RESEARCH REPORT

November 9, 2020

Stock Rating	BUY
Price Target	CAD $24.01
Current Price	CAD $17.83

Ticker	CFP
Market Cap (MM)	$2,233
P/E NTM	7.6x
EV/EBITDA NTM	3.9x

52 Week Performance

Metals & Mining

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Canfor Corporation

Knock on Wood

Historically, QUIC's Metals & Mining sector has had limited exposure to the forestry industry. Given the bullish run that the industry has had since the beginning of the COVID-19 pandemic, our team decided to take a deeper look at the industry and investigate whether there were intriguing companies within it. After conducting a market scan, the team set its sights on Canfor Corporation.

Canfor Corporation is an integrated forest products company based out of Vancouver, British Columbia. The company manufactures and sells softwood lumber, pulp and paper products, remanufactured lumber products, engineered wood products, and wood pellets, as well as produces green energy. The company's products are used in residential, commercial, and industrial construction all over the world.

During the forestry industry's bearish run in the second half of 2018, Canfor was heavily punished, with its share price dropping 71.9% to $8.80 between August 2018 – August 2019. Over Q2 and Q3 2020, Canfor's share price has begun to rebound, but is yet to come close to regaining its losses since 2018.

This report identifies three key reasons why Canfor is a company that the Metals & Mining sector would like to hold: it has efficient business operations, has a runway for growth through a geographic diversification strategy, and has strong financial fundamentals. As well, this report will provide an industry overview, company overview, assessment of risks, and financial analysis.

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Industry Overview

The forestry industry encompasses the economic activities related to lumber production, wood products, and paper & pulp. The lumber industry involves growing trees and harvesting lumber which can then be used for various purposes including plywood, oriented strand boards (OSB), pulp, paper, and other refined wood products. On a simplistic basis, lumber company revenue models are a function of the market price of lumber, which is a commodity, and the volume of lumber sold. Lumber production is measured in board-feet (fbm) which is a square foot of lumber that is one-inch thick.

This overview will comprehensively outline the key elements of the forestry industry to provide a simplified picture of the dynamics surrounding Canfor.

Value Chain

The forestry industry features various intertwined value chains depending on the end-product. Broadly, the key elements of the value chain can be defined as 1. Sourcing, 2. Processing, 3. Refining, 4. Retail.

Sourcing

The first step of the forestry value chain consists of forest management & planning and harvesting. Logging engineers use technology to ensure that soil, water, and other natural resources are protected during harvesting and are also responsible for designing cut-block layouts and road locations. Major lumber producers hold millions of cubic meters of annual harvesting rights in areas approved by a nation's forestry council. In the United States, timberland is private property and can therefore be privately owned. In Canada, aside from in the Maritimes, timber is mostly harvested from government land where companies pay fees for harvesting, known as "stumpage". Once trees are cut down, they are transported to manufacturing facilities via truck, barge, or rail.

Processing

Once logs are ready for transport, they are transported to be processed, most commonly in Sawmills, although sometimes directly to pulp and paper manufacturers or engineered wood product manufacturers. Sawmill facilities use automated processes to debark the logs and dry the sawn timber, ultimately producing lumber, chips, and fibre. Wood chips are then transported to pulp and paper manufacturers and lumber can be transported to various users including engineered wood products manufacturers, secondary product manufacturers (i.e. produce furniture), or directly to distributors or retailers. The major players within the lumber space own various sawmills across their geographies of operation.

Refining

The wood chips that are produced at sawmills are used primarily in pulp mills, which combine wood chips and chemicals to produce pulp. This pulp is further refined to produce various sorts of paper products such as newsprint, cardboard, paper towel, legal paper, etc.

EXHIBIT I

Industry Competitors Within the Value Chain

Integrated	Specialized
CANFOR	*Sawmilling* INTERFOR Building Value
resolute Forest Products	*Engineered Wood* Norbord
West Fraser	*Pulp & Paper* Domtar
WFP Western Forest Products Inc. DEFINING A HIGHER STANDARD	

Source(s): Various Company Filings

Industry Overview

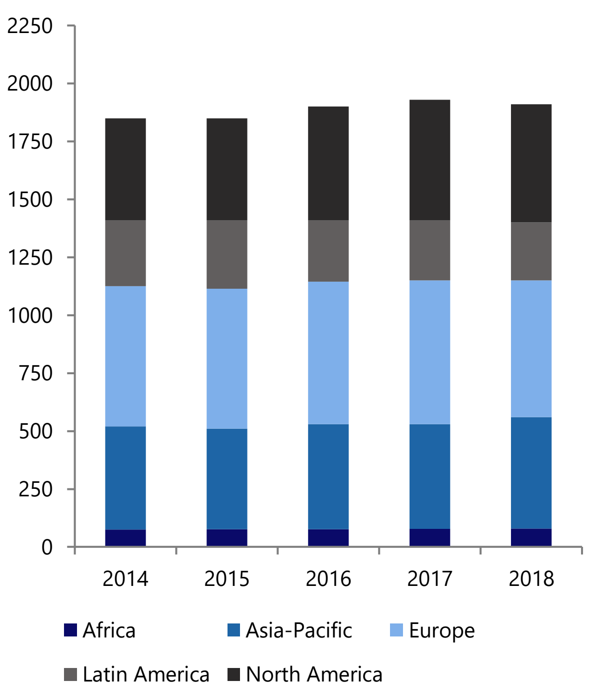
Many integrated forestry companies hold both lumber and pulp & paper manufacturing operations. On the other hand, lumber is transported to secondary product manufacturers who further refine the wood into millwork, furniture, flooring, etc. or to engineered wood products manufacturers who produce products with construction applications like OSB and glulam.

Retail

In the final stage of the value chain, all lumber-based products are sold to distributors, retailers, and contractors who eventually sell to customers. As previously listed, these include paper products, engineered wood products, and secondary products.

EXHIBIT II

Roundwood Removals (Million cubic meters)



Source(s): Food and Agriculture Organization of the UN

Ultimately, the consumer demand for each of these products is a crucial driver of supply and prices.

Industry Landscape

Competitors

The largest Canadian forestry companies within the M&M sector's universe are Canfor, Norbord, Interfor, West Fraser Timber, Resolute Forest Products, Western Forest Products, and Domtar. Among these, Canfor, Resolute Forest Products, Western Forest Products, and West Fraser Timber are integrated forest products companies which own various levels of the value chain. Norbord competes primarily within engineered wood products and is the world's largest producer of OSB. Interfor is a sawmilling company and is one of the largest lumber producers in the world. Domtar is one of the largest pulp and paper producers in the world.

Production by Geography

North America supplies most of the world's lumber production, with most timberland situated in the Pacific Northwest (British Columbia, Washington, and Oregon), sawmills most prominent in the US Southeast, and forest and paper production mostly in the Northeast. In Canada, Quebec is the other forestry hub after British Columbia.

As relatively non-densely populated countries, Canada and the United States make up a combined 16.1% of global forest area, second behind Russia which singlehandedly owns 20.1%. Naturally, North America produces a large percentage of the world's lumber supply, with Canada and the United States having 12.3% and 8.4% market share of wood product exports respectively. As of 2017, there was 63Bfbm of lumber production in North America, with approximately 50Bfbm consumed in the United States and 9Bfbm consumed in Canada. North American lumber producer face competition from Russia and the rest of Europe for exports to Asia.

As of 2020, approximately 5Bfbm of lumber have been

Industry Overview

produced monthly in North America. Of this, 24% was produced in the US West, 38% in the US South, 16% in British Colombia, 20% in the Canada Prairies and East Coast, and 2% elsewhere in the US.

