WEST FRASER TIMBER CO. LTD.
Q4 2023 EARNINGS CONFERENCE CALL
FEBRUARY 15, 2024 - 11:30AM ET
CORRECTED TRANSCRIPT

OPERATOR
Good morning, ladies and gentlemen. Welcome to West Fraser's Fourth Quarter 2023 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. Such statements involve certain risks, uncertainties and assumptions that may cause actual results 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 was included both in the accompanying webcast presentation and in our 2023 Annual MD&A and Annual Information Form, which can be accessed on the West Fraser's website or through SEDAR+ for Canadian investors and EDGAR for United States investors.
I will now hand the call over to Mr. Sean McLaren. Please go ahead.

SEAN P. MCLAREN, PRESIDENT AND CHIEF EXECUTVE OFFICER
Thank you, Jenny. Good morning and thank you for joining our fourth quarter 2023 earnings call. I am Sean McLaren, President & Chief Executive Officer of West Fraser. Joining me today 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.

I will begin today's comments with a brief overview of West Fraser's Q4 and fiscal 2023 financial results and then pass the call to Chris for additional comments before I share some thoughts on our outlook and make some concluding remarks.

West Fraser generated $97 million of adjusted EBITDA in the fourth quarter of 2023 as we continued to experience mixed results across our business segments, with strength in our North American Engineered Wood business partially offset by continued soft demand for our North American Lumber products.

While new home construction in the US remained resilient through the quarter, supporting demand for OSB, relatively high mortgage rates continued to constrain existing home sales activity, which tempered repair and remodeling spending and lumber demand.

For full-year 2023, we generated $561 million of adjusted EBITDA, representing a 9% margin. On a proforma basis with the inclusion of Norbord, our 2023 EBITDA was approximately $320 million higher than that of the last down cycle 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.

Consistent with our strategy, we have remained disciplined in our approach to capital allocation and have preserved capital in the event that we have a down market like that which we are currently experiencing. It is this discipline that has positioned us to be able to execute on our plans and invest in and improve our assets through all market conditions. As we look ahead, our balance sheet remains strong and continues to offer significant financial flexibility, which is a key priority of 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 negative $51 million of adjusted EBITDA, declining from positive $44 million in the third quarter, a period that had benefited from a $62 million export duty recovery. Our North American EWP segment generated $143 million of adjusted EBITDA, down from $289 million in the prior quarter. The Pulp and Paper segment generated $2 million of adjusted EBITDA in the fourth quarter, rebounding from the negative $12 million in the prior quarter. While in Europe, adjusted EBITDA was $3 million in the fourth quarter versus $4 million in the third quarter. Lower prices were the largest driver for the sequential EBITDA declines across our North American Lumber and Engineered Wood Products businesses.

Cash flow from operations was $96 million in the fourth quarter, with our cash balance net of debt, still at a healthy $361 million versus $663 million last quarter. This quarter we invested $157 million back into the business through capital expenditures, repurchased $104 million of our shares, returned $25 million to shareholders through dividends, and completed the $100 million acquisition of Spray Lake Sawmills in Cochrane, Alberta.

In terms of our outlook for 2024, we are providing initial operational guidance for the year as detailed in our earnings release, including our expectations for key product shipments as well as our planned capital expenditures, which are in the range of $450 million to $550 million.

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

SEAN P. MCLAREN, PRESIDENT AND CHIEF EXECUTVE OFFICER
Thank you, Chris. While difficult to predict, we expect our business will continue to experience challenges ranging from the risk of resurgence of input cost inflation and higher mortgage rates, ongoing labor constraints, as well as demand challenges that may result from housing affordability constraints. Having said that, we are encouraged by the fact that so far this year, mortgage rates in the US are well off the highs the industry experienced late in 2023. Further, inflationary cost pressures have continued to ease across much of our supply chain. At least over the near term, we expect this to continue.

Regarding market fundamentals, I'd like to share with you slide 7, which has been updated to reflect the latest FEA estimates for 2023. This exhibit highlights the challenges that the North American lumber industry has faced and continues to face adding net new supply. We have now been through a 10-year period in which total North American lumber supply has been essentially flat, with shrinking supply in British Columbia offsetting the gains in the US South, and this has occurred during a number of strong up-years for lumber demand and pricing.

