

Canfor Pulp Products, Inc.
Q3-2011 Conference Call
October 25, 2011, 11:00 AM (Eastern)

Company Participants:

- Joe Nemeth, President & CEO
- Terry Hodgins, CFO
- Brett Robinson, Executive Vice President of Operations

Operator:

Welcome to the Canfor Pulp Products Inc. Third Quarter 2011 Results Conference Call. Management's comments today, unless otherwise noted, relate to the operating entity Canfor Pulp Limited Partnership, of which Canfor Pulp Products Inc. owns 49.8%. Please be advised that this call is being recorded and webcast live on the company's website canforpulp.com. A recording of the call and the transcript will be available on the company's website as well. The company would also like to point out that this call will include forward-looking statements, so please refer to the Monday, October 24, 2011 press release for associated risks of such statements. I would now like to turn the call over to Mr. Joe Nemeth, President and CEO of Canfor Pulp Products Inc. Please go ahead, Mr. Nemeth.

Joe Nemeth:

Thank you. Good morning ladies and gentlemen and thank you for joining us today. On the call with me are Terry Hodgins, our CFO, and Brett Robinson, our Executive Vice President of Operations. Keeping with our usual format, I'll offer a few comments on the third quarter, after which Terry will provide his financial commentary, and then I will wrap up with some comments on our outlook for the remainder of 2011.

Yesterday, we reported the following financial results for the third quarter: sales of \$234 million, net income of \$24 million, EBITDA of \$49.6 million, and distributable cash of \$0.37 per unit.

Global softwood markets weakened in the third quarter of 2011 with seasonably slow demand during the summer months from Europe and North America and some destocking by China. Global softwood producer inventories increased four days during the third quarter, ending at 32 days of supply. During the quarter, NBSK list prices decreased US\$70 in North America per tonne to US\$970.00 and US\$60 per tonne in Europe to US\$950. In China, NBSK pulp list prices decreased \$90.00 to US\$840.00.

Now to our Operations. The annual maintenance outage at the Northwood Mill was extended to complete the recovery boiler upgrade project funded under the federal government's Green Transformation Program. The outage, previously projected to result in 40,000 tonnes of reduced production, was extended further due to unforeseen delays and was completed in October with a total of approximately 65,000 tonnes of reduced production, of which 45,000

tonnes impacted the third quarter, with the balance in the fourth quarter. As a result, market pulp production for the quarter was 221,000 tonnes, down 45,000 tonnes from the previous quarter. On the paper side of the business, operations continue to perform very well, and we set an average daily production record during the quarter.

Third quarter unit manufacturing costs increased from the prior quarter due primarily to the outage at the Northwood Mill, as well as slightly higher fiber costs.

Now, an update on the status of our progress on the \$1 billion Pulp and Paper Green Transformation Program. As you may know, the Partnership has been allocated \$122.2 million under the Green Transformation Program (GTP) to proceed with four projects. The first two projects were completed in the first half of 2011, and the biggest, the major Northwood recovery boiler upgrade was completed in October. The final project is at the Prince George Pulp and Paper Mill, which will include an upgrade to the feed water system and precipitator.

I will now hand the call over to Terry Hodgins and following his financial summary, I will return with a few additional comments. Terry.

Terry Hodgins:

Thank you, Joe. Comments on the third quarter results are yesterday's press release, so I won't take you through all the details, but would like to highlight some specific items and their impact on the financial results.

As Joe previously mentioned, we are reporting on the results of the Partnership, in which Canfor Pulp Products Inc. holds 49.8% ownership.

For the third quarter, the Partnership reported EBITDA of \$49.6 million compared to \$64.1 million in the second quarter. The causes of the quarter over quarter change are fairly evenly split over between lower pulp prices and the impact of lost production from the Northwood Mill shut. Realized pulp price, which is the US\$ list price less customer discounts and rebates, all translated to Canadian dollars, decreased as a result of lower market NBSK list prices, and this was somewhat offset by a weaker Canadian dollar. Unit manufacturing costs increased approximately 6% as a result of the extended outage at the Northwood Mill, as well as slightly higher fiber costs. The increased fiber costs resulted from sourcing of higher priced whole log chips. As you know, residual chip costs vary with the price of pulp. Residual chip costs lag reductions in pulp mill net prices and we would expect to see lower residual chip costs in the fourth quarter.

