

**Canfor Pulp Products Inc.**

**Second Quarter Analyst Call**

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## **CORPORATE PARTICIPANTS**

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## **CONFERENCE CALL PARTICIPANTS**

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*TD Securities — Analyst*

### **Hamir Patel**

*CIBC Capital Markets — Analyst*

### **Mark Wilde**

*BMO Capital Markets — Analyst*

### **Paul Quinn**

*RBC Capital Markets — Analyst*

## PRESENTATION

### Operator

Good morning. My name's Colin, and I'll be your conference Operator today. Welcome to the Canfor and Canfor Pulp Second 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 risk of such statements.

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

**Don Kayne** — Chief Executive Officer, Canfor Corporation and Canfor Pulp

Thank you, Operator, and good morning, everybody. Thanks for joining the Canfor and Canfor Pulp Q2 2021 Results Conference Call.

I'll make a few comments before I turn things over to Alan Nicholl, our Executive Vice President of Canfor Pulp Operations and Chief Financial Officer of Canfor Corporation and Canfor Pulp. Alan will provide a more detailed overview of our performance in Q2. In addition to Alan and I, we are joined by Kevin Pankratz, our Senior Vice President of Sales and Marketing.

I want to begin by acknowledging the extreme wildfire situation we are currently experiencing in Western Canada, both as an industry and Canfor. There is no imminent risk to Canfor infrastructure, and our teams and contractors continue to work closely with provincial wildfire services to actively mitigate risks and support wildfire identification, response, and suppression efforts.

I want to thank all of the firefighters and first responders on the ground who are fighting the fires and supporting people who have been forced to evacuate their homes. I also want to thank our employees for their continued perseverance and resilience as we face the ongoing challenges of the forest fires, supply chain challenges, and the ongoing COVID-19 pandemic.

As I noted last quarter, Canfor is continuing to make progress on developing a comprehensive sustainability strategy that's aligned with best-in-class ESG standards. The strategy will be launched in early October, along with the release of our 2020 Sustainability Report.

Our strategy will further advance our commitments to the health and safety of our people, the communities where we operate, and continue producing sustainable, low-carbon products. Our strategy will also push us to reach further and expand the sustainable impact we can have as an organization on global climate change. We believe that increasing our focus on sustainability will provide more predictable and sustainable earnings and ensure Canfor's long-term success.

Turning to our financial results, our lumber business generated record-high operating income and revenues of \$1 billion and \$2.2 billion respectively in the second quarter. Global lumber markets benefitted from strong demand and limited available supply during the second quarter, with prices reaching record-high levels in May.

With COVID-19 restrictions easing and consumer spending habits returning to pre-pandemic levels, we have seen a decline in R&R activity in the summer months, contributing to a sharp decline in North American lumber pricing over the last several weeks.

Notwithstanding the current market volatility, US housing activity remains strong, reflecting a number of demand trends that have emerged since the onset of the pandemic, combined with an aging housing stock and low existing home inventories following a number of years of modest housing activity.

Lumber demand in Asia was strong in the second quarter, with significantly higher pricing supported by lean inventories in the supply chain and solid consumption levels. Our European lumber business continues to perform well, with significantly higher sales realizations supporting record-high earnings in the second quarter. European sales realizations have continued to increase in the third quarter, supported by the traditional lag in contract pricing and strong market fundamentals in the region.

Turning to our pulp business, Canfor Pulp reported operating income of \$51 million in the second quarter. Canfor Pulp benefitted from improved productivity, increased shipments, and significantly higher sales realizations following the sharp increase in global pulp prices experienced in the first quarter. Pulp demand from China has moderated somewhat heading into the third quarter, reflecting elevated inventory levels and seasonally slower demand.

Extreme wildfires have significantly impacted transportation networks in Western Canada early in the third quarter, with limited and intermittent rail service to and from our lumber and pulp operations. As a result of the significant transportation backlog and elevated inventory levels, we announced temporary production curtailments at our sawmills in Western Canada.

