

## Canfor Corporation

### Q3 2022 Results Conference Call

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## **CORPORATE PARTICIPANTS**

### **Don Kayne**

*President and Chief Executive Officer, Canfor Corporation*

### **Kevin Edgson**

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

### **Pat Elliott**

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

### **Kevin Pankratz**

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

## **CONFERENCE CALL PARTICIPANTS**

### **Mark Wilde**

*Bank of Montreal — Analyst*

### **Paul Quinn**

*RBC — Analyst*

## PRESENTATION

### Operator

Good morning. My name is Michelle, and I will be your conference Operator today. Welcome to the Canfor and Canfor Pulp 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

Thanks, Operator, and good morning, everyone. Thanks for joining the Canfor and Canfor Pulp Q3 2022 Results Conference Call.

I'll 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, Senior Vice President of Sales and Marketing.

The third quarter resulted in reduced margins in our lumber business as prices moved lower throughout the period. However, we continue to benefit from the diversification of our earnings stream as Europe and the US South generated solid returns.

Our strategic growth in regions that have strong and competitive fibre baskets, the US South, Sweden, and Alberta, will allow us to generate more consistent earnings throughout the cycle.

In British Columbia, the allowable annual cut continues to decrease due to the mountain pine beetle damage, government policy decisions, species at risk, and wildfires. We continue to assess our operating rates against the available fibre supply in the region and remain focused on producing higher-value products and managing production to meet market demand in order to maximize the value of every consumed log.

As a result, Canfor took operational downtime throughout the third quarter, with the majority of our BC sawmills continuing to operate today on a reduced basis. I want to acknowledge our employees for their ongoing hard work and dedication through the downtime. We have worked to support our employees and thank them for their flexibility.

US lumber demand in the repair and remodel sector remained solid throughout the quarter. However, with rising interest rates, ongoing inflationary pressures, and reduced housing affordability, slowing new home construction activity in the US led to lower demand in that segment.

In Europe, our lumber business generated solid financial results in the third quarter despite the impact of seasonal downtime, principally in July.

Rising interest rates, inflationary pressures, and soaring energy costs in Europe have, however, contributed to a sharp decline in lumber consumption in recent months, particularly for the retail sector. Even though pricing is anticipated to remain relatively solid, we will continue to evaluate market activity levels and manage production as necessary through the fourth quarter to align with current demand. To date, the mills have taken minimal downtime.

Notwithstanding the current macroeconomic uncertainty, North American lumber prices continue to trade above pre-pandemic levels, supported by lean inventories throughout the supply chain, steady underlying demand in the repair and remodel sector, and pent-up demand for new home construction in the United States.

While inflationary pressures are anticipated to persist in the near term, we remain focused on growing our lumber business on a global basis, currently through three major capital projects in the US South.

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 Corporation

Thank you, Don, and good morning, everyone. Canfor Pulp had a strong third quarter with solid financial results driven by sustained strength in global pulp pricing and an improved operational performance. This contributed to a 4 percent increase in pulp production, despite planned maintenance downtime at Northwood and Intercon during the quarter.

As previously discussed on these calls, the management team at Canfor Pulp remains focused on improving asset reliability and running the mills more consistently. We have seen some positive momentum in this regard over the last few months, and I expect continued progress over the coming quarters.

Sourcing economic fibre remains a challenge in BC due to the decrease in residual chip supply and inflationary cost pressures on pulp logs. As a result, we recently announced extended downtime at our Intercon mill in order to better balance our chip supply for the winter.

Transportation networks improved through the third quarter and, in general, were able to support our production volume. Our Taylor mill continues to be faced with supply chain challenges, and, at this time, we are not anticipating a restart before the spring of 2023.

While we are encouraged by recent operational performance, we are prepared to adjust future operating plans to match available logistics and economically available fibre. We appreciate the resilience and dedication of our employees as we manage through these headwinds.

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 Corporation

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 companies' websites.

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

Our lumber business generated operating income of \$102 million in the third quarter, which included a net duty recovery of \$98 million and a \$90 million inventory write-down related to logs in British Columbia.

Results reflected a steady decline in global lumber prices throughout the quarter as well as the impact of significant operational downtime in Western Canada.

As Don mentioned, we continue to realize the benefit of our diversification strategy, with our European operations contributing \$57 million in cash earnings in the third quarter, despite taking its traditional summer downtime.

Looking ahead, we anticipate a more challenging fourth quarter reflecting current lumber market conditions as well as the impact of downtime on unit manufacturing costs. While we expect BC's stumpage rates to fall in the fourth quarter, it would likely take much of the quarter before we realize those lower prices into our results.