Q2 EBITDA from the pulp segment of \$48.9 million decreased \$17 million from the prior quarter. The Paper segment EBITDA increased \$2.5 million, reflecting the lower value of slush pulp transferred to paper, lower spending on maintenance costs, and higher operating rates on the paper machine.

We ended the quarter with cash of \$32 million, an increase of \$5.5 million during the quarter. Cash spending on GTP projects during the quarter totaled \$24.1 million and cash reimbursements from the Canadian government totaled \$19.2 million. We do have the \$30

million bridge credit facility available to fund timing differences between expenditures and reimbursements for these projects should the need arise; to date, we have not been required to access that facility.

The forecast level of capital expenditures for 2011 has been increased to approximately \$143 million or \$67 million net of GTP spending from the previously projected \$125 million or \$49 million net of GTP funding. The increase includes estimated cost increases resulting from delays in completing the Northwood recovery boiler project and also reflects amendments to the timing and cost of other projects in the Partnership capital program. The increase in planned capital spending is expected to be funded from cash carried forward from lower than normal cash expenditures in 2010 and excess cash generated over distributions for the first three quarters of 2011.

Now a note on the Partnership's distributable cash. We continue to determine the level of cash distributions based on the level of cash flow from operations before changes in non-cash working capital less capital expenditures, major maintenance amortization and interest expense. During the year, distributions are based on estimates of full year cash flow and capital spending; thus, distributions may be adjusted as these estimates change.

During the quarter, the Partnership generated distributable cash of \$26.4 million or \$0.37 per unit and distributed \$21.4 million or \$0.30 per unit to Canfor and Canfor Pulp Products Inc. (CPPI). Based on the results of the Partnership for the nine months ended September 30, 2011, CPPI declared a quarterly dividend of \$0.40 per share to be paid on November 10, 2011 to shareholders of record on November 3, 2011. I would now like to turn the meeting back to Joe for his additional comments.

Joe Nemeth:

So, as previously discussed, we have substantially completed the Northwood recovery boiler project with a total of approximately 65,000 tonnes of reduced production, of which 45,000 tonnes have impacted the third quarter with the balance in the fourth quarter. This project is expected to deliver significant environmental benefits, as well as further improve our cost position. There are no further maintenance outages planned in the fourth quarter of 2011.

Now to the pulp market outlook. We expect further softening in pulp markets during the fourth quarter. Global softwood producer inventories have risen, however, extended fall maintenance downtime, especially in Canada, due to several large GTP funded capital projects should mitigate growth in inventories in the short term. In fact, recent World 20 results for September showed a drop in days of softwood inventories by two days, down to 32 days. Chilean and Russian softwood producers have led announcements for price decreases in a range of US\$60 to US\$80 per tonne in October for China, with some prices at even lower levels. The Partnership announced an NBSK pulp list price decrease in October of US\$50 per tonne to US\$790 per tonne for China. An NBSK pulp list price decrease was also announced in October of US\$20 per tonne for North America, taking the list price to US\$950.

In conclusion, our Northwood recovery boiler upgrade is complete, and our near-term focus will be on running well and reducing costs with a goal of posting strong financial results regardless of market conditions. Operator, that concludes our prepared comments and we're now ready to take questions.

Operator:

Thank you. We will take questions from the telephone lines. We will first take questions from the financial analysts followed by the media. If you have a question, please press *1 on your telephone keypad. If you're using a speakerphone, please lift the handset and then press *1. If, at any time, you wish to cancel your question, please press the # sign. Please press *1 at this time if you have a question. There will be a brief pause while participants register, and we thank you for your patience. The first question is from Graham Meagher from TD Securities. Please go ahead.

Graham Meagher:

Morning guys. It's Graham Meagher at TD Securities. Joe, the first question, can you compare how the current market feels to both this time last year and to prior cycles?

Joe Nemeth:

How does the same but different sound? We all know that pulp is a cyclical industry so you're going to have swings and you have had swings in price. Last year, we had a similar correction, as you know. I think last year's was shorter lived than what's expected this time, that would be the difference. And the question really is and what we're all asking, is how far do prices go and how long do they stay there until they rebound. Because, I think we all agree, the medium to long-term outlook for softwood is pretty favorable in terms of supply to demand balance.

