WEST FRASER TIMBER CO. LTD.
Q1 2024 EARNINGS CONFERENCE CALL
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CORRECTED TRANSCRIPT

OPERATOR
Good morning, ladies and gentlemen. Welcome to West Fraser’s First Quarter 2024 Results Conference Call. Please note that all lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

During this conference call, West Fraser's representatives will be making certain statements about West Fraser's future financial and operational performance, business outlook and capital plans. These statements may constitute forward-looking information or forward-looking statements within the meaning of Canadian and United States Securities Laws. Such statements involve certain risks, uncertainties and assumptions which may cause West Fraser's actual or future results and performance to be materially different from those expressed or implied in these statements.

Additional information about these risk factors and assumptions is included both in the accompanying webcast presentation and in our 2023 Annual MD&A and Annual Information Form, which can be accessed on West Fraser's website or through SEDAR+ for Canadian investors and EDGAR for United States investors. Please note that today's call is being recorded.

I would now like to turn the call over to Mr. Sean McLaren, President and Chief Executive Officer. Please go ahead.

SEAN P. MCLAREN, PRESIDENT AND CHIEF EXECUTVE OFFICER
Thank you, Lara. Good morning and thank you for joining our first quarter 2024 earnings call. I am Sean McLaren, President & Chief Executive Officer of West Fraser. Joining me today in our Quesnel office on the day of our annual general meeting are Chris Virostek, our Senior Vice President and Chief Financial Officer, Matt Tobin, our Senior Vice President of Sales and Marketing, and other members of our leadership team.

As just mentioned, later today, we will be holding our AGM where among other things we plan to discuss our progress with sustainability initiatives, some of the broader challenges that the North American lumber industry continues to face adding meaningful supply, our recent track record allocating capital, including capital returns through buyback and dividends, and the attractive long term total returns realized by West Fraser's stockholders.

On the earnings call this morning, I will begin with a brief overview of West Fraser's Q1 2024 financial results and then pass the call to Chris for additional comments before I share some thoughts on our outlook and offer concluding remarks.

West Fraser generated $200 million of adjusted EBITDA in the first quarter of 2024, representing a 12% margin. We experienced mixed results across our business again in Q1 with strength in our North American Engineered Wood Products segment as well as SPF lumber markets, partially offset by continued soft demand for SYP lumber products and in our European business. While new home construction in the US remained resilient through the quarter, supporting demand for OSB and to a large extent SPF lumber, continued elevated mortgage rates appear to be constraining existing home sales activity and tempering repair and remodeling spending, which has had a greater impact on SYP lumber demand.

On a trailing four quarter basis, adjusted EBITDA was $703 million, up from the $561 million we reported for fiscal 2023. On a pro forma basis with the inclusion of Norbord, this level of trailing four quarter adjusted EBITDA is approximately $460 million higher than that of the downcycle in 2019, reflecting synergies from the Norbord transaction, the benefits of our capital investment program, as well as the acquisitions and strategic initiatives we've undertaken in recent years. Finally, our resilient balance sheet and $1.8 billion of total liquidity at quarter end remained strong, offering the financial flexibility with which to support our capital allocation strategy.

With that overview, I'll now turn the call to Chris for additional detail and comments.

CHRIS VIROSTEK, CHIEF FINANCIAL OFFICER & SENIOR VICE PRESIDENT, FINANCE
Thank you, Sean and good morning, everyone. A reminder that we report in US dollars and all my references are to US dollar amounts unless otherwise indicated.

The Lumber segment posted $10 million of adjusted EBITDA in the first quarter, improving from negative $51 million in the fourth quarter. Our North American EWP segment generated $188 million of adjusted EBITDA in the first quarter, up from $143 million in the fourth quarter. The Pulp & Paper segment generated $3 million of adjusted EBITDA in the first quarter, similar to the $2 million reported in the fourth quarter. While in Europe, adjusted EBITDA was a negative $1 million in the first quarter versus $3 million in the fourth quarter.

