THE SPIN-OFF REPORT

August 27, 2021 11:45 AM EDT

International Paper Co. (Pre-Spin)
(NEUTRAL)

Current Share Price (8/26/21): $59.07	Ticker: IP
Fair Value Estimate: $69 per share	Dividend: $2.05
Shares Outstanding: 390.8 million	Yield: 3.5%
Market Capitalization: $23.1 billion	

International Paper Co. (Post-Spin)

Fair Value Estimate: $63 per share	Ticker: IP
Shares Outstanding: 390.8 million	Dividend: TBD
Market Capitalization: $24.6 billion	Yield: N/A

Sylvamo Corp.

Fair Value Estimate: $67 per share	Ticker: SLVM
Shares Outstanding*: 44.4 million	Dividend: Nil
Market Capitalization: $3.0 billion	Yield: N/A

TBD – To be determined. N/A – Not applicable.
Note: Market capitalization is based on fair value estimate for post-spin entities and current market cap for pre-spin International Paper Co.
*Sylvamo Corp. shares outstanding are based on a 1:11 share distribution ratio and 19.9% ownership stake retained by IP.

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INVESTMENT THESIS

On December 3, 2020, International Paper (NYSE: IP) announced plans to spin off its Printing Papers business. The spin-off, which is expected to be tax-free to shareholders, is targeted to be completed late in the third quarter of 2021, subject to customary conditions including the declaration of effectiveness of the company's Form 10 filing with the SEC. IP intends to retain a 19.9% stake in the spun-off company, with the expectation that IP will ultimately monetize its ownership position to provide incremental capital to the parent company. In conjunction with the spin-off, IP expects to reduce its current dividend ($2.05 per share) by 15%-20%, while the spin company is not expected to pay a dividend.

The spin company will adopt the corporate moniker Sylvamo Corp., which is derived from the Latin words "silva" and "amo", being defined as "forest" and "love", respectively. Sylvamo intends to list on the NYSE under the ticker "SLVM" and is expected to complete the separation on October 1, 2021, to shareholders of record as of September 15, 2021. When-issued trading in Sylvamo is expected to develop on or shortly before the record date.

IP shareholders of record will receive one share of SLVM for every 11 shares of IP held as of the record date. In conjunction with the spin-off, it is expected that Sylvamo will incur $1.5 billion in new debt, with net proceeds being distributed to IP.

As a standalone company, SLVM will derive almost 90% of its revenue from uncoated papers, including cut size printing, copy, and writing paper, as well as offset, envelope, and forms, among others. The remaining product revenue will be derived from Market Pulp (8% of 2020 revenue), used in making tissue, printing, writing, and specialty paper, and Coated Paperboard (3% of 2020 revenue), which is used in packaging for liquids and beverage containers.

With respect to rationale, the spin-off mainly accomplishes the separation of the structurally declining paper business from the more growth-oriented packaging and cellulose fibers business. Additionally, the lower debt leverage ratios at the parent company will give IP flexibility in pursuing both internal and non-organic growth opportunities that might have been more difficult to achieve with a more levered balance sheet. However, given the relative valuations of post-spin peers, the ultimate ability to unlock value will be derived from post-spin performance over the longer term, rather than realizing more immediate value via a rerating of shares. Thus, we do not view the separation of the two businesses as a catalyst to unlock near-term value and suggest, instead, that the post-spin parent company's ability to drive revenue and earnings is the larger opportunity for shareholders.

We fairly value post-spin shares of Sylvamo at $67 per share. In our view, the secular trends in the paper market make investing in standalone Sylvamo a difficult proposition without a significant margin of safety to our fair value estimate. It can be expected that upon distribution, historical shareholders of IP would exit the position in Sylvamo and would favor holding the parent company in view of the growing market for the parent's remaining business. Additionally, the impact of Sylvamo's lack of a dividend should not be overlooked, as investment mandates may result in indiscriminate selling. According to Bloomberg, approximately 39% of IP shares outstanding are held within portfolios related to dividends. Further, at its estimated market capitalization, Sylvamo is not likely to be included in the S&P 500. Given IP's retained 19.9% ownership stake in Sylvamo, and taking an average of valuation exercises, we fairly value shares of post-spin IP at $63 per share.

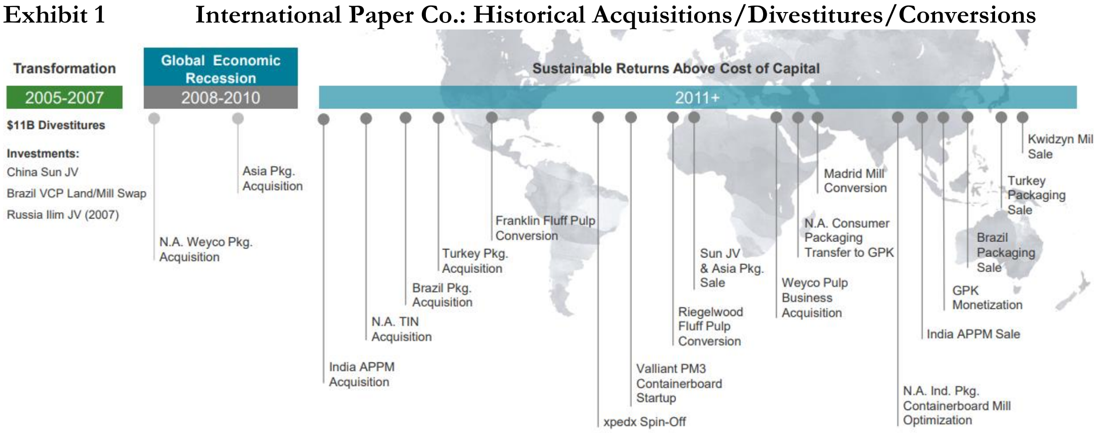
On a pre-spin basis, shares of International Paper Co. are fairly valued at $69 per share, consisting of approximately $61.50 in value from post-spin IP and approximately $7.50 in value from Sylvamo. Although our fair value estimate represents roughly 16% potential upside from the current share price, we assign a NEUTRAL rating to pre-spin IP. Our hesitancy to recommend pre-spin IP shares is rooted in the belief that shares of Sylvamo will likely come under selling pressure in initial trading, which would likely erase any near-term upside potential implied by our fair value estimate. Post-spin, we would favor the parent company's prospects given the current demand dynamics and its ability to pass through price increases that are expected to largely offset higher costs for raw materials and transportation.

COMPANY DESCRIPTION

International Paper Company (NYSE: IP) is a global producer of paper, packaging, and pulp. At its founding in Albany, NY in 1898, IP was initially involved in the pulp and paper business. It eventually established itself as the largest producer of newsprint in the U.S., supplying 60% of the market. By the 1930s, in the throes of the Great Depression, IP began manufacturing new products, including packaging, in order to remain competitive. It was during this time that IP began its long history of pursuing acquisitions and managing diversified business lines.

