

FINAL TRANSCRIPT

Canfor Corporation

Third Quarter Results

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PRESENTATION**Operator**

Good morning, ladies and gentlemen. Welcome to the Canfor and Canfor Pulp Third 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, everyone. And thank you for joining the Canfor and Canfor Pulp Q3 2015 Results Conference Call. I will speak briefly to the results of both companies before I turn things over to Alan Nicholl, who is the Chief Financial Officer for both Canfor Corporation and Canfor Pulp Products Incorporated. Alan will provide a more detailed overview of our performance in Q3, after which we will take some questions.

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On the line with me today to address your questions are Brett Robinson, President of Canfor Pulp; Wayne Guthrie, our Senior Vice President of Sales and Marketing for Canfor; Stephen Mackie, our Senior Vice President of Wood Products Operations Canada; and Peter Hart, our VP of Pulp Sales Marketing.

Canfor reported shareholder net income after onetime items of \$6 million or \$0.05 a share. On a similar basis, Canfor Pulp reported net income of \$35 million or \$0.50 a share, again after onetime items. Over the quarter, we announced the permanent closure of our Canal Flats Sawmill due to a lack of long-term economic fibre supply. The mill's last day of operation will be early next month, and we are focused on placing employees at other Canfor divisions and safely winding down the operations.

In regards to Canfor Pulp, there was a modest increase in NBSK pulp shipments compared to the last quarter owing to fewer maintenance outages and improved mill productivity, including a Kraft mill setting a new monthly production record in August. Global list prices were down in the quarter, but these were outweighed by the weaker Canadian dollar.

Lumber markets continued to face challenges in Q3, with our Lumber segment reporting a small operating loss of \$1 million after onetime items. Prices are starting to recover, as expected, and we've seen positive appreciation, particularly in both yellow pine and SPF price levels.

China volume experienced a slowdown in September and October, particularly low grade; however, high grades were more solid.

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During the third quarter, Canfor announced the acquisition of Anthony Forest Products, which operates six facilities, producing lumber, engineered wood products, wood chips with a combined capacity of approximately 250 million board feet. This reflects a continuation of our strategy to grow our operations in strong, sustainable, high quality fibre regions.

With those introductory remarks, I will now turn the call over to Alan Nicholl to provide more details on Canfor and Canfor Pulp's financial results for the quarter.

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

Thank you, Don, and good morning to everyone. My comments this morning will focus principally on our financial performance for the third quarter of 2015 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 yesterday. And 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 third quarter of 2015, Canfor reported a shareholder net loss of \$17 million or \$0.13 a share, down from net income of \$11 million or \$0.08 a share reported for the second quarter, and down from \$46 million or \$0.34 a share reported for the third quarter of 2014.

On Slide 3 of our presentation, we highlight various non-operating items, net of tax, and non-controlling interest, which affect the comparability of our results between the quarters. In the

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third quarter of 2015, negative market-to-market adjustments on derivative instruments had an impact of approximately \$9 million or \$0.07 a share, and onetime costs related to the announced permanent closure of the Canal Flats Sawmill had an impact of \$14 million or \$0.11 a share.

After taking an account of these adjustments, the third quarter adjusted shareholder net income was \$6 million or \$0.05 a share compared to a similarly adjusted net loss of \$2 million or \$0.02 a share for the second quarter of 2015.

You'll note on Slide 4 of our presentation that Canfor's third quarter operating income was \$9 million, which represented a decrease of 9 million from the previous quarter.

Operating income in the third quarter include onetime costs of \$19 million for the aforementioned Canal Flats closure. Excluding this provision, operating income was up \$10 million versus the second quarter, largely reflecting improved Pulp and Paper segment results, which more than offset a decline in the Company's Lumber segment earnings.

Results for the Lumber segment are highlighted on Slide 5 of our presentation. After adjusting for the Canal Flats closure provision as well as an inventory evaluation adjustment of \$6 million, the Lumber segment recorded a small operating loss of \$1 million, down from operating income of \$5 million reported for the previous quarter. The decrease primarily reflected lower US dollar southern yellow pine lumber sales realizations.

