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Sean Steuart
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Paul Quinn
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Stephen Atkinson
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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the First Quarter Results Conference Call. I would now like to turn the meeting over to Mr. Don Kayne. Please go ahead, Mr. Don Kayne.

Don Kayne

Thanks, operator, and good morning, everybody. Thanks for joining the Canfor and Canfor Pulp first quarter results conference call.

I'll speak briefly to the results of both companies before I turn things over to Alan Nicholl, our Chief Financial Officer. Alan will provide a more detailed overview of our performance in Q1, after which we will take questions. With me today are Brett Robinson, President of Canfor Pulp; Wayne Guthrie, Senior Vice President of Marketing for Canfor; and Sean Curran, Vice President of Sales and Marketing for Canfor Pulp.

Canfor's net income for Q1 was $46 million, which is up from $28 million in Q4. The improvement over the quarter was largely the result of higher lumber and pulp sales realizations; however, our gains here were offset by some of the challenges we've faced in getting product to market.

The severe winter conditions faced across much of North America compromised our ability to move lumber over the rail network, which significantly restricted North American shipment volumes. At the same time, the 28-day trucker strike at the Vancouver port negatively impacted offshore shipments. We are looking forward to a return of normal transportation conditions in Q2 and a long-term labour solution at the Port of Vancouver.

Canfor Pulp posted net income in Q1 of $26 million, up from $14 million in Q4. The improvement is due to higher pulp sales realizations benefitting from the weaker Canadian dollar alongside higher margins and increased shipments to the United States.

Our Quesnel facility was permanently closed on March 17th and we completed the sale of our Daaquam facility on March 28th. After taking account of this, our overall lumber production capacity is 5.2 billion board feet. This reflects Canfor's commitment to divest non-core assets and focus on our major production regions and products.

Looking ahead, we expect to see improvement in the U.S. housing market, which was down in Q1, largely due to some unusually cold weather that impacted our deliveries. Shipments will be up as railcar availability improves and the backlog clears through Q2 and Q3. We are expecting some challenges in NBSK markets toward the end of Q2 though scheduled spring maintenance should offset some supply pressure.

So, with that, I will turn things over to Alan Nicholl to provide more details on our Q1 financials.

Alan Nicholl

Thanks, Don, and good morning, everyone. My comments this morning will focus principally on our financial performance for the first quarter of 2014 by reference to the previous quarter. Full details of our results are contained in the Canfor and Canfor pulp news releases, both of which were issued Tuesday.

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

For the first quarter of 2014 Canfor reported shareholder net income of $46 million or $0.33 a share, up from $28 million or $0.20 a share for the fourth quarter of 2013 and down from operating income of $62 million or $0.43 a share reported for the first quarter of 2013.

On slide three 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 first quarter of 2014 these items had a net negative impact of approximately $1 million or $0.01 a share. After taking account of these items, the first quarter adjusted shareholder net income was largely unchanged at $46 million or $0.34 a share and was broadly in line with our adjusted net income for the fourth quarter of 2013.

With respect to our first quarter operating performance you'll see on slide four of our presentation that our operating income was $84 million, an increase of $30 million from the previous quarter. After adjusting for one-time costs in the fourth quarter, most notably costs associated with the announced closure of our Quesnel sawmill, our operating income was up around $10 million compared to the fourth quarter, largely reflecting gains in lumber and pulp sales realizations, which both benefitted from a 5 percent weaker Canadian dollar. The gains were partly offset by a significantly lower lumber and pulp shipments due to the transportation challenges that Don touched on.

Results for the lumber segment are highlighted on slide six of our presentation. After adjusting for one-time items the current quarter's operating income for the lumber segment was down $2 million. This change largely reflected the 16 percent decrease in shipments and higher manufacturing cost, offset to a large degree by improved sales realizations boosted by the weaker Canadian dollar, and to a lesser extent the absence of export taxes in the current quarter. The increase in unit manufacturing cost for the most part reflected increased market stumpage, higher seasonal energy usage and pricing, as well as continued dust control efforts.

Overall production was also impacted by our Houston planer upgrade as well as the ramp-ups of Mackenzie and Darlington after their major sawmill upgrades. Lumber inventories at the end of the quarter were approximately 200 million board feet higher than anticipated due to the transportation challenges and the trucker strike. We expect this excess to be drawn down over the second and third quarters.