Industry Drivers

End-Markets

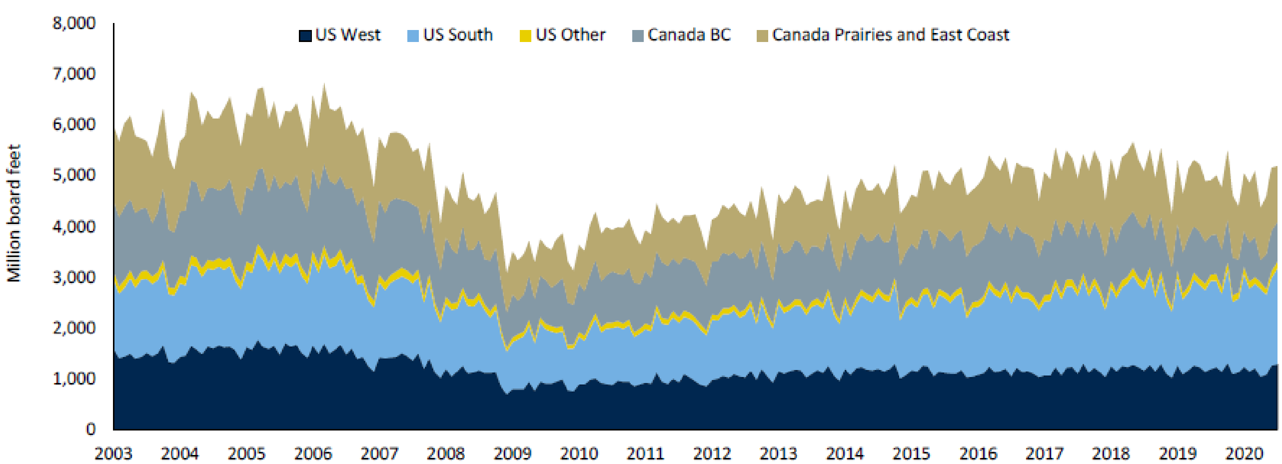
One of the biggest demand drivers for the lumber industry is "Housing Starts" which are the new housing units started in a certain period. This is an important driver in North America, compared to Europe and Asia, where lower population density means that detached houses, which require wood, are more prevalent. As of October 2020, the Homebuilder Confidence Index which measures the market conditions of the single-family housing market, set a new record for the third consecutive month – currently at 85 compared to the 35-year average of 50. This growing confidence is a good sign given that US housing starts peaked in July 2020 at 139,000 units. The performance of this end-market is a big reason why lumber prices are currently at all time highs.

As well, repair & remodel demand is a big driver for lumber. The effects of this demand are reflected in the performance of Home Depot and Lowe's, which are up 86.6% and 153.9% since the end of March 2020. The size of the homeowner improvements and repair expenditure in the United States is up steadily since 2015, growing 22.1% to $326B from Q1 2015 to Q1 2020, with a projected growth to $339B by Q1 2021.

End-markets for pulp & paper producers can be comprised into packaging (i.e. carton-board), graphic paper (i.e. newsprint), and other applications (i.e. tissue). While demand for graphic paper has declined at a CAGR of -6.1% and -1.5% since 2010 for newsprint and printing & writing, decent performance in packaging and other applications is contributing to overall growth. While demand for most graphic papers

EXHIBIT III

North American Lumber Production by Region (Monthly)



Source(s): WWPA

Industry Overview

will decline in all geographies over the next decade, emerging economies in Latin America, Eastern Europe, and Asia will drive >2% CAGR growth in tissue and packaging papers.

Macro-Factors

Climate catastrophes and their effects leave the lumber industry's supply highly susceptible, from soil degradation to wildfires. During the 2018 wildfires in British Colombia, approximately 300,000 hectares (23%) of the area impacted occurred in the timber harvesting land base, where it is legally available to harvest.

Mountain Pine Beetles are a species of bark beetle native to forests of Western North America that can hollow out trees and diminish lumber supply. As of 2020, Mountain Pine Beetle infestation is expected to have killed 55% of British Columbia's mature merchantable pine – approximately 740 million m3.

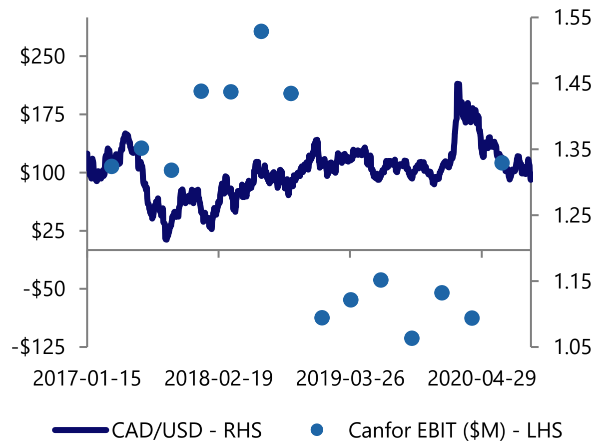
Another macroeconomic factor is trade relationships between key lumber exporters and importers. In 2018, the American government hit the Canadian forestry industry with tariffs, including 22% on newsprint, after alleging that the dumping by Canadian lumber producers enabled them to sell lumber to American markets at less than fair value. As well, offshore lumber demand in China has been down as a result of the ongoing trade dispute between the United States and China.

Cyclicality

As with any commodity market, the lumber sector is cyclical. These cycles are driven primarily through the demand in end-markets which are influenced by general economic performance. When interest rates are low, which is currently the case, overall investment increases, households renew their mortgages and build new homes, and the price of lumber increases. When the economy struggles, households save their money, construction activity declines, and lumber prices decrease.

EXHIBIT IV

USD/CAD Exchange Rate & Canfor EBIT



Source: CapitalIQ

USDCAD Exchange Rate

The high inter-dependence between the American and Canadian lumber industries renders the USDCAD exchange rate important. The US South has the lowest log costs in North America, so many Canadian producers purchase sawmills in the United States. As well, a large portion of American and Canadian lumber exports are sold to one another, with the United States accounting for 69% of Canada's softwood lumber exports in 2015. As a result, lumber producer income and cash flow is heavily influenced by the USDCAD exchange rate.

Recent Trends

Pre COVID-19

Even prior to COVID-19, the global lumber market was

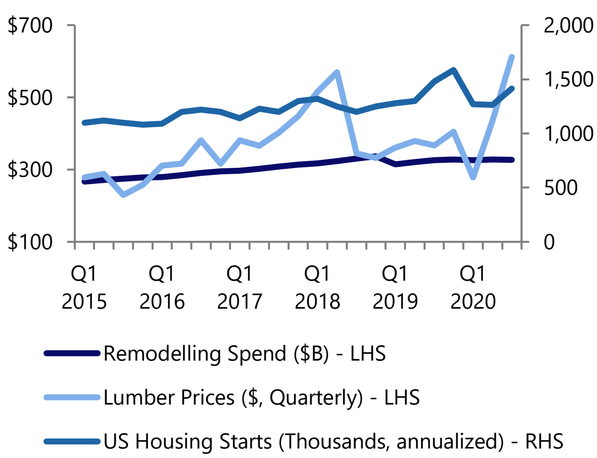
Industry Overview

undergoing heavy instability. Lumber prices hit record lows of $139/mfbm during the financial crisis amidst historically low housing demand. Through heavy volatility, prices increased during the United States' economic recovery until 2015, when prices dropped approximately 33% to $216.60/mfbm in the first two quarters. This was a result of various factors including higher demand from multiple family units which do not require as much wood as single-family units, a weakening CAD forcing American producers to lower their prices, as well as wholesalers buying more conservatively in the absence of strong market indicators.