Our operations leaders have shown creativity and flexibility to develop site-specific plans to limit the impact of the curtailments on our employees, and we appreciate everyone's efforts as we continue to manage the dynamic wildfire season. We anticipate that inventory levels will gradually improve through the balance of the third quarter.

During the second quarter, Canfor also announced plans to construct a new, state-of-the-art greenfield sawmill in DeRidder, Louisiana. The facility will have an annual production capacity of 250 million board feet and is anticipated to start up in the third quarter of 2022.

In addition, Canfor repaid \$150 million of US-dollar debt in the second quarter, and following major growth in recent years with Canfor, excluding Canfor Pulp, ending the quarter with net cash of \$930 million.

Supported by our improved balance sheet, we continue to assess additional internal, and external growth initiatives as we look to grow our business on a global basis. At the same time, we continue to remain patient and disciplined as we wait for the right opportunities to present themselves.

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

**Alan Nicholl** — Chief Financial Officer and Executive Vice President, Finance and Canfor Pulp Products Inc.

Thank you, Don, and good morning, everyone. 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 Companies' websites.

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

Our lumber segment recorded record-high operating income of \$1 billion for the second quarter of 2021, up almost \$400 million from the previous quarter. Lumber segment results continue to reflect strong global market fundamentals, with tight supply and strong demand supporting significant price increases across most grades and jurisdictions. Earnings were also boosted by a 6 percent increase in shipments.

In North America, Western SPF benchmark prices climbed to unprecedented record-high levels in May before coming off sharply over the balance of the quarter. Nonetheless, Western SPF two-by-four 2&Btr prices were still up US\$370 or 38 percent from Q1.

Southern Yellow Pine prices trended similarly to Western SPF early in the quarter. And while weaker demand thereafter resulted in the average two-by-four #2 price being largely unchanged quarter over quarter, strong pricing gains for wider-width dimension products resulted in a significant increase in average sales realizations for our US South business.

The downward trend in North American lumber prices has continued into July, largely reflecting pared-back consumer spending in the R&R sector, and to a lesser extent, moderated new home construction activity.

Turning to our European business, our record-high earnings in the second quarter reflected continued solid demand and favourable pricing in that region, and prices have continued to improve early in the third quarter due to the traditional lag in contract pricing.

Off-shore sales realizations to Asia were also well up in Q2 from Q1, with pricing gains particularly strong in Japan. Similar to Europe, prices for Q3 are anticipated to track higher compared to Q2.

Our Pulp business reported operating income of \$51 million in the second quarter, compared to \$5 million in the previous quarter. Results for the current period reflected significantly higher NBSK pulp unit sales realizations as well as an 8 percent increase in shipments in the quarter. The improved sales realizations reflected the material increase in pulp prices on orders taken in Q1 and shipped in Q2, as well as more stable pricing in the current period.

Pulp unit manufacturing costs were modestly higher than the previous quarter, with increased fibre costs offsetting the benefit of improved production and seasonally lower energy costs.

At the end of the second quarter, Canfor, excluding Canfor Pulp, had net cash of \$930 million and available liquidity of approximately \$2.2 billion. Canfor Pulp ended the second quarter with net debt of \$14 million and available liquidity of approximately \$133 million.

The unprecedented cash flow levels generated in recent quarters supported a further US\$150 million repayment of Canfor's term debt in Q2, taking the total amount of term debt repaid in 2021 to approximately C\$410 million and lowering our North American term debt down to US\$150 million.

As Don mentioned, during the second quarter, Canfor announced plans to invest US\$160 million in a state-of-the-art greenfield sawmill located in Louisiana, with the start-up currently anticipated late in the third quarter of 2022.

We anticipate higher spending in the capital realm in 2021, with approximately \$250 million to \$300 million in the lumber segment and approximately \$50 million to \$70 million for Canfor Pulp, excluding capitalized major maintenance. The range reflects supply chain-related risks, mostly around long lead times. The majority of the greenfield sawmill spend will occur in 2022.