Our pulp business generated an operating income of \$19 million in the third quarter, an improvement of \$27 million quarter over quarter. As Kevin mentioned, third quarter results benefitted from significantly higher sales realizations and improved productivity, offset in part by increased fibre costs.

Despite significant challenges in recent quarters, Canfor Pulp has maintained its strong balance sheet and remains focused on improving productivity, closely managing inflationary cost pressures, and optimizing the available transportation and economically available fibre.

Capital expenditures were approximately \$139 million in the third quarter, including approximately \$29 million for Canfor Pulp. We project capital spend of approximately \$450 million for our lumber business in 2022 and approximately \$110 million for Canfor Pulp.

Looking ahead to 2023, we are currently forecasting a capital spend of approximately \$500 million for our lumber business, including the remaining spend on a DeRidder greenfield sawmill, which is currently on track for completion in the first quarter of 2023.

We also anticipate being modestly active on Canfor's share buyback program in the fourth quarter.

As Canfor Pulp continues their focus on asset reliability and productivity improvement, our expectation for capital spending in 2023 is \$60 million to \$80 million, depending on market conditions.

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

**Don Kayne**

Thanks, Pat. So, Operator, we're now ready to take questions from analysts.

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## **Q&A**

**Operator**

Thank you. Ladies and gentlemen, 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.

Our first question comes from Mark Wilde of Bank of Montreal. Please go ahead.

**Mark Wilde — Bank of Montreal**

Thanks. Good morning, Don, Kevin, Pat.

**Kevin Edgson**

Good morning, Mark

**Pat Elliott**

Good morning.

**Mark Wilde**

The first question I have, Don, if you would just give us a little more colour on the European lumber situation because it sounds like you might be taking a little less downtime than you were pointing to a month or two ago.

**Don Kayne**



For sure, Mark, and that's correct first of all. And we anticipated initially that we would be taking a little more than we've had to. And though we've been fortunate; despite the challenges in our key market in the UK, we've been able to do a real good job. The guys that are on the ground here have done a really good job along with their marketing group in Vancouver to move a lot of that volume quicker and more expeditiously than we would have thought to alternative markets.

So we've been real surprised, and that's one of the reasons why we would have done that.

**Mark Wilde**

Okay. Is it also, is it possible, Don, to get some sense of how much price has moved in the European market? I know it moves differently than it does here in North America, but if we could just get some sense of price movement.

**Don Kayne**

Yeah. Kevin, do you want to talk about that a little bit?

**Kevin Edgson**

For sure, Mark. I would say in that 10 percent, 12 percent range down is kind of quarter over quarter. There was a bit more pressure towards the end of Q3 but in that range is what we experienced.

**Don Kayne**

One thing, Mark, just to quickly add, I'd say in terms of our European business and you've heard us speak about this before, but one of the reasons that stand out—and I keep saying this, but we'll say it again—one of the reasons why we focus heavily on Europe and we have for a while is the flexibility that it presents us that you often don't see that in other markets. So we really see that. So we're able to move around as we see fit to take advantage of market levels as we see fit. Right? So it's really that part of our acquisition that turned out at least as good or better than we ever expected.

**Mark Wilde**

Yeah. And just one more on Europe. What's your expectations looking to '23 in terms of European volumes into the North American market? I mean demand is down in both markets, but the euro is quite weak now, which you might think would push a little more volume over toward North America.

**Don Kayne**

And I'll let Kevin talk about that. And for sure you can add on, Kevin. That's clearly what we're seeing, and that's one of the alternatives that's come about here over the last little while here. Certainly, we see an increase in North America. To what degree, it's a fairly good degree actually. And it's going to help us a lot in North America with some of the BC shuts that we've been experiencing. Kevin, you know way more than I do.

**Kevin Edgson**

Well, just what I'm hearing here too, Mark, is that underlying demand is pretty good. But the big issue that they're dealing with over in Europe is really about energy and really how it's going to play out over the next six to eight months. And then I think if energy prices come down to a certain degree, then you could see, potentially, a pickup in some European demand. But short term for sure, I think you can expect to see increased volumes coming into North America, and actually other markets as well.

**Mark Wilde**

And then the other question I have is just on capital allocation and the share repurchasing. And if I go back to 2018, you bought a couple million shares up at \$28, and today the stock is \$20 a share. You've got over \$10 a share in net cash and \$7 a share in deposits. It looks like a far better value than it

was in '18. So I'm just I'm curious as to why we're not seeing a little more activity there. There was—didn't look like there was anything in the third quarter.

