

Canfor Pulp Products Inc.

Fourth Quarter Analyst Call

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CONFERENCE CALL PARTICIPANTS

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TD — Analyst

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Paul Quinn

RBC Capital Markets — Analyst

Ketan Mamtora

BMO Capital Markets — Analyst

PRESENTATION

Operator

Good morning. My name is Sylvie, and I will be your conference Operator today. Welcome to Canfor and Canfor Pulp's fourth 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 Pulp Products Inc.

Thank you, Sylvie, and good morning, everyone. Thank you for joining the Canfor and Canfor Pulp Q4 2022 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, our Senior Vice President of Sales and Marketing.

Before talking about Q4 and 2022, I'd like to begin by acknowledging the very difficult decisions we made to restructure our lumber and pulp operations in British Columbia in January.

We have taken the necessary steps to right size our BC operations to align with the available fibre supply to ensure a more sustainable footprint for the future.

By doing this, we will create a more stable operating platform, which in turn will provide greater stability for our customers, our employees, our contractors, our suppliers, and our communities while ensuring we continue to provide high-quality, low-carbon products to our global customers.

After careful review, it is clear that there is not enough fibre in the Peace region, and as a result, we made the difficult but necessary decision to permanently close our Chetwynd Sawmill and Pellet Plant. The facility will cease operating in April.

Recognizing that while there are challenges operating in British Columbia, it remains a critical region in our diversified operating platform and allows us to fully serve our customers around the globe with the products they require.

Canfor's global operating regions are interdependent. Together with our lumber operations in Alberta, Sweden, and the US, our BC operations help create a diversified operating base with flexibility to be able to meet the needs of our global customers in an ever-changing supply chain environment.

That's why we also announced a potential major investment at our Houston facility. Subject to a final investment decision currently anticipated by the end of the second quarter, our intention is to build a new state-of-the-art facility in Houston.

The existing, aging mill will be replaced with a modern facility utilizing the latest technology to process the high-quality fibre in the region into high-value products. The Houston facility will be closed for an extended period, beginning in April 2023.

We recognize and deeply regret that these decisions are significantly impacting our employees, contractors, and communities in British Columbia. We are working to mitigate job impacts and support our employees, communities, and contractors through this transition with a variety of programs and support measures.

While Canfor will have a smaller footprint in British Columbia, we will be stronger and better positioned for the future.

In terms of our financial results, despite a number of significant challenges within our lumber business, particularly in BC, we had another strong year, our second-best ever, generating an operating income of \$1.4 billion before adjusting items.

Lumber markets continued to experience significant volatility in 2022, with near record-high pricing in the first half of the year supported by strong market fundamentals and demand in the new home construction and repair and remodel sectors.

While underlying demand fundamentals remained strong, inflationary pressures, economic uncertainty, and rising interest rates resulted in significantly reduced demand for new home construction, contributing to a sharp decline in lumber prices in the second half of 2022.

While we anticipate these challenges to persist in the near term, we believe our longer-term market fundamentals remain very strong, supported by favourable demographic trends, pent-up demand for new home construction activity, and continued strength in the repair and remodel sector.

Supported by our strong financial results over the past few years, we continue to focus on global diversification and made considerable progress on several strategic initiatives in 2022.

This includes a significant acquisition in Alberta, announcement of two greenfield sawmills being constructed in the US South, a major rebuild of our sawmill in Arkansas, organic growth in Europe, and continued progress on our sustainability initiatives.

Together, these investments significantly improve our cost structure, further improve our global diversification, and grow our production capacity through increased automation, innovation, and manufacturing flexibility with a focus on high-value products and sustainability.

Notwithstanding these initiatives, we have maintained a strong balance sheet. We are prepared to remain patient, disciplined, and strategic until the right M&A opportunities present themselves, and we are focused on proactively balancing production levels with market demand.

We also continue to assess additional organic and value-added external growth opportunities as we look to grow our forest products business.

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., Canfor Pulp Products Inc.

Thank you, Don, and good morning, everyone. Like Canfor, Canfor Pulp has also made some difficult decisions due to the lack of fibre in our operating region.

In January, we announced that the pulp line at the Prince George Pulp and Paper Mill will be permanently closed by the end of March. We sincerely regret the impact that the pulp line closure is having on our employees and we are committed to supporting them through this difficult transition.

In addition, as a result of the reduction in the long-term supply of fibre in the Peace region, we don't see a path to restarting our Taylor facility, which has been curtailed since February of '22, and we are currently exploring alternative uses for this site.

By reducing our operating footprint, we have better aligned our operations with the available residual supply in the Prince George region. We believe these difficult decisions will support the long-term sustainability of the Company and allow us to optimize the economically available fibre supply in British Columbia, operating on a more consistent basis to improve our operating margins and performance.

