WEST FRASER
Q1 2022 EARNINGS CONFERENCE CALL
APRIL 29, 2022 – 11:30 A.M. ET
CORRECTED TRANSCRIPT

OPERATOR
Good morning, ladies and gentlemen, and welcome to West Fraser's Q1 2022 Results Conference Call. Please note that all lines have been placed on mute to prevent any background noise.

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 contain forward-looking information or forward-looking statements within the meaning of Canadian and United States securities law. 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 risks, factors, and assumptions is included both in the accompanying webcast presentation and in our 2021 Annual MD&A and Annual Information Form, which can be accessed on the West Frazer's website or through SEDAR for Canadian investors and EDGAR for United States investors. After the speakers' remarks, there will be a question-and-answer session.

[Operator Instructions]

Thank you. Mr. Ferris, you may begin your conference.

RAYMOND FERRIS, CEO, PRESIDENT & CORPORATE DIRECTOR
Well, thank you, Sylvie. Good morning and thank you everyone for joining our first quarter 2022 earnings call. My name is Ray Ferris, West Fraser's President and CEO. And I'm joined today by Chris Virostek, our Chief Financial Officer; Chris McIver, Senior VP of Marketing and Corporate Development; and a number of other members of our executive team.

Before we get into the results today, I'd like to mention a couple of housekeeping items and then after I'll pass the call to Chris Virostek, who will provide an update to our Q1 results before wrapping up and moving to Q&A. Today, we'll limit the scope of our comments to those already provided in our Q1 disclosures, and we will refrain from addressing any questions related to our company or market outlook beyond what has been provided in those disclosures. Further, after this morning's call and in the absence of any material developments that would require a news release, we do not intend to make any additional comments to investors or analysts until after our substantial issuer bid expires, which is currently expected to be June 2, 2022. With that, I am pleased to report that the first quarter 2022 was another strong quarter for West Fraser.

And with that, I'm going to pass the call to Chris to take us through our results.

CHRIS VIROSTEK, CHIEF FINANCIAL OFFICER
Thanks, Ray, and good morning everyone. In the first quarter, West Fraser achieved strong financial results in the face of ongoing transportation and logistics constraints in Western Canada. As you may recall, these challenges were an impediment to our Q4 2021 shipments of SPF lumber and pulp. However, the typical weather issues that challenge our Canadian shipments each winter, these constraints lasted longer than we originally expected, carrying well through the first quarter.

While our ability to supply markets was constrained, demand for our wood-based building products remained robust in the first quarter, and as such we generated $1.59 billion of adjusted EBITDA, representing a margin of 51% of sales.

The benefits of our product and geographic diversity of production were evident once again this quarter, and we saw robust sequential gains across three of our segments with our Lumber segment EBITDA up more than threefold from the prior quarter to $796 million and our North American EWP EBITDA more than doubling to $730 million. In Europe, adjusted EBITDA was $78 million, the second-best result ever for that business. Price was the single largest driver for the gains in North America. While in Europe, the gains were supported by improving seasonal volume trends and recapture of lost downtime for a large capital project that impacted the fourth quarter.

Cash flow from operations in the first quarter was $563 million and cash net of debt increased quarter-over-quarter to nearly $1.3 billion. In the first quarter, we repurchased another $233 million of West Fraser shares and declared a $0.25 per share dividend, up from $0.20 per share in the prior quarter.

You also will have seen that we announced a substantial issuer bid subsequent to quarter end. Under the SIB, we have offered to purchase up to $1.25 billion of our common stock by way of a modified Dutch auction with a tender price range of $80 to $95 per share, and that is set to expire on June 2. We look forward to sharing with you results of the SIB tender process when those results become available.

In terms of our 2022 operational outlook, we're trimming the range of expected SPF shipments to 2.8 to 3.0 billion board feet from our original range of 3.0 billion to 3.2 billion board feet, as the transportation constraints in Western Canada have been more acute and have longer duration than originally anticipated. We are reiterating the outlook for our Southern Yellow Pine, North American OSB and European OSB shipments as well as planned capital expenditures for 2022.

As we identified in our earnings release, we continue to see logistics and transportation constraints affecting our business early in the second quarter, particularly in Western Canada. Currently, it's not possible to estimate when full transportation services will be available or when the backlogs will be cleared. And so further reductions of operating schedules across our production platform may be required to manage inventory levels, raw material supplies and our integrated fiber supply chain. Rest assured, we continue to actively seek out and utilize all alternative transportation routes and methods to the extent they're available to continue to service our customers and to operate our facilities.

