WEST FRASER TIMBER CO. LTD.
Q3 2023 EARNINGS CONFERENCE CALL
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CORRECTED TRANSCRIPT

OPERATOR

Good afternoon, ladies and gentlemen. Welcome to West Fraser's Q3 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 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. Thank you.
Mr. Ray Ferris. You may begin your conference.

RAY FERRIS, PRESIDENT AND CHIEF EXECUTVE OFFICER

Thank you, operator. Good morning and thank you for everyone joining our third quarter earnings call. I am Ray Ferris, President & Chief Executive Officer of West Fraser, and joining me today is Sean McLaren, our Chief Operating Officer, who we announced previously will be assuming the role of President & CEO effective January 1, 2024, Chris Virostek, our Chief Financial Officer, as well as Matt Tobin, our VP of Sales and Marketing, and several other members of our leadership team.

This quarter, I am very pleased to inform you that Sean McLaren, Matt Tobin, and I are joining the call from our OSB mill in Chambord, Quebec. As I'm sure you are aware, our West Fraser team has been particularly busy this past period with the recently announced divestitures of three of our pulp mills, and the acquisition of a sawmill and wood treatment operation and associated forest management agreements in Alberta. All of these moves are aligned with our long-term strategy to be a premier, low-cost, sustainable and renewable wood building products producer and key supplier to our customers. Our team has been successfully processing and executing on these announced changes, all the while navigating uncertain, sometimes conflicting, difficult-to-predict demand fluctuations within the varied product and geographic regions we serve.

Before I hand the call to Chris Virostek to discuss our third quarter financials further, I'd like to reinforce how thankful and grateful we are for the team at West Fraser for continually adapting to meet the needs of our growing company, in particular our employees within our pulp team, of which no organization could ask for more. The dedication and hard work is shared and appreciated by all of our nearly 11,000 employees.

As we will discuss on this call, despite persistently varied and mixed demand markets, we posted strong improvement in EBITDA over the prior quarter. And, as we'll talk further, we'll also have Sean available to answer questions later in the call. But for now, let me hand it over to Chris who will walk us through our Q3 financial results.

CHRIS VIROSTEK, CHIEF FINANCIAL OFFICER & SENIOR VICE PRESIDENT, FINANCE

Thank you, Ray. Good morning, everyone. As a reminder, we report in US dollars, and all my references today will be in the US dollars unless specified otherwise.

West Fraser generated $325 million of consolidated adjusted EBITDA in the third quarter, improving from the $80 million of adjusted EBITDA reported in the second quarter. Our North American EWP segment generated $289 million of adjusted EBITDA, up from $126 million in the prior quarter, as OSB price strength carried over from the prior quarter.

The Lumber segment posted $44 million of adjusted EBITDA this quarter, up from $10 million in the prior quarter, with this quarter negatively impacted by production curtailments for capital projects, as well as extreme weather in parts of Florida and Georgia. The majority of the sequential improvement this quarter was driven by a $62 million export duty recovery. In the prior quarter, we benefited from favorable changes related to inventory valuation adjustments, although these adjustments were not a significant part of the Q3 results in Lumber. The net result was a $35 million negative impact relative to the second quarter on a sequential basis.

The Pulp & Paper segment improved, but profitability remained challenging in the third quarter, posting negative $12 million of adjusted EBITDA versus negative $74 million in the prior quarter. As a reminder, last quarter was marked by considerable disruption within the Pulp segment with all four of our pulp mills taking downtime.
In Europe, adjusted EBITDA was $4 million in the third quarter as the demand weakness that had begun to unfold late in the second quarter persisted. These Q3 results were down from $19 million of adjusted EBITDA in the second quarter.

In summary, price strength across our North American EWP business was the largest positive driver of the company's sequential EBITDA improvement, which more than offset demand challenges in our Lumber, Pulp and EU segments.

Cash flow from operations was $355 million this quarter and cash net of debt increased to $663 million from $449 million last quarter. This quarter's cash flow more than covered $25 million of dividends paid and $115 million for capital expenditures. We also repurchased $25 million of shares in the third quarter and a further $53 million between quarter-end and October 24th.