Graham Meagher:

Okay, thanks. And Terry, just on the GTP, the payables and receivables. I see there's \$26 million payable and \$52 million receivable and it seems most of that is coming in and going out in Q4. Is that a net cash inflow of \$26 million in Q4? Is that the right way to look at that?

Terry Hodgins:

That's correct. It will be on the GTP side. Those two balances will bring in further cash in the fourth quarter. And, as we get near the end of the year, I won't say they will be zero, but both those amounts will be reduced significantly.

Graham Meagher:

So, they will effectively net out, then?

Terry Hodgins:

Yes.

Graham Meagher:

Okay, then. And just one last question on the CapEx increase obviously, most of that at Northwood. Is that pulling any projects forward from 2012 that would have been done sort of at the next shut at Northwood?

Terry Hodgins:

No, not really. It's mainly in at the Northwood Mill, the major boiler project.

Joe Nemeth:

But, what I might add to that is that we did plan, though, to minimize the impact to the company, to do our regularly scheduled maintenance shut concurrent with this major upgrade. So, we did both at the same time.

Graham Meagher:

Got you. Any guidance on CapEx for 2012?

Terry Hodgins:

Not yet, we're working through our 2012 business plans and we will have those developed. We typically present those to our board near the end of the year and we would then be commenting on 2012 in February when we announce our year end results.

Graham Meagher:

Great. Thanks very much.

Operator:

Thank you. Our next question is from Paul Quinn from RBC Capital Markets. Please go ahead.

Paul Quinn:

Yeah, thanks very much. A couple of questions here. One, just on the Northwood outage, you know, at the Q2 call, we expected 40,000 tonnes. Then, you came out at the end of September and said it's going to be an additional two weeks or 10,000 more, and now it turns out to be 65,000. What, specifically, delayed that project so much? And, what did you find once you started the project that you knew you were going to be so much over the time allowed?

Joe Nemeth:

Yeah, Joe here. There were a number of unforeseen delays, nothing to do with the scope of the project or what we hoped to achieve in terms of benefits. In fact, as I mentioned earlier, the mill is up and operating and we expect to deliver the full benefits of the project.

Paul Quinn:

Okay. So, it's not any one specific thing. It's just a whole bunch of little things that accumulated into the overrun?

Joe Nemeth:

Correct.

Paul Quinn:

And just on your outlook going forward there, Joe. You know, there are some pundits out there with \$800 NBSK price forecasts for next year. What's to say that we don't get down to that level?

Joe Nemeth:

Well, as you know, anything's possible. What I would say is the pundits, as you know, have been wrong far more often than they have been right, and by a very large amount. And, so I always find it pretty dangerous to be pretty clear and confident in the exact number. The general consensus is that we expect lower pricing levels in 2012 than we've seen in 2011. Whether that's \$50 or \$100 or more, who knows?

Paul Quinn:

Okay. Then, in terms of your specific contracts with Chinese customers, are you seeing them back off? I'm just trying to get an idea why you dropped the price \$50 in that market as opposed to the \$20 in North America and Europe.

Joe Nemeth:

Yeah. So, the way the market's played out, the Russians and the Chileans, who are normally the leaders in China, because they move quite a bit of volume there, they announced a \$60-80 decrease a number of weeks back. We then followed with a \$50 decrease, not the \$60-80, for our premium NBSK, and we've held firm with that level. In terms of the buying, there's no question that Chinese consumption of pulp in very recent times is less than normal. And we're seeing traders now sitting on the sideline wondering, well, if price should go lower, why should I buy? So, you're kind of in a cat and mouse game right now in the short term, in terms of people holding off just to see where the price is going to go before they place their full orders.

Paul Quinn:

Thank you. Best of luck.

Operator:

Thank you. We will now poll for questions from the media sector. And, as a reminder, if you have a question, please press *1 on your telephone keypad. There are no further questions registered. I would now like to turn the meeting back to Mr. Nemeth.

Joe Nemeth:

Okay. Thank you very much and I thank everyone for taking the time to join us today. Please call if you have any further questions.

Operator:

Thank you. The conference call has now concluded. Please disconnect your lines at this time, and we thank you for your participation.