Canfor

Third Quarter Analyst Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Apurva Kilambi
Scotiabank — Analyst

Ketan Mamtora
BMO Capital Markets — Analyst

Sean Steuart
TD Securities — Analyst

Hamir Patel
CIBC Capital Markets — Analyst

Matthew McKellar
RBC Capital Markets — Analyst

PRESENTATION

Operator

Good morning. My name is Joanna (phon), 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, Canfor

Thank you, Operator, and good morning, everyone. Thank you for joining the Canfor and Canfor Pulp Q3 2024 Results Conference Call.

I'm going to make a few comments before I turn things over to Pat Elliott, our Chief Financial Officer of Canfor Corporation and Canfor Pulp, and our Senior Vice President of Sustainability. In addition, we are joined by Kevin Pankratz, our Senior Vice President of Sales and Marketing.

As you know, Canfor has been focused on building on its globally diversified operating platform by increasing our footprint in Alberta, the US South, and Europe, while maintaining a reduced presence in British Columbia.

This quarter, we made some additional difficult decisions in British Columbia, announcing the closure of our Plateau and Fort St. John operations in Northern BC. Combined with previous announcements, these closures will remove about 1 billion board feet of annual production capacity from our BC operations.

These decisions were driven by the persistent challenge in accessing economically viable fibre in Northern BC, which is not improving. This challenge was further exacerbated by the increase in US tariffs, which are expected to double again next year.

Despite the challenges in the BC Interior, our Kootenay operations continue to perform well, supporting our specialty product and value-added focus, including key high-margin products such as MSR, J-Grade, and home centre grades.

In Alberta, despite weak North American lumber pricing, our operations continue to provide positive earnings in Q3.

In the US South, our focus was on executing on our capital plan.

Today, our sawmill operations in our new facility in Axis, Alabama began production. When the planer mill is completed later this year, we expect the first shipment of finished lumber. The new sawmill will have annual capacity of 250 million board feet on a two-shift basis.

Our Mobile plant ceased operations earlier this month with decommissioning being conducted throughout the remainder of 2024.

The acquisition of the former Resolute El Dorado mill in Arkansas, now called Iron Mountain, was completed on August 1.

The Urbana upgrade project is in its final phase with start-up last month and ramping up production in Q4. This project will increase capacity to 285 million board feet.

With respect to VIDA, although our results were marginally better than expected, 2024 has been challenging with log costs continuing to increase.

On our financial results, our Lumber business in North America recorded significant losses in the third quarter due to persistently weak lumber prices, increasing duties, and a lack of available economic fibre in British Columbia.

Notwithstanding increasing log costs, combined with seasonal downtime, our European operations generated positive operating income in the third quarter.

While global lumber demand remains tepid in the short term, lumber prices have steadily increased over the last several weeks. With interest rates beginning to normalize, we anticipate affordability to gradually improve through 2025, which should support higher pricing into next year.

While we anticipate a challenging fourth quarter, we believe our Lumber business is well positioned to capitalize on improving market conditions over the medium to long term, supported by several significant capital investments nearing completion in the US South, closures of certain high-cost assets across North America, and our strong European platform.

With respect to Pulp, on an adjusted basis, our Pulp business generated improved financial results in the third quarter, supported by higher sales realizations. Pulp production was modestly lower than the previous quarter, with our Northwood mill successfully transitioning to a one-line operation in August.

While Canfor Pulp continues to navigate the uncertainty associated with fibre supply in British Columbia, we have seen improved operating results over the last several quarters and remain focused on improving our cost structure going forward.

I will now 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, Canfor

Thanks, Don, and good morning, everyone.

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

As Don mentioned, this was a challenging quarter, with our Lumber business generating an operating loss of $336 million.

These results include an asset write-down, an impairment charge of $100 million, non-cash duty-related adjustments of $121 million, and several other items recorded in the third quarter.

Adjusting for these one-time items, our Lumber business generated an operating loss of $129 million, compared to a similarly adjusted loss of $115 million in the prior quarter.

These results continue to reflect the impact of weak North American lumber markets, particularly for Southern Yellow Pine, as well as an elevated cost structure due to significant production curtailments in North America, seasonal downtime time in Europe, and losses associated with certain high-cost operations in British Columbia.

We anticipate an improvement in our underlying cost structure following the orderly wind-down of several BC sawmills later this year.

In addition, with several major capital projects in the US South nearing completion, we anticipate a gradual improvement in our unit cost structure, as this low-cost capacity begins to ramp up throughout 2025.

Turning to our Pulp business, Canfor Pulp generated an operating loss of $209 million, including a $211 million asset write-down and impairment charge.

