paper in general, including office paper saw some restocking. Where you see we are from an underlying demand perspective? Do you have any good visibility or items to call out on the demand trends by region in North America, Europe and LatAm?

J. Sims I'll talk a little bit about demand. We have seen restocking in the first half and we talked about that's what drove some of the improvements. If you look at by region— looking at the industry, where we are year-to-date, we're up about 3% in North America, 14% in Europe and LatAm was relatively flat. Again, there was an issue around Argentina.

Going forward, we expect that the demand will be positive for the full year. This is actually consistent with forecasts we're seeing from other industry experts. Some of that is driven not because of the restocking, but because of the weak comp to second half. So, I would characterize our demand now and particularly in North America and Western Europe as relatively stable. But from a comp perspective, easy comp perspective, it's going to be a positive relative to last year. So we're looking at probably Europe around 7% full year, LATAM around up 3% full year and North America around 5%.

J. Ribiéras On the long trend, I think you talked about that also, we see returning in Europe and North America to long-term trends, which is slight decrease.

- Moderator Our next question is from the line of Matthew McKellar with RBC Capital Markets.
- M. McKellar I'd like to first just follow on Cole's question around fiber costs in Latin America. Could you maybe just give a little bit more color around what's happening with fiber costs and what your expectations are in terms of what happens with cost of purchased wood in Latin America over the next few quarters?
- J. Sims So where we've seen and just kind of drove what we talked about in terms of the valuation of our land in Brazil, we see increased cost of fiber in Brazil and we expect that to continue, maybe at the inflation rate, but when you compare— when I talk about increased market price, so that's wood that we're not actually harvesting and growing, but when we have to go to the market, it's about three times the cost of our own wood. So that's what's driving some of the cost increases we've seen down in Brazil is what Jean-Michel talked about.
- Right now, our self-sufficiency is lower than what we had been historically. We're probably supplying about 70% of our needs. We'd like to be around 85%. This is why we're reinvesting and increased our investments in our own plantations, but when you reach out for higher or for market wood, those prices are higher. We're also reaching out to further distances, so you have to pay the additional freight.
- So that's some of the things that are impacting us in Latin America. But as we said, this is why we're reinvesting or increasing our investments in reforestation.
- Finally, I think your question is the trend. We expect that to increase— continue to increase the cost of fiber down in Latin America.
- M. McKellar Maybe next, you called up price mix is somewhat unfavorable for the sequential progression into Q3, mostly on mix. Can you provide just a bit more color there? Is that more export mix and paper sales? Is there maybe also an assumption around what happens if pulp prices in there? Any color would be helpful.
- J. Sims Matt, we can't really talk about future pricing, but that variance that we said is predominantly all mix and it is more export mix, particularly in North America.

Where is that going? That's going to Mexico. You may be aware that Mexico has implemented tariffs for the next two years on countries that don't have a trade agreement. So that gives an advantage to companies like us that are based in the US and we're taking advantage of that. So we're exporting more to Mexico and that's what's accounting for the mix change.

Moderator Next, we'll go to the line of George Staphos with Bank of America.

G. Staphos So two questions to start, and I'll go back in queue. Can you give us a little bit more detail on the projects that are in the pipeline now relative to what you have been working on and what the return differential might be, or are they basically all still above cost of capital? Presumably they're all above cost of capital and the same spread. So any color on how this latest pipeline varies with what's been in the pipeline in terms of processes, approaches and return thresholds? That's question one.

Question two on the dividend, congratulations on raising the dividend. It was another sizable increase. How did you think about raising it to the degree you did on the regular side as opposed to maybe raising it a lesser amount and then doing a special dividend? What gave you the comfort to raise it the full 50%?

J. Ribieras So I'll take maybe the first one and John, take the second question, but we both could also answer it, I guess.

So, yes we still have a very high threshold on capital investment return. So all the projects we're looking at is a strict minimum of 20% return. So this is why it's very attractive. These projects have a different size. Some are very small and some are larger. We are studying them. They're in the pipeline and we're working with our board to plan for the coming years on this investment. But they're very attractive and incremental on both cash and earnings to Sylvamo.

