

## Canfor Corporation

### Q1 2023 Results Conference Call

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## **CORPORATE PARTICIPANTS**

### **Don Kayne**

*Canfor Corporation — President and Chief Executive Officer, Canfor Corporation*

### **Kevin Edgson**

*Canfor Corporation — President and Chief Executive Officer, Canfor Pulp Products Inc.*

### **Pat Elliott**

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

### **Kevin Pankratz**

*Canfor Corporation — Senior Vice President, Sales and Marketing, Canfor Corporation and Canfor Pulp Products Inc.*

## **CONFERENCE CALL PARTICIPANTS**

### **Hamir Patel**

*CIBC — Analyst*

### **Ketan Mamtora**

*BMO — Analyst*

### **Paul Quinn**

*RBC — Analyst*

## PRESENTATION

### Operator

Good morning. My name is Lara, and I'll be your conference Operator today. Welcome to Canfor and Canfor Pulp's first 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 Corporation

Thank you, Lara, and good morning, everyone. Thank you for joining the Canfor and Canfor Pulp Q1 2023 Results Conference Call.

I'm going to make a few comments before I turn things over to Kevin Edgson, Canfor's Pulp President and Chief Executive Officer; 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.

The first quarter and April were very challenging for Canfor as we announced and implemented the restructuring plans for our lumber and pulp operations in British Columbia. Our Chetwynd Sawmill and

Pellet Plant, as well as our pulp line at Prince George Pulp and Paper have permanently closed, while our Houston facility has been closed for an extended period.

Despite the current challenges operating in British Columbia, this province remains a critical part of our diversified operating platform. To that end, we continue to make progress on finalizing the business case to build a new operation in Houston.

We sincerely regret the impact these decisions have had on our employees, our contractors, and our communities. However, with a smaller but more stable operating platform in British Columbia, we will be stronger and better positioned for the future.

Turning to our other operating regions. Construction of our greenfield sawmill in DeRidder, Louisiana is progressing well, with the sawmill starting up in late February followed by the planer in early April. With the facility now fully operational, we continue to make progress through the start-up curve.

We're pleased with the initial performance. We will continue to ramp up production through the balance of this year and on into 2024.

In addition, we continue to execute on our other growth initiatives, including the rebuild of our sawmill in Arkansas, second greenfield sawmill in Alabama, and some organic growth in Sweden.

Notwithstanding current lumber markets, we continue to believe the longer-term market fundamentals remain strong supported by favourable demographic trends, continued strength in the repair and remodel sector, and pent-up demand for new home construction activity.

Despite the seasonal working capital build in the first quarter, our balance sheet remains strong. While we are prepared to remain patient and disciplined until the right opportunities present themselves, we continue to assess additional organic and external growth opportunities as we look to grow our lumber business on a global basis.

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. As Don mentioned, Canfor Pulp implemented the permanent closure this quarter of the pulp line at our Prince George Pulp and Paper Mill.

This was a very difficult decision, and we regret the impact it has had on our employees and the community, but we are focused on improving operational efficiency and reliability with a more stable operating footprint.

In addition, over the next several years, we have identified a significant capital reinvestment plan aimed at improving the operational reliability and stability of our remaining pulp mills. To that end, we are pleased to announce a refinancing that will provide the necessary liquidity for the next four years to backstop this recapitalization.

We have provided guidance of \$70 million of capital this year, but expect taking into account market conditions and cash flow, that in the coming years our capital expenditures will trend in the neighbourhood of \$100 million, consistent with the past couple years.

This spending will focus on improving reliability, and the only significant project that we see on the horizon is the completion of the rebuild of Recovery Boiler #1 at Northwood, which was started in late 2021.

Notwithstanding the significant challenges we have experienced over the last several years, we believe an expanded reinvestment plan will support the sustainability of the Company for the foreseeable future and allow us to recapitalize on the strong global pulp market fundamentals we believe will remain over the medium to long-term.

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 Corporation

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

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

Our lumber business generated an operating loss of \$170 million in the first quarter, which included a \$59 million write-down to the carrying value of logs and finished inventory in Western Canada, as well as restructuring charges of approximately \$11 million and an incremental non-cash ADD expense of \$19 million.

