FINAL TRANSCRIPT

Canfor

Q3 2023 Results Conference Call

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Ketan Mamtora
BMO Capital Markets — Analyst

Sean Steuart
TD Securities — Analyst

Matthew McKellar
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PRESENTATION

Operator

Good morning, my name is Jenny, and I will be your conference Operator today. Welcome to Canfor and Canfor Pulp's third quarter analyst call. All lines have been placed on mute to prevent any background noise.

During this call, Canfor and Canfor Pulp's Chief Financial Officer will be referring to a slide presentation that is available in the Investor Relations section of the Company's website.

Also, the Companies would like to point out that this call will include forward-looking statements, so please refer to the press releases for the associated risks of such statements.

I would now like to turn the meeting over to Mr. Don Kayne, Canfor Corporation's President and Chief Executive Officer. Please go ahead, Mr. Kayne.

Don Kayne — President and Chief Executive Officer, Canfor Corporation

Thank you, Operator, and good morning, everyone. Thank you for joining the Canfor and the Canfor Pulp Q3 2023 Results Conference Call. I'm going to make a few comments before I turn things over to Kevin Edgson, Canfor Pulp's President and CEO, and Pat Elliott, Chief Financial Officer of Canfor Corporation and Canfor Pulp and our Senior Vice President of Sustainability. In addition, we are joined by Kevin Pankratz, Senior Vice President of Sales and Marketing.

I'd like to begin by acknowledging the devastating wildfire season in BC, Alberta, and across Canada this summer. I want to thank the firefighters, the first responders, the military personnel, and forestry contractors who worked tirelessly over the summer responding to record-breaking wildfires. We are working with the provincial governments to assess the impact of the fires on the fibre supply, ensuring timely access to burnt fibre, and discuss any lessons learned. We appreciate the government's willingness to have these open and honest discussions.

While we saw an improvement in our cost structure in British Columbia in the third quarter, it remains a challenging jurisdiction as the fibre supply in the interior of British Columbia continues to be constrained due to the impacts of the wildfires, pest infestations, government policy, and land-use decisions. These factors in combination with a lack of reliable access to economic fibre and weak market conditions are resulting in a very challenging near-term outlook in British Columbia.

While recognizing the significant current challenges, we remain committed to our strategy of having a smaller but stronger operating footprint in British Columbia.

In September, we announced that we will build a new, low-cost, highly efficient facility in Houston that will be globally competitive. This investment decision came after careful review of the economically available fibre supply in the region and after extensive discussions with government and Indigenous nations in the region.

I had the opportunity to meet with many of our employees in Houston a few weeks ago. We certainly appreciate their patience and perseverance while we made the decision, and they share our excitement to have a modern, state-of-the-art facility in their community. We are now working on a detailed project engineering and permitting requirements.

While lumber prices are anticipated to remain under pressure in the short term due to affordability constraints and high interest rates, we do remain optimistic about the medium to longer-term prospects of our industry. We continued to see the benefits of our diversification strategy through the third quarter with strong earnings generated in the US South and solid earnings in Europe despite seasonal downtime.

We are pleased with the ramp-up of our DeRidder facility, which added a second shift in August, and the progress of our other organic growth initiatives, including a rebuild of our Arkansas sawmill, second greenfield in Alabama, and organic growth in Sweden.

We remain committed to our organic growth program, with the investments further improving our global diversification, reducing our cost structure, and significantly increasing our production capacity. Our balance sheet strength will support continued reinvestment in our operations and, while we are prepared to remain patient until the right opportunities present themselves, we continue to assess various external growth initiatives as we look to further grow our lumber business globally.

I will now turn it over to Kevin to provide an overview of Canfor Pulp.

Kevin Edgson — President and Chief Executive Officer, Canfor Pulp Products Inc.

Thank you, Don, and good morning, everyone.

Canfor Pulp had a challenging third quarter with continued weakness in global pulp markets and significant operational downtime weighing on our financial results.

The Northwood pulp mill experienced the brunt of lost production due to a combination of the downtime related with the labour dispute at BC's ports, a planned maintenance shutdown late in the quarter, and then the struggles to restart after both of these curtailments. In total, third quarter production was reduced by approximately 65,000 tonnes, with a further 30,000 tonnes will be lost in the fourth quarter.

With regards to Northwood's planned maintenance shutdown, the key activity was a comprehensive inspection of recovery boiler number one. We are pleased that the results confirmed our expectation that RB1 remains in stable condition thus removing any concerns about the need to advance the rebuild any earlier than 2025.