IP's operations would go on to include the production of containerboard, kraft paper, high-grade pulp, various chemicals, lumber, and even medical products at one time. The company's strategy for diversification stemmed from management's desire to reduce the cyclicality related to its paper segment. Although IP had already succeeded in expanding internationally into Canada and South America during the 1920s, its operations went overseas during the 1950s, through its first manufacturing joint ventures with container businesses in Germany, Italy, Greece, and Israel. In 1986, IP acquired Hammermill Paper Company, including its extensive distribution arm, for $1.1 billion. The distribution segment would later be known as ResourceNet International, which later changed its name to xpedx. In 2005-2007, the company underwent a major restructuring program, which focused the business on its core paper and packaging units; during those years, the company divested roughly $11 billion in non-core assets. Since 2011, the company has made a series of acquisitions, divestitures, and plant conversions, with the goal of achieving "sustainable returns above [the company's] cost of capital" (see Exhibit 1). Parenthetically, it should be noted that in 2014 IP spun off xpedx, its paper and office supplies distribution unit, via a tax-free dividend to shareholders. The spin company was immediately merged with Unisource Worldwide (then private) to form Veritiv Corp. (NYSE: VRTV).

Exhibit 1 International Paper Co.: Historical Acquisitions/Divestitures/Conversions



Source: Company reports.

Today, International Paper operates in three business segments: (1) Industrial Packaging, (2) Global Cellulose Fibers, and (3) Printing Papers. IP also holds a 50% stake in Ilim Holding S.A., a Russia-based paper and pulp producer, which reports results as a separate industry unit. IP's primary markets include North America, Europe, Latin America, Russia, Asia, Africa, and the Middle East. During 2020, the U.S. represented roughly 78% of total sales. As of year-end 2020, IP operated 27 pulp, paper, and packaging mills, 162 converting and packaging plants, 16 recycling plants, and three bag facilities. Additionally, the company owned or managed approximately 314,000 acres of forestland in Brazil, and, through licenses and forest management agreements, owned harvesting rights on government-owned forestlands in Russia. The company is currently headquartered in Memphis, TN.

In 2020 IP generated $20.6 billion in revenue and $3.3 billion in adjusted EBITDA. Year-over-year revenue declined by 8% owing to lower volume and mix of products sold, particularly in Printing Papers, partially offset by volume growth in packaging, while EBITDA margins contracted by almost 300 basis points (see Exhibit 2). Revenue declines were mostly attributed to COVID-19's impact on customer operations, while margin degradation was partially offset by planned plant maintenance outages and "economic shutdowns" given lower volumes. Through 1H 2021, volume increases and a better price and mix environment resulted in a revenue increase of 7.4%, yet EBITDA margins declined as volume/price/mix benefits were outweighed by increased commodity costs and operating costs (including maintenance outages).

Exhibit 2 International Paper Co.: Historical Operating Results

($ in millions, except per share data)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	1H 2020	1H 2021
Revenue	$ 27,833.0	$ 23,483.0	$ 23,617.0	$ 20,675.0	$ 19,495.0	$ 21,743.0	$ 23,306.0	$ 22,376.0	$ 20,580.0	$10,218.0	$10,979.0
Gross Profit	7,246.0	7,207.0	7,363.0	6,362.0	6,076.0	6,941.0	7,796.0	7,223.0	6,326.0	3,045.0	3,219.0
EBITDA	3,542.0	4,191.0	3,972.0	3,780.0	3,895.2	3,869.0	4,361.0	3,990.0	3,269.0	1,593.9	1,671.0
Net Income	1,041.0	1,576.0	1,184.0	1,265.0	1,180.0	1,403.0	2,131.0	1,783.0	1,188.1	577.0	924.0
EPS	$ 2.36	$ 3.51	$ 2.74	$ 3.01	$ 2.84	$ 3.36	$ 5.14	$ 4.47	$ 3.00	$ 1.47	$ 2.32
Revenue Growth YoY	6.9%	-15.6%	0.6%	-12.5%	-5.7%	11.5%	7.2%	-4.0%	-8.0%		7.4%
Gross Margin	26.0%	30.7%	31.2%	30.8%	31.2%	31.9%	33.5%	32.3%	30.7%	29.8%	29.3%
EBITDA Margin	12.7%	17.8%	16.8%	18.3%	20.0%	17.8%	18.7%	17.8%	15.9%	15.6%	15.2%
Net Margin	3.7%	6.7%	5.0%	6.1%	6.1%	6.5%	9.1%	8.0%	5.8%	5.6%	8.4%
EPS Growth YoY	-23.6%	48.7%	-22.1%	10.0%	-5.7%	18.2%	53.1%	-13.1%	-32.8%		57.8%
Net Debt	9,170.0	8,028.0	7,640.0	8,245.0	10,299.0	10,158.0	10,086.0	9,697.0	7,975.0	9,049.0	6,889.0
Leverage	2.6x	1.9x	1.9x	2.2x	2.6x	2.6x	2.3x	2.4x	2.4x		

Source: Bloomberg, and company reports.

IP's **Industrial Packaging** segment is the largest manufacturer of containerboard in the U.S., with annual capacity in excess of 13 million tons, and is the company's largest contributor to consolidated revenue and operating profit. The segment's products include linerboard, corrugating medium, whitetop (linerboard with smoother surfaces for printing advertisements and logos, among others), recycled linerboard, and saturating kraft (processed woodchips that give structure to shelving, partitions, and furniture, among others). The segment is also involved in recycling old, corrugated containers (OCC). Containerboard, or CCM, is composed of two types of material: linerboard and corrugating medium. The corrugating medium is the fluted material situated between two sheets, the linerboards, which give structure to the walls of container boxes. Approximately 80% of the segment's production is converted into corrugated boxes and other packaging materials at the company's 174 container plants located in North America. OCC recycling is completed at 18 company recycling plants. International operations include facilities in Morocco, Spain, France, Italy, and Portugal. Additionally, the segment produces high-quality coated paperboard used in a variety of packaging needs at mills in Poland and Russia, with a combined annual capacity of 14.7 million short tons.

In 2020, the Industrial Packaging segment generated $15.1 billion in revenue and $2.6 billion in adjusted EBITDA (see Exhibit 3). The 2020 year-over-year revenue decline of roughly 2% was largely attributable to lower average sales price and unfavorable mix shift, which, combined with higher operating costs, more than offset higher sales volumes, leading EBITDA margins to decline 11 basis points to 17.5%. Higher sales volumes were primarily attributable to increased demand for corrugated packaging and containerboard related to higher demand for boxes as COVID-19 restrictions shifted consumer shopping toward e-commerce. Offsetting the volume increases were higher raw material costs and increased transportation costs.

Through 1H 2021, revenue increased 7.5% versus the prior-year period, as box demand remained strong (see Exhibit 4). Additionally, the company took price increases beginning in 1H 2021. Profitability was again negatively affected by higher raw material and transportation costs and the severe winter weather in the southern U.S. in 1Q 2021, along with an increasingly tight market for raw materials due to delays at international ports.

Notably, with respect to the port and weather issues, management commented on its 2Q 2021 conference call that the segment ended the quarter with the lowest inventory in company history, which management stated will take several months to build back up. Looking ahead, the price increases instituted in November 2020 and March 2021 will continue to benefit the top line, with about 80% of the increase having been implemented. In addition, the top line should benefit from strong North American demand (partially offset by seasonal weakness from EMEA) and fewer maintenance outages in 2H 2021 vs. 1H 2021, offset by continued headwinds for inputs, particularly OCC, which is seeing strong demand from India and China.

