WEST FRASER TIMBER CO. LTD.
Q4 2022 EARNINGS CONFERENCE CALL
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CORRECTED TRANSCRIPT

OPERATOR
Good morning, ladies and gentlemen, and welcome to the West Fraser Q4 2022 Results Conference Call. At this time, all lines are in listen-only mode. Following the presentation, we will conduct a question and answer session. [Operator Instructions]

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 2022 annual MD&A and annual information form, which can be accessed on West Fraser's website or through SEDAR for Canadian investors and EDGAR for United States investors. I would like to remind everyone that this call is being recorded today, Wednesday, the 15th of February 2023.

I would now like to turn the conference call over to Ray Ferris, President and Chief Executive Officer. Please go ahead, Mr. Ferris.

RAYMOND FERRIS, CEO, PRESIDENT & CORPORATE DIRECTOR
Thank you, Michelle. Good morning and thank you everyone for joining our fourth quarter 2022 earnings call. Joining me today are Chris Virostek, our Senior Vice-President and Chief Financial Officer; Chris McIver, our Senior Vice-President, Marketing and Corporate Development; and Matt Tobin, our Vice-President of Sales and Marketing and several other members of our executive team. I'm going to begin with a brief overview of West Fraser's fourth quarter and full-year 2022 financial results and then I'll pass the call over to Chris Virostek for some additional comments.

West Fraser generated $70 million of adjusted EBITDA in the fourth quarter of 2022 as we experienced weakening demand across several key products, particularly in North America where rising mortgage rates impacted near term housing affordability. This weakness was particularly evident in our Lumber segment and was partially offset by positive EBITDA contributions from our engineered wood products and our pulp business.

Overall, however, 2022 was a strong year of performance for West Fraser as we generated $20.86 of diluted earnings per share and over $3.2 billion of adjusted EBITDA, representing a 33% margin. In the fourth quarter, we invested nearly $150 million back into the business through capital expenditures. We repurchased $117 million of shares and returned $25 million to shareholders through dividends. For the full year, we repurchased nearly $2 billion of shares through our normal course issuer bids, a substantial issuer bid, and now the company has repurchased approximately 39.7 million common shares since early 2021, representing about 73% of the shares issued with the Norbord acquisition.

We have been disciplined in our approach to capital allocation and have preserved 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 and invest 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 short overview, I'll turn the call over to Chris for some additional detail.

CHRIS VIROSTEK, CHIEF FINANCIAL OFFICER
Thanks, Ray. And good morning, everyone, and thanks for joining. And a reminder that we report in U.S. dollars, and all my references are to U.S. dollar amounts unless otherwise indicated.

Our North America EWP segment generated $109 million of adjusted EBITDA, down from $215 million in the prior quarter. This result benefited from a $14 million insurance recovery that partially offset repair costs and lost margins charged to earnings in previous quarters, stemming from unscheduled downtime at one of our OSB mills.

The lumber segment posted negative $77 million dollars of adjusted EBITDA, declining from $160 million in the third quarter, a period that included an $81 million recovery of export duties associated with AR3. Note that these fourth quarter lumber segment results include a $39 million inventory write-down, which we recognized as lumber prices reached a near-term low at the end of the year. Also of note, in the absence of these Q4 inventory write-downs, our B.C. business in the aggregate was profitable in the quarter due to our downstream integration in MDF, plywood and pulp.

The Pulp & Paper segment generated $15 million of adjusted EBITDA in the fourth quarter versus $29 million in the prior quarter. While in Europe adjusted EBITDA rose to $30 million in the fourth quarter from $24 million in the third quarter. Price declines were the largest driver for the sequential EBITDA declines across our North American Lumber and Engineered Wood Products businesses.

We generated $147 million in cash from operations for the quarter. Though our cash balance, net of debt, while still at a very healthy level, decreased modestly quarter-over-quarter to $625 million from $789 million as we allocated $142 million to share repurchases and dividend payments and spent $149 million on capital expenditures in the quarter.

In terms of our outlook for 2023, we are providing initial operational guidance for the year as detailed in our earnings release and on slide 6, including ranges for key product shipments and our planned capital expenditures.

With that overview, I'll now pass the call back to Ray.

