WEST FRASER
Q2 2022 EARNINGS CONFERENCE CALL
JULY 28, 2022 – 11:30 A.M. ET
CORRECTED TRANSCRIPT

OPERATOR
Good morning, ladies and gentlemen, and welcome to the West Fraser Q2 2022 Results Conference Call. At this time, all lines are in a listen-only mode. But 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 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 Fraser's website or through SEDAR for Canadian investors, and EDGAR for United States investors. This call is being recorded on Thursday, July 28, 2022.

And I would like to turn the conference over to Mr. Ray Ferris. Please go ahead, sir.

RAYMOND FERRIS, CEO, PRESIDENT & CORPORATE DIRECTOR
Well, thank you, Silvie, and well done. So, listen good morning, everyone, and thank you for joining our second quarter 2022 earnings call today. I'm Ray Ferris, President and CEO of West Fraser, and I'm joined today by Chris Virostek, our Chief Financial Officer, and Chris McIver, our Senior VP Marketing and Corporate Development, and several other members of our executive team. I'll begin with a brief overview of key highlights of West Fraser's second quarter results, and then pass the call to Chris Virostek for additional comments.

In the second quarter, West Fraser achieved strong financial results in the face of ongoing transportation and logistics challenges. As you may recall from recent quarters, transportation challenges have been particularly acute and of longer duration than we and others had originally expected. However, we did see a start of signs of improvement in the second quarter, and that trend has continued early into the third quarter.

Demand for our wood-based building products was robust in the second quarter, generating $1.12 billion of adjusted EBITDA, representing a margin of 39% of sales. The benefits of our product and geographic diversity continue to be a differentiator for West Fraser. As a result, we saw a more resilient EBITDA for the North American Wood Products segment in a quarter where our lumber business saw more significant sequential decline.

On capital allocation, it's important to note that in the past 18 months, the company has repurchased approximately 37 million common shares through our normal course issuer bids and the completion of two SIBs. Altogether, this equals 67% of the shares issued in respect of the Norbord acquisition. Through this same period, we've increased our dividend three times to a level of $0.30 USD today.

Notwithstanding this return of capital, our balance sheet continues to offer significant financial flexibility, which is a key priority of our capital allocation strategy.

With that short overview, I'll now turn the call over to Chris for additional detail and comments.

CHRIS VIROSTEK, CHIEF FINANCIAL OFFICER

Thank you, Ray, and good morning, everyone. 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 American EWP segment generated $623 million of adjusted EBITDA, down approximately 15% from the first quarter, while lumber generated $449 million of adjusted EBITDA, down approximately 44% from the prior quarter. And while improved from the prior quarter, the Pulp & Paper segment had a negative $3 million of adjusted EBITDA in the quarter. And while we're not satisfied with the pace of progress we are making in this business, we remain focused on our long-term solutions to improve the Pulp & Paper segment, which includes our UKP strategy. In Europe, adjusted EBITDA was $54 million versus $78 million in the prior quarter. Price was the single largest driver for the sequential EBITDA declines in North America, more than offsetting improvement in shipments from the first quarter, while in Europe lower second quarter shipments more than offset better pricing.

Cash flow from operations in the second quarter was $1.06 billion, supported in part by a seasonal decrease in working capital, while cash net of debt declined quarter-over-quarter to $746 million as we repurchased nearly $1.5 billion of our common shares in the second quarter. Included in these share repurchases was $1.13 billion of shares repurchased upon the successful closing of our second substantial issuer bid in the last 12 months, furthering our track record of returning significant capital to the shareholders. As Ray mentioned, we also raised our quarterly dividend to $0.30 per share to distribute a substantially similar amount of cash through dividends, after giving effect to the shares repurchased through the NCIB and the SIB.

I'll now shift to our 2022 operational outlook for the balance of the year.

In part due to the ongoing transportation challenges in North America and despite the considerable progress we made with our Q2 shipment volumes compared to Q1, we're providing a slightly more cautious annual SPF lumber guidance. We now expect SPF shipments to be closer to the bottom end of the range of 2.8 to 3.0 billion board feet. We are maintaining our guidance for SYP shipments which we still expect to fall within the range of 3.0 to 3.2 billion board feet this year. For our North American OSB business, given continued constraints to trucking services and signs of slowing demand, we are reducing our annual shipments guidance to a range of 5.9 to 6.2 billion square feet on a 3/8-inch basis.

