West Fraser Timber Co. Ltd. (WFG)

Updated February 20th, 2023, by Yiannis Zourmpanos

Key Metrics

Current Price:	$81	**5 Year CAGR Estimate:**	5.3%	**Market Cap:**	$7.1 B
Fair Value Price:	$26	**5 Year Growth Estimate:**	30.0%	**Ex-Dividend Date:**	03/16/2023[1]
% Fair Value:	307.5%	**5 Year Valuation Multiple Estimate:**	-20.1%	**Dividend Payment Date:**	04/04/2023[2]
Dividend Yield:	1.5%	**5 Year Price Target**	$98	**Years Of Dividend Growth:**	3
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**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 2022.

On February 14th, 2023, West Fraser Timber announced Q4 2022 results reporting diluted EPS of $-1.13 for the quarter, missing market estimates by $1.24. WFG reported revenue of $1.62 billion, down 20.2% year-over-year from $2.03 billion during the same period last year. The company's revenues during Q4 2022 surpassed the consensus revenue estimate by $90 million. During Q4 2022, the company faced a decline in demand for several important products, particularly in North America. This was due to the impact of increasing interest rates and mortgage rates on near-term housing affordability. The weakness was most notable in the Lumber Segment but was somewhat compensated for by positive EBITDA contributions from the company's engineered wood products and pulp business.

While talking about the outlook going forward in 2023, the management noted that it is expected that the company will continue to face challenges in the near future. These challenges include the risk of a resurgence in inflationary cost pressures, ongoing labor constraints, and potentially reduced product demand due to the continuing overhang of housing affordability on the housing and wood-building products industries. Although the severity and impact of these challenges are uncertain, they are expected to persist in the near term. In 2023, WFG expects SPF Shipments (MMfbm) between 2,600 to 2,800 and 2,900 to 3,100 SYP Shipments (MMfbm).

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$1.91	$2.64	$0.90	$3.02	$6.10	$7.80	($2.34)	$9.50	$27.03	$20.86	***$3.12***	***$11.57***
DPS	$0.13	$0.24	$0.20	$0.21	$0.26	$0.45	$0.61	$0.63	$0.76	$1.15	***$1.20***	***$1.53***
Shares[3]	85.7	83.5	82.5	78.2	78.0	69.8	68.7	68.7	105.9	94.1	***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 30.4% over the past nine years and 27.9% in the past five years. Lumber and OSB demand are significantly influenced by changes in new home construction activity in the United States. Housing starts for 2022 decreased by 3% to 1.55 million units compared to 1.60 million units in 2021. In addition, rising interest rates and elevated housing prices affect housing affordability, potentially reducing near-term demand for new home construction and decreasing demand

[1] Estimated ex-dividend date.
[2] Estimated dividend payment date.
[3] In millions.
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.

for the company's wood-building products. The near-term headwinds are reflected in the company's recent quarterly result and our estimate of a full-year EPS of $3.12 in 2023. Although the company is facing headwinds in the near term, we believe the low supply of existing homes for sale, the backlog of new homes under construction, and changes in homeownership trends resulting from the COVID-19 pandemic is expected to provide offsetting factors that will support long-term demand for home construction activity. As a result, we estimate a 30.0% growth from the 2023 base for the next five years resulting in an EPS of $11.57 by 2028. Lastly, we expect that the DPS will maintain its increasing trend with a CAGR of 5.0% through 2028, considering that the company has grown its dividends over the past nine and five years at a healthy CAGR of 27.4% and 34.6%, respectively.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Avg. P/E	22.6	18.7	51.5	11.1	8.2	8.1	-19.3	4.4	2.8	4.0	***26.1***	***8.5***
Avg. Yld.	0.3%	0.5%	0.4%	0.6%	0.5%	0.7%	1.4%	1.5%	1.0%	1.4%	***1.5%***	***1.6%***

WFG is trading at a forward P/E of 26.1, significantly higher than its long-term 10-year and 5-year normalized average P/E of 10.8 and 5.9, respectively. WFG is a cyclical business, so earnings are sensitive to macro-environment changes, which are expected to worsen going forward. We believe the current valuation is elevated, although it reflects the earnings growth potential of the company. For 2028, we have used a P/E ratio of 8.5 which we believe would be a fair reflection of the company's business, resulting in a five-year target price of $98.

Safety, Quality, Competitive Advantage, & Recession Resiliency

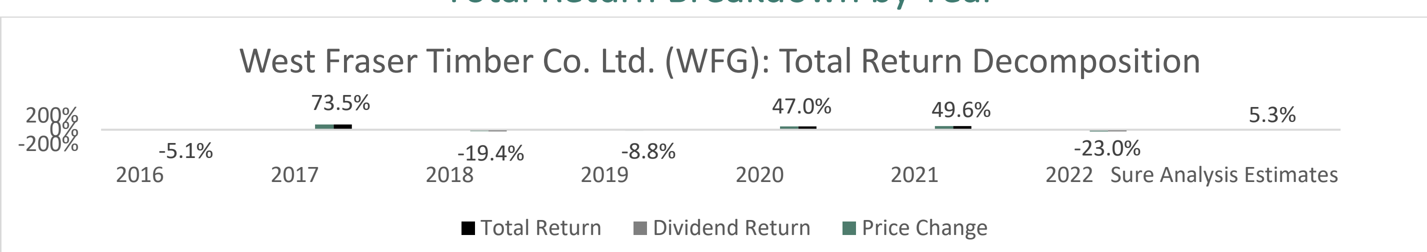
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	7%	9%	22%	7%	4%	6%	-26%	7%	3%	6%	***39%***	***13%***

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 $1.16 billion and access to an active bank line of $1.05 billion, adding to combined liquidity of almost $2.21 billion as of Q4 2022. The management is committed to providing a sustainable dividend return which remains a key priority within West Fraser's capital allocation strategy. Finally, the company has repurchased nearly 39.7 million of its commonshares since early 2021.

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, 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 5.3% annualized total returns for the medium-term, which is derived from our growth estimates and the dividend yield of 1.5% offset by the potential for significant multiple compression.

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.