

CANFOR CORPORATION FIRST QUARTER 2011 CONFERENCE CALL

CORPORATE PARTICIPANTS

Don Kayne

President & Chief Executive Officer

Thomas Sitar

Vice-President Finance & Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Daryl Swetlishoff

Raymond James

Chris Damas

BCMI Research

Paul Quinn

RBC Capital Markets

Sean Steuart

TD Newcrest

Pierre Lacroix

Desjardins Securities

PRESENTATION

Operator

Good morning ladies and gentlemen. Welcome to the Canfor Corporation first quarter results 2011 conference call. A recording of the call and a transcript will be available on Canfor's 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 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.

Don Kayne, President & Chief Executive Officer

Thank you, operator, and good morning everybody and welcome to Canfor's conference call to discuss the Company's first quarter results for 2011.

As you may be aware, I only assumed the role of CEO yesterday. First of all, I would like to thank Jim Shepard for his leadership and guidance over the last four years. I hope to further expand many of the initiatives that he has led. I will be spending the next few weeks and months visiting our operations. Today, I will speak to the results of the first quarter with the assistance of Tom Sitar, our Chief Financial Officer, and Mark Feldinger, our Vice-President of Manufacturing, who are both with me today.

I will begin with the most significant event that occurred in the quarter, the earthquake and subsequent tsunami in Japan, and provide a quick update on the current impacts as we see them.

Canfor has an office in Japan and all of our employees there are fine. That said, the situation in Japan is still very difficult with hundreds of thousands of people affected. We are still getting our product into the country but with so much of the disaster still unfolding we are still trying to determine what the future will hold. With such a huge tragedy we wanted to focus on how we could help from a humanitarian standpoint as quickly as possible. We have so many customers and friends who simply need assistance quickly. Canfor and Canfor Pulp donated \$200,000 to the relief efforts with addition funds to follow as both companies will match additional employee donations. We were joined by other industry partners as well as British Columbia provincial government together donating \$1 million to the relief effort.

In China we continue to see increasing demand. Volumes in the first quarter of 2011 relative to the same quarter a year ago have increased significantly and we are currently on target for an overall annual increase in volume of 50 percent over last year. In the first quarter of this year, China represented approximately 27 percent of our SPF lumber shipments.

This market continues to be extremely important as our largest market, the United States, continues to struggle. Although we are starting to see a broader recovery in the U.S., lumber consumption still remains weak and is similar to last year so far. While housing numbers themselves are not improving necessarily, consumer confidence, unemployment, GDP growth all seem to be moving in the right direction, which gives us reason for some optimism going forward, although we are remaining cautious.

With respect to sales realizations, we have seen many of our lumber products destined for the U.S. market being subject to greater discounts than in previous years relative to the benchmark price. This applies to specific widths and lengths. Transportation was also a key issue and challenging at quarter due to extreme weather

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conditions which seriously impacted railcar supply. This caused inventory levels to increase more than we expected. We will be reducing those inventory levels during the second quarter. We believe weather may also have affected demand from a building perspective as takeaway in many parts of the United States do not meet our expectations. Despite this, we do feel there will be additional seasonal demand during Q2 and Q3.

I would like to now turn the call over to Tom Sitar to discuss Canfor's financial performance in the quarter.

Thomas Sitar, Vice-President Finance & Chief Financial Officer

Thank you, Don.

My comments will be focused on our financial results and those items that affect comparability with other quarters and those factors that contributed significantly to our results.

The Company is reporting for the first time its financial statements and results in accordance with International Financial Reporting Standards and comparative information has been restated accordingly. A full reconciliation of the closing balance sheet under the previous GAAP, generally accepted accounting principles, and the provisional opening balance sheet under IFRS, along with explanatory notes, is included in Note 14 of our financial statements.

During my comments I will refer to our first quarter overview slide presentation, which is on our website in the Investor Relations sections. Also note that for ease of reference I will refer to all dollar amounts rounded to the nearest million, except of course the per-share amount. Full details and exact numbers are shown in our news release.

The first quarter of 2011 shareholder net income, which includes just 50.2 percent share of earnings from Canfor Pulp Limited Partnership, was \$7 million or \$0.05 per share. This compares to a net income of \$31 million or \$0.22 per share for the fourth quarter of 2010 a net income of \$18 million or \$0.13 per share in the first quarter of 2010.