2018 was a tumultuous year, with too little supply with rising prices in H1 2018, followed by too much supply with declining prices by end of year. Resulting from delayed shipments in the beginning of the year, prices peaked at $629/mfbm, the highest ever recorded, in May but fell to $311.50/mfmb by November. Coming out of this, higher cost mills in North America curtailed production to contend with below-cost prices, which led to a quick bounce back in 2019.

EXHIBIT V

Lumber Prices Against Housing Construction Indicators



Source(s): Business Insider, Trading Economics

Through COVID-19

Lumber prices were on a steady upwards trajectory leading into 2020, until the start of the COVID-19 pandemic put downward pressure on prices in Q1 2020. In the heat of the pandemic, there was a large increase in demand for wood chips to be processed into pulp for the production of household paper products. On the other hand, there was a sizeable decrease in demand for pulp from manufacturers of commercial paper due to the closures of schools and businesses.

After the bulk of operational mills were back online in July 2020, North American softwood lumber production increased 5.7% y/y compared to 9.5% y/y growth in consumption. The growth in production was largely driven by the United States as a result of the more drastic curtailment of capacity in Canadian mills. As aforementioned, strong demand in the residential housing space drove the increase in consumption.

Outlook

With lumber prices at a near all-time high of $515.30/mfbm as of November 2020, it is evident that prices are bound to drop in the medium-term. However, overall supply and demand fundamentals continue to look reasonable heading into 2021. With COVID-19 unlikely to cause closures as drastic as those seen in its onset, sawmills operations will most likely resume at more predictable levels. In parallel, all-time low interest rates are leading to strong demand for housing starts and remodelling activity. Companies that are operationally efficient, have strong asset-bases, and continue to seek diversification and growth opportunities should be successful in the coming years.

Company Overview

General Description

Founded in 1938 and incorporated in 1968, Canfor Corporation is a Canadian integrated forest products company that is based in Vancouver, Canada. Canfor is primarily in the lumber industry, and operates production facilities in British Columbia, Alberta, the Southern United States (GA, AL, MS, SC, NC), and Sweden. Canfor Corporation has a 54.8% controlling stake in Canfor Pulp Products Inc. (TSX: CFX, "CPPI"), which is primarily in the pulp and paper industry, and the two enterprises have integrated management of operations. Since 2019, Canfor Corporation also owns a 70% controlling stake of Vida Group, Sweden's largest privately-owned sawmill company, and Elliott Sawmilling Co. Canfor operates in two key market segments: lumber and pulp and paper. Canfor markets its products within North America and globally, with sales offices in Canada, the US, Japan, China, Sweden, England, Denmark, Holland, and Australia. As of December 31, 2019, Canfor employed 6,766 people, 1,292 of which are employed by CPPI.

Operational Processes

Canfor Corporation's North American operations can be split between lumber, pulp and paper, green energy, and laminating. In its lumber operations, Canfor operates sawmills converting logs into lumber, with plants registered and following quality policies under the ISO 90001 standard. Canfor's extensive lumber operations in British Columbia & Alberta are the Houston, Plateau, Polar, Radium, Mackenzie, Fort St. John, Wynnwood, Grand Prairie (Alberta & Green Energy Plant), J.D. Little Forest Centre, and Chetwynd Sawmills. In the Southern United States, Canfor operates the Camden, Marion, Darlington, Conway, Estill, Elliott (under Elliott Sawmilling Co. acquisition) and New South Express plants in South Carolina, Fulton, Jackson, and Mobile plants in Alabama, Moultire and Thomasville plants in Georgia, Graham plant in North Carolina, Urbana plant in Arkansas, and Hermanville Plant in Mississippi. Under Canfor's pulp and paper division plants operated by CPPI, Canfor owns the Taylor, Northwood, Intercontinental, and Prince George Pulp and Paper Mill. Canfor's Houston, Chetwynd, and Fort St. John pellet plants are all operated in BC. Lastly, Canfor operates the El Dorado and Washington laminating plants in Arkansas and Georgia respectively. In terms of Canfor's new Vida Group subsidiary, Vida saws around 4.3 million cubic metres of timber (solid under bark) every year for processing at the sawmills in Alvesta, Borgstena, Hjältevad, Hestra, Hästveda, Mörlunda, Nössemark, Orrefors, Tranemo, Urshult, Vimmerby and Vislanda.

Canfor's Sawmilling Processes

Forest Harvesting: Involves cutting trees and delivering them to sawmills.

Debarking & Scanning: Log's bark is removed, log is scanned to determine the best sawing pattern to yield highest quality and greatest amount of dimension lumber.

Sawing: Logs are cut into lumber using curve sawing technology that can follow any bends in a log to maximize lumber recovery volumes.

Trimmer: After lumber is sawn, each board travels through a trimmer, removing the rough ends.

Sorting: Boards are sorted by dimension and moisture.

Dry Kilns: Used kilns fuelled by biomass and natural gas, dry stacked lumber to a consistent moisture.

Planing: Boards are planed to provide a smooth finish.

Grading: Boards are graded to extract maximum value and provide quality product to our customer that meet specifications.

Storage: Lumber is grade stamped, sorted by grade and dimension, stacked and wrapped for storage and delivery to the customer.

Rail/Transportation: Products move across North America by train and truck, and overseas by ship.

Company Overview

Business Segments

Lumber Segment

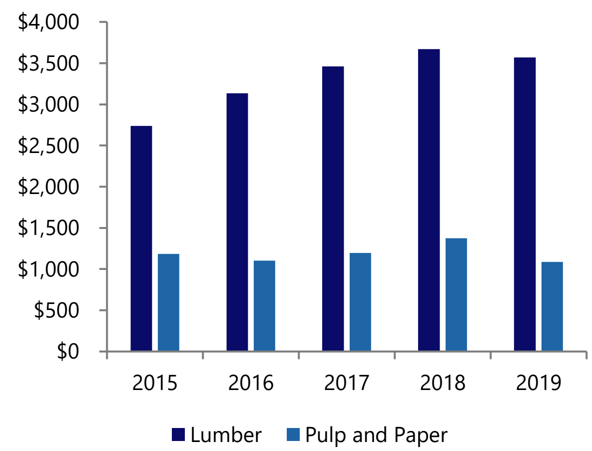
Canfor's lumber operations have an annual production capacity of 6.6 million board feet of lumber, reflecting organic growth capital investments in the Southern US and acquisitions of Elliott and Vida. Canfor is Canada's second-largest producer of softwood lumber products, behind West Fraser Lumber. Canfor also holds approximately 11.0 million cubic metres of annual harvesting rights for its solid wood operations located in the interior region of BC and northern Alberta. Most lumber produced by Canfor from its facilities is construction and specialty grade dimension lumber. The high-value products produced in this segment include Square Edge lumber for the North American market, J-grade lumber for the Japanese market, and machine stress rated ("MSR") lumber used in engineered applications such as roof trusses and floor joists. Over the past few years, Canfor has expanded its product offering through acquisitions to include high-value engineered wood products, higher-grade MSR lumber, premium one-inch boards, and custom speciality boards. In North America, Canfor's lumber operations also include one finger-joint plant, two glulam plants, one whole log chipping plant and a trucking division.

Pulp and Paper Segment

Canfor's Pulp and Paper segment is comprised of three Northern Softwood Bleached Kraft (NBSK) pulp mills and the Taylor Bleached Chemical Thermo-Mechanical Mill (BCTMP), owned and operated by CPPI in BC. CPPI produces NBSK pulp, BCTMP, and specialty paper. CPPI mills have an annual production capacity of 1.1 million tonnes of NBSK pulp and 230,000 tonnes of BCTMP. Canfor supplies CPPI with residual wood chips and hog fuel (principally bark) priced to reflect market prices and conditions for CPPI's paper machine, located at the Prince George pulp and paper mill, has an annual production capacity of approximately 140,000 tonnes of kraft paper.