Exhibit 3 International Paper Co.: Industrial Packaging Segment, Historical Operating Results

($ in millions)

Industrial Packaging	2016	2017	2018	2019	2020	1H 2020	1H 2021
Revenue	14,013	15,249	16,133	15,444	15,149	7,452	8,009
Operating Income	1,741	1,547	2,093	2,076	1,819	919	855
Depreciation and Amortization	760	815	803	794	826		
Capital Expenditures	(832)	(836)	(1,061)	(922)	(525)		
Shipments/Sales (in Short Tons)	18,788	18,674	18,806	18,467	18,655	9,134	9,238
Adjusted Operating Income	1,829	1,919	2,277	2,076	1,819	919	855
Adjusted EBITDA	2,589	2,734	3,080	2,870	2,645		

Source: Company reports, and Bloomberg.

Exhibit 4 International Paper Co.: Industrial Packaging, Historical Sales Volume by Product

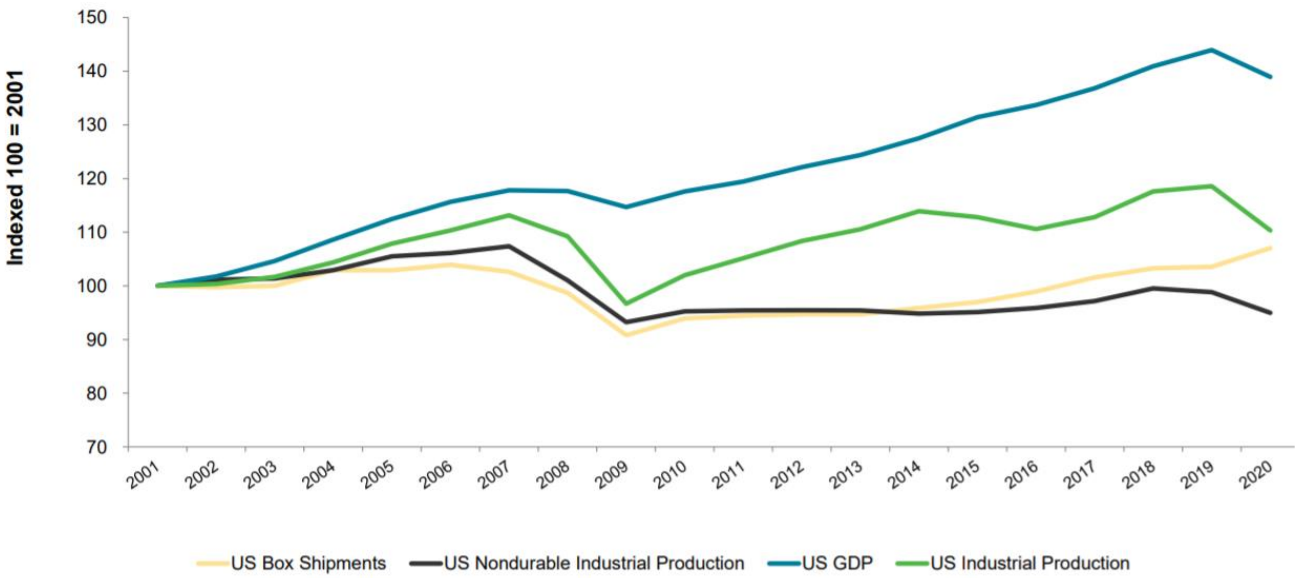
In thousands of short tons (except as noted)	2016	2017	2018	2019	2020	1H 2020	1H 2021
Industrial Packaging							
Corrugated Packaging	10392	10413	10,624	10,454	10,671	5,195	5,417
Containerboard	3091	3294	3,229	2,909	3,097	1,610	1,408
Recycling	2450	2257	2,282	2,388	2,181	928	1,126
Saturated Kraft	182	181	196	174	158	87	95
Gypsum/Release Kraft	200	229	227	199	209	104	123
Bleached Kraft	24	27	31	22	30	15	13
EMEA Packaging	1477	1518	1,476	1,538	1,627	816	845
Asian Box	208	0	0	0	0	-	-
Brazilian Packaging	371	357	351	366	271	173	-
European Coated Paperboard	393	398	390	417	411	206	211
Industrial Packaging	18788	18674	18,806	18,467	18,655	9,134	9,238

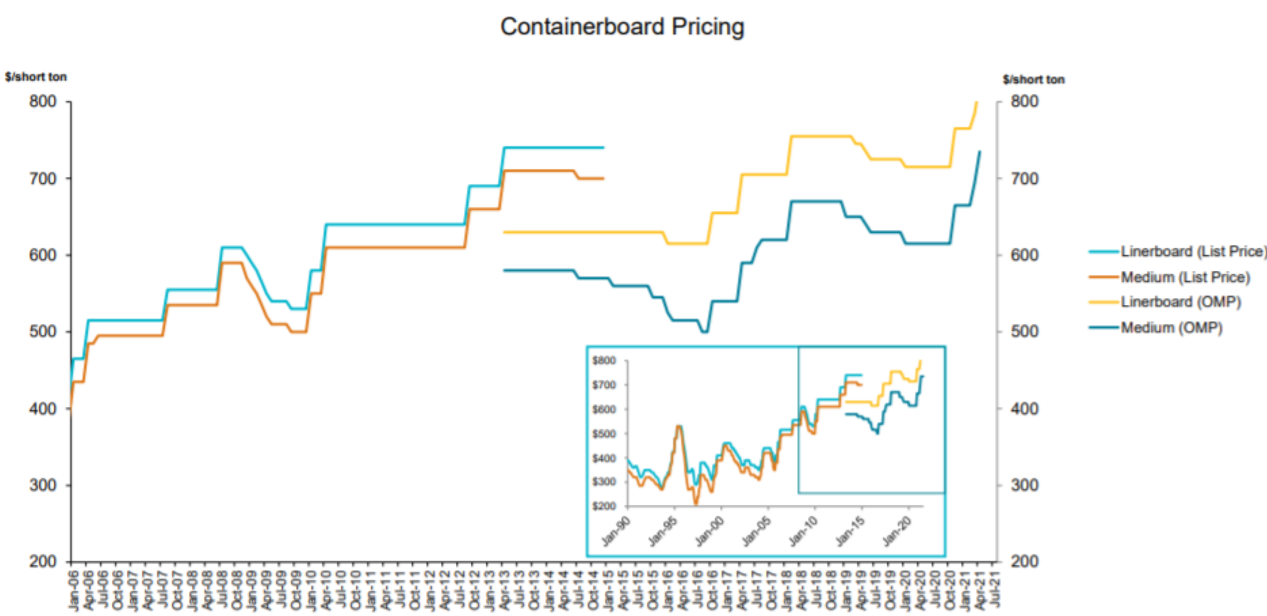
Source: Company reports, and Bloomberg.

The Industrial Packaging segment has made two significant acquisitions since 2006, Weyco Packaging and Temple-Inland (formerly NYSE: TIN), which gave the company increased scale in both production and distribution, while enabling it to continue to operate production facilities within the first quartile of low-cost producers. Roughly 85% of containerboard produced is used by IP box plants (90% U.S.), with the remaining 15% sold on the open market. Of the open market sales, approximately 60% is exported, with 40% of exports to EMEA, 40% to Latin America, and 20% of exports to Asia.

Boxes manufactured are typically used in the food & beverage industry (processed foods, fresh produce, meat, poultry, and beverages), non-durables (chemicals, paper towels, and tissue), and durable goods and distribution (e-commerce, shipping and distribution). With respect to demand and pricing, U.S. box shipments have historically been closely tied to general economic growth (i.e., GDP and industrial production); however, increased demand from e-commerce retailers has somewhat decoupled the historical relationship due to COVID demand factors (see Exhibit 5). Not surprisingly, higher demand has resulted in increased pricing for containerboard and consequently in more competitive bids for OCC (primarily from India and China), which, taken together, support continued favorable demand and profit characteristics for the Industrial Packaging segment. According to Fastmarkets RISI, a market analysis provider for the forest products sector, industry demand for corrugated packaging shipments is forecast to increase to 443 billion square feet (BSF) in 2025 from 407 BSF in 2020.