On slide three of our presentation we have highlighted the current quarter's non-operating items that affect comparability of results between the quarters and they are: a gain of \$3 million or \$0.02 per share due to the effect of translation of U.S. denominated debt net of investments as Canadian dollar strengthened more than \$0.02 compared to the prior quarter end; then a gain of

\$3 million or \$0.02 a share on derivative financial instruments from our hedging program covering lumber, diesel, natural gas, and foreign exchange; and, finally, a gain of \$1 million related to mark-to-market increase in the value of asset backed commercial paper, which have been written down in 2007. After taking account of these items the first quarter adjusted net income is \$0.1 million, \$100,000, essentially at breakeven position, compared to similarly adjusted net income of \$14 million or \$0.10 per share for the fourth quarter of 2010, a decrease of \$14 million.

Turning to our operating performance, and I'm on slide four of our presentation, total sales of \$624 million were \$5 million lower than the prior quarter as higher lumber segment revenues were more than offset by lower revenues in the pulp business. The Company generated EBITDA of \$73 million, a decrease of \$11 million from the prior quarter. If you remove the effect of inventory devaluations reflected in each quarter's results, EBITDA in the first quarter was \$76 million, a decrease of \$7 million from a similarly adjusted EBITDA in the fourth quarter of 2010.

Now looking at each business segment, and now I'm on slide five, slide five shows the history of U.S. housing starts and SPF benchmark price converted into Canadian dollars and shows the North American lumber market continued to reflect a struggling U.S. housing sector in the first quarter.

Now in the lumber segment, we had EBITDA of \$18 million in the first quarter of 2011 compared to EBITDA of \$22 million in the previous quarter. This result included minimal inventory devaluations in Q1 of 2011 compared to a \$1 million recovery in Q4. When these items are adjusted out, EBITDA in Q1 was \$18 million, which represented a \$3 million quarter-over-quarter decrease.

As Don previously mentioned, although the benchmark 2x4 price for western SPF and also southern yellow pine increased during the quarter, these price increases were not matched by price movements in North American markets across most other grades and widths and the benchmark price increases were also not reflective of the pricing in some of the offshore market. At the same time, price increases were offset by stronger Canadian dollar and the higher transportation costs due to rising fuel prices. The overall effect of this is that realizations only improved slightly, despite a large increase in the benchmark price relative to the fourth quarter of last year.

Our lumber unit manufacturing costs were down slightly from the previous quarter, as lower conversion costs were partially offset by higher log cost due to higher

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diesel cost and increased competition for purchased wood.

Now turning to our pulp and paper segment, I'm on the slide seven, the first quarter results reported for the pulp and paper segment include Canfor's Taylor Pulp mill together with Canfor Pulp Limited Partnership. The first quarter EBITDA was \$64 million, down \$2 million compared to the fourth quarter of 2010, due to lower shipments and a stronger Canadian dollar. On a U.S. dollar basis list prices were essentially unchanged relative to the prior quarter for NBSK. Details of results for Canfor Pulp Limited Partnership, of which we own 50.2 percent, were disclosed in Canfor Pulp Products Inc.'s conference call earlier this week.

In the first quarter our capital expenditures were \$49 million, of which \$26 million was in lumber business and \$23 million was in Canfor Pulp. For 2011 we are proceeding the capital spending, which we expect to be approximately \$140 million in the lumber business, of which \$120 million will be for improvement project in our sawmill and facilities.

At the end of the quarter, Canfor excluding Canfor Pulp had cash of \$122 million and non-used lines of credit of approximately \$346 million. Our net debt to total capitalization excluding Canfor Pulp was 4 percent and on a consolidated basis it was 7 percent.

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

Don Kayne, President & Chief Executive Officer

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

QUESTION AND ANSWER SESSION

Operator

Thank you. We will now take questions on the telephone lines. We will first take questions from the financial analysts followed by the media. 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 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 participants register for questions. We thank you for your patience.

Our first question is from Daryl Swetlishoff of Raymond James. Please go ahead.

