

Canfor Corporation Second Quarter 2009 Conference Call

Operator: Good morning ladies and gentleman. Welcome to the Canfor Corporation's second 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 Chief Executive Officer 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 second quarter results for 2009. I am joined here today by Tom Sitar Canfor's Vice President of Finance and CFO. And also 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 items on the quarter.

There's been talk in the last few weeks about an economic recovery. For instance the Bank of Canada is talking about the end of the recession. Some companies are posting acceptable quarterly profits. And today Canfor is in an awkward position, because we are reporting a profit as well, albeit a modest profit of 11 million dollars. But let's be clear, this is not an operating profit.

I wish I could stand up today and say we are once again operating in a profitable way and talk of the end of the financial crisis, but I can't. The fact is we have an accounting profit. Part of it is derived from a recovery of previous inventory accounting write-downs stemming from our seasonal build of log inventories. It is also a result of the stronger Canadian dollar which had a positive effect on our US dollar debt. I'll let Tom explain the accounting further in a moment.

I don't need to tell you about the low housing starts that have been plaguing our industry for some time. You are all aware of this. It was widely expected that housing starts would remain low going into the summer and this has largely borne itself out. But we are now concerned about adjustable rate mortgages coming up for renewal and the impending foreclosures is expected to increase the number of houses for sale. This will further delay the recovery in lumber prices. Also, the rising Canadian dollar, presents an additional challenge to any manufacturer and exporter.

Recently, we have made some very difficult decisions, including indefinitely closing three more of our mills. These closures will all be completed the first week of August. We are also in the midst of our summer curtailment schedule, and have increased the curtailment length for at least one operation in an effort to further remove product from the market. The effect of these curtailments has been significant. Canfor is now running at 50 percent of our lumber production capacity – that's 10 percent lower than last quarter. This statistic alone should be a good indication of where the market currently stands.

Still, amid all of this cutting, we are also looking for opportunities and have invested strategically in operations that present the right conditions to ensure viability today and prosperity tomorrow.

Just last week, I visited our Mackenzie operation, where we restarted that lumber mill after an indefinite closure that lasted more than a year. This mill is starting with one shift, though we hope to increase that to two shifts when it is operationally and economically viable.

Mackenzie is a prime example of how an engaged workforce can combat the economic downturn and turn a difficult situation into an opportunity. Its location near a quality fibre supply coupled with our employee's commitment to lower costs and higher quality created the opportunity for Mackenzie's restart. They are much more in control of their destiny now.

Mackenzie is a good example of Canfor's strategy to ensure we meet the needs of our highly-valued customers. It is in difficult times like this that companies can strengthen customer relationships by ensuring that quality and customer service are not sacrificed.

I also visited our Clear Lake operation south of Prince George last week. Employees there understand the economics of their mill and have approached management about improving those economics. These discussions led to a voluntary wage cut, which employees voted on and approved last week. These are people who are intimately aware of the hardships facing our industry and want to be part of the solution.

And they are not alone. They are following in the footsteps of all of the directors, all of our executive, all of our staff and many of our contractors and suppliers who have had direct reductions in their compensation. In other times and in other companies there have been instances where cost reduction campaigns have resulted in great disruptions, but that is not the case here at Canfor. As this economic storm increased in intensity we've seen our employees mobilize and they are driving our safety and productivity gains, cost reductions, improved product quality and customer service. The entire organization has a strong sense of purpose that is yielding good measurable improvement in all those areas we can control.

For more details of our financial results in the second quarter, 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 second quarter of 2009 with special emphasis on those items that affect comparability with other quarters and those factors that contributed significantly to our results.

I would draw your attention to our Q2 overview slide presentation which you will find on our website, in the Investor Relations section, Presentations tab. I will refer to it periodically. Also note that for ease of reference I will refer to all amounts rounded to the nearest million.

Yesterday, Canfor reported second quarter net income of almost \$11 million or 7 cents per share. This compared to a net loss of \$59 million for the first quarter of 2009, and a net income of \$64 million in the second quarter of 2008. All those results include a number of unusual items.

On slide 4 of our presentation we have highlighted the current quarter's unusual items and I will detail them now. Please note that the amounts I refer to are on an after tax basis:

First, a charge of \$8 million (\$0.05 per share) due to restructuring, mill closure and severance costs related principally to the indefinite closures of three sawmill operations announced in the quarter,

Second, a gain of \$20 million (\$0.14 per share) due to the effect of translation of our USD denominated debt, net of investments,

Third, a gain of \$17 million (\$0.12 per share) on derivative financial instruments, principally due to the increase in the value of the Canadian dollar relative to the US dollar,

And lastly, a charge of \$2 million (\$0.01 per share) to adjust the previously recorded gain related to the NCP mill fire.

After taking account of these items, the second quarter adjusted net loss is \$17 million (\$0.12 per share) compared to an adjusted net loss of \$78 million for the first quarter of 2009, this represents an improvement of \$61 million. These figures are further skewed by the impact of inventory write-downs from cost to net realizable value required by accounting standards, which on a quarter-over-quarter basis positively impacted net income by about \$57 million, or \$0.41 per share, after tax.

Slide 5 of our presentation shows the history of US housing starts and SPF lumber prices, clearly showing the record low levels in Q1 and only a very modest improvement from those levels in Q2.

