NORBORD Q2 2008 CONFERENCE CALL – CORRECTED TRANSCRIPT
July 25, 2008
11:00 A.M. ET

Operator: Good day everyone. Welcome to Norbord's Q2 2008 earnings conference call. As a reminder, today's call is being recorded and webcast on Norbord's website at www.norbord.com.

Norbord's discussion today may include certain projections and forward-looking statements regarding Norbord's business, future actions and expected results. These statements are subject to known and unknown risks and future results may differ materially. For further information on known risks, please see the "Caution Regarding Forward-Looking Information" section of the March 1st, 2008 Annual Information Form, and the cautionary statement contained in the "Forward-Looking Statements" section of the 2007 Management's Discussion and Analysis dated January 31, 2008.

And now, I will turn the call over to Barrie Shineton, President and Chief Executive Officer. Please go ahead sir.

Barrie Shineton: Thank you, Josh. Good morning everyone and thank you for joining Norbord's second quarter conference call. With me today are Robin Lampard, our Senior VP and CFO, Mike Botha, our VP Finance and Treasurer, and Anita Veel, our Director of Corporate Affairs.

Before I ask Robin to review our financial details, there are three points I'd like to highlight for you.

Overall I'm pleased with our operating performance this quarter. Our mills ran very well. The seasonal bump in OSB prices resulted in a $25 million improvement in our EBITDA number.

Second, our European operations delivered a positive contribution again this quarter.

And finally, our current liquidity position supported another dividend payment this quarter. However, we believe our industry will remain under considerable pressure for the rest of this year and next, and we will continue to evaluate alternatives to further strengthen our liquidity and conserve cash.

I'll now turn the call over to Robin.

Robin Lampard: Thanks Barrie. Norbord reported a Q2 loss of $37 million or $0.25 per share. Included in these results is a settlement charge related to the antitrust litigation against the OSB industry in North America. As announced in May, Norbord vehemently denies that it violated US antitrust or any other laws.

However, to limit the risks and costs associated with a prolonged jury trial, Norbord agreed to settle this litigation for $32 million pre-tax or $0.15 per share after tax.

Before the litigation charge, Norbord recorded a loss of $15 million in Q2 2008 or $0.10 per share in the quarter. This compares to losses of $31 million in Q1 of '08 and $15 million in Q2 of '07.

We recorded positive EBITDA of $1 million in Q2 after unallocated corporate costs. This compares to an EBITDA loss of $24 million in Q1 and positive EBITDA of $17 million in Q2 of '07.

Benchmark North Central OSB prices averaged a $179 in the quarter up 30% from $137 in the first quarter.

The South East benchmark prices are more relevant to Norbord with more than half of our production capacity located in that region. South East benchmark prices averaged a $155 in Q2, $24 lower than the North Central benchmark.

The temporary improvement in OSB pricing reflects the seasonal increase in construction demand as the key summer building season got underway. In addition, widespread downtime was taken across North America.

According to APA -The Engineered Wood Association, just over 40% of the industry's North American OSB production capacity was curtailed during Q2.

We expect prices to moderate through the back half of the year as the peak building season winds down.

Norbord took downtime to conserve cash and perform essential maintenance at the beginning of the quarter. Mostly in the month of April before prices improved. In North America, we curtailed 101 mill days of OSB production during the quarter versus 170 days in Q1.

Included in this number is:

- Downtime at our two Quebec mills to conserve cash
- The continuing reduced operating schedule at Jefferson, Texas
- Completion of the press and forming line at Guntown, Mississippi
- And, scheduled essential maintenance at some of our other mills

Combined, this downtime represented about 10% of Norbord's total quarterly OSB production capacity.

Our North American OSB mills achieved break-even EBITDA on net sales of $133 million.

The breakeven EBITDA result is significant considering the continued pressure from rising global energy and resin prices.

Our Q2 North American per unit OSB cash production costs were down 6% from the prior quarter due to the benefit of higher production volumes and lower key input usages more than offsetting increased input prices.

Our European operations contributed $6 million of positive EBITDA in the quarter. Economic weakness across the UK and the Continent intensified during the quarter.

In the UK, mortgage lenders tightened credit terms, resulting in fewer home sales and a drop in housing prices. UK homebuilders have been significantly impacted. Many European panel producers took downtime to lower inventory levels.

At Norbord, approximately 8% of our European capacity was down during Q2. OSB prices retreated 5% and MDF and particleboard prices declined about 3% compared to the first quarter.

