WEST FRASER TIMBER CO. LTD.
Q3 2024 EARNINGS CONFERENCE CALL
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CORRECTED TRANSCRIPT

OPERATOR
Good morning, ladies and gentlemen, and welcome to the West Fraser Q3 2024 Results Conference Call. At this time, all lines are in listen-only mode. Following the presentation, we will conduct a question-and answer session. [Operator Instructions] This call is being recorded on Thursday, October 24, 2024.

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. 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, Emily. Good morning, everyone, and thank you for joining our third quarter 2024 earnings call. My name is Sean McLaren, President and CEO of West Fraser. And joining me today are Chris Virostek, Senior Vice President and CFO; 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 Q3 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 $62 million of adjusted EBITDA in the third quarter of 2024, representing a 4% margin. Note that this quarter was impacted by a $32 million lumber export duty expense related to the 2022 calendar year. Results were varied across our business again in Q3, with relative strength in our North American Engineered Wood Products segment and stronger-than-expected demand for SPF lumber, offset by continued softness in SYP lumber demand.

In the third quarter, levels of new home construction in the US showed further signs of stabilizing, and the US central bank began to trim its benchmark interest rates, which we believe is supportive of demand for OSB, and to some extent, SPF lumber. That said, mortgage rates remain relatively elevated and still appear to be constraining existing home sales activity and the repair and remodeling segment, which we expect at the margin has a greater relative impact on SYP lumber demand.

On a trailing four-quarter basis, adjusted EBITDA was $630 million, which is an improvement from the $561 million reported at year-end 2023. We've now been able to maintain a trailing four-quarter EBITDA above $500 million throughout this latest downcycle that started back in late 2022, aided by actions we have taken, including acquisitions, strategic initiatives to optimize our mill portfolio, and a relentless focus on cost and margin opportunities.

Finally, in terms of our balance sheet, we have more than $2 billion of total liquidity at quarter-end, which offers us the financial flexibility and strength to support a consistent capital allocation strategy through the cycle.

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 a reminder that we report in US dollars and all my references are to US dollar amounts, unless otherwise indicated.

The Lumber segment posted an adjusted EBITDA loss of $62 million in the third quarter compared to a $51 million adjusted EBITDA loss in the second quarter. Note that the third quarter of 2024 included the previously mentioned $32 million export duty expense that relates to the 2022 calendar year period. Excluding the impact of this prior-period adjustment, Lumber adjusted EBITDA would have been a loss of $30 million, a nearly $20 million improvement from the prior quarter. Our North American EWP segment generated $121 million of adjusted EBITDA in the third quarter versus $308 million in the second quarter. The Pulp & Paper segment generated $2 million of adjusted EBITDA in the third quarter, below the $9 million reported in the second quarter. Finally, in our European business, adjusted EBITDA was $1 million in the third quarter versus $6 million in the second quarter.

Lower prices were the largest factor for the sequential EBITDA decline across our North American Engineered Wood Products and Lumber businesses, which was only partially offset by higher North American OSB shipments.

As noted last quarter, our Lumber business continued to benefit from the actions we took earlier in the year to curtail production at three of our higher-cost mills, essentially replacing that higher-cost volume with production from other lower-cost mills, which is positive for our overall cost structure. In the US South, on a year-to-date basis our SYP shipments are now down more than 10% from 2023 and notably, our Q3 shipments are down nearly 12% versus the prior quarter.

With regard to softwood lumber duties, as noted, we recorded a $32 million duty expense in Q3 related to the finalization of the AR5 rates. West Fraser's AR5 final combined rate, which now forms the cash deposit rate, is approximately 11.9%. This is the cash deposit rate that will be in effect until the US Department of Commerce finalizes AR6, which covers the period of January 1, 2023 to December 31, 2023. If West Fraser’s AR6 finalized CVD rate were to remain unchanged from the AR5 finalized CVD rate, and the AR6 finalized AD rate is the same as West Fraser's AR6 estimated AD rate for that period of 8.84%, West Fraser’s AR6 combined finalized rate would be approximately 15.7% and would take effect next August and be in effect through August of 2026.

Cash flow from operations was $150 million in the third quarter, with our cash balance, net of debt and lease obligations, at a healthy $463 million, similar to the $469 million reported last quarter.