These results reflected the sustained impact of a challenging operating environment in British Columbia driven largely by weak lumber pricing and related operational downtime, which continues to have a significant impact on our per unit cost structure.

While we expect the cost curve in British Columbia to moderate through the balance of 2023, we anticipate ongoing challenges during the second quarter as a result of current lumber markets.

Notwithstanding the significant losses experienced in British Columbia, we continued to see the benefits of our diversification strategy, as more modest earnings from our US South operations were combined with strong results from our European business, which contributed approximately \$50 million in cash earnings in the quarter.

These results reflect the slight improvement in pricing and demand in the UK and Europe, as well as increased production and shipments.

Our pulp business generated an operating loss of \$25 million in the first quarter, which included a \$4 million inventory write-down and restructuring charges of approximately \$3 million. On an adjusted basis, results in our pulp segment improved by approximately \$20 million compared to the fourth quarter.

Despite the continued impact of fibre-related downtime, these first quarter results largely reflect improved NBSK productivity quarter over quarter, as well as the associated benefit on per unit costs.

Looking forward, the focus for our pulp business remains on operational reliability and preserving our balance sheet position. With that in mind, earlier this week, as Kevin mentioned, Canfor Pulp successfully completed a refinancing to support a significant capital reinvestment plan over the next several years.

Under the terms of our amended credit agreement, Canfor Pulp converted its \$50 million term debt into a new \$160 million revolving operating loan facility, of which approximately \$65 million is currently drawn.

In addition, we have secured a commitment to receive up to \$80 million of new term debt as part of our capital reinvestment plan, with the additional liquidity projected to more than sustain Canfor Pulp going forward.

In 2023, we anticipate capital spending of approximately \$450 million to \$500 million in the lumber segment, including spending on the three major investments in the US South, as well as organic growth in Sweden. In addition, we will continue a modest share buyback program throughout the year.

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

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

**Don Kayne**

All right. Thanks, Pat. And so, Operator, I turn it back to you, and we'll take questions from analysts.

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## 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 the line of Hamir Patel from CIBC. Please go ahead.

### Hamir Patel — CIBC

Hi. Good morning.

### Don Kayne

Good morning, Hamir.

### Pat Elliott

Good morning.

### Hamir Patel

Don, can you speak to what you're seeing on the R&R side in both North America and Europe?

### Don Kayne

For sure, Hamir. I'll let Mr. Pankratz talk about that.

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

Good morning, Hamir. The R&R market—I'll start with North America—in both Canada and the US has been quite resilient, essentially seeing double-digit growth versus this time last year. And we see that continuing into Q2 and some slight moderation in the back half, but still really strong. And there's some pretty good drivers that are supporting that growth, and we think that's going to continue.

In Europe, we saw a resurgence of DIY strength in particular in the UK market that was strong and supporting that going into Q2. So overall, the R&R market segments, actually globally, have been quite resilient.

**Hamir Patel**

Great. Thanks for that, Kevin. And then just next question for Kevin Edgson on the pulp side. When you think about your longer-term capacity and some of the investments that you're planning, what do you see just looking at the fibre constraints and some of the capital you're putting there, where do you see Canfor Pulp's longer-term capacity trending?

**Kevin Edgson**

Thank you for the question, Hamir. When we made the decision to take the PG pulp line down, what we did is we tried to forecast, to the best of our ability, not the fibre supply as it exists in the short-term this year or next year, but try to look forward as far forward as possible.

In doing so, we think we've rightsized the footprint with the two facilities, the paper machine, as it is now. We think the investments are going to improve our competitiveness, not necessarily increase our capacity, and ensure through that improved reliability and lower maintenance costs to be a more competitive player.

So at this point, unless there is some material change in terms of government policy or the like, we believe that we're in a stable place, as Don referred earlier, to the smaller but stronger. We feel good about where we're at.

We're starting to build chip inventories after coming awfully close at the end of the quarter before the shutdown. And so I think what we've got right now is a good place to be and it's appropriate for the long-term.

**Hamir Patel**

Fair enough. Thanks. That's all I had. I'll get back into queue.

**Don Kayne**

Right. Thanks, Hamir.

**Operator**

Thank you. Your next question comes from the line of Ketan Mamtora from BMO. Please go ahead.

