

FINAL TRANSCRIPT

Canfor Corporation

Canfor and Canfor Pulp First Quarter Analyst Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Canfor and Canfor Pulp First Quarter Analyst Call.

A recording and transcript of the call will be available on the Canfor and Canfor Pulp websites.

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 each 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 and Canfor Pulp's Chief Executive Officer. Please go ahead, Mr. Kayne.

Don Kayne — President and Chief Executive Officer, Canfor Corporation

Thank you, Operator, and good morning, everybody. Thank you for joining the Canfor and Canfor Pulp quarter one 2017 results conference call this morning.

I'll make a few comments before I turn things over to Alan Nicholl, Chief Financial Officer for both Canfor Corporation and Canfor Pulp. Alan will provide a more detailed overview of our performance in Q1, and then we will take questions.

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In addition to Alan, on the line with me today are Brett Robinson, the President of Canfor Pulp; Peter Hart, Vice President of Pulp Sales; Wayne Guthrie, our Senior VP of Lumber and Sales Marketing; and Stephen Mackie, Senior VP of Canadian Operations.

So starting with Canfor Pulp. Strong market demand and higher shipments led to improved results in the quarter. Overall, despite several extreme weather-related challenges, the mills ran well and productivity increased. Global demand, particularly from Asia, continued strong in quarter one. Global softwood demand was positive for both NBSK and BCTMP, and we expect that will continue through Q2, as many companies begin their spring maintenance jobs.

With the addition of new softwood and hardwood capacity in 2017, we continue to see some risk to pricing later on this year and into 2018. For our lumber operations, weather continued to be a challenge throughout the quarter, but through the significant efforts of our people, we saw our productivity improve overall relative to Q4.

All of our operations, pulp and lumber, had exceptional performance in safety over the quarter, building on an excellent year for safety overall in 2016. Our company-wide MIR for Q1 was 1.24, which is the lowest level we have ever achieved in the history of our company.

Prices were up for both SPF and Southern Yellow Pine, due to increased consumption and solid demand across all sectors of our business. North American demand continues to be strong in both new home construction and repair and remodel, and our view is that the increased demand will continue to support higher returns going forward.

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Our key offshore markets continued to improve in the first quarter, and as I said previously, our shipment volumes to Asia remain steady and our outlook for Q2 is positive.

Finally, I will comment on the softwood lumber dispute and the preliminary countervailing duty rates that were announced on Monday. Canfor was assigned a rate of 20.26 percent, slightly higher than the all-others rate of 19.88 percent. We were not subject to a critical circumstances determination, meaning we are not exposed to retroactive duty payments.

These duties are punitive and completely unwarranted. They are not based on fact, but are a result of protectionist efforts by the influential US lumber lobby, aimed at artificially restricting supply for their own benefit, at the expense, ultimately, of US consumers.

We will defend our company and work with our colleagues to defend our industry against these completely unjustified duties, as we have done successfully in the past. We fully expect this determination by the Department of Commerce to be overturned by independent NAFTA and WTO panels, and that the duties will ultimately be rescinded and returned.

We have had excellent support and collaboration from the Canadian federal and BC provincial governments, and have every confidence that they will take all the appropriate steps to successfully fight these outrageous trade actions, again, as they have done previously. However for now, our company will be subject to a duty rate of 20.26 percent on shipments to the US market, beginning May 1.

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We have been preparing for several years for possible trade issues, and as a result, have significantly diversified our markets. We've grown global markets in general, through promotion of wood as a green building material. We've added 14 operations in the US South, representing 1.6 billion board feet or 30 percent of our production, and made significant capital investments at our BC operations to ensure our global competitiveness—close to \$1 billion the last five years. So we've made the investments, we've built new markets, and we have a solid plan that we are executing on.

So with that, I will turn the call over to Alan to provide an overview of our financial results.

Alan Nicholl, — Senior Vice President, Finance and Chief Financial Officer, Canfor Corporation

Thanks, Don, and good morning, everyone. As usual, my comments this morning will focus principally on our financial performance for the first quarter of 2017, by reference to the previous quarter. Full details of our results are contained in the Canfor Pulp and Canfor news releases, both of which were issued earlier this week.

