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Sylvamo Corporation

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Earnings Call

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Call Participants

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Hans Bjorkman
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Jean-Michel Ribiéras
Chairman & CEO

John V. Sims
Senior VP & CFO

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Daniel Harriman
Sidoti & Company, LLC

George Staphos
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Presentation

Operator

Good morning. Thank you for standing by. Welcome to Sylvamo's Third Quarter 2024 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, Investor Relations. Sir, the floor is yours.

Hans Bjorkman

Vice President of Investor Relations

Thanks, Audra. Good morning, and thank you for joining our third 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-U.S. GAAP financial information. Reconciliations of those figures to U.S. 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'd like to turn the call over to Jean-Michel.

Jean-Michel Ribiéras

Chairman & CEO

Thanks, Hans. Good morning, and thank you for joining our call. I'll begin on Slide 4. We had a really strong third quarter. Our teams executed very well, delivering strong commercial and operational performance. Our mill system ran well, and we continue to see relatively stable input costs. We continue to make good progress with Project Horizon, our cost reduction program to streamline overhead, manufacturing and supply chain costs. We are on target to exceed our \$110 million year-end run rate savings goal by up to \$10 million.

Lastly, these combined performances by our teams resulted in very strong earnings and outstanding cash flow in the quarter.

Let's move to the next slide. Slide 5 shows our key financial metrics. We earned adjusted EBITDA of \$193 million with a margin of 20%. Free cash flow generation was \$119 million, and we generated adjusted operating earnings of \$2.44 per share. I'm proud of our teams delivered impressive results while taking care of our customers.

More importantly, I'm proud of our team's commitment to putting people before paper to ensure everyone returns home safe at the end of each day. We are focused on building a resilient safety culture by involving every team member in our efforts to proactively eliminate risk and create a safer environment for everyone every day.

Now John will review our performance in more detail.

John V. Sims

Senior VP & CFO

Thank you, Jean-Michel, and good morning, everyone. Slide 6 contains our third quarter earnings bridge versus the second quarter. The \$193 million of adjusted EBITDA and was better than our outlook of \$170 million to \$185 million and almost \$30 million higher than the prior quarter. Price and mix was unfavorable by \$4 million driven by North America mix. Volume increased by \$10 million, driven by North America. Operations and other costs were stable and better than projected, reflecting solid operations across our mill system. Planned maintenance outages costs decreased by \$28 million as we had no major planned outages in the quarter.

Input and transportation costs increased by \$4 million as negative fiber costs in Latin America more than offset positive in energy and transportation in North America. I'd also like to commend our team for their very strong all-around performance that resulted in a 20% margin.

Let's move to Slide 7. We expect to deliver fourth quarter adjusted EBITDA of \$150 million to \$165 million. We project price and mix to be unfavorable by \$20 million to \$25 million. This is due to pulp and paper price decreases in Europe, higher export mix in Latin America and customer mix effect in North America. We expect volume to improve by \$15 million to \$20 million, mainly due to stronger volume in Latin America.

Operations and Other costs are projected to increase slightly due to an \$8 million operating expense with a planned 10-year turbine generator maintenance event at our Eastover mill. This will be partially offset by better fixed cost absorption from less economic downtime in North America. We expect input and transportation costs to increase by \$5 million to \$10 million, mostly due to transportation and seasonally higher energy. Planned maintenance outages are projected to increase by \$17 million as we have a planned outage at Eastover this quarter.

Let's go to Slide 8. An important part of our strategy is to be a low-cost producer. This time last year, we initiated Project Horizon, cost reduction program to streamline overhead, manufacturing and supply chain costs. As Jean-Michel mentioned earlier, before inflation, we're on target to exceed \$110 million year-end run rate savings goal by up to \$10 million. This will continue to be a focus for us moving forward, and we will provide more details on our next earnings call when we wrap up 2024.

Let's move to Slide 9. As was announced 2 weeks ago, Sylvamo and International Paper have agreed to mutually terminate the Georgetown supply agreement in December. International Paper has also announced that the Georgetown mill will cease production by the end of the year. We have plans to support customers through this transition as they find alternative suppliers.

