

FINAL TRANSCRIPT

Canfor Corporation

Fourth Quarter 2014 Results Conference Call

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PRESENTATION**Operator**

Good morning, ladies and gentlemen, and welcome to the Canfor Corporation Fourth Quarter 2014 Results Conference Call. At this time, all lines are in listen-only mode.

Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for a question.

If anybody has any difficulties hearing the conference, please press *, 0 for Operator assistance at any time.

I would now like to turn the conference over to your host, Don Kayne, President and Chief Executive Officer, Canfor Corporation; and Chief Executive Officer, Canfor Pulp Products Inc. Please go ahead.

Don Kayne — President and Chief Executive Officer, Canfor Corporation

Thank you, Operator, and good morning, everyone. Thanks for joining the Canfor and Canfor Pulp Q4 2014 results conference call. I'll speak briefly to the results of both companies before I turn things over to Alan Nicholl, who is the Chief Financial Officer for both Canfor Corporation and Canfor Pulp Products Inc. Alan will provide a more detailed overview of our performance in Q4 and 2014 overall, after which we will take questions.

With me today to address your questions are Brett Robinson, President of Canfor Pulp; Wayne Guthrie, Senior Vice President of Sales and Marketing for Canfor, and Sean Curran, Vice

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President of Sales and Marketing for Canfor Pulp. Also with me today is Stephen Mackie, who has taken over for Alistair Cook as our Vice President of Wood Products Operations Canada.

For the fourth quarter of 2014, Canfor reported shareholder net income of \$30 million and Canfor Pulp reported shareholder net income of \$21 million.

The lumber business has had some challenges in the fourth quarter relating to several fairly recent major capital upgrades, particularly at two of our largest sawmills at Houston and Mackenzie, but the good news is that those mills have been running increasingly well in the last few weeks.

As you are aware, we have been active in growing our US production capacity and we recently announced the acquisition of Southern Lumber Company, which operates a high value southern yellow pine mill in Hermanville, Mississippi.

In addition, we closed the first phase of our purchase agreement for Beadles and Balfour Lumber Companies on January 2nd, and we now own 55 percent of those two mills in Georgia.

We also announced the sale of our Taylor pulp mill to Canfor Pulp. This transfer of ownership aligns all our pulp operations under our pulp leadership team and doesn't involve any operational changes. We fully anticipate the Canfor pulp team will build on the successes of Taylor's pulp mill going forward.

A quick update on markets. The good news is on housing starts out of the US, and while the recovery has been slower than we expected, all the indicators appear to point in the right direction, and we remain cautiously optimistic that the increasing strength of the US market will continue.

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Our sales to China, after we adjust for the close of Quesnel, have remained relatively strong with comparable shipments, 2013 over 2014, are up slightly. While we recognize that there is currently some inventory overhang there, this will be worked through in the next few months, and we remain confident in the Chinese market overall and will continue to be important for us in the future.

With those introductory remarks, I will now turn the call over to Alan Nicholl to provide more details on Canfor and Canfor Pulp's financial results for the quarter.

Alan Nicholl — Senior Vice President, Finance and Chief Financial Officer, Canfor Corporation

Thanks, Don, and good morning to everyone. My comments this morning are focused principally on our financial performance for the fourth quarter of 2014 by reference to the previous quarter. Full details of the results, as always, are contained in the Canfor and Canfor Pulp news releases, which were both issued yesterday.

As always, you'll find an overview slide presentation on both the Canfor and Canfor Pulp websites in the Investor Relations section under Webcasts. The presentation highlights consolidated and segmented results, and I'll be referring to this presentation during my comments.

For the fourth quarter of 2014, Canfor reported shareholder net income of \$30 million, or \$0.22 a share, down from \$46 million, or \$0.34, for the third quarter, and up from \$28 million, or \$0.20 a share, reported for the fourth quarter of 2013.

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On Slide 3 of our presentation, we highlight various nonoperating items net of tax and noncontrolling interest, which affect the comparability of our results between the quarters. In the fourth quarter of 2014, these items had a net negative impact of approximately \$5 million, or \$0.04 a share. After taking account of these items, which related principally to mark-to-market adjustments on derivative instruments, particularly on our crude oil collars, the fourth quarter adjusted shareholder net income was \$35 million, or \$0.26 a share, compared to similarly adjusted net income of \$51 million, or \$0.38 a share, for the third quarter.

