

Canfor Corporation Third 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 third quarter results for 2009. I am joined here today by Tom Sitar Canfor's Vice President of Finance and CFO and Don Kayne – Vice President of Marketing and Sales. 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.

First of all let me say these are trying times for our employees. Especially those who work in operations that have taken curtailments to respond to the markets. This is a difficult time for them that is not helped by the conflicting headlines that appear each day about the present economy. That's why, in the last month, I've been travelling to our operations and meeting with our employees. I've been briefing them on my outlook for the economy going forward and our strategy as a company.

For the purpose of clarity to described my economic outlook I chose a military image as an analogy. It's the image of a besieged military unit that has been holding out and its spirits are lifted by the site of dust on the horizon indicating that the cavalry is coming at last. A "John Wayne" movie, if you will.

I don't have to tell you that the forest industry was one of the first to feel the effects of this recession. And, after nearly two years, it's natural for people to start hoping for an economic recovery to save us from the terrible markets we've faced – a cavalry coming to our rescue.

It's true there have been some positive signs lately to entice one into thinking that the cavalry is coming. Unfortunately, there also a compelling number of signs to indicate that the dust on the horizon may not be the cavalry coming, but a dispatch rider saying that is not the case and we will need to continue to conserve our resources in order to last until the cavalry can get to us. In other words, we can't count on the markets saving us just yet.

There is good news however, Canfor has been continuously preparing for and adjusting to these harsh conditions since the spring of 2007. As you are no doubt aware, Canfor has been aggressively reducing costs in every aspect of our business. From the Board of Directors who voluntarily reduced their fees by 33 percent, to the staff who saw their salaries rolled back two years running, we are all aligned to the same goal. We've been curtailing operations and reducing working capital. We sold the corporate jet in the beginning of 2008, as well as surplus real estate. And, more recently, we decided to vacate our downtown Vancouver offices by year end. All of these activities have contributed to our cash conservation efforts, but they have also set a tone across the company that will enable us to survive these challenging economic times.

What is most impressive is that our people have maintained their focus. Over the last two years, all of our employees have come to understand the economic challenges we face and all are focussed on finding solutions across the business. The tremendous response from our employees has meant that we have reduced costs and improved the efficiency of our operations, despite the distractions and uncertainty presented by a volatile market situation. As I toured our operations last month, my message to them was one of congratulations for a job well done, but also a warning that we cannot rest on our laurels, because the recovery in the forest industry is likely to be a slow one.

A recent report by the Harvard Centre for Housing Studies shows the U.S. housing industry still faces strong headwinds. This report reveals some sobering figures to consider, such as: At June 30th, one third of all houses in the U.S. are worth less than their mortgages. This negative home equity factor has driven up foreclosures and will likely continue to do so for several more quarters. The trend here should be a deep concern for all who depend on a recovery in the housing sector. And you can add to this a few other factors that are mostly negative, such as job losses, mortgage investment losses and the overall tightening of home mortgage credit standards. It is for this reason that we are going to continue our efforts in the face of what we expect will be continued challenging economy.

It is also for this reason that we have been aggressively pursuing new markets for our products. We've been expanding our customer base in China. For the first time, our shipments to China surpassed our shipments to Japan this year. What is especially encouraging is that these increasing shipments to China are also moving towards higher value grades of lumber.

Despite all of these efforts, we are once again reporting a net loss. During the 3rd quarter we had a net loss of \$5.2 million and for 9 months a net loss of \$53.5 million. While we are seeing gains in our productivity and efficiency, the U.S. lumber market continues to struggle.

However, it is important to note that Canfor's liquidity position is strong and that is a testament to all of the efforts that we've put forward in the last couple of years.

So my message to you today is the same message I delivered to our employees in the last month. I see nothing wrong with hoping that dust on the horizon is the cavalry coming to our rescue and that the economy is truly turning around. But I have to be honest and say that I personally doubt it. It's for this reason that we continually evaluate all aspects of our business to preserve our balance sheet so that we are well positioned to take advantage of the recovery when it comes.

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 his morning will focus on our financial results for the third quarter of 2009 with special emphasis on those items that affect comparability with other quarters and highlight those factors that contributed significantly to our results.

I would draw your attention to our third quarter financial performance overview slide presentation which you will find on our website, in the Investor Relations section, Webcasts 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.

As Jim mentioned, Canfor reported second quarter net loss of \$5 million. This compared to a net income of \$11 million for the second quarter of 2009, and a net loss of \$94 million in the third 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 gain of \$20 million (\$0.14 per share) due to the effect of translation of our US dollar denominated debt, net of investments,

Second, a gain of \$13 million (\$0.09 per share) on derivative financial instruments, principally due to the increase in the value of the Canadian dollar relative to the US dollar during the quarter,

Finally, a loss of \$5 million (\$0.04 per share) related to restructuring and mill closure costs of our idled operations,

After taking account of these items, the third quarter adjusted net loss is \$32 million (\$0.23 per share) compared to an adjusted net loss of \$17 million for the second quarter of 2009, or an increased loss of \$15 million.

Slide 5 of our presentation shows the history of US housing starts and SPF lumber prices expressed in Canadian dollars, clearly showing the record low prices in Q2 and only a very modest improvement from those levels in Q3.

Turning to our operating performance, on Slide 6 of the presentation, sales were unchanged from the prior quarter but reflect lower lumber shipments offset by higher pulp and lumber prices. The Company generated positive EBITDA of \$7 million, the same as the prior quarter. But if you remove the effect of the inventory devaluations and restructuring costs reflected in each quarter's results, EBITDA in the third quarter was positive \$15 million, an improvement of \$49 million from negative EBITDA of \$34 million in the second quarter of 2009.