With that overview, I'll return the call to Ray.

RAYMOND FERRIS, CEO, PRESIDENT & CORPORATE DIRECTOR

Thank you, Chris. I'm confident that we're on the right path to navigate the current operating environment, including the challenging logistics environment. And so, I'm pleased and very thankful of the adaptability of our team and our people as they adjust to meet our operating and customer needs. I thought I would touch briefly on supply and demand and note the step change in West Fraser's EBITDA generation in an environment where U.S. housing starts are near or above 1.4 million.

In the current housing environment, in which seasonally adjusted starts have regularly come in at 1.5 million starts or higher, it is clear that the industry's supply and demand fundamentals are robust after an extended 10 plus year recovery from the last down cycle. We continue to monitor trends in interest and mortgage rates and the potential risk to demand for new home construction and our wood building products. That said, based on what we see today, those fundamentals for housing and repair and remodeling remain favorable. Our product and geographic diversity also provides a buffering effect on the cycles that can happen in our products and the relative contributions across the business segments have reduced some of the volatility quarter-to-quarter, owing to different customers and markets that we serve. Another area that I'd like to highlight is our approach to capital allocation.

So, moving to slide 6. We continue to believe in a balanced approach across the business cycle and that a consistent approach to capital allocation is key to long-term value creation. A top priority for us is to ensure that we are reinvesting into our existing businesses in order to re-life assets, deploy advanced automation technologies and drive innovation to further enhance our operating platform. We continue to see opportunity to improve our business further over the next few years. We also maintain financial flexibility through the cycle, keeping sufficient cash to be able to be opportunistic acquirers or to pursue larger scale strategic growth initiatives when they are available. And then finally, we believe that returning excess capital to shareholders is a key priority, whether that's through dividends or share repurchases when our shares are trading at a discount to our estimate of intrinsic value.

Reflecting on these priorities, slide 7 shows our recent track record. Through both capital expenditures and acquisitions, nearly 40% of our cash generation has gone toward improving and expanding the company since 2016. Approximately, one-quarter of our cash flow has been retained or used to pay down debt. And lastly, more than a third of our cash flow generation has been returned to shareholders, including $2.2 billion of share repurchases over the last six plus years, highlighted by our CAD 1 billion substantial issuer bid last year.

In summary, we are pleased with our results this quarter. Our balance sheet remains strong with considerable liquidity, offering us the ability to navigate future challenges and opportunities, including the recent launch of our second SIB in less than 12 months. We have the knowledge and expertise to continue to move the company forward and are able to grow accretively as attractive M&A opportunities arise while remaining focused on our operating platform.

In closing, we remain optimistic about the continued growth and use of sustainable and renewable wood products, which we believe we are well positioned to serve. And I remain energized and excited about the depth, scale, capability and commitment of our people who remain focused and being agile and creative to navigate our supply challenges and the evolving needs of our customers.

With that, we'll turn the call back to the operator, Sylvie, yourself and take questions.

OPERATOR
Thank you, sir. [Operator Instructions] And your first question will be from Sean Steuart at TD Securities. Please go ahead.

<Q – Sean Steuart>: Thank you. Good morning, everyone. First question for Ray or for Chris McIver. Can you give us a sense of what you're seeing in the market right now? I'm just trying to square up the recent resiliency we've seen for lumber and OSB prices in North America. Any specific end markets where you're seeing better pull in recent days and weeks and your thoughts on sustainability of recent strength?

<A – Chris McIver>: Hi, Sean. It's Chris here. I'll take a stab at this and maybe Ray can fill in what I miss. Yeah, it's – we certainly saw at the high prices that the R&R market slowed down, particularly DIY and the box stores. We have seen that come back pretty significantly in the last few weeks to a month. New housing remained strong throughout the entire quarter, I would say. And I think the difference is that we are seeing the box stores come back a bit. Saying that, we would like to see the treaters come back a bit more than we've seen so far in the South. But overall, we're seeing R&R come back which has really stabilized the market for us.

<Q – Sean Steuart>: And Chris, do you have a sense of where inventories are at the big box level?

<A – Chris McIver>: Well, I can only speak to our inventories at the big box level and they're quite lean. We've kept them lean sort of anticipating a bit of a slowdown. We backed off from that. And so, they're quite lean, I would assume others are as well. But I can't speak to others.

