West Fraser Timber Co. Ltd. (WFG)

Updated November 20th, 2023, by Yiannis Zourmpanos

Key Metrics

Current Price:	$77	**5 Year CAGR Estimate:**	18.8%	**Market Cap:**	$6.7 B
Fair Value Price:	$151	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	12/29/2023[1]
% Fair Value:	51%	**5 Year Valuation Multiple Estimate:**	14.5%	**Dividend Payment Date:**	01/12/2024[2]
Dividend Yield:	1.6%	**5 Year Price Target**	$175	**Years Of Dividend Growth:**	3
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Rating:**	Buy

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 October 25th, 2023, West Fraser Timber announced Q3 2023 results, reporting Q3 GAAP EPS of $1.81, beating market estimates by $0.91. WFG reported revenue of $1.71 billion, missing market estimates by $30 million. West Fraser's third quarter of 2023 report reflects a period of mixed outcomes amidst challenging market conditions, especially in the Lumber segment. Despite these hurdles, the North American Engineered Wood Products (EWP) division achieved notable success, recording its best performance in several quarters amidst rising mortgage rates considerably higher than a year ago.

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	***$1.01***	***$17.47***
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. However, Lumber and OSB demand are significantly influenced by changes in new home construction activity in the United States. In September 2023, the U.S. Census Bureau reported a seasonally adjusted annualized rate of 1.36 million housing starts in the U.S., alongside 1.47 million issued permits. Thus, the outlook for new home construction faces challenges, primarily due to rising interest rates, which affect housing affordability. However, the U.S. is experiencing relatively low unemployment rates, and North American central bankers hint that the current cycle of rate hikes might be close to its end. Despite these potentially positive indicators, there is a concern that demand for new home construction and related wood-building products could decrease soon. This anticipated decline is attributed to potential economic slowdowns and persistently high or further increasing interest rates, which could negatively impact consumer sentiment and housing affordability.

---

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

West Fraser Timber Co. Ltd. (WFG)

Updated November 20th, 2023, by Yiannis Zourmpanos

WFG is a highly cyclical stock, and even though the company might be in the mid-term cycle, its earnings can bounce back to their previous levels from 2024 onwards. For estimating WFG's fair value for the next five years, we used the earnings power method since it is more representative of the company's value due to non-recurring events that negatively affected the company's earnings in 2023. Therefore, our EPS estimate for WFG stands at $15.07, but we anticipate much slower growth through 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	***5.1***	***10.0***
Avg. Yld.	0.3%	0.5%	0.4%	0.6%	0.5%	0.7%	1.4%	1.5%	1.0%	1.4%	***1.6%***	***0.9%***

WFG is a cyclical business, so earnings are sensitive to macro-environment changes, which are expected to worsen going forward. 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 10.0, which we believe would be a fair reflection of the company's business, resulting in a five-year target price of $150.

Safety, Quality, Competitive Advantage, & Recession Resiliency

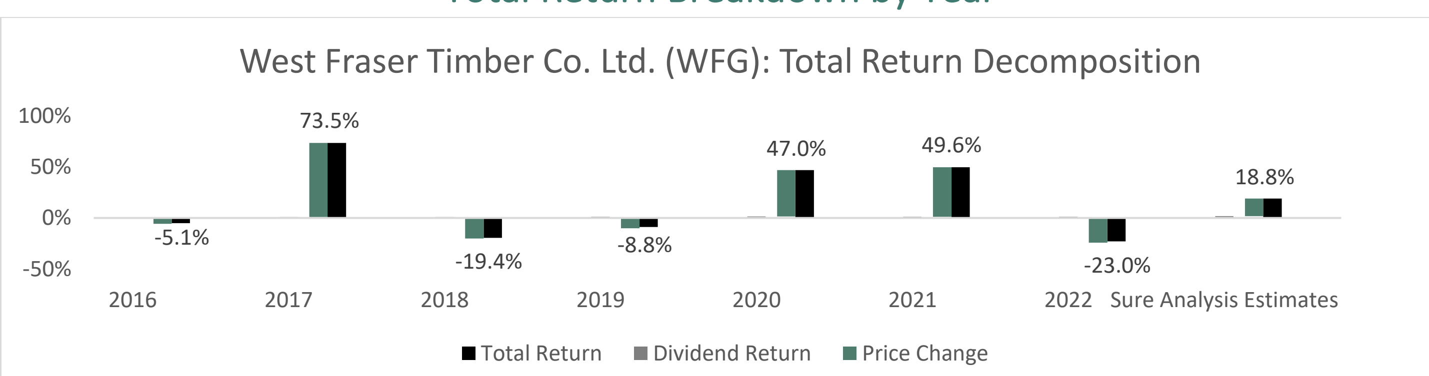
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	7%	9%	22%	7%	4%	6%	-26%	7%	3%	6%	***8%***	***9%***

