WEST FRASER TIMBER CO. LTD.
Q1 2023 EARNINGS CONFERENCE CALL
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CORRECTED TRANSCRIPT

OPERATOR
Good morning, ladies and gentlemen. Welcome to West Fraser Q1 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 laws. Such statements involve certain risks, uncertainties, and assumptions, because West Fraser's actual or future results and performance could 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 in our 2022 Annual MD&A, and Annual Information Form, which can be accessed on West Fraser's websites or through SEDAR for Canadian investors and EDGAR for United States investors.

Thank you, Mr. Chris Virostek, you may begin your conference.

CHRIS VIROSTEK, CHIEF FINANCIAL OFFICER & SENIOR VICE PRESIDENT, FINANCE
Thank you, Julie. Good morning, everyone, and thank you for joining our first quarter 2023 earnings call. I'm Chris Virostek, Chief Financial Officer of West Fraser. And joining me today are Ray Ferris, our President and CEO, and Matt Tobin, our Vice President of Sales and Marketing, and other members of the executive team.

I'll begin with a brief overview of West Fraser's Q1 2023 financial results, and then pass the call to Ray who will give an update on the business as well as provide a few concluding remarks before we transition the call to Q&A. Our comments today will be brief as we've recently provided a company update at last week's Annual General Meeting. As a reminder, we report in U.S. dollars, and all references today will be U.S. dollar amounts unless otherwise indicated.

West Fraser generated $58 million of adjusted EBITDA in the first quarter. This was largely comparable to the $70 million dollars of adjusted EBITDA generated in the fourth quarter, which included a one-time $7 million benefit of carbon credits from our EU business, as well as a $14 million insurance recovery from our North American Engineered Wood business. Our North American EWP segment generated $31 million dollars of adjusted EBITDA, down from $109 million in the prior quarter. This Q1 result included a $15 million dollar inventory write down while the prior quarter had benefited from the $14 million dollar insurance recovery just noted.

The Lumber segment had zero adjusted EBITDA, improving from negative $77 million in the prior quarter. You'll recall that prior quarter included a $39 million inventory write down recognized as lumber prices reached a near term low at the end of last year.

The pulp & paper segment generated $7 million of adjusted EBITDA in the first quarter versus $15 million in the prior quarter. While in Europe, adjusted EBITDA was $20 million in the first quarter, down from $30 million in the fourth quarter, a period that had included a one-time $7 million dollar benefit from the sale of carbon credits. Price decreases were the largest driver of the sequential EBITDA declines across our Lumber and North American EWP businesses.

Cash from operations was a use of $198 million for the quarter, though our cash position remained very healthy. Cash, net of debt, decreased to $309 million in the first quarter from $625 million last quarter, as we paid $25 million of dividends, spent nearly $100 million on capital expenditures, and invested seasonally more than $200 million in our working capital build.

In terms of our outlook for 2023, we are reiterating our operational guidance for the year as detailed in our earnings release, including ranges for key product shipments and our planned capital expenditure.

Capital allocation is an important part of how we run our business every day at West Fraser. Our capital allocation strategy is a durable, three-pronged approach where we reinvest in the business, maintain financial flexibility that allows us to pursue inorganic and organic strategic growth opportunities, and return excess capital to shareholders. The strategy has served us well over the years and frankly, we think it is this balanced and prudent approach that has put us in a position of strength today despite softer market conditions.

Let's dig into the specifics for a moment. Since 2016, a period that has seen both up and down cycles, we have generated more than $8.5 billion of cash from operations. Nearly one-third of that cash flow has been invested in the business through capital projects and acquisitive growth, approximately 10% has been allocated to repay debt and build a cash buffer, and more than 50% or nearly $4.5 billion has been returned to shareholders through share buybacks and dividends.

Slide 9 provides a snapshot of a few of our key balance sheet and liquidity metrics, further highlighting the success of our patient and balanced approach with capital. Note, West Fraser is rated investment grade by three key ratings agencies. We also continue to have strong liquidity with combined cash and bank lines approaching $2 billion dollars, and our debt ratios remain well within the bounds of our lending covenants.

As we look ahead, West Fraser remains committed to investing in the business and we have reiterated guidance of $500 million to $600 million of capital expenditures in 2023, including an estimated $100 million dollars that we plan to spend on a sawmill modernization in Henderson, Texas.

With that overview, I will now pass the call over to Ray.