In terms of our operational outlook for 2023, we are reiterating guidance for North American OSB and SPF lumber shipments but reducing guidance for SYP shipments as market demand for lumber in the US South has begun to cool. We therefore now expect our SYP shipments to be at the bottom end of the guidance range of 2.9 billion to 3.1 billion board feet. Also, given the weakening trend in European OSB demand, we now expect OSB shipments there to be near the low end of the guidance range of 1 billion to 1.2 billion board feet on a 3/8-inch basis.

In terms of capital spending for 2023, based on equipment delivery schedules and spending levels to-date, we now anticipate capital investment will be approximately $450 million, down from last quarter's expectation that we would spend near the bottom end of our $500 million to $600 million guidance range.

Looking back over the last four quarters, which have undoubtedly been challenging for the wood products industry, our diversified portfolio of assets has generated consolidated EBITDA of $472 million, excluding the $62 million export duty recovery this quarter. This trailing 12-month EBITDA would have been markedly higher on a pro forma basis after giving effect to the pending sale of the three pulp mills and the pending acquisition of Spray Lake Sawmills.

For comparison, this latest level of trough-like EBITDA is significantly higher than the financial results generated in similarly weak markets experienced in 2019, which reflects the success of the Norbord Acquisition and integration, as well as the other mill additions and capital improvements we have made to the West Fraser portfolio in recent years. With that overview, I'll now pass the call back to Ray.

RAY FERRIS, PRESIDENT AND CHIEF EXECUTVE OFFICER
Thank you, Chris. Before I reflect on our financial performance in the third quarter, I'll just spend a couple of moments addressing some of the key corporate development initiatives we've undertaken recently, as Chris just mentioned, namely the sales of the pulp mills, as well as the acquisition of a sawmill in Alberta.

In early July, we announced the planned sale of our Hinton, Alberta pulp mill to a key strategic partner, Mondi Group plc, which we addressed on our last earnings call, so I won't spend much time on that transaction other than to say that we now expect the transaction to close early in 2024.

Since the Hinton announcement, we also announced the planned sale of our two BCTMP mills, namely the Slave Lake Pulp mill in Alberta and the Quesnel River Pulp mill in British Columbia to Atlas Holdings, for $120 million.

Upon closing of this transaction, which is expected in early 2024, these two mills are to be operated by Millar Western Forest Products, a 100-year-old Canadian forest products company that joined Atlas Holdings in 2017. We believe this transaction will provide these great pulp mill assets and teams with a strong strategic future, while also allowing West Fraser to focus its resources on our objective of being a premier wood building products company.

This quarter, we also announced the planned C$140 million acquisition of Spray Lake Sawmills located in Cochrane, Alberta. This transaction includes not just a sawmill and wood treatment facility, which produces value-added treated wood products as well as a variety of innovative wood residuals and other biproducts, but this acquisition also comes with two forest management agreements with a total annual allowable cut of approximately 500,000 cubic meters. With the current expected transaction to close by year-end, this will enable West Fraser to grow its footprint in southern Alberta and expand its Canadian treated wood business, while providing access to a high-quality fiber supply, which is synergistic with our existing sawmill and treating facilities in Sundre, Alberta. We believe over the long term that these three transactions are a continuation of our ongoing strategy of always looking to improve our earnings quality through the cycle for the regions and products we serve.

Now, shifting thoughts back to Q3. This quarter, we continued to experience relatively soft demand, particularly in our Lumber segment, as consumers managed through a period of elevated mortgage and interest rates, which appear to be impacting affordability and overall consumption. Market weakness was also evident in our European operations where high inflation and mortgage rates are dampening housing and home improvement markets.
Contrast these trends, however, with our North American engineered wood panels business, where we experienced more solid demand through much of the quarter before showing signs of slowing towards the end of the quarter, particularly for our OSB products.

With respect to outlook, we expect the wood building products industry will continue to face near-term challenges from factors including interest rates that may remain higher for longer, ongoing labor constraints, and the potential for muted product demand, primarily due to housing affordability headwinds.