While we are comfortable retaining our existing liquidity until attractive opportunities present themselves, we continue to assess various organic and external growth opportunities and plan to continue to repurchase additional shares under our share buyback program on an opportunistic basis in the coming quarters.

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

**Don Kayne**

All right. Thanks, Alan. So, Operator, I'll turn it back to you, and we'll be pleased to answer questions from analysts.

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## Q&A

### Operator

Questions from financial analysts. If you have a question, please press \*, 1 on your telephone keypad. If you're using a speakerphone, please lift your receiver and then press \*, 1. If at any time you wish to cancel your question, please press \*, followed by 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.

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

### Sean Steuart — TD Securities

Thank you. Good morning, everyone. Don or Kevin, you guys were closer to the big box retail part of the lumber market than your competitors. I'm wondering if you can give us a sense of your impression on where inventories sit in that channel right now. How much does that sector need to churn through in terms of supply before you anticipate a rebound potentially coming in demand there?

### Don Kayne

Thanks, Sean. Maybe I'll get Kevin, who's real close to that, to make some comments for you.

### Kevin Pankratz — Senior Vice President, Sales and Marketing, Canfor Pulp Products Inc.

Sure. Good morning, Sean. Yeah. Obviously, the home centres experienced some fairly larger inventories through basically building up since about April-ish. But the last couple of weeks, we've seen an improved takeaway, and we anticipate that we can get back to a bit of a more normalized supply-demand equation by maybe late September. But we think we've got a little bit more work to do still.

### Sean Steuart

Okay. Thanks for that, Kevin. Second question I had was on your greenfield project. A competitor just announced a greenfield project also in Louisiana, and it looks like their budget capacity multiple is

about \$750 per thousand board feet, which is—it's a premium to what you're targeting. Can you remind us if you're locked in at that budget that you've guided to? And remind us of any incentives you have at the state or local level? And how that factors into the cost economics for the project?

**Don Kayne**

Absolutely, Sean.

**Alan Nicholl**

Yeah. So the numbers are pretty solid for our sawmill. Pleased about that. And to your point, Sean, there are incentives there. It's a very supportive state, and we're very pleased with the engagement we had there. I can't get into specific numbers, but pleased with what we think is available, and certainly, we'll be working hard to get as much of that as possible.

**Sean Steuart**

Thanks, Alan. And then, the last question I have. European results continue to be really strong for you guys. Don, can you give us an impression of what the M&A opportunity set looks like in Europe? And how do you weigh expansion opportunities there versus the opportunity set that you might have in the US for sawmill growth?

**Don Kayne**

Yeah. For sure, Sean. Like you mentioned at the outset, first of all, we are very pleased about the European acquisition and the way that's performed and continues to perform, and more importantly, what the future looks like there in Europe. When you look at all the markets that they serve, it looks very, very positive. And on the fibre side, relatively consistent; good fibre there as well.

In terms of opportunities there going forward, certainly, it's something that we look at on a relative basis to North America. But as we've said before, it's really Europe and the US South that we're really focused on, and we've been pretty consistent on that for a while.

And so that continues to be the case. Like it is in North America as well, with the markets doing what they've done, valuations are for sure a bit aggressive right now and so it's something that we're watching. But certainly, we believe there are opportunities there for sure, and we'd be looking at them probably on a pretty similar basis as we are in the US South.

**Sean Steuart**

Thanks for that, Don. That's all I have, guys. Thanks.

**Don Kayne**

All right. Thanks.

**Alan Nicholl**

Thanks, Sean.

**Operator**

Your next question comes from Hamir Patel from CIBC. Please go ahead.

**Hamir Patel — CIBC Capital Markets**

Hi. Good morning. Don, I wanted to ask you, where do you think BC industry breakeven levels are today? And any thoughts about where that kind of might move into by early 2022, just given the duties are going up and stumpage changes that you might expect for October?

