# West Fraser Timber Co. Ltd. (WFG)

*Updated July 12th, 2022, by Yiannis Zourmpanos*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $81 | **5 Year CAGR Estimate:** | 4.8% | **Market Cap:** | $7.2 B |
| **Fair Value Price:** | $162 | **5 Year Growth Estimate:** | -10.0% | **Ex-Dividend Date:** | 06/21/2022 |
| **% Fair Value:** | 49.9% | **5 Year Valuation Multiple Estimate:** | 14.9% | **Dividend Payment Date:** | 07/08/2022 |
| **Dividend Yield:** | 1.5% | **5 Year Price Target** | $96 | **Years Of Dividend Growth:** | 7 |
| **Dividend Risk Score:** | C | **Retirement Suitability Score:** | D | **Rating:** | Hold |

## Overview & Current Events

West Fraser Timber Co. Ltd. (WFG) is a diverse manufacturer of wood products with over 60 locations in Canada, the United States, the United Kingdom, and Europe. The company produces pulp, newspaper, wood chips, various residuals, lumber, engineered wood products (OSB, LVL, MDF, plywood, and particleboard), and renewable energy. WFG's products are used in industrial applications, papers, tissue, packaging materials, house building, maintenance, and renovation. The company's business is comprised of 34 lumber mills, 15 OSB facilities, six renewable energy facilities, five pulp and paper mills, three plywood facilities, three MDF facilities, two particleboard facilities, one LVL facility, one treated wood facility, and one veneer facility.

WFG's business segments comprise of Lumber Segment, North America Engineered Wood Products, Pulp & Paper Segment and Europe Engineered Wood Products Segment with the primary business segments being Lumber Segment and North American Engineered Wood Products segment constituting 46.7% and 40.6% of the revenues in 2021.

On April 28th, 2022, West Fraser Timber announced Q1 2022 results reporting diluted EPS of $10.25 for the quarter, up 47.3% YoY from $6.96 in Q1 2021. The company beat the market consensus EPS by $0.10. WFG reported revenue of $3.1 billion, up 32.7% YoY from $2.3 billion during the same period last year. The reported revenue by the company during Q1 2022 also surpassed consensus revenue estimate by $40 million.

WFG reported a quarterly Adjusted EBITDA of $1.6 billion during Q1 2022 posting a remarkably YoY growth of 158.9%, from $615 million in the same period last year. The lumber segment's adjusted EBITDA was reported at $796 million, while the North American Engineered Wood Products segment reported an adjusted EBITDA of $730 million during the quarter.

The management noted that the company continued to face transportation and logistics constraints in Western Canada during the quarter, resulting in a constrained ability to supply markets. However, the demand for the wood-based products remained robust due to which the company posted a strong result. The management maintained a cautiously optimistic outlook for the future and noted that the rising rate environment poses significant risk to housing affordability. However, the company expects robust demand for lumber, plywood, timber and OSB in the medium term amidst strong fundamentals for housing and repair and remodeling activity.

## Growth on a Per-Share Basis

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2027 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| EPS | $1.01 | $1.91 | $2.64 | $0.90 | $3.02 | $6.10 | $7.80 | ($2.34) | $9.50 | $27.03 | ***$23.20*** | ***$13.70*** |
| DPS | $0.28 | $0.13 | $0.24 | $0.20 | $0.21 | $0.26 | $0.45 | $0.61 | $0.63 | $0.76 | ***$1.20*** | ***$1.39*** |
| Shares | 85.7 | 85.7 | 83.5 | 82.5 | 78.2 | 78.0 | 69.8 | 68.7 | 68.7 | 105.9 | ***87.5*** | ***83.2*** |

West Fraser Timber has delivered exceptional results over the past decade and has increased the EPS by a significant CAGR of 44.1% over the past nine years, and 55.0% in the past five years. The company has been doing exceptionally well in the past three years as demand recovered after the outbreak of COVID-19, and the prices of the company's products increased significantly. More recently, the Norbord Acquisition led to incremental revenues and earnings, reflected in results from February 1, 2021. The housing market is expected to remain robust in the current year. However, declining commodity prices and rising interest rates will weigh the company's results as we advance in the medium term. As a result, we forecast a decline in growth in the next five years as deteriorating affordability slows down housing demand. As a result, we estimate a negative 10.0% growth for the next five years resulting in an EPS of $13.70 in 2027, while the DPS will maintain its increasing trend with a CAGR of 3.0% through 2027.

## Valuation Analysis

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2027 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Avg. P/E** | 26.5 | 22.6 | 18.7 | 51.5 | 11.1 | 8.2 | 8.1 | -19.3 | 4.4 | 2.8 | ***3.5*** | ***7.0*** |
| **Avg. Yld.** | 1.0% | 0.3% | 0.5% | 0.4% | 0.6% | 0.5% | 0.7% | 1.4% | 1.5% | 1.0% | ***1.5%*** | ***1.5%*** |

WFG is trading at a forward P/E of 3.5, significantly lower than its long-term 10-year and 5-year normalized average P/E of 12.8 and 5.9, respectively. Even though WFG runs a cyclical business, earnings are sensitive to macro-environment changes, which are expected to worsen going forward. We believe the current valuation is highly depressed and, in our view, a P/E ratio of 7.0 would be a fair reflection of the company's cyclical business, resulting in a five-year target price of $96.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

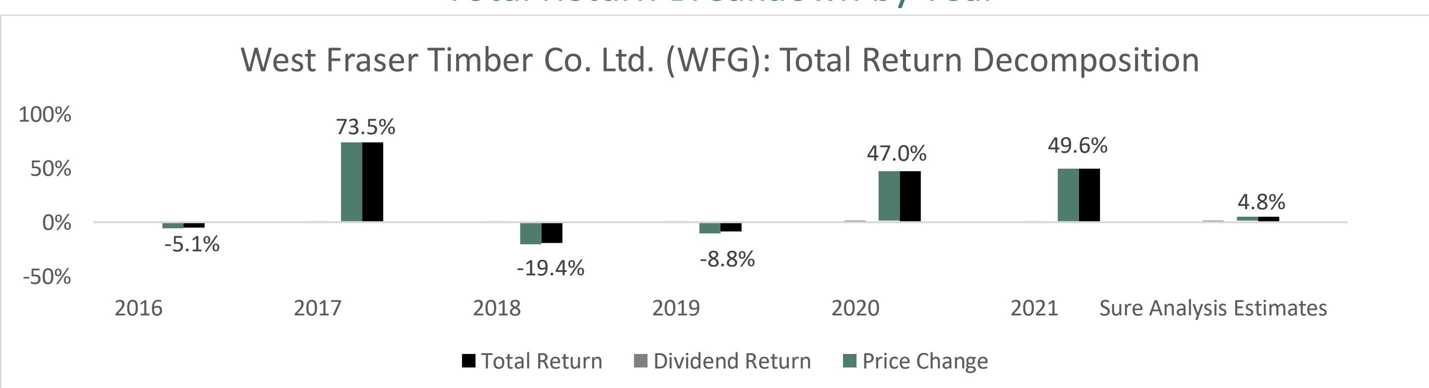
| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2027 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Payout** | 28% | 7% | 9% | 22% | 7% | 4% | 6% | -26% | 7% | 3% | ***5%*** | ***10%*** |

WFG maintains a strong balance sheet and liquidity profile, enabling the company to execute a balanced capital allocation strategy. The company has ample liquidity with an outstanding cash and short-term investments balance of $1.8 billion, coupled with access to an active bank line of $1 billion, adding to combined liquidity of $2.8 billion as of the first quarter. The management is committed to providing a sustainable dividend return which remains a key priority within West Fraser's capital allocation strategy. As a result, the company has grown its dividends in the past nine years at a healthy CAGR of 11.7% and 29.3% in the past five years.

## Final Thoughts & Recommendation

We expect housing affordability to be negatively impacted going forward in a rising rate environment, reducing demand for new home construction and the company's wood building products. However, we believe that the persistence of secular trends in the housing markets, aging housing stock and repair and renovation spending, and growing market penetration of mass timber in industrial and commercial applications would ensure healthy demand for portfolio products of WFG. Accordingly, our hold rating on the stock is premised upon the 4.8% annualized total returns for the medium term, derived from the forecasted earnings-per-share growth of -10.0% and dividend yield of 1.5%.