Our European business is being disproportionately impacted by rising global energy and resin prices as our European products are more energy and resin intensive.

Operating working capital was $13 million at quarter-end compared to $58 million at the end of Q1 and $79 million at the end of '07.

The lower Q2 balance is largely due to the $32 million accrual for the litigation settlement.

The Q2 2007 balance is higher as $50 million of accounts receivable were sold under a securitization facility established in Q4 of 2007.

Operating activities generated $88 million of cash this quarter - a significant improvement over the prior quarter - largely due to the $85 million of income tax refunds received and higher North American OSB prices.

Capex was $10 million in the quarter and $15 million year-to-date, and relates primarily to US MACT compliance and the press frame project at Guntown.

Our capex plan for 2008 has been constrained to $30 million and we are on track to meet this target.

Net debt stood at $509 million at period end, representing 33% of capitalization on a market basis and 59% of capitalization on a book basis.

At quarter end, Norbord had $187 million of liquidity consisting of cash, unused bank lines and term debt facilities.

Subsequent to quarter end, we concluded an additional $35 million commitment under our accounts receivable securitization program, bringing total committed liquidity to $222 million.

We are considering various alternatives to further strengthen our liquidity position and conserve cash as we move through what we see as a prolonged downturn.

And with that, I'll turn the call back over to Barrie.

Barrie Shineton: Thanks Robin. As I said at the start of the call, the increase in OSB prices was welcome. But we don't expect it to hold through the rest of the year as there hasn't been any underlying improvement in demand.

US housing starts are forecast to be less than 1.0 million. In our view, there are several market adjustments that must occur before we see a meaningful improvement in housing starts and stronger OSB prices. The high inventory of new and used homes in the U.S. needs to be depleted, housing affordability must continue to correct pre-bubble norms; and mortgage lenders have to put first time buyers back into the housing market

We believe that all these things are going to happen, but not likely before 2010.

In Europe, economic conditions on the Continent and in the UK now mirror some of the challenges we face in North America. The fact that most of our European capacity is located in the UK continues to be an advantage, as the weak pound versus the euro favours UK manufacturers and limits imports from the continent.

To maintain our leadership position in this increasingly challenging environment, we are focusing on expanding business with existing customers, adding new customers for our higher margin products and squeezing out more costs.

To sum up, 2008 is unfolding as anticipated and we feel we have taken the right steps at this point in the cycle. Markets are exceptionally difficult and we expect demand and pricing challenges will last for some time.

We will continue to constrain capital. As Robin said we will spend $30 million this year. We will renew our commitment to improve our safety performance – I'm encouraged by the 25% improvement achieved year-to-date. We will continue to take curtailments during the year, to do maintenance in our mills, to conserve cash, and we will also work on strengthening our liquidity position.

I certainly believe Norbord will be well positioned when markets recover.

I'll turn things back over to the operator who will open up the lines for your questions.

Operator: Thank you. Ladies and gentlemen, if you'd like to ask a question, press star one on your touchtone phone. To withdraw a question, press the pound sign. If you use a speakerphone, please lift your handset before entering your request. Please press star one now if you have a question.

Your first question comes from Sean Steuart, TD Newcrest. Please go ahead sir.

Sean Steuart: Thank you and good morning everyone. Robin, wondering if you can go into any more detail and provide some insight into what you are looking at in terms of enhancing liquidity. Is it just balance sheet restructuring or potential asset sales down the road, any detail you can give us there?

Robin Lampard: No, there isn't really anything specific I can speak to at this time Sean. What I will do is remind you what we've done so far on that front. We have been taking steps for a couple of years now. We refinanced our 2008 bond maturity back at the beginning of 2007. We increased our bank lines by $35 million, we securitized $85 million of accounts receivable. We put in place the $100 million facility from Brookfield, and we've taken steps to conserve cash by constraining capex to $30 million this year. So, we continue to look at everything that's available to make sure we have the liquidity to get through the cycle.

Sean Steuart: The term loan with Brookfield - you basically have $74 million of additional losses before you would potentially trip the minimum equity trigger levels for that covenant, is that right?

Robin Lampard: If you are looking at where we were at the end of the second quarter, it's probably something like that.

Sean Steuart: Okay. And Barrie, following up from last quarter regarding potential growth opportunities for the company or surveying your options, you're not talking about it as much this quarter, can you talk about any initiatives and maybe in the context of what Tricap has done with Ainsworth?