Higher prices were the largest driver for the sequential EBITDA increase across our North American Lumber and Engineered Wood Products businesses, while increased shipments of SPF products also contributed meaningfully to the sequential improvement. Further, our lumber business benefitted from the actions we took in January to curtail production at two higher cost mills. In effect, we replaced that volume with production from other lower cost mills.

Cash flow from operations was negative $41 million in the first quarter with our cash balance net of debt still at a healthy $174 million versus $361 million last quarter. The relative decrease in our cash balance reflects a combination of the typical seasonal build in working capital, $122 million of capital expenditures plus the approximate $31 million of cash deployed towards share buybacks and dividends.

With that brief financial overview, I will pass the call back to Sean.

SEAN P. MCLAREN, PRESIDENT AND CHIEF EXECUTVE OFFICER
Thank you, Chris. We are proud of the company we have built with the geographic and product diversification that has allowed us to weather what has been a period of challenging markets, particularly in our lumber business. As seen in the right-side figure on slide 6, our North American EWP segment has generated nearly $750 million of adjusted EBITDA over the last four quarters, which has been a period of tougher cyclical conditions for our other segments. It is this diversity in our wood building products offering that has allowed us to generate more than $700 million of adjusted EBITDA on a consolidated basis over the last four quarters, representing a meaningful improvement from the downcycle of 2019.

As an update to our ongoing portfolio optimization strategy, we recently completed two important transactions, namely the disposition of our Hinton pulp mill in February, and more recently, the disposition of our two BCTMP mills, which we disclosed earlier this week. We also announced in April the dissolution of our 50/50 joint venture at Cariboo Pulp & Paper where we are now the sole owner and operator of the mill, which better positions us to support the mill's needs as well as its talented workforce. On balance, we believe the sale of the three pulp mills along with many other recent adjustments to high-grade our mill portfolio will allow us to reduce the variability of our earnings stream while also providing a higher EBITDA floor through the cycle.

Shifting to our outlook and concluding remarks. We expect to continue to face a number of market uncertainties over the near term. Having said that, we remain encouraged that inflation expectation and mortgage rates in the US are below the highs of last year. Inflationary cost pressures have largely stabilized across much of our supply chain, and we do not expect to see any meaningful upward cost pressures over the near term. Further, constraints to new supply are very real, particularly for the North American lumber industry where net new supply growth has been essentially nil over the last several years despite a number of strong upcycles.

Of modest concern, as we suggested on our Q4 2023 earnings call in February, unusually warm weather in Western Canada hampered our winter logging activities, limiting the accumulation of log inventories at some of our mills, which required us to take downtime at select SPF mills in the first quarter.

The impact of weather on our log decks remains a risk factor to our near-term ability to manufacture and ship SPF lumber in Western Canada, and we continue to monitor the situation closely. For our lumber operations in the US South, persistently weak market conditions are a challenge and have increased the downside risks to our near-term production and shipments of SYP in the region.

In conclusion, while demand markets remain mixed early in 2024 and there are near-term challenges across our business, we continue to be pleased how our teams are performing all across West Fraser. We remain confident that we have the right people, processes, and foundation to execute on challenges and opportunities as they unfold. As always, we remain optimistic about the continued growth and future demand for the types of sustainable and renewable wood products that West Fraser manufactures and for which the company is known.

With that, we'll turn the call back to the operator for questions.

OPERATOR
Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] Our first question comes from the line of Ben Isaacson from Scotiabank. Please go ahead.

<Q – Apurva Kilambi >: Good morning. This is Apurva on for Ben. Congrats on the quarter, folks. My first question is whether you can give us a sense of how customer buying patterns have evolved over the quarter? I think last quarter you'd mentioned that things looked stable, so wondering if there's been any evolution there.

