

## Canfor Corporation Third Quarter 2010 Conference Call

Operator: Good morning ladies and gentlemen. Welcome to the Canfor Corporation Third Quarter Results 2010 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. Tom Sitar, Chief Financial Officer of Canfor Corporation. Please go ahead Mr. Sitar

Tom Sitar – Vice President Finance and Chief Financial Officer: Thank you operator. Good morning everybody and welcome to Canfor's conference call to discuss the Company's third quarter results. I am joined here today by Mark Feldinger, our Vice President of Manufacturing.

Unfortunately, Jim Shepard, our President and CEO, will not be on the call today as he left yesterday on another forestry trade mission to China. This mission has been organized by BC's Minister of Forests, Mines and Lands, Pat Bell, and it will be Jim's seventh trip to China since taking over as Canfor CEO. I will talk about the positive impact that China is having on our business a little later in my commentary.

Lumber markets overall were subdued during the third quarter due principally to continued economic weakness and a troubled US housing market. The quick but short-lived upturn in prices for about 3 months in the first half of the year came to an abrupt end. Quarter over quarter, average prices were down more than \$40 for benchmark SPF lumber *[you can see the price graph on page 4 of our online presentation]*. The short-lived nature of this rally supports our view that it was largely the result of supply factors, rather than improved underlying U.S. demand. The Southern Yellow Pine market was hit even harder with average prices down nearly US\$140 per thousand board feet.

Our lumber operations ran at approximately 70% of capacity, a slight increase from Q2, reflecting a full quarter of operations at the restarted Quesnel mill and the planned production ramp-up at our Chetwynd facility.

In September, we made the decision to permanently close the Clear Lake operation in January 2011. This was a difficult decision, but was driven by the weak U.S. housing sector and the lack of economical fibre supply available to this mill. At the same time, we remain focused on making our existing mills more cost competitive as evidenced by the major capital upgrade of our Fort St. John mill which has ample green fibre for the foreseeable future. Project budget for this modernization and expansion is approximately \$45 million dollars. Phase one of the modification to the sawmill and a new planer facility were put into operation just this past week and final completion is slated for first quarter next year. When complete, this project will increase capacity of the mill by about one third or about 75 million board feet.

So with Jim Shepard and Don Kayne our Vice-President of Marketing and Sales in China, it is appropriate I comment on that market.

Shipments to China again represented a significant proportion of our sales volumes. As you know, we have been focused on developing the China market for several years. In 2010, this has started to yield very impressive numbers in terms of sales volumes and also sales value as the proportion of higher grades is increasing. For example, when Canfor first started to focus on China the percentage of shipments of #2&Btr grade was minimal. This year, 35-40% of our shipments are #2&Btr grade. The interest our Chinese customers are showing in higher grades has been very positive for overall lumber pricing in light of the continuing recession level in the United States home construction sector.

In the third quarter we shipped 15% of our lumber to China and for the first 9 months of this year it was 14% of total lumber volume, a year ago it was half that volume.

In the fourth quarter, we expect the growth in the Asian market, principally in China, to continue and thus help offset the challenges in the North American lumber market, driven by high US unemployment levels and record mortgage foreclosures. So demand from Asia should continue to positively influence SPF lumber pricing in North America.

Subsequent to quarter end, the U.S. Trade Representative sent a letter to the federal Minister of International Trade requesting formal consultations under the Softwood Lumber Agreement. Without having seen the specifics, we understand the U.S. complaint relates to pricing of mountain pine beetle-killed timber in the BC Interior. Until the consultations are complete, it really is premature to comment further on this matter and how it may turn out.

The NBSK pulp market appeared to have peaked at record levels in the third quarter, driven by steady demand and tight supply. For the fourth quarter the outlook is only slightly weaker as the recent restart of two North American producers will be partially offset by regularly scheduled maintenance outages in the industry.

I would now like to focus on our financial results and identify those items that affect comparability with other quarters and those factors that contributed significantly to our results.

During my comments I will refer to our Third Quarter overview slide presentation which is on our website, in the Investor Relations section, Webcasts tab. 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 amounts. Full details numbers are shown in our news release.