Barrie Shineton: Sean, it's difficult for me to talk about our acquisitions. We've always said from a strategic point of view that we want to grow our OSB business and we see doing that in North America at this point in the cycle by acquisition. So, we do have interest in that and we continue to explore opportunities. With respect to Ainsworth, let me be clear that we have nothing to do with the change in ownership at Ainsworth, and we have no part in those kinds of discussions. So, I can't comment on what that might mean for the industry, or for us.

Sean Steuart: Okay and then finally just a question on operating costs. Barrie, can you talk about how much resin cost pressure you saw in the second quarter? As we're forecasting through the latter half of the year, will the run up in natural gas costs through the second quarter be reflected in the higher resin costs through the third and fourth quarters? Is there a lag effect there?

Barrie Shineton: We are certainly seeing cost pressure. If we go back a year, it looks like our cash manufacturing cost is up about $10 on a 7/16th basis. Almost all of that is resin in our case, and some electricity costs. So, virtually none of that is natural gas costs. That's a reflection of the investments we've made in biomass energy. The cost portion is significant for us, in North America, it's about $10 year-over-year. Does that help you?

Sean Steuart: That helps. Thanks.

Operator: Thank you. Our next question today comes from Richard Skidmore of Goldman Sachs. Please go ahead sir.

Richard Skidmore: Thank you. Just a follow up on that last question Barrie, about the resin cost push year-over-year. What are you seeing quarter-over-quarter?

Barrie Shineton: Resins are a derivative of energy inputs and we're feeling that pressure of course. Our costs are actually down 6% quarter-over-quarter, which reflects less curtailment time in the second quarter versus the first quarter, and we've done some things to mitigate the cost pressures on the resin side.

Richard Skidmore: Okay. I have a couple of questions for Robin on some items that were in the press release. First if I look at the numbers right, the 59% net debt to capitalization, if you assume that the $32 million of cash gets paid out for the OSB settlement plus the dividend, you are going to be pretty close to that 65% covenant that you have on your bank line. Are you comfortable with the current covenants or are you in conversations with the banks currently to get those relaxed, or to make some changes there?

Robin Lampard: Rick, we still have $25 million available on the Brookfield line, which is counted as shareholders equity, so that's available to us. I would say we are comfortable where we are at today and near-term, but I think as we said a few times already on the call, we are looking at all kinds of alternatives to make sure that we do get through this cycle.

Richard Skidmore: Great. And then just a couple other questions about cash. You had a big source of cash from working capital in the quarter, how should we be thinking about working capital for the rest of the year and then second question would be the cash equivalents on the balance sheet, how liquid are those?

Robin Lampard: I will answer the second question first. The cash equivalents on the balance sheet are very liquid. They are basically available at any point, so they are very liquid. In terms of working capital Rick, the reversal that you see in the second quarter is largely due to the income tax refunds that we received, and that's the $85 million that we talked about. We always see a build in our working capital in the first quarter. And you would have seen that in our first quarter numbers and then that reverses over the remainder of the year, primarily in the fourth quarter. The first quarter build is due to a seasonal build in log inventories and also the timing of our interest payments on our bond.

Richard Skidmore: I see - it's the normal seasonal working capital or source of cash in the fourth quarter that you normally do?

Robin Lampard: Yes.

Richard Skidmore: Okay. I'm just coming back to the net debt to capital covenants. Even if you use the $25 million from Brookfield, if you assume the markets are getting more difficult and the denominators getting smaller as you go forward, is there much concern there on that covenant? Does that cause anything else that might be problematic for Norbord in the near-term?

Robin Lampard: Well, we clearly don't want to breach our covenants, but as we sit here today we are comfortable with where we are in the near-term.

Richard Skidmore: Thank you

Operator: Thank you. Our next question today comes from Michael Boam of BlueBay Asset Management. Please go ahead sir.

Michael Boam: Hi, most of my questions have been answered, but just another quick follow up. Have you actually approached the banks to look for some additional headroom under the covenants? If so, can you outline where they stand at the moment?

Robin Lampard: We are in constant discussions with our banks. We have bilateral agreements with a group of banks, as you know, and we are always in discussions with them and keeping them in the loop on how our business is unfolding. That's really all I can say at this time.

Michael Boam: So, there has been no specific request for an amendment to the covenants?

Robin Lampard: There has been nothing that we've announced so far. So, you can read from that what you will.

Michael Boam: Thank you.

