

Canfor Corporation & Canfor Pulp

Fourth Quarter 2020 Results

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Canfor and Canfor Pulp Fourth Quarter Analyst Call. A recording and transcript of the call will be available on Canfor's website.

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 now would 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 & Canfor Pulp Products, Inc.

Thanks, operator, and good morning, everyone. Thanks for joining the Canfor and Canfor Pulp Q4 2020 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 as well as Canfor Pulp. Alan will provide a more detailed overview of our performance in Q4. In addition to Alan and I, we are joined by Kevin Pankratz, our Senior Vice President of Sales and Marketing.

Before I talk about our 2020 and Q4 results, I'd like to start by recognizing the exceptional efforts of our employees this past year. 2020 was a very volatile and unpredictable year with extreme highs and lows, largely due to the uncertainty caused by the COVID-19 pandemic. Our employees have

demonstrated an unwavering commitment to health and safety and have implemented our COVID-19 protocols, policies, and procedures. I can't thank them enough for their resilience, determination, and commitment to Canfor and Canfor Pulp.

2020 also marked a shift for us as we started the process of developing a comprehensive sustainability strategy and significantly increasing our focus on ESG and associated priorities. Around the world, countries are embracing low carbon strategies to aggressively reduce greenhouse gas emissions and, as a producer of renewable green forest products, we are excited about the role we can and are playing in reducing society's environmental footprint. The green attributes of our products are increasingly being recognized, whether it's in mass timber, hybrid construction applications, or bio innovation opportunities. In addition, with increasing opportunities in the bio economy and bio innovation space, there are exciting opportunities to produce both advanced bio fuels and bio products. We're also pleased that we've been able to generate significant economic activity throughout most of the pandemic and believe the forest industry will continue to play a significant role in the post-pandemic economic recovery.

Turning to our financial results, beginning with our pulp business, Canfor Pulp reported an operating loss of \$56 million in 2020, reflecting the significant impacts of COVID-19. Global pulp market fundamentals were very challenging throughout most of the year. In response to weak markets and extensive sawmill curtailments at the onset of the pandemic, Canfor Pulp took significant operational downtime during the year, which weighed heavily on our financial results. During the fourth quarter we also made the decision to replace the lower furnace of our main recovery boiler at Northwood, which was completed on time and under budget in early 2021. Despite the many challenges faced during the year,

Canfor Pulp maintained its solid balance sheet and, with significant capital projects now behind us, we are well positioned to capitalize on the recent increases in the price of pulp and the improved market fundamentals we are seeing in early 2021.

Turning to lumber, despite extreme volatility experienced during the year, our lumber business generated record high operating income of \$816 million in 2020, reflecting unprecedented strength in lumber markets worldwide, particularly in the second half of the year. At the onset of COVID-19, significant market uncertainty resulted in widespread production curtailments across the lumber industry. Reduced supply was not able to meet the unexpected increase in demand as a result of strong R&R activity, a change in consumer spending habits due to a large percentage of people working from home, and a sharp increase in North American new home construction activity. These favourable demand conditions far exceeded available supply, resulting in unprecedented price increases and record high earnings for our lumber operations in North America. Our European lumber business achieved record high earnings in the fourth quarter of 2020, supported by strong market fundamentals in Europe and increased production levels. While European pricing has lagged North America due to the nature of overseas contract pricing models, our operations performed well in the year, generating annual EBITDA of approximately \$180 million in 2020.

Despite the unprecedented challenges due to the pandemic, we continued to make significant progress on our strategy during the year with our recent acquisitions in Europe and growing footprint in the US South and significantly improving our geographic diversification. Following major growth in recent years, we significantly strengthened our balance sheet in 2020, supported by strong lumber markets, solid operational performance, and a disciplined approach to cash management.

Looking ahead to 2021, we anticipate increased capital spending, supported by our strong balance sheet, favourable lumber market fundamentals, and improving global pulp market conditions. Canfor and Canfor Pulp will continue to deploy capital internally that target strong rate of return projects that align with the strategy and consider M&A opportunities that will grow our business on a global basis.

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

Alan Nicholl — Executive Vice President, Canfor Pulp Operations & Chief Financial Officer, Canfor Corporation & Canfor Pulp Products, Inc.