While 2022 was a very challenging year, global pulp market fundamentals remain strong.

For 2023, fibre-related curtailments in BC, coupled with the possibility of further supply disruptions, has helped stabilize markets, especially in China. We're also heading into spring maintenance for producers in the Northern Hemisphere, which will further limit supply.

For the back half of 2023, we are projecting prices to correct off of peak levels as we head into the seasonally slower summer period, coupled with the market digesting approximately 5 million tonnes of new production capacity coming onstream this year.

We remain focused on improving operational reliability, closely managing our cost structure, and optimizing available transportation as we look to capitalize on the strong pulp market fundamentals.

I will now turn it over to Pat to provide an overview of our financial results.

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

Thanks, Kevin, and good morning. The Canfor and Canfor Pulp quarterly results were released yesterday afternoon and come together with our overview slide presentation in the Investor Relations section of the respective company's websites.

In my comments this morning, I'll speak to quarterly financial highlights, a summary of which is included in our slide presentation.

Our lumber business generated an operating loss of \$200 million in the fourth quarter, which included an \$89 million asset write-down and impairment charge and an incremental \$6 million inventory write-down. Adjusting for these non-cash items, our lumber business generated an operating loss of \$104 million in the fourth quarter.

The results reflected the impact of the sharp decline in global lumber prices, combined with significant operational downtime in Western Canada due to underlying market conditions and the resulting impact of this downtime on our cost structure in British Columbia.

Notwithstanding the lower pricing, results in the US South and Europe remain solid, with our European operations contributing \$43 million in cash earnings in the fourth quarter and \$487 million in 2022.

Our pulp business generated an operating loss of \$91 million in the fourth quarter, including a \$50 million asset write-down and impairment charge.

In total, we reduced the net book value of our lumber and pulp assets in BC by approximately \$140 million, reflecting the rightsizing of our balance sheet as a result of the reduced availability of fibre supply in British Columbia.

Fourth quarter results for our pulp business principally reflected the impact of reduced residual fibre supply as a result of extensive sawmill curtailments, as well as challenging winter conditions, which contributed to an 18 percent decline in pulp production quarter over quarter.

On a consolidated basis, capital expenditures were approximately \$278 million in the fourth quarter, including approximately \$28 million for Canfor Pulp. Capital spend totalled \$625 million in 2022, of which \$113 million was Canfor Pulp.

For 2023, we currently anticipate capital spend of \$450 million to \$500 million in the lumber segment, including the spend on three major investments in the US South which are already underway, as well as organic growth in Sweden.

For Canfor Pulp, we are currently forecasting capital spend of approximately \$70 million, including capitalized maintenance.

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

Don Kayne

Yeah. Thanks, Pat, and with that, I'll turn it back to you, Operator, and we're now okay to answer questions from analysts.

Q&A

Operator

Thank you. We will now take questions, as stated, from financial analysts. If you have a question, please press *, 1 on your telephone keypad. And if you're using a speakerphone, please lift the handset and then press *, 1.

And if at any time you wish to cancel your question, please press *, 2.

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

And your first question will be from Sean Steuart at TD. Please go ahead.

Sean Steuart — TD

Thanks. Good morning, everyone. A question for Don or Pat. You guys chewed through a chunk of your liquidity in the fourth quarter. The 2023 CapEx budget you referenced, does that envision any cost inflation for discretionary projects you've already outlined versus previous guidance?

And I guess to follow on to that, maybe you don't even see a need to toggle back, but if this is an extended cash flow trough, do you have an ability to toggle back on that CapEx if needed?

Don Kayne

Pat, why don't you go ahead?

Pat Elliott

We're being prudent with the capital here, and to the extent that we can trim or make decisions that don't sort of move away from our core strategy of reinvesting in our business, we're doing that.

But I think we've made commitments to particularly the three big projects in the US South, and those are moving forward and we continue to move forward with those.

As we think through our capital plan for the next couple of years, I think we're comfortable that our cash balance will support that. We've got lots of liquidity to kind of continue along that path.

So I think we've embedded some incremental costs that are related to sort of the inflationary environment we're in, but I would say that we're able to encompass all of our capital needs that align with our strategic priorities within that budget.

Sean Steuart

Okay. Thanks for that, Pat. Question for Kevin Edgson. The alternative uses, potentially, for the Taylor site, can you give any preliminary thoughts on what you're thinking of with respect to that site? And when those decisions might be made?

Kevin Edgson

Thank you, Sean. I'd love to be able to give you a sense of what we're looking at. At this point, what we've been able to determine is, based on the lack of fibre in the Peace region, running it as a pulp mill is not a viable option.

As far as what else we might be able to do with that site, at this point we're collecting options. It's a good facility in a good location, but I can't give you any sort of colour as to what that might look like in the future.