In Europe, we are seeing early signs of slowing demand and as such are slightly reducing our OSB shipments guidance. We now expect 1.0 to 1.2 billion square feet on a 3/8-inch basis this year. And lastly, we are reiterating our guidance range of $500 million to $600 million for planned capital expenditures in 2022. However, given the rate of expenditures in the first half of the year and ongoing supply chain challenges, we expect our capital spend may fall closer to the bottom end of this range.

As discussed last quarter, it remains difficult to estimate when full transportation services will be available. In the meantime, we continue to actively seek and utilize alternative transportation routes and methods to the extent they are available to continue servicing our customers. Given this uncertainty, further reductions of operating schedules across our production platform may be required to manage raw material supplies, inventory levels, and our integrated fiber supply chain.

Consistent with our previous quarters across much of our supply chain, we are experiencing greater than usual inflationary cost pressures and availability constraints for labor, transportation, energy, and raw materials such as resin and chemicals. We expect these cost pressures and availability constraints to remain elevated through the remainder of 2022.

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

RAYMOND FERRIS, CEO, PRESIDENT & CORPORATE DIRECTOR

Thank you, Chris. Look, as we navigate the current operating environment and manage the ongoing challenges, as Chris noted, I remain confident that our product and geographic diversity, our culture of cost control and operational discipline, our strong customer relationships and our balanced approach to capital allocation will continue to serve us well. Equally as important is the diligence and determination of our people who continue to adjust as needed to meet our operating customer needs.

Given the macro and market developments in recent months, I'd like to make just a few comments about the environment in which we find ourselves today. We acknowledge that there is a growing uncertainty surrounding rising interest rates, elevated energy prices and broad inflationary cost pressures that in many instances are directly connected to strained supply chains.

In particular, there are questions surrounding the potential impact these and other factors may have on housing affordability and repair, remodel, renovation spending, which may result in short-term fluctuations in demand for our wood building products. It's important to remind everyone that our focus is on the long-term, and our simple and proven strategy is to be low-cost, have great people and assets and supported by a strong balance sheet. And we are very fortunate to have a seasoned team with a proven track record of successfully navigating through previous cycles.

So, in terms of market fundamentals, despite these near-term headwinds, we believe the longer-term supply, demand, and the growing role and importance of sustainable forest products and low carbon economy remain robust. Ongoing constraints both due to limited fiber availability and supply chain may continue to make it difficult to quickly adapt to increasing demand. Also, the historically key lumber producing region of British Columbia continues to see downward pressure of its longer-term ability to contribute to the needed supply. And this has recently been exacerbated by increasingly stringent public policies that are driving further reductions to that province’s annual allowable cut.

In contrast, despite significant industry investment growth in the U.S. South region, overall North American supply response has not been sufficient to offset reductions in other regions. In terms of demand, an apparent housing shortage in North America appears to be constrained by affordability, limiting consumers' ability to purchase homes. Rising interest rates and wage inflation, although a short-term impact, can play an important role to improving housing affordability in the longer-term.

I would now like to update you on the progress we’ve made with some of our recent acquisitions, specifically the Allendale OSB mill and the Angelina sawmill. First with Allendale, which is our idled OSB mill we acquired late last year. We continue to make progress rebuilding the front-end of the mill, which we expect will simplify the process and make the mill easier to operate, thereby improving productivity. I'm also pleased to note that our Allendale team has made good progress with our early staffing needs, giving us confidence that we will be able to attract the necessary talent as we move towards eventual start up. Supply chains and cost inflation have impacted us everywhere, including Allendale, and we now expect our potential restart date will be in the first quarter of 2023. We believe the large-scale Allendale mill, with the help of our skilled OSB team, will be among the lowest cost mills in our OSB portfolio when it's operating at full production.

Secondly, and moving to Angelina, I'm pleased to report that this acquisition has gone very well so far, exceeding many of our base assumptions for that sawmill. Operationally, we are seeing better production and at lower cost than what we anticipated. The mill's EBITDA since acquisition is approximately three times our original base forecast. Thanks to this financial performance and better than expected timing of certain tax deductions, we estimate the IRR for this acquisition, while still early, is approaching high-teen percentages, well ahead of our original estimate of approximately 13%.

