# Canfor Corporation Fourth Quarter 2009 Conference Call

Operator - Good morning, ladies and gentlemen. Welcome to the Canfor Corporation's fourth quarter results 2009 conference call. A recording of the call and a transcript will be available on Canfor's website.

During this call, Canfor's Chief Executive Officer and 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. Jim Shepard, President and Chief Executive Officer of Canfor Corporation. Please go ahead, Mr. Shepard.

Jim Shepard - Thank you, operator. Good morning everybody and welcome to Canfor's conference call to discuss the company's fourth 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, Manufacturing.

I will give a brief overview of the quarter and Tom will speak to our financial results, including providing some detail of the unusual items on the quarter.

Looking back over the last few years, I am truly amazed at how much has happened and how far we have come. In 2008, we thought we had faced a huge challenge, with average lumber prices and demand plummeting. What we didn't factor in were the ramifications of the global meltdown in 2009. This event was an unexpected challenge to redouble our cost-containment efforts.

I am happy to report that our results show that we, in fact, did achieve our objective of still having a reasonable cash balance at year end. In the face of some of the lowest lumber prices ever seen and very low demand, we indefinitely shut our Rustad, Radium, and Vavenby operations last summer. Unfortunately, 2009 ended on much the same note as it began. Our executives were grappling with yet another difficult decision, as we examined all of our operations and sought to continue with strategy of being responsive to the markets, reducing costs and conserving cash.

In the first week of January, we announced that we would taking an indefinite curtailment of our Quesnel operations. All of these closures happened because of the higher cost profile of these operations that made them uneconomical in the given marketplace.

Having said that, I am happy to report that we reached an economically viable labor arrangement for five years in Mackenzie last year, with the support of our employees and the community. This allowed us to start up that operation in July with one shift. We upgraded this mill by investing $20 million, and we are now completing recruitment for a second shift over the next few weeks. We also reached a similar labor agreement with the United Steel workers at our Chetwynd facility, again thanks to all of the stakeholders looking for solutions and investing in the future. This clears the path for us to approve a $16 million investment to help make this operation economically viable in this market. Non-unionized employees at our Clear Lake operation also chose to reduce labor costs in a similar fashion to make their mill more competitive.

What I like most about what we have been able to do with our employees at these saw mills is that we have created a profit sharing agreement, where they will share the success of our operations in the future. This is intended to engage the efforts and the ideas of our hourly employees. While we have made these dramatic changes inside our company, we have also been focusing on making gains in our emerging markets. We have been working with our colleagues at Canada Wood and FII China in the development of new markets in China and those efforts are now starting to pay off.

Until last year, most of those shipments were of low grade lumber, destined for applications like concrete forming. But the market in China is now starting to recognize the advantageous qualities of SPF lumber, especially in wood frame constructions. We ended the year with over 20% of our shipments now #2&Btr, that is our construction-grade lumber. We are also very active with forming relationships with remanufacturing partners in China, who are using several grades of lumber to make higher grade products that serve the various markets in Asia. While it can be said that it is fortunate to have the new Asian markets fill in for the downfall of the US housing market at this time, it has become apparent that these markets are not a passing phase. This market will only grow in appetite for higher-grade SPF lumber from Canada. We at Canfor are pleased to benefit from our relatively long presence in this area.

The previously mentioned focus on cash conservation is just part of the overall margin improvement focus that we have at Canfor, and it is now starting to bear results. This progress is the result of the company's ongoing focus on cash conservation, which works at driving out all extraneous costs, not directly related to the delivery of our products to our valued customers. It is also the result of the support we have from our customers, who appreciate our commitment to be the best we can be in providing their wood product solutions. That said, I think it is worthwhile to note that we don't believe the market fundamentals have changed very much. Markets will likely be volatile, with price variations due to low supply. We have already seen 2010 start that way. Housing starts, one of the reasons we curtailed our Quesnel operations, remain low. We are not expecting sustained demand in the short term.

As a result, we believe it is likely we will see run-ups in prices, followed by some fairly significant drops. But we are prepared for this. As a company, we have been focusing more closely on tailoring our productions to the needs of our key strategic customers. This means we are tying our productive capacity more closely to the real market. We expect our capacity to remain much the same, unless we see very clear indications of sustained demand actually being there. I think the general consensus in the industry is that we saw the bottom of the markets last year. That said, there are still a number of challenges that we must navigate through before we can safely say that this downturn is behind us. It appears that the unemployment in the United States isn’t going to tumble anytime soon, and will likely persist at around 10%. We must also be mindful of the looming number of homes in foreclosure, which tend to dampen recovery in the US housing starts.

