

CANFOR PULP INCOME FUND
Second Quarter 2007
Conference Call
July 25, 2007

Company Participants:

Paul Richards, President & CEO
Tom Sitar, CFO
Joe Nemeth, Vice-President, Sales & Marketing

Operator:

Good morning ladies and gentleman. Welcome to the Canfor Pulp Income Fund second quarter results 2007 conference call. Please be advised that this call is being recorded at webcast live at www.canforpulp.com. A recoding of the call and a transcript will be available on Canfor Pulp's web site. 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 that statement. I would now turn the meeting over to Mr. Paul Richards President and Chief executive officer of Canfor Pulp Limited Partnership. Please go ahead Mr. Richards.

Paul Richards – President and Chief Executive Officer:

Thank you operator and Good morning and welcome to Canfor Pulp Income Fund second quarter of 2007 conference call. Also available to answer questions on the call are Tom Sitar, our Chief Financial Officer and Joe Nemeth, Vice Present Sales and Marketing. Our comments today and less otherwise noted related to the operating entity Canfor Pulp Limited Partnership of which Canfor Pulp Income Fund owns 49.8%. Yesterday we reported sales of \$239 million for the second quarter, net income of \$35.9 million, distributable cash of 54 cents per unit and EBITDA of \$51.9 Million.

Overall the mills ran well. Manufacturing costs were in line. List prices were up. But these were more than offset by the strong Canadian dollar, the increase in fibre costs.

Now a quick comment on the markets in the second quarter. They were strong and, and supply continued to be tight. Producer inventories were dropped and are now reported to be 24 days in reasonably tight market.

In the operation side our mills the Intercon and Northwood Pulp mills took schedule maintenance down time, which amounted to about 8600 tonnes in the second quarter approximately the same as the first quarter. No issues arose from the down time and all the mills are running very well and based on the performances of the mills of the first half

of the year, we are - I ahead of last year's record production level. Paper operation also performed well during the quarter meeting expectations.

I'll turn the call over to Tom now for calling his financial summary; will return with some additional comment.

Tom Sitar – Chief Financial Officer:

Thank you Paul. I won't take you through all the details of yesterday's press release, but I would like to add several areas and provide comment on how the partnership performed in the second quarter. Before I start I like to remind you that the comparatives provided for 2006 represent the NBSK business of Canfor Corporation for all periods prior to July 01, 2006, when the partnership commenced operation.

Net income for the quarter was \$35.9 million versus \$48.6 million in the first quarter. EBITDA was down in the second quarter was \$51.7 million compared to \$60.1 million in the first quarter. On a quarter over quarter comparison, the change in EBITDA reflects the negative impact of the rise in Canadian dollar and higher fiber cost which were only partially off set by the increase in higher pulp and paper prices. In the first quarter the Canadian Dollar averaged approximately 85 cents is compared to 91 cents in the second quarter. This had a negative impact of approximately \$13 million on EBITDA in the current quarter.

First to the pulp segment now, the segment earned EBITDA of \$54.9 million in the first quarter which is, sorry in the second quarter which is \$8.9 less than in the previous quarter. Although list, prices in US dollar terms were 3% higher, the 7% rise in the Canadian dollar meant that realized pulp prices were 4% lower. Also negatively impacting EBITDA was a 7% increase in fiber cost during the quarter. Productivity and cash conversion costs were in line with previous quarter as production volume taken out with scheduled maintenance.

We expect schedule maintenance down time to reduce pulp production by approximately 6000 tones in the third quarter and a further 6000 tones in Q4. Shipments for the quarter were almost 3% higher as we were able to clear the back log of inventory arising from the CN strike in the first quarter.

Turning to the paper segment, the segment had EBITDA of \$900,000 which is a touch lower than the previous quarter of \$1.1 million. Sales volume was 18% higher in the quarter but just as in the pulp segment realized sales prices were 4% lower due to the strengthening Canadian dollar. The 7% increase in production was due to less down time taken for maintenance and higher mill productivity. Price increases into the North American market were implemented during the second quarter.

Other items that I would like to highlight, cash flow from operations, this is for the entire business, before working capital changes were \$45.6 million compared to \$58.5 million in the first quarter. The major reasons for the change were the lower operating earnings.