**Don Kayne**

Yeah. For sure, Hamir. I think you've heard and you've spoken to us a little bit already in terms of some of the expectations on stumpage increases going forward. But I think, if you look at where we're

at today in terms of current prices, at least for two-by-four SPF, it's tough to make any kind of income at these levels for sure, at these numbers. There's no question about that.

With the duty, as you mention, later in the back half and some of the increases that we're seeing in stumpage in October will make it challenging for Q4 for sure, if prices were to stay where they're at, without a doubt.

If you look beyond that, though, in Q1 of next year, we are looking at material reductions, though, in stumpage. So really, it's the next three to six months here that will potentially be difficult for sure, to operate at these levels, if the prices were to stay at these levels, but some improvement hopefully, certainly from a log-cost point of view starting in the beginning of 2022.

**Hamir Patel**

Thanks, Don. That's helpful. And can you maybe scale for us what that improvement level might be?

**Don Kayne**

It'll be material, for sure. I mean, we're looking somewhere at—and for Q3, giving a bit of a relative basis here—is in Q3, we're looking at probably 30-plus-per-cubic-metre increase, and then Q4, probably 10-plus-cubic-metre increase for Q4, and then Q1, we'll see a material reduction from both of those numbers coming down.

**Hamir Patel**

Okay. Thanks, Don. That's helpful. And just a last question for me for Kevin. How much of the SPF mix right now is J-Grade? And I just ask because it looks like lumber prices there are still holding up quite high relative to North America.

**Kevin Pankratz**

Yeah, Hamir. Yeah, it's actually fairly consistent for us. It's around that 10 percent range.

**Hamir Patel**

Okay. That's great. That's everything I have. Thanks.

**Don Kayne**

Thanks, Hamir.

**Operator**

Your next question comes from Mark Wilde from BMO Capital Markets. Mark, please go ahead.

**Mark Wilde — BMO Capital Markets**

Good morning, Don. Good morning, Alan. Congratulations on a very good quarter.

**Don Kayne**

Thanks, Mark.

**Alan Nicholl**

Morning, Mark.

**Don Kayne**

Good to talk to you.

**Mark Wilde**

Just to start off, Don, I wondered if we could talk a little bit about influx of lumber coming in from Europe, both your own volume of exports into North America and then also what you're seeing from other producers. I noted last night, Mercer said that 39 percent of their second quarter lumber in Europe came to the North American market.

**Don Kayne**

Yeah. I'll let Kevin talk about that, but just a couple quick things. First of all, ourselves, it's pretty consistent. We're not big shippers into North America for a bunch of reasons. Probably the main one being is, we're not focused so much on commodity products. We're mostly specialty products and they go to a lot of more offshore destinations, I would say.

In terms of some of the others, though, that particularly the ones in Central Europe would be more commodity-based, and so definitely we're seeing some increases in there. But we're not really too concerned about that at all because we don't really compete with that, first of all, in a measurable way. If you compare it also to back 15 or 20 years ago, the last time we had a big surge of imports, it's still well less than that, if you look at that on that basis.

So, I don't know, Kevin. I mean, in terms of our customer base, what would they say?

#### **Kevin Pankratz**

Yeah. Don, you're bang on with respect to our European volume. And I think another thing to add there, Mark, is that the supply chain to make those changes, it takes a lot longer than a North American producer. They've got vessels and commitments, and so, even if they want to change, it's going to take a little while for them to make that accommodation.

But anecdotally, hearing reports of them migrating wood back to feed the shortages within Central Europe and into some of the Asian markets, but that might play out later in the year, should prices stay the same. But that's the only thing I would add.

#### **Don Kayne**

When you think about that, Mark, it's a good question and that's one we hear about a lot. But if you really think about all the manufacturers in Europe, other than maybe the ones that are in that commodity region of Central Europe that were impacted by the beetle, most of the rest, if not all of the

rest, have really built alternative markets around the world with a heavy focus on high-value products. And they're mostly contracted out for longer terms than what we see in North America, as well. So the ability or even the desire to shift markets is very minimal.