As always, you'll find an overview slide presentation on both the Canfor and Canfor Pulp websites in the Investor Relations section under Webcasts. The presentation highlights consolidated and segmented results, and I'll be referring to this presentation during my comments.

For the first quarter of 2017, Canfor reported shareholder net income of \$66 million or \$0.50 a share, up from net income of \$38 million or \$0.29 a share reported for the fourth quarter of 2016, and well up from net income of \$26 million or \$0.20 a share reported for the first quarter of 2016.

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On Slide 3 of our presentation, we highlight various nonoperating items net of tax and noncontrolling interests, which affect the comparability of our results between the quarters.

In the first quarter of 2017, these items included a \$3 million post-tax gain on the sale of our joint venture with Anthony EACOM, an I-joist plant acquired with the Anthony transaction in late 2015.

After adjusting for the aforementioned items, shareholder net income from Q1 was \$59 million, or \$0.45 a share, compared to an adjusted shareholder net income of \$38 million, or \$0.29 a share, for the fourth quarter of 2016.

Results for the lumber segment are highlighted on Slide 5 of our presentation. The segment recorded operating income of \$84 million for Q1, a \$26 million increase from the prior quarter. The increase in operating income principally reflected higher Western SPF and Southern Yellow Pine sales realizations. A solid demand across all sectors contributed to the improved lumber prices. This was offset in part by higher market-based stumpage and weather-related challenges, and increased log cost in Western Canada.

Production was up 5 percent compared to the previous quarter, while shipments were in line with Q4, reflecting a tightening supply of railcars and trucks in North America, mostly a result of the harsh weather conditions. Unit manufacturing costs were broadly in line with the previous quarter, with the positive impact of productivity gains and stable log costs in the US offsetting the increased log costs for Western SPF.

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Canfor's pulp and paper segment comprises the results of Canfor Pulp Products Inc. The Company reported net income of \$24 million, or \$0.36 a share, compared to net income of \$10 million, or \$0.15 a share, for the fourth quarter, and net income of \$23 million, or \$0.34 a share, for the first quarter of 2016.

I shall stay on the summary of Canfor Pulp's operating results on Slide 6. The increase in operating income primarily reflected higher pulp shipments in the quarter, reflecting both improved softwood pulp markets and a delayed vessel shipment from Q4.

NBSK pulp sales realizations were relatively unchanged from the previous quarter, reflecting shipments of a higher proportion of orders taken in late 2016 and early 2017, as well as further pressure and customer discounts and a stronger Canadian dollar. Much of the benefit from the success of price increases implemented during the first quarter will be reflected in our second quarter sales realizations. Higher BCTMP sales realizations reflected a continued improvement in demand and prices during the quarter.

Pulp shipments were up 22 percent from the previous quarter, mostly due to increased shipments, particularly to China, and the 14,000 tonne delayed shipment from the previous quarter, as well as improved productivity. Unit manufacturing costs were lower in the quarter, largely reflecting improved productivity and lower fibre costs, offset by seasonally higher energy usage.

Operating income for the paper segment in Q1 was \$7 million, down \$1 million from the previous quarter, mostly due to the stronger Canadian dollar.

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Capital spending in the first quarter totalled \$39 million and included \$19 million in the lumber business and \$17 million in Canfor Pulp. The 2017 capital spend is currently projected to be approximately \$165 million for Canfor and \$75 million for Canfor Pulp, including major maintenance.

Consistent with the prior quarters, Canfor Pulp's Board of Directors approved the continuance of a quarterly dividend of \$0.0625 a share. In the first quarter, Canfor Pulp restarted its shares repurchasing program, spending approximately \$3 million. We will continue to look for appropriate opportunities to repurchase additional shares going forward.

At the end of the first quarter of 2017, Canfor excluding Canfor Pulp had net debt of \$352 million, with availability liquidity of 319 million. Canfor Pulp had net cash of \$28 million, with available liquidity of just over \$100 million. Net debt to total capitalization, excluding Canfor Pulp, was 18.2 percent, for Canfor Pulp it was 0, and on a consolidated basis, it was just over 15 percent.

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

Don Kayne

Thanks, Alan. So, Operator, we're now ready to take questions.

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

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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.