Cash, capital expenditures in quarter was \$7.2 million and are \$10.4 million on a year to date basis. For 2007, we still expect our capital spending to be about \$30 million, maybe a bit more.

Now comments about earnings we reported for Canfor Pulp Income Fund. We have an unusual accounting item as a result of the Federal Government Legislation to implement tax on distributions of publicly traded Canadian Income trusts starting in 2011. Canfor Pulp Income Fund is now required to record a future income tax liability. A one time, non cash charge of \$39 million to net income was recorded in the fund income statement. The fund will review this estimate of future income tax liability periodically and adjust it, adjust it if needed. This calculation is principally affected by differences between the tax basis and the accounting basis of fixed assets of the partnership. This charge is not and will not be dependent on the level of earnings or cash flow and to repeat, it is the non cash item and it will not effect distributions of the fund before 2011.

Paul back to you.

Paul Richards - President and Chief Executive Officer:

Thanks Tom. Markets today, the current list price in the United States is US\$830 per tonne, in Europe it is US\$800. In Asia's averaging between US\$740 to US\$785, on a net basis. The markets are snug, balanced. We have paper closures in for North America and Europe, off set against the threat with the rise in Canadian dollar or further closures in a pulp capacity. It's balanced out there and, and still reasonably strong.

Fiber prices, as Tom mentioned that prices have increased and will continue to increase as we ramp up the whole log chipping program. We saw the price of chips rise 7%, Q2 over Q1. It's really three components in that. The base price rose 2% so the rest is a rise in two other areas: One is because some saw mills close to our mills in Prince George took some down time, the net effect on freight cost was a little bit higher in the quarter and in the other area is the, we do have a modest adjustment in the chip quality and going from a winter season where we tend to have more times to a warmer season where the cold is better it was actually a slight increase in sales because of improved chip quality. Those, those accounted for the 7% increase.

As we go forward we do expect to see the supply for residual chips to stay relatively lower than it's been historically and we do expect to see a modest increase in round wood chipping. In the last call we had said that we, that we would have about 5% of our chips produced from whole log chipping. Today we expect that to approach 8%.

Finally we like to point out that we're pleased to announce the regular distributions that were made at 18 cents per unit. We believe that the markets are strong enough to off set the strength in Canadian dollars in rising price of fiber and with that I would like to pass the call back over to the operator.

Operator:

The team will now take questions from the telephone line. If you have a question, please press *1 on your telephone keypad. If you're using a speaker phone please lift the handset and then press *1. If at anytime you wish to cancel your question please press the # sign. Please press *1 at this time if you have a question, there'll be a brief pause and the participant will register the question. Thank you for your patience.

The first question is from Patrick Yung from Raymond James. Please go ahead.

Patrick Yung – Raymond James:

All right. Good morning just a, just a couple of questions here. I wonder if you could elaborate a bit of more on fiber costs and actually what, what your seeing in terms of spot pricing today in the region.

Paul Richards - President and Chief Executive Officer:

The spot pricing today really hasn't changed very much, it's still approximately what it was in due to the base price with chips that has remained, again, within a percent to what it would be.

Patrick Yung – Raymond James:

All right and any – any expectations of what's going to happen with Canfor Corp's Mackenzie sawmill and whether you guys have any contingency plans in case it does go down and [indiscernible] becomes more tight.

Paul Richards - President and Chief Executive Officer:

Well I think that of course Mackenzie doesn't directly supplies us chips but with all this, it effects overall market and we don't know what exactly what the Canfor final resolution is for that and we we'll have to see, however what we are saying is we do – we are planning to increase our supply of round wood chipping to compensated for any other tightening in the market.

Patrick Yung – Raymond James:

That makes sense and – and then overall, and an overall question is. What is your distribution strategy in terms of how you're going to look at supplemental distributions going forward and especially with the current exchange rate, what sort of threshold levels are - are going to make you guys you know really look closely at your regular distribution and in terms of FX.

Paul Richards - President and Chief Executive Officer:

Yeah, probably FX is the one concern that we have out there but our distribution is based on looking forward on the annual bases and so we think that 18 cents. We really don't know where the Canadian dollar will go and we're not exactly sure whether the pulp price will go but we did have a price announcement increase in July for North America and we see those markets really tight. We'll see how tight over the next few quarters, few months.