So that's the case with us, but we also have well-developed relationships with most of the producers over there. And I would say that that's certainly what we hear in quite a prevalent way.

**Mark Wilde**

Okay. That's really helpful. Just back on DeRidder here real briefly. I'm just curious. We hear all this talk about contractor shortages, equipment being really tight, but you're getting this up in what seems like pretty impressive timing. Can you help us understand that? Were you able to just hold the position from that Georgia project a few years ago?

**Don Kayne**

No doubt we'll have some of the same challenges. I've mentioned, I think, or Alan did in his beginning comments here, that we're going to—we're planning third quarter, early fourth quarter 2022 to complete everything. But then from there, we're looking at an 18-to-24-month start-up kind of time frame overall. And to be determined yet in terms of how that spend will occur over that period.

But certainly, what you're hearing from others around challenges labour-wise, challenges supply-chain wise, challenges equipment lead time-wise, all of those key areas, we're experiencing some of the same challenges and just trying to stay on top of that as best we can to meet some of the deadlines that we've stated.

**Mark Wilde**

Yeah. Don, I'm also just kind of curious. I mean, you're building 250 million board feet, which seems to be kind of right in the sweet spot for most mills that are being built in the South, but I noticed

that Roseburg announcement in North Carolina is 400 million board feet. I mean, that's maybe the biggest sawmill in the Southern US. Are we seeing do you think over time kind of a step change in kind of size and productivity in the South? Because typically they've been way behind what you have in Western Canada.

**Don Kayne**

Yeah. For sure. The 250 number that you allude to, I think that's a fair comment, for sure, and that's come up a long ways. I mean, if you go back, as you would know, Mark, several years ago, probably the number was closer to 100, 150 at the most.

**Mark Wilde**

Yeah.

**Don Kayne**

So 250 was a step up. In terms of that next step up, I can't comment at all in terms of Roseburg. I mean, clearly, they would have done a lot of due diligence there and had the fibre and had the labour, which are the two biggest issues there, not the steel so much.

For us, we like that 250 number. I mean, we do, and we think it gives us a lot of flexibility, and we're able to manage some of the fibre resource as well better at those numbers. But I don't know the circumstances at all that Roseburg made those decisions. But ourselves, we haven't really contemplated anything materially larger than a 250 million-foot mill sort of thing.

**Mark Wilde**

Okay. And then finally, Alan, can you just give us a little bit of help on the pulp side at Canfor Pulp in thinking about the impact of maybe lower shipments, as well as that 47,000 tonnes of production out in the third quarter and what that kind of financial impact may be, separate from price?

**Alan Nicholl**



I'll certainly do my best, Mark. I think, in terms of supply chain and transportation shipments and so on, Q2, things eased and then they tightened up, and of course, some of those challenges have spilled over to July, as I think you're alluding to. So clearly, we've got a few challenges ahead of us.

I think things are starting to improve, notwithstanding the risk from the wildfires. So we're hoping that shipments certainly will stay at similar levels to Q2. If things work out maybe a little bit higher, but clearly, we'll have to wait and see.

In terms of production, the amount that you refer to, some of that clearly is planned. And in terms of maintenance downtime, obviously, some of that was unplanned. So that will have an effect, for sure, but hoping that we'll be able to have a strong period production after we get up and running, particularly on the Northwood side there, Mark. So, other than what we've kind of guided in the press release, I think you've kind of got that. In terms of cost impact, nothing more than what you'd typically expect from this type of upset and maintenance turnaround.

**Mark Wilde**

Okay. Sounds good. Alan, I'll turn it over.

**Don Kayne**

Thanks, Mark.

**Operator**

Your next question comes from Paul Quinn from RBC Capital Markets. Paul, please go ahead.

**Paul Quinn — RBC Capital Markets**

Yeah. Thanks very much. Morning, guys.

**Don Kayne**

Morning, Paul.

**Alan Nicholl**

Morning, Paul.

**Paul Quinn**

Just maybe to start on the pulp side. We're seeing higher global inventories. China prices are rolling over. What do you expect the balance of the year overall?