The third quarter equity shareholder net income, which includes our 50.2% share of earnings from Canfor Pulp Limited Partnership, was \$6 million (or 4 cents per share). This compares to a net income of \$18 million (or 13 cents per share) for the second quarter of 2010, and a net loss of \$5 million (or 4 cents per share) in the third quarter of 2009.

On slide 3 of our presentation we have highlighted the current quarter's non-operating items that affect comparability of results between the quarters and I will detail them now

A charge of \$13 million (9 cents per share), relating to the permanent closure of the Clear Lake lumber operation.

A gain of \$6 million (4 cents per share) due to the effect of translation of our US dollar denominated debt, net of investments, as the Canadian dollar strengthened approximately 3 cents compared to the prior quarter end.

Finally, a \$1 million gain (1 cent per share) on derivative financial instruments. Though the amount is small this quarter, we include it for consistency of adjustment between the quarters.

After taking account of these items, the third quarter adjusted net income is \$12 million or \$0.08 per share, compared to a similarly adjusted net income of \$28 million or \$0.20 per share for the second quarter of 2010.

Turning to our operating performance, [Slide 5 of our presentation] total gross sales were \$46 million lower than the prior quarter. The Company generated EBITDA of \$66 million, a decrease of \$37 million from the prior quarter. If you remove the effect of inventory devaluations reflected in each quarter's results and the permanent closure of Clear Lake, EBITDA in the third quarter was \$81 million, a decrease of \$27 million from a similarly adjusted \$108 million of EBITDA in the second quarter of 2010.

Now looking at each of our business segments in turn

[Now on Slide 6] The Lumber segment had EBITDA of \$5 million in the third quarter of 2010, compared to EBITDA of \$39 million for the previous quarter. This result included an inventory valuation recovery of \$1 million in Q3 compared to a \$2 million devaluation expense reported in Q2 of this year. In addition, there was the one-time charge of \$18 million related to the closure of Clear Lake. When these items are adjusted out, EBITDA in Q3 was \$22 million, which represented a \$19 million quarter over quarter decrease. This decrease is mainly due to North American lumber prices. Although for most grades the prices have climbed slowly from their lows at the beginning of the quarter, the average SPF benchmark price still remained \$40 below the Q2 average.

Shipments have remained consistent with the prior quarter, and overall the unit manufacturing costs were in line with the previous quarters.

And now turning to the Pulp and Paper segment [Slide 7].....

The third quarter results reported for the pulp and paper segment include Canfor's Taylor Pulp Mill together with Canfor Pulp Limited Partnership. The third quarter EBITDA was \$65 million and was down by \$2 million compared to the second quarter of this year 2010 as higher realizations were offset by lower shipments, both from Canfor Pulp's Northwood mill and our Taylor BCTMP mill.

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

For the quarter, our capital expenditures were \$44 million, which was comprised of \$31 million for the lumber business and \$13 million for Canfor Pulp. We expect that our capital spending for the full year 2010 will be about \$90 million, on the lumber side. In addition to the upgrade of our Fort St. John mill, we are taking steps to technologically upgrade other mills with smaller projects. These are principally projects to improve the cost profile and grade outturn rather than to increase capacity.

At the end of the quarter, Canfor, excluding Canfor Pulp, had cash of \$196 million and unused lines of credit of approximately \$380 million. During the quarter we extended our main operating credit facility to October 2013 and lowered the potential borrowing costs

under this facility. Our net debt to total capitalization, excluding Canfor Pulp was 2%, and on a consolidated basis it was 6%.

Subsequent to quarter-end, we completed the sale of all operating assets of Howe Sound Pulp and Paper Limited Partnership to Howe Sound Pulp and Paper Corporation, an unrelated, and newly formed subsidiary of Paper Excellence B.V. The sale is not expected to have a material impact on Canfor's net income in the fourth quarter or on the Company's total assets or liabilities.

And with that Colleen I would like to turn the call back to you so we can open the lines for questions.