We've spoken about the many constraints the lumber industry faces when it comes to adding capacity, and the first and foremost of these is accessibility and availability of economic fiber. While the US South remains a critical area of lumber supply growth and a key region for West Fraser's growth strategy, it's important to note that this region's economic fiber supply, cost profile and access to end use markets for sawmill residuals are not homogeneous and that all of these factors are headwinds to growth.

As many of you are aware, the complexity of the operating environment in British Columbia continues to take its toll on sawmilling capacity in the province. Rapid policy change and uncertainty regarding decision-making on the land base have constrained available timber supply, resulting in a lack of access to economically viable fiber.

Our recent decision to close Fraser Lake sawmill, one of West Fraser's founding mills, after having reduced its capacity to a single shift in 2022 to match available timber supply, reflects these realities. Without significant policy change in British Columbia, the forest sector in BC is on a path to further contraction.

Lastly, and of additional concern today, unusually warm weather in Western Canada has hampered logging activity so far this winter, which has limited the accumulation of log inventories at some of our mills and has the potential to constrain our ability to manufacture and ship SPF lumber. This is something we are monitoring closely.

In our view, challenges to meaningful supply additions in the North American lumber industry will persist for the foreseeable future, and as such we remain optimistic about our portfolio of assets, our capital allocation strategy, and our long-term prospects for our lumber business.

When we acquired Norbord in 2021, a key strategic rationale for the deal was adding a measure of diversification to help us manage through market cycles. The benefits of this product diversity were front and center in 2023.

Over the last four quarters, our North American EWP business generated nearly $600 million of adjusted EBITDA, as OSB has lesser reliance than lumber on demand from the repair and remodeling segment, plus there's generally a much lower level of OSB demand met by competing imports.

Our ongoing strategy to optimize our portfolio remains an important focus of the organization. The next slide outlines a number of key steps we have taken in recent years to refine our portfolio, as management's focus is on a continuous improvement of the business and not just growth for growth's sake.

More recently we announced the sale of our three pulp mills, which we expect will help reduce variability of future EBITDA, as well as help us concentrate more of our resources on being the premier wood building products company in North America.

We completed the Hinton pulp sale earlier this month and continue to expect the sale of the BCTMP mills to close early in 2024.

I'd like to briefly shift my comments to our balance sheet and liquidity, the strength of which we believe provides us with great flexibility and a competitive advantage in the current market environment.

With our prudent approach to cash management, particularly in a difficult 2023, we were able to balance capital investment in the business, execute on acquisitive growth and distribute significant capital to our shareholders. Entering 2024, we held $900 million of cash and equivalents with nearly $2 billion of available liquidity. Of note, the limited change in our cash balance from a year ago, which is only lower by about $260 million, is nearly equal to the

$100 million of dividends paid and $129 million of shares repurchased last year. As per our Q4 disclosures, we have continued to buy back shares early in Q1 with the view that they are trading below our estimate of intrinsic value.

We also plan to invest $450 million to $550 million of capital in 2024, as we believe that countercyclical investing will allow us to exit the current market downturn better off than when we entered it.

The next slide shows a longer-term track record of our balanced capital allocation strategy. Here you can see our focus has been on both reinvesting in the business, which has accounted for approximately 30% of our cash flow from operations since the start of 2016, as well as returning capital to our shareholders, which has accounted for approximately 50% of our cash flow over that same period.

The culmination of supportive industry fundamentals and our execution, performance and focus on returning capital to shareholders are reflected in the attractive returns generated for West Fraser shareholders over a number of cycles. With total annualized return approaching 10% since the beginning of 2006, which includes share price appreciation and reinvested dividends, we remain proud of what the West Fraser team has been able to accomplish.

In closing, while demand markets were challenging in 2023 and there are near-term uncertainties across our business, we remain confident in our people, processes and the foundation we have built. We have been through many industry cycles before and we have the talent, assets and financial flexibility to handle both the challenges and opportunities that lie ahead. As always, we remain optimistic about the continued growth and 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. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] Your first question is from Ben Isaacson from Scotiabank. Please ask your question.

<Q – Ben Isaacson >: Thank you very much and good morning. Good to be on the call. Your guidance on OSB is to put more volume into the market as Allendale ramps. Does the market need that product right now? And if not, will you build inventory or will you slow the ramp?