Operator: Thank you. Ladies and gentlemen, once again a reminder to press star one on your touchtone phone if you wish to ask a question. Our next question today comes from Joe Licursi of BMO Capital Markets. Please go ahead sir.

Joe Licursi: Thank you. Barrie, I just wanted to know about the downtime that you had - 101 mill days in Q2. Can you guide us as to what are you expecting in Q3 based on current market conditions?

Barrie Shineton: I can't guide you on this. I think what I've said in this difficult market condition is that we'll give you a summary at the end of the quarter. We're really driven by the market and the economics of our mills here. But what I have said in the past and I can say again is that we look at the mill net for each of our mills that either has the cash break-even or has losses that exceed shutdown costs, and when we hit that shutdown hurdle, we have a practice of taking those mills down. So the other thing we do is we forecast on a mill-by-mill basis our EBITDA on a monthly basis and a quarterly basis and so we've got a pretty good handle on what we are looking at going forward. And like I said, if it is better for us to shut our mills down than run them, we will shut them down.

Joe Licursi: All right. Are Jefferson and Cordele still running at 80%?

Barrie Shineton: Well, Cordele is running at 100% capacity. It's producing in the neighborhood of 4 billion board feet a day. Jefferson, Texas has been curtailed for a year now, and it's running 10 days on, 4 days off kind of schedule. It's really a wood related decision at Jefferson because it's in a small regional area where demand for pulp wood is very competitive. And in this kind of market with low OSB prices, we really are not prepared to push the wood price up. So, we keep it curtailed and we get better economic performance when we do it that way.

Joe Licursi: Okay. I have one more question that concerns the tax refunds. You mentioned you had $5 million that we can expect in 2008, is there anything that we can expect in 2009 and has anything changed in relation to the U.S. lawsuits?

Robin Lampard: No, nothing has changed Joe. There are minimal amounts that we can expect next year. What I have said before is that there is talk of homebuilder release packages being considered in the U.S., and should that result in a lost carry back period being extended beyond two years, then that could have a meaningful impact on our ability to carry back losses. But in the absence of that, the bulk of it is this year.

Joe Licursi: So you wouldn't forecast any refunds for next year, and we shouldn't build it into our models?

Robin Lampard: No. We'll obviously be able to carry losses forward as we incur tax losses this year and next, but in terms of carrying back that's pretty much the extent of it.

Joe Licursi: Okay. I just had one more question. On the MACT capital expenditures, how much is left on that?

Robin Lampard: The full year spend is $12 million, Joe. And, we've spent $15 million year-to-date on capex and certainly the bulk of that would be for MACT and for the Guntown project.

Joe Licursi: Okay. Thank you very much.

Operator: Thank you. Our next question comes from Paul Quinn of RBC Capital Markets. Please go ahead sir.

Paul Quinn: Thanks. Just a couple follow up questions on the liquidity issue and on the accounts receivable securitization program. I thought there was a potential to raise another $50 million so I'm curious as to why you bumped it only $35 million?

Robin Lampard: We said the pool could support up to $100 million. Given where the pool is at today and the fact that we have taken some curtailments, we've brought the program up to $85 million and we are pretty comfortable that that's the right level at this point in time. So, that's likely as far as we go.

Paul Quinn: Okay. And on pricing you see a definite weakness in the South East prices recently. Do you see additional capacity coming on in that region that could push the spread between benchmark prices even wider?

Barrie Shineton: No. There have been little curtailments in the South East relative to the other producing regions in the U.S. and that's principally because the South East is a lower cost operating region today. Other than LP's new mill, which is in the process of start-up, we don't see any more capacity coming on than there is already.

Paul Quinn: Okay. So, the second big mill in South Carolina you are not expecting that to come on in 2008?

Barrie Shineton: Well, I am not going to speak for Grant. So you should talk to them.

Paul Quinn: Okay, fair enough. Thanks.

Operator: Thank you. Our next question comes from Richard Skidmore of Goldman Sachs. Please go ahead sir.

Richard Skidmore: Barrie, I just wanted to follow up on downtime. How much downtime have you taken in July?

Barrie Shineton: None. Other than the Jefferson, Texas mill. As Robin mentioned Rick, most of our downtime in the quarter was taken in April, when we had the period of lower prices.

Richard Skidmore: So you haven't taken any additional downtime other than at Jefferson in July?

Barrie Shineton: Not yet, no, but I told you how we are managing on those decisions. When prices come up we will make different decisions.