With the announcement of our second quarter financial results, I'm also pleased to announce the publication of our 2021 Sustainability Report. A tremendous amount of work went into this report, and we are proud of our progress to-date. I wish to specifically recognize our Chief Sustainability Officer, Shenandoah Johns, and our dedicated team for the progress we've made. As we continue to take steps toward becoming a sustainability leader, highlights from the report, which I encourage all to read, include: West Fraser becoming the first Canadian wood products company to commit to joining the Science Based Targets initiative to materially reduce greenhouse gas emissions by 2030 in alignment with the Paris Agreement; as well as improving the overall diversity inclusion of our workforce, more than doubling the female representation on our board in 2021; and perhaps most importantly, and why we clearly understand that we have much more work to do to eliminate serious incidents and injuries in the company, we achieved our lowest recordable injury rate in our history.

Before turning to the Q&A portion of today's call, I'd like to make a few additional remarks on our capital allocation strategy. Our priorities aim to balance disciplined investments in the business with returning capital to shareholders, all while maintaining our financial flexibility. We continue to believe that a consistent balanced approach is key to long-term value creation. To that end, a top priority for us continues to be reinvesting in our existing businesses. This includes deploying capital towards advanced automation technologies that drive further innovation to enhance our operating platform.

We will also continue to prioritize returning excess capital to our shareholders, whether that's through dividends or share repurchases when we believe our shares are trading at a discount to their intrinsic value. At the same time, with the objective to maintain financial flexibility through the cycle, keeping sufficient cash to invest in the business and enable opportunistic acquisitions and/or pursue larger scale strategic growth initiatives when they are available.

Given our strong balance sheet, we will continue to look for additional opportunities to effectively deploy our capital as we execute on our strategic objectives. Reflecting on these priorities, slide 11 shows our track record. Since 2016, nearly 35% of our cash generation has gone toward capital expenditures and acquisitions directed to improving and expanding the company. Approximately 15% of our cash flow has been retained or used to pay down debt. And lastly, nearly half of our cash flow generation has been returned to shareholders, including approximately $3.7 billion of share repurchases over the last six plus years, highlighted by the successful completion of the two substantial issuer bids in the last 12 months.

In short, and overall, we are pleased with our results this quarter. Our balance sheet is strong. We have the necessary liquidity to allow us to aptly navigate future challenges and opportunities. And just as important, we have the knowledge and bench strength to continue to move the company forward and to grow and create value, whether organically or through acquisitions, if and when attractive M&A opportunities arise, all while recognizing there are potential near-term headwinds for our business. But we remain optimistic about our people and the company's longer-term prospects, as well as continued growth in the use of sustainable and renewable wood products. And we remain diligent and focused on being agile to navigate and adapt to market challenges and the demands of our customers.

Finally, and I'd be remiss if I didn't note this, as you are all aware, we issued a press release last week in response to recent media speculation. I believe that the release is clear, it's concise and so in that spirit I will not be adding any further comment and will simply refer you to the press release.

Thank you, and with that, I'll turn the call back to the operator and ask for questions. Thank you.

OPERATOR

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

<Q – Sean Steuart>: Thank you. Good morning, everyone. A few questions for you, Ray. With respect to the lower 2022 volume guidance for a few of the segments, it sounds like it's a combination of ongoing freight availability constraints and demand backing off, and I guess I'd like to focus on the latter a little bit. In North America, can you give us a bit more detail on specific end market weakness? It feels like it's more skewed to new home construction right now than repair and remodeling. But any details you can give us on what you're seeing in the North American end markets for the lumber and panels?

<A – Raymond Ferris>: Well, good morning, Sean. And look, I'm going to – we're going to tag-team on this one. I'll turn it over to McIver here. But I would say, for the second quarter, I would say that a lot of our demand has fallen off. And I'll – interestingly enough, we saw furniture demand in some of our OSB and industrial specialty business slowed down significantly. I think we've seen more softening in those areas and less in the single-family housing area. But I think that's – I'll let Chris kind of fill that gap there. Chris?

<A – Chris McIver>: Yeah. Good morning. Sean. Yeah. Not a lot to add really. I think we suspect or we think that we will see a little slowing down in single-family going forward. But so far we haven't and repair and remodel has remained robust.