Daryl Swetlishoff, Raymond James

Thanks very much. Good morning guys. Don, just a question on Asian lumber shipments: What are you seeing right now with respect to Asian, and specifically Chinese, demand for some of the better grades, the two and better, and how do you see that unfolding this year and next?

Don Kayne, President & Chief Executive Officer

Sure, Daryl. I guess we are seeing sales to China continuing very, very consistent throughout the quarter, both in quarter one and also forward sales through quarter two. We haven't seen really any change. It's been very consistent and remains very solid. In terms of the two and better portion, we also see that continuing to increase, and we would estimate now probably in the neighbourhood of 40 percent of our business now would be in the two and better or higher grades, Daryl.

Daryl Swetlishoff, Raymond James

That's interesting. So what would be the end uses currently in China for a two and better standard?

Don Kayne, President & Chief Executive Officer

Of course some of it, albeit probably a small amount still on the construction side, new home construction side, but a lot of that goes into the remanufacturing side and also for substrates for, either for furniture or for flooring or for door cores, or those types of items, as well as some of the repair and remodelling type products.

Daryl Swetlishoff, Raymond James

Okay. And what about wider widths? Is it strictly still mainly 2x4 or narrower or are you seeing some demand increase for the widers as well?

Don Kayne, President & Chief Executive Officer

We are. A good percentage of it is 2x4 and continues to be, although we are seeing solid demand as well for 2x6 and wider, particularly 2x6 and some 2x8. And, again, the wider the width the more opportunity there is for

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remanufacturing. So that will be the primary use for the wider widths.

Daryl Swetlishoff, Raymond James

Okay. And then just finally on Japan rebuilding potential, how do you see that incremental lumber demand developing and is there an opportunity for the western lumber, western BC lumber producers there?

Don Kayne, President & Chief Executive Officer

Yeah, on that, I mean right now we are still very much focused just on the humanitarian effort there. And we do believe that down the road there will be definitely some opportunities there for some of the rebuilding, but when that occurs and to the degree that it will is still ways off. We probably would estimate, Daryl, that that's probably, before we get a really good feeling on that, probably 12 months away. At this point in time we really haven't seen any change in our shipments to Japan, though I would make that comment. It's been pretty consistent.

Daryl Swetlishoff, Raymond James

Okay. Thanks very much guys. I will turn it over.

Operator

Thank you. The next question is from Chris Damas of BCMI Research. Please go ahead.

Chris Damas, BCMI Research

Yes, just a question on the EBITDA in the lumber sector. I would have expected it to be slightly up rather than slightly down. If your unit manufacturing cost were slightly down but we have much higher pricing on, ah, over the mills and a higher operating rate. So could you explain that a bit?

Thomas Sitar, Vice-President Finance & Chief Financial Officer

Well, on a quarter-to-quarter comparison there are a number of things that sit in, ah, especially on the cost side, that doesn't necessarily directly tie just to lumber volume. That lumber segment has other product costs in it such as log trades are there, there is unrealized

income, and in inventory we had higher inventory volumes. We have lumber that we purchased for resale. So there are a fair number of items like that flow into it, so especially on just the quarter to quarter sometimes difficult to make that comparison.

And also, I guess, prior quarter had some credits in it as well. So I guess you can call it noise but there is some distortion on the (readily) comparison quarter to quarter. But our unit manufacturing cost, if you look at it at the mill level, we're lower quarter to quarter.

Chris Damas, BCMI Research

And is that a total cost or cash cost?

Thomas Sitar, Vice-President Finance & Chief Financial Officer

That's cash cost. And the non-cash items, ah, not that different.

Chris Damas, BCMI Research

Great. And the second question if I may: There's constantly this problem of lower pricing for wide dimension and different grades; are those related to poor building season or what's going on there in the U.S.?

Don Kayne, President & Chief Executive Officer

Yeah, largely, Chris, it would be related to that. I mean clearly the wider widths are used mostly for new home construction, particularly in the higher grades, and so those are the items that have been impacted the most for sure. And that will probably continue at least until we see some sort of sustained rebound in the United States home building market.

Chris Damas, BCMI Research

Great. Thanks and good quarter.