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 $1.204 billion as of Q3 2023. The management is committed to providing a sustainable dividend return, which remains a key priority within West Fraser's capital allocation strategy.

Final Thoughts & Recommendation

The lumber business will likely face difficulties in the following months as we approach the end of the year. West Fraser will likely see reduced demand due to home affordability in the near future, persistent labor shortages, and rate hikes from central banks, which will pressure its revenues and profitability. WFG has increased in value in 2023, and following our sell rating, the stock has entered a correction phase with additional downside risk. Therefore, we revised our rating to buy, premised upon the 18.8% annualized total returns for the medium-term, derived from our growth estimates, the dividend yield of 1.6%, and a valuation tailwind. We note that the stock is best suited for investors with a higher tolerance for risk.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us.

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.

West Fraser Timber Co. Ltd. (WFG)

Updated November 20th, 2023, by Yiannis Zourmpanos

Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	3,263	3,322	2,955	3,311	4,083	4,492	3,734	4,373	10,518	9,701
Gross Profit	1,140	1,135	883	1,100	1,598	1,836	938	1,814	5,873	4,559
Gross Margin	34.9%	34.2%	29.9%	33.2%	39.2%	40.9%	25.1%	41.5%	55.8%	47.0%
SG&A Exp.	635	639	546	595	701	712	712	723	1,198	1,333
D&A Exp.	150	146	138	147	167	189	198	203	584	589
Operating Profit	347	350	179	359	692	787	(96)	831	3,945	2,619
Op. Margin	10.6%	10.5%	6.1%	10.8%	16.9%	17.5%	-2.6%	19.0%	37.5%	27
Net Profit	328	223	75	243	474	595	(115)	588	2,947	1,975
Net Margin	10.0%	6.7%	2.5%	7.3%	11.6%	13.2%	-3.1%	13.4%	28.0%	20.4%
Free Cash Flow	76	56	58	310	450	396	(226)	788	2,917	1,730
Income Tax	(30)	100	37	88	199	192	(53)	202	951	618

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	2,915	2,926	2,619	2,678	3,592	3,518	3,594	4,178	10,433	9,973
Cash & Equivalents							10	434	847	1,162
Acc. Receivable	215	202	182	182	235	197	159	244	441	286
Inventories	487	505	455	432	533	581	561	578	1,061	1,032
Goodwill & Int.	761	758	677	686	1,005	940	974	963	2,808	2,709
Total Liabilities	1,087	1,178	1,072	1,011	1,424	1,391	1,689	1,700	2,777	2,354
Accounts Payable	177	174	136	157	194	191	160	198	411	359
Long-Term Debt	308	394	433	307	506	553	795	507	499	499
Total Equity	1,829	1,748	1,547	1,667	2,168	2,126	1,905	2,478	7,656	7,619
LTD/E Ratio	0.17	0.23	0.28	0.18	0.23	0.26	0.42	0.20	0.07	0.07

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	11.8%	7.6%	2.7%	9.2%	15.1%	16.7%	-3.2%	15.1%	40.3%	19.4%
Return on Equity	19.7%	12.5%	4.5%	15.1%	24.7%	27.7%	-5.7%	26.8%	58.2%	25.9%
ROIC	16.6%	10.4%	3.6%	12.3%	20.4%	22.2%	-4.3%	20.7%	52.9%	24.3%
Shares Out.	85.7	83.5	82.5	78.2	78.0	69.8	68.7	68.7	105.9	94.2
Revenue/Share	37.36	38.55	35.01	40.83	51.71	59.81	53.97	63.50	96.00	103.01
FCF/Share	0.87	0.65	0.69	3.82	5.70	5.27	(3.26)	11.44	26.62	18.37

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