<Q – Sean Steuart>: Okay. Thanks for that detail, Chris. On Allendale, it sounds like you're taking a measured approach to doing the work there ahead of the restart and you mentioned the Q1 2023 target. I think in some of your other work in the slide deck and investor materials and work would correspond with this. So, you think the OSB market right now, the capacity fits basically 1.5 million U.S. housing starts. And I guess the question is, if we trend a little bit below that on an annualized basis, is there potential that the Allendale restart could be pushed out later in 2023 or even 2024, if demand dictates that?

<A – Raymond Ferris>: Well, Sean, look, I mean, look we've got a plan. We're executing on that. Our intention is to start that mill up as we discussed. As you can imagine, starting a mill, it will take us at least a couple of years to get up to somewhere near rated capacity. And so, decisions that we make aren't likely to be quarter-to-quarter ones, they are going to be longer-term ones; this is a longer-term decision. But look, you know, we'll read the tea leaves as we get closer to that final decision and if the market doesn't want any more OSB, we're going to have to take that into context. But again, we'll be looking to the long-term in making that decision. But currently, our plans are to continue ahead as we've discussed.

<Q – Sean Steuart>: Okay. Thanks very much, Ray. I will 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. I wanted to first ask about the European OSB business. Just wondering, if you can give us more sense as to how much demand has moderated there, if there's any notable differences between maybe the new res and R&R component, and how you see prices evolving for OSB in Europe in the second half.

<A - Raymond Ferris>: Well, good morning, Hamir. And I think it's a good question. I think the European OSB is interesting. I think with the onset of the war, the impact on Russia and Ukraine, Belarus, I think there's been a lot of focus about how that will shake out. I think many of us are still seeing how that sorts out. So, look, demand did soften. It's hard to determine exactly why that is. Part of it, we believe, has to do with the fact that although all these sanctions come on, you have to remember these impacts on shipments out of Russia, Belarus and other areas didn't take effect until July 10. I think it's going to be interesting to see what Q3 and Q4 look like for demand, but I do think it's going to take some time to kind of understand what the impact of those sanctions are and to understand how much demand has softened versus potentially a lot of shipments getting out of Eastern Bloc countries and getting into Europe. So, I wish I had a better answer for you, but I think we're trying to understand that. It certainly is soft and slow, but I would say rather than a specific R&R or a single family, I would say it's probably even across the segment.

<Q – Hamir Patel>: Fair enough. Thanks Ray. That's helpful. And just coming back to the lumber business. I know B.C. is only about a quarter of your capacity. But could you just fill us in on how much stumpage in the province, at least in your geographies, is up in Q3? Where do you see that going in Q4, and where you'd estimate breakeven is today for the B.C. industry?

<A - Raymond Ferris>: Well, I think we – I think in – earlier, in Q1, I think we said we thought it was going to be around $40 a cubic meter. I think the final number came out around $35 to $40 depending on the region that you're in. So, that's a pretty significant jump in costs now. And so, it obviously plays an impact on how much the available economic fiber that you're willing to go out and chase to bring into your operations. I'm not going to comment on what I think the breakeven price is in British Columbia. I think there's lots of information out there. And I'd say it's directionally accurate, depending on where you look at. It's a pretty high number. And we don't see stumpage softening until early Q4. So, thanks, Hamir.

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

OPERATOR
Thank you. Next question will be from Mark Wilde at BMO. Please go ahead.

<Q – Mark Wilde>: Thanks. Good morning, Ray.

<A - Raymond Ferris>: Good morning, Mark.

<Q – Mark Wilde>: I got a question for Chris McIver. I wonder if you could just talk with us a little bit about what he sees in channel inventories, whether he's seen buyers a little more willing to kind of step in and take on some inventory with lower prices. And then also just help us with your thinking around how much carry-through there is with builders just working through kind of current backlogs right now.

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

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

<A – Chris McIver>: That's a big question, but yeah – well, firstly, around inventories, the information is anecdotal because there is no, what I would call any really legitimate measure. But we understand from our customers that generally they're being cautious. Inventories are low. And they're purchasing as they need to. So, which I think is very good for the industry. With regards to prices coming off, we've seen a rebound in the retail sector, which has been very helpful. And with regards to builders, again, we hear what you do. They're finishing what they have and sort of looking to the future. But that's more or less what we're seeing.

<Q – Mark Wilde>: Do you have any view, Chris, on how long that sort of working off the backlog process might take? You have a view that's at kind of six months, is it four months, is it eight months? What would be kind of your best estimate of that?

