WEST FRASER TIMBER CO. LTD.
Q2 2024 EARNINGS CONFERENCE CALL
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CORRECTED TRANSCRIPT

OPERATOR
Good morning, ladies and gentlemen, and welcome to the West Fraser Q2 2024 Results Conference Call. At this time, all lines are in a listen-only mode. Following the presentation, we will conduct 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 the 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. I would now like to turn the conference over to Sean McLaren, President and Chief Executive Officer. Please go ahead.

SEAN P. MCLAREN, PRESIDENT AND CHIEF EXECUTVE OFFICER
Thank you, Julie. Good morning, everyone, and thank you for joining our second quarter 2024 earnings call. I am Sean McLaren, President and CEO of West Fraser, and joining me today are Chris Virostek, Senior Vice President and Chief Financial Officer; Matt Tobin, Senior Vice President of Sales and Marketing; and other members of our leadership team.

On the earnings call this morning, I will begin with a brief overview of West Fraser's Q2 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 $272 million of adjusted EBITDA in the second quarter of 2024, representing a 16% margin. We experienced mixed results across our business again in Q2 with strength in our North American Engineered Wood Products segment, partially offset by continued soft demand for SYP lumber products.

While levels of new home construction in the US showed signs of stabilizing in the second quarter, supporting demand for OSB, and to some extent SPF lumber, continued elevated mortgage rates appear to be constraining existing home sales activity and repair and remodeling spending, which we believe has a greater relative impact on Southern Yellow Pine lumber demand.

On a trailing four-quarter basis, adjusted EBITDA was $894 million, which is an improvement from the $703 million reported in the trailing four-quarters as of Q1, and the $561 million reported at year-end 2023.

On a proforma basis, with the inclusion of Norbord, this level of trailing four-quarter adjusted EBITDA is approximately $650 million higher than that of the last down cycle in 2019, in part 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, in terms of our balance sheet, we have $2 billion of total liquidity at quarter-end, which offers us the financial flexibility and strength 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. And a reminder that we report in US dollars and all our references are to US dollar amounts unless otherwise indicated.

The Lumber segment posted an adjusted EBITDA loss of $51 million in the second quarter, compared to $10 million of positive adjusted EBITDA in the first quarter. Our North America EWP segment generated $308 million of adjusted EBITDA in the second quarter, up from $188 million in the first quarter. The Pulp & Paper segment generated $9 million of adjusted EBITDA in the second quarter, ahead of the $3 million reported in the first quarter, and perhaps more significantly versus the negative $74 million of EBITDA in Q2 of last year. Finally, in Europe, adjusted EBITDA was $6 million in the second quarter versus negative $1 million in the first quarter.

Higher prices and shipments drove the sequential EBITDA increase across our North American Engineered Wood Products business, while lower lumber prices and the resultant required inventory valuation adjustments were a primary EBITDA detractor in the quarter.

Worth noting, however, that our Lumber business benefited from the actions we took earlier in the year to curtail production at two higher cost mills, essentially replacing that higher cost volume with production from other lower cost mills. Specifically in the US South, on a year-to-date basis, our SYP shipments are down approximately 10% from 2023.

With regard to softwood lumber duties, as you may have already seen disclosed in our Q2 financial statements, if the preliminary Administrative Review Five rates are confirmed later this quarter, we anticipate realizing a $35 million duty expense adjustment in Q3 and for our combined cash deposit rate for duties to increase to approximately 12%.

Cash flow from operations was $378 million in the second quarter, with our cash balance, net of debt and lease obligations at a healthy $469 million versus $174 million last quarter.

The relative increase in our cash balance reflects a combination of improved earnings, the typical seasonal release of working capital, plus proceeds from the sale of the pulp assets. All of that partially offset by a $102 million of capital expenditures and approximately $95 million of cash deployed towards share buybacks and dividends.

Of note, in the second quarter, we repurchased another approximately 900,000 shares or nearly 25% of the shares available under the NCIB, and we increased our quarterly dividend by approximately 7%, declaring a dividend of $0.32 per share versus $0.30 per share previously.

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 remain proud of the company we have built, including the geographic and product diversification that has allowed us to weather the extended period of challenging lumber markets within which we find ourselves today.

As seen in the right-side figure on slide 7, our North American EWP segment, which is shaded brown, has generated $927 million of adjusted EBITDA over the last four quarters, 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 $894 million of adjusted EBITDA on a consolidated basis over the last four quarters. Shown in the figure on the left, more than 3.5 times the level of proforma EBITDA experienced in the down cycle of 2019.

