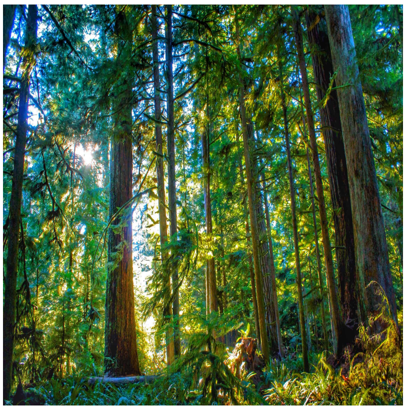

Why Is West Fraser Timber (TSX:WFG) Stock up 22%?

Description

Canada's commodity sector is red hot right now. Two years of volatility have left these stocks in an odd position. Unsurprisingly, institutional investors are taking advantage of these distortions and snapping up acquisition targets. Lumber giant **West Fraser Timber** (TSX:WFG)(NYSE:WFG) looks like the latest target.

West Fraser stock is up 25% this morning as a private equity firm announced its intention to acquire the company. CVC Capital and wood panel manufacturer Kronospan have announced joint negotiations to purchase West Fraser.

Here's a closer look at the potential deal and what this means for investors seeking undervalued bets in the commodity market.

West Fraser acquisition

West Fraser's market value is closely correlated with the price of its underlying product: lumber. Lumber prices skyrocketed during the pandemic, as consumers spent excess savings on home improvement projects. Since then, the boom has ended. Lumber is trading 56% below its all-time high. In fact, it's trading at the same level as it was in 2018.

Unsurprisingly, this bust pushed West Fraser's stock lower. The company lost nearly a fifth of its market value since the start of 2022. Last month, the stock was trading at just 2.5 times earnings per share and 0.82 times book value per share. Put simply, it was deeply undervalued, despite lower lumber prices.

That's probably why CVC and Kronospan want to acquire the firm. The deal hasn't been finalized yet, but it's likely that the final acquisition price will be much higher than West Fraser's market value from yesterday's close. This is why the stock is surging 22% this morning.

Other undervalued stocks

Vancouver-based **Canfor** (TSX:CFP) is just as undervalued right now. The company is West Fraser's smaller rival. The stock trades at just 2.2 times earnings per share. If West Fraser is acquired for a premium in the near future, it could raise the industry's valuation metrics and push stocks like Canfor higher. Indeed, Canfor could also be a potential acquisition target at these levels.

Investors can also expect some consolidation in the energy sector. Oil and gas prices have been just as volatile as lumber, which means energy producers are potentially mispriced right now.

Mid-cap companies like **Tamarack Valley Energy** (TSX:TVE) are trading at a discount. The stock has lost 35% of its value since June and is now trading at just 3.9 times earnings per share. Earnings could be much higher in the year ahead if the price of crude oil remains around US$100. Even if oil drops to US$70, companies like Tamarack Valley could generate substantial free cash flows.

Canadian energy companies have committed to rewarding shareholders instead of investing in expansion this year. The sector is deploying nearly all of its excess cash flow into either paying down debt, buying back stock or boosting dividends. However, mergers and acquisitions could be a potential strategy to expand earnings without investing in risky infrastructure. Keep an eye on this trend in the energy sector.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:WFG (West Fraser Timber Co. Ltd.)
2. TSX:CFP (Canfor Corporation)
3. TSX:TVE (Tamarack Valley Energy Ltd)
4. TSX:WFG (West Fraser Timber Co. Ltd.)

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