**Ketan Mamtora — BMO**

Thank you, and good morning. A couple questions. I mean, it certainly sounds like the repair/remodelling market in the US has held up remarkably well so far. Some of the home builders have also started to talk about uptick in the orders. We've seen OSB prices kind of strengthen the last few weeks.

Why hasn't lumber not moved higher? What do you think are among the key issues?

**Don Kayne**

Go ahead, Kevin.

**Kevin Pankratz**

Good morning, Ketan. So yeah, you're right. The R&R has been the one segment that has been quite strong. And fundamentally, we just haven't seen the same growth that we've seen in the new home construction. I think that's a big fundamental driver that'll support the growth in some of the pricing.

We also have on the lumber side still inventories that are quite high on the ports and in certain jurisdictions, and it's probably going to take through Q2, maybe towards the end, before we're going to start seeing, I believe, some price appreciation get a little bit more attention in the market.

So essentially, just working through some surplus inventories. And we're starting to see Euro imports come off quite significantly and coupled with the impact of some of the curtailment announcements that have been announced in BC and then we could see some price appreciation towards the end of Q2.

**Ketan Mamtora**

Got it. That's helpful. On the new residential side, are you seeing any signs at all of activity improving? I mean, in the last couple of weeks and some of the recent data points from the home builders suggest that things may be turning. Curious what you guys are hearing.

**Kevin Pankratz**

We're hearing the same thing, Ketan. And I think the one thing that's kind of materially different than maybe the last four or five months, but the US South, Southeast has been actually quite strong. That's where the bulk of new home construction has been. But we're starting to see a resurgence in the Texas market, which is really significant. It's a huge consuming region for lumber.

We're also starting to see parts of Western United States like in Phoenix that's another large-consuming area start to come back after having a pretty quiet Q4 and into Q1. So we are starting to see

certain regions starting to bounce back, which gives us a little bit more confidence. But we'll have to see how that plays out long-term here.

**Ketan Mamtora**

Got it. That's fair. And then turning to Houston, Don or Pat. Maybe kind of talk about how you guys are sort of thinking about it. And kind of what are the key things you have in mind as you look to kind of highlight this decision. And when should we expect an update from you guys on this?

**Don Kayne**

For sure. Thanks, Ketan, and I'll maybe start with the last part of the question. Our plan, I think we indicated before, was to have a decision from management's perspective by the end of Q2, and we were on track for that. There's obviously a number of areas that we're looking at to get more clarity on before we make that decision, but that's all underway now.

And assuming that goes in the direction that we hope, which will be to get it all approved here, then the next step will be in mid-July to go to our board. So that's kind of the timing.

I think Kevin mentioned it as well but, clearly, our strategy in BC, as I think you're aware of, is we believe we're going to be or we will need to be smaller, but we'll be stronger. And this will be an important part of that, assuming that it all goes ahead. And we will see a mill there, probably a smaller mill than we've had before, but a much more focused mill, much more focused on higher value and more of a less commodity than maybe we've been accustomed to in the past.

But other than that, that's kind of where we're at today. But there's lots of questions that we still need to answer as we go forward, and that'll be a consideration going forward with the biggest one being fibre and fibre availability and what kind of certainty or, we could get around that and maybe leave it at that.

**Ketan Mamtora**

Understood. That's helpful. I'll jump back in the queue. Thank you.

**Don Kayne**

Thanks, Ketan.

**Operator**

Thank you. Your next question comes from the line of Paul Quinn from RBC. Please go ahead.

**Paul Quinn — RBC**

Yeah. Thanks very much. Good morning, guys. Maybe start with Don on softwood lumber. I think last quarter, we were talking sort of more optimistically about that file. We had Trudeau sitting down with Biden, and I know you guys tried to press to get it on the agenda. That wasn't successful. Maybe if you could just give us a recap of what happened and where that file sits now and is there any change?

**Don Kayne**

For sure, Paul. And I can't add too much there other than, clearly, we were disappointed the fact that it wasn't on the agenda to the degree that we thought it should've been in the President/Prime Minister meeting here a week or two ago for sure, but.

And so at the end of the day, we're still working on it, and I think we're trying to make sure that, at least from a pan-Canadian position, that we're kind of aligned there.