On an adjusted basis, Canfor Pulp generated an operating income of $2 million, an improvement of $7 million from the previous quarter, largely driven by improved pulp unit sales realizations.

In total, we reduced the net book value of our lumber and pulp assets in BC by approximately $311 million, reflecting the rightsizing of our operating footprint and balance sheet as a result of recent closure announcements and the reduced availability of economic fibre supply in the province.

At the end of the third quarter, Canfor Pulp had net debt of $68 million and $85 million of available liquidity, excluding a term loan commitment of $80 million related to a potential reinvestment in Northwood's recovery boiler #1 (unintelligible).

Canfor, excluding Canfor Pulp and the $314 million duty deposit loan completed in late September, ended the third quarter with net cash of approximately $330 million.

On a consolidated basis, capital expenditures were approximately $117 million in the quarter, including approximately $18 million for Canfor Pulp.

We anticipate capital spend of approximately $450 million in the Lumber segment in 2024, including the remaining spend on our Alabama greenfield, as well as various growth initiatives in the US South and Sweden.

We anticipate a significant reduction in our capital spend in 2025, following the completion of three major projects in the US South in recent years.

For Canfor Pulp, we are currently forecasting capital spend of approximately $50 million in 2024, including capitalized maintenance.

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

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

Don Kayne

All right. Thanks, Pat. So, Operator, we're okay now to take 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.

Please press *, 1 now if you have a question. There will be a brief pause while participants register for questions. Thank you for your patience.

Your first question comes from Ben Isaacson at Scotiabank. Please go ahead.

Apurva Kilambi — Scotiabank

Good morning. This is Apurva on for Ben.

My first question is, we've seen a bit of a general slowdown in European lumber imports. Wondering if you could comment on what Canfor's volume out of the region looks like?

And how much of that slowdown is due to North American imports versus domestic demand in Europe?

Don Kayne

Yeah. Thanks very much. Kevin, you could comment on that?

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

Sure. Yes. Thanks for the question. And yes, European imports are down, and that was largely predicated in slumping pricing here in North America. That made it not very competitive for many of the operators there.

Our volume from VIDA into North America was actually relatively stable quarter over quarter, and a lot of that is committed to program business, and a bunch of that with the home centre business. So, I would say because of that, our volumes are more stable, but I think transactional volume did see a shift.

Apurva Kilambi

Thank you. And then my second question, if I can sneak it in, is can you provide us any update on how the modernization of Urbana is going? As well the greenfield in Axis? Roughly how much incremental capacity do you expect will come online this year?

And then, given kind of where market conditions are today, are you considering delaying or differing any ramp-ups?

Don Kayne

Yeah. So, first of all, on Urbana, we'll be commissioning that in Q4 2024 for sure. And the spend there's about 93 percent completed. So, for us, we've got a little bit more we need to spend there. The additional capacity's going to be about 115 million board feet.

Apurva Kilambi

Thank you.

Don Kayne

And then for Axis—you mentioned Axis also. The capacity there, that's also going to be complete—I think I mentioned in my comments that they're starting that up. But the capacity there will be 250 million board feet, that's all I need to say around Axis, for now.

Operator

Thank you. The next question comes from Ketan Mamtora at BMO Capital Markets. Please go ahead.

Ketan Mamtora — BMO Capital Markets

Good morning and thanks for taking my question.

Maybe, Don, to start with, in general, I thought your release and your comments this morning are striking a pretty cautious tone in terms of near-term demand in lumber. Some of the others that have reported are probably expecting a little more sort of recovery as we go through into Q4 and '25.

I'm just curious, as you look at your demand and what you are hearing from your customers, can you comment at all in terms of repair, remodelling demand? New residential demand? How that's holding up?

And how that has trended through the quarter and into October? Thank you.

Don Kayne

Okay. So, Ketan, thanks for the question, Ketan. And I'll maybe start real quick, and then I'll pass it over to our sales and marketing guru here, Kevin.

But first of all, just really on demand, I think we are cautious, but we've become cautious the last couple, three years. Right? Well, we've done a fair bit of travelling lately in the United States and even in Japan. And overall, I think demand looks fairly stable, actually. It's not disappointing us in any way. We're just being cautious for any major uptick at this time and more believe a lot of the increase that we see will come from supply reductions, as opposed to demand increases.

But overall, we're certainly not negative at all, Ketan, and matter of fact, looking forward, we're actually quite positive. And I'll let Kevin talk about that—

Kevin Pankratz

Yeah.

Don Kayne

—in more detail.

Kevin Pankratz

Yeah. Sure. Actually, the outlook actually looks a bit promising there, and we are a little bit cautious. However, we had some major interest rate drops. And a lot of our customers believe that, that trend's going to continue, which is going to help address affordability. And I guess it's just a question of timing and, once that affordability threshold gets achieved, I think the demand unlocked is going to be pretty good.