Canfor's pulp and paper segment principally comprises the results of Canfor Pulp Products Inc. As you can see on slide seven of our presentation, Canfor Pulp reported net income of $26 million or $0.36 a share compared to net income of $14 million or $0.20 a share for the fourth quarter and net income of $11 million or $0.15 a share for the first quarter of 2013.

Staying on slide seven, we've highlighted the common non-operating items net of tax which affect the comparability between the quarters. After taking accounting of these adjustments Canfor Pulp's first quarter adjusted net income was $27 million or $0.37 a share. This represented a $10 million or $0.13 a share increase from adjusted net income of $17 million or $0.24 a share for the fourth quarter of 2013.

You'll see from slide eight that increase in Canfor Pulp's results for the most part reflect the gains in NBSK pulp sales realizations, which more than offset the impact of a 19 percent reduction in shipments, mostly due to the transportation challenges discussed earlier. Average NBSK pulp list prices saw solid gains in all regions through the first quarter of 2014, reflecting both higher prices and the weaker Canadian dollar. At the same time, higher operating rates helped mitigate increased fibre and energy costs.

Canfor Pulp's paper segment earnings showed a modest improvement with higher sales realizations attributable principally to the weaker Canadian dollar, partially offset by higher unit manufacturing costs, which reflected market-related increases in cost for slush pulp. Similar to lumber, the pulp segment had finished product in excess of plan at the end of the quarter and again we expect this to be released into the market over the next two quarters.

Capital spending in the first quarter totalled $53 million, of which over $40 million was for the lumber business and $10 million in Canfor Pulp. We are currently projecting capital spending of $160 million for the year and we're now forecasting Canfor Pulp's capital spend to be slightly above $60 million.

During the first quarter Canfor repurchased 196,000 common shares under its renewed normal course issuer bid. Given the financial position of both companies, both Canfor and Canfor Pulp will be looking to continue to take advantage of opportunities to repurchase shares under both programs through the balance of the year.

Yesterday the Canfor Pulp Board announced a dividend payment of $0.0625 per share for the quarter. The increase from Q4 reflects stronger than expected results in Q1 and an improved outlook for Q2, in part reflecting the delay of new capacity, which is scheduled to come on early this year. As we previously mentioned, the Board reviews the dividend each quarter.

At the end of the quarter Canfor excluding Canfor Pulp had net debt of $209 million with available liquidity of $159 million. Canfor Pulp had net debt of $38 million with available liquidity of $113 million. Net debt to total capitalization excluding Canfor Pulp's 13 percent for Canfor Pulp of 8 percent and on a consolidated basis it was 13 percent.

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

Don Kayne

Okay. Thanks, Alan. So, operator, you can now open the lines up for questions.

QUESTION AND ANSWER SESSION

Operator

Thank you. We will now take questions from the telephone lines. We'll first take questions from the financial analysts. If you have a question, please press star one on your telephone keypad. If you are using a speakerphone, lift the handset and then press star one. If you would like to cancel your question, please press the pound sign. Please press star one if you have a question. There will be a brief pause while the participants register. Thank you for your patience. The first question is from Sean Steuart from TD Securities. Please go ahead.

Sean Steuart, TD Securities

Thanks. Good morning, everyone. A few questions. Can you give some context, the Northwood turbine upgrade, I guess there were some energy sales in the first quarter from that, can you give us an idea of how much that was?

Don Kayne

Brett, maybe you can take that one?

Brett Robinson

So the Northwood turbine came on, COD was January 29^{th} and we were not at full capacity but it was, let's call it, maybe half of what we would have expected if we had a full quarter.

Sean Steuart, TD Securities

Okay. All right, that helps. The Polar project you guys announced last night, can you just give us some context on that CapEx item, how long will the project take, any guidance you can give on expected returns there.

Don Kayne

Sure, Sean. It's Don. I think that, first of all, the capital that we're going to spend there is basically an upgrade at the sawmill that will include additional increases in some of the optimization capabilities there particularly. The other thing we'll be doing there is improving the building itself there. It's an old, old mill with an old building that we've had some issues with in the past so we're going to be upgrading that significantly as well, but the bulk of the spend will be on new technology and equipment related to the sawmill. In terms of timing, you know, it'll be hopefully completed towards the end of this year and early next year, and in terms of returns, it'll be the typical returns that we look for historically from the projects that we invest capital in, right? So that's about all I can say right now on that.