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

Our lumber segment reported operating income of \$461 million for the fourth quarter compared to \$337 million in Q3. Results included a net duty recovery of \$95 million following the finalization of CVD and ADD rates applicable to the Department of Commerce's first period of review. After adjusting for this, the lumber segment generated operating income of \$366 million compared to a similarly adjusted operating income of \$387 million in the previous quarter.

Lumber segment results continued to reflect strong global market fundamentals. While North American benchmark lumber prices saw extreme volatility through the fourth quarter, increased demand

over the traditionally slower season further reduced the inventory levels and supported material price increases towards the end of the fourth quarter and into early 2021.

Unit sales realizations in Western Canada increased modestly in the fourth quarter, reflecting a favourable timing lag in shipments versus orders, as well as improved offshore sales realizations and, to a lesser extent, a reduction in the duty deposit rate to 4.62% in December. In the US South, notwithstanding the impact of seasonally lower pricing and wider width Southern Yellow Pine lumber products, our operations performed well and continued to generate strong financial results in the fourth quarter, supported by historically high lumber prices and stable log costs. North American lumber demand has continued to increase in early 2021 and strong market fundamentals and order files have supported record high Western SPF and Southern Yellow Pine pricing in recent weeks.

Our European business reported record high earnings in the fourth quarter, supported by improved unit sales realizations and higher production following the September 1st acquisition of Bergs Timber in Southern Sweden. With most business in Europe conducted based on pricing negotiated quarterly in advance, European prices are also seeing solid increases in the first quarter of 2021.

In contrast to our lumber business, our pulp business reported an operating loss of \$28 million in the fourth quarter, which was in line with that of the previous quarter. Results for Q4 reflected continued soft market conditions and weak prices on pulp shipments as well as the capital related downtime at Northwood. While global pulp markets improved towards the end of the fourth quarter, unit sales realizations were in line with those of the previous quarter due in part to the timing of shipments versus

orders. Global pulp prices have surged in recent weeks with improved market fundamentals supporting significant price increases.

In the fourth quarter, as previously reported, Northwood completed a scheduled maintenance outage in October and took an extended outage on one production line to enable the replacement of the lower furnace in the mill's recovery boiler number five. The lower furnace replacement was completed as scheduled in mid-January at a total capital cost of approximately \$27 million. Pulp production was up 3% from the previous quarter while unit manufacturing costs were slightly lower, as reduced fibre cost outweighed seasonally higher energy costs and usage.

At the end of the year, Canfor excluding Canfor Pulp had net debt of \$227 million and available liquidity of approximately \$1.3 billion. Liquidity improved by approximately \$255 million during the quarter, reflecting the significant cash earnings associated with the strong lumber markets. Canfor Pulp ended the year with net debt of \$43 million and available liquidity of approximately \$105 million.

Excluding capitalized major maintenance, we currently anticipate significantly higher capital spending in 2021 with approximately \$300 million in the lumber segment and \$70 million for Canfor Pulp. From a broader capital allocation perspective, we continue to assess various options related to M&A and growth and diversification in our preferred regions of the US South and Europe. In addition, we will consider the potential for restarting our share buyback program on an opportunistic basis. Having said that, we are comfortable with retaining and enhancing our existing liquidity until a reasonable opportunity presents itself.

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

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Thanks very much, Alan. And operator, I'll turn it over to you and we're ready to take questions from analysts.

Q & A

Operator

We will now take questions from financial analysts. If you have a question, please press star one on your telephone keypad. If you are using a speakerphone, please lift your receiver and then press star one. If at any time you wish to cancel your question, please press star two. Please press star one 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 Hamir Patel with CIBC. Hamir, please go ahead.

Hamir Patel — Analyst, CIBC Capital Markets

Hi. Good morning. Don, the AIF talked about a decision on the potential Washington, Georgia greenfield project coming later in 2021. Any update on timing or how you're thinking about that project given the strength in the lumber market?