Turning to our operating performance, [Slide 6 of our presentation] sales increased \$54 million to \$542 million, up 11% from the prior quarter. Sales were higher across all segments. The Company generated positive EBITDA of \$7 million, a \$92 million improvement from the previous quarter. But if you remove the effect of the inventory devaluations and restructuring costs, EBITDA in the second quarter was negative \$34 million, an improvement of \$15 million from negative EBITDA of \$48 million in the first quarter of 2009.

Now looking at each of our business segments in turn....

[Slide 7] The Lumber segment had positive EBITDA of \$11 million in the second quarter of 2009, compared to negative EBITDA of \$69 million for the previous quarter. Two major factors affect comparability:

First, there was a quarter-over-quarter \$67 million positive impact of log inventory valuation adjustments, principally reflecting the effects of spring break-up and result in a reduction in log inventories, but also improved costs and net sales values.

Second, restructuring and closure costs were \$7 million higher in Q2

When these items are adjusted out, EBITDA was negative \$23 million, which represented a \$19 million quarter over quarter improvement from the negative \$42 million in the first quarter. This change was primarily driven by a modest increase in Western SPF prices and lower unit manufacturing costs which were down about 7%. These were partly offset by the strengthening of the Canadian dollar.

As a reminder, we no longer report our panels business as a separate operating segment, given that all but one of the Company's panel operations are now indefinitely idled.

And now turning to the Pulp and Paper segment [Slide 8] of our presentation.

The second quarter results reported for the pulp and paper segment include Canfor's Taylor Pulp Mill combined with Canfor Pulp Limited Partnership. The second quarter EBITDA was positive \$6 million and was up by \$11 million compared to the first quarter of 2009 principally due to the impact on unit manufacturing costs of higher production volumes, as well as lower fibre, chemical and natural gas costs, which more than offset a decline in average US list prices and the effect of the stronger Canadian dollar.

Results of Canfor Pulp Limited Partnership, of which we own 50.2%, were discussed in the Canfor Pulp Income Funds' news release and conference call earlier this week.

Capital spending in the second quarter was just over \$7 million, which was comprised of \$5 million for the solid wood business and \$2 million for Canfor Pulp. We anticipate that full year capital spending will be about \$40 million on the solid wood side of the business.

At the end of the second quarter, Canfor, excluding Canfor Pulp, had cash of \$135 million and unused lines of credit of approximately \$398 million. We made long-term debt payments of US\$60 million on April 1st from cash reserves. The net debt to capitalization at the end of June was 16% on a consolidated basis. Excluding Canfor Pulp, the net debt to capitalization is 9%.

And Jim, with that I would like to turn the call back over to you.

Jim Shepard – President and CEO: Thank you, Tom. I would be remiss if I didn't make some reference to what we can expect moving forward. I am not a fan of making predictions. As Warren Buffett recently stated, the economic turnaround is coming, he just doesn't know when. If Warren Buffett doesn't know, then I sure don't. And therefore, Canfor will continue with its focus on cash conservation and cost reduction opportunities. But we can take heart in the fact that our Company has become very lean and efficient to the commit effort of all of it's employees.

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 Paul Quinn of RBC Capital markets. Please go ahead, your line is now open.

Paul Quinn – RBC Capital Market: Thank you, good morning, just a couple of questions, one, just on cost improvements, specially on the wood products side, we've seen a very impressive cost reduction as far back as I've got the records, I guess the question is do you've seen some drop in log cost and you've seen the benefit of closures from higher cost facilities, but what do you think the underlying cost reduction in, you know, your core set of Mills that you're running now has been year over year?

Jim Shepard – President and CEO: I don't think that we'd want to get into that much detail, Paul, in all fairness.

Paul Quinn – RBC Capital Market: Ok, ah, how about an easier one?

Jim Shepard – President and CEO: Yeah, Ok, try an easier one.

Paul Quinn – RBC Capital Market: Labor strategy going forward, you mentioned that Director have taken cuts, Executive staff have taken cuts, some of your contractors have taken cuts, I know you don't want to negotiate in the public with your labor force with the upcoming contract, but what is sort of the strategic direction that Canfor wants to see if hourly labor force move to over the next number of years. Is that more like a Clear Lake contract? Is it more like a Conifex type of contract that we've seen? Is it something like Mackenzie? What is it?

Jim Shepard – President and CEO: Well, first of all, we've given our position to the Union and they've given us their position, so, we're just commencing negotiations so, quite frankly, we just never comment on that. But let me just give you a little bit of the back ground here, like I've just said to you right from the beginning of at least my tenure here, in the last two and a half years, we have seen the directors, we have seen the executive, we have seen the management, we have seen the staff, we have seen the contractors, suppliers, and recently, as I mentioned in my comments here, we have seen Mackenzie and Clear Lake, which is a non-union Mill, you know, step forward and become aligned which the direction we're going in. So, quite frankly, when it's all said and done, we're looking for alignment in our purpose, and our purpose is to be a survivor and a competitive Mill that is going to provide the quality products for our customers going forward.

Paul Quinn – RBC Capital Market: Ok, that's all I had, thanks guys.

Jim Shepard – President and CEO: Ok.

Operator: Thank you. (Operator instructions)

Tom Sitar – Vice President Finance and Chief Financial Officer: Anybody from the media?
Operator, Are there any questions from the media?

Operator: We have no questions from the media.

Jim Shepard – President and CEO: OK. Well ok everybody, that's great. Thank you very much for participating today. I look forward to speaking with you again at the end of the next quarter.