The nominal change in our net cash balance reflects some further release of working capital this quarter, offset by $107 million of capital expenditures and approximately $65 million of cash deployed toward 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 remain steadfast in our strategy and proud of the company we have built with its geographic and product diversification that has allowed us to weather the period of challenging lumber markets we have experienced for more than a year now.

As seen in the right-side figure on slide 7, our North American EWP segment, which is shaded brown, has generated $760 million of Adjusted EBITDA over the last four quarters, a period of challenging cyclical conditions for our other segments.

It is this diversity in our wood building product offering that has allowed us to generate $630 million of Adjusted EBITDA on a consolidated basis over the trailing four quarters, shown in the figure at left, which is more than 2.5 times the level of proforma EBITDA experienced in the down cycle of 2019.

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

We remain encouraged that the Fed's rate hiking cycle is seemingly in the rearview mirror and that rate cuts are now the general market expectation over the near term, which should be supportive of demand for wood building products in the housing and repair and remodeling markets we serve.

Further, West Fraser's overall inflation risks are relatively benign, with costs having stabilized across much of our supply chain. As such, and based on what we can see today, we are confident that we are unlikely to experience meaningful upward cost pressures over the near term.

For our lumber operations in the US South, we continue to make progress refining and optimizing our operations by removing costs and looking for additional margin opportunities. Although market conditions for SYP remain challenging today, the industry supply/demand balance appears to be stabilizing, which is supportive for the industry over the medium term.

As a reminder, between permanent shift reductions, mill closures and indefinite curtailments, we have reduced available capacity by more than 800 MM fbm since 2022, which includes the latest announcement to indefinitely curtail 110 MM fbm at our lumber mill in Lake Butler, Florida. We have also reduced the number of shifts or hours of operations at various lumber mills across our platform.

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.

SPF products realized better demand than we originally expected in Q3 as new housing markets appear to have demonstrated more resilience than repair and remodeling markets, in which we tend to see a greater demand pull for our SYP products.

In our North American EWP business, we continue to ramp production at our Allendale OSB mill, where we are pleased with the cost progression of that facility. We still expect the mill to be among our lowest cost OSB facilities when it achieves its full operating rate.

Given this backdrop, we now expect SPF shipments to slightly exceed the top end of our previous 2024 guidance range of 2.6 to 2.8 BN fbm, while we reiterate our previously reduced 2024 guidance for SYP shipments in the range of 2.5 to 2.7 BN fbm. We also now expect 2024 North American OSB shipments to be closer to the top end of the guidance range of 6.3 to 6.6 BN square feet on a 3/8” basis.

Lastly, as we near year-end, we are narrowing the guidance range for our 2024 capital expenditures to $475 million to $525 million versus our previous guidance range of $450 million to $550 million.

Before I shift to my concluding remarks, I wanted to briefly reflect upon the attractive returns generated for our shareholders. As you can see in the figure at the bottom of slide 9, our shareholders have been rewarded for their patience as we have executed on our plans to grow the business both organically and inorganically.

We have optimized our portfolio through dispositions and/or closures of highly variable or underperforming assets such as the pulp mill divestments we recently completed and we have returned surplus capital through dividends and buybacks. And you should expect us to look to do more of the same on our journey towards creating value for our shareholders.

In conclusion, the downward trend in interest rates looks to be favorable over the near-term, which should be supportive for industry demand. We are taking actions that we expect will make us even stronger when the industry begins its recovery from the current downturn. We will continue to focus on costs and margins in order to build a more resilient business through the cycle, while maintaining the type of financial strength that gives us the flexibility to be able to take advantage of opportunities if and as they arise. We remain optimistic about the longer-term demand prospects for West Fraser and look forward to continuing to build one of the world's leading wood building products companies.

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

OPERATOR
Thank you, ladies and gentlemen. [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 >: Good morning and thank you for taking my question. Sean, perhaps, to start with, can you give some additional color on how the R&R demand is trending as we think about lumber? Did we see any signs of stabilization as the quarter progressed or is it more of the same, and looking for interest rates to drop before things actually start to stabilize?

<A – Sean P. McLaren >: Good morning, Ketan. I'll make a couple of comments here and then maybe ask Matt to fill in what I miss. I would say from our perspective, as the quarter progressed, we have seen a little better demand on the SYP side. Saying that, I think largely the recent price improvement has been related to supply side adjustments that we and others have taken. Our treated customers are our best proxy for that. But with that, maybe I'd ask Matt to add in anything he'd like to.