<A – Sean P. McLaren >: Good morning, Apurva. I'll make a couple of comments then ask Matt Tobin to fill in what I miss. From our perspective, we started the year stable, and expected some more activity out of our R&R segment, on our treaters in particular, which really has been slower than we would typically expect for the spring season. As a result, we've seen price pressure in particular in southern yellow pine.

Maybe I'll just stop there and ask Matt to weigh in with anything I missed there.

<A – Matt Tobin >: Thanks, Sean. I think that's correct. The R&R markets have slowed down, demand has slowed a little bit from our customers, particularly in SYP, but we think long term R&R, that we're in a strong position with the age of housing stock and it will bounce back with affordability.

<Q – Apurva Kilambi >: Perfect. Thank you. A quick follow up to that, when we consider R&R and I know long term, you expect that the R&R segment will continue to push strong demand. When we do see some weakness in that segment, do you view that as demand deferral or demand destruction? Is it that someone is pushing out a remodel a couple of quarters or is it they're no longer pursuing that? Any thoughts there?

<A – Matt Tobin >: I think we would consider that demand deferral. With the age of housing stock, we believe that R&R is well positioned for the long term. And right now, it's just around the affordability and market dynamics.

Operator:
Our next question comes from the line of Hamir Patel from CIBC Capital Markets. Please go ahead.

<Q – Hamir Patel >: Hi. Good morning. Sean, given how low prices have fallen in the south, are you surprised we haven't seen more curtailments in the region from some of your peers that are perhaps higher cost? And what do you think has been holding producers back from announcing shuts?

<A – Sean P. McLaren >: Good morning, Hamir. Not a lot of visibility to what everybody is doing in the south. I can only speak to what we're doing. As we announced early in the year, we took strong action with the indefinite curtailment of Huttig and the closure of Maxville, and we continue to run, to first our economics and secondly our customer needs. When those things line up, we operate and when they don't fit, we take action. In the south, I can't speak to what others are doing but you don't really have the ability to build big inventories in the south. I think probably people would behave like we are, which is reacting to what your inventories are doing and what you can move into the market.

<Q – Hamir Patel >: Fair enough. I wanted to ask you about pulp and paper side, you've taken full ownership now of the Cariboo mill. How big a capex investment in coming years would you expect to need to commit there to keep that mill viable over the long term?

<A – Sean P. McLaren >: What I would say there Hamir is Cariboo Pulp, as we've talked about multiple times on these calls, and the capital needs that were required at Hinton, Cariboo Pulp is in a very different place. The asset is approximately 20 years newer. It's been well maintained over the years. Saying that, kraft mills require a meaningful shutdown every couple of years and every year some level of shutdown. Things can always happen, but we don't foresee any major capital needs outside of what I would call ongoing regular maintenance at a kraft mill.

<Q – Hamir Patel >: Great. Thanks, Sean. That's all I had on the pulp side. Just a final question for Matt. It looked like your lumber realizations fared quite a bit better than the benchmarks, at least what one of your peers had been pointing to. Any thoughts on what drove the relative strength?

<A – Matt Tobin >: Maybe it’s just down to mix. I can't really comment on what our peers are doing, but it might just deal with a mix in the quarter that will average out over time.

<Q – Hamir Patel >: Okay. Fair enough. That's all I had. I'll turn it over. Thanks.

Operator:
Our next question comes from the line of Ketan Mamtora from BMO Capital Markets. Go ahead, please.

<Q – Ketan Mamtora >: Thank you and good morning, everyone. First question, to your earlier comments, Sean, around SPF inventories being below normal levels on the log side to be clear. Is there any way to quantify where your log inventories are versus the typical levels for this time of the year? Just a rough order of magnitude.