And your first question comes from Sean Steuart from TD. Please go ahead.

Sean Steuart — TD Securities

Thanks. Good morning, everyone.

Don Kayne

Good morning.

Sean Steuart

A few questions. The lift in corporate costs that we saw this quarter. I gather it was tied to legal expenses on softwood lumber. How should we think about that run rate going forward? Is that a steady quarterly amount going forward until the next bilateral agreement is hopefully struck?

Don Kayne

Maybe, Alan, you can touch on that.

Alan Nicholl

Yes. Good question, Sean. No, I think as a general comment that, that run rate is much higher in Q1 than we would expect to see going forward. Clearly there was a lot of work being undertaken in Q1, in light of everything that's happened. So fair to expect some continuing legal costs, obviously, but not at that run rate.

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**Sean Steuart**

Okay. Thanks.

Don Kayne

And Sean, that's one of the things we were faced with as a result of being one of the respondents—paying a heavy bill there relative to maybe some others.

Sean Steuart

Understood. Question on pulp markets, I guess for Brett. You guys referenced the strong run we've seen in pricing softwood and BCTMP since, I guess, last November. And it sounds like you're expecting markets to stay tight through the second quarter as maintenance kicks in. Just thoughts on the sustainability of recent momentum through the second half of the year. We're hearing some anecdotal reports of resistance in China—it's an ongoing price increase efforts. How are you guys thinking about the second half of the year shaping up?

Brett Robinson — President, Canfor Pulp Products Incorporated

I'll start off and then I'll kick it over to Peter Hart. But as we look out, we continue to watch what's going on with the new capacity coming on around the world, and we take people at their word for their guidance on start-ups. There's been a lot of challenges with these mills hitting their milestones and ramping up, so we got to watch what happens here with markets, but Peter can give you maybe a little bit more colour. So Peter?

Peter Hart — VP of Marketing, Canfor Pulp Products

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Yeah. Thanks, Brett. Certainly in the last couple weeks we've seen a bit of a slowdown in order intake from China, but that's counterbalanced by spring maintenance. So not unexpected. And to Brett's point, depending on when the new capacity comes on stream in the second half of the year, there is a risk of weakness out there.

Sean Steuart

Okay. Thanks for that. And then just lastly. You referenced strength in North American lumber demand is a contributor to tighter markets. Can you give us a little context on what you're seeing in offshore markets, particularly China, right now for lumber demand?

Don Kayne

Sure. Wayne, why don't you talk a little bit about that?

Wayne Guthrie — Senior Vice President, Sales and Marketing, Canfor Corporation

Sure. Thanks, Don. Good morning, Sean. In China, we've got—we're very, very pleased with the way China looks. We've got a good order file for Q2 and more demand in excess of that, so China looks really strong going into, at least through the next quarter. Sometimes we'll have a little bit of a slowdown in the summer there—and during the heat there but then during the holiday season—but we're expecting to exceed our plans into China for 2017.

Furthermore, we make a lot less low grade than we used to because of the greening up. And so if you look at the absolute volume shipping to China, you may see some slippage there because we're just not going to make the low grade. But with the higher value going there—and the bigger

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April 27, 2017 — 10:30 a.m. E.T.

Canfor Corporation Canfor and Canfor Pulp First Quarter Analyst Call

issue with China is the traction in wood frame construction. So we expect more and more #2&Btr to make its way there, here over the next couple of quarters.

Sean Steuart

Got it.

Wayne Guthrie

And Japan—good. Japan continues to be resilient, and we were really pleased with the start, and we're expecting another good quarter in Japan going forward.

Sean Steuart

Great. Thanks for the context. That's all I have.

Don Kayne

All right. Thanks, Sean.

Operator

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

Hamir Patel — CIBC

Hi. Good morning. Wayne, I was wondering if you could give us some colour of the—on the magnitude of price changes in China compared to North America for lumber since the beginning of February? I mean, obviously, you saw a big surge in North America, but curious maybe about the level of pricing differences between both markets right now.