Operator

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

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Paul Quinn, RBC Capital Markets

Yeah, thanks. Good morning guys. And welcome aboard, Don. Question on just operating rates. We've seen a material drop in U.S. dollar lumber prices, we've also see the rise in the Canadian dollar; do you expect to change your operating rates in Q2 and Q3?

Don Kayne, President & Chief Executive Officer

I think at this point—we are always looking at that but at this point we have nothing anticipated.

Paul Quinn, RBC Capital Markets

Okay. And then on just the pulp segment here, we saw Canfor Pulp report EBITDA up \$4 plus million, your segment is down, the only difference really is Taylor. I can't see Taylor having a \$6 million swing. What's in that number?

Thomas Sitar, Vice-President Finance & Chief Financial Officer

Well, Taylor did have poorer results quarter to quarter, but there is a bit of noise in there. Q4 had some one-time items; there were investment tax credits that were in there in the fourth quarter later to the entire pulp business. So it was a bit of the distortion that way. But there is no question the BCTMP pulp business (worse) quarter to quarter and so those are two are the things that make it up.

Paul Quinn, RBC Capital Markets

Okay. So what was the size of the investment tax credits in Q4 then?

Thomas Sitar, Vice-President Finance & Chief Financial Officer

Well, we're not specifically identifying it, but it did make up a portion of that difference.

Paul Quinn, RBC Capital Markets

Okay. Question on just the change to IFRS. We've seen other companies capitalize major maintenance; is that Canfor's policy as well? What's the overall effect on EBITDA in the quarter?

Thomas Sitar, Vice-President Finance & Chief Financial Officer

The effect of that is completely in Canfor Pulp and it is something that IFRS requires for anything that stretches over a year. I don't remember their number, it's in there, but it is completely in the pulp business. It doesn't affect the solid, ah, our lumber business at all. There is no change in accounting (for us on that).

Paul Quinn, RBC Capital Markets

Okay. And then just a clarity on the increase in number two and better volumes sold; is that a function of, ah, with respect to China, is that a function of them moving up market in lumber or is it just a function of higher shipment volumes and we sort of max it on low grade shipments?

Don Kayne, President & Chief Executive Officer

Definitely there is a bit of both, Paul. I mean and there is no question that we probably maxed it on low grade shipments. But what we are encouraged by and we're starting to see more and more of is just the recognition of SPF as a preferred specie in the country, and we worked hard on that as an industry, as you know, for several years here, and we are starting to see that. And it is escalating more quickly now and we're seeing it a lot more in some of the more specific remanufacturing opportunities, as well as new home construction to some degree as well now going forward. So it's a bit of both.

Paul Quinn, RBC Capital Markets

So I guess just following up on that, if there is any change there in Russian log export tax or additional Russian lumber shipments into China, do you feel that just your position with SPF lumber, that it will be the dominant and, ah, the growth in the market won't be as slow as one or the otherwise expect?

Don Kayne, President & Chief Executive Officer

I think I understand your question. I mean, regardless of what happens in Russia now I guess I would firmly

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believe that we have made some substantial gains there and we are recognized now as a reliable and a quality producer, from an industry point of view as well as Canfor, and so I wouldn't expect, regardless of what happens there, that we would suffer at all, and I'm still very optimistic that going forward, we are well established there and we should be able to capitalize even further going forward as the China market improves domestically.

Paul Quinn, RBC Capital Markets

Great, that's helpful. Thanks guys.

Operator

Thank you. once again, please press star one on your telephone keypad if you have a question.

The next question is from Sean Steuart of TD Newcrest. Please go ahead.

Sean Steuart, TD Newcrest

Good morning. Just a couple of questions. Don, wondering on the, I guess the discretionary CapEx of \$120 million for the sawmills this year, if you can go into a few specifics on certain projects beyond, I guess Fort St. John, which you've talked quite a bit about. Any there any other big-ticket projects within that \$120 million that you can provide some detail on?

Don Kayne, President & Chief Executive Officer

Sure, Sean. We've earmarked about \$62 million so far this year of a total of \$125 million that we are looking to possibly spend this year. Of the \$62 million, that's basically Vavenby, which we're going to be adding some (planer) optimization there, a grader-less system, and also a new (cantor) and increased sorting capacity, which should add about \$70 million additional feet on an annualized basis when it's complete towards the end of September. At Polar sawmill we are doing a complete (planer) rebuild there as well as some sorter work optimization, etcetera, and that should add about 60 million board feet on an annualized basis. And then at Plateau we're building an energy system there and a (hogger) so that we can remove the tier-two burner, and we will also have, it will be the same system as we currently have at Fort St. John and PG Saw, and that

should be completed sometime in the fall, towards November probably.