Exhibit 5 **Historical Box Demand vs. Economic Indicators, and Containerboard Pricing**





Source: RISI, company reports, and Bloomberg.

The **Global Cellulose Fibers** business produces fluff, market, and specialty pulps. Fluff pulp in used in a variety of absorbent hygiene products such as diapers (baby and adult), feminine care, and other non-woven products, while market pulp is the primary input used to make paper and related products. IP has been investing in additional uses for pulp products, including textiles, filtration, and reinforced plastics, among others. Segment manufacturing facilities, which are located in the U.S., Canada, France, Poland, and Russia, have annual dried pulp capacity of approximately 4 million metric tons.

In 2020 revenue decreased 9% versus the prior year, as trends similar to those in the Industrial Packaging segment affected price and mix despite volume increases, primarily in North America (see Exhibit 6). Operating profitability was challenged as lower average selling price due to price cuts in 2019 worked through the company's supply chain. Demand improved throughout the year, however, as consumer destocking occurred. Through 1H 2021, demand for fluff pulp remained relatively stable; although shipments were lower as port delays continued to affect supply chains, this was offset by higher price/mix, resulting in a revenue increase of 6.7%. Notably, while segment operating profit was negative in 1H 2021, 2Q 2021 was profitable, albeit only $10 million on $671 million in revenue.

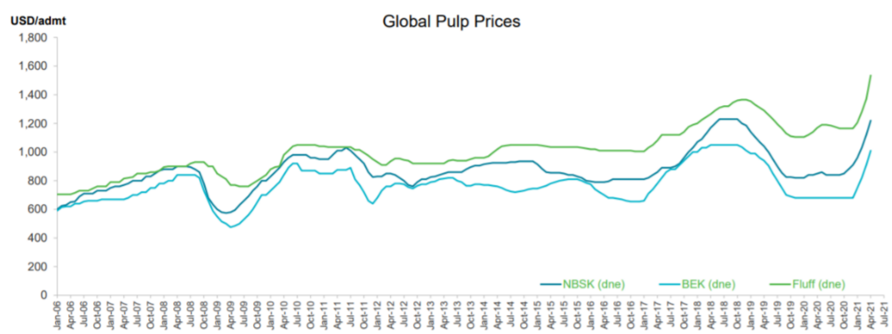
Exhibit 6 International Paper Co.: Global Cellulose Fibers Segment, Historical Operating Results
($ in millions)

Global Cellulose Fibers	2016	2017	2018	2019	2020	1H 2020	1H 2021
Revenue	1,092	2,551	2,819	2,551	2,319	1,173	1,252
Operating Income	(179)	65	262	(6)	(237)	(64)	(72)
Depreciation and Amortization	110	264	262	263	271		
Capital Expenditures	(174)	(188)	(183)	(162)	(97)		
Shipments/Sales (in Short Tons)	1,870	3,708	3,573	3,501	3,676	1,866	1,749
Adjusted Operating Income	(129)	116	262	(6)	(237)	(64)	(72)
Adjusted EBITDA	(19)	380	524	257	34		

Source: Company reports, and Bloomberg.

The outlook for the remainder of 2021 includes continued benefits from previous price increases, coupled with continued strong demand. Plant maintenance outages should be slightly fewer versus the first half, which should allow the segment to operate profitably; however, port congestion and freight costs will continue to act as headwinds. IP has a targeted mix of 85% of production being fluff pulp and specialties, with the remaining 15% of capacity being used for market pulp; currently 75% of the segment's product mix is fluff and specialties. Demand is primarily being driven by a growing worldwide population and increased standards of living and disposable income, which results in the increased use of fluff pulp, primarily for diapers and hygiene products. A large demand driver is China, where it is forecast (by Euromonitor) that disposable income will exceed $10,000 per capita by 2030, from the current estimate of $6,000. Latin America and Asia Pacific are also expected to see large increases, while the Middle East and Africa are forecast to remain fairly stable. Exhibit 7 details historical global pulp prices.

Exhibit 7 Historical Pulp Prices



Source: RISI, and company reports.

The **Printing Papers** business is one of the largest suppliers of coated and uncoated paper in North America. Products include printing and writing papers, with the primary product being uncoated paper used in copiers, desktop and laser printers, and digital imaging. Coated products are used in advertising brochures, pamphlets, books, and direct mail, among other uses. Uncoated papers are also converted by customers into items such as envelopes, forms, and file folders, among others. Brand names that uncoated products are sold under include *Hammermill, Springhill, Williamsburg, Postmark, Accent, Great White, Chamex, Ballet, Rey, Pol, and Svetocopy.* Products are produced in mills located in the U.S., France, Poland, Russia, and Brazil, with capacity in excess of 4 million tons annually. Notably, the Brazilian operation owns or manages approximately 314,000 acres of forestlands in Brazil. Demand for the segment's products is closely tied to demand for commercial printing and advertising and direct mail volumes. Given the use of copy and laser printer paper, uncoated demand also correlates with white-collar employment levels. The paper industry (especially in relation to freesheet) is widely viewed to be in secular decline, caused by the transformation of business documents from paper to digital forms over the past several decades. Given the recent impact of COVID-19 in causing a shift to a more work-from-home/hybrid work environment, this trend could be accelerated.

In 2020, revenue declined by 29.7% to $3.0 billion, as COVID-19 closures resulted in "unprecedented demand decline" for uncoated freesheet paper with the widespread pause in business activities. Loss of demand resulted in margins declining to 13.6% versus 17.8% in 2019. Through 1H 2021, demand has experienced a degree of recovery, with sales increasing 9.1% to $1.6 billion versus $1.49 billion in 1H 2021(see Exhibit 8). Profitability has also recovered modestly to approximately 9.6% (EBIT margin) versus 5.7% in 1H 2020. IP differentiates the Printing Papers segment operations into three regional reporting business: U.S. Uncoated Papers, European and Russian Uncoated Papers, and Brazilian Uncoated Papers. IP sold its Indian Uncoated Papers business unit in 2019. Sales volume by geographical business area is detailed in Exhibit 9.

Exhibit 8 International Paper Co.: Printing Papers Segment, Historical Operating Results

($ in millions)

Printing Papers	2016	2017	2018	2019	2020	1H 2020	1H 2021
Revenue	4,063	4,181	4,388	4,333	3,044	1,491	1,627
Operating Income	540	457	533	529	228	85	156
Depreciation and Amortization	242	254	258	244	186		
Capital Expenditures	(215)	(235)	(303)	(172)	(116)		
Shipments/Sales (in Short Tons)	4,763	4,818	4,714	4,633	3,498	1,683	1,885
Adjusted Operating Income	540	459	543	529	228	85	156
Adjusted EBITDA	782	713	801	773	414		

Source: Company reports, and Bloomberg.

