Canfor Corporation First Quarter 2009 Conference Call

Operator: Good morning ladies and gentleman. Welcome to the Canfor Corporation's first quarter results 2009 conference call. A recording of the call and a transcript will be available at Canfor's website. During this call Canfor's CEO and CFO will be referring to a slide presentation that is available in the investor relation 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 press release for the associated risk of such statement.

I would now like to turn the meeting over to Mr. Jim Shepard – President and CEO of Canfor Corporation. Please go ahead Mr. Shepard.

Jim Shepard – President and CEO: Thank you operator. Good morning everybody and welcome to Canfor's conference call to discuss the company's first quarter results for 2009. I am joined here today by Tom Sitar Canfor's Vice President of Finance and CFO. Don Kayne – Vice President of Marketing and Sales and Mark Feldinger – Vice President of Manufacturing. I will give a brief overview of the quarter and then Tom will speak to our financial results including providing some detail on the unusual item on the quarter.

The massive market meltdown continues to batter anyone producing a stick, a panel or a pound of pulp in the forestry sector. The World Bank recently reported that the global economy has shrunk for the first time since World War II. As you look at the daily news you can see for yourself how difficult economy has become. There is no safe haven from the turmoil that is testing the core strength of every forest company. I recently attended a CEO summit in Washington DC and heard from some of the top economist in the US. Several of which are advising the current president. By the time the gathering finished, it was obvious that no one could say when we would see a recovery. The only clear message we receive was to treat our business situation as it is in crisis. Canfor has been operating under this assumption for some time now. We are already two years in to this heavy going and while we have shown substantial operating statement losses. We continue to maintain a strong position with our balance sheet. We expect to maintain our positive cash position for the remainder of this year and early in to next year with no assumption of market recovery. We have been watching the market freefall closely and we are working to minimize the depletion of our cash which rolling shutdowns the curtail production. Just last week we announced that six more mills will take downtime to ensure that we are not building up inventory that and that we are matching our production to the demand of the market. We also notes that all of our Canadian mills will take summer shuts of one or two weeks.

As you no doubt aware a year ago, we started a concerted effort to reduce cost and conserve our cash position. We saw a tremendous success through our efforts. But let me assure you that our work is far from complete. Earlier this month I announced to all of our staff about the challenges that lay ahead and outline the new program that targets further cost reduction and reduction in working capital. We will be seeking additional cash savings moving forward. Capitalizing on the momentum we created through our original efforts.

I am confident that we will continue to benefit as we scour our operations for more savings and efficiency. This exercise will reduce our cash depletion to get us through this economic storm and we will make Canfor stronger in the longer term. In the meantime, management's approach of being open with employees, customer suppliers, contractors and analyst continue to bear results. We have managed to contain our cost in the face of curtailments that have us running at approximately 60% of our rated capacity, which is a significant attributor to our ability to minimize cash depletions as we stalled in to challenging markets.

It is no secret that Canfor's strength continues to be our deliberate market strategy that is focused on our highly valued channel and customers. This is the sector we believe will hold the most growth for us if the market does turn around. Our reference to diversify our markets. In particular off shore and Asia and in Canada continue to prove beneficial in light of the massive United States meltdown. Our highlight of our offshore market is China where our volumes have grown significantly over the last three years. China is also showing increasing promise for higher grades. We will continue to pursue growth in this country as it becomes more accustomed to the advantages that wood frame construction has in the way of seismic safety, energy efficiency, comfort and low carbon footprint. For more details of our financial results. I would now like to turn the call over to Tom Sitar…

Tom Sitar – Vice President Finance and Chief Financial Officer: Thank you Jim. My comments this morning will focus on our financial results for the first quarter of 2009 with special emphasis on those items that affect comparability with other quarters and those factors that contribute significantly to our results. I would draw your attention to our Q1 overview slide presentation on which you will find on our website in the investor relation section webcast. I will refer to it periodically.