<A – Sean P. McLaren >: Good morning, Ketan. The way I would quantify it is, we've got a couple of places where we came in below what our targets would have been, and we've flagged it as a risk. What really that means is we need to have a little earlier start to our delivery season. We typically wouldn't be expecting to bring logs in in Western Canada till the second half of June or late June. We've got a few sites where we're going to need to start hauling wood earlier than that. Our team has done an excellent job of staging product roadside and having us in position to be able to haul that, but we are going to need some support from, the conditions are very dry, there's fire risk in both provinces so we’re going to need things to align for us to be able to do that. I wouldn't view it though as we're talking a couple of mills in our portfolio of a dozen mills.

<Q – Ketan Mamtora >: Understood, that's helpful. Just one follow-up on that. Have the production disruptions at those two mills continued into Q2 or into April at this point or have you guys been able to manage it?

<A – Sean P. McLaren >: No, we've been able to manage it. We took some forward action in Q1 to ensure that we had log inventories to at least get us to the early part of June, and we have plans in place, weather permitting, to be able to operate normal through the period. We flagged it as a risk, if weather conditions change or we have disruption in the forest, it's going to impact a couple of our plants.

<Q – Ketan Mamtora >: Got it, that's helpful. Switching to OSB, can you update us as to where Allendale is with the ramp-up and where you expect that mill to be by the end of this year in terms of rate of production? I know you flagged an extended ramp-up period in your release, but just curious of what you're seeing and what you're expecting for 2024?

<A – Sean P. McLaren >: The first thing I would say there Ketan is, we're very pleased with the progress that we're making at Allendale and the team we have in place there. That mill started in July of last year and we're 10 months later. The mill is going to take two to three years to ramp up and when you look at the capacity of the mill and look out three years from when we started, you know, if you drew a startup line, you'd probably end up pretty close in terms of where we'd expect to be by the end of this year. Saying that, we're happy with the progress. It's going to lower our cost footprint in our OSB business, which is the reason we bought Allendale and we're well on track to deliver that.

<Q – Ketan Mamtora >: Understood. And just one final question from my side before I turn it over. To an earlier question around R&R demand, have you seen outside of seasonality, obviously, as we move through April and May and June activity picks up, but outside of seasonality, have you seen any change in the demand pattern whether sort of, you know, any slowdown or has it kind of largely been stable with this recent uptick in interest rates? Just curious about that.

<A – Matt Tobin >: I think we've seen a slowdown in R&R demand across our different products. Like I said, we don’t think it's a long-term issue. We think that we're well positioned for R&R on the long term, but certainly this quarter, we've seen across our segments just weakened customer demand around R&R.

<Q – Ketan Mamtora >: Okay. That's helpful. I'll jump back in the queue. Good luck. Thank you.

OPERATOR
Our next question comes from the line of Sean Stewart from TD Cowen. Go ahead, please.

<Q – Sean Stewart >: Thank you. Good morning, everyone. Matt, I just want to follow up on that last point. When you talk about a slowdown in R&R volumes, can we put some percentage numbers around that quarter-over-quarter? Are we talking mid-single digit volume declines? Just trying to get better granularity on what's happening across various demand channels.

<A – Matt Tobin >: We don't have perfect visibility to the end markets around that but our customer segments, that's anecdotally what we’re recording, and that's what we're seeing through the typical channels that we see those products move for R&R. I can't give you an exact percentage because we don't have that visibility, but we certainly feel that slowness through the channels that we typically move our products through to support R&R.

<Q – Sean Stewart >: Okay. And on lumber with respect to finished goods inventories through the distribution channel, you guys and comps the last few quarters have routinely positioned it as lean, but I'm hoping you can reconcile that characterization with prices spinning our wheels here looking for traction. Any updated thoughts on finished product inventories? It feels like it's pretty low at the mill level but what are you guys are seeing through the supply chain and at end markets?

<A – Sean P. McLaren >: Good morning, Sean. I'll make a comment on that and then ask Matt to pitch in anything I miss. Tough for us to speak to what's happening. It's difficult to see what it is across the supply chain. We can only speak to our inventories and our customer buying patterns. Our inventories are normal, and our customers appear to want to buy when they need it. Nobody seems to be under a lot of pressure to buy. So at least we're not feeling anybody building inventory because they're concerned about supply. I would just leave it at that but hard for us to really give you a sense on what it is across the whole system.