Patrick Yung – Raymond James:

All right great. That's all I have. Thanks a lot.

Operator:

Thank you the next question is from Mark Bishop from RBC Capital Market. Please go ahead.

Mark Bishop – RBC Capital Market:

Thanks, two questions. Paul you mentioned that the run rate for the year for whole log chipping will go from five percent to eight percent. Was the second quarter at the five percent level or – or was it all ready little higher than that.

Paul Richards - President and Chief Executive Officer:

Actually the second was a little bit lower than that because of the deliveries of round wood, it was difficult to get into the – into the woods, but so it was below the five percent we do expect to see it ramp up in Q3.

Mark Bishop – RBC Capital Market:

Okay, so- so we should be obviously weighting our overall average fiber cost for the second half at – at actually a higher level then eight percent given that if your going to average it at eight percent for the year you'll be obviously higher than that for the second half.

Paul Richards - President and Chief Executive Officer:

I would say that – that's probably correct.

Mark Bishop – RBC Capital Market:

Okay, and just looking at your – with the fiber cost increase in the second quarter being seven percent. Well I guess from our perspective your overall costs wear actually pretty good considering that you had your down time. Looks like your conversion costs taking

the down time into effect and the fiber coat were actually very good. Can you elaborate a little more on maybe what the impact of the down time was in the quarter and what your – may be year over year even if it's percent, year over year improvement in your conversion cost might be.

Paul Richards - President and Chief Executive Officer:

The rise in Canadian dollar is hiding the fact that we're running very well and our, the operations are good and our costs are very good control. But we – we don't break it out exactly that way but I would say that the second quarter numbers were very similar to the first quarter number in terms of tonnes with a very little – little change in the impact and going forward you know, well we do expect to see slightly lower numbers for – for down time – a schedule down time. Last year you recall we took most of it all in the second quarter, this year it's been spread out so we would - should see a very modest improvement in Q3 and Q4 relative to Q2 for scheduled maintenance shout downs but I'm always a little nervous talking about that because when your going into schedule maintenance shutdown your doing inspection, your doing work and you may find something that – that will off set what you think will be your shutdown so I would say that there is a pretty – the quarterly over quarter numbers will be pretty similar.

Mark Bishop – RBC Capital Market:

Okay, well that's helpful, the second half down time being I guess six per quarter, is that the same as the - the guidance you anticipated last quarter for the remainder of the year. It sounds a little different and I just wanted you to get specialized which mills are taking the down time.

Paul Richards - President and Chief Executive Officer:

If may be about a two tonnes higher, you know we are just hedging our bets a little bit, but what we're saying is the - the numbers that we have Q1 and Q2 are perform, our operating preferences been very well. We're probably estimating down time a little bit higher some what we've all set the may be the thought that we were not going to always run as well as we have been running the last two quarters. We've been doing very well.

Mark Bishop – RBC Capital Market:

Okay and which mills are taking the third and fourth?

Paul Richards - President and Chief Executive Officer:

Oh, sorry Northwood is taking a line down and Prince George is taking it there. The first one was Q3 and the second one is Q4.

Mark Bishop – RBC Capital Market:

PG in Q 4.

Paul Richards - President and Chief Executive Officer:

Yeah.

Mark Bishop – RBC Capital Market:

And, and Northwood was also down a [indiscernible] and Q2 were they not in the beginning of the quarter.

Paul Richards - President and Chief Executive Officer:

Yeah but basically they took one line down in Q3 and one line down, sorry Q2 and one line down in Q3. Now there is a little bit of a over lap there but that's really the way that's working out.

Mark Bishop – RBC Capital Market:

Okay, and I guess just stepping back I think earlier in the year maybe end of last year you were giving it a little bit of insight into some of the options you might be looking at in terms of capital spent not, not meeting the cap, but you know broader, I mean it's capital spending in the Prince George area. Is your thinking crystallized all and in terms of a direction you might go or, or sort of timing maybe of some of the boiler capex.