Also know for a reference I will refer to all amounts rounded to the nearest million dollars. Canfor recorded the first quarter net loss of 59 million, this compared to a net loss of 230 million in the fourth quarter of 2008 and a loss of 85 million in the first quarter of 2008. Those results include a number of unusual items and on slide 4 of our presentation we have highlighted the current quarter's unusual items and I will detail them for you now.

Please note that the amount I referred to are on after tax basis. First, I a gain of $38 million or $0.27 per share from the sale of property on which our panel and fiber operation was formerly situated. Second, a loss of $12 million or $0.09 per share. Principally due to the decline of value of the Canadian dollar and lower natural gas prices and their marking to market impact on our derivative positions. Third, a loss of $9 million or $0.06 per share due to the effects of marking to market our US denominated debt and that is with US investment. Fourth, a gain of $7 million or $0.05 per share related to the change in provincial corporate tax rate. Finally, a loss of $4 million or $0.03 per share related to the restructuring cost at our indefinitely idled operations.

After taking account of these items the first quarter adjusted net loss is $78 million or $0.55 per share. This represents a $25 million decline from the fourth quarter and as you mentioned, results directly from the historically lower lumber prices and also the more recent fall off in stock markets. The history SPF lumber prices and the US housing starts are shown in graph on slide 5 of our presentation.

Turning to our operating performance and I am now at slide 6 of our presentation. Sales declines to $488 million down 17% from the prior quarter. The company reported negative EBITDA of $85 million, $54 million worth than for the previous quarter. After taking account of inventory devaluation and restructuring cost EBITDA was negative $48 million down from break even in the last quarter of 2008. Canfor pulp limited partnerships reduction in EBITDA quarter over quarter with $10 million of (indiscernible).

Now looking at our business segments in turn and I am slide 7 of our presentation. Lumber statement has a negative EBITDA of $69 million in the first quarter of 2009 compared to a negative EBITDA of $24 million in the previous quarter. Affecting comparability are restructuring severance and closure cost which were $1 million lower in Q1 and an inventory devaluation which was $9 million higher than in the previous quarter. Principally reflecting seasonal build up of logs and weaker prices.

When these items are adjusted out, there was a $37 million quarter over quarter deterioration in our EBITDA. This change was primarily driven by weak markets reflected in lower SPF and southern yellow pine prices and weaker residual chip prices. As well as the lumber export tax refund of $11 million recorded in the fourth quarter last year. More specifically the average price for the benchmark SPF 2x4 in Canadian dollar terms went from $230 per thousand to $193.

Our unit manufacturing costs were little changed quarter over quarter. Turning to panel, you will note that effective January 1st of this year we no longer report our panel business as a separate operating segment with the exception of Peace Valley OSB Limited partnership of which Canfor owns 50%. All panel operations are indefinitely idled.

Now turning to the pulp and paper segment and I am on slide 8 of our presentation. The fourth quarter results reported for the segment included Canfor's tail of pulp mill combined with Canfor Pulp Limited partnership. The first quarter EBITDA was negative 5 million and was down 14 million compared to the fourth quarter principally owing to lower pulp prices where NBSK list prices declined from $954 per tone to $838 on a Canadian dollar basis. This was the partially outfit by lower freight and fiber cost and higher production.

Results of Canfor Pulp Limited's partnership of which we own 50.2% were fully discussed in Canfor Pulp's income funds news release and their conference call earlier this week. Capital spending in the first quarter was $19 million which was comprised of $13 million for the solid wood business and $6 million for Canfor pulp. We have reviewed and scaled down our 2009 capital spending plans in light of our expectation of continued difficult market condition. We anticipate fully year capital spending of about $40 million on the solid wood side of the business. At the end of the first quarter Canfor excluding CPLT or Canfor pulp had cash of $155 million and unused lines of credit of approximately $415 million.

We made long-term debt repayments of USD 77 million on March 1st and further USD 60 million immediately after the quarter end on April 1st. Both of these payments were made from our cash reserves and no further debt repayments are required during 2009. During the first quarter there was a significant increase in working capital related to our usual winter logging. We expect this to be reduced over the next two quarters. The next debt to total capitalization at the end of March stood at 21% on a composited basis.