<A – Matthew Tobin >: I think I agree on the supply adjustments that have created positive pricing environments for us. We believe that there are multiple factors that influence that pricing and R&R demand is one of them, and our long-term view of R&R is unchanged. Historically, it's a GDP-like grower, and we expect that to be the case over the medium to longer term.

<Q – Ketan Mamtora >: Understood. Just maybe one more on this, you talked about in SYP, supply/demand starting to get in better shape, yet SPF you've taken up your volume targets. Any sort of high-level thoughts on why we've not seen a bigger price response in SPF given that new residential is holding up better relative to R&R?

<A – Sean P. McLaren >: Yeah, there's a lot of moving parts Ketan, to what customers do and the products they choose to buy or not to buy. I would say to look beyond the benchmark pricing, you can see there was quite a spread early on in the quarter between SPF and SYP, that's corrected. But if you go to the wider widths, 2x6, 2x8, those spreads continue to be quite dramatic, better for SPF. So, I think combined with more curtailments on the SPF side, the supply/demand balances is in a little different spot there than SYP, and that's why there's more volume coming from us in SPF.

<Q – Ketan Mamtora >: Got it. And just one last question from me. Chris, as you think about CapEx for next year, without getting into specific projects, how would you have us think about it at this time? Would it be similar to 2024, lower, higher? Just at a high level. Thank you.

<A – Chris Virostek >: Yeah, and we'll have some guidance out when we release year-end around where we think the CapEx range is going to be next year. I'd say if you think about the last couple of years, we've had quite a bit of projects underway and we're quite happy to be bringing those projects to completion here, just as maybe we're reaching an inflection point on the demand side and feel that will really prepare us well for the backside of this cycle when it improves. I'd say a few things: Henderson will be wrapping up, that's been a big project, been a big part of our CapEx here over the last couple of years. I don't think we're quite ready to start something as big as Henderson again in the near term. Here, we do have more opportunities, but I'd say we're still considering those things. So, I think where we've been the last couple of years is a good place to start. But bias is probably a little bit to the downside on that number going forward, just because we're bringing so much stuff to completion here over the next couple of quarters. Which we're actually really excited about, about wrapping up some of these projects that we think will serve us well going forward.

<Q – Ketan Mamtora >: That's very helpful. I appreciate it. Good luck. Thank you.

<A – Chris Virostek >: Thanks.

<A – Sean P. McLaren >: Thank you.

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

<Q – Sean Steuart >: Thanks. Good morning, everyone. Couple of questions. I want to first touch on capacity closures in the South. And you attributed some of the recent price momentum for Southern yellow pine lumber to the capacity shut announcements. A lot's been announced, it feels like a lot of that won't actually start to hit the market until towards the end of this year and into early 2025. So, wondering if you can give some context on how much of the initial price response is actual markets getting tighter or speculative buying ahead of these supply reductions actually hitting the market?

<A – Sean P. McLaren >: Yeah, sure, Sean, good morning. I guess it's hard for me to speak for across the whole industry, but I will speak for us. We took action early in the year, and as things really deteriorated even further through Q2, we took further action. And I would say that the impact of that action was fairly quick. The inventories are relatively small in a southern mill compared to what you'd see in a northern mill, or areas where there are bigger log and process inventories. So, our customer demand patterns, speaking for West Fraser, probably are a little better but not materially different. So the improvement we've seen in our business has really been related to the actions we've taken on the supply side.

<A – Chris Virostek >: I think, Sean, when you're unwinding all the inventory at a mill in the north and the supply chain, the length of it, and the logging season and so forth, it's probably a matter of months to see the impact as you unwind everything. In the South, when we think about our recent experience around the facilities that we've closed in the South, it's a matter of days or weeks until the inventory is exhausted.

<Q – Sean Steuart >: Got it. So, Lake Butler would've sold all the inventory off at this point?

<A – Sean P. McLaren >: Correct. Yeah. Very quickly.

<Q – Sean Steuart >: Thank you for that. Second question is on softwood lumber trade file. We've seen a competitor borrow against receivables on the duty file. You guys don't need the money, but wondering if you can comment on those types of opportunities and any updated thoughts on a path forward here? Do we just need to wait for elections to play out before we get any potential momentum towards this? Any updated thoughts on the trade file?