Thank you. We will take lines from the telephone lines for questions. We will first take questions from the financial analysts followed by the media. If you have a question, please press \*1 on your telephone key pad. If you are using a speaker phone please lift your receiver then press \*1. If at any time you wish to cancel your question please press the # key. Please press \*1 now if you have a question. There will be a brief pause while participants register for questions. Thanks for your patience. Our first question is from Daryl Swetlishoff, Raymond James, please go ahead.

Daryl Swetlishoff – Raymond James: Thanks. Good morning guys, a couple of questions first, just colour on the Chinese market. Obviously with the mill changeover, you're making a bigger commitment to that market. What's your sense of end uses for BC lumber right now or are we still focusing on the utilities grades? Or is there more number 2+Btr – any colour on that?

Tom Sitar – Vice President Finance and Chief Financial Officer: As I said in my comments we are now at around almost 40% of our volume is in the 2+Btr, so it has grown significantly. The uses, you know principally it's varied. There are a number of places, everything from concrete forming, scaffolding to remanning, furniture and floor substrate, doors, pallets. It's a varied use. What I will say is that wood construction as such is still in its early stages and that is the part that is still yet to grow significantly is the wood frame construction, whether it be low-rise six story buildings. Part of the volume goes there and that is very small and is about to grow very significantly and that is what we would expect.

Daryl Swetlishoff – Raymond James: Thanks Tom. I'm not sure if you can comment but I would be curious what Canfor's view is on the North American lumber market and what prices might be without the volumes going to China. Is it a \$25 or \$30 dollar a thousand impact? What is Canfor's sense?

Tom Sitar – Vice President Finance and Chief Financial Officer: I don't know if I have a specific percentage, but there is no question that we feel that is influencing the market and really lumber is starting to follow in step with some of the other commodities. It's becoming a commodity that is a world wide commodity as opposed to the just regional one, and so there is definitely an impact in I think judgment as to what specifically that may be but we have no doubt that it is now positively influencing the North American pricing.

Daryl Swetlishoff – Raymond James: Thanks Tom. I will turn it over.

Operator: Thank you. Once again should you have a question from the analyst community please press \*1 on your telephone key pad. Our next question is from Paul Quinn of RBC Capital markets. Please go ahead.

Paul Quinn – RBC Capital Markets: Thanks very much and good morning. Just a question on your capital structure Tom, you went through that. I guess Canfor's net debt to total cap, excluding Canfor Pulp, is down to 2%. What do you see is the ideal capital structure for sort of an integrated lumber producer?

Tom Sitar – Vice President Finance and Chief Financial Officer: While you could say that, at this stage, we probably have a low level of debt, but the reality is we are in a commodity business that has shown how we can fluctuate very dramatically and so having low level of debt doesn't trouble me at this stage. If there is appropriate uses, then we will change that, but I'm not going to be concerned about being at low debt level, as we are right now.

Paul Quinn – RBC Capital Markets: In terms of offshore, pricing was up in the quarter vs. domestic pricing that was down, maybe you can just give us some colour on your contracts in the offshore and how they work and what the lag is.

Tom Sitar – Vice President Finance and Chief Financial Officer: Well, China pricing there is a number of ways it is done. It is a mix of pricing that's one month pricing or three month pricing. At the time when prices are being taken, it is very comparable to North American pricing, but it does have a lead time to it but it does vary with customers. So to a degree you have lag affect, but at the time when pricing is being done it is very comparable to North American pricing.

Paul Quinn – RBC Capital Markets: In your freight, that market is pretty comparable to average North American market?

Tom Sitar – Vice President Finance and Chief Financial Officer: Yeah it actually is and when we look at it in Canada at a net mill basis and what do we get at the end, and that's when I say pricing is comparable on a net basis to us that is judged.

Paul Quinn – RBC Capital Markets: Do you see at some point in the future shipping Southern Yellow Pine to China?

Tom Sitar – Vice President Finance and Chief Financial Officer: From everything I hear, Southern Yellow Pine is heavy, it doesn't transport well across the warm climes, so there is some of that but I don't see that as being a very major player in that export or growth in that market. I just don't see it at this time.