EXHIBIT VI

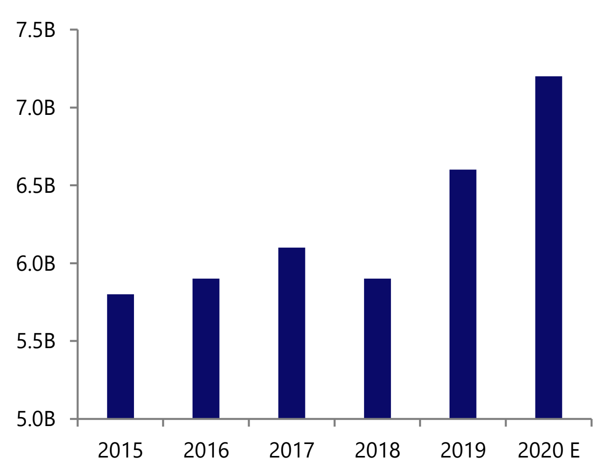
Annual Revenue by Business Segment ($ millions)



Source: Canfor Company Filings

EXHIBIT VII

Annual Lumber Production Capacity (billion board feet)



Source: Canfor Company Filings

Company Overview

Background

Company History

In 1938, Canfor Corporation was founded as Pacific Veneer – a furniture and paneling veneer company - founded by John Prentice and L.L.G. Bentley after fleeing Austrian persecution. Pacific Veneer grew from a mill supplying plywood and Douglas fir plywood for aviation and marine applications in WWII. After substantial growth during WWII, Pacific Veneer renamed to Canadian Forest Products Limited in 1947 to reflect broader operations in the lumber industry. In 1975, Peter Bentley was named President and CEO of Canadian Forest, and transitioned Canfor's operations and strategy from family to corporate structured, decentralizing management and transforming Canfor into an integrated forest products company. Bentley sold Canfor's shingle and plywood mills, divested non-forest assets, and focused the company's efforts on three business areas: lumber, pulp and paper, and fiber products.

In 1983, Canadian Forest became a public company, switching its name to Canfor Corporation. During the 1990's, Canfor struggled with profitability and severe economic downturns in the Canadian economy prevented its efforts from being successful, resulting in various business restructurings and senior management changes. In 1999, Canfor acquired Northwood Inc., which made Canfor Canada's largest producer of softwood lumber and kraft market pulp, and helped guide the Canfor back to profitability. In 2004, Canfor purchased Slocan Forest Products Ltd. after failed acquisition attempts in 1996, increasing production to over 5 billion board feet annually. In 2006, Canfor expanded its product line and operations internationally, purchasing the operations of New South Companies Inc. in the southeast United States.

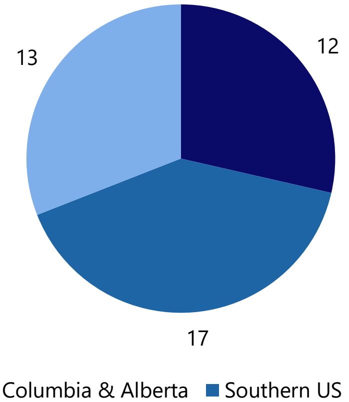
In 2011, Donald Kayne became the President and CEO of Canfor Corporation. In 2012, Canfor Corporation and Canfor Pulp integrated management of their two companies, with Donald Kayne as CEO of both companies. Between 2014 and today, Canfor has faced significant challenges with the mountain pine beetle epidemic in British Columbia and the wildfires in BC which has resulted in destroyed harvesting areas, supply and demand imbalances, and highly fluctuating lumber prices. These forces have caused Canfor to shutdowns its Quesnel, Canal Flats, Isle Pierre, and Vavenby Sawmill facilities, and Canfor's strategy focusing on geographic diversification to mitigate future risks and losses in the BC market. In 2019, Canfor agreed to be acquired by Great Pacific Capital Corp. at a price of $16.00 per share. Despite management's recommendation for shareholders to approve the transaction, as well as Canfor's significant insider shareholder structure, the transaction was ultimately rejected by shareholders' majority vote.

Company Strategy

Canfor's overall business strategy is to be a leader in the forest products industry achieving top-quartile margin performance by expanding its geographical

EXHIBIT VIII

Operational Facilities by Geographic Distribution (2020)



Source: Canfor Company Filings

Company Overview

markets, increasing market share of value-added products and building strong long-term partnerships with valued customers; optimizing the extraction of high-margin products and value from its available fibre sources and maintaining the premium quality of its products; attaining world class supply chain performance; achieving and maintaining a low cost structure and maintaining a strong financial position; and developing an enterprise-wide culture of safety, innovation and engagement.

Management Overview

Assessing Key Management

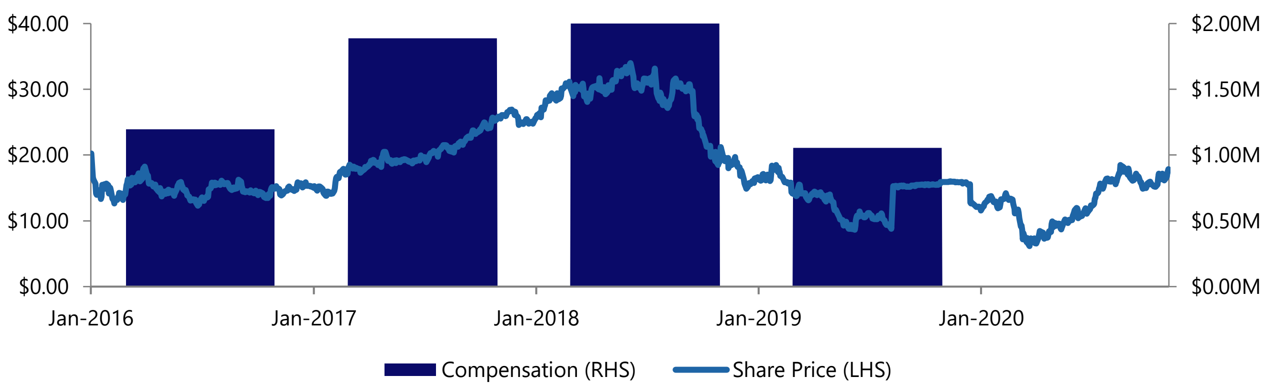
Donald B. Kayne is the President and the Chief Executive Officer of Canfor Corporation and the CEO of Canfor Pulp. He was appointed this position in 2011 and additionally received the CEO position of Canfor Pulp in 2012. Donald Kayne has spent his entire career at Canfor, having begun his career as a regional sales representative in 1979. In addition, he is also the director of the company and Canfor Pulp. For industry leadership positions, he is the Director and past Chairman of the Forest Products Association of Canada and acts as the Chairman of the Council of Forest Industries, a Director of the Alberta Forest Products Association and the BC Lumber Trade Council. Because of that, not only does he have deep expertise in Canfor's operations and the opportunity that exists, he has deep connections to markets and customers in every region that Canfor serves.

It is unique for someone to spend their entire career at one organization, so Donald Kayne understands Canfor's operations extremely well and thus can effectively execute on strategies that will most benefit the company.