You'll see on Slide 4 of our presentation that Canfor's fourth quarter operating income was \$62 million, a decrease of \$24 million from the previous quarter. The decrease principally reflected higher log costs in BC, lower lumber production, and seasonally higher maintenance activity and energy usage, including a scheduled outage at Canfor Pulp's Northwood pulp mill.

Results for the lumber segment are highlighted on Slide 5 of our presentation. The current quarter's operating income was \$41 million; that was down \$19 million from the previous quarter. Most of this variance is attributable to upward pressure on log costs in Western Canada as mentioned previously, and reflected increased logging and hauling costs as well as higher purchase wood costs at our Canadian operations.

Our lumber production was down 4 percent from the previous quarter, largely due to additional statutory holidays, as well as several capital upgrades at our US site operations. The lumber sales realizations were slightly improved, reflecting a 4 percent weaker Canadian dollar.

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Canfor's pulp and paper segment principally comprises the results of Canfor Pulp Products Inc., and as you will see on Slide 6 of our presentation, Canfor Pulp reported net income of \$21 million, or \$0.29 a share, compared to net income of \$24 million, or \$0.34 a share, for the third quarter, and net income of \$14 million, or \$0.20 a share, for the fourth quarter of 2013.

Staying on Slide 6, Canfor Pulp's fourth quarter net income, after taking account of onetime nonoperating items net of tax, was \$21 million, or \$0.30 a share, and this represented a \$4 million, or \$0.04 a share, decrease from adjusted net income of \$25 million, or \$0.34 a share, for the third quarter.

Canfor Pulp segment results on Slide 7 mostly reflected moderate increases in unit manufacturing costs, mainly due to the scheduled maintenance downtime in the quarter, and to a lesser extent increased fibre costs.

Shipment volumes increased in the quarter, largely driven by solid demand in the Asian markets. Sales realization showed a modest increase, mostly as a result of the 4 percent weaker Canadian dollar, which more than offset slightly lower pulp prices.

Capital spending in the fourth quarter totalled \$55 million, of which 42 million was in the lumber business and 11 million in Canfor Pulp. 2014 total capital spend was approximately \$176 million for Canfor and \$58 million for Canfor Pulp.

For 2015, we're currently planning to spend capital of around 140 million for our lumber business and around 60 million for our pulp business.

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During fourth quarter, Canfor issued \$75 million of five-year, non-amortizing term debt within its bank group to finance long term bioenergy projects such as the Chetwynd and the Fort St. John pellet plants that we announced in the fall of last year.

And as Don mentioned, on January the 2nd this year we acquired 55 percent of the Balfour and Beadles sawmills in Southern Georgia as announced last year. In addition, last Friday, we increased our ownership interest in Scotch Gulf (sic) [Scotch and Gulf] to 50 percent as part of our phased acquisition, which will be fully completed in July 2016.

The cash cost of these two transactions was approximately \$6 million US, and was financed by cash on hand.

Also last Friday, we completed the sale of the Taylor pulp mill to Canfor Pulp from Canfor for initial consideration of approximately \$15 million, principally comprised of working capital. The deal also includes an earn-out provision over the next three years. And yesterday, the Canfor Pulp Products Inc. Board announced a dividend payment of \$0.0625 for the quarter, consistent with the previous quarter.

At the end of 2014, Canfor, excluding Canfor Pulp, had net debt of \$115 million, with available liquidity of 306 million. Canfor Pulp had net cash of \$26 million, with available liquidity of \$118 million.

Net debt to total capitalization, excluding Canfor Pulp, was around 8 percent. For Canfor Pulp, it was negative 6 percent, and on a consolidated basis it was approximately 5 percent.

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And with that, Don, I'll turn the call back over to you.

Don Kayne

Great. Thanks, Alan. So, Operator, we can open the call up to questions now.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press *, followed by 1 on your touch-tone phone. You will hear a three-tone prompt acknowledging your request, and your questions will be polled in the order they are received. If you are using a speakerphone, please lift the handset before pressing any keys. One moment, please, for your first question.

Your first question is from Sean Steuart, TD Securities. Sean, please go ahead.

Sean Steuart — TD Securities

Thanks. Good morning, everyone. A couple of questions to start. The wording around the dividend at Canfor Pulp, it sounds like your bias is to hold it at the current level through this year, and I'm wondering if you can go into a bit of detail on your thinking there, given Canfor Pulp is now in a net cash position; free cash flow remains strong. Maybe talk about the dividend versus growth opportunities and how you're thinking about capital allocation there.

