

## CORPORATE PARTICIPANTS

### **Don Kayne**

*President & Chief Executive Officer*

### **Alan Nicholl**

*Chief Financial Officer*

## CONFERENCE CALL PARTICIPANTS

### **Daryl Swetlishoff**

*Raymond James*

### **Mark Kennedy**

*CIBC World Markets*

## PRESENTATION

### **Operator**

Good morning, ladies and gentlemen. Welcome to the Canfor Corporation Second Quarter Results 2012 Conference Call. A recording of the call and a transcript will be available on the Canfor website. During this call Canfor's Chief Financial Officer will be referring to a slide presentation that is available in the Investor Relations section of their website. Also the Company would like to point out that this call will include forward-looking statements, so please refer to the key press release for the associated risks of such statements.

I would now like to turn the meeting over to Mr. Don Kayne, President and CEO of Canfor Corporation. Please go ahead Mr. Kayne.

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### **Don Kayne, President & Chief Executive Officer**

Thank you, operator. Good morning, everyone, and welcome to Canfor's conference call to discuss the Company's second quarter results for 2012. I will speak briefly about our Q2 highlights before passing the discussion to our CFO, Alan Nicholl, to discuss our financial results. Wayne Guthrie, our Senior Vice President of Sales and Marketing and Tom Lewis, our Vice President of Woodlands, are available today as well to answer any questions you may have related to their responsibility areas.

We are seeing some strengthening in the lumber segment with strong global markets supporting some higher price levels. Housing starts in the US are

continuing to rise at a modest but steady pace and Canadian starts are up 12 percent over quarter one. Both these markets have helped to generate some positive, upward movement on North American lumber prices over the quarter. Lumber shipments were up 18 percent over quarter one reflecting volume additions from our recently acquired Canal Flats and Elko mills and continued productivity improvements from our capital investment program. Our targeted capital expenditures and strong focus on continuous improvement are generating steady gains in productivity and reductions in conversion costs at our lumber operations.

We were also encouraged earlier this month with The London Court of International Arbitration ruling in favor of Canada and British Columbia with respect to the United States claim that Grade 4 log pricing in BC breached the Softwood Lumber Agreement. Although a growing share of our production is now marketed in Asia and the Middle East, the US market will always remain significant for us. We remain committed to the Softwood Lumber Agreement and its dispute settling mechanisms as well as to our US customers.

We initiated capital improvements during the quarter at our Radium Hot Springs and Canal Flats operations in British Columbia. A \$39.5 million capital upgrade project is underway at Radium, which includes significant sawmill upgrades, a new planer, and a biomass energy system that will heat our lumber dry kilns. At Canal Flats we are in the process of implementing kiln improvements and a cut-to-length conversion in the saw mill. We also continue to evaluate strategic capital investment opportunities at our Elko sawmill near Cranbrook.

Overall, Q2 showed steadily improving operating performance and market conditions for lumber and panels. While persistent challenges in Europe continue to create some global economic uncertainty, we are cautiously optimistic in light of the gradual increase we see in North American construction activity and the continued growth taking place in Asia.

I will now turn things over to Canfor's Chief Financial Officer, Alan Nicholl, to provide more details concerning our Q2 financials.

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### **Alan Nicholl, Chief Financial Officer**

Thanks, Don, and good morning, everyone. My comments will be principally focused on our financial performance for the second quarter of 2012 by reference to the previous quarter and in my comments I will be referring to our second quarter overview slide presentation, which you will find on our website in the

Investor Relations section under Webcasts. Full details and amounts are contained in our news release that was issued yesterday.

For the second quarter of 2012 we reported an equity shareholder net income of \$5 million or \$0.03 per share. This compares favorably to a shareholder net loss of \$16 million or \$0.11 per share for the first quarter of 2012 and shareholder net income of \$2 million or \$0.01 per share for the second quarter of 2011.