We released our 2023 Sustainability Report at the end of May, three weeks earlier than the release of last year's report. Once again, it was the accumulation of significant effort by many people, both within and outside the organization, working together to bring this important document to fruition.

The latest version of our Sustainability Report highlights the company's performance across a variety of environmental, social and governance goals. I am proud of the work we have done to date and the level of commitment shown across our entire organization towards achieving our sustainability goals. Although we have more work to do, I'm confident we're on the right path. If you haven't already reviewed our 2023 Sustainability Report, I encourage you to do so.

I'll now shift to our outlook and add some concluding remarks.

Although we expect to continue to face a number of market uncertainties over the near term, we remained encouraged that inflation expectations and mortgage rates in the US are below the highs of last year and have been generally trending lower.

Inflationary cost pressures appear to have stabilized across much of our supply chain, and on balance we do not expect to see any meaningful upward cost pressures throughout the remainder of the year.

For our lumber operations in the US South, the weak market conditions of recent quarters are ongoing, and as such we must continue to be nimble with our operating strategy. As a reminder, last year we permanently removed approximately 100 million board feet of lumber capacity with a mill closure in Florida and earlier this year, we further rationalized our lumber platform, announcing the closure or curtailment of three of our higher cost mills, which included approximately 270 million board feet of total capacity at two mills in the US South, and approximately 160 million board feet of capacity in British Columbia. We have also reduced the number of shifts or hours of operations at several other mills.

In conjunction with these capacity adjustments, and to manage costs, we have transitioned some production to our lower cost, more productive mills where we have been spending our modernization capital.

In Q3, we plan to continue to operate with fewer hours across both our SPF and SYP platforms and we expect to do so through the second half of 2024, so long as market demand warrants such action.

In our North American Engineered Wood Products business, we continue to ramp up production at our Allendale OSB mill, where we are pleased with the cost progression of that facility, having recently marked the first anniversary of its re-start. We continue to expect that Allendale will be among our lowest cost OSB mills when it achieves its full operating rate.

Given this backdrop, we have reduced 2024 guidance for Southern Yellow Pine shipments to a range of 2.5 to 2.7 billion board feet, versus our prior guide of 2.7 to 2.9 billion board feet. This reduced guide implies approximately 1.1 to 1.3 billion board feet of SYP shipments in the second half of 2024, with the bottom end of this range representing a nearly 20% reduction from our first half shipments. We are not adjusting shipping guidance for our other key products at this time, though we will adapt our operating rhythm and guidance if and as warranted by changes in market demand.

In conclusion, while demand for our various products remains mixed and there are near-term challenges across our businesses, we continue to be pleased with how our teams are performing. We remain confident in our people, processes, and foundation to continue to execute on both the challenges and opportunities in front of us. We also remain optimistic about the future and long-term demand prospects for the types of renewable wood products that we manufacture and are known for here at West Fraser.

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

OPERATOR
Thank you. [Operator Instructions] One moment please for your first question. Your first question comes from Ketan Mamtora from BMO Capital Markets. Please go ahead.

<Q – Ketan Mamtora >: Thank you for taking my question. Good morning. Perhaps to start with, Sean, can you give any additional colour in terms of the repair and remodeling trends in the quarter? Is there a way to ballpark what kind of percentage declines you saw in that segment of the market and how it trended through the quarter?

<A – Sean P. McLaren >: Good morning, Ketan. I'll make a few comments and then ask Matt Tobin, our Senior Vice President, Sales and Marketing, to pick up what I miss. From my perspective, our best proxy is our treated customers in our US South lumber platform. They largely service the repair and remodeling sector. And I would say what we saw this past quarter was a muted demand through the quarter. We did not see a typical season of building ahead of it and typical buying patterns throughout. Again, it was hard to judge. It was just available supply on the market. But I can tell you our customers were typically slower than what we would normally expect throughout the quarter. So, I think that's a good proxy of overall demand, at least in the Southern repair and remodeling segment.

<A – Matthew Tobin >: No, I think that covers most of it. I think affordability continues to be a headwind in R&R, but historically it's been a GDP-like grower, and we expect that to continue to be the case over the longer term. The age of housing stock, we think R&R will continue to be a long-term outlook for the product.