RAYMOND FERRIS, CEO, PRESIDENT & CORPORATE DIRECTOR

Thanks, Chris. As mentioned, in Q1 2023, we experienced soft demand, particularly in North America, as the rapid increase in mortgage rates in 2022 continued to have an impact on overall consumption. I will note that as the first quarter unfolded, we did see many of our production costs come down and the trajectory of our demand improve. This demand improvement was particularly true for our U.S. South Lumber and OSB segments, which allowed us to return to a more normalized operating environment when compared to significant production downtime we took in the fourth quarter.

In Western Canada, and specifically in B.C., where we have an integrated operating strategy, our business decisions can be more complex as we evaluate profitability in the aggregate across our lumber, pulp, plywood, and panels segments, while also trying to balance short-term decisions with the long-term considerations of preserving key aspects of our manufacturing, fiber procurement, and staff ecosystems. As a result, our overall B.C. business in the aggregate was profitable in the first quarter due to our downstream integration as mentioned with MDF, plywood, and pulp.

In terms of our more important longer-term strategy, while the first quarter SPF production was flat to slightly up in Q4, the historic downward trend in our B.C. production has been clear. From 2018 through 2022, our West Fraser B.C. lumber production declined by more than 40%, representing a reduction of nearly 1 billion board feet through that period, reflecting our continued adjustment to available economic fiber and customer demand.

With ongoing government policies such as old growth deferrals, species at risk, and other potential further reductions due to policy, we expect annual allowable cuts to continue to be constrained. We reiterate our optimism about our U.S. growth strategy for the long-term aspects and prospects for our lumber business.

With respect to outlook, the wood building products industry may continue to face challenges ranging from further rate hikes by central banks, ongoing labor constraints, and the potential for muted product demand due to the apparent constraints that consumers face with regard to housing affordability, at least in the short term. That said, inflationary cost pressures have moderated across much of our supply chain for the raw materials such as energy, resins, chemicals, and fiber, and we believe this trend will continue through the remainder of 2023.

On the demand front, we are seeing some positive signs in the spring building season, much to do with the public homebuilder commentary that is in the marketplace. And the upward trend in mortgage rates that we experienced much of last year appears to be slowing or easing. Both of these factors are helpful for driving new home construction and consumption of our wood building products.

In closing, while near-term uncertainties exist across the industry and our business, we remain confident in the foundation we have built. We have been through these cycles before and it is not by accident that we have the talent, assets, and the financial flexibility to position us well to handle both the challenges and the opportunities that lie ahead.

We have been disciplined our approach to capital allocation and to preserve capital in the event that we have a down market like the one we are currently experiencing. It is this discipline that has positioned us to be able to execute on our strategy, to invest in and improve our assets through all market conditions, as well as be ready to take advantage of growth opportunities, if and when they arise.

As we look ahead, we'll continue to focus on our core strengths of being low cost, remain true to our capital allocation strategy, and we look forward to a future with a growth in demand for the types of sustainable and renewable wood products for which West Fraser is known.

With that, I'll turn the call back to the operator and we'll take Q&A. Thank you.

OPERATOR
Thank you. [Operator Instructions] Your first question comes from Ketan Mamtora from BMO. Please go ahead.

<Q – Ketan Mamtora>: Thank you very much. First question, I was hoping you can provide some additional colour around timing of Allendale restart. I noticed that the release from last evening still says that it's a potential restart. Are there any indicators that you are watching or we should be watching that could have an impact on when the mill could start up? I know you've talked about potential at the end of, sort of, Q2.

<A – Ray Ferris>: Well, good morning, Ketan, and thanks for that. So, yeah, our past guidance on that, I think remains unchanged. We're quite pleased with the progress that the team has made there, and we expect to start as we talked about. And I think what we said is, really at the end of Q2, early-Q3, is kind of – we're still on that same timeframe.

<Q – Ketan Mamtora>: Understood. Okay. No, that's helpful. And then switching to capital allocation, you guys renewed the NCIB late February, but you haven't repurchased any shares since then. Was there any kind of blackout periods or anything else that I should be, or that we should be thinking about in terms of why you didn't repurchase shares?