RAYMOND FERRIS, CEO, PRESIDENT & CORPORATE DIRECTOR
Well, thanks, Chris. Although, you know, too difficult or difficult to predict, we believe that in the near term, we expect that the business will continue to experience challenges ranging from the risk of resurgence of inflationary cost pressures, ongoing and continued labour constraints, and the potential for dampened product demand owing to overhang of housing affordability on the housing and wood building products industries. Inflationary cost pressures have been moderating across much of our supply chain for raw materials such as energy, resins, and chemicals, and we expect this trend to continue throughout 2023. On the demand front, there may be early indications that demand conditions are improving as the cadence and magnitude of mortgage rate increases has eased somewhat, which is particularly relevant for the use of our products in new home construction.

With respect to market fundamentals, I'd like to share with you slide 7, which highlights the challenges that the North American lumber industry has faced and continues to face in terms of supply. We have now been through a period in which four of the last six years have experienced strong lumber demand and pricing, yet the growth in North American lumber supply has been effectively zero. We often speak about the many constraints that the lumber industry faces when it comes to adding capacity, and the first and foremost of these is fiber availability.

As this slide indicates, while the U.S. South remains a critical area of supply growth within North America and a key region for West Fraser's growth strategy, shrinking fiber baskets in other regions, most notably British Columbia, have offset U.S. South growth in recent years. In our view, these fiber and supply challenges will persist for the foreseeable future. And as such, we remain optimistic about our U.S. growth strategy with respect to the long-term prospects for our lumber business.

Nonetheless, we remain very attuned to the potential risks that West Fraser faces and will continually and diligently manage our operations accordingly, to meet available customer demand with our geographic and product diverse operations.

Executing on our core strategy to be low cost, to reinvest in our operations, and to continue to prioritize financial discipline, which we believe will allow us to be well positioned to capitalize on the more favorable supply and demand fundamentals we expect to see for our products over the medium and longer term. Importantly, our team has a proven track record of managing through market cycles, and we will continue to focus on being a low-cost producer of wood building products.

With another fiscal year behind us, I'd like to provide an update on our track record on return of capital employed. Moving to slide 8, our strong performance in 2022, underpinned by adjusted EBITDA and operating earnings of $3.21 billion and $2.56 billion respectively, drove a ROCE of 28% for the year. Notably, including 2022, the company's ROCE has now exceeded 15% in six of the last seven years and has averaged more than 25% since 2016. Attractive returns like these are a reflection of our continued attention to managing costs and expanding margins through product mix improvements as well as our product and geographic diversification. We believe these strong returns and performance are underpinned by the continued gains we've made in our environmental, social, and governance efforts in 2022, such as committing to the greenhouse gas emissions reduction targets for the Science-Based Targets Initiative, which demonstrates our commitment, sustainability leadership and contribution to global climate action.

I am pleased to see that much of the work our team has done to improve these attributes and disclosures is now being more broadly recognized externally. Slide 9 highlights several of the organizations that provide ESG ratings of West Fraser. And in many cases, we are not only scoring well but showing improving trends. Although we have more work to do, we believe this will continue to be an improving and very good story to tell as we move forward.

On slide 10, a combination of supportive industry fundamentals and our execution and performance are reflected in the attractive returns generated for West Fraser shareholders over a number of cycles as you can see. With a total annualized return in excess of 12% since 2006, which includes share price appreciation and reinvested dividends, we are proud of what the West Fraser team has been able to accomplish.

In closing, while demand markets were challenging in the fourth quarter and there are near-term uncertainties across our business, we remain confident in the foundation we have built and our strong momentum. And, as I alluded to earlier, we've been through industry cycles before and believe we have the talent, assets, and financial flexibility to handle both the challenges and opportunities ahead, whether they be in the near, medium or long term. We remain optimistic about the continued growth and demand for the types of sustainable and renewable wood products that West Fraser manufacturers and for which the company is known.

Finally, I want to share that my friend and colleague, Chris McIver, West Fraser's Senior Vice-President of Marketing and Corporate Development, will be retiring at the end of March. Chris has had a long and distinguished career with the company, spanning more than 32 years during which he has made significant contributions to West Fraser. Chris, you will be missed and we congratulate you and look forward to hearing about your adventures as you move forward.

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

OPERATOR
Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] Your first question will come from Ketan Mamtora of BMO Capital Markets. Please go ahead.