In recent quarters, we have seen inflationary cost pressures moderate across much of our supply chain, including for raw materials such as energy, resins and chemicals, and to some extent, wood fiber. Though difficult to predict, we do expect some upward cost pressure in Q4, particularly for energy related inputs.

In terms of new home construction and repair and remodeling markets, while we do see demand risks in the near term, we continue to believe the North American housing market is structurally underbuilt and has an aging housing stock, which over the mid- to longer-term, should and will support a favorable demand potential for our building products.

In closing, while near-term uncertainties exist across the industry and our business, we are confident in the geographic and product diversity we have built and in our operating and growth strategies. Our company has a long and successful track record of steadily and progressively evolving to meet the needs of our employees, our communities and, of course, our shareholders, including more recently with the acquisitions of Norbord, the modern Angelina sawmill, the large-scale Allendale OSB mill that's currently in start-up, our balance sheet remains strong and well positioned for the future.

This team has been through economic and industry cycles before and we continue to believe we have the people, the assets and financial flexibility to allow us to take advantage of opportunities and overcome challenges when they arise. And although it is unclear when market cycles will turn, we will remain disciplined in our capital allocation strategy, investing in and improving our assets through the cycle.

As we look ahead, we will continue to focus on being a low-cost, efficient supplier of renewable and sustainable wood building products, while we remain committed to our prudent capital allocation strategy and to a future where good fundamentals support growth in demand for the types of sustainable and renewable wood products for which West Fraser is known.

Finally, before I turn the call over for our Q&A, I thought I would mention a few things about the transition to Sean as President and CEO at year-end. Sean and I have worked very closely together for almost 20 years, both growing together with the company. Sean originally joined with Weldwood Canada, based in Vancouver, but has lived and worked across the company from Burns Lake, British Columbia to Hinton, Alberta, both in pulp and lumber, to Sundre, Alberta to Rocky Mountain House laminated veneer lumber, to Quesnel pulp and lumber operations, including two different stints, one in Savannah, Georgia, and of course, the last number of years based in our Memphis office in Tennessee.

Sean has been a key driver and a leader across multiple business segments and regions, often moving seamlessly between finance and operations roles. We are so fortunate to have such a strong, knowledgeable and natural people leader in our company, which will support a seamless and efficient transition for all of us here at West Fraser. And for me, I'm very thankful for that.

With that, I will 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] And your first question is from Hamir Patel from CIBC. Please ask your question.

<Q – Hamir Patel>: Hi. Good morning. Ray, I saw the Henderson start-up. Looks like it's pushed out two quarters. Can you speak to some of the other projects that you might have over the next couple of years? I know you do Opelika and Henderson, but I'm assuming there's some other ones that are to follow and what sort of scale we could expect in terms of production growth?

<A – Raymond Ferris>: Well, good morning, Hamir, and good question. I'll maybe get Sean to tap in on the end of this one. But before I do that, I think one point I'd want to make on Henderson is, I mean, we're and all of our capital, it is what I would call full steam ahead. The only thing that slows us down today is really supply chain issues. That's the only reason for the slight delay and we're pretty excited about getting through and seeing that mill started up.

With respect to – I'm not sure exactly what we've given in guidance. What I would say is, we're continuing to make significant progress on our platform, US lumber platform, but we still do have a few more, what I would call, excellent projects that we have in the queue. I don't think we've given a lot of detail on that, but these are ones that we're going to be very excited to announce them and bring them forward when that time is right and looking forward to having those conversations.

So, when we think about our future in the US South, it's one where we see much opportunity to improve what we have both by lowering cost and by growing our footprint. Sean, anything you want to add to that?

<A – Sean McLaren>: No. I think that is perfect, Ray. We continue to have a number of projects, merchandisers, canter lines**,** different things that are smaller in nature than a Henderson, but really kind of move our cost curve and our competitive position in the US South. So, a number of those are in motion and very pleased with the progress on them.

<Q – Hamir Patel>: Great. Thanks, Ray, and Sean. Sean, another question I had for you is with the pending sale of most of the Pulp & Paper assets, do you expect future M&A to be focused on the remaining sort of lumber and OSB businesses, or do you see some adjacent categories in wood products that might interest the company to grow into either organically or via M&A?