At the end of Q1, we had in place USD 300 million worth of foreign exchange collared contracts designed to protect the company against the Canadian dollars strengthened beyond CAN $0.98 to the US dollar. The contract extends to December 2009. They provide protection for more than half of our monthly cash flows from the solid wood side of the business.

The current exchange rate the topside of this collar is below the spot and so we will be limited in the benefit of the weaker Canadian dollar. With the unprecedented volatility of in the Canadian dollar it is impossible to estimate the final impact these options will have, and these contracts were put in place in the summer of 2008 and no new contracts have been added since that time.

Last week we settled our claim related to the fire at North Central Plywood with our insurer. The amount of the settlement is $65 million of which we have already received $30 million, we expect to receive the remainder of the settlement and net of the deductible in the second quarter. Jim, with that, I will turn the call back to you…

Jim Shepard – President and CEO: Thanks Tom. It is impossible to predict when the recovery will come. But given the production cuts that have come in the last year and in the current year. It is hard to imagine we would not see some positive pressure of lumbar prices as we approach 2010. If on the other hand this incredibly horrible market was to continue in to 2010, we have bank lines of credit of over $400 which will see us through to win the market as it turn.

I also want to take this opportunity to publicly thank all of our employees. I know that many of them are listening to this call. They listen, because they are engaged in what we are doing. They understand the challenges we face, and have seen the changes we have made in the last year and the effect that it had on making our business stronger. Their commitment is very much appreciated. Operator I would now like to ask that we take questions from the telephone lines.

Operator: Thank you. I will now take questions from the telephone lines. We will first take questions from the financial analyst followed by the media. (Operator instructions) Our first question is from Daryl Swetlishoff of Raymond James. Please go ahead.

Daryl Swetlishoff – Raymond James: Well thanks and good morning. Tom question for you, are there any test for example minimum EBITDA or net worth that could affect your availability on any of your operating lines?

Tom Sitar – Vice President Finance and Chief Financial Officer: We do not expect to be in our operating lines during 2009 and yes there are tests but we have not disclosed those things that they will not come in to play during the course of this year.

Daryl Swetlishoff – Raymond James: Question just on… you mentioned lumber capacity, what is Canfor's sense of the permanent reduction in North America and lumber capacity that occurred over this down turn. Is it 8, is it 9, is it 10 billion board feet, do you think it is permanently reduced?

Tom Sitar – Vice President Finance and Chief Financial Officer: If you take a look at overall in the North America, we would say that we are probably averaging overall running above 35% less below capacity overall as an industry, and know that some of that perhaps can and will come back as things turn around. But we still think there is a good probably 10% to 15% of that that would be permanently removed from the market overall.

Daryl Swetlishoff – Raymond James: That 10% to 15% of the 35 or 10% to 15% of the total?

Tom Sitar – Vice President Finance and Chief Financial Officer: Of the total.

Daryl Swetlishoff – Raymond James: Okay, thanks Tom.

Tom Sitar – Vice President Finance and Chief Financial Officer: Yes, no problem.

Jim Shepard – President and CEO: If you are thinking about the balance of supply versus demand. I think a more relevant factor is the allowable cuts that is going to be available for SPF fiber and that allowable cut has come down and will continue to come down. So quite frankly going in to the future there will be less lumber available for the market place just because of the less fiber.

Daryl Swetlishoff – Raymond James: Thanks I have nothing else.

Operator: Thank you. (Operator instruction) Our following question is from Paul Quinn from RBC Capital Market. Please go ahead.

Paul Quinn – RBC Capital Market: Thanks. Good morning guys. Jimmy described the market as incredibly horrible. Given this period and the cycle it seems like there is many assets for sale out there and your balance sheet is still very strong. Is that something that you guys have started to look at yet. Or we are still too early and you still want to see a recovery before you shift focus?