And more specifically, if I talk like multifamily, that's been a big segment that's been underperforming, and we're starting to see that, that has actually bottomed, and that could help demand down the road. But those are longer-term projects that take time to get done versus a single family.

So that's why we're a little bit cautious going into Q1 of 2025. But we do share that view that demand actually looks more promising. But really, the uplift in pricing today has been largely driven by supply reductions.

Ketan Mamtora

Got it. That's helpful context. And then, Pat, one for you. You mentioned you expect a pretty meaningful reduction in 2025 CapEx for Lumber. Order of magnitude, how should we be thinking about that sort of reduction? Just rough numbers?

Pat Elliott

Yeah. Ketan, we're fine-tuning still, but I'd say it's like $250 million to $300 million versus the $450 million we spent this year. That'd be the range I'd use for Lumber.

Ketan Mamtora

$250 million, Pat, is that what you said for Lumber?

Pat Elliott

$250 million to $300 million.

Ketan Mamtora

I see. Okay. Got it. Perfect. That's all I had. I'll turn it over. Good luck.

Don Kayne

Thanks.

Operator

Thank you. Next question comes from Sean Steuart at TD Cowen (sic) [Securities]. Please go ahead.

Sean Steuart — TD Securities

Thanks. Good morning, everyone. Couple questions.

Pat, I'll start with the loan against the duty receivable. Hoping you can give us some of your rationale there, given you already have a strong balance sheet, and it looks like the borrowing costs, depending on the time frame here, could be reasonably high.

I guess the read-through is either you're expecting this is going to be a very drawn-out process towards any sort of resolution on the trade file, or you feel the need to bolster an already strong balance sheet ahead of, maybe, a difficult market environment, or ahead of potential M&A opportunities. Can you give us some more context on the rationale, Pat or Don, on that front?

Pat Elliott

Yeah. Sure, Sean. I mean, you're right. There's a timing call in there for sure, I think on both sides of the equation. I can't tell you when this will settle. We're on the record as sort of identifying we don't see a near-term settlement.

Canfor has over US$725 million on deposit and, with the rates increasing here to 16 percent and probably doubling or more again next year, we're going to have a lot more, unfortunately, on deposit. So for us, the opportunity to take some of the money off the table, even at a discount, seemed to make some sense.

There's no specific use of funds we have in mind but just the flexibility. And these opportunities maybe don't come along all the time. It took us a while to do it. And so while it was there, we thought it was sort of prudent to take sort of 40 percent of our current exposure off the table, and that's how we came to do it now, Sean.

Sean Steuart

Okay. Understood. Second question is on European fibre costs. You mentioned the pressure you've seen on that front. And we've seen reports that Södra in Sweden is increasing log costs again, I suppose over the last week or so.

Can you speak to the general fibre cost environment? Your ability to recoup that in local prices for lumber with the quarterly contract system? It seems to be more in place there. Suppose just general comment on fibre costs in Europe?

Don Kayne

Yeah. I mean, I think you can—well, you raised that well. I think that it's safe to say across Europe, fibre costs have increased pretty dramatically from a fairly low base, though, to start with, but still, they have definitely increased, and northern Europe particularly have increased.

I guess there is some offset there, though, in terms of quality of the fibre that we get there. And as you know, and we've spoken about it before, we have a very, very high percentage of high-value product opportunities there that we've been able to develop over years. Long before we came along, even VIDA was focused on that before.

So, we're in BC, we're in Canada, and even in the US, we're 40 percent to 60 percent high value; there, it's more like 80 percent, 90 percent. So significant recovery, a great recovery, improvements in Sweden compared to anywhere else, really in the world, probably, but certainly at the top of the list there.

And the other thing there too, Sean, is we've got a lot more flexibility on markets. We have the ability to move around to where the markets are the highest value as well. And so even though log costs have gone up, we're certainly never comfortable with increases, but we've got lots of options, and with a high-value percentage of our portfolio, feel pretty good about that too.

Sean Steuart

Okay. That's great detail. Thanks, Don. That's all I have for now.

Don Kayne

Yeah. All right. See you.

Operator

Thank you. Next question comes from Hamir Patel at CIBC Capital Markets. Please go ahead.

Hamir Patel — CIBC Capital Markets

Hi. Good morning. Don, I wanted to get your thoughts on how much of the capacity that's been removed this year is kind of gone for good versus just maybe idled for a period of time and at risk of coming back in a stronger market, and just thinking specifically in the US South?

Don Kayne

Yeah. Good question. It's one that we wrestle with ourselves. Right? And ourselves, we've—just speaking of Canfor, we got a couple mills down and added kind of half of one back, kind of thing.