**Don Kayne**

Pat, why don't you talk to Mark a little bit about that, and we can maybe talk also about overall capital allocation and what we're thinking.

**Pat Elliott**

Sure, Mark. I'm not sure I can reconcile the math to 2018 directly, but what I would say is we've kind of been thinking that there's pullback coming. I don't think that's a big surprise. We've made some significant capital investments; three big projects as Don mentioned in US South that got us up to the US\$500 million. And I just think we kind of took a little bit of a pause and assessed how things were going to play out.

We do have a very strong balance sheet, and we want to have a very strong balance sheet. But we also want to be able to build and diversify our business either through organic growth or M&A. And frankly, I think the arriving into a weak market with a balance sheet like we have is going to be a strategic advantage.

So we're always going to do this on a modest basis anyways. And you know some of the background on that and liquidity in our stock. So as I said in my comments, I think we'll be active again, but it'll remain a modest part of our overall capital allocation.

**Don Kayne**

And if you look at our overall like we do, and we've been dealing this way for a while now, probably late half of the second quarter that things are going to—demand's going to temper it quite a bit due to affordability and probably carry on through a big part of 2023.

So we're try to be extremely disciplined here and we'll call it conservative, whatever you want, or patient around the fact that we do believe we're going to get opportunities here over the next 12 to 18 months at a far better value than we may have seen in the last 24 months.

**Mark Wilde**

Okay. And just one more, Pat. You mentioned that those log costs in BC take a while to work their way through your inventories. Can you give us just a little more colour on that?

**Pat Elliott**

We basically, Q3, Q4, Q3 log costs were up to \$35 a cubic metre. Rough and dirty they came down to roughly that in Q4. And that lag's probably two to three months, something like that, into Q1. Yeah. So where it's going to probably drop in the order of \$5 a cubic metre. Right? So lag's probably two to three months, something like that. Of course because of how much you harvested, that would be our guess right now.

**Mark Wilde**

Okay. All right. That's helpful. I'll turn it over.

**Operator**

Thank you. And the next question comes from Paul Quinn, RBC. Please go ahead.

**Paul Quinn — RBC**

Yeah. Thanks very much. Good morning, guys.

**Don Kayne**

Good morning, Paul.

**Paul Quinn**

Yeah. Just trying to understand this European dynamic with lumber prices and log prices. So what I've seen in the past is if the lumber prices come down, log prices are coming down as well. So that margin sort of seems a little bit more stable than what you'd typically experience in North America. Is that the case right now?

**Don Kayne**

Yeah. I think, for the most part, we always try to compare it a little bit coming down to the Western Canadian and Southern Yellow Pine. So in that vein, certainly, European log prices are up. But they're getting definitely manageable for sure.

And most of that increase is due to some of the pressure around pulp and energy primarily, which is really, obviously, as you know, there's been—we've seen significant increases in energy costs, particularly in Europe, all across Europe, so. But again, obviously, it's a bit more of a change there than in the past, but it's so definitely manageable and not anywhere near like it is here in North America.

**Paul Quinn**

Okay. And then maybe over on Canfor Pulp side, just this BC log supply continues to decline. Just wondering, when you look at future chip availability for the Canfor Pulp mill, does that equate to all the existing mills that you're operating right now? Or is it more prudent to take one mill out of the quiver as opposed taking some rotating downtime because of the lack of chips?

**Kevin Edgson**

Thank you for the question, Paul. I think we all can recognize the fact that there have been both indefinite and permanent curtailment within BC on the sawmilling side. There have been a number of pulp assets that have likewise been either curtailed permanently or indefinitely. It would be my opinion that for the industry, it's not yet done.

As to where we sit will be a function of how well our assets run and what the fibre supply is in our region versus other regions within BC.

**Paul Quinn**

Okay. And then just maybe on thinking strategic here, there's a couple pulp mills that are available in Eastern Canada. Is that something that you guys would be interested in growing that pulp business on the Canfor Pulp side?

**Kevin Edgson**

Well, I think today our primary focus is ensuring that the assets we have are well capitalized and running well before we start looking at expansion. And so at this point, I don't think that's really a key focus for us.

**Paul Quinn**

All righty. That's all I had for you. Best of luck.

**Don Kayne**

Thanks, Paul.

**Operator**

Thank you. There are no further questions. I will turn the call over to Don Kayne for closing comments. Go ahead, Mr. Kayne.

**Don Kayne**

All right. Thanks, Operator, and thanks, everyone, for joining the call. And we look forward to talking to you as the year progresses here. Thanks.

**Operator**

This does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines.