



West Fraser Timber Co. Ltd. (WFG)

Updated July 30th, 2022, by Yiannis Zourmpanos

Key Metrics

Current Price:	\$94	5 Year CAGR Estimate:	5.7%	Market Cap:	\$8.2 B
Fair Value Price:	\$197	5 Year Growth Estimate:	-10.0%	Ex-Dividend Date:	06/21/2022
% Fair Value:	47.5%	5 Year Valuation Multiple Estimate:	16.1%	Dividend Payment Date:	07/08/2022
Dividend Yield:	1.3%	5 Year Price Target	\$116	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 July 27th, 2022, West Fraser Timber announced Q2 2022 results reporting diluted EPS of \$7.59 for the quarter, down 38.4% YoY from \$12.32 in Q2 2021. WFG reported revenue of \$2.9 billion, down 23.6% YoY from \$3.8 billion during the same period last year. The company's revenues during Q2 2022 surpassed the consensus revenue estimate by \$180 million.

WFG reported an adjusted quarterly EBITDA of \$1.1 billion during Q2 2022, constituting 39% of the total sales. The lumber segment's adjusted EBITDA was reported at \$449 million, while the North American Engineered Wood Products segment reported an adjusted EBITDA of \$623 million during the quarter. Lower North American lumber/OSB prices and higher log and other input costs have put downward pressure on earnings compared to a year before. However, the company has significantly increased SPF and SYP shipments to partially offset this impact.

The management noted that the company's persistent transportation and logistics challenges showed improvement during the quarter, and the demand for wood products remained favorable. WFG maintained a cautiously optimistic outlook for the future as rising mortgage rates and elevated energy prices pose downward risks to the company's profitability. WFG, over the medium term, expects resilient demand for its products, including lumber, plywood, and OSB, due to aging housing stock, lagging completion of previously started new home construction, and greater acceptance of work-from-home practices.

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	\$1.53
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.

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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 5.0% 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	4.0	8.5
Avg. Yld.	1.0%	0.3%	0.5%	0.4%	0.6%	0.5%	0.7%	1.4%	1.5%	1.0%	1.3%	1.3%

WFG is trading at a forward P/E of 4.0, 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 8.5 would be a fair reflection of the company's cyclical business, resulting in a five-year target price of \$116.

Safety, Quality, Competitive Advantage, & Recession Resiliency

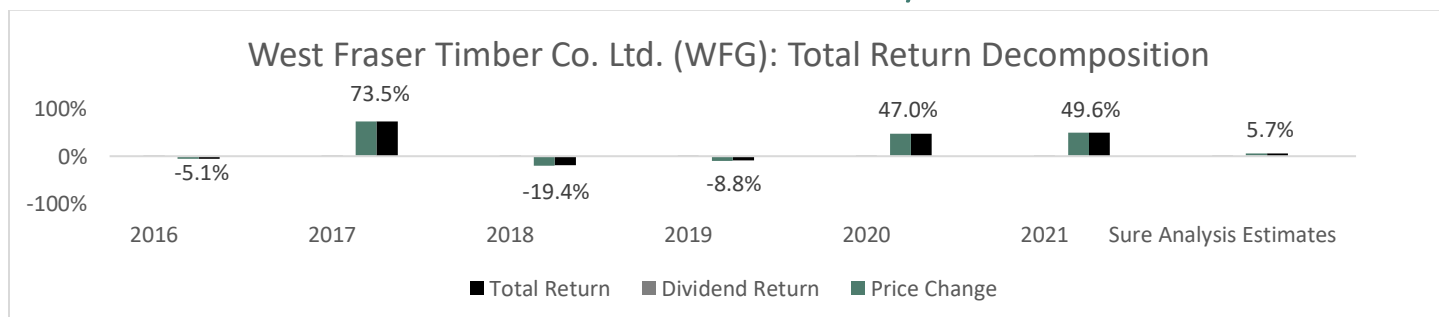
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	28%	7%	9%	22%	7%	4%	6%	-26%	7%	3%	5%	11%

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 nearly \$1.3 billion and access to an active bank line of \$1 billion, adding to combined liquidity of almost \$2.3 billion as of Q2 2022. 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 over the past nine years at a healthy CAGR of 11.7% and 29.3% for the past five years. Last but not least, the company has re-purchased 18.57 million shares during the current year for \$1.7 billion.

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 5.7% annualized total returns for the medium term, derived from the forecasted negative earnings-per-share growth of 10.0%, dividend yield of 1.3%, and sizable tailwind from multiple expansion.

Total Return Breakdown by Year



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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.

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