Don Kayne

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Sure, Sean; it's Don. I think the way we've, I think, consistently been thinking about it, first of all, we haven't concluded at all that that's what we'll be doing for the whole year. I think Al has probably mentioned before, or we all have, is that we would look at that on a quarterly basis, have a discussion about it with our shareholders and our Board, and determine what we're going to do there.

In terms of allocation, though, of cash going forward, clearly now that we have a strong balance sheet, as you're aware of, we're looking basically in terms of priorities of course at the dividend, but also around share buybacks and to what degree we want to do that. Of course, we want to make sure with the investments that we've made to get to top quartile as a company to make sure that we continue to reinvest and keep us there. That's extremely important as well to us.

So we're basically looking at all those options and all those opportunities, including, now, because of the cash position, what may be available as an opportunity from the M&A side.

Sean Steuart

Okay. So potential other acquisitions beyond Taylor...

Don Kayne

Correct.

Sean Steuart

Is the way we should think about it?

Don Kayne

For sure.

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Don Kayne

Okay. And a question for Alan, and I'll get back into the queue. The 17,000 tonnes you took at Northwood this quarter, which you guys have talked about previously, can you put a dollar figure around the EBITDA impact that that downtime had this quarter?

Alan Nicholl

Yeah. We don't typically do, Sean. There is obviously the production impact as well as the additional costs directly associated with the shut, but no, we don't typically communicate that impact. But it's fair to say that it was fairly significant, as it typically is with any major scheduled downtime. But no...

Sean Steuart

I mean, I guess—go ahead, sorry.

Alan Nicholl

Sorry, just...

Sean Steuart

I guess...

Alan Nicholl

Go ahead, Sean. Go ahead.

Sean Steurt

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I guess the question I have is were there any other moving parts in the cost structure this quarter beyond the downtime? I guess the way I look at it is your unit costs on the pulp side were the highest on a quarterly basis I think we've seen in five years or so. Were there any other major moving parts on the input cost side that would have contributed to inflation in Q4?

Alan Nicholl

Yeah. So I guess two things: typically because it's Q4 we see seasonally higher energy usage as you would expect. The other item that I alluded to was slightly higher fibre costs, which for the most part, Sean, were really tied to the higher realizations we're getting for pulp.

Sean Steuart

Okay. I'll get back in the queue. Thanks, guys.

Don Kayne

Thanks, Sean.

Operator

Thank you. Your next question is from Paul Quinn, RBC. Paul, please go ahead.

Paul Quinn — RBC

Yeah. Thanks very much, and good morning. Couple of easy questions: one, just taking a look at the material change in the Canadian dollar, and just trying to get a Canfor and Canfor Pulp view on what the US dollar pricing impact would be from a SPF and NBSK basis for both lumber and pulp, and I guess that's directed for Wayne and Sean, but welcomed any comments.

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Don Kayne

Wayne, why don't you start with that?

Wayne Guthrie — Senior Vice President, Sales and Marketing, Canfor Corporation

Sure. Paul, on SPF, I mean, really our US price is going to be determined by the supply/demand equation in the US. Right now, we're a little bit disappointed in the US benchmark prices because we've got a little bit more supply, even though demand's been very good. Once we get that market starting to move back the other direction, which we're starting to see just here recently, that exchange will be to our benefit.

So we don't see it really directly impacting US prices, we see that being more independent related to supply/demand within the US.

Sean Curran — Vice President, Sales and Marketing, Canfor Pulp Products Incorporated

And, Paul, it's Sean. I would echo the same comments. We see more on the supply and demand side driving the price. What we're seeing now you have a moderate price decline that's happening in the marketplace. We see that more as seasonally hitting the prices versus the currency at this point.

Paul Quinn

Okay. Thanks. And then just on log costs, which seem to be up significantly, especially in BC, maybe you could just give us sort of your outlook at that inflation in each of the jurisdictions you're

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in: BC, Alberta, and the US South, and whether that's going to be offset by at least our expectation for lower conversion costs.

Don Kayne

Okay. Paul, it's Don. Just on that, in terms of log costs overall, we'd say that certainly in BC, we're seeing in the neighbourhood of 10 to 12 percent in terms of inflation next year from a log cost standpoint. And at this point, most of that we feel will be offset by some of the productivity improvements that we expect to get now that we're through the start-ups that we spoke about earlier, next year and the productivity improvement to come from that.