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Thanks, Hamir. I think we're looking at Washington greenfield in the context of several different choices that we're hoping we'll have here as the year progresses and also looking at it in the context of some of the other opportunities on organic capital growth and M&A and so forth. So, for right now, we're not ready to make a decision in terms of whether we'll go ahead there or not, but what I can say is we are looking at some different alternatives there as well, too. So that's maybe how I would answer that right now.

Hamir Patel — Analyst, CIBC Capital Markets

And Don, if you do decide to go forward with a greenfield, what's the timing? I mean we've been hearing sort of equipment lead times stretching out to 18 months, so what are you seeing out there?

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

I think that's accurate, or longer. My view is, as it was in 2018 when we seemed to be getting a new greenfield mill announced every other day, where a lot of them didn't end up actually materializing, I think we're looking here at least 18 months, probably more like two years in my view.

Hamir Patel — Analyst, CIBC Capital Markets

Great. Thanks, Don. That's helpful. And Alan, I was wondering if you could just give us an update on Canfor Pulp's chip supply agreements with Canfor. I think they're coming up for renewal at some point this year. How should we expect the impact of that given the moves in the commodity prices?

Alan Nicholl — Executive Vice President, Canfor Pulp Operations & Chief Financial Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Yeah, I think it's a fair question, Hamir. We will continue our productive discussions between both companies. The residual sawmill and residual chip supply reflects very much (lumber operating rates), and it's a function of pulp prices as well that's built into the mechanism there.

Hamir, the area that we're wrestling with is clearly on the whole log chip side where there are challenges in terms of procuring that fibre on a cost-efficient basis, so that's an area certainly Canfor Pulp, we're looking very closely at and looking to see what we can do to mitigate those costs.

Hamir Patel — Analyst, CIBC Capital Markets

Fair enough. And Alan, any update you can give us on how negotiations are going for Canfor Pulp's collective agreements? I think they're set to expire at the end of April.

Alan Nicholl — Executive Vice President, Canfor Pulp Operations & Chief Financial Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Yeah, no, it's fairly quiet on that front at this point, so nothing much to update, Hamir.

Hamir Patel — Analyst, CIBC Capital Markets

Okay. That's all I had. Thanks.

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Thanks, Hamir.

Operator

Thank you. We have a following question from Sean with TD Securities. Sean, your line is now open.

Sean Stuart — Analyst, TD Securities

Thanks. Good morning, guys. A couple questions. Just drilling into the capital allocation biases, Don, you touched on lumber M&A opportunities in Europe and North America. Can you comment on where the opportunity set is? Are there more opportunities or more attractive valuations between those two regions? Is there any bias one way or the other right now?

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

To answer your second part of that question first, I mean I don't think there's any bias. I mean clearly we've mentioned in the past that Europe, as well as the US South, are our two primary areas where we think there's opportunity going forward. However, in both of those areas, I'm not sure it's equal but pretty darn close, valuations have definitely accelerated here over the last number of months. But I would say, you know, we wouldn't be able to differentiate too much between the Europe and the South. But clearly there are opportunities for sure in both areas that we're interested in and I think that'll continue, it's just whether or not they'll become available at a valuation level that's acceptable to us.

Sean Steuart — Analyst, TD Securities

Thanks for that. And Don, a question for you or Kevin: When you're looking at lumber markets right now, these prices don't feel sustainable, but I would have said the same thing three months ago and been wrong, but when you're thinking about downside risk, what is of greater concern? Is it demand slowing or supply catching up? And whether that's organic growth in North America or European imports. What are you more concerned about over the midterm with respect to lumber?

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

It's a good question and one that we spend a lot of time on, because, like you, one thing for sure is we're often not correct. But maybe, Kevin, why don't we let you comment on that? You may have a couple of things to add.

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

Good morning, Sean. From a demand perspective, we are feeling very confident on new home construction, particularly single-family home construction for the year, so that's going to help support some good consumption. The one risk area potentially would be on the R&R side where consumer behaviour, as we come out a post-COVID environment, and where people will spend their money and prioritize events could be a potential risk. We're not seeing it today, but it could be a risk that maybe on the back half of the year. And of course, as we go throughout the year, we do expect to see some modest increase in supply given Southern Yellow Pine and also from Europe. So, there are a couple of headwinds

on the other side. And of course affordability is another risk down the road in the back half that just gives us a little bit of caution. But overall feel very optimistic or positive on the market fundamentals.