Exhibit 9 International Paper Co.: Printing Papers Segment, Historical Sales Volume

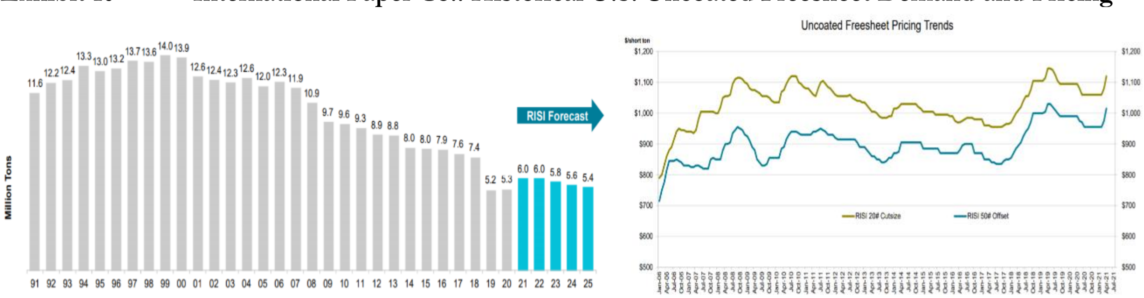
In thousands of short tons (except as noted)

Printing Papers	2016	2017	2018	2019	2020	1H 2020	1H 2021
U.S. Uncoated Papers	1872	1915	1,886	1,799	1,339	662	725
European and Russian Uncoated Papers	1536	1483	1,440	1,456	1,249	631	634
Brazilian Uncoated Papers	1114	1167	1,125	1,172	910	390	526
Indian Uncoated Papers	241	253	263	206	0	0	0
Printing Papers	4763	4818	4,714	4,633	3,498	1683	1885

Source: Company reports, and Bloomberg.

Management's outlook for the Printing Papers segment includes back-half 2021 realization of prior price increases, continued demand recovery from the impact of COVID, and stable operating costs, at least partially offset by higher input and transportation costs. Longer term, the Printing Papers business is likely to continue what is widely deemed a secular decline, particularly in the U.S. At its peak in the late 1990s, the demand for uncoated freesheet totaled approximately 14 million tons, which declined to 5.2 million tons in 2019. Industry forecasts expect a rebound from 2019-2020 levels, as demand declines are expected to moderate, with a forecasted 5.4 million tons of demand in 2025 (see Exhibit 10).

Exhibit 10 International Paper Co.: Historical U.S. Uncoated Freesheet Demand and Pricing



Source: RISI, company reports.

While IP reports its results through three primary segments, the company accounts for its 50%-owned joint venture (JV) partner **Ilim Holding S.A**. as a separate reportable industry unit under the equity method of accounting. In October 2007, IP entered into a 50:50 JV with Ilim by purchasing half of the company for approximately $620 million, establishing Ilim Group. The value of the JV is currently held by IP at $425 million on the company's balance sheet, reflecting foreign exchange and post-transaction adjustments, according to management. Anecdotally, the JV provides a provision for either party to acquire the remaining 50% for approximately $700 million (subject to approval from various regulators). Ilim's assets include three paper mills located in Bratsk, Ust-Ilimsk, and Koryazhma, Russia, with combined total pulp and paper capacity in excess of 3.6 million metric tons. Additionally, the JV has exclusive harvesting rights on 19.8 million acres of timberlands.

Ilim's sales volume increased by 9% in 2020, as a modernized pulp line at Ust-Ilimsk and an upgraded containerboard machine at Bratsk allowed for increased softwood pulp shipments to China among other export markets. The increased volumes were offset by lower-margin sales and higher wood cost (see Exhibit 11). IP received cash dividends of $141 million and $246 million in 2020 and 2019, respectively, and $144 million during the first six months of 2021.

Exhibit 11 International Paper Co.: Ilim Holding JV, Historical Operating Results
($ in millions)

	2013	2014	2015	2016	2017	2018	2019	2020
Sales Volume (million met tonnes)	2.4	2.9	3.0	3.2	3.1	3.3	3.2	3.5
Sales ($B)	1.9	2.1	1.9	1.9	2.2	2.7	2.2	2.0
Debt ($B)	1.5	1.4	1.2	1.5	1.6	1.6	2.2	2.2
Adj. Operating EBITDA ($MM)	203	459	694	680	695	1,207	706	519
F/X Gain (Loss) ($MM)	(80)	(674)	(188)	63	37	(204)	79	(131)
EBITDA ($MM)	1,213	(215)	506	743	732	1,003	785	388
Depreciation ($MM)	176	188	128	121	151	156	134	161
EBIT ($MM)	(53)	(43)	378	622	581	847	651	227
Interest Expense ($MM)	39	69	52	81	88	70	82	85
Net Income (Loss) ($MM)	(72)	(359)	237	385	362	571	424	113
IP Equity Earnings (Loss)	(46)	(194)	131	199	183	290	207	48
Dividends to IP ($MM)	-	56	35	60	134	128	246	141

Source: Company reports.

Sylvamo Corp.: Printing Papers Spin-Off

On December 3, 2020, International Paper (NYSE: IP) announced plans to spin off its Printing Papers business. The spin-off, which is expected to be tax-free to shareholders, is targeted to be completed late in the third quarter of 2021, subject to customary conditions including the declaration of effectiveness of the company's Form 10 filing with the SEC. IP intends to retain a 19.99% stake in the spun-off company, with the expectation that IP will ultimately monetize its ownership position to provide incremental capital to the parent company. In conjunction with the spin-off, IP expects to reduce its current dividend ($2.05 per share) by 15%-20%, while the spin company is not expected to pay a dividend.

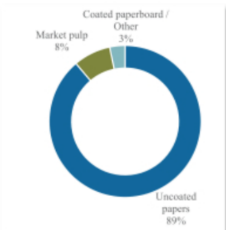
The spin company will adopt the corporate moniker Sylvamo Corp., which is derived from the Latin words "silva" and "amo", being defined as "forest" and "love", respectively. Sylvamo intends to list on the NYSE under the ticker "SLVM" and is currently targeting completion of the separation on October 1, 2021. It should be noted that IP filed its first Form 10 with the SEC on August 9, 2020. IP shareholders of record will receive one share of SLVM for every eleven shares of IP held as of the yet-to-be-determined record date. In conjunction with the spin-off, it is expected that Sylvamo will incur $1.5 billion in new debt, with net proceeds being distributed to IP.

SLVM will be a vertically integrated paper manufacturer, with seven owned mills with total production capacity of 3.5 million short tons. Capacity is fairly spread out regionally, with Latin American capacity of 1.3 million short tons, and North America and Europe each having 1.1 million short tons of capacity. Additionally, the company has an additional 680,000 short tons of capacity under offtake agreements with non-owned mills. For the industry as a whole, worldwide market pulp capacity totals 580 million short tons, while liquid paperboard (LPB) and coated unbleached kraft (CUK) capacity totals 130 million short tons. Sylvamo's vertical integration allows it generally to be the low-cost producer in the industry and has helped it gain significant market share in its respective markets. The company will be the largest supplier in Latin America, the second largest in North America, and the third largest in Europe (which includes Russia). In terms of geographical revenue and operating profit contribution, Latin America contributed 21% of revenue in 2020 and 41% of segment profit, while Europe contributed 30% and 38% of revenue and operating profit, respectively, and North America generated 49% of revenue, yet only 21% of operating profit.

As a standalone company, SLVM will derive almost 90% of its revenue from uncoated papers, including cut size printing, copy, and writing paper, as well as offset, envelopes, and forms, among others (see Exhibit 12). The remaining product revenue will be derived from Market Pulp (8% of 2020 revenue), used in making tissue, printing, writing, and specialty paper, and Coated Paperboard (3% of 2020 revenue), which is used in packaging for liquids and beverage containers.