Wayne Guthrie

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I don't want to get into any specifics on pricing here and, as you can appreciate, all the markets are trying to digest all the news here of the last few weeks and going forward. Can say this though: that we are—the pricing in China is progressing faster than we thought it would. It's very solid. We've been aided there a little bit by some European container rates that have gone up substantially, and also maybe a little less shipments to China by some others have created low inventory. So we're pleased with the price appreciation there, and as far as how that will relate to the other markets, we'll have to see how this all shakes out in the next few weeks.

Hamir Patel

Thanks, Wayne. That's helpful. And just another question I had on the lumber side was—I know the market-based BC stumpage system is pretty complicated, but can you help us understand how stumpage prices would change because of the duties? Because I was under the impression that the duties in themselves would have a downward impact on stumpage, particularly in BC, but I gather the July revision is expected to lead to higher prices. If you could help us to reconcile those two things?

Don Kayne

Yeah, Hamir. Why don't you speak to that, Stephen?

Stephen Mackie — Senior Vice President, Canadian Operations, Canfor Corporation

Sure. Yeah. Hamir, so good question. In terms of the BC stumpage system, you're right that ultimately, although it lags, it does reflect changes in lumber price realizations and AMBs (phon). However, if they're—the thing that is really impacting the stumpage rates in British Columbia today

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April 27, 2017 — 10:30 a.m. E.T.

Canfor Corporation Canfor and Canfor Pulp First Quarter Analyst Call

is, more than anything else, is just the extreme competition for fibre and on a dwindling fibre supply. So although we would expect that ultimately, the impact of the duties will be reconciled in BC, we still anticipate upward pressure on log costs—about 3 percent to 5 percent through the balance of the year.

Hamir Patel

Great. Thanks. That's helpful. And just a final question I had for Don. Could you maybe speak to the Company's appetite for larger scale M&A, now that you have certainty on at least the countervailing portion of the duties?

Don Kayne

Yeah. I guess, though when you say larger scale, I'm not sure what that means. But just overall, Hamir, I mean, I think that, certainly we've got an appetite for M&A of course, we always have. It's just one of several priorities. And I'll maybe just say real briefly—just speak about the kind of—how we look at capital allocation—which hasn't really, frankly changed that much. But I maybe would say that—just to give you a bit of context, Hamir—is that, our number one: we made some significant progress on improving our balance sheet in the last couple years. And that was our focus, and I think we're certainly in an area now that we're glad we are, with all the uncertainties that are going on everywhere. And so we're in—I think we're in very, very good shape there.

Going forward, though, clearly we're going to be balancing off and looking at these—we believe—some pretty significant opportunities for organic growth within the Company. And we're

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Canfor Corporation Canfor and Canfor Pulp First Quarter Analyst Call

targeting ourselves of around 200 million board feet through now and somewhere in 2018. And even beyond that, we see another couple of hundred million, potentially, that—just organically—we see amongst our own operations.

We're also, and Alan may talk about it a bit later, but talking about certainly ranking in there or qualifying in there are share buybacks. And then lastly, M&A. And so M&A clearly now, with the valuations and so forth—we're closely watching that, but clearly we're—we want to continue to grow in the South as we've said many, many times and we still do. And so we're just evaluating all those opportunities that may come up on an individual basis, so.

Hamir Patel

Right. And, Don, would Canfor be open to other areas of the wood product spectrum? Like I know you tried OSB several years ago. You got out of that. But arguably, that market is structurally different now than it was when you exited, and your platform in the South is a lot bigger now than it was when you had exited.

Don Kayne

Yeah. I mean speaking, Hamir, specifically about OSB, I think we'll leave that to others that are—got a lot of expertise in that. There's some—there's been lots of consolidation taking place there, and so I don't see ourselves getting into OSB again at all, or panels for that matter, at all, period. A way we would look at it is, where else, in addition perhaps even to Southern Yellow Pine, that may

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make sense globally that we may be interested in. But for the most part it'll be wood products or forest products oriented between pulp and paper, energy, and solid wood.

Hamir Patel

Thanks, Don. That's all I had. I'll turn it over.

Don Kayne

All right.

Operator

Thank you. There are no further questions at this time. I will now turn the call back over to Mr. Kayne.

Don Kayne

All right. Thanks, Operator, and thanks, everyone, for participating on the call this morning, and we look forward to talking to you at the end of quarter two. Thanks very much.

Operator

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

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