<Q – Sean Stewart >: Okay. Thanks for that, Sean. Just one last question maybe for Chris. The $11 million quarter-over-quarter decline in operating costs was referenced in the waterfall slide in the deck. How much of that is tied to the US South optimization initiatives? And can we expect follow-on progress on that front in the coming quarters? Or is that a step function change and a new level and we should just expect that same level going forward?

<Q – Chris Virostek >: Here's how we're thinking about it as we look at the next several quarters. We've seen with the lower price a little bit of stumpage relief in Canada, that's been a tailwind for us, that benefitted us on the cost side. The impact of Fraser Lake won't really be felt until the third or fourth quarter as that mill winds down through the balance of this quarter and the inventory gets liquidated there and we wind up operations. The closure of the two mills in the US South was a much more expeditious process given how lean the inventories are typically in the south, and those mills wound down operations quite quickly. But what we did there was, as you can tell from the shipments, we effectively replaced that volume at our other newer lower cost mills. We had effectively internal cost arbitrage by moving that production and keeping our shipping pace where it was but with an overall lower cost platform.

Those are the things I would say that we're laser focused on doing every day. We've spent a lot of capital in the last several years and continue on our capital program. I think that's one of our differentiators is we're spending the capital and trying to improve the quality of the assets in the businesses and how they run even through the bottom of the cycle. We're going to keep pushing on that cost lever, as much as we can to keep driving cost down across the platform in lumber, and in all the businesses. We saw some great results on that in the first quarter and certainly the teams are working on that every day.

<Q – Sean Stewart >: Okay. Thanks for that, Chris. Appreciate it, guys.

Operator: Thank you, ladies and gentlemen. [Operator Instructions] We have our next question coming from the line of Matthew McKellar from RBC Capital Markets. Go ahead, please.

<Q – Matthew McKellar>: Hi. Good morning and thanks for taking my questions. First, I'd like to ask, I think you talked about having a few more organic projects in the queue for your US lumber platform. Is the softness you're seeing in southern yellow pine today changing your view at all on whether those projects pencil out over the longer term or potentially change the timing of when you maybe move forward with some of those new investments in the US South?

<A – Sean P. McLaren >: Good morning, Matthew. When we refer to that, it's projects we have in motion and which the largest is our Henderson project and that project, we're not slowing down there. It's on schedule, on budget. It is a strategic investment that we think we will be well positioned whatever the market cycle is, once we get it up to rate and integrated in our full East Texas platform. I think for future projects, we are very focused on ramping up what we have in motion and executing on the capital we've spent, and finishing the capital we have underway. So even though we are doing planning for the future, I think new projects, we're going to pick our time. When we do that, focus job one today in West Fraser is delivering on the projects we already have in motion and in startup.

<Q – Matthew McKellar>: Great. Thanks very much for that. The next question, you've been pretty clear on outlining what factors you consider when pursuing M&A. With that as a background, can you describe what the pipeline of opportunities you're seeing in the market looks like today?

<A – Sean P. McLaren >: I'll make a comment or two on that and ask Chris to weigh in. But I would say, our view in West Fraser is and has been, for an M&A opportunity, it needs to be high quality, immediately make us stronger and support our existing business. It needs to tick all the boxes, like Angelina did, like Allendale did, like Spray Lakes or Cochrane did. I would say those opportunities are pretty few and far between today, and people with high quality assets, the odd one might come to market, but tough to find them. So that would be my perspective and who knows, but I think we're well positioned to react to anything that we're interested in that comes on the market, but the bar is pretty high in West Fraser.

<Q – Matthew McKellar>: Great. Thanks very much. One last kind of cleanup for me. On Hinton, and I know you have a long-term contract with Mondi to supply residuals into that facility. My question is whether you expect any significant downside on that mill between now and 2027 as they work through their paper machine investments? It would mean you have to find a home for those residuals on an interim basis, and if so, how should we think about the financial significance of that?