<**Q – Ketan Mamtora**>: Thank you and good morning. Ray, I was just curious how you were thinking about the timing of, you know, restart of the Allendale OSB mill. The release talked about sort of potential restart in Q2. So, if you can just help us understand, you know, would that still depend on where demand is? Or are you all planning to go ahead with a restart in Q2? Thank you.

<**A – Raymond Ferris**>: Well, good morning, Ketan, and thanks for the question. Our purchase of that asset and our reinvestment strategy is a long-term consideration. And so, our restart that we expect in - I think at the end of Q2 2023 - really has only been pushed out by supply chain issues. We're quite pleased with how the team has performed and how the capital and preparing for a restart has gone. So, we remain committed to that long-term investment strategy.

And look, as we think about how we run our business, it will always be about finding the way to make sure that we meet available customer demand in the best way possible. But I think it's important to note that Allendale we see is an important part of that portfolio mix that as we ramp that up over the next two or three years, we see it as being one of our best positioned and lowest cost assets that we'll have. And so, we remain committed to that at this time.

<Q – Ketan Mamtora>: Got it. That's helpful. And can you provide a little bit of sort of perspective in terms of what you are seeing with current demand? It seems like most homebuilders are pointing to a better than expected start to January. I'm not asking for specific January numbers but in terms of what you are hearing from your customers as we start 2023.

<A – Raymond Ferris>: We've got Chris McIver on the line. Mr. McIver, would you like to take a shot at that?

<A – Chris McIver>: Sure. Thanks, Ray. Good morning, Ketan. I think what we're hearing is very similar to what you're hearing. Firstly, our R&R business both on panels and lumber is stronger than we probably thought it was going to be right now, it's held up very well. And we're beginning to hear that the builders are actually seeing things better than what they expected. Our takeaway on the lumber side and panels, we see customers keeping their inventories pretty lean and they'll come in and buy and then they'll back away a bit. So, I think it's very early to make any sort of forecast as to what's going to happen in the balance of the year, but I would say demand is better than we expected at this time.

<Q – Ketan Mamtora>: Okay. Now that's helpful perspective. Thank you and I'll jump back in the queue.

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

<Q – Hamir Patel>: Hi. Good morning. I just want to follow-up on that question about the demand. And Chris McIver with respect to that R&R channel, do you expect demand there to be up this year or you're building in a decline because we've seen a wide range of forecast for R&R activity for 2023?

<A – Chris McIver>: Hi. Good morning, Hamir. I think it's a pretty difficult question for us. We really don't put out forecasts as far as, you know, as what − where we think the markets are going to go. Yeah, I would say that it's holding up better than we expected, and they continue to tell us that they expect business to continue much along what we've seen in January. So, you know, beyond that so, beyond that, I really don't know so...

<Q – Hamir Patel>: Fair enough. Thanks.

<A – Raymond Ferris>: I think – I'll just add a comment, Hamir. I think that's very true. I think everyone's visibility is about the same. I think it's so early in the year to get a sense of where interest rates are going to go and whether it's a recession, shallow, deeper. I think we're all kind of – I think that'll be the primary driver of short-term demand for our building products. And it's going to be interesting to see how it plays out.

<Q – Hamir Patel>: Fair enough. And Ray we've seen some of your peers announce some permanent mill closures in B.C. for both lumber and pulp. How much more lumber and pulp capacity do you think needs to come out of the province and how do you think West Fraser fits into that.

<A – Raymond Ferris>: Ah. Well thanks Hamir. I have no idea what others will do. I think over the last number of years we've continually shaped and positioned our assets to the available timber supply. We will continue to do that. And much of this depends on policy decisions that continue to - the impact of those policy decisions sometimes is still yet unknown what impact that will have on going forward. And as those decisions, we'll adjust our capacity as necessary, whether that's up or down and, you know, I'll kind of leave it at that. It's really a provincial decision on how much fiber they want to make available to the industry.

<Q – Hamir Patel>: Great. Okay. Thanks, Ray. And just the last question I had was on mass timber. I know the company always gives a slide there about the long-term potential there. I noticed the sort of 2035 demand base case there has been reduced from I think it was around 5 billion last quarter to just over a billion this quarter. So can you speak to maybe what made you reset your expectations there?

<A – Raymond Ferris>: Great question, Hamir. I'm supposed to know the answer, but I don't think I do. So, we − that's − it's probably an SLB or softwood lumber board data. But what I would say is we're big fans of the mass timber market. We've been big supporters of helping develop that market through participation and industry associations like the softwood lumber board and others.

