# Why Western Forest Products Inc. Has Soared Almost 20% Since the Beginning of the Year

## Description

If we look at **Western Forest Products Inc.'s** (TSX:WEF) financials over the last five years, we can see a picture of a company that has grown its revenue, improved margins, and has had strong cash flows, all while the lumber market has been tough, to say the least. And now the company is faced with an improving outlook, a cheap stock, and a business that has been very effectively managed. The 3.7% dividend yield will also appeal to investors.



Here is my bullish take on the company and stock.

**Strong, consistent financial performance**

Management's stated goal is to "maximize product margins while increasing sales volumes." Gross margins have increased over the years and now stand at almost 20%, and operating margins currently sit at 11%. Furthermore, the company's ROE is roughly 20%. The company has been free cash flow positive for many years now, and its balance sheet is quite strong with a debt-to-total capitalization ratio of 6.2%. These numbers are well above **Interfor Corp.'s** profitability metrics, and Interfor has not been consistently free cash flow positive, as Western Forest Products has been.

Free cash flow in the latest quarter, the fourth quarter of 2016, was $33 million — $9 million more than last quarter.
The company is able to achieve higher and more stable margins because more than 74% of its lumber revenue is generated from non-commodity products, and this specialty lumber sells at a significant premium to commodity lumber.

**Going forward**

We can reasonably expect continued strength in the U.S. repair and renovation sector and gradual improvement in U.S. new home construction, as the company continues to work on its $125 million worth of projects that are aimed at reducing costs and improving productivity. This should be reflected in the upcoming years through reduced costs and higher production.

Longer term, the company’s strong balance sheet and financial position put it in a good position to pursue growth in its business. Management is actively looking at external opportunities to drive shareholder value.

Last year, EPS increased 50%. The stock currently trades at a P/E ratio of 9.3 times EPS and a 1.6 times price-to-book multiple. The dividend yield is an attractive 3.59%

While investors should remember that the company is in a very cyclical business and its biggest risk is a slowdown of the U.S. housing market, it remains a solid company with attractive, defensive qualities that investors can take comfort in. And its strong balance sheet and cash flow generation means that it can increase the dividend, buy back shares, invest in the company and/or make acquisitions.

**CATEGORY**

1. Investing

**TICKERS GLOBAL**

1. TSX:WEF (Western Forest Products Inc.)



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