Sean Steuart, TD Securities

Okay. And then lastly for me, any context you can give on offshore lumber markets right now, a sense of what you guys are seeing for inventories in China and Japan. It looks like pricing has held up pretty well but your sense of I guess how much pent up volume has been built up at the port and how you expect demand to be in offshore markets the next couple quarters.

Don Kayne

Sure, Sean. I think on that, I'll turn that over to Wayne, because he's been over there extensively over the last few months here, so maybe, Wayne, you can give Sean an update there.

Wayne Guthrie

Sure. Thanks, Don. Sean, in China there is some, and it's been well documented, some heavy log inventories there that we're going to have to stick-handle around but the SPF inventory in general is quite light and so there'll be some competition from other species, as there always is in China, but we don't anticipate any impact on our volume into China here for Q2. We've pretty much got that put to bed. Q3 and Q4 look, again, stable, maybe a little bit better for Q3 and Q4. Japan is, you know, we had a record year in Japan last year ahead of the tax increase so it'll be a little bit softer this year. We're going to have to look at some different applications. We expect a little bit of a tougher market there in Japan but nothing serious, but it will be off a little bit from last year.

Sean Steuart, TD Securities

Has that started to show up yet, Wayne? I mean I guess the consumption tax started a month ago. Have you seen a reaction to this point in volumes?

Wayne Guthrie

Oh, I think we've been seeing it here for the last couple of quarters really in Japan and, you know, there's so much noise around the port strike that you'll see shipments to Japan likely go up here in the short term, but that's hangover from what couldn't ship in Q1.

Sean Steuart, TD Securities

Got it. Okay, that's all I had. Thanks, guys.

Don Kayne

Thanks, Sean.

Operator

Thank you. The next question is from Paul Quinn from RBC Capital Markets. Please go ahead.

Paul Quinn, RBC Capital Markets

Thanks very much. Good morning. A couple easy questions here. One, just following up on Sean's offshore comment, do you expect volumes into China to grow this year or is it going to be flat with 2013 or even down?

Don Kayne

Wayne, why don't you give Paul...?

Wayne Guthrie

We will be, in terms of Canfor, because we've closed Quesnel and that mill was 100 percent in China so it's going to, we'll be struggling to replace that. But what's going to China today will continue to go to China. Our customers want that and a little bit more. And we'll eventually replace that volume. It might take us a year or two but we'll eventually replace that volume with higher-grade products. Our fastest-growing component there is J grade and home centre type products and while that takes time to develop we'll replace the low grade with the high grade over time.

Paul Quinn, RBC Capital Markets

Okay, great. And then just turning to the domestic front, I mean prices seem to be hanging in here. Do you see that as a result of, and we haven't seen U.S. housing really pick up at all, do you see that as a result of transportation? And then on the transportation side, I mean you documented in your release that you expect to get through the inventory I guess by Q3. Do you see that changing, you know, if we go forward another year, i.e. is that transportation network ever going to get better in Q1?

Don Kayne

Yeah, maybe, Paul, just on that, first of all, North America, like you say, we're seeing it pretty flat there and it hasn't increased to the level that we probably thought it would, but aside from that and in terms of related directly to transportation, you know, we're working hard, I think not only Canfor, I think the industry as well, we're working hard on some solutions there that we can work with the railroads on, you know, both the CN, I guess, and the CP, who are the dominant carriers, as you know, in Canada. So we're taking the approach that there are some things that we need to be working on together to try to improve that for the long term as, you know. As all the companies in BC and the forest products inventory continue to expand and so forth we need outlets, obviously, from a transportation point of view. So that has been a challenge for sure but as a result of that I think we think there are some opportunities to work closer on some new areas, right? So that's what we're going to be doing here over the next while.

Paul Quinn, RBC Capital Markets

Okay. And then just on Canfor Pulp, I like the fact that you raised the dividend, but it's still a fraction of what the company is generating in cash; maybe you could share sort of your thoughts around dividend policy and respect to how you look at the share repurchase.

Don Kayne

Sure. Maybe, Alan, you can talk to Paul about that.

Alan Nicholl

Yeah. No, for sure. Good morning, Paul. You know, as we said on various occasions, our core objectives really are to maintain a very strong balance sheet in what I think we'd all acknowledge as a highly cyclical commodity business and being particularly cognizant that the potential impact from the significant new hardwood capacity may be fairly significant and what we're seeing today obviously is some delay in that but we fully expect that capacity to come on line fairly soon.