<Q – Ketan Mamtora >: Got it. Now, that's helpful. And then, Sean, maybe just a little more colour on what you were mentioning earlier around Southern Yellow Pine production in the back half. Can you provide any additional colour in terms of the reduction in operating hours and the approach that you're taking? Is there a way to quantify how much production you're going to cut in the back half and is there a timeline to how you are approaching this?

<A – Sean P. McLaren >: I'll make a few comments on that, Ketan. I think the best guidance is the guidance we've given, dropping our annual guidance down to 2.5 to 2.7 billion board feet, which is a reduction of 200 million board feet from our previous guidance. And I'll just speak briefly of how we think about it. And again, as a reminder, we took action early, starting in early 2023 with the closure of Perry, and then again in January of this year with not only the closure of Fraser Lake in British Columbia, but also the closure of Maxville and the indefinite curtailment of Huttig. So that removed high cost out of the system and did it in a way that was cost effective. From there, we continue to monitor price as well as the demands from our customer. And we made a series of changes throughout the quarter, which was shift reductions and operating hour reduction, along with inventory curtailments. And that is the mode we continue to operate in. And I can tell you our team meets weekly on what our operating footprint is and actions we need to take to make sure we're running to the economics of that particular plant and mill, as well as what demand is available in the market.

<Q – Ketan Mamtora >: Got it. That's very helpful. I'll jump back in the queue. Good luck.

<A – Sean P. McLaren >: Thank you.

OPERATOR
Thank you. Your next question comes from Sean Steuart from TD Cowen. Please go ahead.

<Q – Sean Steuart >: Thanks. Good morning, everyone. Couple of questions. Sean, can you give us a sense of in the EWP segment, OSB in North America in particular, how much of this sequential volume growth was Allendale ramping versus pushing legacy mills harder into what was a strong price environment until towards the quarter-end. And then following on that, there's an implied pullback in your second half volumes for OSB just given the guidance range you reiterated. How much of the unit cost gains we saw for that segment in Q2 do you think you might give up if you're pulling back volumes through the back half of the year?

<A – Sean P. McLaren >: Yeah. Good morning, Sean. Just a few comments on your first comment. I would say that the majority of the – and Chris can fill in what I miss here, but the majority of the increase would have been Allendale continued to ramp up. Saying that, we had a number of mills that operated very well in Q2 and major capital projects that were done over the last 12 to 24 months that came to fruition, that we're seeing the benefits of. So, I would say just generally across our OSB platform we're very pleased with our operating performance across the segment. To your second question around the implied pullback and what that would do to our cost, I would say again, it'll ultimately depend on the rate we run at for the second half of the year. But other than unexpected adjustments to our operating schedule, we expect really no material cost pressure. We would expect cost to be stable through the second half.

<A – Chris Virostek >: Just as a reminder, Sean, Q4 is a seasonally slower period for us in OSB, the slowdown in building activity, and then that's when we typically schedule a lot of our maintenance downtime across the fleet in the fourth quarter. So that plays in a little bit to the weighting of the shipments first half versus second half as well.

<Q – Sean Steuart >: Got it. Okay. Thanks for that. Next question, Capex beyond this year, you guys reiterated the 2024 budget range. How are you thinking about discretionary projects at the sawmill level beyond 2024? Not necessarily referencing specific projects, but the backlog of potential projects you have, and with a weaker market, are you seeing any relief in capital costs for brownfield expansion projects at the various sawmills? Has there been any relief on that front?

<A – Sean P. McLaren >: I'll make a few comments here, and then Chris please fill in what I don't cover. But to your first question on discretionary products, I think the way we think about capital in West Fraser, so we have a baseload of maintenance business Capex, which is safety, environmental, all the things we need to manage the core part of our business on an ongoing basis. We always have a basket of what I would call small capital, high payback, opportunistic projects. I would probably see those would be normal, depending on the mills readiness and what we were taking on.

For the larger, more strategic projects, I can tell you our view in West Fraser is finishing what we started and wrapping up what we've already completed, and that's job one for us. We're always planning what's coming next. But in terms of that, especially in our lumber platform, it's more about our capacity to take that on and our readiness to move forward with those projects. I think we'll always have a number of projects that we're planning. But in terms of taking that next step, right now our focus is on finishing Henderson, ramping up Maplesville, continuing to ramp up Dudley, things we've already done that we're focused on and making good progress on.