J. Sims Yes and George, to your second question, it goes back to our capital allocation strategy. First and foremost, our priority is to have a strong balance sheet. Second is to reinvest back into business where we can grow our earnings and cash flow. Then the third is returning cash to shareholders. And core to that is a dividend, a dividend that we have, believe and have confidence that we can sustain forever, if you will, a dividend that doesn't restrict us from a strategic flexibility perspective.

So we had a lot of confidence in terms of increasing the dividend and mostly driven by what your first question pertained to. We believe there's opportunities for us to increase earnings and cash flow in this business through smart reinvestments and high return projects going forward, which we're executing right now. Because we have a good line of sight on that and because of our, we believe, competitive advantages we have, and in the markets that we operate, give us a lot of confidence to be able to sustain the dividend that we put forward.

G. Staphos John, maybe if I could sort of do a quick tag on, then turn over. Maybe I'm reading between the lines incorrectly, but does that suggest any next dividend increases maybe are more of the special side as you return once again to— I mean, the balance sheet's in great shape as we sit here at the moment, develop the next pipeline and increase, presumably the cash generation of the business, the reinvestment, would that be the right way to think about the cadence and staging?

J. Sims Yes, I wouldn't want to foreshadow that. I think we review that and we think about that as we review our strategic plans with the board. And I think to the extent that we believe that we can sustainably increase the dividend, that we'll do that, or if we think that there may be better uses for cash, such as buying back shares or reinvesting back in the business, we may do that prior to a special dividend, or in the case like we did last year, we may issue a special dividend.

Moderator We'll go back to the line of Matthew McKellar with RBC Capital Markets.

M. McKellar As we get closer to the Fall election, what are you seeing in terms of impacts to uncoated freesheet demand, as far as you can discern?

J. Ribieras So the ballot is always an opportunity for us, but it's not a big volume. So it's something we have largely the capacity between us and our competition in North America to supply. So it's an opportunity, but it's nothing very significant. It's a few thousand tons, not a big deal.

J. Sims So Matthew, in general, yes, we've seen less of an election impact on uncoated freesheet demand. It used to be a pretty significant driver, but that's become less and less.

M. McKellar Next, maybe shifting to imports, it looks like they continue to tick higher in North America. Can you just maybe provide some updated perspective here? Are imports more of a concern as it relates to how you're thinking

about the market landscape today versus how you're maybe thinking about the market at the start of the year?

J. Ribieras So let me maybe give back the history. Imports in North America since 2018 have varied between 8% to 13% and they really vary depending upon freight rates, home market, foreign exchange. So we have been in the same range since early 2023 and even this year.

So I think we should always be on the 10%, 13%, something like that range and I don't read more than that. I think some of the importers to the US have been down due to freight. Some have been down to local markets, opportunity to send spot. If you look at it, it's interesting because where the imports come in North America, it changes also through the years, It's not always the same regions because it's very opportunistic, kind of. So I still see it opportunistic and on that range like we have today. Nothing significant change.

M. McKellar If I could just sneak one more in. I was a little bit surprised to see some economic downtime in the European pulp system in Q2. Could you just provide maybe a little color on what happened there?

J. Sims I'll answer that question. So yes, we had economic downtime both in Europe and North America. That's just a matter of us matching our capacity to customer demand. So in the outlook, we're expecting a little bit more in the third quarter than we had in the second quarter but in the second quarter we had significant outages. So although volumes are up, we're still matching our supply to our customer's demand and we're being careful not to build unnecessary inventories.

M. McKellar Just to confirm, that's true of the pulp side as well, where it looks like you had a couple thousand tons of economic downtime in Europe and recognizing it's fairly small volumes, but just wanted to confirm.

J. Sims Oh, I'm sorry, I misunderstood your question. You were asking about the pulp. That was really driven just by some constraints that we had in balancing the pulp production with our paper production and nothing more than that. There was plenty of demand for pulp in the second quarter. It's just a matter of a misbalance, if you say and our ability to move pulp that we produced at the pulp dryer. We didn't do it, so that's what that was.