<A – Chris Virostek>: Thanks for the question, Ketan. Look, I think as we think about it, that program lasts for 12 months. And what we're able to uptake in the program this year is somewhat smaller in terms of the share count than it's been historically, just because we've reduced the share count so much in the last couple of years. And so, we'll look for those opportunities to step in when it makes sense for us. We consider all kinds of things: the macro backdrop, our liquidity, how things are trading. And so, we've been quite disciplined, I think, about how we execute that NCIB over the last couple of years and we'll continue to do so. And the pace of those purchases can ebb and flow during the year. The renewal was the end of February, so really not that much time has passed since we renewed it at the end of February. So, I think that's about all we would say about that.

<Q – Ketan Mamtora>: Got it, now that's helpful perspective. So, just a final question before I turn it over. The 2023 in capex, Chris, can you talk a little bit about what flexibility you have to either dial up or dial down depending on market conditions? And let's say, if back half of the year turns out to be kind of softer, what flexibility do you have there? Thank you.

<A – Ray Ferris>: So, Chris and I are looking at each other deciding who's going to answer this one. So – and Chris can jump in here. Look, I think we have tremendous flexibility to go up or down based on our balance sheet and the capability of the company. But – so we always, and I think we've demonstrated in the past, that we can dial that up or dial that down based on what we think is in the best interest of everyone. But look, at this point, we're all full steam ahead and pushing to execute on all of our capital program. We see these periods as the opportunity to get ourselves in good position, to be ready for a turnaround. So, at this point, it's full steam ahead.

<A – Chris Virostek>: Yeah, I think what we've said consistently over the last couple of years as we've managed the allocation of the capital and those outsized amounts of capital that were generated in the last couple of years is, we're going to be patient and thoughtful about this because we know that these market conditions won't last forever. And we don't want to be having to be facing a decision that we've got, because of market conditions, we've got to turn down high return capital. We'd actually just as soon be doing some of that capital in weak markets, and preparing for when things turn around, which they eventually will. So, I think the spend this year is really a reflection of, we've got a lot of projects that we're quite excited to do, and we preserved the balance sheet over the last two years despite all the share buybacks and the activity that we've done. We preserved the balance sheet and liquidity that we don't have to cut capex. We can continue to execute our strategy in good markets and in bad.

<Q – Ketan Mamtora>: Got it. No, that's very helpful. Thanks, Ray, Chris. I'll jump back in the queue. Good luck.

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

<Q – Hamir Patel>: Hey, good morning. Ray, I was wondering if you have any thoughts as to what's driving the large premium we're seeing for southern yellow pine to SPF?

<A – Ray Ferris>: Well, Hamir, well, good morning. And look, I asked the same question. I can give you what our best guesses are. And I think we'll be smarter as the next quarter unwinds. And so, look, I think it's been a surprise to us to see this gap. I suspect it's a surprise to many. And our views are kind of this: I think look, obviously it's been – we see a bit of a slowdown on demand. And so, the first one that we look at is that when you look at the robustness of the SYP, we really believe there's been a bit of a product substitution because of the supply chain, which is, people aren't really interested in taking risk on inventories. The supply chain, at least from our view, appears very lean and that SYP is quite prompt and can get to the market very quickly, much more quickly than what we can ship into the U.S. So, we think that's one aspect.

Look, I think it's also been a bit of a surprise to see European imports coming in to the level that they have. I guess, we'll see how much legs that has. I think, I would expect that they're surprised with how low SPF has gone. But – so, there's been a bit of an offset seeing European imports come in to the level that they have, at least early in the year.

And then the third part – the third part is I think there's been – you see a lot of these announcements to come out of British Columbia and it's a significant volume, both temporary and permanent that's been announced and for the stuff that probably wasn't announced. And that's a big number, but the market doesn't see the impact of those curtailments until really now or in the next month or two. And so that volume of wood it continued to flow. But as we get into the end of this, well, really over the next month or two, we would expect to see that supply constraint in SPF kind of, at least out of Canada, hit the ground. So those are the three things that we look at and we are starting to see that gap moderate, because I think it was around probably around $200 at one time and it's certainly come off of that. But our thoughts would be that it's a temporary dislocation and you would expect over time for that to correct.

<Q – Hamir Patel>: Okay. Thanks for that, Ray. That's helpful. And then kind of sticking with B.C., it seems like there's a lot of pulp downtime coming throughout Western Canada just given the decline in pulp prices. Do you think that's going to further weigh on costs for the B.C. industry? I'm just thinking if there's risk that chip prices fall materially here.