But considering we have now completed three years of indescribably challenging market depths, and we are still managing to stand tall with a strong balance sheet, committed workforce and satisfied customers, we look forward to the future with great confidence, and Canfor will be in a good position to take advantage of market recoveries, whenever they come.

I would now like to turn the call over to Tom Sitar to provide some commentary on our financial results. Tom?

Tom Sitar - Thank you, Jim. My comments this morning will focus on our financial results for the fourth quarter of 2009, with emphasis on those items that affect comparability with other quarters and those factors that contributed significantly to our results. In my comments, I will refer to our Q4 overview slide presentation, which is on our website in the Investor Relations section, webcast tab; and I will refer to it periodically. Also I note that for ease of reference, I will refer to all dollar amounts rounded to the nearest million, except of course, for per-share amounts.

Yesterday, we reported a fourth quarter net loss of $17 million or $0.12 per share. This compares to a net loss of $5 million for the third quarter of 2009 and a net loss of $230 million in the fourth quarter of 2008. All of those results include a few items that can affect comparability between the quarters.

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, we had a gain of $6 million or $0.04 per share due to the effect of translation of our US dollar denominated debts, net of investments. Second, a gain of $1 million or $0.01 a share on derivative financial instruments, and these were principally due to increase in the value of the Canadian dollar relative to the US dollar. And finally, a loss of $5 million or $0.04 per share related to restructuring and mill closure costs of our idled operations. After taking account of these items, the fourth quarter adjusted net loss is $19 million or $0.13 per share compared to an adjusted net loss of $32 million or $0.23 per share for the third quarter of 2009, or an improvement of $13 million.

Slide 5 shows the history of US housing starts and SPF lumber prices, clearly showing the low prices in Q3 and only a very modest improvement from those levels in Q4, and also the fact that US housing starts have not recovered yet.

Turning to our operating performance, and this is the slide 6 of our presentation, sales were $9 million higher from the prior quarter. The company generated positive EBITDA of $15 million, an increase of $8 million from the prior quarter. But, if you remove the effect of inventory devaluations and restructuring costs reflected in each quarter's results, EBITDA in the fourth quarter was positive $21 million, an improvement of $6 million from the $15 million EBITDA in the third quarter of 2009. The increase reflected higher Canadian dollar realized pulp prices and to a lesser extent, further cost improvements.

Now, looking at each of our business segments in turn, slide 7 of our presentation. The lumber segment had a negative EBITDA of $9 million in the fourth quarter of 2009 compared to negative EBITDA of $15 million in the previous quarter. Affecting comparability were inventory write-downs of a very small $0.1 million recorded in the fourth quarter, compared to $2.5 million of write-downs in the quarter in Q3. We had restructuring costs of $4 million, which were effectively the same as in the prior quarter. When you adjust these items out of EBITDA, Q4 had a negative $4 million, which represented a $3 million quarter-over-quarter improvement. This change was primarily attributable to higher shipments and production in the fourth quarter, reflecting the impact of summer shuts in Q3. The modest price increases for SPF lumber were partially offset by the stronger Canadian dollar.

Cash unit manufacturing costs were down about 2% from Q3. The further cost reductions and improved residual chip prices in the current quarter were slightly offset by higher energy costs and scheduled maintenance costs. Compared to Q4 of last year, cash unit manufacturing costs were down about 8%, continuing a multi-year trend.

As a reminder, we no longer report our Panels business as a separate operating segment, given that all but one of company's Panels is indefinitely idled.

Now turning to segment, which is slide 8 of the presentation, the fourth quarter results reported for the Pulp & Paper segment include Canfor's sale of pulp mill, which combined with Canfor Pulp Limited Partnership.

The fourth quarter EBITDA was $29 million and was up by $3 million compared to the third quarter of 2009, principally from higher pulp prices in Canadian dollar terms, both for NBSK and BCTMP. The results for Canfor Pulp Limited Partnership, of which we own 50.2%, were discussed in some detail in Canfor Pulp income funds news release and conference call earlier this week.