J. Ribieras We can sell how we want in pulp in Europe. We have no issue there.

- Moderator We'll go back to the line of George Staphos with Bank of America.
- G. Staphos So gentlemen, I want to return back to the project line of questioning. Can you talk to the regions that are more likely to see some of this capital? Number one. I know it's going to be in all three regions. I know it's going to be a mixture, but if there's any way that you could maybe give us some view on where it might be a bit more weighted relative to the size of the business.
- Secondly, can you talk to the degree to which some of the investments will be moving Sylvamo further down on the cost curve? And that's a presumption. If that's true, what do you do with that benefit? Again, you have a really strong position in the market from a balance sheet standpoint. How are you leveraging that for the longer term competitively?
- J. Ribieras So let me answer the first question. As we mentioned, we intend to invest, essentially in our flagship mills. So we intend to invest in our lowest cost mills, which is mostly in North America, Eastover, as you know and in Brazil, Luis Antonio and in Europe, Nymölla. So those are the low cost mills. This is where we intend to continue to invest with high returns.
- In terms of the cash, as we said, we want to continue to give back cash to our shareholders. We have a policy right now of 40% of our free cash flow. If we had more cash, we could give back. We could also, which is a good thing, even if we have a low debt right now, we could also reduce a little bit more debt. So we have plenty of opportunity of cash flow use.
- G. Staphos Jean-Michel, I guess what I was asking, if you can hear me, are some of these projects designed to put you at an even better position versus your peers in the market, from a cost cash standpoint or not really?
- J. Ribieras Completely. Most of them are cost-oriented or cost impact. So they are really on that direction— we are the low cost and we want to be even lower cost.
- J. Ribieras Just maybe to finish the discussion with George, let me give you one example of a project we just did. So that gives you — that was our Eastover mill. We increased our wood chip capacity to boost the supply of low cost wood. This was a \$1.2 million investment. We forecasted to save \$0.5 million and actually we're saving about \$1 million on a yearly basis— 35%. It's purely cost. So that's one example of cost project we have.

- Moderator We'll go back to the line of George Staphos.
- G. Staphos Last question from me, gentlemen. So we spent a lot of time on costs and capital and the like and rightly so. What are your customers asking you for now relative to say six months and a year ago? How has it changed? How are you leveraging whatever commercial requests are coming in, to appropriately, profitably at a high return, all that maintain and grow your presence in the market with your best customers? How are you turning that into commercial margin?
- J. Ribiéras I'm trying to make sure I understand what your question, George. I think we've been —
- G. Staphos What are your customers asking you for differently now, Jean-Michel, than might have been the case six months ago or a year ago? How are you turning that, whether it's service, whether it's SKUs, whether it's whatever— online ordering? I mean, that's an old one. How are you turning it into higher revenue per ton?
- J. Ribiéras So demand of customers is actually a little bit different in the regions. If you're in Europe, there is more and more demand around sustainability. The key customers, they want to be aligned with a sustainable company, which we are very well positioned, especially in Europe.
- In Brazil, it is more continuing to develop our brands and supporting the importance of the brand because they are our partners. A lot of the merchants in Brazil on cut size are exclusive because they are very common to the brand.
- In the US, I would say it's more and more around service. How can we optimize the service and having capacity worldwide and including strong capacity in the US, allow us to bring this unique service and integrations of supply chain. I would say those are the trends, if it's what you are asking for.
- Moderator I'll now turn the call back over to Hans Bjorkman for closing comments.
- H. Bjorkman Thank you, Colin. John-Michel, any closing comments?
- J. Ribiéras First of all, thanks for joining our call and your question. We really appreciate it. Let me remind you that core to our strategy is managing a

strong financial position, reinvesting in our business to increase our competitive advantages and returning cash to shareowners. We're confident in our ability to generate strong earnings and cash flow throughout the cycle.

So again, thank you and have a good day.

J. Sims

Thank you.

Moderator

Once again, we would like to thank you for participating in Sylvamo's Second Quarter 2024 Earnings Call. You may now disconnect.