But at the end of the day, hard to know. And the reason it's difficult is a lot of the independents don't report, they don't speak about it. But we can only tell by the performance in the last 12 to 18 months of the Southern Yellow Pine operations overall, that they've got to be under significant pressure.

So our belief is it's definitely down. We talk about this a lot. But if you went back two, three years, when a lot of these larger mills, the 15 big mega mills everybody's built through that big construction, there's expected to be significant increases in yellow pine production which, of course, this year, year to date's probably down 7 percent, 8 percent. So, it's not anywhere near what was expected even a couple years ago.

So our view is that, yeah, there is. But how much of that's permanently down, hard to tell. But I would say that there's a portion of that for sure is, just hard to get a complete handle on. But safe to say, though, I think that we're not going to see anywhere near the increase that we thought we would have seen, based on forecasts a couple years ago.

Hamir Patel

Yeah. Fair enough.

And so, Don, how do you think about your European exports to the US, just given the rationalization you've done to your BC platform? Do you expect that to grow?

And maybe you could speak to the relative attractiveness of selling into the US from Europe versus selling domestically?

Don Kayne

Yeah. I think that's one of the reasons why we diversified like we did. We anticipated the BC situation for a long time because of beetle and fires, and everything else that you hear, and trade issues and everything else. So that's why we invested in other markets to start with.

So certainly, VIDA gives us some options there for sure. So, we're looking at that in terms of what those are and can be going forward. So, yeah, there is a part to play, from our view, from VIDA, and that's already underway in a lot of cases already. I know Kevin's been working on a lot of programs there already to supplement what we get out of Alberta particularly, and British Columbia.

So I think, if you had to look at that acquisition and what we believe to be the case in terms of capitalizing on that diversification, I think that's playing just the way we thought it would.

Hamir Patel

Great. Thanks, Don.

And just the last question I had was dependent—obviously, with the US upcoming election, if we were to have another Trump administration, and he's talked about putting, sort of across the board, 10 percent tariff on imports. Is there any reason lumber would not also get hit with that additional 10 percent if that occurs? I'm just thinking with the ongoing trade dispute. And is that maybe a risk that your duties, which already are going to go up, go up potentially even more?

Don Kayne

With all due respect, Hamir, I think it's obviously a really, really difficult one to call because there's a lot of—it seems like weekly and annually, we get little surprises on that subject but hard to speculate—

Hamir Patel

Yeah.

Don Kayne

—at this point on that. I mean, obviously, just like the duties that we're dealing with today, you got price responses and timing and all of that, so really difficult one to answer at this point.

Hamir Patel

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

Don Kayne

All right. Thanks, Hamir.

Operator

Thank you. Next question comes from Matthew McKellar at RBC Capital Markets. Please go ahead.

Matthew McKellar — RBC Capital Markets

Good morning. Thanks for taking my questions.

Can you talk a bit about what you're seeing across the landscape for acquisitions in wood products today, both in North America and Europe, please?

Don Kayne

Yeah. I mean, just from our standpoint, I mean, we certainly have been pretty active in the last three or four or five years in terms of acquisitions in strategic geographies that we felt was important for the future. And that, combined now with some of the capital projects that we've done with the two new greenfields and the pretty extensive brownfield that we've done in Urbana, overall, we're continuing to look at opportunities in Europe. And there's lots of opportunity, all over the place.

But right now, we're just being really focused on completing the capital that we've got in place, those plans we got, the start-ups that are forthcoming here. And then we'll continue to look at opportunities as they look forward. There's nothing that I can speak to at this point at all. But you've heard us talk before, and it's still the case that we really like Europe, we really like Alberta, and we really like the US South.

Matthew McKellar

Okay. Thanks for that.

Don Kayne

And we like the Kootenays.

Matthew McKellar

Okay. Thank you. And then just one more cleanup from me on CapEx. I think I heard $250 million to $300 million on the Lumber side next year. Are you expecting on the Pulp side that 2025 looks something like 2024? Or any comments around that, please?

Pat Elliott

Yeah. Matthew, I think, given that we've rationalized the line at Northwood, we'll be below $50 million. We're still working through that, but I anticipate it being below $50 million.

Matthew McKellar

That's helpful. Thank you. I'll turn it back.

Don Kayne

Thanks, Matthew.

Operator

Thank you. We have no further questions. I'll now turn it over to Don Kayne for closing comments. Go ahead, Mr. Kayne.

Don Kayne

All right. Thanks, Operator. And thanks, everyone, for participating this morning. We appreciate you tuning in, and we'll look forward to talking to you at the end of Q1 (sic). Thank you.

Operator

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