I would hope we would find a solution very quickly. But at this point, it'll really be determined by how quickly we can figure out what else we might do there and then how quickly we might be able to execute. So, sorry for the lack of colour.

Sean Steuart

Okay. Last question for Don. Can you give us an update on your appetite for acquisitions? And what the opportunity set looks like right now in North America and/or Europe?

Don Kayne

For sure. Thanks, Sean. I think at the end of the day, we're continuing to look at US South and Europe. Those are our two primary regions, which we spoke about before maybe aside from Alberta, and we'll continue to do that.

But again, at the same time, and Pat maybe touched on it a little bit, but we're going to continue to remain real disciplined and real patient and real strategic because we certainly believe that by waiting and being disciplined and patient that we're going to get an opportunity going forward for probably better value than we otherwise would have seen. And we can now continue here for the next 12 to 24 months.

So we're going to continue to look at it because there is more and more opportunity soon to start to show up a bit.

But at this stage, we're very, very focused on DeRidder. As you know, we're focused on Urbana with the project there. And we're focused on the new mill that we just announced in Axis, Alabama, as well. Those are three pretty big projects for sure, combined with some of the organic capital that we're going to be investing and are investing in Europe currently.

So we've got lots on the go and we'll keep our eye on M&A as those opportunities arise.

Sean Steuart

Okay. Thanks, Don. That's all I have.

Operator

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

Hamir Patel — CIBC Capital Markets

Hi. Good morning. Don, we've seen Canfor announce some large, permanent capacity removals in BC this year. How much additional capacity across the rest of the industry and the province do you think is at risk of closure this year?

Don Kayne

That's a good question, and it's hard to comment on what others may do. All I can say from— this is just from my own from travelling around and whatnot—I think there is certainly areas of the province still that have more work to do there. Not in our areas, though. I think with our recent announcement here at Chetwynd and our recent announcement at Houston, we're probably pretty close to where we need to be.

But I think that there will be opportunities that others are going to need to look at in other areas of the province.

Hamir Patel

Yeah. Thanks for that, Don. And what type of potential stumpage relief are you expecting in the subsequent quarters of our 2023?

Don Kayne

So in BC, in Q4 it came down a fair bit and we spoke about it last time that we expected that to happen. So we'll (see) some of that in Q1, but it won't be that material really. There's a lot of offsets there

from an inflation standpoint in a number of areas that will prevent us from seeing the majority of that decrease that we saw in Q4.

And as we go through the year it'll depend, obviously, on what mill nets are throughout the year, or AMVs, average mill value.

Hamir Patel

Great. Thanks, Don. And maybe just a quick question for Kevin on markets. Just curious to understand your forecast for the renovation markets. It sounds like you're expecting demand there to be resilient. But would you still expect perhaps a year-over-year decline? And how does that vary between North America and Europe?

Kevin Pankratz

Thanks, Hamir. I think the R&R market continues to be quite resilient despite all these inflationary pressures. And I think the big drivers for the R&R segment, Hamir, is the age of the average home in the United States, and some degree Canada is like approaching 50 years or over. And they think that's going to be sustained growth for them.

And then they're also focusing quite a bit on the pro segment. I think that R&R segment and with their focus on the pro is going to continue to be a big focus.

We're also seeing that trend actually kind of globally. We've seen that in Australia as well. We're also seeing that in the European markets. And the European markets, while off from Q4, we're starting to see a little bit of a pickup in the European market, but not to the extent that we're seeing in North America.

Hamir Patel

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

Operator

Thank you. Next question will be from Paul Quinn at RBC Capital Markets. Please go ahead.

Paul Quinn — RBC Capital Markets

Yeah. Thanks very much. Morning, guys. Maybe start on the Canfor Pulp side. Just, Kevin, you referenced the 5 million tonnes of new capacity that's coming in. I think just about all of that is on the hardwood side. Just wondering what you're seeing on the softwood side and pricing indications as a result of that.

Kevin Pankratz

I think just a little over 4 million is hardwood. About 1 million is coming out of the new mill up in Finland—I think it's the Metsä mill—which is 500,000 or 600,000 tonnes. There'll be some conversions in the Finnish area when they can no longer get the hardwood out of Russia.

From a market perspective, we're starting to see signs of life. The demand weakness that I think is evident has been more than offset by supply constraints, including our own. North America and Euro's off a little in this quarter, maybe \$20. But that's more than offset by APAC and especially China, which we saw a \$30 increase in February.

We're feeling pretty good about the first half of the year in terms of stability. We do think that as we get into the more traditional period in the summer when things slow down, we'll see some erosion out the back end as the market digests that extra tonnage.

But generally, I think the market's in pretty good shape for this year.