<A – Chris Virostek >: Maybe I'll take the liquidity side of it and Sean can deal with kind of path forward on it. Sean, I would say, when we think about where we are from a liquidity standpoint, I would agree we don't need to kind of raise the money through some sort of duty transaction. We repaid our notes a couple of weeks ago. So, our gross debt is down to $200 million. We just got an upgrade this week from Moody's, upgraded another notch. So, I feel very good about the investment grade rating that we have and our ability to access capital markets if there was something out there compelling for us to do. So, I think for us, our primary sources of financing would be the traditional sources of financing that we would tap into. So, I think on liquidity front, I think we're very well-covered off from that standpoint. And, Sean, maybe you want to comment on path forward here?

<A – Sean P. McLaren >: Yeah, sure. Maybe a couple of comments on path forward. Again, from my perspective, our perspective, really not a lot new to report. As everybody on this call knows, West Fraser's always been supportive of some type of managed trade. Saying that, there's a lot of moving parts in the political arena, and this is a deal between two governments. So, really tough to see how something happens in the short term, but I guess you never know. I would say in West Fraser, our focus is on controlling what we can, which is our costs and how that plays into any duty rates that we're going to be exposed to, and the pieces that we can control, and continuing to litigate to get a refund of money that is owed to us.

<Q – Sean Steuart >: Understood. Thanks for that detail. That's all I have for now. Thanks, guys.

OPERATOR
And the next question comes from Ben Isaacson from Scotiabank. Please go ahead.

<Q – Ben Isaacson>: Thank you very much. And good morning, everyone. First question, Sean. Can you talk about your order book for SYP, SPF and OSB? What should it be at this time of the year? And is it evolving from where it's been over the summer?

<A – Sean P. McLaren >: Good morning, Ben. I'll just make a quick comment and maybe Matt can add, but in lumber, our order book currently is normal, and it typically doesn't materially change seasonally. It generally is not that long and it's a cash market and it moves around a little bit, but not a great extent. And nothing unusual that I would say today. Matt, anything to add to that?

<A – Matthew Tobin >: No. I think you covered it.

<Q – Ben Isaacson >: Okay. Thank you for that. Moving on to the supply curtailments that we've seen in the industry. So, I understand we've seen about roughly 5 BN fbm and most of that looks like it's going to be structural. Do you think that the supply side has now done enough, and we really are just waiting for demand to normalize? Or do you think that there's still more curtailments needed to get down to a steady state of demand?

<A – Sean P. McLaren >: Again, it's really tough to have visibility, because it really depends on what future demand is going to be. I can only speak to the actions we've taken, and just as, you know I said it in my comments, but 800 MM fbm since 2022 that we have taken action on. And what that has done, frankly, has brought us to a point where we're essentially in balance with what our customers are currently buying and their demand. If that changes, we'll change. But I think we feel like the moves we've made, we're well-positioned to build from here as demand gets better.

<Q – Ben Isaacson >: Fair enough. And then just very last question for me on the OSB side. You mentioned in the press release that curtailments at the mills have created chip shortages for pulp producers, which has increased demand tension for pulp logs and that's impacting OSB margins. Can you talk about where we are on that kind of path? Are pulp logs still going to go higher in your view over the next couple of years, or is that starting to stabilize and when OSB prices get back to their normal run rate we should get back to normal margins?

<A – Sean P. McLaren >: Yeah, Ben, I'd say it's very localized depending on the drain, depending on where the pulp mills are located, very short term. Our view would be that longer term, our OSB business and pulpwood is well-positioned. There will be more production over the long-term shifting to SYP, which will create more chips, which will in combination with the number of pulp mill closures that have happened in the US South this year, we believe will mean there will be a favorable trend to wood costs long term versus any short-term spikes we might see.

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

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

<Q – Hamir Patel >: Hi. Good morning. Sean, when you think of the closures announced in the South over the past 12 months, it looks like they totaled maybe over 1.5 BN fbm. How much of that do you think is actually being dismantled versus just sort of being in a cold, idle state that perhaps would come back in a stronger market?