Exhibit 12 Sylvamo Corp.: Product Portfolio

2020 Revenues by product type



Product type	Product line	Examples of end uses
Uncoated papers (UFS)	Cutsize	Printing, copy and writing paper
	Offset	Commercial printing, such as brochures and books
	Envelope	Statement mailers and direct mails
	Forms	Financial statements and other print applications
	Other	Tablets, receipts and construction applications
Uncoated papers (Others)	Uncoated bristols	Index systems, file cards, case records, menus, direct mail, counter displays
Market pulp	BHK/BSK/BEK/BCTMP	Used for producing tissue, printing and writing paper, specialty paper and board grades
Coated paperboard / Other	Aseptic/LPB	Packaging for liquids, such as beverages
	CUK	Beverage containers (beer and soft drinks) and heavy-duty retail packaging (hardware and laundry detergent)

Source: Company reports.

The company will operate under three reportable business segments defined by geographical region: North America (~49% of revenue), Latin America (~21% of revenue), and Europe (~30% of revenue) (see Exhibit 13). During the last three years, the company would have operated with an average operating margin of approximately 11%, with Latin America exhibiting the highest average margin at 17.6%, Europe averaging 11.6%, and North America with the narrowest margin, at 7.3%.

Exhibit 13 Sylvamo Corp.: Historical Operating Results by Segment

($ in millions)

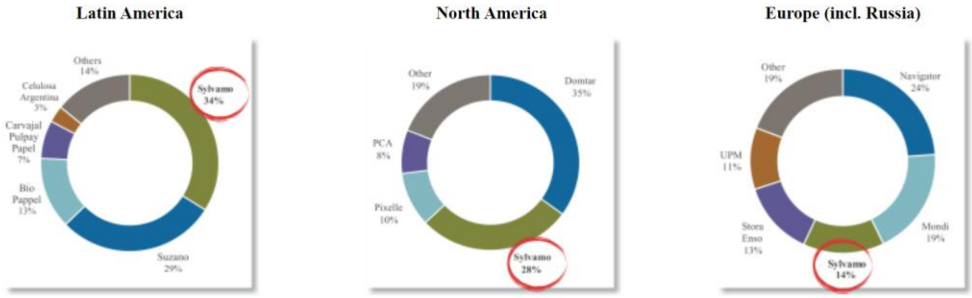
	2018	2019	2020	1H 2019	1H 2020
Revenue					
North America	2,037	1,996	1,490	739	808
Latin America	979	969	632	284	357
Europe	1,143	1,122	921	462	481
Total Revenue	4,159	4,087	3,043	1,485	1,646
Operating Profit					
North America	185	200	43	(4)	40
Latin America	227	158	84	29	87
Europe	159	140	77	46	42
Total Operating Profit	571	498	204	71	169
Adjusted EBITDA	788	709	373	157	247
Revenue Contribution					
North America	49.0%	48.8%	49.0%	49.8%	49.1%
Latin America	23.5%	23.7%	20.8%	19.1%	21.7%
Europe	27.5%	27.5%	30.3%	31.1%	29.2%
Operating Margin					
North America	9.1%	10.0%	2.9%	-0.5%	5.0%
Latin America	23.2%	16.3%	13.3%	10.2%	24.4%
Europe	13.9%	12.5%	8.4%	10.0%	8.7%
Total Operating Margin	13.7%	12.2%	6.7%	4.8%	10.3%
EBITDA Margin	18.9%	17.3%	12.3%	10.6%	15.0%

Source: Company reports.

The North America segment primarily produces uncoated paper and market pulp. Annual capacity totals 975,000 tons for uncoated paper and 115,000 tons for market pulp. Latin American operations include the ownership or management of about 250,000 acres of Brazilian forestland and includes three mills for production of printing and writing paper, with annual capacity of 1.1 million tons of paper and 165,000 tons of market pulp. Lastly, the Europe segment includes a mill in France and one in Russia that produce uncoated papers, coated paperboard, and market pulp. Exhibit 14 details Sylvamo's market position within each of its geographical regions.

Exhibit 14 Sylvamo Corp.: Market Position by Geography

UFS supply position per region according to Fisher International, as of December 2020



Source: Company reports.

In a normal operating environment (i.e., pre-COVID), the company generates free cash flow in excess of $400 million annually, after incorporating historical levels of roughly 3% of sales for capital expenditures. Management has been able to somewhat offset the impact of lower sales on cash flow by delaying some capital expenses, yet the company has still reported lower free cash flow conversion of 70% of EBITDA versus the historical average of 80%. Aside from capex, management has stated that a primary use of free cash flow will be to lower the outstanding debt ratio (total indebtedness to adjusted EBITDA) to less than 2.5:1 by the end of 2022 (See Exhibit 15).

Exhibit 15 Sylvamo Corp.: Historical Cash Flow Generation and Uses

($ in millions)

	2018	2019	2020	1H 2019	1H 2020
CFO	589	524	359	152	222
CFI	(171)	(16)	(79)	(25)	(38)
CFF	(510)	(387)	(350)	(187)	(3)
Cap Ex					
North America	37	36	15	7	9
Latin America	86	61	45	27	15
Europe	27	21	15	8	8
Total Cap Ex	150	118	75	42	32
FCF	439	406	284	110	190
% of Adj EBITDA	55.7%	57.3%	76.1%	70.1%	76.9%
% of CFO	74.5%	77.5%	79.1%	72.4%	85.6%

Source: Company reports.

VALUATION ANALYSIS

With respect to rationale, the spin-off mainly accomplishes separating the structurally declining paper business from the more growth-oriented packaging and cellulose fibers business. Additionally, the lower debt leverage ratios at the parent company will allow IP flexibility in pursuing both internal and non-organic growth opportunities that might have been more difficult to achieve with a more levered balance sheet.

Following the separation of Sylvamo, each of the two post-spin companies will have much more similar peer sets. The parent, IP, will more closely resemble packaging companies, including Graphic Packaging Holding Co. (NYSE: GPK), Packaging Corp. of America (NYSE: PKG), and Westrock Co. (NYSE: WRK), which on average trade at approximately 8.8x 2022E consensus EBITDA, 16.0x 2022E P/E, and 1.5x 2022E revenue. Sylvamo, as a focused paper manufacturer, will be more aptly compared to the likes of Glatfelter Corp. (NYSE: GLT), Domtar Corp. (NYSE: UFS), Neenah Inc. (NYSE: NP), and The Navigator Co. SA (NVG PL), among others. These paper companies trade in two disparate ranges based on earnings, with the higher end (NP and GLT) trading at an average 7.5x 2022E EBITDA, 13.4x 2022E P/E, and 1.1x 2022E revenue, and the lower-end peers trading at 2.7x EV/EBITDA, 5.4x P/E, and 0.3x sales. Notably, Domtar Corp. (NYSE: UFS) currently trades at 5.2x 2022E consensus EBITDA; however, the company is currently being acquired by Paper Excellence for $55.50 per share, while anecdotally M&A in the space has averaged roughly 8x trailing and 7.5x forward EBITDA in recent years. For its part, IP has historically traded at 7.6x EBITDA and 12.8 forward P/E and has yielded 9.2% on free cash flow and 4.1% on its dividend.