<A – Sean McLaren> Good morning, Hamir. From an M&A perspective, I think you can look at what we've done over the last several years that make us stronger. The bar is quite high for us in West Fraser in terms of we look at a lot of things. But in terms of things that we know will fit into our existing footprint and make us immediately stronger, our biggest opportunity is modernizing what we have internally. So, we'll continue on that path and if it's synergistic to our existing business in wood products, we'd look at it and if it's a strong addition to the company, we'd continue to discuss it internally.

<A – Raymond Ferris>: One thing I'd add on to that, Hamir, is that built into the DNA of the company is every day we sit down and talk about what we need to do and things that we may not have considered yesterday, we might be able to consider going forward as the company continues to change, it's an ongoing conversation. And as the world changes, I'm sure we're going to continue to look at all things that are out there and figuring out where to take the company.

<Q – Hamir Patel>: Yeah. Fair enough. Thanks. That's all I had. And Ray, all the best in retirement. Thanks.

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

Operator
Thank you. And your next question is from Sean Steuart from TD Securities. Please ask your question.

<Q – Sean Steuart>: Thank you. Good morning, everyone. Couple of questions. And Ray or Sean, I want to just follow up on the CapEx question. With respect to supply chain lag and longer lead times for equipment, I guess, I would have expected that with weaker markets, there might have been a little more slack in that element, potentially some of your competitors slowing their discretionary spending plans because markets have weakened. Is there any particular part of the supply chain, particular pieces of equipment where you're seeing these lags intensify? Just any more detail you can give us on that front.

<A – Raymond Ferris>: Well, good morning, Sean. I'll take a crack at it first. We'll see what happens over the next few years here, but I would say, there was so much stuff in the pipeline that as we look out, you can see that things are improving and easing, but the things that were in the pipeline were still in the pipeline. I think there are certain segments and parts that where you can see equipment and things coming quicker and others which quite frankly haven't changed at all yet, but they may down the road.
The one thing that hasn't changed is access to people and what I call contractors and people that can actually build a project. Labor is still the primary constraint, assuming you've overcome your equipment part.

<A – Sean McLaren> Good morning, Sean. Not a lot to add to that. I really think the Henderson and some of the delays we've experienced have been due to the backlog and that is getting better. So, I think on future projects, it might be a bit faster, but there's still a backlog out there.

<Q – Sean Steuart>: Okay. Thanks for the extra detail there. Question on your European EWP business. Weakest margins we've seen there for a while, which I suppose isn't entirely surprising given the macroeconomic backdrop. Can you give us a sense of given that it's a less transparent market, ongoing pressure you're seeing into the fourth quarter and maybe early next year? And it sounds like you're curtailing your shipment guidance a little bit for that business. Do you have a sense of any incremental downtime that's being taken elsewhere given skinny margins for that business at this point?

<A – Raymond Ferris>: Well, Sean, look, I don't really have anything on respect to other curtailments, but if you look at the trends over the last year, the economy certainly has continued to slow steadily throughout the last year and it remains weak at the moment. I think our visibility into next year is probably the same as yours and I think we're just really focused. What I would say is we're quite pleased with how our operations are performing over in Europe, really operating to meet available customer demand.

So what I would say in a very difficult demand market, we're pretty happy with where we're kind of, so it gives us quite a bit of confidence that even if things slow down a little bit more, that our team has figured out how to weather that storm, if you will, if that's the right way to put that. But I guess we'll see, but I do think our outlook is probably a little bit slower going forward at least in the short term.

<Q – Sean Steuart>: Okay. All right. Thanks very much for the detail. Congrats to both Sean and Ray on the transition, we look forward to seeing what comes of it going forward.

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

<A – Sean McLaren> Thank you, Sean.

Operator
Thank you. Your next question is from Paul Quinn from RBC Capital Markets. Please ask your question.

<Q – Paul Quinn>: Yeah. Thanks very much. Morning, guys. Just to start with Allendale, I know you started that mill up in June. Just what's the run rate at the end of the Q3 or how do you see that mill progressing and what is it qualified to sell?