Paul Richards - President and Chief Executive Officer:

Well, we, we haven't [indiscernible] in on the boiler capex. At this point we're still looking at the relatively modest capital spending in the \$3 to \$5 million project type think, that would improve our cost structure and improve our power generation so those guys working on now, we continue to look at the longer term focuses in terms of where we are going to be getting new regulations of the impact what we may want to do on boilers and we are looking at you know fiber supply long term what makes them to upgrade the boilers. We continue to look at those things we have not finalizing direction yet.

Mark Bishop – RBC Capital Market:

Okay. That's great. Thanks very much.

Operator:

Thank you. The next question is from Herve Carreau from CIBC World Markets. Please go ahead.

Herve Carreau – CIBC World Market:

Thank you. I just back on the fiber cost, Paul you mention that you expect some good increase down the road because of more wood chipping but just wondering if you see more pressure on the base price itself for the rest of the year.

Paul Richards - President and Chief Executive Officer:

I don't see anything significant there. In fact to some degree you might see some easing but, but at least from the interior of British Columbia there's not a lot of pressure today, well mean obviously suppliers would like to see higher numbers if they could but the reality is that's the market price and it hasn't changed a whole lot over the last two months and we don't see that change in the near term.

Herve Carreau – CIBC World Market:

Great thank you.

Operator:

Thank you the next question is from Stephen Atkinson from BMO Capital Markets. Please go ahead.

Stephen Atkinson – BMO Capital Markets:

Thank you good morning. In terms of the whole log chipping, I assume you're using beetle wood for that?

Paul Richards - President and Chief Executive Officer:

That's correct.

Stephen Atkinson – BMO Capital Markets:

And in terms of the differential, I think last time I, we spoke, I was looking at about a 10% higher cost for whole log chipping verses if you bought chips on the open market is that the correct assumption.

Paul Richards - President and Chief Executive Officer:

Oh no it's more than that.

Stephen Atkinson – BMO Capital Markets:

It's more than that.

Paul Richards - President and Chief Executive Officer:

Oh yeah for sure. I think that typically today you're probably looking at \$30 to \$40 tonne type differential.

Stephen Atkinson – BMO Capital Markets:

Higher for whole log chipping.

Paul Richards - President and Chief Executive Officer:

Yes, yes.

Stephen Atkinson – BMO Capital Markets:

But you're not paying anything for the wood I assume.

Paul Richards - President and Chief Executive Officer:

That's only, that's delivered chip that's [indiscernible] down the path.

Stephen Atkinson – BMO Capital Markets:

Yeah what, what I meant is sorry I asked the question wrong. What I meant to say was that I assume there's no stumpage on these, on this beetle wood that you're getting.

Paul Richards - President and Chief Executive Officer:

Very small stumpage, yes 25 cents.

Stephen Atkinson – BMO Capital Markets:

Yeah in terms of your major projects where or smaller projects where you're going to spend \$20 million in the later half of the year after spending you know just over 10 in the first half. Can I assume that maybe half of that is directed to cost reduction?

Paul Richards - President and Chief Executive Officer:

I would say you can assume one way or another it's all directed to cost reduction or productivity improvement.

Stephen Atkinson – BMO Capital Markets:

Okay. And can you talk about your order back log at the moment in terms of pulp?

Paul Richards - President and Chief Executive Officer:

We're generally, we're generally balanced you know we're always looking for opportunities to generate high revenues if there's opportunities so we don't like to be fully sold out all the time because markets are changing, but basically we're, we're sold out and we're, we're in a good balance position. That's not a, not a problem for us.

Stephen Atkinson – BMO Capital Markets:

Okay and the last question do you have any tax shields?

Tom Sitar – Chief Financial Officer:

Yes, yes we do Stephen. The partnership had a tax basis has capital cost allowance and that is been currently used in, in determining the taxable level of, of distributions so yes, yes we do have.

Stephen Atkinson – BMO Capital Markets:

Okay. Thanks a lot.

Operator:

Thank you once again, analysts may press star one to register for questions. The next question is from Paul Quinn from Salman Partners. Please go ahead.

Paul Quinn – Salman Partners:

Yeah. I just wanted to get an idea. What our current spot price is for fiber and the interior?