<Q – Chris Virostek >: How they're going to execute their capital is really a question for them, but we feel very good about our ability to dispose of our residuals in Alberta. That's a low-cost region for us that we want to make sure operates. We think we've definitely taken all the right steps with that transaction to provide us the comfort that we can continue to do that over a very long extended period of time.

<Q – Matthew McKellar>: Great. Thanks a lot for the color. I'll turn it back.

Operator:
We have a follow-up question coming from the line of Sean Stewart from TD Cowen. Go ahead, please.

<Q – Sean Stewart >: Thanks. Just one follow-up, guys. OSB in North America, it looks like prices are starting to crack after a surprising run over the last several months. Can I get your perspective on downside risk to that market? How far do you expect prices could fall before downtime kicks in? And, I appreciate you're taking a slow and steady approach with Allendale, but broader thoughts on managing supply as prices potentially correct here over the next little bit.

<A – Sean P. McLaren >: I'll make a comment or two here, Sean, and then get Matt to fill in. From my perspective, our OSB sales team and entire team has done a very good job. I think we've strengthened relationships with key customers, built programs that both are supported by OSB and lumber and that's given us an ability to ramp up Allendale into those programs. In terms of what is going to happen, really tough for us to say. We know supply is coming on but saying that, the business has consistently held up, better than our expectations, which we've been pleased by, and our team has done an excellent job of strengthening relationships with our key customers for both products. Matt, anything to add...

<A – Matt Tobin >: I think that's perfect. We're really focused on supporting our key customers to meet their demand and supply them through all markets.

<Q – Sean Stewart >: Okay. That's it for me. Thanks, guys.

Operator:
We have a follow up question coming from the line of Ketan Mamtora from BMO Capital Markets. Go ahead, please.

<Q – Ketan Mamtora >: Thanks for taking my follow-up question. What are you seeing in Europe in terms of activity level? Are you seeing activity under pressure or are you seeing things stabilize?

<A – Sean P. McLaren >: Hi, Ketan. Europe is slow, has been slow for a number of quarters now. What I would say as we come into Q2 is that we've seen, even though prices really haven't materially improved, we have seen some volume improvement. The rate of inflation seems to be coming down a little quicker over there. Saying that, it's still really slow in Europe, we have really good assets and a strong team so we'll see when things improve, but we feel pretty good about operating even in this environment and moving all of our operational excellence and business goals forward even though pricing is tough.

<Q – Ketan Mamtora >: Got it. And then just one related question to that. If Europe remains weak and it sounds like it is fairly weak, what is the risk that we start to see an uptick again in imports of lumber into the US from Europe? I mean, it's been coming down here in the last little bit, but just curious how you see that potentially shaping out as we move through Q2 and into Q3?

<A – Sean P. McLaren >: We don't have lumber assets in Europe so our visibility is not as good as maybe some others, but our view is that, there's been a lot of investment by European producers, opening up those supply chains. They're unlikely to let those supply chains close so we likely will continue to see volume flowing. Saying that, as things improve in other markets that they normally go to, we'll see that volume go to those markets. So, it could be up and down, but we view it long term likely volumes going to stay in their more traditional markets.

<Q – Ketan Mamtora >: Got it. That's helpful. I'll turn it over. Thank you.

Operator:
Thank you. There is no further question at this time. I'd now like to turn the call back over to Mr. McLaren for final closing comments.

SEAN P. MCLAREN, PRESIDENT AND CHIEF EXECUTVE OFFICER

Thanks, Lara. As always, Chris and I are available to respond to further questions, as is Robert Winslow, our Director of Investor Relations and Corporate Development. Thank you for your participation today. Stay well and we look forward to reporting on our progress next quarter. Thank you.

Operator:
Thank you, sir. Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines. Have a lovely day.