Canfor Corporation (TSX: CFP): Money Really Does Grow on Trees

Description

Long-term shareholders of **Canfor Corporation** (TSX: CFP) are used to volatility. Since 1995, the company's stock has fallen by more than 50% six times, the most recent of which started in the summer of 2018, where shares fell from a high of $33 to just $16 today.

One of the largest softwood lumber producers in North America, Canfor is heavily exposed to domestics housing markets, particularly the U.S. considering its size. When the housing market swoons, Canfor stock swoons.

Recently, however, volatility has been exacerbated by political considerations. The ongoing drama between U.S. President Donald Trump and Canadian Prime Minister Justin Trudeau—particularly in terms of tariffs and trade—have caused major exporters like Canfor to suffer. While the long-term impact remains unknown, it's possible the company will face higher costs. At worst, it could be rendered uncompetitive versus American players.

While political risk can have real impacts, investors are now getting a rare chance to buy into a globally diversified producer with massive cash flows to support its valuation.

International dilemmas have caused unique buying opportunities

Global pressures from a single country aren't new for Canfor. In 2015, shares hit a high of $31. By April of 2016, shares were under $14. What happened? In a word: China.

From 2005 to 2015, lumber companies benefited heavily from the rise of China. As with many other commodities, China had been importing lumber from all over the world to fuel its growth. When China slowed, the world slowed. Growth in Chinese lumber imports started to taper off in 2011, and by 2014 was nearly flat. While the market hadn't anticipated it, Canfor had just lost its biggest growth driver of the last decade.

After six months, however, Canfor shares rose 100% to an all-time high of $32. Chinese concerns were real, but fears overshadowed true strength in other parts of the world, particularly in the North American market. Are today's conditions setting up Canfor for another 100% run?

Canfor is more diversified than ever

While pressures from any one region can have real effects on Canfor's financials, the company has done well over recent years to mitigate any sole source of risk.

For example, in addition to its British Columbia and Alberta assets, Canfor now has heavy operations in the U.S., with presences in Arkansas, Georgia, Alabama, Mississippi, North Carolina, and more. These assets will help protect profits from any future trade wars. It also positions Canfor well in a region with a softwood lumber deficit. In 2017, U.S. demand equated to 48 billion FBM, versus domestic supply of just 34 billion FBM. Additionally, with Canada experiencing excess supply of 19 billion FBM, it's unlikely the U.S. will be able to meet its needs without Canadian imports.

Canfor also made a transformation acquisition in 2018 by purchasing 70% of VIDA at an implied valuation of $830 million. They maintained an option to acquire the remaining interest in VIDA over the long term. Based in Sweden, VIDA delivers timber products not only to Europe (75% of sales), but also to faster growing regions such as Asia (10%).

Following this acquisition, Canfor is more diversified than ever. In the third quarter of 2018, the company posted operating income of $200 million, an annualized rate of roughly $800 million. With its market cap down to just $2.1 billion, Canfor is throwing off a ton of cash with an underappreciated level of diversification. Don't be surprised to see the stock take off yet again once the market stabilizes.

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Date
2025/08/26
Date Created
2019/01/04
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