<Q – Sean Steuart>: Okay. Thanks for that. Second question I have, the Hinton reconfiguration, can you walk us through the expected economic uplift tied to that initiative and the risk of your not answering this question., can you give us a sense of how concentrated the Q1 pulp and paper losses were to that mill? I'm just trying to get a sense of the upside you're seeing after this reconfiguration takes place?

<A – Raymond Ferris>: Well, good morning, Sean, and the third question might have been better, but no, I don't think we can highlight much around Hinton per se or the losses. But I would just say first on the pulp side in Q1, we were significantly impacted in almost every aspect of our pulp business around transportation. It had dramatic impacts and on our production and our shipping ability. And so, we've taken significant curtailment. And so, I'm not going to single out one mill versus the other, but I can tell you it was incredibly difficult. As you know, pulp mills need to run and running a few days a week or 50% or 60% capacity is not a recipe for good costs and good earnings. So, it was difficult. Look, we're – on the Hinton piece, we're pretty excited. We think we're landing in a spot with the product line in Hinton that we think – first, we think from an asset point of view, it's a simpler, more efficient process that I think we've demonstrated over a number of trials and with our customers that we got confident on where we're going with that. It's going to take us a few months to transition mostly for customer reasons. And we're pretty eager to kind of continue to move forward on that. But I would just say across the landscape for us, it was a tough quarter to try and run and supply our customers across our entire pulp business.

<Q – Sean Steuart>: That's useful detail. Thanks, Ray. I'll get back in the queue.

<A – Raymond Ferris>: Thanks, Sean.

OPERATOR
Next question will be from Hamir Patel at CIBC Capital Markets. Please go ahead.

<Q – Hamir Patel>: Hi. Good morning. Ray, given all the inflation over the past year, I was curious to get your thoughts on what you would consider replacement costs to be today for anybody looking to build a new lumber mill or OSB mill?

<A - Raymond Ferris>: Well, good morning, Hamir, and that's a question that we ask ourselves, the same one, and I would – and I think I've spoken to this in previous calls. And I'm going to – not everybody builds exactly the same mills or has all the same objectives. And I'm going to be probably pretty vague. I think you saw what we did at Angelina, and I think there's been lots of comment on that. I think that's probably a pretty good reflection of how we see what the costs of a greenfield mill are today. They are significantly higher than they were two years ago, particularly for the mills we're trying to build. I would say we do probably do a few things that maybe others don't. We believe they create more value for us. But we – there's a couple of things. We often will put added energy strategy to our mills, which comes at an increased cost, which we also think comes with an enhanced payback. The other one is that we pay particular focus kind of on environmental conditions in the mill. We're shooting for environmentally controlled operations that are – and so we think that comes at a bit higher cost as well, we also think that comes with a payback as well. So, I'm not answering your question very well, Hamir, but I think our view is if you've picked a number from two to three years ago, it's up by 30%, 40%, 50% depending on what you're looking at.

<Q – Hamir Patel>: Fair enough. Thanks for that, Ray. That's helpful. And just one for Chris McIver. Chris, can you speak to how OSB prices in Europe have changed since the conflict in Ukraine began and maybe how industry prices there have trended into April?

<A – Chris McIver>: Good morning, Hamir. Quite honestly, the OSB prices really haven't changed since the conflict. At least that's our experience. The market is probably a little tighter, but we haven't really seen any noticeable changes in the market price.

<A - Raymond Ferris>: Yeah. The only thing I think I would add to that is good news, bad news, things move slower. Log costs don't move up as quickly. Product prices don't move up as quickly. But I would say demand remains strong, our business looks good. I think we'll see whether that bodes well as – for pricing in the latter half of the year, but it tends to move just a little bit slower, that's all.

<A – Chris McIver>: Yeah. And Hamir, just to add to Ray's comments, we have seen a significant shift over the last year on pricing. So, it isn't like prices haven't moved. They've moved up significantly in Europe. They just haven't moved in the last quarter.

<Q – Hamir Patel>: Okay, great. Thanks. That's all I had. I'll turn it over.

<A - Raymond Ferris>: Thanks, Hamir.

OPERATOR
Next question comes from Mark Wilde at Bank of Montreal. Mark, please go ahead.

<Q – Mark Wilde>: I got one for either Ray or Chris. I wonder if you can just walk us through your expectations for how you think trade may shift around as a result of the war in the Ukraine, both in North America and in Europe?

<A - Raymond Ferris>: Well, good morning, Mark. Chris?

<A – Chris McIver>: Okay. Good morning, Mark.