<A – Sean P. McLaren >: Good morning, Hamir. Again, hard for me to comment on what everybody else is doing. I'll just comment on West Fraser. So, we've had four Southern mills; two have been permanent, two have been indefinite. I'd say it's sort of a nuance, in my view. All that means, the difference in West Fraser means, is that we don't immediately begin taking down the mill. And a good proxy for us is, I'm looking back a few years now, but you go back to 2008, we announced Folkston, Citronelle, McDavid. Folkston and Citronelle were dismantled after about a year or so, they were permanent closures. McDavid, we left as indefinite, but it was five years before that mill restarted. These are not short term, month-to-month, quarter-to-quarter decisions. There needs to be adequate wood supply, adequate lumber market, and a reinvestment plan that makes that mill competitive at the bottom of the market. There's a reason a mill shuts down- because it's not competitive. We would not restart a mill till we had a plan to make it competitive, and that is an uncertain time. There are a lot of factors that go into that before we make that decision. In terms of what others are doing, hard for me to comment on that.

<Q – Hamir Patel >: Yeah, fair enough. That's helpful. And Sean, I just want to ask on the European Panels business. Looks like it's kind of basically gone to zero over the past year. I know historically that used to be kind of the steadiest part of the old Norbord business. What do you think it's going to take to restore profitability in Europe?

<A – Sean P. McLaren >: It continues to be slow over there. I would say in Q3 for us, we had a major shutdown at our MDF facility in Scotland, that was planned for some time, that impacted results. On the OSB side, I would say we've seen a little bit of price improvement, but we've seen more volume improvement. So, I think it's going to take just general economic improvement in Europe for things to get back to maybe normal or where they were previously. We feel quite good about our position. As we've got to know the European business at West Fraser, the investments Norbord made, and we continued on, really have put those plants in a good place in a tough market.

<Q – Hamir Patel >: Great. Thanks, Sean. That's all I had. I'll turn over.

OPERATOR
[Operator Instructions] Your next question comes from Matthew McKellar from RBC Capital Markets. Please go ahead.

<Q – Matthew McKellar >: Good morning. Thanks for taking the questions. I'd like to start by asking about your conversations with customers in the Lumber business. And specifically, if you're hearing a greater desire from the big box home centers to secure larger volumes of lumber under contract for 2025.

<A – Matthew Tobin >: I think our customer demand, where we fill our customer demand is relative to what they're looking for. We're going through what I would say, the season right now is 2025 planning, but those volumes can adjust as the markets adjust and shift over time. So, I think from a customer standpoint, they see the shortage of homes long term, the strong fundamentals that we see. But still uncertainty around affordability, but certainly doing that planning with our customers to ensure they're supplied over 2025.

<Q – Matthew McKellar >: Okay, thank you. Maybe next on lumber operations in the US South. You mentioned looking for some additional cost savings and margin opportunities. Can you just provide a bit more color around what kind of opportunities and projects you're pursuing in the South right now?

<A – Sean P. McLaren >: Yeah. Good morning, Matthew. I think really a lot of stuff will be a continuation of what we've talked about previously. We've taken out a lot of high-cost volume with the four mills we've curtailed. And as we've brought on volume, it's going to modernize plants. Dudley, Henderson will be coming on mid-next year, other projects that we've completed that are all related to margin improvement. So, it's better recovery, better grade, better productivity, better working conditions that improve our turnover, a number of things that we've done. We've got a whole series of smaller and larger projects that have been in motion for some time. We've been at this for a while, and it'll be a continuation of that which we expect will continue to make our Southern business more competitive.

<Q – Matthew McKellar >: Great. Thanks very much. And then last one for me, just a quick cleanup on Cariboo. It looks like you expect to be down for four weeks in the quarter versus maybe two weeks previously. Can you talk about what drove the change there?

<A – Sean P. McLaren >: Yeah. Absolutely, Matthew. So Cariboo, it's been 18 months, I think, since our last major. So, we had a lot of work lined up for our major shutdown, we expected it to be a full two weeks. We had an additional two projects that we wanted to complete. As well as our fiber supply situation with all the sawmill curtailments here in British Columbia, we need to be able to make sure we've got adequate fiber supply to get through the coldest months. So that additional two weeks, we'll finish those two additional projects as well as get the mill through the coldest part of the season. And we feel good about next year's fiber supply, we wanted to make sure we didn't have any problems when it was cold.

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

<A – Sean P. McLaren >: Thank you.

OPERATOR
At this time, we have no other questions. Please proceed.

SEAN P. MCLAREN, PRESIDENT AND CHIEF EXECUTVE OFFICER
Thanks, Emily. 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 the conference. You may now disconnect your lines.