Richard Skidmore: Thanks. Robin, just a quick question on the tax rate. Would you expect the tax rate or the recoveries to be higher than your normal tax rates? Or something closer to the 40% range going forward? How should we think about that?

Robin Lampard: We operate in multiple jurisdictions Rick and that's the primary driver of why it doesn't equal the statutory rate. But yes it's in that range.

Richard Skidmore: Somewhere in the 40-ish percent range?

Robin Lampard: Yes

Richard Skidmore: That's great. Thank you.

Operator: Thank you. Our next question comes from the Chris Deyoung of Schroders. Please go ahead.

Chris Deyoung: Good morning. A couple of questions about liquidity. When you referred to the $197 million you say is unused; is in fact all of that available pursuant to a borrowing base or any other formula?

Robin Lampard: There was $79 million of bank lines available at the end of second quarter and $83 million of cash and $25 million under the Brookfield line. And then subsequent to quarter end, we closed the additional $35 million of accounts receivable securitization. We do have covenants on the bank lines that we obviously need to live within. Those are fully disclosed in our documents, but its $300 million of tangible net worth and 65% debt to cap.

Chris Deyoung: Okay. As far as other sources of liquidity, what’s your thought on the dividend for the next quarter and are you extending any payables?

Robin Lampard: We closely manage working capital all the time, not just when we get to this point in the cycle. And, our working capital actually on the payable side is in line, and our receivables are performing very well. In terms of dividends, it is a Board decision to pay dividends, and obviously they take that decision very seriously. As we talked about in our prepared remarks, the North American OSB producers are in unusually difficult markets and we believe that they will last through this year and next, with perhaps some transition in 2010. Obviously this is all factored in. The Board did declare a dividend this quarter. But as we said the company is continuing to look at alternatives to strengthen our liquidity position and conserve cash.

Chris Deyoung: I had noticed that Brookfield added another 3.25 million shares to its holdings in the latter half of last year. To your knowledge is this the most recent purchase they have made?

Robin Lampard: Well, as an insider they are obviously disclosing all of their activity on SEDI. They have certainly been purchasing shares to the quarterly dividends through the dividend reinvestment program, and you can see that - it's all available on SEDI.

Chris Deyoung: When did they accumulate the majority of their shares, was it subsequent to '03, '04?

Robin Lampard: Brookfield has been a very longtime shareholder of this company. It dates back to their association with Noranda, out of which Noranda Forest, which was our predecessor company, was formed. So, their holdings date back many years.

Chris Deyoung: Okay. One final question, are you getting any pressure from any of your vendors regarding terms?

Robin Lampard: No, we are not.

Chris Deyoung: Who are your larger resin suppliers?

Barrie Shineton: In the last 4 years, GP Resins have been our largest supplier. We recently renegotiated our resin supply contracts, and we split that business up between the four big resin suppliers in North America: GP, Hexion, Tembec and Arclin. So, all four roughly supply equal amounts of resin to our company.

Chris Deyoung: Great, thank you very much.

Operator: Thank you. Our next question comes from Jonathan Sacks of Stonehill Capital. Please go ahead.

Jonathan Sacks: Most of my questions have been answered, but I will ask you to clarify two small things. The accounts receivable securitization, the $50 million that you had prior to quarter end - that was already fully drawn or executed, correct?

Robin Lampard: Yes.

Jonathan Sacks: And then the $35 million that happened post, is that a new line that's available or was that $35 million that was drawn or executed?

Robin Lampard: It's a new commitment that we just recently concluded and it's available to be drawn.

Jonathan Sacks: Okay, thank you. And then the other question is on the dividend. I sensed rightly or wrongly from the press release perhaps a slight change in tone on the dividend. Am I right to perceive a slight change in tone in that the dividend might be more closely considered or being reviewed now than it was a quarter or two ago?

Robin Lampard: We haven't been saying anything different from what we've been saying for several quarters now; that we see our business in unusually difficult markets and we believe they will last for some time. So, for several quarters now we have been asked about the dividend and the Board looks at it every quarter and it is a quarterly decision.

Jonathan Sacks: Okay. Is it fair to assume that amongst the many liquidity options that are being considered that reducing or cutting the dividend is amongst those options?

Robin Lampard: Everything is on the table.

Jonathan Sacks: Okay. Thank you very much.

Operator: Ladies and gentlemen, thank you for attending. This does conclude your conference call for today. You may now disconnect your line and have a great day.

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