Now commenting on capital expenditures. For the year, they were $59 million, which was comprised of about $42 million for the solid wood business and $17 million for Canfor Pulp. At the end of the fourth quarter, Canfor, excluding Canfor Pulp, had cash of $120 million and unused lines of credit approximately $406 million. Our net debt to capitalization, excluding Canfor Pulp was just under 9%.

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

Jim Shepard - Thank you, Tom. I would expect that 2010 will see a more stable running environment than what we saw in 2009. It is my hope that 2009 was the bottom of the market, and the question is, how much better will it be in 2010?

One area that is showing the ability to have a positive effect on lumber prices is the supply-demand equation, which has now been brought into balance. This is seen in the current lumber price of around $290 US for SPF 2x4s, an increase of $82 since the beginning of the year, illustrating the significant volatility in the current market. I must confess to being mildly optimistic for 2010 and 2011. As we move forward, we remain committed to maintaining our cost reduction strategies, and as always, to producing quality products on tally, on grade and on time for our highly valued customers.

Operator, I would now like to ask that we take questions from the telephone lines.

Question-and-Answer Session

Operator - Thank you, sir. We will now take questions from the telephone lines. We will first take questions from the financial analysts, followed by the media.

(Operator Instructions).

Our first question is from Paul Quinn from RBC Capital Markets. Please go ahead.

Paul Quinn – RBC Capital Markets - Yes, thanks, and good morning, guys. I had just a couple of questions. One, volume of the lumber shipments to China was what in 2009?

Jim Shepard - Don, can you answer?

Don Kayne - 2009, it was about, we have increased significantly, it is up about 40% from 2008. So we are probably sitting between 7% and 8%, something like that, Paul.

Paul Quinn – RBC Capital Markets - 7% and 8% of like $3.2 billion?

Don Kayne - Right.

Paul Quinn – RBC Capital Markets - Okay. In terms of log costs, I guess given the drop in lumber prices in 2009, B.C stumpage has sort of hit a low point. What is your expectation going forward here in 2010?

Jim Shepard - Mark, do want to answer?

Mark Feldinger - Well, obviously, Paul, the stumpage prices do reflect market dynamics in the purchased wood area of the business and the way the system works. So, if we see a sustained price increase, we would expect to see some increase to log costs and the proportional history of that is there for people to explore in the system.

Paul Quinn – RBC Capital Markets - So, log costs averaged what in Q4 then?

Mark Feldinger - I am sorry, we don't give that.

Tom Sitar - We are not disclosing individual costs.

Paul Quinn – RBC Capital Markets - Okay. Let me just turn to – in terms of some of your strategic customers such as Lowe's and Home Depot, they are definitely growing and seem to be taking market share. Given fiber issues and I guess economics as well, you guys seem to be going the other way. Maybe you could just sort of share some of the strategic thinking at Canfor, you know, going out three to five years, where do you want to be?

Jim Shepard - Excuse me? When your say "you're going the other way" – could you explain that, Paul, what you are saying?

Paul Quinn – RBC Capital Markets - Well, I mean, I am just referring to shuts at Rustad, Radium, Vavenby, and we sort of have that non-pine issue looming ahead in three to five years. So, just trying to understand how you are going to grow with your customer, given where you are located.

Jim Shepard - Well, I think it is pretty apparent that we have made a focused attempt to move forward more of our projects offshore, and that is certainly varying results. But first of all, we started up Mackenzie, which takes us back into green timber, and we have recently announced we are going to be starting up Chetwynd, which is also up in the green fiber area. So, you know, we are focused on growing the prime products side of our business as we go forward, and we certainly have demonstrated our ability to look after our prime customers in Japan and in the United States, and certainly, we see that aspect of the business having great growth potential throughout the rest of Asia, especially China.

Paul Quinn – RBC Capital Markets - Okay, maybe I had confused you. Just trying to figure out whether you are going to grow outside of the BC borders. I'm sort of thinking down the road that you are going to have to do that, and it looks like, you know, given your comments that 2009 was a low point. So, you know, are you guys starting to look at strategic acquisitions outside of BC?

Jim Shepard - I mean, there is basically – we have two basic markets, if you look at the big picture, and that is the SPF market and the Southern Yellow Pine market. And certainly, we will look for opportunities to grow our SPF basis as we go forward; and certainly, when the time is appropriate, Southern Yellow Pine as well. We have got a very good beach head in the United States with new sites for four mills and as the opportunities present themselves in the future, we will explore opportunities in both those arenas.