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Western SPF bench mark prices were generally in line with the second quarter reflecting a 6 percent weaker Canadian dollar, which offset weaker low-grade prices and to a lesser extent, higher average export taxes over the quarter.

Total lumber production was down by 3 percent from the previous quarter, with productivity gains partly offsetting the impact of additional staff holidays in Canada and shift configuration changes at certain western SPF operations.

Overall, unit manufacturing costs were lower than the previous quarter with the productivity improvements and seasonally lower energy costs positively impacting operating costs in the third quarter. Lumber shipments were down 2 percent quarter over quarter.

Canfor's Pulp and Paper segment comprises the results of Canfor Pulp Products Inc. As you will see on Slide 6 of our presentation, Canfor Pulp reported net income of \$31 million or \$0.45 a share compared to net income of \$15 million or \$0.25 a share for the second quarter, a net income of \$24 million or \$0.34 a share for the third quarter of 2014.

Canfor Pulp's third quarter net income, after taking account of losses on financial derivatives, was \$35 million or \$0.50 a share, and this represented a \$22 million or \$0.32 a share increase from adjusted net income of \$13 million or \$0.18 a share for the second quarter.

As you'll see on Slide 7, Canfor Pulp's results reflected fewer maintenance outages and improved productivity as well as a modest increase in NBSK pulp sales realizations that reflected the

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6 percent weaker Canadian dollar, which outweighed a small decrease in US dollar list prices. And as Don noted, the Kraft pulp mill set a new monthly production record in August.

The weaker Canadian dollar also had a positive impact on the paper operation results, which also benefitted from a 12 percent increase in production, as the paper mill returned to more normalized production levels following its own scheduled maintenance outage in the second quarter.

Capital spending in the third quarter totalled \$61 million, of which \$43 million was for the Lumber business and \$15 million for Canfor Pulp. 2015 total capital spend is currently projected to be around \$170 million for Canfor and \$60 million for Canfor Pulp.

During the third quarter, Canfor announced the acquisition of Anthony Forest Products for a purchase price of US\$93.5 million, including approximately \$15 million of working capital. The transaction is scheduled to close in the next week.

Around quarter-end, Canfor also completed several financings and refinancings, including the issuance of a new US\$100 million nine-year term loan with Prudential Capital and a new US\$100 million eight-year term loan commitment. These financings both strengthen our liquidity and support our growth in the US South.

During the third quarter, Canfor Pulp paid a special dividend of \$1.125 per share as well as a quarterly dividend of \$0.0625 per share, resulting in total distributions to Canfor Pulp shareholders of \$83 million. Also during the third quarter, Canfor Pulp repurchased approximately 557,000 of its common shares at an average price of \$12.38 per share for a total of \$7 million. And yesterday, the

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Canfor Pulp Board announced the continuation of its \$0.0625 dividend payment per share for the quarter.

At the end of Q3, Canfor, excluding Canfor Pulp, had net debt of \$260 million with available liquidity of 149 million before taking account of the aforementioned US dollar financings.

Canfor Pulp had net debt of \$33 million with available liquidity of 117 million. Net debt to total capitalization, excluding Canfor Pulp, was 16 percent; for Canfor Pulp it was 7 percent; and on a consolidated basis, it was 15 percent.

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

Don Kayne

All right. Thanks very much, Alan. So, Operator, we'll now go ahead and 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 then press *, 1. If at any time you wish to cancel your question, please press *, 2. Please press *, 1 now if you have a question. There will be a brief pause while participants register for questions. Thank you for your patience.

Your first question comes from Sean Steuart of TD Securities. Please go ahead.

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Sean Steuart — TD Securities

Thanks. Good morning, everyone. Couple of questions on capital allocation with respect to both companies, I guess starting with Canfor Corp. On a pro forma basis for the Anthony Forest Products acquisition and backing out Canfor Pulp, I would get your pro forma net debt to cap up around 30 percent, maybe a little bit higher. I guess just general thoughts on comfort with leverage at the Canfor Corp. level and your thoughts on additional room for incremental sawmill acquisitions from here.