We are also pleased with recent market developments with a resumption of demand supporting price increases in Asia and announcements recently in North America and Europe. We would note that our reduced output in Q3 and expected impact in Q4, the anticipated lag between market middle net realizations, will extend such that we do not expect to see the impact of these increases until early in the new year.

Previously, we announced a recapitalization program covering all three of our facilities; Northwood, Intercon, and Specialty Paper. We remain committed to this program supported by cash generated from operations and existing liquidity. Though the market is improving, we are still cautious about the outlook, so our early guidance on capital will be for another modest year in 2024.

I'd like to take this moment to acknowledge and extend our appreciation to the employees at Northwood and Intercon and Specialty Paper for their continued efforts, perseverance, and commitment to safety as we navigate the current challenges facing our business.

And with that, I will turn it over to Pat to provide an overview of our financial results.

Pat Elliott — Chief Financial Officer, Canfor Corporation & Canfor Pulp Products Inc., and Senior Vice President Sustainability, Canfor

Thanks, Kevin, and good morning, everyone. The Canfor and Canfor Pulp third quarter results were released yesterday afternoon.

In my comments this morning I'll speak to quarterly financial highlights, a summary of which is included in our overview slide presentation in the Investor Relations section of Canfor's website.

Our Lumber business generated an operating loss of $1 million in the third quarter, which included a $19 million recovery of a previously recorded write-down of inventory in Western Canada and a net duty recovery of $43 million.

While our cost structure in British Columbia improved slightly in the third quarter, these results continue to reflect losses associated with our BC operations as a result of weak lumber pricing and a high-cost operating environment.

Notwithstanding these challenges, we continue to see the benefit of our diversification strategy with our US operations generating strong results in the third quarter, supported by stable unit margin and increased volume.

Our European operations contributed cash earnings of approximately $31 million in the quarter with slightly improved sales realizations offset by seasonal summer downtime.

Our European operations have generated cash earnings of $135 million to date in 2023.

Canfor Pulp generated an operating loss of $49 million in the quarter, which included a $2 million recovery of a previously recorded inventory write-down. These results reflected weak global pulp markets and extensive downtime at Northwood due to supply chain interruptions, scheduled maintenance downtime, and reliability issues upon restart, which weighed heavily on production and unit cost structure in the quarter.

With production at Northwood stabilizing, we anticipate improved results in the fourth quarter, although our results will reflect the impact of unplanned downtime in October and an unfavourable timing lag in shipment versus orders.

At the end of the third quarter, Canfor Pulp had net debt of $81 million and $146 million of available liquidity, of which $80 million is restricted for use towards future reinvestment in Northwood's recovery boiler number one.

Notwithstanding the current challenges facing our pulp business, we believe the longer-term market fundamentals remain strong. In the short term, we have undertaken a series of measures to mitigate the financial impact of weak global markets and persistent reliability issues.

In 2023, we anticipate a capital spend of approximately $500 million in the lumber segment and $70 million for Canfor Pulp, including capitalized maintenance. We anticipate capital spend of $450 million to $500 million in the lumber segment in 2024, including the remaining spend at Urbana and our Alabama greenfield and various organic growth initiatives in the US South and Sweden. For Canfor Pulp, we expect capital spending to be at or lower than 2023.

In addition, we anticipate Canfor will continue to allocate a modest amount of capital to repurchasing shares.

And with that, Don, I'll turn it back to you.

Don Kayne

Thanks, Pat.

So, Operator, we're okay now to go ahead with questions from analysts.

Q&A

Operator

Thank you. We will now take questions from financial analysts. If you have a question, please press *, 1 on your telephone keypad. If you are using a speakerphone, please lift your receiver and then press *, 1. If at any time you wish to cancel your question, please press *, 2.

There will be a brief pause while participants register for questions. Thank you for your patience.

Our first question comes from Hamir Patel from CIBC. Please ask your question.

Hamir Patel — CIBC

Hi. Good morning.

Don Kayne

Morning, Hamir.

Hamir Patel

Don, in your outlook, you were pointing to European lumber prices coming under some pressure in Q4. Has there been any change this year in the sort of share of your European lumber output that's exported to the US?

And could you comment on how the returns for VIDA might compare between selling to the US versus selling within Europe?

Don Kayne

Yeah. For sure. Kevin, maybe you can talk a little bit with Hamir in terms of the volumes coming into the US compared to last year first of all.