Of the approximately 250,000 tons, we expect Georgetown to supply this year, we will exit about 150,000 tons. This will have roughly a negative 400 -- I'm sorry, negative \$40 million earnings impact, assuming 2024 margin, i.e., no change in operating costs, prices, input costs, et cetera. We will retain about 100,000 tons of the most profitable products.

These products have largely been qualified and transitioned to our Ticonderoga and Eastover mills, which will reduce economic downtime in our North America business. The combination of optimizing our mix of products, segments and customers while leveraging efficiencies from a simplified footprint will help us mitigate the loss of volume. As a result of the Georgetown closure, our North America business will become leaner and more productive. Also we are continuing to focus on strategic initiatives to simplify the business, unlock efficiencies and drive earnings growth.

Let's move to Slide 10. With the Georgetown mill closing by the end of December, in addition to the capacity reductions announced earlier this year, North America uncoated freesheet capacity will be reduced by approximately 10%. On this slide, you can see the effect of these capacity reductions. The left-hand side, shows the supply position as of the end of the first half of the year. And on the right-hand side, you have the view after all announced capacity reductions have been removed. Consistent with our strategy and our investment thesis, we are committed to the uncoated freesheet business and are very well positioned to help our customers win in their respective areas.

Let's go to Slide 11. Uncoated freesheet industry conditions are improving in Europe and North America, as seen on this slide. Next year, European demand is estimated to decline 2%. However, supply is expected to drop by 7% after 2 uncoated freesheet closures later this year. Latin America demand supply are both expected to be stable in 2025. Lastly, North America demand is estimated to decline 3%. However, supply is expected to drop by 10%.

As industry conditions evolve, we are well positioned to serve our customers for the long run through our talented team, the iconic brands and our low-cost global footprint.

I'll conclude my comments on Slide 12. I want to wrap up with some encouraging news as it relates to the Brazil goodwill tax dispute. Last month, a Brazilian Federal Regional Court ruled in our favor on a court

case covering 2/3 of the disputed amount. As a result of this, we are currently discussing with our lenders the possibility of eliminating the \$60 million escrow requirement that we funded in 2023. The Brazilian task authorities will appeal the court ruling, and it could be several years before there is a final resolution on this matter. As of now, that's all we have to report on this. We will keep you posted on any material changes as we progress, and there is also more detail in the appendix. I'll now turn the call back over to Jean-Michel.

Jean-Michel Ribieras

Chairman & CEO

Thanks, John. I'll conclude my comments on Slide 13. Sylvamo is a cash flow story, and we are creating shareholder value through strong cash generation and disciplined capital allocation. I continue to be impressed with our teams as we work to take care of our customer needs and remain the supplier of choice.

We generated outstanding free cash flow in the third quarter. We're reducing our cost structure and are reinvesting in our business with a great pipeline of high-return capital projects which will enable us to grow earnings and cash flow in the coming years. We are simplifying our North America business to become leaner and more agile to drive earnings growth. We are committing to return at least 40% of our cash flow to shareholders this year.

Looking forward, we are encouraged by the uncoated freesheet conditions across our regions. We're confident in our future and motivated by the opportunities that lie ahead.

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

Hans Bjorkman

Vice President of Investor Relations

Thanks, Jean-Michel, and thank you, John. Okay, Audra, we're ready to take the questions.

Question and Answer

Operator

[Operator Instructions]. We'll take our first question from Daniel Harriman at Sidoti & Company.

Daniel Harriman

Sidoti & Company, LLC

With the upcoming closure of Georgetown and then the announced strategy changes at IP, to the extent that you can, could you provide any comment or ideas about how the capacity reduction has any impact on how you think about the Riverdale agreement that you have going forward with the company?