Sean Steuart, TD Newcrest

Okay, that's helpful detail. And then, Tom, just following up on one of the previous questions on the sawmill costs, you mentioned lower manufacturing costs offset by higher log costs this quarter; can you put an order of magnitude in terms of the sequential change there for both of those, just so we can refine the model a little bit better?

Thomas Sitar, Vice-President Finance & Chief Financial Officer

I am not sure that I can do it individually in the pieces but it did add up to a relatively, you know, a reasonably sizable cost of goods sold sort of variance quarter to quarter. You know, logs, unrealized inventory, wood purchased for resale, because we do buy product that we resell, um, I'm not sure I can come up with sort of a number that represents it, but it's a number of millions of dollars, more than ten anyway.

Sean Steuart, TD Newcrest

Okay. Thanks.

Operator

Thank you. The next question is from Pierre Lacroix of Desjardins Securities, please go ahead.

Pierre Lacroix, Desjardins Securities

Thank you very much. Just one question on China again on the pricing side. Wanted to get some kind of an update on how the pricing structure is going on there, especially with the growth of the number two and better that you are having there. Just want to have colour overall.

Don Kayne, President & Chief Executive Officer

Okay, Pierre. Basically in China, the returns there are very similar to what we would receive in the North America market, and actually into quarter two here probably would be a little bit better. So it continues to

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improve there as the two and better market grows in China.

Pierre Lacroix, Desjardins Securities

In terms of quarterly, monthly, and weekly pricing, how does it look like? What is the breakdown between the timing and the pricing?

Don Kayne, President & Chief Executive Officer

I would estimate it'd be about 50 percent of that business that we do there would be monthly and probably 25 percent quarterly, and then we also do, I guess the remainder, more on a two-week to three-week basis.

Pierre Lacroix, Desjardins Securities

Okay, good. Excellent. One last on China, Don: I don't know if you can or if you have any kind of information about the outlook for any kind of big milestones coming up on the, either on the policy side or structural side, to see even more demand coming from China using more wood in construction, so on and so forth. Just wanted to have some color on structurally what could happen in the next couple years that could boost even further the demand.

Don Kayne, President & Chief Executive Officer

Yes, that's a good question, Pierre, and I think that we expect, I guess the big change that's, ah, it's underway today and we see it in the next two to three, four years to be able to impact is the increase in domestic demand as this urbanization situation continues to increase, as you've no doubt heard, with the 25 million to 30 million people moving into urban areas, we see an increase in wealth as a result of that.

Employment is getting better there, wages are going up, and so we expect that as Chinese economy focuses more on the domestic demand that will have a very positive impact in addition to the exports that they typically relied on in the past. So we believe China going forward is going to continue to just get stronger, as many parts of Asia will, so we are very positive that would be a big structural change that will benefit our industry and Canfor.

Pierre Lacroix, Desjardins Securities

But anything specific related to the transaction industry using more wood or and should we look at anything coming up in terms of incentives by government to build more on wood?

Don Kayne, President & Chief Executive Officer

Yeah, I think along those lines, I mean the biggest change that you're seeing there is the focus on green building and the whole environmental push in terms of focus on carbon reduction, and that's very real. It's across the country. We see it on a regular basis.

And you are probably aware of the vice minister that has endorsed that as the country and he has been handling this whole green building initiative across the country. So as that takes hold clearly, with wood being such an environmentally-friendly product of choice, we would expect that we would be able to benefit from that quite a lot going forward.

Pierre Lacroix, Desjardins Securities

That's great. Thank you very much, Don.

Don Kayne, President & Chief Executive Officer

Okay. Thanks, Pierre.

Operator

Thank you. We have no further questions registered for this time. I would now like to turn the meeting back over to Mr. Kayne. Please go ahead.

Don Kayne, President & Chief Executive Officer

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

Operator

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