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Sean, maybe just one maybe thing just on the supply side though, and Kevin, you're absolutely right, and our view would be, that if you're not running at full capacity right now, it'd be surprising, really around the world. We're still not sure how it's going to end up yet, but the impacts, we talked a lot about it for a couple of years now, but the impacts of the forest fires that we had for two serious years is still out there and we're not sure about the magnitude of that in British Columbia. And then add to that what's occurred down in the US, they're still trying to figure out what the impacts of that are going to be. The beetle in Europe, you know, that's still much more serious than what was expected I think initially and we've all seen the numbers in terms of log exports now versus lumber exports.

So in terms of upside on the supply side, yeah, there'll probably be some, there always is, but it's a ways away for sure. And I'm not sure that the magnitude of that is going to be super significant for sure. And I totally agree, Kevin, on the demand side, right? So anyway, hopefully that gives you a bit of colour.

Sean Steuart — Analyst, TD Securities

Yeah, that's useful context. Thanks. Just one last one. Alan, the CapEx budget for 2021 you mentioned, the \$300 million for lumber and \$70 million for pulp, did you say that was before maintenance? And if so, what's the increment we could expect above and beyond those figures?

Alan Nicholl — Executive Vice President, Canfor Pulp Operations & Chief Financial Officer, Canfor Corporation & Canfor Pulp Products, Inc.

So, what I was referring to there, Sean, was the major maintenance turnarounds that we have for Canfor Pulp, and so they vary, obviously, depending on each year, but guiding close to \$15 million, \$20 million for the balance of the year looking forward.

Sean Steuart — Analyst, TD Securities

Got it. Okay. That's all I had. Thanks very much, guys.

Operator

Thank you. Your next question comes from Mark with BMO. Mark, please go ahead.

Mark Wilde — Analyst, Bank of Montreal

Good morning, Don. Good morning, Alan, Kevin.

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Good morning, Mark.

Mark Wilde — Analyst, Bank of Montreal

I guess the first one might be either for Don or for Kevin. I just would like to get your perspective on what you see in European and Chinese markets right now and what that might imply for an increase in European exports into North America this year.

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Okay. Good question. Go ahead, Kevin.

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

So, on China, maybe I'll start there, and it's quite interesting. China, the inventories are extremely lean over there on the lumber side and even a bit on the log and, as they're coming out of their Chinese New Year and the growth of their economy, we do see demand actually picking up quite strong. And they're seeing quite a bit of strength in logs and lumber imports from Central Europe. So that's going to be a factor that might limit North American shipments on certain grades, because we're seeing some pretty material price increases that we didn't normally see in that market where it would be \$5 to \$10 a cubic metre we're seeing material shifts. And those markets are going to, while lagging, are going to start to materially improve pricing over time.

And the other market too of course is Japan. Japan is also starting to recover. And Europe is a big exporter into that market as well, especially in the post and beam market, and that's going to start to improve and add another demand component to the European supply equation.

And then just in Europe itself, I think Don, you mentioned earlier, the fundamentals there are quite good and we feel quite optimistic about there and that's going to limit the degree of how much lumber

can actually come to the US. And part of it is just mill capabilities in Europe, that they can't fully switch everything into North America. They've got commitments, quarterly-type commitments with key customers, and we do for sure, and so that's going to limit how much wood is going to come into North America.

So, Don, if I missed anything else that you'd like to add or..?

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

No, I think maybe just one thing, Kevin. You maybe talked about this too a little bit, because, Mark, I know you're up to speed on this too, but if you kind of separate Central Europe from Scandinavia or Northern Europe particularly, you might see some additional product coming from Central Europe just because the opportunity to get the high-value products there isn't as great as it is up in Scandinavia, right? So, up in Scandinavia, look, we really don't focus on the commodity business at all and that's why our percentage of volume into the North American market is quite small and hasn't really increased any significant material the last, you know, couple of years, Mark, and it's not going to, just basically because we're focused more on high-value products there, right? But Central Europe, for sure, that'll continue to be logs and lumber probably more likely to move into North America, to some degree, right?