Jim Shepard – President and CEO: Well thanks. First of all, we do not normally disclose our plans for acquisitions or mergers or anything like that. But to give you a direct answer, I think it goes this way. We are actually focused on cash preservations, and we have cut back on our capital allowances, we are cutting back on inventories. So we are really hunker down to make sure that we maintain a cash positive position throughout this year and in to the first quarter. So I think that will give you a pretty good idea of our attitude towards acquisitions at the moment.

Paul Quinn – RBC Capital Market: Okay, so it does not sound that you are looking too hard. One of the issues that might pop up in the future and it is something that you raised. The decline in AC and BC near the mountain pine beetle. How do you see tackling that issue… or is that a 2010 sort of strategy as opposed to this year.

Jim Shepard – President and CEO: Mark Feldinger will give you an answer on that one Paul.

Mark Feldinger – Vice President of Manufacturing: Good morning Paul. I guess it is our sense that there will be an individual decline in AC in BC as it relates to the mountain pine beetle. Really that decline will be predicated along the lines of how long people utilize the product and based upon our projections that those fall downs will start approximately three years out from now and will continue potentially even as long as another decade beyond that. However, they are coming down and they will come down significantly as we deplete the dead pine.

Operator: Our following question is from David Elstone from Equity Research. Please go ahead.

David Elstone – Equity Research: Hello. I have a question on sales. Just curious to know if you could comment on the sort of the (indiscernible) impediment to sales with regard to customer credit issues or any comment on maybe on bad debt.

Don Kayne – Vice President of Marketing and Sales: I think up to now, so far, and we have been, of course that is a serious concern, we monitor that on a regular basis. But so far we are pretty confident with the customer base that we have, we are able to… for the most part avoid that. But clearly it is a concern for us, it is something that we are on a regular basis. But up to now it has not had any significant impact on us.

David Elstone – Equity Research: Okay. Switching back to the mountain pine beetle. Have you seen, I guess reduction in the quality of the product that you have been able to produce with regards to the beetle? Sort of a shifting in grade?

Mark Feldinger – Vice President of Manufacturing: Yes David, it's Mark here, so we have had some minor changes to our grade outturns and clearly the challenge of manufacturing this fiber has cost us to put in place very astringent quality control processes in the mill to ensure that we get the proper quality to our customers. I guess that would be a summary of the challenge we face.

David Elstone – Equity Research: Okay, great, thank you.

Operator: Thank you. There are no further question from the analyst. We will now take questions from the media. (Operator instruction) We have a follow up from Paul Quinn from RBC Capital Markets. Please go ahead.

Paul Quinn – RBC Capital Market: This is great, I can ask as many questions as I want. Just a question on obviously we got a collapse in the US market and it appears… our assessment is (indiscernible) but it still got ways to go. Have you shifted deliveries in to Asia and how big is that market for you right now?

Unidentified executive: Well that is definitely the strategy we have been working with for the last three years and have shown up with the increase in the volume that we are shipping to China. China really does represent a huge potential for us going in to the future and it is moving along much faster than even we expected, as a matter of fact this year at China in terms of volume will surpass Japan for us. We are up 25% from last year and what is really especially interesting about China is that initially it was taking low-grade, but is now starting to take SPF – to a better wood frame construction quality lumber, which is really the marketplace that we want to be in there.

Paul Quinn – RBC Capital Market: Just on relative profitability on size of (indiscernible) I guess right now on the lumber operations. Canada versus US if you could just give some sort of rough guidance on that, are they operating about the same?

Jim Shepard – President and CEO: We do not specifically break out components within the lumber segments, so Paul we would not go in to details on how we are doing in the US versus Canada.

Paul Quinn – RBC Capital Market: Okay, (indiscernible).

Operator: Thank you, there are no further questions registered. I would like to turn the meeting back over to Mr. Shepard.

Jim Shepard – President and CEO: Since there are no further questions, I would like to thank everyone for participating in the call this morning and for your interest in Canfor. We look forward to talking to you all again next quarter.