<A – Sean P. McLaren >: Good morning, Ben. Just a couple of comments on that. When we look at our OSB business and the ramp-up, which is largely related to our ramp-up at Allendale, it really is improving our cost position, and our sales group and marketing team has done a good job of creating new opportunities for us to move that product into our key customers. Our intention is not to build inventory, it's to bring down our overall cost structure of our OSB business and work with our customers to place that product.

<Q – Ben Isaacson >: Great. Thank you. And then just looking to interpret the R&R activity forecast on slide 24, it shows that spending is going down to the mid-$400 billion in 2024. I'm just curious, with commodity prices having come down, does that mean that activity levels will stay the same, but just the absolute spend will be lower or is actual activity supposed to fall as well?

<A – Sean P. McLaren >: I'll maybe make a couple of comments and ask Matt Tobin, our Senior Vice President, Sales and Marketing, to pick up what I miss here. But I can only really speak to our customers and what we're seeing, and frankly, we're seeing stability year-over-year. We think longer-term that as we have existing home sales pick up and new home construction continue to grow, R&R will steadily improve. Saying that, it's kind of hard to unpack a lot of what goes into that number. Matt, would you like to add anything to that?

<A – Matthew Vincent Tobin > I think it's been a stable business for us. And I think historically, it's been a GDP-like grower. We expect that to continue over the medium to long-term and with the age of the housing stock, we believe R&R is going to continue to be a long-term outlook for our products.

<Q – Ben Isaacson >: Great. And then just last one for me. You mentioned at the start of the call some issues with respect to weather in BC and how that could impact availability of logs. I didn't appreciate that. Can you just give some more details around what that is and what the risks are? Thank you.

<A – Sean P. McLaren >: Yeah. Sure, Ben. We wanted to flag this issue. I would comment that the logging season has not finished yet. We typically will bring logs in, in Western Canada right through to late March. Our teams are working hard to bring in as much wood as we can. Saying that, the weather has been warmer than normal, which has impacted ground conditions, so when ground conditions and road conditions are soft, our ability to log right through the season is impacted and that's what's happened. We're behind at a few spots, not everywhere, but a few spots on our target inventories. It’s hard to predict what the impact is but we want to flag it as a risk to Q2.

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

OPERATOR
Thank you. Your next question is from Ketan Mamtora from BMO Capital Markets. Please ask your question.

<Q – Ketan Mamtora >: Thank you. First question, can you give us some sense on just channel inventories in both lumber and North America OSB, as we head into the busy spring season?

<A – Sean P. McLaren >: Good morning, Ketan. I'll make a couple of comments, then Matt can weigh in. Again, visibility to the channel inventories, that's difficult. I can only speak to our inventories, which are normal, and our customer buying patterns appear to be buying what they need because the products are readily available. It’s hard for me to speak to what total inventories are across the system other than we wouldn't really flag anything unusual. I don't know, Matt, would you…?

<A – Matthew Vincent Tobin > I think the information on channel inventories is anecdotal at best and transportation has been fluid, product’s available and we're happy with our position.

<Q – Ketan Mamtora >: Okay. Understood. Got it. And then, one more question on Lumber. You talked about R&R demand being steady and we've heard that consistently from some of the other peers as well. New residential demand has held up reasonably okay, given where rates were, yet lumber prices have been quite challenged for the last quarter or so. I'm just curious, as we kind of move through the next couple of quarters, what will help drive lumber prices to kind of a reasonable level where there's sort of EBITDA profitability? Is it demand that needs to get better? Are there things on the supply side that need to get better? How do you think about it?

<A – Sean P. McLaren >: Thank you, Ketan. Maybe a couple of comments there. Our medium, longer-term view on demand is it will be better so we're bullish. Matt touched on the age of the housing stock, what that will do to R&R, housing continuing to pick up as rates come down. Saying that, on the supply side, as everybody is aware, there's been announcements on the supply side, but things take a long time to work their way through the system. Our Fraser Lake mill is a good example where we made that announcement in mid-January, but product will still ship from there right through Q2. Some of the supply things that are in motion are going to take some time to work its way out. To answer your question, it's both, but hard to predict when that all plays out.

<Q – Ketan Mamtora >: Got it. Now, that's helpful perspective. I'll jump back in the queue. Good luck.

<A – Sean P. McLaren >: Thank you.