Mark Wilde — Analyst, Bank of Montreal

Okay. The next question I have was, I guess, more for you, Don, and that is just how do you think about sort of the new normal kind of price range going forward in lumber just given less supply, higher costs in BC, it looks like the Pacific Northwest of the US is pretty well maxed out in terms of kind of fibre

supply. So when you put all of that together, what does that tell you about sort of a lumber price band going forward relative to where we've been in the past?

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Yeah, I mean Kevin is the expert on this, but I'll just give you my two cents worth first. First of all, I think there is a bit of a new normal, and I hate using that word because it's overused, but compared to what we've been dealing with before and I do think there's a new base, right? And so, whether that number is 700 or 600 or 800 or whatever, to me it's somewhere in that kind of band. But there's some fundamental changes in the market in how lumber is viewed worldwide that's having a big impact here. You've got supply of course, and I mentioned some of them already earlier, and I think it's hard to tell yet how much impact that's going to have long term, but it's going to, right? Whether that's in Russia with the fires and the beetles, whether it's Central Europe, whether it's North America, it doesn't matter.

But in terms of demand though, some of the fundamental shifts that we're seeing in the market from a consumer level, you know, with the suburbanization, for lack of a better word, versus what we've seen in the past, that's definitely having a bigger impact than we thought. How lumber is viewed in the world from a green aspect and how we can be big contributors to the decarbonisation of the planet and those sorts of things, that's gained a lot of ground around the world, much quicker, much bigger than we think in markets that we probably wouldn't have thought before. So I think that's catching hold.

And then you got the whole mass timber piece. And the mass timber piece, you know, again, the reason we got a lot, it shows a lot of promise in our view is, is that in Europe it went from demonstration to commercial fairly quickly. And of course it's the largest in the world. We see that same opportunity

here. That's going to take some time, clearly, but it is progressing. And so, you know, if you add all that up, I mean I think that more than supports sort of some of those bands that we're talking about.

Kevin, in terms of offshore, like that's the one area that—is there anything you want to add to that?

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

Just that whole comment around green building, zero carbon, you've got governments like in China that are taking that so seriously and got some pretty material objectives to 2030, 2060, and when they put their minds to it, they do execute. So aligning lumber, forest products, pulp products in that stream is going to be a very positive outlook for demand. That's going to be incremental to what we have today. So we're pretty positive on that. And Europe's got some pretty aggressive policies too on decarbonisation and net zero and so we see that as a pretty positive impact.

Mark Wilde — Analyst, Bank of Montreal

Yeah. Okay. Next question, Don. If we think about 2020, as you said, you know, you had a lot of supply come out kind of late first quarter, early second quarter, so that kind of reduced supply in the market. And then the second element seems to be just either some production losses or less efficiency because of sort of the ongoing drag from kind of COVID with workers out as we move through the year.

Any way to get a sense of how big you think that drag might have been on overall kind of production volumes for North America last year?

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Yeah, less than we would have thought. I know, I'm speaking from our own experience in talking to Stephen and our operating guys, I mean definitely. I mean everybody got on it quickly, put in protocols and procedures, et cetera, bearing in mind the health and safety of their employees first and foremost. I think everybody did a superb job at that, frankly. And so that maybe mitigated pretty significantly the amount of downtime. Now we lost a lot of hours and shifts here and there for sure, no question about that, but that was largely in the back half of Q3 into Q4 where we saw some of that. But overall, materially, I don't think it was that material at all. I think it was much better than we would have expected.

Mark Wilde — Analyst, Bank of Montreal

Would you want to hazard just like a ballpark number? Like was it 1%? Was it 1.5%? 2%?

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Less than 1%.

Mark Wilde — Analyst, Bank of Montreal

And turning to kind of capital allocation, I'm just curious. You've talked about Europe. You've talked about the US South. If there was a package on the market that gave you a nice bump in US South capacity but it kind of came with some capacity in the Pacific Northwest of the US, would you take that?

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

I guess it would just depend on, to some degree, on the valuations. Although I would say this: We are, and we've been pretty consistent between us all, and I still feel as strong as we did a year, two, three, even five years ago, is that Europe and the US South are our primary focus as a company, right? We would be more interested in any opportunities for some vertical integration around that then we would to try to get into potentially into another region. But, yeah, that would be more likely to be our focus.