It should be noted that IP has consistently raised its dividend payment at a five-year growth rate of 3.1%, increasing it every year since 2009 with the exception of 2020-2021, given the unprecedented market and economic conditions, when the company maintained its $0.5125 per share quarterly dividend. IP has already stated that the parent company will reduce its current dividend payout by 15%-20% post-spin, while Sylvamo will not pay a dividend (as noted earlier. the company will use cash flow for debt retirement).

Sylvamo Corp.: Valuation

We base our forward earnings estimates on the historical results published in the company's Form-10 filing. However, given the three-year history and the current impact of COVID-19 on industry demand, while acknowledging the challenges that would exist without COVID and will create headwinds post-COVID, we also incorporate further historical segment operating results from the combined IP financial statements. As such, we look to 2019 operating performance (for margin reference) more than to 2020 results as a better baseline going forward.

Based on 2020 revenue of approximately $3 billion, and 1H 2021's growth rate, we forecast 2022 revenue of $3.4 billion. The company operated with a 6.7% operating margin in 2020, while in 1H 2021 margins expanded to 10.3%. Looking at 2018 and 2019, operating margins were 13.7 and 12.2%, respectively. We model margins of 11.5%, to account for margin expansion from increased plant utilization from the sales rebound and cost controls, partially offset by increased standalone corporate costs, and incorporate $175 million in depreciation and amortization expense, resulting in 2022 estimated EBITDA of $563 million.

Valuing Sylvamo Corp. at 7.5x, the company would have an enterprise value of $4.2 billion and a market capitalization of $2.8 billion when accounting for $1.4 billion in net debt. On a per share basis, under these assumptions, Sylvamo would be fairly valued at $64 per share based on the one-for-eleven share distribution ratio and the 19.9% stake retained by IP (see Exhibit 16).

Exhibit 16 Sylvamo Corp.: Fair Value Estimate Based on 2022E EBITDA

($ in millions, except per share data; shares in millions)

2020 Revenue	$	3,009.0
Growth		10.0%
2021 Revenue		3,309.9
Growth		2.0%
2022E Revenue		3,376.1
Margin		11.5%
Operating Income		388.3
D&A		175.0
EBITDA		563.3
Multiple		7.5x
Enterprise Value		4,224.4
Net Debt		1,403.0
Market Capitalization		2,821.4
Shares Outstanding		44.4
FVE $ / Share	$	63.61

Source: Company reports, Bloomberg, and Institutional Research Group estimates

Based on the above derived EBITDA, an earnings per share estimate may also be used to fairly value shares of the spin company. Adding back $175 million in depreciation and amortization expense, $45 million in interest expense (approximately $1.5 billion at 3.2%), and $86 million in taxes, the company would earn $258 million in net income, or $5.81 per share. Valuing shares at 12x P/E, Sylvamo would be fairly valued at $70 per share (see Exhibit 17).

Exhibit 17 Sylvamo Corp.: Fair Value Estimate Based on 2022E EPS

($ in millions, except per share data; shares in millions)

2022E EBITDA	$	563.3
D&A		175.0
EBIT		388.3
Interest Expense		44.9
Pre-Tax Income		343.36
Tax Expense		85.84
Net Income		257.52
Shares Outstanding		44.4
EPS	$	5.81
Multiple		12.0x
FVE $ / Share	$	69.67

Source: Company reports, Bloomberg, and Institutional Research Group estimates

Based on the above two valuation exercises, we fairly value post-spin shares of Sylvamo at $67 per share. In our view, the secular trends in the paper market make investing in standalone Sylvamo a difficult proposition without a significant margin of safety to our fair value estimate. It can be expected that upon distribution, historical shareholders of IP would exit the position in Sylvamo and would favor holding the parent company in view of the growing market for the parent's remaining business. Additionally, the impact of Sylvamo's lack of a dividend should not be overlooked, as investment mandates may result in indiscriminate selling. According to Bloomberg, approximately 39% of IP shares outstanding are held within portfolios related to dividends. Further, at its estimated market capitalization, Sylvamo is not likely to be included in the S&P 500.

International Paper Inc.: Post-Spin Valuation

Excluding the contribution of Sylvamo, International Paper would have generated $18.2 billion in revenue and $3.1 billion in EBITDA (17.2% margin) in 2019, and $17.7 billion in revenue and $2.7 billion in EBITDA (15.2% margin) in 2020. Through 1H 2021, revenue increased by 7.2% versus the prior-year period, with operating margins of 8.4%. Looking forward, we expect the demand for industrial packaging and cellulose fibers to continue to rebound in 2021 and 2022, with higher costs (raw materials and shipping) persisting as well, albeit largely offset by price increases already enacted, with optionality for future price hikes. Additionally, we incorporate management's plans for margin expansion into our forecast, given the planned $350-$400 million in incremental earnings opportunities by the end of 2023, which includes $300 million of structural cost reduction (lean effectiveness, and process and asset optimizations).

We forecast a revenue increase of 7.4% in 2020 and another 5% in 2021, resulting in post-spin 2021E revenue of $19.8 billion. Assuming an 11.0% operating margin and $1.1 billion of depreciation and amortization, the company would generate $3.3 billion in EBITDA. Valuing shares at 8.8x, post-spin International Paper would have an enterprise value of $28.9 billion. Adjusting the current net debt for the cash dividend from Sylvamo, IP would be fairly valued at $23.9 billion, or $61 per share (see Exhibit 18).

Exhibit 18 International Paper Co.: Post-Spin FVE Based on 2022E EBITDA
($ in millions, except per share data; shares in millions)

2020 Revenue	$	17,571.0
Growth		7.4%
2021 Revenue		18,871.3
Growth		5.0%
2022E Revenue		19,814.8
Margin		11.0%
Operating Income		2,179.6
D&A		1,100.0
EBITDA		3,279.6
Multiple		8.8x
Enterprise Value		28,860.7
Net Debt		4,985.0
Market Capitalization		23,875.7
Shares Outstanding		390.8
FVE $ / Share	$	61.09

Source: Company reports, Bloomberg, and *The Spin-Off Report* estimates.

Based on the above derived EBITDA estimate, we forecast 2022 EPS of $3.88 per share when incorporating interest expense at 3.2% and a 25% tax rate. If post-spin IP were valued at 16.0x P/E, the shares would be valued at $62 per share (see Exhibit 19). Of note, assuming the post-spin company reduces its current dividend by 15%-20%, this implies that the company would pay an annual dividend of $1.64-$1.74. Shares of IP currently yield 3.5%; thus, if the yield were maintained, shares would be fairly valued at approximately $49 per share. At our $62 fair value estimate, the shares would yield roughly 2.8%.

Exhibit 19 International Paper Co.: FVE Based on 2022E EPS
($ in millions, except per share data; shares in millions)

2022E EBITDA	$	3,279.6
D&A		1,100.0
EBIT		2,179.6
Interest Expense		159.5
Pre-Tax Income		2,020.11
Tax Expense		505.03
Net Income		1,515.08
Shares Outstanding		390.8
EPS	$	3.88
Multiple		16.0x
FVE $ / Share	$	62.02

Source: Company reports, Bloomberg, and *The Spin-Off Report* estimates.

Given its retained 19.9% ownership stake in Sylvamo and taking an average of the above two valuation exercises, we fairly value shares of post-spin IP at $63 per share (see Exhibit 20).

Exhibit 20 International Paper Co.: Post-Spin Fair Value Estimate
($ in millions, except per share data; shares in millions)

EPS	$	24,241.3
EBITDA		23,875.7
Average		24,058.5
Sylvamo Stake		588.2
		24,646.7
Shares Outstanding		390.8
FVE $ / Share	$	63.06

Source: Company reports, Bloomberg, and *The Spin-Off Report* estimates.