<A – Raymond Ferris>: Hamir, I think in B.C., and I can only speak for us, I mean, we've announced our Cariboo curtailments, and that's primarily as a result of not being able to find enough fiber, quite frankly, somewhat because of all the sawmill curtailments that have occurred. So, I see, look, there's obviously a cost impact depending on where people are sourcing fiber and how far are you willing to go to do that. And I think we've made – so we've made decisions around that. But I think it's less about cost, it's more about fiber availability at this point.

<Q – Hamir Patel>: Great. Thanks, Ray. And just the last question I had on the on the OSB side, where we're seeing more idled capacity being converted or planned to be converted to siding in coming years. Do you see any opportunities for West Fraser to participate in growth in that siding market?

<A – Raymond Ferris>: Well, first of all, so I'd like to kind of just – on the idle capacity, I think we're pretty excited about our Allendale facility and the position that we're in and our start-up and where we think we're going to be on the cost curve and our strategy. On other products, I would say, we like our product strategy and – but look, we're always looking to find ways of growing our customer portfolio. So, with respect to siding, I can't comment on that. I mean, there's companies out there that do a pretty good job at that. And no – but we're pretty comfortable with where we're with our strategy to-date on OSB.

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

<A – Raymond Ferris>: Thanks, Hamir.

OPERATOR

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

<Q – Sean Steuart>: Thanks. Good morning, everyone. First question on the balance sheet. You touched on the ample liquidity position you have, but you're churning through it through this extended trough. Just wondering Ray or Chris, if you can speak to your appetite for leverage on the balance sheet, updated thoughts on that front, and how potential M&A ambitions factor into that outlook for the company?

<A – Chris Virostek>: Sure. So, I think what we've got to keep in mind about the first quarter, Sean, is that consumption of cash and liquidity in the first quarter is really around the working capital build and the log decks, right? So probably $200 million dollars of that consumption was around that seasonal inventory build. And that typically unwinds in the second and into the third quarter. So probably some of that, a good portion of it gets clawed back here over the next couple of quarters. So, we're pretty comfortable with where we think liquidity is going to end at the end of the year, even in a fairly conservative outlook for the market. So, I don't think the addition of leverage for us is a real pressing issue right now that we've got to go out and secure leverage because of tightness of liquidity. In respect of capacity what I would say is, we're carrying the same debt level that we carried prior to Norbord at $500 million U.S. with a substantially larger company that's more diversified across products and geography. So, we operated at that $500 million number in a much smaller and much different environment. And so, if the right opportunities are out there for us to continue to improve the company, I'm confident we'll find a way to finance those things the right way.

<Q – Sean Steuart>: Yeah, I was more – I'm not worried about you guys hitting any liquidity wall, but trying to gauge the scale of the M&A opportunity you might look at vis-à-vis your current liquidity position, but I think I have a sense of that. One follow-up question on Allendale. As you think about the restart here in the coming months and I appreciate there is going to be an extended ramp, but I believe one of the issues with that asset historically in that part of the South is its acute labor constraints. How have things trended with respect to that variable? And you're comfortable that the staffing is there as needed for an extended ramp-up for that asset?

<A – Raymond Ferris>: Well, hey, Sean, thanks. So, I think we've got about 85 people on site, something like that right now. And it might be a little bit more than that. That's going actually better than we expected. And I can only take my hat off to the team that's worked extremely hard in the last year to get it to that stage. So, if you'd ask me a year ago, I would've been cautious on my comment. I think, we got a lot more confidence today than we did a year ago. And so, we're seeing that as a much lower risk than we would have a year ago. But look, it remains throughout North America, in particular the US South. Skilled and unskilled labor is constrained and you need to work hard to ensure that people want to come work for you and stay for the long term. So that remains the challenge. At this point, I wouldn't put Allendale at a different risk than any one of our other U.S. South assets, quite frankly.

<Q – Sean Steuart>: Okay. That's great context. Thanks, Ray. That's all I have.

OPERATOR
Your next question comes from Andrew Kuske from Credit Suisse. Please go ahead.

<Q – Andrew Kuske>: Thanks. Good morning. I guess maybe a broad question, but it comes back to the balance sheet. You've got ample flexibility despite the market environment we're in right now, and you've mentioned mass timber in the past as really being a driver of wood products demand. To what degree or what extent do you find that market just interesting fundamentally, given the growth potential for you actually being involved in end-market mass timber?