<Q – Mark Wilde>: Good morning, Chris.

<A – Chris McIver>: That's a great question. It's very early days, first of all. None of this shifts dramatically. Our view is that you will see more wood probably heading from Russia to China and a little less from Russia to Europe, if any. You combine that with a really robust European market already. I think you're going to see and are seeing already less product come into North America. But saying that, there are trade flows that have been set up from Europe to North America and we suspect they will continue. So, that's kind of what we're seeing so far.

<A – Raymond Ferris>: Certainly some conflicting views out there. And I think much depends on – I think, our view would be less over to good markets in Europe, less over to North America. However, if for some reason Europe slides into recession, then I think that – and product prices remain strong in North America, you can see that more products. So, it’s hard to predict today. But I would say in the face of, how I would think about that a little bit, in the face of very strong product pricing on a number of fronts, I think if you look back at the last year or two of European imports into North America, it’s – I think it’s been far below most of our expectations. So, I – it's hard to imagine it would go beyond there in any situation.

<Q – Mark Wilde>: Yeah. Okay. That's good. There have been a lot of different views on what all this is going to mean. I guess the other question I have this morning is when I look at the data for the lumber business last year and I particularly look at the U.S. South, it looks like the capacity base was up close to a 1 billion board feet, yet the production was only up about 140 million. And so, the operating rates dropped 400 basis points and they dropped in the face of all-time record prices. So, I’m just trying to get a sense of what you think happened there. I mean, is all of this just lost production because people couldn’t get labor or labor was turning over more often so, you had – you lost some efficiency in the mills. And then, how would you expect those operating rates to trend as we go forward?

<A – Raymond Ferris>: Well, Mark, I think it's a great question and I think it ties into a number of things. One, I would start by saying a year in our business today seems like 10 years. And people forget that early in 2021, the U.S. experienced a significant winter weather event that led to disruptions - extensive disruptions to production and consumption throughout the South. But I can speak…you know a number of our mills were down a week or more. And then – so I think that was a widespread impact early in 2021. Hopefully I’m getting my years right. And then there were other weather events, Florida, Georgia area was – again, I won't get the stats right. But if you look at weather in certain areas, there were unprecedented levels of moisture, again, which did a number of things, it impacted - people ran out of logs, because they just couldn't get into the woodlands. It reduced production from some of those areas and it increased log costs in some of those areas as well.

And then the one that we talk about all the time is the production and announcements that have come out over the last number of years, the capacity is not – I think we've said this a number of times, it's easy to announce, it's harder to bring this stuff on. And so, from a capital and execution point of view, our view has been – is that it will come on, it'll just come on slower than maybe what some would predict and I think that's the reflection. So, I'd say weather and the ability to execute and we're not – West Fraser's part of that, the ability to execute and ramp up as quickly as you like.

<Q – Mark Wilde>: Okay. All right. If I can slip in just one more, I'm just curious about how you read the OSB market over the last few weeks. I mean we saw a $500 plus drop in the composite in two weeks and now we're bouncing. How do you interpret that?

<A - Raymond Ferris>: Well, I'm going to pitch this to one of the Chris's. But I would say, Mark, I – and I don't mean to be dismissive, but we really don't spend a lot of time worrying about the short-term fluctuations. I mean, I think some of this has played out in the past few years where people start speculating on – and it drives the market in a certain direction. And what I would say – the things that we see fundamentally don't change our view of the next few quarters or a year or two. So, I see what happens. People unwind certain positions and empties out the supply chain. There's – and you go, well, we've seen this play out before. And so just on that, before I give it to someone smarter here is that I – the underlying theme that I think that we've had for a number of years is that the ability for the supply side to react to – just really isn't there anymore. I mean we're – the systems have remained lean for the last number of years. And I would say – again, I tend to use that 1.4 million, 1.5 million housing starts, things are very tight. So, there may be speculation in the market, but the underlying supply and demand fundamentals speak that what's in the system are – have pronounced effects, but don't really change our view on how we want to operate the business. Sorry, Chris, maybe...

<A – Chris McIver>: No, I mean, I would just add that it appears to us that inventories are very lean in the field. And when demand comes back, you see an immediate reaction from the customer side.

<A - Raymond Ferris>: One thing I've learned slowly over my career is that, particularly out of Canada, the supply chain is a lot longer, and when that gets emptied out, you just don't turn a tap and fill it back up again. And it causes some of these swings for sure.

<Q - Mark Wilde>: Yeah. Okay. I appreciate the color, Ray. Thanks, and I'll turn it over.