Jean-Michel Ribiéras

Chairman & CEO

Yes. So Daniel, thanks for joining the call. Since we started the spin-off of IP and started Sylvamo, we've been preparing for that. So we know it will happen. We have no information on when. We've not been noticed of anything. But we're prepared. The one thing which is important to understand with Riverdale, which is different than Georgetown, is Riverdale grades are grades we produce in our other mills. So if Riverdale was going to go down, we believe that the mix improvement, we will realize at current margins will essentially mitigate any potential negative impact to our earnings. So Riverdale for us, we're ready, we're prepared. And if it was to happen, it will probably be a breakeven with the benefits we would have from it.

Daniel Harriman

Sidoti & Company, LLC

Perfect. And then with the 100,000 tons that you are retaining of that business, has that all been transitioned over to your existing footprint? Or is that still ongoing?

Jean-Michel Ribiéras

Chairman & CEO

Yes, it's all been transferred. It's ready.

Operator

We'll move next to George Staphos at Bank of America.

George Staphos

BofA Securities, Research Division

Congratulations on a very strong quarter, guys. My two questions to start. Can you talk about what offset you may have from tightening the footprint, et cetera, that would help offset the, if you will, the gross impact from Georgetown and those 100,000 tons. So said differently, of the \$40 million currently based on current operating margins or margins. What do you think the net would be all else equal in 2025, given all the other things that you're working on? That's question number one.

Question number two, Sylvamo has been a cash flow story since it's been to its credit, and you certainly been very singular in executing your strategy here and elsewhere. When we look at free cash flow for the fourth quarter based on where EBITDA is based on CapEx and interest expense and then tax affecting that, we're coming up with something around \$65 million to \$75 million for free cash flow. Could you talk to that? I don't know if there's a comment in the slides around that in terms of whether that's a reasonably good estimate or other things that we should be thinking about?

John V. Sims

Senior VP & CFO

George, it's John Sims. Thanks for joining the call. On your first question I'm going to be careful. We're not going to project anything in terms of pricing impact that we should have next year. But certainly, as we put out the capacity closure, if you will, of the Georgetown mill, it's going to be a net positive for the industry. And on top of that, with the other closures that have occurred. So again, the \$40 million impact we have is based on 2024 margins not projecting 2025 margins. Of course, there's other things other than the impact of pricing that could impact that cost and other things like that.

I also want to mention though, we talked about Project Horizon. We are slightly exceeding our target of \$110 million. We are now projecting \$120 million. Remind you that is before inflation, we estimated about \$50 million of inflation this year. And we're running ahead of that. So we think that, that also we did Horizon in anticipation of Georgetown. And so that also helps us mitigate the impact of the Georgetown.

George Staphos

BofA Securities, Research Division

John, I understand. I guess maybe what I'm saying is could you help us with the reduced economic downtime, the improved mix and streamlining SKUs, holding everything else constant, we understand why you need to do that, does that add back \$5 million, \$10 million or too hard to say or it's modest enough that we should just think about \$40 million? And then my other question.

John V. Sims

Senior VP & CFO

Yes, I understand your question now. That's factored into the \$40 million impact reduction of the simplification of the business and reduction of lack-of-order downtime.

George Staphos

BofA Securities, Research Division

Okay. And on free cash flow for the fourth quarter?

John V. Sims

Senior VP & CFO

Yes. Free cash flow for the fourth quarter, I think you said estimated about \$65 million I would say that, that's approximately that's not out of the realm of possibility. Yes.

George Staphos

BofA Securities, Research Division

Go ahead sorry.

John V. Sims

Senior VP & CFO

No, I'm just saying we don't usually give an outlook on cash flow. I'm a little bit hesitant, but I don't see anything that's wrong with your estimate.

Operator

[Operator Instructions]. We'll go next to Matthew McKellar at RBC Capital Markets.

Matthew McKellar

RBC Capital Markets, Research Division

I'd like to ask about planned maintenance in Europe in 2025, which you've communicated I think will be in the \$30 million to \$40 million range across Saillat and Nymolla. Could you first maybe just remind us of where those outages will fall in the year. And then I'd assume Europe is the largest moving part year-over-year, but how do you expect your total maintenance outage costs in '25 to compared to the \$73 million you're guiding to in 2024?