**Kevin Pankratz**

Sure, Paul. Yeah. For sure, we're seeing prices stabilize for basically the back part here in the summer months. And then we do see a little bit of strength in the back half of the year, is what our outlook is, Paul.

**Paul Quinn**

Okay. And then specifically at Northwood. I mean, you had some issues with RB5. That seems to be behind you. Maybe you could comment on that. But this quarter, you had some digester issues. How material are those?

**Alan Nicholl**

Yeah. In terms of recovery boiler performance, we're very pleased with it, Paul. No issues at all there. Running very well. So this digester upset that we've had at the beginning of this quarter didn't impact us Q2 but at the beginning of this quarter, is something that we've got folks focused on. But I would classify it as a not insignificant operational upset but one that we can quickly recover from, and we're hoping that things will be up and running here in about a week's time. That's certainly our target. So nothing to be unduly alarmed about, would be my view on that one.

**Paul Quinn**

Okay. And then so that '22 CapEx budget, that \$50 million to \$70 million for the pulp assets.

What percentage of that or how much is maintenance and how much is margin-enhancing projects?

**Alan Nicholl**

Yeah. In terms of the upper range, I would say it's close to 50/50, Paul. And so, obviously, if we're unsuccessful in spending the full \$70 million this year, it'll be a bit higher on the maintenance side, given that that's essential maintenance-of-business spend.

**Paul Quinn**

Okay. And then, I guess flipping over to North American lumber markets; hopefully, we've seen the bottom here. But just thinking about how you see operating in BC on a long-term basis. I mean, obviously we got a premier here that's looking for more investment. Is that something that Canfor's willing to do, given the cost structure that we see in BC?

**Don Kayne**

Yeah. Thanks, Paul. I mean, I think, certainly, BC's been actually performing pretty well here the last 18 months, to say the least, or 12 months anyway. I mean, if you look forward, I think what our focus has been and will continue to be is, being in the Kootenays, we like the area. It's a good area. We've got lots of fibre and we've got lots of—the labour market there's pretty decent, for sure. I mean, access to all the markets in terms of market access is solid. So we like the Kootenays and we'll be there and we'll make sure those mills are capitalized to the degree they need to be.

We also like the Peace region where we are, as you know, with Fort St. John and Chetwynd. And we're not the only game in town, but we're one of the only ones. And those mills we've invested, particularly in Fort St. John, but there's lots of fibre up there as well, and we like those areas. So we're focused there as well, and we'll continue to capitalize those mills appropriately as well.

And then the central interior, you've seen with Isle Pierre, and made some decisions elsewhere as well. But the ones that we have there right now, we certainly believe that those are viable operations as well, of course, and that we'll continue to capitalize them as we need to to ensure that they're competitive on a worldwide basis.

I think that's pretty consistent with what we've said. We know that we're down a long way from where we are, but we think that the footprint that we are getting close to here certainly can be competitive on a long-term basis.

**Paul Quinn**

Okay. And just lastly, if I take a look at Canfor share price performance over the year, I mean, you lag everybody else in the group. Just wondering what investors are missing? Or is there other things that you guys can do on the management side to improve that performance?

**Don Kayne**

Do you want to try that, Alan?

**Alan Nicholl**

Yeah. It's a fair question, Paul. I mean, it's not easy to answer; you'll appreciate that. I do think that our diversification strategy will become increasingly evident here as we go through the year, particularly in Q3, bearing in mind what's happened, and I think our exposure to Europe and other places will yield dividends there. But it's hard to speculate on all of the factors that may be impacting share price relative to other companies.

**Paul Quinn**

All right. I hope you're right. Best of luck, guys. Thanks.

**Operator**

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

Go ahead, Mr. Kayne.

**Don Kayne**

All right. Thanks, Operator. And thanks to all of you that participated in the call this morning. We appreciate all your support and hope you enjoy the rest of the summer, and we'll look forward to talking to you at the end of the third quarter. Thank you.

**Operator**

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