On slide three of the presentation we highlighted various non-operating items net of tax and non-controlling interests, which affects variability of the results between the first and second quarters. The net negative impact of these items in the second quarter was approximately \$7 million or \$0.05 a share and related to both foreign exchange losses on long-term debt as well as losses on various financial derivatives. After taking account of these non-operating items the second quarter adjusted net income was \$11 million or \$0.08 a share. This compares to similarly-adjusted net loss of \$22 million or \$0.16 a share for the first quarter of 2012, an improvement of \$33 million or \$0.24 per share.

With respect to our second quarter operating performance you'll see on slide four of our presentation that reported operating income was \$26 million, an increase of \$48 million from the prior quarter. Excluding quarter-over-quarter inventory value adjustments the adjusted operating income for the second quarter was \$19 million compared to negative \$26 million in the first quarter. That was up \$45 million. For the most part this reflected, ah, the increase reflected stronger solid wood markets and higher lumber shipment volumes. I will speak more on our operating performance in a few minutes when I discuss the individual segment performances.

Slide five shows us the Western SPF benchmark lumber prices for 2x4, #2&Btr, and US housing starts. As you will see, the US lumber demand continued to slowly improve as historically low mortgage risk and a gradual strengthening in housing markets resulted in improved prices for the second quarter. Total US housing starts averaged 739,000 units in Q2, a 3 percent increase from the previous quarter. The June seasonally adjusted US housing starts number of 760,000 was the highest in almost four years.

Turning to slide six, you will note that the lumber segment reported operating income of \$19 million in the second quarter of 2012 and that represented an increase of \$39 million from the prior quarter. After adjusting for unusual items, operating income for the lumber segment was \$16 million in the second quarter, a \$44 million improvement

from Q1. The improvement in the second quarter's results largely reflected improved sales realizations in both North American and offshore markets and a higher proportion of higher-value grade lumber in part from the recently acquired Kootenay, BC sawmills. In addition, shipments were higher by 16 percent, for the most part reflecting the additional production from those same sawmills as well as continued productivity improvements from our recently completed capital projects. Overall, production was up 10 percent from the previous quarter.

Turning to the pulp and paper segment on slide seven you will see that the second quarter operating income was \$12 million, substantially unchanged from the first quarter. North American US dollar NBSK list pulp prices up US\$30 from the previous quarter and average to around US\$900 per tonne in the second quarter; however, pulp production during Q2 was significantly impacted by both scheduled maintenance outages and an on-schedule shutdown at Canfor Pulp's Northwood pulp mill, which reduced production by a total 49,000 tonnes, an increase to unit manufacturing costs. More details of Canfor Pulp's results were discussed in their news release and conference call yesterday morning.

Capital spending in the second quarter to a total \$44 million, of which \$25 million was for the lumber business and the remainder of \$19 million of Canfor Pulp. Canfor Pulp has not completed its Green Transformation Program spending and expects to collect its remaining \$11 million receivable from the program during the third quarter.

At the end of the second quarter, Canfor excluding Canfor Pulp had net debt of \$198 million with available liquidity of \$315 million. Net debt to total cap excluding Canfor Pulp was 15 percent and including Canfor Pulp it was closer to 19 percent.

As Don previously mentioned, the SLA case before the London Court of International Arbitration has been settled in Canada's favor. We had made no provision in our financial statements previously so no adjustment to our financials in Q3 will be necessary.

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

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**Don Kayne, President & Chief Executive Officer**

Thanks Alan. Operator, I would now like to open the call up for questions.

**QUESTION AND ANSWER SESSION**

**Operator**

Thank you, Mr. Kayne. We will now take questions from the analysts on the telephone lines. If you have a question, please press star one on your telephone keypad. If you are using a speakerphone, please lift the handset and then press star one. If at any time you wish to cancel your question, please press the pound key. Please press star one now if you have a question. There will be a brief pause while the participants register for questions. Thank you for your patience.

The first question is from Daryl Swetlishoff with Raymond James. Please go ahead.

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**Daryl Swetlishoff, Raymond James**

Thanks. Good morning, guys. Don, we are hearing reports of slowing in China obviously on the macro front but also with respect to building some of the social housing units that we've seen in the most recent five-year plan. What is Canfor seeing in terms of lumber demand of late?