Alan Nicholl

Yeah. Good morning, Sean. So to your point on our pro forma debt, we come out actually with a slightly lower number than I think you mention on a pro forma basis, but I think the point you highlight is around our comfort on slightly higher debt to cap.

What I would say to you is that we remain very disciplined and very keen to stay with a very conservative balance sheet and are very keen to make sure that we preserve that. So we're looking into that very closely, and we're not concerned at all with this purchase and where it takes us. And as we look out, actually, we see lots of room for further strengthening of our balance sheet without jeopardizing our strategy and our key priorities.

Sean Steuart

Okay. And then on the Canfor Pulp level, notwithstanding I guess you're going to have more downtime near term and that could pressure your cost structure, but we would see a transition back

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to net cash at some point next year. Maybe just the bias for returning capital to shareholders, your thoughts on that. You've been busy on the buyback, but beyond that, maybe talk about, I guess, your thinking behind special dividends, which was your route you took in Q3, and how you'd weigh that against something like a Dutch auction in terms of returning capital to shareholders.

Don Kayne

Alan, why don't you go ahead and talk about that.

Alan Nicholl

No. Sure. For sure, Sean. So to try and answer the various questions you've put forward; so I think just as a refresh, we did pay a total of \$83 million, I think, in terms of total dividends, including that special dividend, and it is important to emphasize that that was a onetime, kind of, special dividend and was intentionally communicated as such. And also it reflected the absence of attractive acquisition opportunities as well. So it was made after careful thought by the Board. And so we believe it was well received, and we've heard very good feedback from our shareholder base with that in mind.

To your point around our cash generally, for sure we're benefitting from strong operating performance and a strong balance sheet. We are mindful that there does appear to be a little bit of weakness in pulp markets, but notwithstanding, we still expect to have a fairly solid performance over the next couple of quarters.

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We're very keen to pursue—keep that top quartile margin focus, Sean. We do like the share buyback and the baseline dividend hybrid if you like, and as you will have noted, we spent about \$7 million on share buybacks in the quarter. We're keeping that going as well. So right now we're feeling pretty comfortable with that we've got the balance right, but for sure we need to revisit this periodically, and we do so with the Board.

Sean Steuart

Okay. That's all I have for now. I'll get back in the queue. Thanks.

Operator

Thank you. Ladies and gentlemen, as a reminder, should you have any questions, please press *, 1 on your phone. Thank you.

Your next question is from Paul Quinn, RBC Capital Markets. Please go ahead.

Paul Quinn — RBC Capital Markets

Yeah, maybe you could—sorry. Good morning, guys. Just a couple of quick questions; one on Anthony Forest Products. Maybe you could just go through the mills that they've got. It looks like there's two sawmills, two engineered wood plants, two chip plants. Have I got that right?

Don Kayne

Yeah; one sawmill, two engineered wood plants, Paul, and two chip plants.

Paul Quinn

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Okay. So you've got the 150 million at Urbana. Where's the extra 100 million of lumber capacity coming from?

Don Kayne

That's coming from Urbana, in Arkansas, and then I also didn't add there we've got a joint venture in terms of an I-joist plant too up in Ontario with EACOM.

Paul Quinn

Okay. So I'm still confused because you're got combined capacity at 250 million equivalent, but then you're talking about Urbana at 150. So the delta is 100. Where is that?

Don Kayne

That's combined with the two engineered wood products plants and the OSB plant adjusted into FBM because those products are cubic metres. The two engineered wood plants and the I-joist plant combined are 100 million.

Paul Quinn

Oh, okay. I got it. I got it. Okay. And no OSB. Okay.

And then just looking at the lumber operations given the net loss in the quarter, and it looks like that would be given—most of that would be in the US South. Why didn't you take any associated downtime in the quarter?

Don Kayne

In the south, Paul?

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Paul Quinn

Yes.

Don Kayne

Primarily I guess, I mean, everybody does things for different reasons. We've had a—in terms of no doubt the prices have come down there, but from our standpoint the mills that we have operating down there are making a sufficient margin that we didn't feel it was justified whatsoever.