Jean-Michel Ribieras

Chairman & CEO

So Matt, Jean-Michel speaking. We will deliver a more precise estimate in our next earnings. But directionally, the thing is our European mills are mostly on a 24-month cycle, which means 1 year, you have outages cost and the other year, we don't have outage cost. That's probably the biggest change with this year. Then there will be some small ones here and there, but -- and that's \$40 million impact because we are on the year with outages at both mills, Saillat and Nymolla, next year. So I don't have the exact number, but I would say when we finish the budget, we'll inform them to you.

But directionally, you take what we've done historically and you have the \$40 million and that would be -- that will be good. Post-outage, by the way, will be on the first half of the year, the 2 European outage.

Matthew McKellar

RBC Capital Markets, Research Division

Okay. Next, I'd like to ask about the implementation of the European Union Deforestation Regulation, which has been pushed out a year. But -- what is your view on how its eventual implementation will affect the European uncoated freesheet markets and maybe imports into Europe in particular?

Jean-Michel Ribieras

Chairman & CEO

So, yes, I think it's always the same thing. Intention of the EUDR is a good one. We are very in favor of controlling the wood and making sure we use appropriate wood with no deforestation. And we do that all the time, and have always done it. Specific of the rules still needs to clarification. We've got some improvement in understanding what Europe is expecting. I think that's why it's been moved. It's not because people don't want to do it. It's because we need to be clear on how the law will impact some of the things we do every day, which we don't know what it's going to be, really.

Considering potential import in Europe, I think it's a little bit early to say. Because it will depend on the details of the ruling. But it could have an impact, which would be positive for us being a European producer.

Matthew McKellar

RBC Capital Markets, Research Division

Great. And if I could just sneak one last one in on capital allocation. Can you share any updated perspective on how you may be evaluating resumption of share repurchases here with where the shares are today versus how you potentially think about a special dividend.

Jean-Michel Ribieras

Chairman & CEO

We haven't changed our strategy in terms of capital allocation. We maintain a strong balance sheet. We have a strong dividend, which is the foundation of our cash return. And as long as we find the repurchase share price attractive, we will share back. And on special occasions, it could be we do a onetime, but I would say -- we've got still a lot of opportunities on repurchasing share. So we're looking at it like we look at other elements, but we're committed to our 40% for this year return back to shareholders.

Operator

And we'll take a follow-up from George Staphos at Bank of America.

George Staphos

BofA Securities, Research Division

So as we look at your fourth quarter bridge versus third quarter, and thanks for doing that work for us. Are there any things that we should particularly consider as continuing into the first half of '25 on that waterfall, particularly on Slide 7, does price mix stay unfavorable recognizing that sequential not year-on-year, but nonetheless, do we have to worry about a little bit of pressure into the first half of the year based on what you can see right now.

And then secondly, we've been seeing generally pulp prices heading lower. Certainly, you have some effect in terms of merchant sales of your pulp, but what's that doing to the cost curve and how the markets are developing on paper particularly in Europe.

John V. Sims

Senior VP & CFO

Yes, let me George take that. So from -- if you look at the price and mix, certainly, the pulp price and the European pricing as a result, that does have a strong correlation between the two. We expect that to continue and that will be offset somewhat by some things that from a mix perspective. Remember also that the first quarter is typically our lowest volume in LatAm. And then it increases throughout the year. So we're going to go from a very strong quarter. Typically, we have for LatAm volume into seasonally a little bit slower going into the first quarter.

I think from operations and costs, both the fourth quarter and the first quarter were burdened by a little bit more operating costs due to colder temperatures in the northern Hemisphere. Being offset somewhat by the warmer temperatures in LatAm. I do want to call your attention and we called this out that burdening our ops and this outlook is the turbine generator outage. That's a 50-day outage. It shows up in ops. It's a 10-year inspection that we have. And so what it means is that while that turbine generator is being inspected, we're purchasing energy that we normally would be making, and that's about a negative \$8 million impact that won't repeat into the first quarter.

