West Fraser Timber Co. Ltd. (WFG)

Updated February 22nd, 2024, by Yiannis Zourmpanos

Key Metrics

Current Price:	$79	**5 Year CAGR Estimate:**	18.1%	**Market Cap:**	$6.9 B
Fair Value Price:	$151	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	03/14/2024
% Fair Value:	52%	**5 Year Valuation Multiple Estimate:**	13.8%	**Dividend Payment Date:**	04/04/2024
Dividend Yield:	1.5%	**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 annual revenues.

On February 14th, 2024, West Fraser Timber announced Q4 2023 results, reporting Q4 GAAP EPS of -$1.87, missing the market's estimates of -$0.21. Despite the loss, WFG reported revenue of $1.51 billion, beating market estimates by $60 million. This partly reveals some operational resilience amidst very challenging market conditions. EBITDA for the Lumber segment amounted to -$51 million, while it amounted to $143 million for the North American engineered Wood Products (NA EWP) segment. The Pulp & Paper and Europe Engineered Wood Products (Europe EWP) segments have made insignificant contributions to EBITDA, standing at $2 million and $3 million, respectively.

Lastly, Sean McLaren took over as President and CEO, succeeding Ray Ferris, and the company announced significant strategic moves, including mill closures and the sale of Hinton pulp mill. Despite the current market uncertainties, West Fraser remains optimistic about the medium- and long-term demand for its products, particularly in new home construction, repair and remodeling, and industrial applications in North America.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$2.64	$0.90	$3.02	$6.10	$7.80	-$2.34	$9.50	$27.03	$20.86	-$2.01	***$2.79***	***$17.47***
DPS	$0.24	$0.20	$0.21	$0.26	$0.45	$0.61	$0.63	$0.76	$1.15	$1.20	***$1.20***	***$1.53***
Shares[1]	83.5	82.5	78.2	78.0	69.8	68.7	68.7	105.9	94.1	83.2	***87.5***	***83.2***

The company currently anticipates favorable medium-to-long-term outlooks for its North American Lumber, OSB, and EWP businesses, supported by a backdrop of increased housing affordability, demographic trends, and aging housing stocks that are likely to push further the demand for new home builds and repair and renovation activities. The firm expects demand growth for its European products as well, more so than OSB over plywood, supported by all of those above while carrying out sustained repair and renovation activities. Nevertheless, amidst the uncertainties brought about by interest rates in the near term and geopolitical matters, West Fraser is optimistic it will overcome such short-term challenges to capture long-term growth opportunities. The company successfully closed the sale of its Hinton pulp mill and expects further to close the sales of its Quesnel River Pulp mill and Slave Lake Pulp mill early in 2024, respectively—strategically optimizing its portfolio. WFG is a highly cyclical stock, and even though the company might be

[1] In millions.

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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 slower growth through 2029. Lastly, we expect that the DPS will maintain its increasing trend with a CAGR of 5.0% through 2029, considering that the company has grown its dividends over the past 10 and five years at a healthy CAGR of 19.6% and 21.7%, respectively. Investors should note that the company has maintained its quarterly dividend of $0.30 for eight consecutive distributions.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	18.7	51.5	11.1	8.2	8.1	-19.3	4.4	2.8	4.0	-38.3	***5.2***	***10.0***
Avg. Yld.	0.5%	0.4%	0.6%	0.5%	0.7%	1.4%	1.5%	1.0%	1.4%	1.6%	***1.5%***	***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 2029, 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 $151.

Safety, Quality, Competitive Advantage, & Recession Resiliency

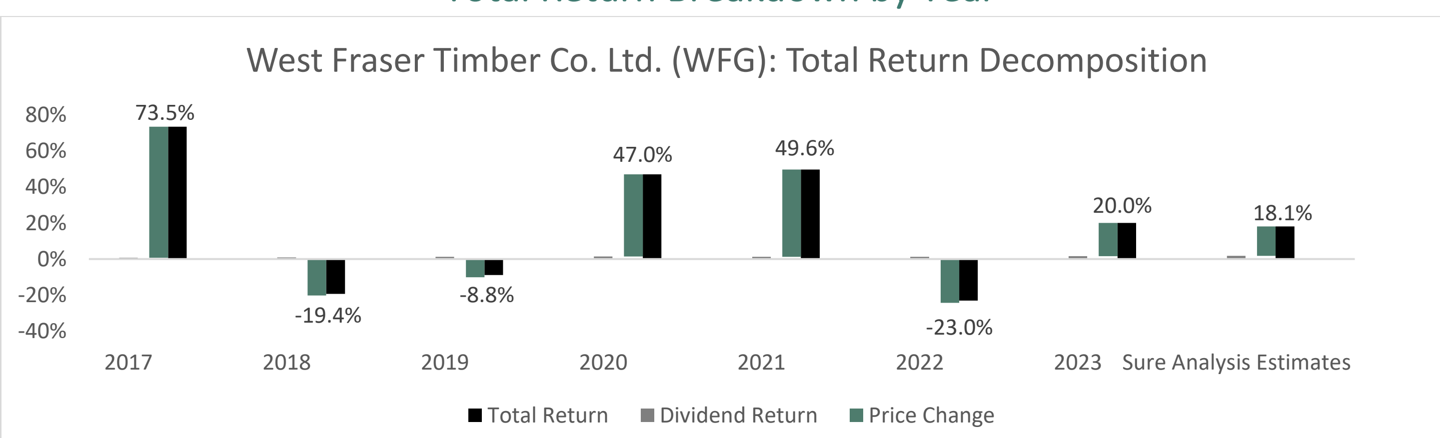
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	9%	22%	7%	4%	6%	-26%	7%	3%	6%	-60%	***8%***	***9%***

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 $900 million as of Q4 2023. The management is committed to providing a sustainable dividend return, which remains a key priority within West Fraser's capital allocation strategy. The company also continued repurchasing shares in the year, bringing the total for the quarter to 1.495 million shares for $104 million, and it also finished the acquisition of Spray Lake Sawmills, enhancing the company's operational footprint.

Final Thoughts & Recommendation

We maintain our buy rating on West Fraser premised upon the 18.1% annualized total returns for the medium-term, derived from our growth estimates, the dividend yield of 1.5%, 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



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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.