Alon Nicholl serves as the Chief Financial Officer of Canfor Pulp and was the Executive VP of Finance for two years prior. He has been the CFO of Canfor Corporation since 2011 and has been involved with the business since 1995. He spent 10 years in senior finance positions within the forest industry, such as having served as the CFO of Canadian Forest Products, which is an affiliate of Canfor Pulp Products. Due to his extensive experience with Canfor and the industry, he

EXHIBIT IX

Donald Kayne's Compensation vs Canfor's Share Price



Source(s): Capital IQ

Company Overview

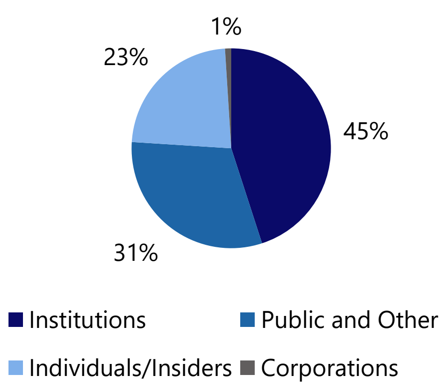
can effectively operate the business and ensure that Canfor remains solvent. This is especially important in a highly commoditized business such as in lumber, where reducing a company's cost of capital is extremely important.

Overview of Compensation Policies

It is also important to note that there is significant insider ownership in Canfor, so the management's incentives are aligned with shareholders. Many of the senior leaders within the company have shares in Canfor, with their being largely based on several key performance factors of the company.
The company's executive compensation policies are designed to attract and retain high-calibre executives who will successfully lead the organization. To achieve this, consulting fees were paid to Mercer, which reduces the possibility for there to be a conflict of interest. There is a short-term incentive program that provides employees compensation based on achieving the company's strategic objectives, which are largely based on Return on Invested Capital or ROIC. This reinforces Canfor's goal to achieve a minimum ROIC threshold and to align the corporate, team, and individual performance objectives with the overall company's. 50% of the incentive plan is based on ROIC and 50% is based on the controllable performance gains, which is important to determine how effective the company is being operated. This incentivizes the executives to achieve a minimum ROIC target, as they are able to double their salary if they do.

EXHIBIT X

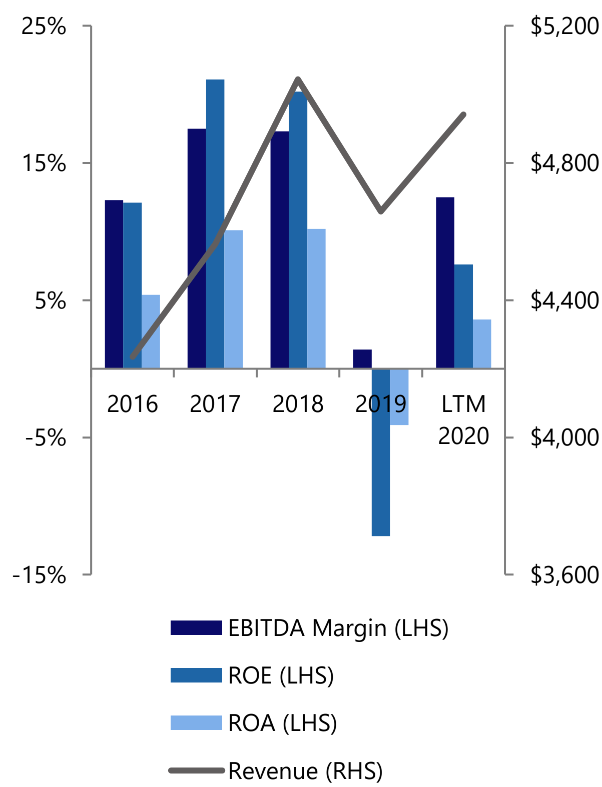
Canfor's Ownership Structure



Source(s): Company Filings

EXHIBIT XI

Key Financials (in millions)



Source(s): Capital IQ

Company Overview

Ownership Breakdown

The bonuses are paid over three years, which means that the individuals are incentivized to have a long-term focus on the operations of the business. A potential area of concern would be that the bonus incentive only spans three years, which is not a significant time horizon. Interestingly, part of the reason that there is significant insider ownership is that in 2018, there were significant share repurchases at $28/per share, which suggests that the company has strong fundamentals. Over 22% of the company's ownership is insider ownership, so the management has conviction in the company. The overwhelming approval of management's compensation and the significant insider ownership illustrates that management's incentives are aligned with shareholder's incentives.

Thesis I: Efficient Business Operations

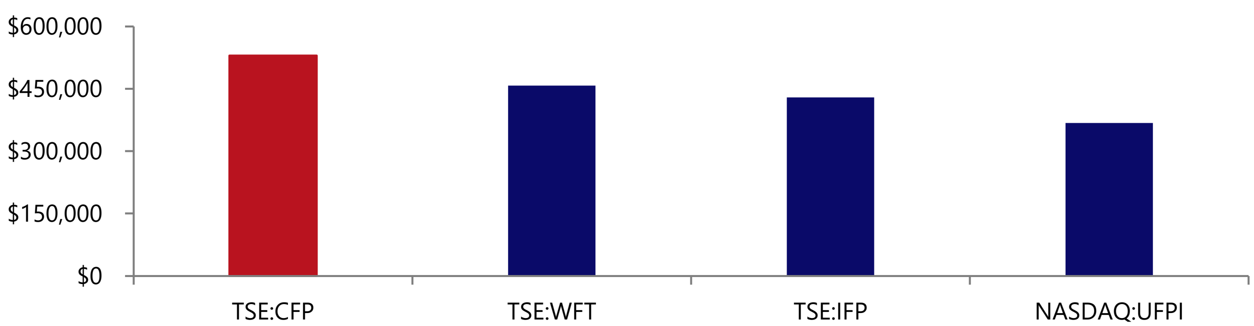
In a highly commoditized industry such as forestry, companies generally have a negligible amount of pricing power. In order to maintain profitability in commodity price downturns, having a highly operationally efficient business allows for a company to have a low cost position. If the company has a low cost position, even if there is a downturn in the price of lumber or pulp, Canfor will remain solvent and maintain its margins.

Canfor has highly integrated business operations with a very effective supply chain. It has subsidiaries and join venture facilities to produce lumber, pulp, wood, and more. The company distributes its wood products through truck, rail and ships. Based on how integrated its supply chain and operations are, it is able to have an advantage by providing greater flexibility, which allows the company to hedge against market fluctuations. One of its main business strategies is to optimize its supply chain performance and achieve and maintain a low-cost structure. It is driven by an investment strategy of positioning itself as a top-quartile margin performer, and has focused on optimizing its usage of its lumber supply through targeted capital investments, improved lumber utilization, cost management, and maximized residual fibre revenue.
One measure of business efficiency is to analyze the company's sales per employee or assets per employee when compared to its peers to understand the company's efficiency. Evidently, Canfor is one of the most efficient companies in the space, generating $530,011 sales per employee in FY 2019, which has grown to $688,487 sales per employee in 2020. Another measure of business efficiency is the asset utilization rate of its sawmills, which Canfor has been successful at, as its sawmills have run at an average of 88% of capacity.

For example, when looking at metrics such as ROIC, the return will be variable due to commodity price fluctuations. Canfor's ability to manage their own debt while maintaining a strong liquidity position is important. Because of that, not having a lot of debt improves their overall liquidity position. Notably, it has recently undergone significant deleveraging efforts, and deleveraging is one of its primary business focuses for the upcoming months, with the company being projected to be debt-free by the end of 2021 based on lumber price projections.

EXHIBIT XII

Sales per Employee



Source(s): Company Filings

Thesis I: Efficient Business Operations Cont.