George Staphos

BofA Securities, Research Division

Okay. And John, maybe if I can just sneak one in to use a phrase. So overall, again, you've given us the guide for the fourth quarter. Should Latin America be up given the uptick in volume or will the mix effect and it will be an offset -- said differently, if LatAm is flat to up than North America and Europe are holding more of the burden, would that be fair? Or how would you have us think about that?

John V. Sims

Senior VP & CFO

Yes. So Latin America in the fourth quarter is up in volume. The mix is let's say, slightly negative. And that meaning because of Brazil, the Brazil demand is slightly down, where the rest of the LatAm is up. So that's having a little bit offsetting effect in the fourth quarter outlook. So we're seeing a negative mix impact in LatAm, but that's showing up in a positive volume which you can see in our bridge or our outlook because of the seasonally stronger LatAm.

Operator

And we'll take a follow-up from Daniel Harriman at Sidoti & Company.

Daniel Harriman

Sidoti & Company, LLC

Just a quick one. How should we think about economic downtime in Europe moving forward? Obviously, it was up both in Europe and North America in 3Q, which based on comments in the second quarter call was not unexpected. But North America is going to benefit from reduced capacity from Georgetown, but should we expect the same in Europe as capacity leaves the system in 2025?

Jean-Michel Ribieras

Chairman & CEO

Daniel, it's Jean-Michel. As we've show it to you before, there is a reduction in capacity in Europe also. In total, there is 2 mills, which -- 2 machines which are shutting down, which effect will be by the year-end. So we expect for both North America and Europe to have stronger capacity reduction versus demand decrease. So net should be good for volume. And if we have better volume, we have less LOO in those two regions.

John V. Sims

Senior VP & CFO

Daniel, if you recall from our statements around the fourth quarter outlook, we actually talked about less lack of order downtime in our operations and other costs, and that's across the board, both North America and Europe. So we're already seeing less lack of order downtime in the European system.

Operator

[Operator Instructions]. We'll go back to George Staphos at Bank of America.

George Staphos

BofA Securities, Research Division

I know no guarantees in this certainly. But my last question, if you're looking at demand both from North America and Europe that are however you pitched it flat to up, should shipments be comparable with your demand outlook? Or do you expect shipments might track above or below? And if so, what would be the reasons that you see at this juncture?

Jean-Michel Ribiéras

Chairman & CEO

I think we expect about the same number.

George Staphos

BofA Securities, Research Division

And forgive me, I misspoke. You're looking for demand to be down a little bit in Europe and in North America. Shipment should be the same.

John V. Sims

Senior VP & CFO

Yes. I just want to make sure you're talking about the 2025 comments we made.

George Staphos

BofA Securities, Research Division

Correct. I'm on Slide 11. With demand down, call it, 2% and 3% in Europe and North America, you expect shipments should be comparable from what you can see right now?

Jean-Michel Ribiéras

Chairman & CEO

Yes.

Operator

And that concludes the question-and-answer session. I'll now turn the call back over to Hans Bjorkman for closing comments.

Hans Bjorkman

Vice President of Investor Relations

Thanks, Audra. Before we wrap up the call, I'll turn it back over to Jean-Michel for some closing thoughts.

Jean-Michel Ribiéras

Chairman & CEO

Thanks, everybody, for joining our quarter -- our call, it was, as we said, a good quarter. We intend to continue to maintain a strong financial position. We intend to continue to return cash to shareholders. And one thing which we've talked a lot and maybe not progress as fast as we wanted up to now, but it's going to accelerate is reinvesting in our business to increase our competitive advantages. As we've told

you before, we have a pipeline of greater than \$200 million of high-return projects. As we are preparing our budget for next year, we are looking at some high-return projects that are nearing finalization of engineering work and even preparation for more approval.

So we expect to be able to invest and ultimately get the increased returns from this project relatively soon for some of this \$200 million. So lastly, we're confident in our ability to generate strong earnings and cash flows through the cycle. So we're looking at the upcoming quite positive. Thank you to all of you for joining today.

Operator

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

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