Paul Quinn

Okay. And then switching over to the lumber side. Don, you mentioned the three big projects. Maybe you could just walk us through the timing of those because when I take a look at your slide deck on Slide 8, it looks like you've got DeRidder coming up in early '23 and that's kind of confusing.

Don Kayne

So that's correct. We've already put a couple of logs through already, so that's kind of progressing.

In terms of Heritage which is the Alabama, Axis we talked about, that's Q3 2024. Urbana will be Q1 2024. And Millar Western, so the latest—well, that's actually already going, so we don't even need to worry about that one at all. That's already 100 percent.

Paul Quinn

Okay. And then just one of your competitors talking on the softwood lumber file mentioned about the number of meetings or phone calls that have been taking place. The activity on that file's stepped up. Just wondering if you can comment on where you think that file is going and what's required to get a resolution.

Don Kayne

I think it's progressing a little bit. I mean, for sure there's been more dialogue than we've seen in some time, frankly, and we have had that across Canada. The dialog's progressing for sure.

You're probably aware the President and the Prime Minister are meeting this week potentially and we don't know if that'll be on the agenda or not. We're hoping that it will. We made some efforts to try and make that happen, but you never know.

In terms of what it's going to take, I mean, there's two concerns—we've talked about that before—market share and also how the distribution of deposits. But at this stage in terms of what it will take to get a final settlement there, it probably continues to be a bit early to try and speculate on that.

Paul Quinn

All righty. That's all I had. Best of luck. Thanks, guys.

Operator

Thank you. Next question will be from Ketan Mamtora at BMO Capital Markets. Please go ahead.

Ketan Mamtora — BMO Capital Markets

Thank you, and good morning. Don, can you talk a little bit about what you are seeing in the European market, both in terms of demand and prices?

Don Kayne

In what was that?

Kevin Pankratz

European.

Don Kayne

Oh, European market. What are we seeing in European markets? Why don't you talk about —

Ketan Mamtora

Yes. European lumber markets.

Don Kayne

Yeah. Europe, for sure. Kevin, you go ahead.

Kevin Pankratz

Ketan, I think the European market is coming off a pretty tough Q4, we're actually, pleasantly surprised with what we've seen recently and demand picking up, particularly in the UK market, which is a significant market for Scandinavian/Central European producers. So that's been a positive. And we've also seen a pickup domestically in Central Europe.

Now how long that's going to last it'll be hard to determine, but definitely a pickup there. And then, hopefully, that will help maybe offset some European lumber coming into the Eastern Seaboard of the United States.

But definitely a little bit better than we thought going into the year.

Don Kayne

One thing maybe, Kevin, I might add to that a little bit is, and I know you've been leading this for us, but the one thing about Europe, and it's one of the reasons that we've talked about why we really like Europe and it's proven out 100 percent, is the percentage of high value that we get in those markets. It's significant and it's consistent for the most part.

And the other maybe significant point here is there's many choices in terms of markets there as well. So we have ability to move around a bit more than we do in other jurisdictions.

And so to Kevin's point, we've taken advantage of that and it's been real successful. So that continues to be a real benefit in terms of Europe, at least from our standpoint.

Ketan Mamtora

Got it. That's helpful. And then either, Don or Pat, can you provide some perspective on the Houston investment? I know you said at the end of second quarter is when you thought to have a final sort of decision, but it sounds like you're going to, based on what you just said, going ahead with it.

Can you give us some sort of perspective on kind of the size? The investment? What kind of projects you are looking at?

Don Kayne

All of those are kind of TBD. I can tell you this. It'll be smaller than maybe the facility we have today, and we've got lots of obstacles that we've got to overcome here going forward. But we do intend

on overcoming those for sure, assuming we can get the competitive timber that we need to operate a mill in that area.

So we're positive at this point. But we've got, like I say, a lot of challenges that we have to overcome as we move through it. But at this point, we expect to be able to make a decision, as you're aware of, sometime towards the end of Q2.

Ketan Mamtora

Okay. And, Don, if you decide to go ahead with it, when do you think you should be able to kind of finish building the mill and then start?

Don Kayne

Yeah. I mean, I think probably just guessing here a bit, but 2025 for sure. It'd be something like in that area for sure.

Ketan Mamtora

Understood. That's helpful. Good luck in 2023.

Don Kayne

With lead times and so forth.

Operator

Thank you. And at this time, there are no further questions. I will turn the call over to Don Kayne.

Go ahead, Mr. Kayne.

Don Kayne

All right. Thanks, Sylvie, and thanks, everyone, for joining the call and your interest in Canfor and Canfor Pulp. And we look forward to speaking to you at the end of the next quarter.

Have a good day.

Operator

Thank you, sir. Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending. And at this time, we do ask that you please disconnect your lines.