<A - Raymond Ferris>: Thanks, Mark.

Operator:
[Operator Instructions] And your next question will be from Paul Quinn at RBC Capital Markets. Please go ahead.

<Q - Paul Quinn>: Great. Thanks very much, guys. Just maybe go back to this European OSB pricing question. I'm surprised that you say prices are flat even though they have come up over the last year. Given that our supply side in that area, I think, includes Russia, Ukraine, Belarus - those countries there, kind of own 25% of European capacity. So, taking that away because of the embargoes, I would have expected prices to come up. Is it due to the fact that consumption has come down there because the demand has come down there because of the conflict?

<A – Chris McIver>: Good morning, Paul. Well, a couple things, Paul. One is that an awful lot of that Eastern European production stays in Eastern Europe and Russia particularly. So, it's not – the demand – I can't speak to the demand in Russia, but very little of that product comes West. And so really the demand situation has not changed dramatically in the West in our experience. Saying that, demand is very good right now, and so is pricing. But I think it's more about where that product naturally flows. It doesn't flow West. It stays in the East.

<A - Raymond Ferris>: Yeah. I mean, I would think it's more – I think Chris nailed it, and I think we're very pleased with the demand and pricing is good. And I would just say, again, it's more of a reflection of the different style of transactions that occur in Europe, which tend to be not week to week and so prices do come up, but slower over time. They also come down slower over time. And it's the same on logs. So it's – it just doesn't react week to week. But I think over the next few quarters, I think if Europe stays strong, I would expect that we – I'd hope we'd see continued strength.

<Q - Paul Quinn>: Okay. And then just on the exports out of Europe, I mean, last year because of the record prices we saw in North America, you had exports ramp up to kind of 650 million square feet level, which is kind of equivalent to an OSB mill. So, if there's no supply impact from Russia into Europe, do you expect it to stay at that level in 2022?

<A – Chris McIver>: I'm not sure, Paul. I mean, we really – we can't speak for others. We've had a couple of vessels that we've brought over to North America. But I can't – I'm not sure what others are doing. Yeah. And it's a very small amount of OSB that comes to North America, quite frankly pretty inconsequential.

<Q - Paul Quinn>: Okay. And then I'd just move it over to pulp and paper. Just wonder what's the road to EBITDA breakeven is. We've got pretty decent pulp pricing here. Is that expected in the short term at some point in 2022?

<A - Raymond Ferris>: Well, I sure hope so. And so, first, I – we haven't seen the same upside on BCTMP as we have on NBSK. And unfortunately, our NBSK business has been pretty significantly impacted by transportation in the first quarter. I'd like to tell you that we've got great visibility going forward on transportation and that we can see nothing but green flags waving here. But it is better, things are returning more to normal. But I can tell you this changes week to week. And so, we're still nervous about our ability to ship. I would expect – so that's maybe not a great answer. But I would think we should see – our view would be we're going to capture more of the mill net increases. I think that's happening. We're going to be able to – we should be able to see improved shipping in Q2 and that should support returning to better results. But I just – if I sound like I'm hedging my bet, I think our confidence in rail transportation is going to take a while to get rebuilt based on the last six months, and we just don't have that confidence yet.

<Q - Paul Quinn>: Okay. And then last one I had, Ray, just on the lumber M&A pipeline. I mean, Angelina last year sort of set the high watermark for capacity additions. Has that led to higher expectations on the mill owners or is there still a certain number of sawmills available for sale?

<A - Raymond Ferris>: I don't know if it's led to higher. I think they were pretty high before. I think you look at the pricing and four of the last five years, I think everyone looks at whatever their capacity is and says it's worth more than what others think it is. So, has it changed recently? I'm not sure it's significantly different. But I would say, there aren't more opportunities available. There aren't more high-quality opportunities that we see. So, I just – I would say expectations remain high. And there's – not every opportunity is one that's going to fit a West Fraser view.

<Q - Paul Quinn>: Alright, that's all I had. Best of luck.

<A - Raymond Ferris>: Thanks, Paul.

OPERATOR

Thank you. And at this time, gentlemen, we have no further questions. Please proceed.

<A - Raymond Ferris>: Well, again, thanks everyone for joining our call. And we'll look forward to talking to people over the next weeks and months and for that, we'll sign off and turn it back to you, operator.

OPERATOR

Thank you, sir. Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending. And at this time, we do ask that you please disconnect your lines. Have a good weekend.