Mark Wilde — Analyst, Bank of Montreal

Okay. And then the last one for me is just, Alan, can you give us some help in just thinking about the roll through of all of these price hike announcements? Because they're coming fast and furious and some of them are quite large. I'm just trying to get a sense of how that's likely to kind of roll into Canfor Pulp's realizations.

Alan Nicholl — Executive Vice President, Canfor Pulp Operations & Chief Financial Officer, Canfor Corporation & Canfor Pulp Products, Inc.

No, it's a very good question, Mark. It's great to see all these price increases for sure, but I think, to your point, we're likely to see the fuller effects of those as we get into the end of this quarter and into Q2. And that's largely a reflection of our order file. In our case, catching up a little bit in RB5 and also just the way the difference, if you will, between the timing of shipments and orders as well, so certainly we're expecting a very positive Q2 at this point and a more moderated outlook for Q1.

Mark Wilde — Analyst, Bank of Montreal

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

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

All right. Thanks Mark.

Operator

Thank you. We have a following question from Paul with RBC Capital Markets. Paul, please go ahead.

Paul Quinn — Analyst, RBC Capital Markets

Thanks very much. Good morning, guys.

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Good morning, Paul.

Paul Quinn — Analyst, RBC Capital Markets

Hey, just a question, obviously 2020 was very strong in North America for lumber prices, just how much volume you shifted from overseas back into the domestic market. And then looking forward to 2021, given your outlook on Asian prices coming back, is there a little bit of a shift back over to that jurisdiction going forward here?

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

Good morning, Paul. So, yeah, I mean we do have a core group of customers, long-term strategic customers in those markets in Japan and China and Southeast Asia that we just don't abandon. But there is a percentage of volume of flex, I can say, where we could optimize it and position that in those products there. So we're going to continue to modify that. And for sure, given the strength in North America, you would expect to see a little bit of that happening in Q1 and Q2, but the core volume there, we're fairly committed into those markets and to those customers.

Paul Quinn — Analyst, RBC Capital Markets

Okay. And while I got you, Kevin, just what's your assessment of lumber inventories in North America right now as opposed to the beginning of the year and do you see any slowdown in pricing there?

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

Paul, the demand and the consumption has still been quite resilient and inventories might be modestly improving, but they're below target levels for most. And in anticipation of strong order files, whether it's with homebuilders and committed levels on the R&R side, I still think there's quite a (bit of) room to go. So I would still classify it as lean.

Paul Quinn — Analyst, RBC Capital Markets

Okay. And then maybe a higher-level question for you, Don, just on the softwood lumber file. We've seen, I guess, increased lobbying efforts from US homebuilders obviously with a change in government on the US side. Any movement on that file that you're seeing going forward?

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

No, not at all. The NAHB has been increasingly vocal about it and domestically down in the States and they're looking for US producers to produce more volume and that's probably not going to happen too much. And they're looking about freeing up logs from the national forest. Unlikely to happen. The only one that's on there that maybe makes some sense, and hopefully it does down the road here, is to reduce tariffs. Right? But that's a ways away. They still haven't appointed, that I know of, a commerce secretary yet. And so once that happens they're going to have to educate in that area and so forth. But I don't see this—talking to the coalition guys and so forth, I think we're a good two years away, myself, at least. And it's going to be a complicated and much more complex negotiation than it was in the past.

Paul Quinn — Analyst, RBC Capital Markets

Okay. And then maybe just lastly, just on your capital allocation opportunities and looking at that greenfield, what have you noticed, you know, since you first announced the Washington plant, what kind of cost escalation have we seen between that point and current?

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

That's a good question. Alan, do you have a sense on that? Just like there's been on lumber, there's been escalation in steel prices and labour costs and all of that. To actually quantify how much, I think it would be probably in the neighborhood of 5%. Maybe 10% at the most, but probably closer to 5%. That's kind of what I've heard.

Alan, would you agree with that?

Alan Nicholl — Executive Vice President, Canfor Pulp Operations & Chief Financial Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Yeah, I think it's in that ballpark, based on our knowledge, Paul.