<A – Raymond Ferris>: Well, good morning, Paul. We're quite pleased with the start-up so far. As you might understand, it's pretty early in the ramp-up curve, which I think we've said kind of two or three years. I don't know if we've given what the actual guidance was for this year, but I would say, if historically you look back and look at the OSB ramp-up curves, we're very close or on plan with where we want to be and happy with the start-up so far. But I think what we've said is, it wouldn't be significant this year that, I don't mean to be flippant, but I guess we're going to have to stay tuned to see how well that goes next year.

<Q – Paul Quinn>: Okay. And then just noticing that you've got now almost $825 million on deposit. Hearing from some of your competitors that there's been some chatter on that file, the softwood lumber. What is your take on the current situation and how do we get to a resolution?
<A – Raymond Ferris>: Well, I would say it remains certainly a frustration for the industry and for West Fraser. We're on both sides of the border, we certainly do not agree with the duties and I think that's well documented. Paul, you will see chatter in the paper from time to time with industry trying to work together to develop some thoughts

about how to overcome the impasse. But I can also say that there really isn't anything going on other than people talking about what could be done or what might be done, should things improve. But today, the governments aren't talking and there's really no discussion between the US and Canada. But, we continue to want to see resolution to the duties and we're going to look for those catalysts to try and do that for what impact West Fraser has on those decisions.

<Q – Paul Quinn>: Okay. And just in the past, that sort of the legal route, whether it's through NAFTA or WTO, used to really sort of spurn on those discussions. Where are we at in those two legal paths?

<A – Raymond Ferris>: First, Paul, I would say I'm quite involved, and I can tell you that as involved as I am, I'm confused about, if I tried to describe the legal status of all the different things that were going on between CVD and antidumping, I'm sure I would get it wrong. I think it's out there in the public domain and I don't want to try and trip something up. I think you saw that there's a couple of recent announcements around decisions being remanded back to the Department of Commerce. But again, those immediately go on appeal and away we go again. So, I would say despite the fact that you'll see and read things in the media and there are some decisions being made, I don't think from a West Fraser point of view, that's fundamentally changed materially where we're at. This hasn't moved us closer to a resolution at this standpoint. So, from our perspective, it looks like this is a ways away before resolution.

<Q – Paul Quinn>: Okay. And then just lastly, I mean, I've been covering the company for 20 years and it seemed when I first started, West Fraser had a pretty decent gap on competitors. It seems to be eroded over time. Just wondering is that because the competitors have gotten a lot better or to what do you attribute that? I mean, you used to have a little bit of blue sky between you and others and now it seems to be, you're right there or neck and neck with the top ones. What's the change?

<A – Raymond Ferris>: Well, I'm not sure I 100% agree with that statement, Paul. But I will say I don't think anyone has grown more than West Fraser. We continue to operate in our lumber side, three distinct areas, British Columbia, Alberta and US South. These are the tale of three cities and I would say we're very happy in some areas and not so happy in others and making the decisions with our portfolio and operating strategy to put ourselves in the position in the long term. Those that don't have to spend a lot of time in the more difficult areas, that can be helpful. But I really do think we very much think we have the right asset mix and are growing in the regions that we want to grow in and shrinking in the regions that we think we need to. It's a long race and I guess we'll see where we get to.

<Q – Paul Quinn>: All right. Hey. Congratulations on the retirement, Ray. Best of luck, Sean.

<A – Sean McLaren> Thanks, Paul.

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

Operator
Thank you. [Operator Instructions] The next one is from Ketan Mamtora from BMO Capital Markets. Please ask your question

<Q – Ketan Mamtora>: Okay. Let's try this again. Can you hear me?

<A – Raymond Ferris>: We can hear you, Ketan.

<Q – Ketan Mamtora>: Can you hear me okay?

<A – Raymond Ferris>: We can hear you, Ketan.