Paul Quinn – RBC Capital Markets - And just lastly, just on Canfor Pulp, you know, we have seen sort of over 7% increase in the unit price there. Just thinking, what is Canfor's sort of strategic direction around that 50% interest, is that something that, you know, it didn't seem like you wanted to buy more of it or take it back into Canfor, but is that something that is going to be liquidated or sold in the next little while?

Jim Shepard - Well, we don't have any plans to do either one of those at the moment. This is a good working relationship. They are a good customer for chips for us, and we are a supplier of chips for them, and it works well.

Paul Quinn – RBC Capital Markets - All right. Thanks, guys.

Jim Shepard - Okay.

Operator - Thank you. (Operator Instructions). The following question is from Pierre Lacroix from Desjardins Securities. Please go ahead.

Pierre Lacroix – Desjardins Securities - Thanks very much. I just want to have your sense on production capacity and how we can – or your shipments can be brought up in response to increasing demand eventually. Right now, you are running something like 65% of capacity, if it is right, and you have what, maybe between 500 to a billion square feet of capacity that is idled. What is, for the temporary curtailed capacity, what is the timeline you could expect to bring that capacity online in order to respond to any demand, you know, what is the line of time you could see there, and what is also the line of time that you can see or you could restart the idled capacity? Can you give some perspective on this?

Jim Shepard - First of all, let me – and Mark Feldinger is the gentleman that should answer that question, but the first thing I want to emphasize is that the supply-demand equation is quite good at the moment. We are not going to be in a rush to start up a mill because the market has spiked like it has right now, any time real soon. We would have to see a sustainable recovery in the markets before we would entertain any starting up of any of our operations. I think that would be true of anybody else in the industry, because it is just – the volatility of this market is just a really a dangerous place to be in when you start to talk about adding capacity, but I will pass it over to Mark.

Mark Feldinger - Thank you, Jim. So, our ability to respond will have certain seasonality to it. Obviously, log inventories must be in place for capacity to come on. As Jim mentioned, we will be very disciplined in terms of how we bring capacity back on and we would clearly focus on our highest margin operations in doing so. We have a number of mills where we have reduced shifts, and we would look at our opportunities to add those shifts back on as the market would dictate. I think that is really all that we can say at this point in time.

Pierre Lacroix – Desjardins Securities - Okay. Maybe I am going to ask the question otherwise to see if you can answer that, but let us say that you are running at 65% of capacity. How high can you go if tomorrow morning we suppose that there is a demand for 80% of capacity, are you able to fill that gap tomorrow morning or it is at more of 75% of capacity you will be running?

Jim Shepard - No. The answer is no because we wouldn't have the logs in place, for one thing. Okay?

We would also have to recruit the shifts to bring that up to that level. So, no, we wouldn't be able to do it tomorrow morning.

Pierre Lacroix – Desjardins Securities - Okay, so any magnitude you could bring that up, somewhat to 70%, 75%, or –

Jim Shepard - Well, the point is that if there is any production brought back on, it would only happen after we saw a sustained demand, okay? If we see the market is coming back up, we have the ability to do it, but it would have to be in a measured way and there is logistics involved here, getting timber into the yards is one and getting people to the mills is another. So I guess there's three things. First, there is the – we got to have sustained demand. Secondly, we have to get the logs into the yard, and three, we would have to get the people recruited back into those mills that we are going to start back up again. But that wouldn't happen any time real quick, that's is for sure.

Pierre Lacroix – Desjardins Securities - Okay. I appreciate your answer. Thank you.

Jim Shepard - Okay.

Operator - Thank you. The following question is from Daryl Swetlishoff from Raymond James. Please go ahead.

Daryl Swetlishoff – Raymond James - Thanks. Good morning, guys. A couple of questions, first on just weather conditions in BC. We know how much snow there is on Cypress. Is the weather also impacting your ability to get logs in your yard up north as well? Are we experiencing an earlier than expected spring break up?

Jim Shepard - Mark?

Mark Feldinger - So, very good question. We are about a week behind in our overall log deliveries versus our plan. Some sites are fine, but there is no question that the unseasonably warm weather that we had coming out of the Christmas period caused us to be a little slower than normal with respect to January deliveries. We don't anticipate any problems with respect to having sufficient fiber in the yards. We are actually in the catch-up mode as we speak.