In terms of the south, probably in the neighbourhood of between 1 and 2 percent, we're expecting in terms of log cost inflation next year down in the south.

Paul Quinn

Okay. And the last question I had really on the Canfor Pulp side, because Sean's already hammered you on the dividend, but it's really on the energy side. Maybe you could just recap energy in terms of production and EBITDA impact going forward; change over '14?

Alan Nicholl

Yeah, Paul. Yeah, so I'll take that one and then maybe, Brett, feel free to jump in, but essentially, Paul, as you're aware, we've got our Intercon PG upgrade in the works and hoping to generate EBITDA starting in the second quarter today.

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So in terms of 2015, I think kind of the guidance would be roughly 20 million EBITDA on an annualized basis. Or looking at it another way, 2016 probably closer to 25 million when we take full account of the Intercon upgrade.

Paul Quinn

Great. That's all I had. Thanks, guys.

Don Kayne

Thank, Paul.

Operator

Thank you. Your next question is from Daryl Swetlishoff, Raymond James. Daryl, please go ahead.

Daryl Swetlishoff — Raymond James

Thanks. Morning, guys. Just a question on—I understand Mr. Guthrie's recently back from China. Wouldn't mind hearing what he saw there on the ground. And also, just what are you seeing in terms of gaining market share by some of our competitors in China related to the lower ruble and euro?

Wayne Guthrie

So yeah, thanks, Daryl. So I don't usually get Mr. Guthrie, so thank you for that. It was—yeah, so we just did get back, and we kind of had a focus of trying to get after some of the higher value products over there. Honestly, we are seeing continued improvement in demand for Canadian

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SPF products in higher value applications. So we kind of had a bit of a focus on furniture building, and so we were quite pleased with the trip.

On the lower value side, no doubt there's a bit of a slowdown going on, and the Russians are quite competitive here right now, so we'll have to work through that for the next couple of months, as Don mentioned in his opening comments.

Honestly, though, by the back half of the year, our customers are expecting things to straighten out. So we'll be focused in on the high value for the next little while, and at the end of the day our volume to China is expected to be flat year over year.

Daryl Swetlishoff

Okay. Thanks for that. Just with the depreciation of the euro, at what US dollar lumber price do you think there's a chance we could see more European wood coming to North America?

Wayne Guthrie

Darrell, it's really difficult to speculate. The reason why is because it's all relative to other markets in the world. If other markets in the world don't recover and the US is offering the best return, even if that's not great for the euro we might see an increase there. But at the end of the day though, we don't see a material amount of euro coming in this year that would have a major impact on the market.

Daryl Swetlishoff

Okay. (unintelligible)

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Operator

Thank you. Ladies and gentlemen, as a reminder, should you have a question, please press *, followed by 1 on your touch-tone phone.

Your next question is from Mark Kennedy, CIBC. Mark, please go ahead.

Mark Kennedy — CIBC

Ah, yes. Don, just wondering—or Alan—if you could maybe on terms of your CapEx profiles, on the lumber side—does that include your wood pellet CapEx? And how much would that be?

Alan Nicholl

Yes, Mark, that's a very good question. No, it does not include that already-committed expenditure. We think the cash spend on that will be roughly 40 million this year, give or take.

Mark Kennedy

Okay. So is that not—so that's not being run through your CapEx on your balance sheet then?

Alan Nicholl

Oh it is, sorry. When I was talking about the lumber I'm just talking about a regular dimension lumber business, around that 140, and that would include US South and Western Canada. It did not include pellet plants, Mark.

Mark Kennedy

Okay. So your total CapEx this year would be more like 240 then on a consolidated basis?

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Alan Nicholl

Yep. In terms of cash spend, yes.

Mark Kennedy

Okay. And then on the pulp side too, that 60, how much of that is sort of discretionary? And is that still going into the energy side? Or where is that going?

Brett Robinson — President, Canfor Pulp Products Incorporated

It's Brett here. It would be about 50-50. Energy, we're really finishing up the Intercon project. Our next energy project would be likely two years out.

Mark Kennedy

Okay. And so when you say 50-50, you mean about 30 is maintenance capital and 30 is discretionary? Or...

Brett Robinson

That is correct.

Mark Kennedy

Okay, great. Thanks, Brett. All right, that's it for me.

Operator

Thank you. There are no further questions at this time.

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.

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Don Kayne

Thanks, everyone, and we'll look forward to talking to you at the end of the next quarter.

Thank you.

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