## Total Return Breakdown by Year

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*Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.*

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## Income Statement Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | 3,016 | 3,263 | 3,322 | 2,955 | 3,311 | 4,083 | 4,492 | 3,734 | 4,373 | 10,518 |
| Gross Profit | 981 | 1,140 | 1,135 | 883 | 1,100 | 1,598 | 1,836 | 938 | 1,814 | 5,873 |
| Gross Margin | 32.5% | 34.9% | 34.2% | 29.9% | 33.2% | 39.2% | 40.9% | 25.1% | 41.5% | 55.8% |
| SG&A Exp. | 656 | 635 | 639 | 546 | 595 | 701 | 712 | 712 | 723 | 1,198 |
| D&A Exp. | 153 | 150 | 146 | 138 | 147 | 167 | 189 | 198 | 203 | 584 |
| Operating Profit | 124 | 347 | 350 | 179 | 359 | 692 | 787 | (96) | 831 | 3,945 |
| Op. Margin | 4.1% | 10.6% | 10.5% | 6.1% | 10.8% | 16.9% | 17.5% | -2.6% | 19.0% | 37.5% |
| Net Profit | 77 | 328 | 223 | 75 | 243 | 474 | 595 | (115) | 588 | 2,947 |
| Net Margin | 2.6% | 10.0% | 6.7% | 2.5% | 7.3% | 11.6% | 13.2% | -3.1% | 13.4% | 28.0% |
| Free Cash Flow | 45 | 76 | 56 | 58 | 310 | 450 | 396 | (226) | 788 | 2,917 |
| Income Tax | 25 | (30) | 100 | 37 | 88 | 199 | 192 | (53) | 202 | 951 |

## Balance Sheet Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Assets | 2,646 | 2,915 | 2,926 | 2,619 | 2,678 | 3,592 | 3,518 | 3,594 | 4,178 | 10,433 |
| Cash & Equivalents | | | | | | | | 10 | 434 | 847 |
| Acc. Receivable | 203 | 215 | 202 | 182 | 182 | 235 | 197 | 159 | 244 | 441 |
| Inventories | 461 | 487 | 505 | 455 | 432 | 533 | 581 | 561 | 578 | 1,061 |
| Goodwill & Int. | 830 | 761 | 758 | 677 | 686 | 1,005 | 940 | 974 | 963 | 2,808 |
| Total Liabilities | 1,146 | 1,087 | 1,178 | 1,072 | 1,011 | 1,424 | 1,391 | 1,689 | 1,700 | 2,777 |
| Accounts Payable | 164 | 177 | 174 | 136 | 157 | 194 | 191 | 160 | 198 | 411 |
| Long-Term Debt | 302 | 308 | 394 | 433 | 307 | 506 | 553 | 795 | 507 | 499 |
| Total Equity | 1,500 | 1,829 | 1,748 | 1,547 | 1,667 | 2,168 | 2,126 | 1,905 | 2,478 | 7,656 |
| LTD/E Ratio | 0.20 | 0.17 | 0.23 | 0.28 | 0.18 | 0.23 | 0.26 | 0.42 | 0.20 | 0.07 |

## Profitability & Per Share Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|
| Return on Assets | 3.0% | 11.8% | 7.6% | 2.7% | 9.2% | 15.1% | 16.7% | -3.2% | 15.1% | 40.3% |
| Return on Equity | 5.2% | 19.7% | 12.5% | 4.5% | 15.1% | 24.7% | 27.7% | -5.7% | 26.8% | 58.2% |
| ROIC | 4.4% | 16.6% | 10.4% | 3.6% | 12.3% | 20.4% | 22.2% | -4.3% | 20.7% | 52.9% |
| Shares Out. | 85.7 | 85.7 | 83.5 | 82.5 | 78.2 | 78.0 | 69.8 | 68.7 | 68.7 | 105.9 |
| Revenue/Share | 34.73 | 37.36 | 38.55 | 35.01 | 40.83 | 51.71 | 59.81 | 53.97 | 63.50 | 96.00 |
| FCF/Share | 0.52 | 0.87 | 0.65 | 0.69 | 3.82 | 5.70 | 5.27 | (3.26) | 11.44 | 26.62 |

*Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.*