Daryl Swetlishoff – Raymond James - How about in the US south, we have reports of, you know, extremely wet weather happening there. Are you also having trouble getting the logs into your mills there?

Jim Shepard - Well, it is challenging. They had a lot of wet weather down there that makes for more difficult logging and let us put it this way, we haven't curtailed any production because of the shortage of logs; and we don't expect to, but it is a challenge at the moment with the weather conditions they have down there.

Daryl Swetlishoff – Raymond James - Switching gears a bit, Tom, could you just remind us what your current FX hedging strategy is, and also what your current sensitivity to penny changes on an EBITDA basis?

Tom Sitar - We have hedges in place in formal collars that we have done following year end and we try to hedge approximately half of our financial exposure or net exposure to the US dollar. We have that in place effectively from April 1 and we have a fairly wide collar in place, so we are protected at over $0.98 Canadian and have a fair bit of room to go down below before the taxes. So we have continued our hedging, but in a wider collar.

Daryl Swetlishoff – Raymond James - Around $10 million, is that still –

Tom Sitar - No, it is about $5 million on an EBITDA basis.  $0.01 change.

Daryl Swetlishoff – Raymond James - Okay. And that would include your ownership of Canfor Pulp too, or is that just Canfor?

Tom Sitar - Sorry, that is just Canfor, the solid wood side of the business. And on a combined basis, it is like $8 million when you do it on a consolidated basis.

Daryl Swetlishoff – Raymond James - That makes sense. Okay, thank you. I have nothing further, thanks, guys.

Operator - Thank you. The following question is from Sean Stewart from TD Newcrest. Please go ahead.

Sean Stewart – TD Newcrest - Thank you. Good morning, everyone. A couple of questions. Just wanted to reconcile your lumber price realizations this quarter. When I look at Q4 versus Q3, we had slightly improved Canadian dollar Western SPF prices, but when I do the math on your results, it looks like your realization has dropped quite a bit. Just wondering if you can speak to mix issues this quarter that might have affected that.

Tom Sitar - Yes, there was a bit of a mix issue in the quarter that was probably a harder proportion of low grade as a proportion of a quarter and that wasn't a specific strategy, it is just the way it came out. So – and there were some changes in the spreads. You have to remember that all we are doing, Sean, is the 2x4 and the relationship between the entire product mix, the wides and things like MSR and – they are very J-grade stuff going offshore. So, it is a bit of a mix issue in the quarter.

Sean Stewart – TD Newcrest - Okay. And then, Tom, just wondering if you can speak to the SG&A expense this quarter. It looks quite low, such as year-end adjustments, or is this the sustainable improvement we can expect to see going forward?

Tom Sitar - Yes, I think the fourth quarter is actually pretty even. The comparison shows the change, but there were some unusual items in Q3. So the comparison shows it as an increase, if I remember it correctly, but I think the quarter itself is actually quite representative I think of the normal quarter.

Sean Stewart – TD Newcrest - Okay. And then finally, just opportunities for further working cap reductions. You took your finished lumber inventories down quite a bit this quarter. Can you just speak to overall levels and any further improvement there?

Tom Sitar - Well, we have been bringing down working capital quite significantly for the entire year, and there was a little bit more room, but frankly, not much. We have focused on all of our inventories, both finished log and in process and brought it down significantly. So in terms of further significance, I don't see that anymore. We are running pretty lean to where we are right now.

Sean Stewart – TD Newcrest - Okay. And then, just one last question, Jim, you noted the progress you have made at the few mills, your restarting with respect to labor, but can you speak to where things stand right now with the general labor negotiations?

Jim Shepard - Well, we are in negotiations right now. So I have restrained from really commenting on that at all, quite frankly.

Sean Stewart – TD Newcrest - Okay. We will wait a little bit longer. Thanks very much.

Jim Shepard - Okay.

Operator - Thank you. We will now take questions from the media.

(Operator Instructions with long pause for media questions).

There are no questions registered from the media. I will now turn the meeting back over to Mr. Shepard.

Jim Shepard - Okay. Thanks everybody for joining the call today. We look forward to speaking with you again in April.

Operator - Thank you, gentlemen. This concludes today's conference call. Please disconnect your lines, and thank you for your participation.