We think - and I think you're seeing that - we see that continuing to grow in certain segments of the building sector and whether it's 2 billion or 5 billion, I don't know, but I do think it's another indication of more around the growing demand for wood products. I think, you know, just those sustainable environmental carbon capturing attributes of wood products, I think mass timber is just one example - people are familiar with it - but I'm not sure exactly what the final number will be.

<Q – Hamir Patel>: Yeah. Fair enough. Thanks, Ray. That's all I had. I'll get back in the queue.

OPERATOR
Your next question will come from Sean Steuart at TD Securities. Please go ahead.

<Q – Sean Steuart>: Thanks. Good morning, guys. A couple of in-the-weeds questions. The carbon allowance gain on sales in Europe you had this quarter, can you give us some context on that item and any element of recurring gains going forward related to that?

<A – Chris Virostek>: Hi, Sean. Thanks. Thanks for that. Yeah, I would say, probably not be thinking about that as a recurring item here. Confluence of events over the last couple of years in terms of energy consumption and energy pricing in the markets there enabled us to generate a bit of a windfall on that in 2022. But I wouldn't suggest you should be baking that into kind of long-term run rates in terms of earnings potential for us or the generation of those credits over the longer term.

<Sean Steuart>: Okay. Thanks for that, Chris. And with respect to the Cariboo curtailments, you guys outlined a few weeks ago, any context you can give us on the expected earnings impacts in 2023?

<A – Chris Virostek>: Not at this time.

<Q – Sean Steuart>: Okay. The rest of my questions have been answered. Thanks very much, guys.

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

<Q – Paul Quinn>: Yeah. Thanks. Morning, guys. I guess I'll put McIver on the hot seat here just cause he's fading off into the sunset. But, Chris, maybe you can sort of describe what you're seeing in terms of M&A opportunities for West Fraser. Is that increased with the drop in lumber prices or is it sort of status quo?

<A – Chris McIver>: Good morning, Paul. Firstly, we don't really answer any questions around M&A. But what I would say is that we're always in the market looking at opportunities in North America and in Europe and other spots. And I would say that it's sort of business as usual as we sort of go along. But there's nothing specific.

<Q – Paul Quinn>: Have you guys noticed any more equipment available in the industry? It's guys that are looking to build either sawmills or OSB mills, but they backed away given the difficult conditions presently?

<A – Raymond Ferris>: I can take that one, Paul, and good morning. Generally, I would say it's – we're seeing some signs of supply chain getting better, but it's more looking down the road than right in front of us today. So, with respect to equipment availability, and specifically to, say, capital, that still remains challenged. Again, as you look out, say, a number of months from now, it looks like it's improving. But in the short term, it's still quite constrained.

And I don't have any visibility to what others may or may not have done around orders. But for us it’s business as usual. We're moving ahead with everything that we have planned and trying to move up what we can and adjusting to whatever the constraint might be on a particular item.

<Q – Paul Quinn>: All right. And just lastly, you've got on slide 7 sort of your expectation in the 2023 outlook on fiber costs. Near-term log costs expected to moderate in the U.S. south. So just wondering, can you quantify moderation, is that a 5% or 10% drop? And does that change the outlook for the closure at Perry?

<A – Raymond Ferris>: So generally, I would say in North America, most of our regions we've seen some moderation in fiber costs and, including the U.S. South, and including the area around Perry. But look, we made that decision with a view to the next year, the next six months to a year sort of thing. So, I can't give it to you in a percent because the quarter's not done and so things can change. And it varies widely between regions, quite frankly, very region specific. And to a great extent, the Perry decision was very region specific.

<Q – Paul Quinn>: All right. That's all I had. Best of luck guys. Thanks.

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

<A – Chris Virostek>: Thanks, Paul.

OPERATOR
At this time there are no further questions. So, I would turn the conference back to Mr. Ray Ferris for any closing remarks.

RAYMOND FERRIS, CEO, PRESIDENT & CORPORATE DIRECTOR
Well look, thanks everyone for taking the time in your schedule to join us on our call. And we look forward to talking to you next quarter. Thank you. Thank you, Operator.

OPERATOR
Ladies and gentlemen, this does conclude your conference call for this morning. We would like to thank you all for participating and ask you to please disconnect your lines.