Kevin Pankratz — Senior Vice President, Sales and Marketing, Canfor Corporation

Sure. Now, Hamir, I would say it's a little bit off from last year, but overall, it's pretty consistent year over year in the markets that we serve because we do have the core programs that we support, and there's maybe a pivot of about 20 percent that we could allocate to markets that maybe have better demand signals or stronger economics.

But I'd say that in Q3, off a little bit into the US and then the pickup on that volume was into other markets such as in the Middle East/North Africa markets and, of course, into the UK and then more into Japan. So just really leveraging the global footprint and the diversification in the markets they serve.

Don Kayne

Maybe just, Hamir, add to that, I mean I think, Kevin, I mean it's one thing for sure that we have in Sweden is, first of all, we're very specific on the products that we manufacture there for North America, and it's very specific and customized products. But at the same time, we've got a lot of flexibility and a lot of options in other markets that in a lot of cases are more favourable from a return standpoint.

So I think the key takeaway, really, in Europe or in North America is we've got lots of flexibility, and we utilize it as we need to for customized use for the most part.

Hamir Patel

Great. Thanks, Don, that's helpful. And then just turning to the US market. Just given some of the affordability headwinds facing consumers, what would be your view of 2024 for the R&R market in terms of volumes?

Don Kayne

Go ahead, Kevin.

Kevin Pankratz

Hamir, like as we've said in previous calls, the R&R market has actually been quite resilient. And while we're not at the pace that we were at the first half of the year, we're still at more normalized growth kind of expectations in that sort of like 2 percent to 3 percent.

So for 2023, we'll be ahead of 2022. And 2024, we're guiding to some modest increases, not to some of the surges that we've seen in the past few years, to your point, because of some of the affordability and interest rate challenges. But the key drivers that are driving R&R are still there. The age of homes is a big driver that they look at. And, of course, people staying in their homes, not selling as much, and investing in their home. So we do still think that that segment's going to be resilient through 2024.

Hamir Patel

Fair enough. That's all I had. I'll turn it over. Thanks.

Don Kayne

Thanks, Hamir.

Operator

Thank you. Your next question is from Ketan Mamtora from BMO Capital Markets. Please ask your question.

Ketan Mamtora — BMO Capital Markets

Thank you. Hey. Just coming back on the Pulp capital expenditure. Can you just remind me again how you guys are thinking about the multiyear program that you have? Sounds like if you guys seemed to have pushed it back a little bit. Correct me if I'm wrong on that. And just sort of how you think about sequencing over the next few years.

Kevin Edgson

Ketan, are you referring to the Pulp recapitalization?

Ketan Mamtora

That is correct.

Kevin Edgson

Ketan, when we made the announcement, what we were doing is indicating the level of reinvestment that we felt was needed in these facilities. We also indicated at that time that it would have to come from existing liquidity and the ability of our operations to generate cash.

What we were concerned about was how our recovery boiler at Northwood was faring. And the feedback from the latest turnaround is it's actually in very solid condition. We did not see any material deterioration and, therefore, at this point, don’t have a timeline on that, which allows us to have some more flexibility around the priorities on capitalization and matching that to our ability to generate cash.

So it’s a long-winded way of getting back to (it), I do believe that we’re stretching out that capital over a longer period of time to ensure that we protect the balance sheet as it is.

Ketan Mamtora

All right. Okay. No. That’s very helpful. I’ll jump back in the queue.

Don Kayne

Thanks, Ketan.

Operator

Thank you. Your next question is from Sean Steuart from TD Securities. Please ask your question.

Sean Steuart — TD Securities

Thank you. Good morning, everyone.

Don Kayne

Good morning, Sean.

Sean Steuart

—I just want to follow up on that last question with respect to the Pulp CapEx plan. So beyond RB1 at Northwood, the rest of these initiatives that you had planned over a four to five-year time frame, this is all modular, discrete spending initiatives across the portfolio that you can toggle on timing. There’s flexibility beyond RB1. Is that the right way to think about it?

Kevin Edgson

Absolutely, Sean. And the way I would look at it is it's a general commitment to maintenance capital, is low on strategic ROI, and really should be viewed at recapitalizing the mills to get them back into the best condition they can be.

And so the trade-off on when you do that is what are the maintenance costs and what are the impacts on productivity between now and then. And so they're a multitude of smaller, discrete projects that will be prioritized based on the risk and impact that they have. And they'll be slotted based on available liquidity or cash to advance on them.