Now, Looking at each of our business segments in turn and I'm on Slide 7,

The Lumber segment had negative EBITDA of \$15 million in the third quarter of 2009, compared to positive EBITDA of \$11 million for the previous quarter. Affecting comparability are:

- Inventory write-downs of \$3 million recorded in Q3 compared to recoveries of \$43 million reported in Q2.
- Restructuring and closure costs of \$5 million in Q3 compared to \$10 million in Q2.

When these items are adjusted out, EBITDA was negative \$8 million, which represented a \$15 million quarter over quarter improvement. This change was primarily attributable to increased pricing in SPF lumber and decreased shipments when compared to the previous quarter.

Cash unit manufacturing costs were down marginally compared to Q2 despite additional curtailments in Q3. Compared to Q3 of 2008, cash unit manufacturing costs were down 6%, continuing a trend of the past two years.

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 which is on 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 third quarter EBITDA was positive \$26 million and was up by \$20 million compared to the second quarter of 2009 principally from higher NBSK and BCTMP prices and, to a lesser extent, lower fibre and chemical costs.

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

Year to date, in total we have spent \$49 million on capital projects, of which \$34 million was in the lumber business and \$15 million at Canfor Pulp. We anticipate that full year capital spending will be about \$40 million for the lumber business and \$16 million at Canfor Pulp.

At the end of the second quarter, Canfor, excluding Canfor Pulp, had cash of \$109 million and unused lines of credit of approximately \$389 million. The net debt to capitalization at the end of September was 14% on a consolidated basis. Excluding Canfor Pulp, the net debt to capitalization is 9%.

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

Jim Shepard – President and CEO: Thank you, Tom. Before I turn this call over for questions, I just want to say that Canfor is planning for a recovery that will be very gradual. We are recalibrating the way we do business; we are not waiting for a cavalry to come to our rescue. It is this approach that will guarantee Canfor remains financially sound and is well positioned to take advantage of opportunities when markets do turn around.

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.

Paul Quinn – RBC Capital Market: Yeah, thanks, good morning guys, uh, just a couple of questions. One, one on just labor, I know that this is out there, I know sounds like negotiations are still going on, off and on, maybe you could comment on just on whether you see progress or weather we're going to see some kind of deal by the end of the year?

Jim Shepard – President and CEO: Hi Paul, its Jim. Ok, as far as the union negotiations just to be clear, it relates only to our BC sawmills with the exception of Mackenzie and Clear Lake. Our contract with Steelworkers expired July 1st this year and right in this moment we are still in a very preliminary stage and because of that we really comment much further at this time Paul.

Paul Quinn – RBC Capital Market: Ok, talking about lumber inventories, they seem to be coming down in your system. What have you seem out there in terms of your customers, the information I'm getting out there is there are almost record lows, is that consistent with what you are seeing?

Jim Shepard – President and CEO: Well, I think Don would be the best to answer that question, Don...

Don Kayne – Vice President of Marketing and Sales: Yeah, Hi Paul, its Don. Yeah, absolutely, we are seeing that across the system. I think as we go into the, as we progress further into Q4 we'll see more of that in terms of everyone trying to reduce inventories just as much as possible. I think clearly we're sitting at probably the lowest that we've been in quite some time and that would apply to pretty much all markets.

Paul Quinn – RBC Capital Market: And, and just lastly, Just on cost. It looks like you've done a great job on reducing those cost and I'm just wondering weather that's a er..er what the sort of the breakdown would be in productivity increases and lower log costs.

Tom Sitar – Vice President Finance and Chief Financial Officer: It's probably uh, bit of both. In there, I'm not sure if I'd break it specifically, but our productivity has been going up gradually but so has log costs. So both have probably contributed equally.

Paul Quinn – RBC Capital Market: Ok so more equally. Alright, thanks very much guys, good luck with the wait for the cavalry.

(Laughing)

Operator: Thank you the next question is from Daryl Swetlishoff of Raymond James. Please go ahead.

Daryl Swetlishoff – Raymond James: Thanks, Good morning guys, just a question regarding your winter logging plans. As you look out to the potential recovery next spring, and of course you have to make plans now for your winter logging season, how are you approaching that? Are, Do you plan to build the same log inventories that you normally do, or is there a chance you'll build less given expected demand levels?

Jim Shepard – President and CEO: Um, basically, we've adopted a Lean Sigma methodology here where we're removing waste and excess cost to the company and we've now incorporated it into our own, and we now call it the Canfor Operating System, and basically our approach, we think our ability to reduce costs, the opportunities remain there, and it boils down to anything that doesn't relate directly to cutting down of the tree and converting it to a board and delivering that board to a customer is wasted time and effort. So, it continues and quite frankly what we'll be doing is being very deliberate and very strategic with regard our logging this year. We will not be doing logging as usual and then be cutting back lumber inventories, or our mill yard inventories. We will deliver it right from the stump all the way through to the mill yard in terms of being reactive to what the marketplace is offering to us as an opportunity.

Daryl Swetlishoff – Raymond James: Uh, thanks for that Jim. Good luck guys.

Jim Shepard – President and CEO: Thanks

Operator: Thank you. (Instructions) There are no further questions registered at this time I'd like to turn the meeting back over to Mr. Shepard.

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

Operator: There are no questions at this time.

Jim Shepard – President and CEO: Ok. Well, thank you for your interest in Canfor everybody, I look forward to speaking with you again at the end of the next quarter. Thank you operator.