<A – Chris McIver>: Yeah. Mark, we really don't have a view. We don't have visibility into that on, from builder to builder, so I really can't say.

<Q – Mark Wilde>: Okay. And then I'm just curious, has there been any impact on your OSB and plywood operations from all this litigation around Brazilian plywood imports?

A – Chris McIver>: No. Nothing that we have noticed anyways, no.

<Q – Mark Wilde>: Okay. All right. That's it for me. Thank you.

<A - Raymond Ferris>: Thanks, Mark.

Operator:
[Operator Instructions] And your next question will be from Paul Quinn at RBC.

<Q - Paul Quinn>: Yeah. Thanks very much. Good morning, guys.

<A - Raymond Ferris>: Good morning, Paul.

<Q - Paul Quinn>: Hey, I just want to follow up on this point on your slide deck that you're continuing to ramp up at Inverness Phase 2 and Genk and try to reconcile that with the comments that shipments overall in 2022 here will be down.

<A - Raymond Ferris>: Can you – I hate to do this, but can you repeat that question, Paul?

<Q - Paul Quinn>: Sure. So just on your, I guess this slide 8. You've got a point that you continue to ramp up at Dudley, Chambord, and but you've also named Inverness Phase 2 and Genk. And I know you've got capital projects. You've spent a lot of money at both those facilities. So just trying to reconcile that with your reduced guidance on shipments going forward to the balance of 2022 – does that mean you're getting increased operating rates to build inventory, or how do we reconcile that?

<A - Raymond Ferris>: You're forcing me to look at the webcast now, and I'm trying to – yeah. I think we're looking at – yeah. So, I'm trying to unpack the question there, Paul. I mean, I think when it comes to, like I'll just kind of go through this and tell you what we're trying to say. So, Chambord, we're ahead of our plan. And I'm going to call it, let's call it somewhere around three quarters of capacity sort of thing. We're quite pleased with the progress the team has made there. Inverness is essentially there. And I think we've talked about the slowdown in Europe where we are kind of operating to meet market. Genk is running extremely well. I think we've talked about Angelina. I'm not sure I'm answering your question very clearly, Paul, but maybe I can help clarify something if you have a follow-up question.

<Q - Paul Quinn>: Maybe I should just ask easier questions. Maybe just flipping over to the lumber side. Now that North American prices have come down, does that give you a bigger opportunity or an increased opportunity to export more in offshore markets?

<A - Raymond Ferris>: Well, first of all, Paul, I need easy questions. You should – you know that. So, thanks for that. But look, I would say, any contraction in pricing has been relatively short-lived. I would say, no real change at this point. I think it would take an extended period of time before we see an opportunity to create further opportunity. I think Chris mentioned – I think although things have softened and people have become more cautious, I think people still have a pretty robust view around the supply and demand fundamentals of our business and the needs out there. So, I think if you look past the next few months or next couple of quarters, I would think people's expectations are still pretty strong.

<Q - Paul Quinn>: Okay. And then just lastly, not that you need the cash, but just wondering what it's going to take to get a solution on softwood lumber. Is there any movement here at all? And is it something you guys are pushing for?

<A - Raymond Ferris>: Well, certainly, we believe that the continued – that the dispute is without merit. We expect to see those duties returned and continue to fully support the litigation process that we're involved in. And we'll see – we would expect to see an announcement around final determination of the AR3 in the next week or two. And we expect that to support that point of view. So, but with respect to negotiations and resolve, there's really nothing happening. There's a little bit of back and forth in the media, but I – it doesn't really appear to be anything meaningfully happening to move that forward.

<Q - Paul Quinn>: Okay. And just as a follow-up, I understand the AR3 is coming out, but where are with the WTO and NAFTA processes? And is there any expectation that you'll get some kind of ruling in 2022 or 2023?

<A - Raymond Ferris>: I'm not – I really don't have anything to add there, Paul. I can't predict what comes from them and at what time.

<Q - Paul Quinn>: All right. That's all I have. Best of luck, guys. Thank you.

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

OPERATOR
Thank you. And at this time, Mr. Ferris, we have no further questions. Please proceed.

<A - Raymond Ferris>: Well, listen, thank you so much for everyone joining the call and we'll look forward to talking to you on our Q3 results. Thank you.

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.