Sean Steuart

Okay. That helps. It helps frame it for me. Second question, for Pat, you had $48 million of investments that you acquired this quarter. Can you give us any context on what that was?

Pat Elliott

$48 million of investments like in our—

Sean Steuart

I mean cash flow.

Pat Elliott

Sean, I'm going to have to get back to you. Apologies for that. I'll get back to you.

Sean Steuart

Okay. All right. That's all I had. Thanks, guys.

Don Kayne

Okay. Thanks, Sean.

Operator

Thank you. Your next question is from Matthew McKellar from RBC Capital Markets. Please ask your question.

Matthew McKellar — RBC Capital Markets

Hi. Good morning. Thanks for taking my questions.

First, when you look across the markets, and this is kind of following Hamir’s question, but do you see any risk of increased imports of European lumber into North America given some of the softness in European demand?

Or does the combination of relatively low lumber prices in the US and reduced supply into Europe from Russia and Belarus just not support that scenario?

Don Kayne

Go ahead, Kevin.

Kevin Pankratz

Hi, Matthew. I think that the European producers are going to look at other markets and, the US will be one of them. How much upside, it’s going to be hard to really estimate, but there’s going to be other markets that are going to support growth that are going to have comparable or not better returns be it China, be it Japan, be it the Middle East.

And so I do think we’ll see some modest things there. But they’re also facing some cost challenges as well. If we don’t see a material pickup in price in North America, it could keep those volumes at bay. But that’s our outlook I should say.

Matthew McKellar

Okay. Thanks for that. Maybe just thinking of the lumber business here. VIDA bought a 50 million board foot mill in Sweden in the quarter. Sounds like there's potential to expand that mill. Can you talk at all around what that mill looks like today?

And then, as you think about a potential expansion, how we should think about, maybe, a timeline there? Or required investment dollars? Return-on-investment targets? Things of that nature?

Don Kayne

For sure, Matthew. It's Don. I'll just, real quickly, on at least the first part of it. It's really a facility that's a unique opportunity that came up for us, for our Swedish folks, that we really thought could add some more specific added value to our customer base. So it was really driven by our customers and the opportunity.

It's a treated lumber facility, and we've got opportunities there to increase production there as we move into next year. In terms of how much dollars it's going to cost to get that incremental production, it's early days on that. We just closed recently here. But it's a real good opportunity here to get closer to our customer base in Sweden.

As you know, our Swedish company, one of the things that they do that we think is a huge advantage and one of the reasons we have had such an interest in it is their focus on value-added products and distinguish themselves outside of the commodity arena. And this is just another example of that, that we really think we can capitalize on.

Matthew McKellar

Great. That's helpful. Thank you. And then just maybe to close with Pulp. Can you elaborate at all on exactly what the operational issues were at Northwood around the restarts? Thanks.

Kevin Edgson

Matthew, a very fair question, and I wish I could point at one thing being a problem. But it was, very sadly, a combination of different things, just failing to operate or restart the way we wanted and then the struggles that we had to get those mills up and stable.

And of course, they're very complex facilities as everybody knows, but we really stumbled out of the gate. And none of the issues that we ran into were related to work that was done on the turnaround. It was all various pumps and different cleaners and screens and the like that just tripped us up all the way along. And so I don't have a singular thing to point out other than the general condition of the facility.

Matthew McKellar

Okay. Thanks. That's all for me. I'll turn it back.

Operator

Thank you. We have another question from Ketan Mamtora from BMO Capital Markets. Please ask your question.

Ketan Mamtora

Thank you. Hey. Can I just, on the Lumber side, can you talk about what you guys are seeing on the log costs in the south and BC and in Europe?

Don Kayne

Yeah. Log costs, if I understand the question, Ketan, 100 percent. Log costs in BC are relatively flat. Stumpage is down a bit, so it'll be down a small amount I would say overall, and we expect that to kind of continue.

In terms of Europe, it's up. Log costs in Europe are up a bit but not significantly, but they are up, definitely. And but we're not concerned about that.

Ketan Mamtora

Got it. Okay. Perfect. That's helpful. Good luck.

Don Kayne

All right. Thanks, Ketan.

Operator

Thank you. There are no further questions. I'll now turn the call over back to Mr. Don Kayne for the closing remarks. Please go ahead, sir.

Don Kayne

All right. Thanks, Operator, and thanks to everyone that participated in the call. And we look forward to talking to you at the end of the year. Thanks very much.

Operator

Thank you. Ladies and gentlemen, that concludes our conference call for today. Thank you all for participating. You may all disconnect.