OPERATOR
Thank you. Your next question is from Hamir Patel from CIBC. Please ask your question.

<Q – Hamir Patel >: Hi. Good morning. Sean, I wanted to get your thoughts on the BC Land Act changes that are under consideration in the province and what impact do you think that might have on existing tenures and your future investments in the province?

<A – Sean P. McLaren >: Good morning, Hamir. One thing I might highlight is the Forest Act was first changed in 2019 so we've been operating under joint decision-making in British Columbia for a number of years now. Will additional regulation and additional kind of joint decision-making be helpful? Probably not. But saying that, our teams are already well into this, working through it. I wouldn't expect materially different than what we're already experiencing, which is – which needs to improve. So that's one thing.

The second thing I might highlight relative to your question on investment is, BC is where the company was built, where it was founded, we've got great people and assets that are competitive. Saying that, access to timber is the focus, and for investment, we need that. Our company now is well positioned outside of the province. Our BC team is important to us, it's important to the company. We're working hard on access and that will determine what investment we do.

<Q – Hamir Patel >: Okay, great. Great. Thanks, Sean. That's helpful. And just turning to the European business, can you give us a sense as to how pricing levels there for OSB compared to North America? And are there perhaps some opportunities to bring product from Europe to North America?

<A – Sean P. McLaren >: Thank you, Hamir. First off, what I would say about Europe is things are slow over there. Pricing is down, but saying that, we have a good business over there: strong team, well-capitalized asset and a good cost position. We're focused on Europe and from time to time we do look at opportunities in North America. Pricing is higher, but there's a long lead time to do something like that. It's not as quick as, this is what the spot market is and let's move product. So, we have typically focused our efforts in Europe and opportunistically looked over to North America, but it's not a huge priority for us.

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

OPERATOR
Thank you. [Operator Instructions] Your next question is from Sean Steuart from TD Securities. Please ask your question.

<Q – Sean Steuart >: Thanks. Good morning, everyone. Sean, a question on the CapEx plan…one of your competitors has suggested that capital costs for discretionary sawmill projects have increased to an extent that returns are compromised, and it's contributed to a lower CapEx budget for that company. Be interested in your perspective on long-term sawmill IRRs, and given your commitment to continue with aggressive CapEx in 2024?

<A – Sean P. McLaren >: Good morning, Sean. I'll speak to our guidance for 2024. A lot of that capital is projects that are in motion and West Fraser for a number of years has been modernizing our portfolio in the US. A big piece of that is our Henderson project which is a new mill on our site in Henderson, Texas, that supports our whole integrated platform, and is one of the best regions to be operating in. That project has been in motion now for the better part of a year and we're not seeing that cost inflation. We're on budget on that project and excited about the return and what it's going to do for our platform.

Saying that, when we think about next projects coming on, like anything, we always look to what makes the company stronger, what achieves our hurdle rates. I don't know if there's been material inflation over where we were a year ago or 18 months ago. Saying that, I know in West Fraser, our focus is on delivering what we have in motion and that's our priority today, and new projects will be based on our readiness to take them on, as well as the returns on those projects.

<Q – Sean Steuart >: Okay. Thanks for that detail. Chris, I'm hoping you can give us some context on this, but in the Pulp and Paper segment results for Q4, can you give us a sense of what the contribution was, or the losses were, for Hinton and the mechanical pulp mills just as we think about run rates for that segment going forward?

<A – Chris Virostek >: Sean, that's actually called out if you take a look at the year-end MD&A, we've got the full-year contribution from those facilities there. I think similar data was there in the Q3 as well. It's there to be derived from those two documents that are out there. As we've said before, there's five assets in that segment, it's not proportionate that three of those five make up 60%. Those three make up the lion's share of the results in those facilities, because the other two are both 50% joint ventures. The majority of what goes on in the Pulp and Paper segment, positive or negative, has typically been contributed by those three assets.

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

<A – Chris Virostek > Thanks, Sean.

OPERATOR
Thank you. Ladies and gentlemen, [Operator Instructions] There are no more further questions at this time. I will now hand the call back to Mr. Sean McLaren for the closing remarks.

SEAN P. MCLAREN, PRESIDENT AND CHIEF EXECUTVE OFFICER
Thanks, Jenny. 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. Ladies and gentlemen, the conference has now ended. Thank you all for joining. You may all disconnect.