

THE SPIN-OFF REPORT

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UPDATE: Sylvamo Corp.

Sylvamo Reports Strong 3Q 2021 Results Following Spin-Off from International Paper; Continue to See Value in Current Share Price; Maintain BUY, \$45 FVE

- On November 10, 2021, before the market open, Sylvamo Corp. (NYSE: SLVM) reported 3Q 2021 results which included revenue of \$908 million, adjusted EBITDA of \$177 million, and free cash flow of \$135 million. 3Q revenue increased 23% versus the prior year period on realization of previously taken price increases, and to a lesser degree improvement in volume and mix (particularly in Europe).
- 3Q EBITDA margins were 19.5%, a 540 basis point improvement from 3Q 2020, on benefits from price and mix, volume, and implementation of operational efficiencies, which were partially offset by higher input costs.
- As a reminder, this is SLVM's first quarterly report as an independent company following the October 1, 2021, spin-off from International Paper Co. (NYSE: IP). IP Shareholders of record as of September 15, 2021, received one share of SLVM for every 11 IP shares owned. IP retained a 19.9% stake in SLVM with the expectation that IP will ultimately monetize its ownership position.
- In terms of cash flow, SLVM generated \$166 million in free cash flow in 3Q (\$325 million year-to-date). Primary use of free cashflow will be for capital investments, and debt reduction, with the goal of eventually being positioned to return capital to shareholders via a dividend or share repurchases.
- Management issued 4Q guidance, which includes continued price increase realization, and seasonal strength in Latin America, which will be partially offset by higher operational, input, and distribution costs. 4Q 2021 EBITDA is currently expected to total \$140 - \$150 million, implying full year 2021 EBITDA of ~\$569 million.
- We maintain our 2022 earnings estimate of \$563.3 million, which we view as a conservative base for earnings on a go forward basis given risks to revenue and margins given current supply chain constraints and input cost trends. Our \$45 fair value estimate is based on a 6.0x multiple of our 2022 EBITDA estimate, incorporating net debt of \$1.4 billion and 44.4 million shares outstanding.
- Our BUY rating on shares is rooted in our view that the current trading multiple is too heavily discounted, despite general concerns about structural issues within the printing paper industry. We note that SLVM's vertically integrated business model allows for the company to be a low-cost producer, which should be viewed positively versus peers.
- In support of our view of value in the current share price, we point to the company's ability to generate free cash flow. Pre-COVID the company generated more than \$400 million in annual cash flow in 2018 and 2019. Through 3Q 2021 free cash flow has totaled \$325 million. Assuming a normalized free cash flow generation capability of \$400 million shares currently yield ~15% while peers trade with

Sylvamo Corp. - BUY

Current Share Price (11/9/21): \$28.79
Ticker: SLVM

Fair Value Estimate: \$45 per share

Shares Outstanding: 44.4 million
Market Capitalization: \$1.3 billion

Market capitalization at current share price.



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free cash flow yields closer to 12%. By our calculation, if SLVM were to trade at a 12% free cash flow yield (and generate \$400 million in free cash flow) the shares would be valued at \$44 per share.

- As background on our recommendation, our initial NEUTRAL recommendation was rooted in the belief that investors in pre-spin IP would likely exit their ownership position in SLVM for a variety of reasons, including the lack of a dividend at Sylvamo, its inclusion in the S&P SmallCap 600 versus IP's S&P 500 membership, and the printing paper industry's structural issues (i.e., the secular decline demand for printing paper). We upgraded shares to BUY on October 7, 2021, when shares were trading at \$24.80.
- In terms of valuation, at the current price shares trade at 4.8x our 2022 EBITDA estimate, while other paper companies trade at ~7.0x average. We believe the forced selling dynamics resulting from the spin-off have eased and shares of SLVM will trade in closer proximity to the peer group.
- For more details, please refer to *The Spin Off Report* dated August 27, 2021, and UPDATE on October 1, 2021, and October 7, 2021.

Exhibit Sylvamo Corp.: Fair Value Estimate

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

	<u>Sylvamo</u>
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	6.0x
Enterprise Value	3,379.5
Net Debt	1,403.0
Market Capitalization	1,976.5
Shares Outstanding	44.4
FVE \$ / Share	\$ 44.56

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

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Disclosures

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