In terms of just an overall capital cost, others – Chris, maybe weigh in here. But we've not priced out anything recently. Our view would be is there's probably been a little bit of relief in steel costs, but not a material change in the overall costs of a brownfield. I think if we were looking at a brownfield or greenfield today, it's going to be in the same range as Henderson. There might be some relief there, but not material relief. Again, not as fresh to that because we haven't done that work recently but that would be my view.

<A – Chris Virostek >: That's a good summary. I have nothing to add to that.

<Q – Sean Steuart >: And just one follow-on, Chris. I mean, all else equal, just based on Sean's commentary, would you expect 2025 Capex to moderate a little bit year over year?

<A – Chris Virostek >: Well, there's a big number I think we said in there for Henderson this year and that'll kind of ramp up going into next year. And then I think as Sean indicated, we don't have firm plans or commitments yet on another big major project like Henderson that spans over two to three years. That being said, we go through that process in the back half of the year. We've got a pipeline of things in front of us. But the timing of when we sort of pull the trigger on those as far as execution will be dependent on a bunch of things. And we'll be back to you guys early in the year with guidance for 2025 on Capex. But we've been pretty stable in terms of our Capex the last couple of years, but we've also been very busy with a lot of projects as well too. So that's probably as far as we can go on that at this time.

<Q – Sean Steuart >: Okay. That's all I have. Thanks very much, guys.

<A – Sean P. McLaren >: Thanks, Sean.

<A – Chris Virostek >: Thanks, Sean.

OPERATOR
Your next question comes from Hamir Patel from CIBC Capital Markets. Please go ahead.

<Q – Hamir Patel >: Hi. Good morning. Sean, given the weak pricing backdrop for lumber, are you surprised we haven't seen more downtime in the industry, both in the South and in BC and with the duties going higher soon, do you think that'll have an impact?

<A – Sean P. McLaren >: Good morning, Hamir. Again, so difficult for me to comment on others and what others are doing other than what comes out publicly. And I would say, and I may have said this in the past, that in the South the mills tend to do flex around hours, shifts, and who knows what everybody is up to. Maybe I'll just reinforce a few things from our perspective, down 10% year-over-year, guiding significantly lower in the South in the second half. So, I guess the surprising part for me is the extent of action we've had to take because of the price environment and the demand environment. And I'm guessing others aren't immune to it as well, but it's hard to have visibility to that.

<Q – Hamir Patel >: Fair enough. And Sean, are you able to give us a sense as to Allendale, one year in, what kind of operating rate you're achieving at that mill?

<A – Sean P. McLaren >: Yeah, happy with the progress we're making at Allendale. Just moved our one-year anniversary here several weeks ago. And I think we've been pretty consistent right from the beginning. These are, call it a 36-month ramp up curve and it's steeper in the beginning, but if you drew a line from 0 to 36 and then maybe elevated a little bit in the first year, you're probably going to be pretty close. So, we're tracking as we would expect to get this mill up to rate over the next couple of years, a year into it.

<Q – Hamir Patel >: Okay. Fair enough. And the last question I had was, given the weak lumber market, are you seeing any change in vendor expectations when you consider potential sawmill acquisitions?

<A – Sean P. McLaren >: Yeah. And again, our team is always planning and thinking about what is next. You don't really get to that until you're ready to move forward and actually make a commitment, issue a purchase order. And just to reiterate some comments that I made a few minutes ago, we are really focused on, we've had a lot of capital, we're in startup at several places still, we want to finish Henderson, we've had some success at Allendale, other OSB projects. Job one for us is really delivering on the commitments we made and getting those mills up to rate and finishing what we have in motion. So, taking on the next big project, we're doing a lot of planning, but we're really not at the point to test that. Saying that, clearly the activity is going to be less today than it was a few years ago.

<Q – Hamir Patel >: Yeah, Sean. I guess I was referring more to the potential for West Fraser to take advantage of this weaker market for sawmill acquisition.

<A – Sean P. McLaren >: Oh, sorry. I thought it was more capital. Yeah, and I think maybe I've touched on this in the past. For us, I think you look at what we've done the last few years with Angelina, Allendale, Cochrane / Spray Lakes. It really has to have a path to be very competitive in this kind of market, at the bottom of the market. It's got to be synergistic with our existing business. It's got to be in the right fiber basket. So, it's got to be high quality and that's really the bar in West Fraser, and those opportunities are few and far between. Saying that, I think we've got the balance sheet and the footprint to be able to react to anything that we're interested in when that becomes available.

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

<A – Sean P. McLaren >: Thanks.