Paul Richards - President and Chief Executive Officer:

Well the, when you talk about spot prices, there really isn't a spot price. Everything is pretty much under contract and so it's being traded on the contract basis.

Paul Quinn – Salman Partners:

Okay. What are contract prices?

Paul Richards - President and Chief Executive Officer:

Well they range and I think they range from one of base price without freight, because freight is different across the board, but their probably in the \$70, \$75 range.

Paul Quinn – Salman Partners:

Okay and your freight is averaging somewhere around the, I don't know low 20's.

Paul Richards - President and Chief Executive Officer:

Well it's little less than that for sure and, but it certainly varies and it's varies Q2 over Q1.

Paul Quinn – Salman Partners:

Okay. And, and you made a comment on the base rate, you expect it to be on change going forward. I'm a – I'm a little puzzled with that given that saw mills in the BC interior are loosing some money right now and the outlook doesn't look too cheery.

Paul Richards - President and Chief Executive Officer:

Well, most – most fiber pricing in the interior British Columbia are long term contracts and so over the longer term you could see that the – that pricing change, but they're still running on longer term contracts that run for the next six months to two years.

Paul Quinn – Salman Partners:

I understand the long term contracts. Do you see any more closures on the permanent side then?

Paul Richards - President and Chief Executive Officer:

Oh, I don't know about that, I think there – well, I don't know. We haven't anticipating anything other than what we have today.

Paul Quinn – Salman Partners:

Okay. In terms of geographic sales. Where is that shifted to right now?

Paul Richards - President and Chief Executive Officer:

Well we have – we've generally been growing in North America. We've also been growing a little bit in Asia and we've been trekking a little bit in Europe primarily because those are the best freight effective and customer base for our products.

Paul Quinn – Salman Partners:

Okay and just lastly on, you mentioned at the start on – on higher Canadian dollar and might lead to additional curtailments, Where do you curtailments, I mean in the market place, not naming specific mills, but which area do you see – might come under, I mean

obviously the BC coast here is under some constraint going forward, but where else in Canada?

Paul Richards - President and Chief Executive Officer:

Well, I – I really don't want to say. I think that we all can look at the quarterly statement and form our own conclusion.

Paul Quinn – Salman Partners:

Okay, that's so much so thanks.

Paul Richards - President and Chief Executive Officer:

Okay.

Operator:

Thank You. The next question is from Derek Bobbe from CUNA Mutual Group. Please go ahead.

Derek Bobbe – CUNA Mutual Group:

Hi gentlemen. I have a question for you regarding the Canadian dollar. Apologies if it's already been asked. I joined a little bit late. I was just wondering if you are thinking about hedging out Canadian dollar as going forward to preserve your margin.

Paul Richards - President and Chief Executive Officer:

Good question. We – we obviously think about that and we did yet a little bit of a surprise with one off in Q2, so we haven't made any formal conclusion on it but we - we do talk about it. We certainly will consider it.

Derek Bobbe – CUNA Mutual Group:

Okay. Thank you.

Operator:

Thank You. The next question is from Mark Bishops from RBC Capital Markets. Please go ahead.

Mark Bishop – RBC Capital Markets:

Thanks. Well I just follow up in a additional question, just on the fiber pricing again. What you to, your terming contract prices I think which you said were 70 to 75 before freight. Just to clarify that, does not include the bonus payment. Is that correct?

Paul Richards - President and Chief Executive Officer:

What do you mean by bonus payment?

Mark Bishop – RBC Capital Markets:

Well, you said at the start of your conversation this morning you highlighted that you actually are paying a higher bonus.

Paul Richards - President and Chief Executive Officer:

Oh. The chip quality bonus, sorry yeah. That's a generally normal, yes you have to [indiscernible] just before that. Right.

Mark Bishop – RBC Capital Market:

And the bonus can range, I guess its bonus and quality and other but, what \$10 - \$15?

Paul Richards - President and Chief Executive Officer:

Oh no. It wouldn't be that much. It's just that you can get a claim for maybe \$2 or \$3 to maybe \$4 or \$5 dollars in that kind of a range.

Mark Bishop – RBC Capital Markets:

For the total bonus?

Paul Richards - President and Chief Executive Officer:

Yep.