Paul Quinn – RBC Capital Markets: In terms of I guess wood peak lumber prices, residual values went up. Could you give us a sense as to what percentage of lumber segment revenues were represented by residuals, just a bulk park?

Tom Sitar – Vice President Finance and Chief Financial Officer: Well, the residuals are not priced on lumber prices, I'm not sure I follow your question. They are driven by pulp prices.

Paul Quinn – RBC Capital Markets: Right, but you are accounting for them in the lumber segment?

Tom Sitar – Vice President Finance and Chief Financial Officer: Yes, yes, we are. They are part of the lumber segment.

Paul Quinn – RBC Capital Markets: Right, so I'm just trying to get an idea as to what proportion of the lumber segment is represented by residuals.

Tom Sitar – Vice President Finance and Chief Financial Officer: I don't have that right now handy. We will look it up and we can get back to you on that, I just don't have that ready.

Paul Quinn – RBC Capital Markets: And last question, just on change to IFRS, what is the major change for Canfor there?

Tom Sitar – Vice President Finance and Chief Financial Officer: Well the major change will be accounting for our pension plan costs and assets, and we will show that at year end. Our plan right now is that we will show an opening balance sheet in our annual report, so we will detail that at that point. So that's principally the change for us, the accounting for pension.

Paul Quinn – RBC Capital Markets: Okay thanks very much. Good luck.

Tom Sitar – Vice President Finance and Chief Financial Officer: Thank you.

Operator: We will now take questions, sorry we do have questions from Sean Stewart of the Analyst community.

Sean Steuart – TD Securities: Thanks good morning. Tom, just wanted to follow-up on Paul's question. In your slide deck, you referred to just slightly higher lumber price realizations in offshore markets. Just reading through what you said to Paul, am I correct to say that the spike we had in prices in North America through the second quarter, that was just the lag effect of the contracts flowing through to better pricing in China in Q3? And as such, can we expect a little bit of price softness in what you're sending to China in Q4?

Tom Sitar – Vice President Finance and Chief Financial Officer: There is a bit of a lag effect as part of it, but also pricing in markets like Japan was a bit better. So it's a combination of the two, but I don't see that there will be much of a softness in comparison to the North American market. There is no question there is a bit of a lag affect in pricing.

Sean Steuart – TD Securities: Okay that's all I had. Thank you.

Operator: Thank you. We will now take questions from the media community. If you are from the media, please press \*1 on your telephone keypad to ask a question. There will take a brief pause while participants register for questions. Thank you for your patience. Our first question is from Allan Dowd of Reuters. Please go ahead.

Allan Dowd – Reuters: Question on the China market. Do you see a point at which pricing for China begins to lure in some other players, I'm thinking of some of the European players or I suppose more logs out of New Zealand going to domestic Chinese producers? Have we reached that level yet or do we see that coming up?

Tom Sitar – Vice President Finance and Chief Financial Officer: I don't think so at this stage dramatically, not specifically, I don't see it.

Mark Feldinger – Vice President, Wood Products Manufacturing: Just to add to that Allan, China historically has consumed logs from New Zealand as well as logs from Russia, so those commodities do flow there today. In order to attract significant additional volumes, particularly from Europe, prices would have to be orders of magnitude higher to get there economically.

Allan Dowd – Reuters: Also, on the grades of lumber, are you sort of seeing developing as sort of a permanent mix you were saying the amount of grade 2 and other lumber is

increasing in their purchases, have you figured out where there might be a balance between the overall types of grades utility vs. higher grades?

Tom Sitar – Vice President Finance and Chief Financial Officer: Well, we see the proportion of the higher grades potentially rising more, but we will see a market that will consume both the lower grade and the upper grade. But over time, I would expect the 2+Btr to continue to increase.

Allan Dowd – Reuters: Thank you.

Tom Sitar – Vice President Finance and Chief Financial Officer: Thank you.

Operator: There are no further questions registered at this time. I would like to turn the meeting over back to Mr. Sitar.

Tom Sitar – Vice President Finance and Chief Financial Officer: Thank you operator. Thank you all for joining us on the call. We look forward to speaking with you again next quarter. Thank you.