Paul Quinn

Okay. And then just turning to the expiry of the softwood lumber; it seems like market prices have come up, i.e. this wall of wood hasn't really materialized; not that many expected it except for a few traders, but what's happening in terms of current negotiations, and what's your outlook on that file?

Don Kayne

In terms of softwood lumber file, I mean clearly we were working towards an extension as you're aware, but I think part of the issue there was, of course, with the Canadian election coming up. And that caused some problems and probably was the main reason for not being able to get that done. I think going forward, we're fairly positive that we, over the next probably three to six months, there'll be some negotiations definitely underway after the election and the new Cabinet's introduced on November 4th.

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We would expect that that would start to begin fairly soon. I think there is some motivation and some feelings from both sides I think that we would like to see a deal certainly during the stand still period. So we remain somewhat optimistic there, but time will tell.

Paul Quinn

I know it's early days in terms of the Liberal government, but do you see any change in philosophy with respect to the SLA file on that change?

Don Kayne

I don't think so. I think that whether it's the Conservatives or the Liberals, I think they both have a fairly good recognition, at least from what I've heard and we've heard, that they're keen to recognize that we need to get a deal done and get some certainty in markets and whatnot going forward. So we don't see it having any negative implications whatsoever.

Paul Quinn

Okay. And then just lastly, you know we were expecting actually really strong pulp results last quarter. That didn't happen, but they sure came through this quarter. Can you talk to the productivity improvements at your mill system? And do you expect that to be ongoing at this level?

Don Kayne

Sure, Paul. Maybe I'll let Brett talk about that.

Brett Robinson — President, Canfor Pulp Products Incorporated, Canfor Corporation

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Yeah. Done a good job. We've put in place an initiative called AIM 88 (phon) over the last couple of years focused on reliability. The guys are doing a tremendous amount of effort into training, documentation, and building a strong approach to our maintenance outages as well as our area shutdowns. It's starting to show in reliability across the board as well as execution of our outages. So yeah. We feel pretty good about our results there; our productivity, and I think going forward, we should be able to continue to deliver that.

Paul Quinn

Great. That's all I had. Thanks a lot, guys. Thanks.

Operator

Thank you. Your next question is from Daryl Swetlishoff from Raymond James. Please go ahead.

Daryl Swetlishoff — Raymond James

Oh, thanks. Good morning, guys. Question for Wayne on just the low-grade lumber market. How long do you think that this discount to the benchmark persists? And what will be the mechanisms that will lead to low-grade pricing getting higher?

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

Good morning, Daryl. Well, who knows, right? It went a lot lower than any of us anticipated. It is going back as you can see. It's trending back towards normal. I think we're seeing a little bit of an

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uptick in our volume for the November and December bookings into China, so that will help. It's still not back to normal but trending back towards normal.

The US absorption of the low grade, and you can see what's happened with the prices in the last four weeks, has been a lot better than we anticipated. So I think business there might have been a bit better than we anticipated. So that's helped. So I guess we got Chinese New Year. We got winter. So it's not going to happen overnight, but I would think in the next quarter or two we'll see it trend back towards normal.

Daryl Swetlishoff

Okay. That's helpful. And Don, just as you look out over the next couple of years, you've been concentrating, it appears, more in the US South for growth opportunities. Ultimately, I mean assuming that you can find the right assets, what sort of proportion of the US South production would Canfor liked to have in fullness of time?

Don Kayne

Thanks, Daryl. I think probably over the next five-year period, I mean clearly you know we like being down in the South. We see the opportunity there to probably increase from where we are. In terms of how much that will be in terms of order of magnitude, I think that's a bit dynamic now. But we wouldn't be unhappy to see another 5 to 10 percent growth down there over time. But clearly it just depends on what—we're more interested in the quality of the growth than we are just growing of course, and we've also got some equivalent opportunities, we think, down the road in terms of BC

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as well. So just overall, I think that probably in the neighbourhood of 5 to 10 percent wouldn't be out of the question in longer term, but it's more around the quality of the growth and the growth.

Daryl Swetlishoff

Okay. Thanks for that.

Operator

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

Don Kayne

Thanks, Operator, and appreciate everybody participating on our call for Q3, and look forward to talking to you next quarter. Thank you.

Operator

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

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