And secondly, as we said, a lot of our focus is around cementing our position as a top quartile global pulp producer and building a very strong energy business. So those are our key priorities. Thereafter, as cash flow permits, we're looking opportunistically at share repurchasing, as I mentioned, and also looking to pay a modest dividend through the cycle.

And so that's really where our heads are at. I mean it's a little bit of a hybrid approach, if you will, with share repurchasing and the dividend approach, but it's something that we're very comfortable now and at this point that's where our heads are at, Paul.

Paul Quinn, RBC Capital Markets

Okay. So, if I could summarize the dividend policy of Canfor Pulp, you're sort of taking a look at it through the cycle as to what you should be able to generate and it'd be a portion of that funds as to what you'd get that dividend up to and then the balance would be share repurchases if you have the cash.

Alan Nicholl

I might not play it back quite the way you said there. I mean I would say that at this point we're fairly confident that we can sustain the level of dividend for the foreseeable future maybe rather than the way you put it, Paul.

Paul Quinn, RBC Capital Markets

Okay. And then, just lastly, and I know you guys love to talk about this, but just, ah, you've seen a number of your competitors acquire a number of mills, just wondering what you're seeing in the M&A pipeline and whether you're active out there.

Don Kayne

For sure, Paul. You know, we're always looking for sure and, you know, we think there's definitely opportunities and there'll be more going forward. We're looking at those as they come up and, you know, as we think they're worthwhile we'll pursue them. And we're in no rush. We're doing it in a thoughtful organized way and we'll continue to do that. But clearly, as we've said many times, we like the south and our view is on a long-term basis continue to add production and add quality production, more importantly, in that area and also perhaps some other areas in Canada. So that continues to be our strategy and we just want to make sure that we get the right opportunity nailed down.

Paul Quinn, RBC Capital Markets

Great. Okay, thanks for that. Best of luck.

Operator

Thank you. Once again, if you are a financial analyst and would like to ask a question, please press star one.

The next question is from Stephen Atkinson from Dundee Capital Markets. Please go ahead.

Stephen Atkinson, Dundee Capital Markets

Thank you. Good morning. In terms of the turbines, like you've got another turbine at Intercontinental and I don't know whether you've announced how big they are in terms of megawatts, but if you have that would you be able to share it with us?

Brett Robinson

Yes, thank you. It's Brett here, President of Canfor Pulp, and with regards to the turbines, the Intercon mill is smaller than Northwood, almost half the size, so the turbine there would be more like seven megawatts coming into the grid. And we'll usually use an 85 percent supply rate to that number.

Stephen Atkinson, Dundee Capital Markets

Okay. And that one, I guess, is starting up in the third quarter?

Brett Robinson

No, no, that's Q1 2015 start, the end of the quarter, yes.

Stephen Atkinson, Dundee Capital Markets

Okay. Thanks a lot. In terms of the lumber projects, like I know you have a whole mass of them but, um, I guess you have Elko, Quesnel, (inaudible) and Houston. Are you happy with those projects or are you still optimizing?

Don Kayne

I think, yeah, certainly I am pleased with what we're doing there so far. I mean I think the big, you know, in particular at Houston and Mackenzie probably, I mean the ramp ups that we've are partly due to the weather we encountered in the first quarter and a few other things.

I mean the ramp-ups have been a bit longer than we would have expected and, as we mentioned I think yesterday in our conversation, but overall absolutely pleased with the projects. The ones that we're doing now are more focused on the sawmill side as opposed to the planer side, which we've been doing in the past and are completed, but overall, yeah, we're satisfied with the projects for sure.

Stephen Atkinson, Dundee Capital Markets

Okay. And aside from Polar are there any other major ones I've missed?

Don Kayne

Yeah, no, I think you've got them all between what I said and what you said.

Stephen Atkinson, Dundee Capital Markets

Okay. Thanks, Don. And for this quarter, any major maintenance? Like will there be, you know, especially on the pulp side?

Brett Robinson

Yes, it's Brett again. We do have the Intercon mill down for a normal annual outage. There's nothing really out of the ordinary there, as I say. And we will be going into a mini at the PG mill. Northwood has a shut as well in the fall. Again, there's nothing extraordinary there. Our big investments in our boilers are done and behind us so this is just normal maintenance.

Brett Robinson

That's great. Thanks very much.

Operator

Thank you. There are no further questions at this time. I would like to turn the meeting back over to Mr. Kayne.

Don Kayne

Okay. Thanks, operator, and thanks to everyone who participated this morning and look forward to chatting with you at the end of Q2. Thank you.

Operator

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