Paul Quinn — Analyst, RBC Capital Markets

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

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Thanks, Paul. Take care. See yah.

Operator

Thank you. We have a following question from Mark with BMO. Mark, please go ahead.

Mark Wilde — Analyst, Bank of Montreal

Thanks. Alan, a couple for you. One, can you give us a sense of what cash taxes should look like for you?

Alan Nicholl — Executive Vice President, Canfor Pulp Operations & Chief Financial Officer, Canfor Corporation & Canfor Pulp Products, Inc.

In terms of both businesses, Mark?

Mark Wilde — Analyst, Bank of Montreal

Yes, in terms of both businesses.

Alan Nicholl — Executive Vice President, Canfor Pulp Operations & Chief Financial Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Sorry, just in terms of our regular cash taxes?

Mark Wilde — Analyst, Bank of Montreal

Yes. Yes, exactly.

Alan Nicholl — Executive Vice President, Canfor Pulp Operations & Chief Financial Officer, Canfor Corporation & Canfor Pulp Products, Inc.

I mean it typically will follow what you would expect based on the taxes in jurisdictions, so it's typically around that 25% level for Canfor if you look at in aggregate. And then in terms of Canfor Pulp, obviously, that's a different situation where we're looking at a cash tax refund reflecting the losses that we incurred in 2020.

Mark Wilde — Analyst, Bank of Montreal

And then the other one I wanted to ask about was just kind of share repurchase activity, because this tends to be kind of devilishly hard for people in companies and in cyclical businesses. So can you just—you talked about doing this, I think, in like a disciplined fashion if you were going to bring back or an opportunistic fashion. Could you just talk a little bit about kind of how you might think about strategy there for share repurchase activity?

Alan Nicholl — Executive Vice President, Canfor Pulp Operations & Chief Financial Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Yeah, it's a very good question, Mark, and clearly a lot struggle with this. As I mentioned in my comments, we certainly are open to entertain this as we go through the year and somewhat on a more opportunistic basis. The challenge of course is to buy at levels that we feel makes sense. And of course, with such volatility around, it's hard to make a call there. But we do have a process that we follow and Pat works with me on that and we typically look at IRR and what we think is a reasonable value based at points of time. And we have other factors that guide us in our decision as well, Mark. So apologies, I've not given you a very precise answer there, but more guiding to general principles, if you will. But it's something we are keen to look at as we go through the year, particularly if the market outlook continues to be as favourable as we see it today.

Mark Wilde — Analyst, Bank of Montreal

And kind of along those lines, Alan, can you give us like some sense of just how much cash you guys might be willing to build on the balance sheet? I mean, again, remembering that you're in a cyclical business and your stock moves around cyclically, asset values move around cyclically, it looks to me like you're going to be net debt free at the end of the first quarter. How far might you be willing to go in terms of building dry powder? Any general guidelines?

Alan Nicholl — Executive Vice President, Canfor Pulp Operations & Chief Financial Officer, Canfor Corporation & Canfor Pulp Products, Inc.

I'm not sure if that's a rhetorical comment there, Mark, but what I would say is, listen, we're not going to apologize for building cash, for all the reasons that Don's outlined. And to your point, we are generating significantly positive cash flow at this point in time. Can't guide to precisely when we'll be debt free, but certainly it's coming sooner than we all thought even a month or two ago. So it's very positive. But clearly we are charged with making sure that we make that cash count in the appropriate context and at the right time we'll certainly make very measured and hopefully good decisions with it.

Mark Wilde — Analyst, Bank of Montreal

Okay. Fair enough. Good luck, guys, in the first quarter and through the year.

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

For sure. Thanks a lot, Mark.

Alan Nicholl — Executive Vice President, Canfor Pulp Operations & Chief Financial Officer, Canfor Corporation & Canfor Pulp Products, Inc.

Thanks, Mark.

Operator

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

Don Kayne — Chief Executive Officer, Canfor Corporation & Canfor Pulp Products, Inc.

All right. Thanks, operator, and thanks everyone that joined the call this morning and we look forward to talking to you again at the end of the first quarter. Have a great day. See 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.