On a pre-spin basis, shares of International Paper Co. are fairly valued at $69 per share, consisting of approximately $61.50 in value from post-spin IP and approximately $7.50 in value from Sylvamo (see Exhibit 21). Although our fair value estimate represents roughly 16% potential upside from the current share price, we assign a NEUTRAL rating to pre-spin IP. Our hesitancy to recommend pre-spin IP shares is rooted in the belief that shares of Sylvamo will likely come under selling pressure in initial trading, which would likely erase any near-term upside potential implied by our fair value estimate. Post-spin, we would favor the parent company's prospects, given the current demand dynamics and its ability to pass through price increases that are expected to largely offset higher costs for raw materials and transportation.

Exhibit 21 International Paper Co.: Pre-Spin Fair Value Estimate

($ in millions, except per share data; shares in millions)

	SOTP	Net Debt	Sylvamo Ownership	Market Capitalization	Shares Outstanding	Post-Spin $ / FVE
Post-Spin IP	$ 29,043.5	4,985.0	588.2	24,646.7	390.8	$ 63.06
Sylvamo	4,358.8	1,403.0		2,955.8	44.4	$ 66.64
Enterprise Value	33,402.3					
Net Debt	6,485.0					
Market Capitalization	26,917.3					
Shares Outstanding	390.8					
FVE $ / Share	**$ 68.87**					
Current Price	$ 59.07					
Implied Upside	*16.6%*					

Source: Company reports, Bloomberg, and *The Spin-Off Report* estimates.

CONCLUSION

With respect to rationale, the spin-off mainly accomplishes separating the structurally declining paper business from the more growth-oriented packaging and cellulose fibers business. Additionally, the lower debt leverage ratios at the parent company will give IP flexibility in pursuing both internal and non-organic growth opportunities that might have been more difficult to achieve with a more levered balance sheet. However, given the relative valuations of post-spin peers, we think the ultimate ability to unlock value will be derived from post-spin performance over the longer term, rather than realizing immediate value via a rerating of shares. Thus, we do not view the separation of the two businesses as a catalyst to unlock near-term value, and suggest instead that the post-spin parent company's ability to drive revenue and earnings is the larger opportunity for shareholders.

We fairly value post-spin shares of Sylvamo at $67 per share. In our view, the secular trends of the paper market make investing in standalone Sylvamo a difficult proposition without a significant margin of safety to our fair value estimate. It can be expected that upon distribution, historical shareholders of IP would exit the position in Sylvamo and would favor holding the parent company in view of the growing market for the parent's remaining business. Additionally, the impact of Sylvamo's lack of a dividend should not be overlooked, as investment mandates may result in indiscriminate selling. According to Bloomberg, approximately 39% of IP shares outstanding are held within portfolios related to dividends. Further, at its estimated market capitalization, Sylvamo is not likely to be included in the S&P 500. Given the retained 19.9% ownership stake in Sylvamo and taking an average of two valuation exercises, we fairly value shares of post-spin IP at $63 per share.

On a pre-spin basis, shares of International Paper Co. are fairly valued at $69 per share, consisting of approximately $61.50 in value from post-spin IP and approximately $7.50 in value from Sylvamo. Although our fair value estimate represents roughly 16% potential upside from the current share price, we assign a NEUTRAL rating to pre-spin IP. Our hesitancy to recommend pre-spin IP shares is rooted in the belief that shares of Sylvamo will likely come under selling pressure in initial trading, which would likely erase any near-term upside potential implied by our fair value estimate. Post-spin, we would favor the parent company's prospects given the current demand dynamics and its ability to pass through price increases that are expected to largely offset higher costs for raw materials and transportation.

Exhibit 22 Sylvamo Corp.: Pro Forma Income Statement

($ in millions, except per share data; shares in millions)

	Six Months Ended June 30, 2021				Year Ended December 31, 2020			
	Historical	Autonomous Entity Adjustments	Transaction Accounting Adjustments	Pro Forma	Historical	Autonomous Entity Adjustments	Transaction Accounting Adjustments	Pro Forma
Net sales	**1,622.0**	-	-	**1,622.0**	**3,009.0**	-	-	**3,009.0**
Costs and expenses								
Cost of products sold (exclusive of d&a and cost of timber harvested)	1,050.0	(21.0)	-	1,029.0	2,101.0	(23.0)	-	2,078.0
Selling and administrative expenses	99.0	21.0	-	120.0	209.0	98.0	8.0	315.0
Depreciation, amortization and cost of timber harvested	71.0	-	-	71.0	154.0	-	-	154.0
Distribution expenses	178.0	-	-	178.0	321.0	-	-	321.0
Taxes other than payroll and income taxes	13.0	-	-	13.0	30.0	-	-	30.0
Interest (income) expense, net	(29.0)	-	27.0	(2.0)	(4.0)	-	54.0	50.0
Income (loss) before income taxes	**240.0**	-	(27.0)	**213.0**	**198.0**	(75.0)	(62.0)	**61.0**
Income tax provision (benefit)	63.0	-	(7.0)	56.0	28.0	(18.0)	(15.0)	(5.0)
Net income (loss)	**177.0**	-	(20.0)	**157.0**	**170.0**	(57.0)	(47.0)	**66.0**
Pro forma earnings per share of common stock:								
Basic				$ 3.59				$ 1.53
Diluted				$ 3.59				$ 1.53
Pro forma weighted-average shares outstanding:								
Basic				43.6				43.7
Diluted				43.6				43.7

Source: Company reports.

Exhibit 23 **Sylvamo Corp.: Pro Forma Balance Sheet**
($ in millions)

	Historical	Autonomous Entity Adjustments	Transaction Accounting Adjustments	Pro Forma
ASSETS				
Current Assets				
Cash and temporary investments	226	-	(105)	121
Accounts and notes receivable (less allowance)	417	-	-	417
Related-party receivable	223	-	(223)	-
Inventories	340	-	(28)	312
Other current assets	108	-	(1)	107
Total Current Assets	1,314	-	(357)	957
Plants, Properties and Equipment, net	944	-	-	944
Forestlands	309	-	-	309
Goodwill	147	-	-	147
Right of Use Assets	42	-	-	42
Deferred Charges and Other Assets	353	-	29	382
TOTAL ASSETS	**3,109**	**-**	**(328)**	**2,781**
LIABILITIES AND EQUITY				
Current Liabilities:				
Accounts payable	289	-	(28)	261
Notes payable and current maturities of long-term debt	2	-	-	2
Accrued payroll and benefits	65	-	(14)	51
Related party payable	43	-	(9)	34
Other current liabilities	142	-	(6)	136
Total Current Liabilities	541	-	(57)	484
Long-Term Debt	20	-	1,502	1,522
Deferred Income Taxes	166	-	(6)	160
Other Liabilities	98	-	56	154
Commitments and Contingent Liabilities				
Equity				
Common stock, $1.00 par value	-	-	43	43
Additional paid-in-capital	-	-	1,911	1,911
Parent company investment	3,777	-	(3,777)	-
Accumulated other comprehensive income (loss)	(1,493)	-	-	(1,493)
Total Equity	2,284	-	(1,823)	461
TOTAL LIABILITIES AND EQUITY	**3,109**	**-**	**(328)**	**2,781**

Source: Company reports.

Disclosures

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