<Q – Ketan Mamtora>: Okay. Perfect. Sorry about that earlier. Hey, Chris, maybe to start with, can you give us some sense of how you are thinking about CapEx for 2024? It certainly sounds like there is some carrying forward from 2023 particularly in this environment where there is still quite a lot of uncertainty, perhaps maybe even at a high level that would be helpful.

<A – Chris Virostek>: Sure, when we consider what's happened the last couple of years is we've had fairly ambitious capital plans and we've been, in particular the last couple of years, a bit frustrated by the delays that have happened from a supply chain standpoint, and have had spillover into the following year in that case in the last couple of years and it looks like 2023 to 2024 is not going to be any different in that front.

In terms of the philosophy and how we're thinking about CapEx kind of relative to the market is we were quite careful through 2021 and 2022 to preserve liquidity to make sure that our allocation strategy could be durable, agnostic to market cycles. And so, we've got some great opportunities to invest capital, as Sean and Ray indicated, that continues to take action in the portfolio where it makes sense to improve the asset quality over time. And frankly, some of the best time to do that is in a weak market because the market will recover at some point in time and we'd rather spend the capital now and make the improvements now. And that's across everything. It's not just about capacity. It's grade, it's recovery, it's cost, all those elements, and to do that work now in a softer market, when there's room to do it from a supply/demand standpoint. And then when the market recovers, we're ready to meet our customers' demands and produce what they're looking for and the quantities they're looking for at that time.

So, I think with where we positioned the balance sheet, we're not contemplating major cuts to CapEx here over the next 12 months and we do still have a lot of projects in flight that are spilling over. So, I'd welcome Ray or Sean to kind of add to that if they've got other thoughts on that.

<A – Raymond Ferris>: No. Nothing to add, Chris.

<Q – Ketan Mamtora>: Okay. So, Chris, would it be then fair to say that 2024 CapEx should be actually similar to 2023, if not higher? Is that directionally the right way to think about it?

<A – Chris Virostek>: Yeah. We'll release our CapEx guidance when we put our year-end financials out, just as we put our shipment guidance for next year out at that same point in time. And so, that's when we'll be providing CapEx for the next year. We started with a range of $500 million to $600 million this year and we're saying that there's, probably, $50 million to $100 million that's going to spill over into next year as carryover on top of maintenance and the other stuff that we would ordinarily do next year.

<Q – Ketan Mamtora>: Got it. No, that's fair. Maybe then shifting to capital allocation, obviously, balance sheet is in a very strong position. You've got a lot of – you're sitting on quite a bit of net cash. Can you talk about one sort of how is your M&A pipeline looking at this point? Have seller expectations moderated given what we've seen so far this year? And then on the other side, how you think about sort of appetite for kind of larger share repurchases? Thank you.

<A – Chris Virostek>: I can start there, and then if Ray wants to jump in, he can as well, too. On the M&A front, there's been a number of active years. I think participants in the industry understand that there's cycles here and valuations don't really sort of wildly adjust whether you're in a soft market or a frothy market here. It's really about asset quality, which has been of particular importance to us in the last few years when you look at our strategy around how we've deployed capital. So, there's always stuff happening for us, as Ray said earlier, we're going to be quite selective around the opportunities that we action because they need to be high quality opportunities and we believe we're positioned with the balance sheet that if those opportunities are there, we're well positioned to take advantage of those high-quality opportunities. On the share buybacks, there's lots of things that impact that decision process, including our view on the macro environment. We're not going to commit to where and when and how many on a call like this. But we can say when it's at a discount to intrinsic, when the balance sheet is where we want it to be and when our other priority uses of cash are met, we have that opportunity to return capital through the buybacks and our track record shows that we do that. So, I think that's about all that we would say on share buybacks.

<Q – Ketan Mamtora>: That's fair. Appreciate the thoughts. I'll turn it over. Thank you.

Operator:
Thank you. There are no further questions at this time. Please proceed.

<A – Raymond Ferris>: Thank you, everyone. As always, Chris, Robert, Sean and I are available to respond. Thank you for your participation and I look forward to tuning into the next quarter and hearing the update. Thank you. Bye now.

Operator:
Thank you. Ladies and gentlemen, the conference has now ended. Thank you all for joining. You may all disconnect.