<A – Raymond Ferris>: Well, good morning, Andrew. And so, I'll just put it in context. So West Fraser with really the Softwood Lumber Board for the last dozen years has played a major role in developing those markets in North America. So, there's been millions of dollars, which we've been a big part of that going into creating that opportunity. So, we're excited by – and I think mass timber is one example of the growing wood product demand, because of its sustainability and ESG qualities and characteristics. So that's it – I mean that's why we talk about it. You look at the growth of mass timber in the last few years and it's exploding. We're very supportive of that industry, and we see ourselves as someone that wants to supply those, the CLT manufacturing business. And whether we do or we don't, it's another area, example of growing demand. So, I think that's the context of what I would say. Now look, I think depending on who you talk to, how big will mass timber be? Our eyes are still focused on, I think if it's wildly successful, it's going to be somewhere and this is really, it comes from SLB or FEA or others, but you're looking at somewhere between 3% and 10% of the overall market. So, we'll see. It's still early stages, but we just think it's an example of wood products demand that didn't exist 10 years ago, when we started thinking about where the future constraints are going to be on supply and demand.

<Q – Andrew Kuske>: That's helpful. So maybe just for an additional point of clarity, so on the CLT, you're not saying no to that industry, but it's just sort of early right now. It's stimulative for your core business, but it could be an interesting opportunity longer term should it become bigger.

<A – Raymond Ferris>: I think that's fair, Andrew. Sure.

<Q – Andrew Kuske>: Okay. Appreciate it. That's it for me.

<A – Raymond Ferris>: Thank you.

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

<Q – Paul Quinn>: Yeah. Thanks very much. Good morning, guys. Challenging quarter. Just wondering if European OSB prices have stabilized here and what's the expectation for the balance of the year?

<A – Raymond Ferris>: Well, what I would say is that energy costs have come down. And so that's helped kind of offset a little bit around fiber. And the market, everywhere including Europe is still choppy, but it's held up better than what we had expected, Paul. I think that's as far as – so it's hard for me to forecast what this is going to look like over the next few quarters. But I would just say when we look backwards in the last couple, it's held up better than we expected. And I guess, we'll see what the balance of the year looks like, but yeah, I think that would be all I can say on that.

<Q – Paul Quinn>: Okay. And then, I'm looking for an update on softwood lumber. I know the industry was trying to get that on the agenda when Trudeau sat down with Biden. Where we at on that and where we at on the – this little trade WTO, NAFTA processes as well?

<A – Raymond Ferris>: So, look – the WTO and litigation and trade processes, I mean, we need five experts to get in and unpack that. It's just incredibly complicated. But what I would say is, we're disappointed that it really didn't become something that our political leaders really wanted to take forward. And so, we'll just leave that at that. There really isn't very much going on. So really it just continues to go along on the – on really managing through the administrative review process on an annual basis today and so I mean, and you've seen the disclosure in our statements, that describes it better than I ever will. But from a negotiation standpoint, there's not anything much going on that I'm aware of. And I don't have a strong view that it'll get resolved any time in the near future.

<Q – Paul Quinn>: Okay. Then just lastly, looking at your M&A opportunities here, what do you see in the marketplace right now? Are guys getting more realistic on pricing given the drop in overall commodity prices?

<A – Raymond Ferris>: Yeah. Thanks Paul. So, if I just reflect on the last few periods, I mean look, there continues to be opportunities out there that do things. I think our view is we're going to focus on quality and on things that we think we can execute and achieve meaningful synergies and kind of have an opportunity to be in that kind of those – that first and second quartile type thing. So, I would just say, we continue to say, no, a lot more rather than yes. So, I would say, I think it has been active and I'd say it remains to be active. I think when it comes to value, look, I think everyone or say, many, have the same view on the future that we do and that they're bullish. And I would say expectations probably remain in that. So, I guess if they're stressed assets, that's something different. But I think most people are in pretty good shape and have – I can't speak for others, but I would say, experience would say people have a bullish outlook on the mid to longer term.

<Q – Paul Quinn>: Alrighty. Thanks very much. Best of luck.

<A – Raymond Ferris>: Thank you, Paul.

OPERATOR
Presenters, there are no further questions at this time. Please proceed with your closing remarks.

RAYMOND FERRIS, CEO, PRESIDENT & CORPORATE DIRECTOR
Well listen, thanks, everyone, for tuning in today and we'll look forward to talking to you at the end of Q2. Thank you.

OPERATOR
Ladies and gentlemen, this concludes your conference call for today. We thank you for joining and you may now disconnect your line.