But at the end of the day, we still think it's a ways away here before we make any significant progress. But we are talking about it. As things evolve here, we got close to \$10 billion on deposit now and Canfor, as you know, is \$850 million, closing in on \$900 million ourselves. So it's clearly something that we think long-term here we need to get some certainty around. But it's kind of a work in progress and it continues to be that way.

**Paul Quinn**

You're pretty close with some of these US Coalition members. Any movement on those guys at all? Any interest in sitting down now that lumber prices have fallen back to more normalized levels?

**Don Kayne**

No. We know them fairly good, a bunch of us do, and we run into them once in a while here and there, but personally anyway I haven't heard of anything that would give me additional confidence that we're seeing any kind of progress on their side.

At this stage they're still dug in with some of their views and so are we, frankly. So I don't get any confidence yet that we're making a bunch of progress there.

But that's not to say we won't. I think, ultimately, these things come to a negotiation, so maybe we'll get there, my view is probably one to two years.

**Paul Quinn**

Okay. And then just turning to the BC Interior. I mean, it still seems like we need to shut down a bunch of capacity there. You guys have taken some really hard steps in closing mills. But you look at some of the privates and what they've been doing is taking their two-shift operation down to one shift, which I don't quite understand how that's sustainable in the long-term.

Does that move kind of frustrate you a little bit to be able to get to more of a quicker supply/demand balance in the BC Interior?

**Don Kayne**

Actually, not really. From our standpoint, we can't control it, and we don't actually spend a lot of time on what others are doing, frankly. And we're just trying to make sure that as we look forward that we're just focused on what we can do and what our geographical footprint ought to be, right, which is

clearly focused on Europe, focused on the US South, focused on Alberta and BC with some of the associated challenges here that you're aware of.

We're just trying to get the right production volumes here to match demand, for sure, and the fibre availability.

**Paul Quinn**

Okay. And then maybe switching over to the pulp side for Kevin. You've had great markets in the last couple years on the macro pulp side. And you guys have really had challenging operations through that period. Now we've got a major correction happening in pulp and you guys are reinvesting. So I'm just wondering down the road with this reinvestment, do you believe that Canfor Pulp is going to be well positioned to be sustainable in the long-term?

**Kevin Pankratz**

I appreciate the question. And I think it's a bit of a fool's gambit if the answer wasn't yes. But let's get to the heart of it, and I think it goes back to the first question, which is around fibre supply. As I had made mention to Hamir, when we look forward, we anticipate additional permanent closures in the fibre supply, so we think we're rightsized for at least what we anticipate to be our fibre supply level.

When we made the decision to take the PG pulp mill down, what we did is we chose the mill that had the greatest flexibility and whose platform we thought was the best from a future competitiveness level. Yes, it would've been nice to have strong markets for another year, just to help us through the transition, but we do believe that we can be amongst the most competitive on the NBSK side.

We think our product, which is amongst if not the very best in the marketplace in terms of a reinforcing product, and if we position ourselves or continue to position ourselves with those customers that appreciate that and continue to pull a premium that we'll be able to be sustainable for the long-term

and, actually, return to the kind of ROIC or ROCE, whichever measure an investor is most interested in, to the same sort of degree we were, let's say, five years ago.

It's just a function of getting from where we are to there and it won't be easy, Paul, but I have a dedicated team that believes in the future, and we'll continue to work in that direction.

**Paul Quinn**

All right. Best of luck with that. And then just one quick housekeeping. I mean, I think that Mackenzie Mill sale you announced February of '22, it's been over a year. What is the status of that agreement?

**Don Kayne**

Well, I guess right now we've been waiting for the timber supply review to take place and we're expecting to see that hopefully today, actually. So you're about four hours early. So if you'd call me back or call Pat back in four hours, we'll give you an answer.

**Paul Quinn**

Okay. That's all I had. Best of luck. Thanks.

**Don Kayne**

Thanks, Paul.

**Operator**

Thank you. There are no further questions. I'll now turn it over to Don Kayne for closing comments.

Go ahead, Mr. Kayne.

**Don Kayne**

Yeah. Thanks, Lara, and thanks, everybody, for joining the call this morning and your interest in Canfor. And look forward to talking to you at the end of the second quarter.

Have a good day.

**Operator**

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

Have a lovely day.