Analysis of Recent Performance

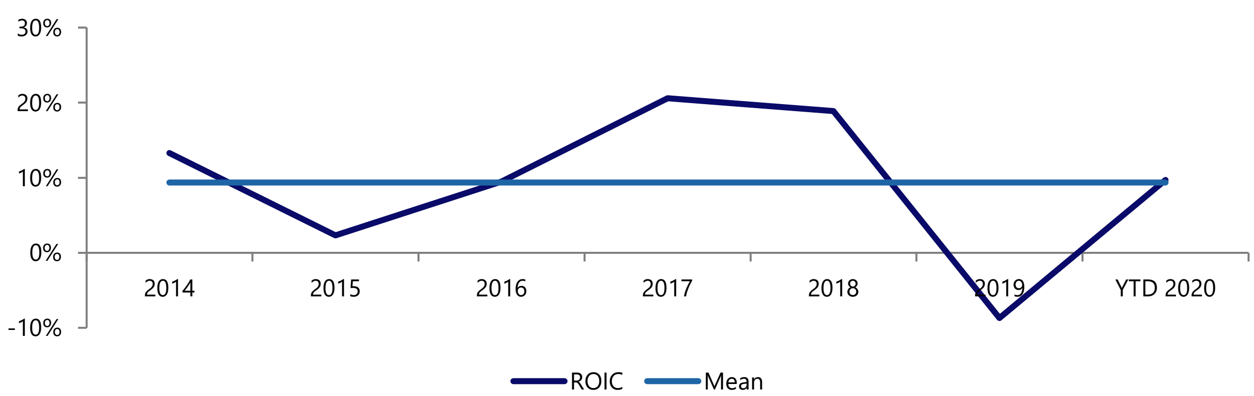
Canfor Corporation's primary segments are in the lumber and pulp & paper industry. These industries are highly commoditized, which means that if the commodity prices are high, it correlates to Canfor performing well. In 2018, there was record-high lumber and pulp prices, so Canfor performed very well. However, in 2019 its excess inventory levels from the prior year's production led to a sharp drop in market pricing for both lumber and pulp products. Due to a combination of deterioration in market conditions, fibre supply challenges, and log cost increases in British Columbia where most of Canfor's sawmills are, the company really struggled in 2019.

However, in 2020, there have been record-high lumber prices, which led to Canfor having one of its best quarters ever. It reported an adjusted EBITDA of $393M, which beat analyst estimates of $356M.
This was primarily driven by their lumber segment, which led to robust cash flow generation and significant deleveraging efforts. Significant deleveraging efforts were conducted, as debt was reduced by $300M in Q3, and will likely continue in the coming quarter, with lean inventories and healthy demand.

A potential reason for its current undervaluation is the market over punishing Canfor for operating in two segments: lumber and pulp. It is North America's number two producer of lumber and a major producer of market pulp. However, most of Canfor's pulp capacity is within Canfor Pulp Products (TSE:CFX), and it is the price of pulp that is currently struggling, compared to the price of lumber. In addition, 77% of its revenue is from lumber, so its current undervaluation compared to its peers that also trade significant volumes of lumber is irrational. Overall, it has overperformed the Paper & First Products index and has a mean ROIC of 9.37%, which suggests that it has a highly efficient business model and is able to produce commodities at a low cost.

EXHIBIT XIII

Historical ROIC



Source(s): Company Filings

Thesis II: Growth Through Geographical Diversification

Canfor's Historical Losses from Overexposure to British Columbia Forestry

Canfor's geographical overexposure to operations in British Columbia over the past decade has resulted in a high degree of risks and losses. The mountain pine beetle epidemic and BC wildfires reduced both quality and supply of wood fiber for regional lumber producers. The re-elected BC NDP government's policy against logging in old growth forests limits supply recovery for BC lumber producers. The declined fibre availability in BC resulted in industry bidding competition for logs in 2018 and 2019. Additionally, the US imposed anti-dumping and countervailing duties against Canadian lumber producers, including Canfor, since 2016. Furthermore, increasing sales volume to Asian markets has also increased log hauling costs from BC and the Southern US. These combined factors have caused operating margin losses for lumber producers with substantial BC operations. The 2018 lumber market crash reduced sales for lumber producers like Canfor, and the continued high costs of BC operations caused negative operating cash flows and production curtailments, all while Southern US operations were largely unimpacted. Resulting from these market conditions, Canfor reported sales of $4.66 B in 2019, a 7.7% decrease from 2018. This was attributable to a 20.8% decline in pulp and paper and a 7.7% decline in lumber sales. The market's reaction to these losses was substantial, falling to a low of $8.80 CAD on Aug. 9, 2019 from its peak of $33.62 on June 8, 2020. In response to market conditions in 2019, Canfor took 1 billion board feet of production curtailments in BC, including 300 million board feet from permanent facility closures.

Benefits of Geographical Expansion

Geographical diversification in forestry will provide Canfor with greater product diversification and sales opportunities to European and Asian markets where it has failed to reach its full market potential. It also limits risk exposure to North American market uncertainty, BC production, and global trade tensions. Geographical expansion will also reduce costs of shipping to major international markets, expand Canfor's tangible addressable market, and potentially achieve economies of scale from expanded production.

Acquisitions Based Geographical Diversification Strategy

Over the past three years, Canfor's investment activity highlights have the completion of three major acquisitions. In 2019, Canfor acquired Vida Group (70% majority) and completed its phased acquisition of Elliott Sawmilling Co. as of Q3 2020. Regarding Canfor's purchase of Vida, Canfor acquired nine sawmills in Sweden with an annual production capacity of 1.1 billion board feet for $589.9M. This strategic acquisition increased sales, reduced risk from BC operations, and increased Canfor's sales in Europe from $95.9 M in 2018 (1.9% sales volume) to $665.8 M in 2019 (14.3% sales volume). Despite 2019's lumber market conditions, Vida Group was profitable, generating $111.6M in operating income before amortization. In 2020, Canfor's Vida division continued to expand, acquiring $45.6 M sawmill assets from Bergs, providing three operating sawmills and one idled sawmill located in Southern Sweden, adding 215 million board feet of spruce and pine products to Vida's annual capacity. Vida's financial success is derived from sawmills' strategic locations in a high-quality sustainable fibre region, commodity costs associated with European market pricing, integrated packaging and value-added remanufacturing processes, and log optimization. The Vida acquisition has allowed Canfor to optimize manufacturing, ensure a consistent supply of high-value spruce and pine fibre to European, African, and Asian markets, expand its product line to include custom speciality products, and stabilize earnings relative to North America's volatility. In terms of Canfor's $110M two-phased acquisition of Elliott Sawmilling Co. in Estill, South Carolina, this acquisition helped expand Canfor's presence in Southern US production which have

Thesis II: Growth Through Geographical Diversification (Cont.)

escaped the supply and demand imbalance BC productions have faced due to their surmounting costs.

Ultimately, the Vida, Elliott, and Berg acquisitions indicated management's ability to profitably execute on strategic direction related to geographical expansion. These acquisitions represented a major step in Canfor's global diversification, providing a significant source of high quality spruce and pine fibre, access to new markets, financial stability, and an increased global presence that reduces geographical risk.

Opportunities for Growth in International Addressable Markets

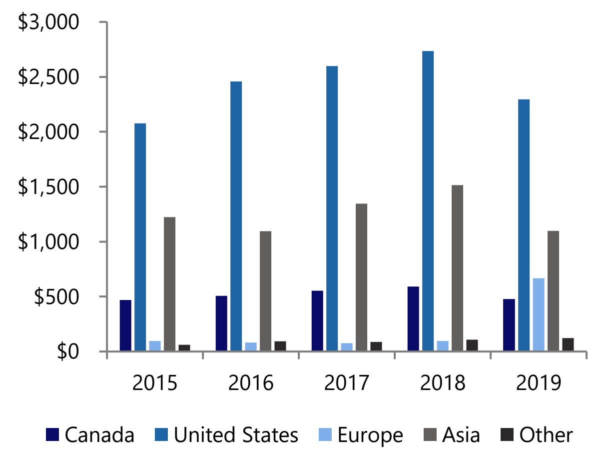
In terms of global lumber demand, North America represented 30 per cent of total global demand, followed by Europe at 29 per cent and Asia at 26 per cent. These three continents consumed 86 per cent of global softwood lumber in 2018. With Canfor's sales volume in 2019 allocating approximately 60% of sales between Canada and the United States, 14% in Europe, and 24% in Asia, Canfor has significant opportunity for growth in its European sales volume, growth which can be facilitated through further acquisitions by Vida. With global demand for lumber at 144.5 billion board feet in 2019, and with Canfor's lumber shipments at 5.12 billion board feet in 2019, Canfor had 3.5% of the total addressable lumber market.