Mark Bishop – RBC Capital Markets:

Okay, okay. And just stepping back, I guess a little bit from the near term on fiber and looking forward as to developments and then BC with the, I guess the tenders that were put up by the BC government and some of your peer companies, I guess it'll maybe a little more vocal on their concern around projects that might be coming up for energy and – and competition for fiber. Just wanted to get, kind of a pulp as a - as a view on, on where the government currently standing on, on with respect to these issues and sort of

what you think the vulnerability is for fiber to, to be a bit up due to other projects out there?

Paul Richards - President and Chief Executive Officer:

Well, we do share our, our peers news that there could be a fair circumstance that would have a, in the kind of in the power producer for example been a, get a, get a subsidy in effect to, to be able to – to want to use the wood and then generate power. So we do have a concern about that. Having said that we've – we've ourselves put forward a request to saying that we would like to participate in – the additional power generation. Well, as in a freight, we today produce about a 100 mega watts of power from either black liquor residual, so we – we're a large power producer. We have the ability to grow in that area and so we also want to participate in that call for power if I'm going to exist on the same basis that others do, so we would be concerned if there is a non level playing field in terms of that cause the fiber for whatever use, whether it be energy or reproduction of pulp.

Mark Bishop – BRC Capital Market:

And are you, at this point, are you sensing that, that we are heading down a path of a non level playing field. I guess the politics seem to be directing to that kind of an outcome, at least that's the way it works for this point.

Paul Richards - President and Chief Executive Officer:

I'm not sure. I think that the – without some of the concerns that had been raised that might of occurred, but I think there's a revelation that we do have an industry based on a certain balance and I think there is a concern that we don't want to throw that too much or to bounce it. I don't know that we're going down toward a level – an unlevel playing field. We'll have to see how that play goes.

Mark Bishop – RBC Capital Markets:

Okay. But I guess that relates to - to my final question, that when you look at kind of a long term capital planning and some of the options that you might have been looking for, that has to be one of the, the biggest impacts or the influences playing on your analysis, that may in fact drive you to, to look maybe else where, if there are growth opportunities.

Paul Richards - President and Chief Executive Officer:

I don't know if I would say look out for it, but certainly the potential generation of power is part of the thought process.

Mark Bishop – RBC Capital Markets:

Okay. Thanks very much Paul.

Operator: Thank you once again. Analysts please press *1 to ask the question.

Operator: No further questions, we'll now take questions from the media. Media if you have a question please press star one your telephone keypad. There'll be a brief pause after the register of the question. Thank you for your patience. The first question is from Arthur Williams from the Prince George Free Press. Please go ahead.

Arthur Williams – Prince George Free Press:

Good morning gentlemen. You just mentioned, desire to expand your electrical production capacity. Can you may be elaborate a little bit on that in terms of what kinds of plans you have to expand that capacity?

Paul Richards - President and Chief Executive Officer:

Well we, there's a range of options, so it's not like we have a set planned and like report on that. We are looking at what options are okay, but we do have four generators, none of which are running at a full capacity for a range of reasons, so there would be a ability to increase those, it's part of what we're looking at, but also the potential to actually even go further in power generation in, increase [indiscernible] so there's no reason why we can't consider that as well with anybody else. We do already have a lot of the infrastructure and could move forward in that so there's a range of options that we would be looking at.

Arthur Williams – Prince George Free Press:

And, like we'd be a sort of a co-gen expansion in terms of expanding your electrical capacity at the existing mills at this point or.

Paul Richards - President and Chief Executive Officer:

Oh, that certainly could be an option.

Arthur Williams – Prince George Free Press:

Okay. Thank you.

Operator:

Thank you. There are no further questions registered this time. Like to turn the meeting back to Mr. Richard.

Paul Richards - President and Chief Executive Officer:

Well, thank you very much operator and – and I'd like appreciate, I appreciate everybody showing up on the call and again I hope for our business will continue to see as far as [indiscernible] prices and – and also hope that we see a mitigation, a little bit of the rise in Canadian dollar, but again we had a – we had a good quarter and, and again thank you very much for being on the call.

Operator:

Thank you. The conference is now ended. Please disconnect your lines at this time. We thank you for your participation and have a great day.