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**Don Kayne, President & Chief Executive Officer**

Thanks, Daryl. I think overall we really haven't seen all that much change there at all. As a matter of fact, I think that we have experienced similar volumes in Q2 as we've seen in Q1 and going forward we don't see any significant difference at all. You know, as much as—and we haven't also seen any real difference in the social housing as well in terms of change, and even if there was any we are certainly seeing new opportunities are (evolving) as well at the same time that would more than compensate for that.

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**Daryl Swetlishoff, Raymond James**

In the event the top-line housing number in China does slow, what are the other end uses that you are pushing some lumber into that that could help offset some of that lost demand?

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**Don Kayne, President & Chief Executive Officer**

Probably the key area aside from the obvious ones, Daryl, that you are aware of in terms of forming, is more on the upper-end type markets such as remanufacturing that would end up primarily in the furniture industry or used in (joinery)-type products and that type of thing, some other R&R, repair and remodeling type products on interior applications for some of these housing projects,

those types of things. So probably largely more on remanufacturing side.

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**Daryl Swetlishoff, Raymond James**

Okay. Just on the Tembec Mills that you acquired, what sort of condition were they in, what sort of capital do you think they'll need over and above the normal amounts?

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**Don Kayne, President & Chief Executive Officer**

I think overall we are real, in a positive way, surprised that at how well the mills, ah, the shape that they were in for sure. You know, whether it would be from a quality standpoint of the fibre that's down there, we're certainly surprised at the level of quality there. I mean it is obviously an extremely good. In terms of the mills, there's going to be some capital needs there for sure. I mean they were no surprises in terms of the condition that we thought they were in, although there is, to get them up to the level of a lot of our mills we'd probably need a special capital there. So, as I mentioned in my comments, probably, ah, we've done some minor things in Canal Flats already and we're looking as well at Elko and what we may need to do there as well. But there will definitely be some capital needs or requirements at probably both those mills.

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**Daryl Swetlishoff, Raymond James**

Okay. Thanks very much. Good quarter.

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**Operator**

Thank you. The next question is from Mark Kennedy with CIBC World Markets. Please go ahead.

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**Mark Kennedy, CIBC World Markets**

Good morning. Yeah, just following up there, looking at your operations now in Southeast BC, can you give us any guidance that once you've completed all your work what you think your ultimate lumber production is going to be out of that region?

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**Don Kayne, President & Chief Executive Officer**

I think, just—down the road here I mean it's going to depend a little bit on when we finally determine what type of capital we'd like to put into there. Right now, with all

the three mills running, probably a safe bet is 150 to 200 per mill, you know, with the three mills that we have down there. That could go up a little bit depending on what we do with capital going forward to increase productivity.

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**Mark Kennedy, CIBC World Markets**

So it could to be as high as or even slightly better than 600 million board feet for that—?

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**Don Kayne, President & Chief Executive Officer**

Correct. Yeah, it's probably in that neighbourhood.

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**Mark Kennedy, CIBC World Markets**

Okay. And then just a question as you look here over the next couple of quarters on cost, where do you see the most pressure coming from? Maybe you can comment both on things like logs and freight and whatnot.

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**Don Kayne, President & Chief Executive Officer**

Yeah, I think on the log side, you know, there will probably be some minor pressure there. We see probably, you know, in Q3 probably go up a couple of bucks, something like that, that sort of level. The other area that we watch carefully and we're working hard to mitigate is transportation and we've had some excellent success there and we'll continue to push hard on that. Those are probably the two key areas.

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**Mark Kennedy, CIBC World Markets**

Okay, great. Thank you.

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**Operator**

Thank you. Once again, please press star one if you have any questions. There are no further questions registered at this time. I would now like to turn the meeting back over to Mr. Kayne.

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**Don Kayne, President & Chief Executive Officer**

Thank you, operator, and thanks to all of you for participating and I look forward to speaking with all of you again at the end of Q3. Thanks again.

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**Operator**

Thank you. The conference has now ended. Please disconnect your lines at this time. Thank you for your participation.

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