Greater Geographical Distribution over Competitors

Canfor's geographical diversification strategy differentiates the company from most of its North American competitors. West Fraser Timber, Interfor, Lousiana-Pacifc, Boise Cascade, and Stella Jones' currently only operate in the Americas. By further pursuing geographical distribution, Canfor will gain competitive advantages through cost optimization and differentiated product offerings. Major competitors Domtar and Norbord both have European operations.

EXHIBIT XIV

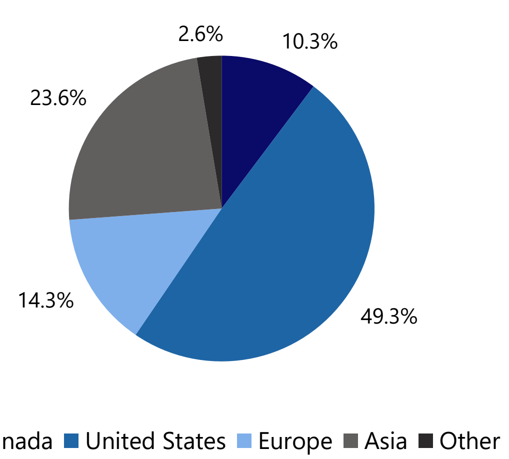
Sales by Location ($ millions)



Source: Canfor Company Filings

EXHIBIT XV

Sales Volume by Location in 2019



Source: Canfor Company Filings

Thesis II: Growth Through Geographical Diversification (Cont.)

Continuing Geographical Diversification Strategy

Given Canfor’s recent major acquisition of Vida, management may focus on fully integrating and optimizing Vida’s operations under Canfor in the short-term. However, management continues to indicate strategic focus on geographical diversification. Canfor’s current available liquidity of $1B at the end of Q3 2020, combined with low interest rates that make cheap credit options available, Canfor has the ability to pursue another major acquisition. With balanced operations in Western Canada, the Southern US, and Sweden, Canfor is well-aligned to pursue a major acquisition in Asia or Europe to continue its diversification strategy.

Thesis III: Strong Financial Position

Overview

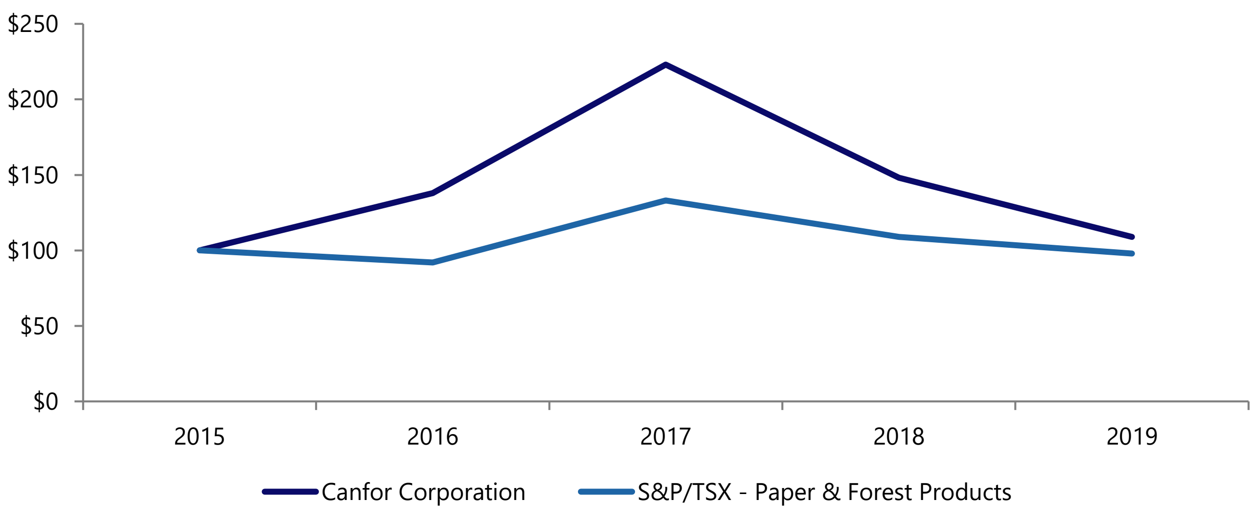
In a commoditized industry such as forestry, revenue will fluctuate depending on the current price of lumber. The price of lumber is subject to the dynamic interplay between market supply and demand, which will either drive the price of lumber upwards or downwards. This will lead to the cyclicality of cash flows, so maintaining a strong and liquid financial position is imperative. This allows for firms to control their costs and to weather economic downturns, while capitalizing on upswings within the market. On top of Canfor's product diversification through pulp and lumber, and its strong geographically diversification, it has a very strong balance sheet and cash position.

Robust Cash Generation

In early 2020, given the uncertainty of the severity of COVID-19, it led to Canfor increasing their debt position in order to alleviate any potential liquidity issues. Rather than weak market conditions materializing, instead there were record-high lumber prices, which led to very strong performance in 2020. In the third quarter, Canfor generated nearly $400M of free cash flow, with deleveraging being one of its key priorities. In the recent quarter, it reduced debt by $300M with plans to further reduce debt in the upcoming quarter, illustrating its robust cash flow generation potential. Currently, it has consolidated liquidity of $1.13B, or 40% of total capitalization, which means that if there was a downturn in the market, Canfor's operations would not be severely impacted. The company also currently is at a cash position of $192.5M, which is a substantial improvement from its 2019 position at $96.3M, further illustrating its strong liquidity position.

EXHIBIT XVI

Five-Year Cumulative Return for $100 Invested



Source(s): Company Filings

Thesis III: Strong Financial Position Cont.

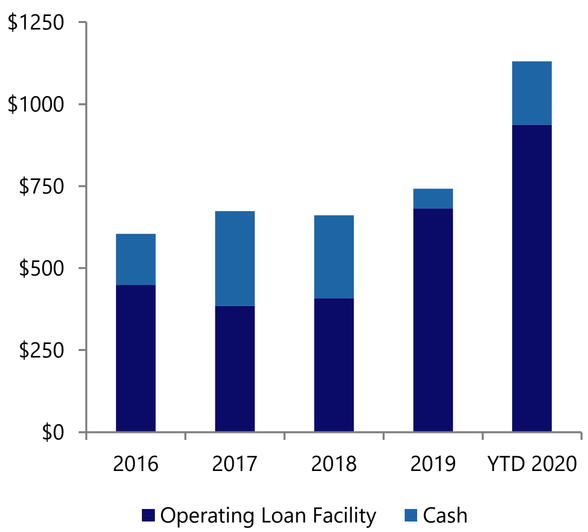
Reasons for Undervaluation

Based on its current financial position, capital allocation is one of the reasons behind the company's current undervaluation. Management has indicated the share repurchases are a low priority due to prioritizing debt repayment and potential growth opportunities. Due to the cyclicality of the business, investors typically expect to see some form of return of capital, either through share repurchases or special dividends. As management is reluctant to pursue either of those, it has led to a sluggish reaction in the share price. However, the M&M team believes there is potential for future returns as Canfor targets a 20% return on invested capital and a five-year payback period for internal capital projects, so once high-return investment projects run out, Canfor will likely return capital back to its shareholders. The efficiency in which Canfor is able to generate free cash flow, even into the upcoming years, is also something that the market is not fully appreciating. Recently, Canfor announced a future capital return program, and its focus on reinvesting into its existing asset base illustrates that Canfor has a long-term focus for the company. This will only strengthen the fundamentals of the business in the long-run, creating significantly more value than temporary returns.