OPERATOR
Your next question comes from Matthew McKellar from RBC. Please go ahead.

<Q – Matthew McKellar >: Hi. Good morning. Thanks for taking my questions. I think you mentioned that you're seeing lower saw log costs in the US South, but similar competition for pulpwood on the OSB side. Can you give us a sense of how material these trends are and if you're seeing much variance across the region?

<A – Sean P. McLaren >: Good morning, Matthew. They are drifting lower. I would say from materiality, it's a few percentage points and moving in that direction. So, it's not significant. Saying that, they are coming down. And as we've seen over the years in US South log costs, they tend to be sticky and it takes a period of time for landowner expectations, and then things kind of find an equilibrium and the market moves down. We do think availability for logs, as prices are coming down and production is being adjusted, that there are pockets where availability has improved, so price decreases are more. Other areas where landowner expectations are different, so it's taking a little bit longer. But I'd say overall it's moving in the right direction, probably not as quick as any of us would like, though.

<Q – Matthew McKellar >: Thanks. That's helpful. And then one more from me. Historically, the industry has seen some labor turnover issues at mills in the US South. Would you be able to provide any colour on whether you're seeing any increase in turnover with some of the reductions in hours and shifts you implemented in your SYP platform in Q2?

<A – Sean P. McLaren >: Our turnover has been stable. It's something we watch very closely and that's why it's important to get the right shift configuration, the right operating schedule. It's really difficult to turn these mills on and off and not have an impact there. So, we tend to make longer-term decisions around shifting and operating hours, so we can give people predictability and that stability in a tough market. I would say also our capital program, we've been very focused on improving work conditions, making the jobs better, taking away dependency from what I would call high turnover jobs, and I think that's paying some dividends for us in this market.

<Q – Matthew McKellar >: Thanks a lot. That's all for me. I'll turn it back.

<A – Sean P. McLaren >: Thank you.

OPERATOR
[Operator Instructions] Your next question comes from Ben Isaacson from Scotiabank. Please go ahead.

<Q – Ben Isaacson >: Good morning. First question is on SYP. You lowered your volume guidance to 2.5 to 2.7 billion, but you kept the range the same of 200 million board feet. Because half the year is now behind us, does that unchanged range imply that there's greater uncertainty now than you had earlier in the year? And if so, is that greater uncertainty all on the demand side, or do you have an expectation of competitor supply cuts as well? Just want to figure out what brings you to the lower end or the higher end of that range.

<A – Sean P. McLaren >: Good morning, Ben. That's a good question. So, I think for the guide, again, we've got 19 mills operating across our platform. We've got mills that are still in stages of ramp-up, and we've also got mills where we've adjusted operating schedules. If we run those full adjusted operating schedules, we're moving towards the higher end of the range, but we're expecting that we're going to have to take additional action within those schedules based on demand conditions. That would move us to the lower range. So, it's really hard to pin that exactly. There's a lot of moving parts that go into landing on an exact production number. So that's why we kept the range the same. And really, the high end of the range would be a more stable demand in the second half of the year, a low end of the range would be a continued deterioration that we saw in the second quarter.

<Q – Ben Isaacson >: Got it. Thank you. And then my final question is on not so much channel inventory, but is your view that through the channel inventory has been fully destocked and now it's just weak underlying demand, or are we still going through a process of destocking?

<A – Sean P. McLaren >: Really hard to have visibility on inventories through the channel. The channel is quite long. Not only where it starts at the mill, through transit, through our customers' yards, through the end users. I can only speak to our inventories and we're in a normal range within our normal operating range. I would also – the only other anecdotal comment I might make, Ben, is just the sense of urgency around buying. Lumber has been readily available, and I think buying patterns demonstrate that. So, there's not been an urgency to build inventory. Saying that, people might be being opportunistic to take positions at low prices. But our view would be that there's nothing unusual that we see. Matt, anything to add to that?

<A – Matthew Tobin >: No, I think that's a good summary.

<Q – Ben Isaacson >: Great. Thank you very much. Appreciate it.

<A – Sean P. McLaren >: Thank you, Ben.

OPERATOR
And there are no further questions at this time. I will turn the call back over to Sean for closing remarks.

SEAN P. MCLAREN, PRESIDENT AND CHIEF EXECUTVE OFFICER
Thanks, Julie. 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.

OPERATOR
Ladies and gentlemen, this concludes your conference call for today. You may now disconnect. Thank you.