When looking at comparable companies' debt to capitalization ratios, Canfor has taken the lead with the lowest amount of debt. By reducing the amount of debt, it will reduce Canfor's interest expense and cost of capital, which will improve its cash flow generation potential in the future. Reducing debt will allow for not only the amount organic capital to increase but to also help de-risk that capital. Overall, Canfor is in a very strong financial position when looking at its balance sheet, and further improving its balance sheet is one of the firm's top priorities, which will only help further Canfor's attractive business fundamentals.

EXHIBIT XVII

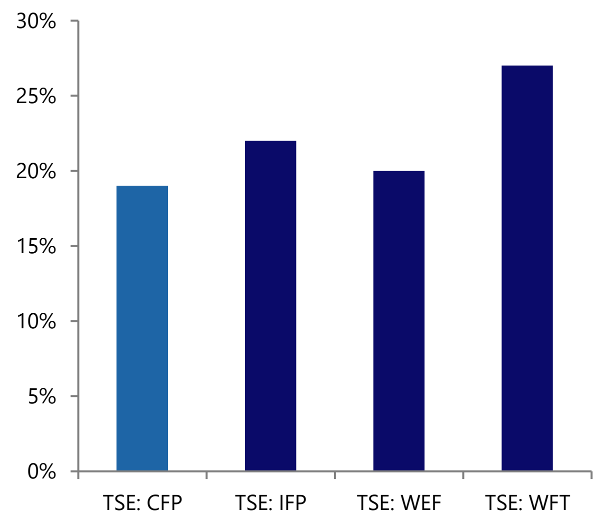
Canfor's Overall Available Liquidity ($M)



Source(s): Company Filings

EXHIBIT XVIII

Comparable Debt to Capitalization Ratios



Source(s): Company Filings

Valuation

The M&M team's base case DCF valuation of Canfor Corporation results in a 34.2% return or a target price of $24.01.

This valuation discounts cash flows at a WACC of 8.6%, which the team felt was an appropriate discount rate for a company in an industry as cyclical as forestry. It projects minor revenue increase from 2021-2024 in light of the attractive pricing environment which has inflated near term revenues to what is likely – for the short term – an unsustainable level. After the initial 5-year projection period, a 3% growth rate was projected to close out the full 10-year projection period.

The terminal value of the company was projected using a relatively conservative 5.6x EBITDA multiple in line with what they are currently trading at and have historically operated at, while still being slightly below industry averages.

At this valuation, the M&M team has solid conviction that the company has room to create shareholder returns and that the market is not properly pricing in the strong cash flow portfolio of the company. With that said, while we feel as if the model is relatively conservative – particularly in the near term – we do want to be cognisant of the risk associated with investing in a highly cyclical industry as a poor pricing environment can place a significant strain on the company's cash flow.

EXHIBIT XIX

DCF Valuation

DCF	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2017E	2028E	2029E
Revenue	5,124.1	5,021.6	5,071.9	5,173.3	5,302.6	5,461.7	5,625.6	5,794.3	5,968.2	6,147.2
Revenue Growth %	*10.00%*	*-2.00%*	*1.00%*	*2.00%*	*2.50%*	*3.00%*	*3.00%*	*3.00%*	*3.00%*	*3.00%*
Cost Of Goods Sold	3228.2	3264.1	3448.9	3517.8	3605.8	3714.0	3825.4	3940.1	4058.3	4180.1
Gross Profit	**1,895.9**	**1,757.6**	**1,623.0**	**1,655.5**	**1,696.8**	**1,747.7**	**1,800.2**	**1,854.2**	**1,909.8**	**1,967.1**
Selling General & Admin Exp.	922.3	903.9	862.2	879.5	901.4	928.5	956.3	985.0	1014.6	1045.0
Depreciation & Amortization	281.8	276.2	279.0	284.5	291.6	300.4	309.4	318.7	328.2	338.1
Other Operating Expense/(Income)	139.4	136.6	138.0	140.7	144.2	148.6	153.0	157.6	162.3	167.2
Total Operating Expenses	**1,343.5**	**1,316.7**	**1,279.1**	**1,304.7**	**1,337.3**	**1,377.4**	**1,418.8**	**1,461.3**	**1,505.2**	**1,550.3**
Operating Income	**552.4**	**440.9**	**343.9**	**350.7**	**359.5**	**370.3**	**381.4**	**392.9**	**404.6**	**416.8**
Less: Taxes	(138.1)	(110.2)	(86.0)	(87.7)	(89.9)	(92.6)	(95.4)	(98.2)	(101.2)	(104.2)
Plus: Amortization	281.8	276.2	279.0	284.5	291.6	300.4	309.4	318.7	328.2	338.1
Less: Increase in Working Capital	103.7	0.3	(23.6)	(12.4)	(15.8)	(19.4)	(20.0)	(20.6)	(21.2)	(21.9)
Less: Capital Expenditures	(333.1)	(326.4)	(329.7)	(336.3)	(344.7)	(355.0)	(365.7)	(376.6)	(387.9)	(399.6)
Unlevered Free Cash Flow	466.7	280.7	183.6	198.9	200.8	203.7	209.8	216.1	222.6	229.2
Present Value of Free Cash Flow	447.8	247.9	149.2	148.8	138.3	129.1	122.4	116.1	110.0	104.3
Discount Period	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5
Discount Factor	0.9594	0.8831	0.8128	0.7482	0.6887	0.6339	0.5835	0.5371	0.4943	0.4550

Source(s): BMO Equity Research, Company Filings, RBC Capital Markets

Risks and Conclusion

Risks

The biggest risk associated with an investment in Canfor is its exposure to downturns in lumber commodity pricing. The company's financial performance is dependent on the selling prices of its products, which have in the past shown to be extremely volatile – namely due to volatile end-markets for lumber. While we have some faith in lumber outlook, it is impossible to be certain and we would need to have conviction that this equity has limited downside in the case of a poor economic environment. In addition to an inconsistent commodity environment, one has to be wary of potential political and legislative risk factors such as tariffs. With that said, Canfor's presence in both the US and Canada alleviates some of the risk associated with that issue.

Another risk facing Canfor is a lack of opportunities to grow shareholder value. A key aspect of Canfor's model is their high standard for capital investment projects, focused on delivering a high return on capital. While Canfor has been able to find such investments over the past years, they may potentially run out of attractive investment opportunities. This would place some strain on the M&M team's valuation which factors in some degree of capital investment to grow the firm's revenues and free cash flow.

Canfor, and forestry names at large, also face the risk of operational stoppages impacting company supply. These stoppages could result from worker's strikes to other more environment related issues but given Canfor's diversification likely would not constitute large enough of risk to prevent the team from investing in the name.

Conclusion

This report identified three key reasons why Canfor is a company that the Metals & Mining sector would like to hold: it has efficient business operations, has a runway for growth through a geographic diversification strategy, and has strong financial fundamentals. On top of this, the forestry industry within which it operates currently hones strong fundamentals and reliable catalysts for demand exist.

Based on our discounted cash flow analysis, our implied return of 34.2% indicates that Canfor is currently undervalued.

Moving forward, the Metals & Mining team will look to enter a position in Canfor, enabled by trimming our position in existing holdings – most likely CCL Industries.

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