Cascades Canada ULC

Third Quarter 2017 Financial Results

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PRESENTATION

Operator

Mesdames et messieurs, bienvenue à la téléconférence des résultats financiers du troisième trimestre 2017 de Cascades. Je m'appelle Julianne et je serai votre opératrice aujourd'hui. Toutes les lignes sont présentement en mode écoute seulement. Suite aux commentaires des dirigeants, il y aura une période de questions.

Good morning. My name is Julianne, and I will be your Conference Operator today. At this time, I would like to welcome everyone to the Cascades Third Quarter 2017 Financial Results Conference Call. All lines are currently in a listen-only mode. After the speakers' remarks, there will be a question-and-answer session.

I will now pass the call to Jennifer Aitken, Director of Investor Relations for Cascades. Ms. Aitken, you may begin your conference.

Jennifer Aitken - Director, Investor Relations, Cascades Canada ULC

Thank you, Operator. Good morning everyone and thank you for joining our Third Quarter 2017 Financial Results Conference Call. Our speakers on this morning's call will be Mario Plourde, our President and CEO; Allan Hogg, our CFO; Charles Malo, President and COO of our Containerboard Packaging Group; Luc Langevin, President and COO of our Specialty Products Group; and Jean Jobin, President and COO of our Tissue Papers Group. After discussion surrounding our North American operations, Mario will then discuss results from Boxboard Europe, followed by some concluding remarks, after which we will begin the question period.

Before I turn the call over to my colleagues, I would like to highlight that Reno De Medici's third quarter financial report, released on November 3, can be reviewed on Reno's website.

I would also note that certain statements made during this call will discuss historical and forward-looking matters. The accuracy of these statements is subject to risk factors that can have a material impact on actual results. These risks are listed in our public filings.

These statements, the Investor Presentation, and the press release also include data that are not measures of performance under IFRS. Please refer to Slide 2 in our accompanying Q3 2017 Investor Presentation for details. This presentation, along with our third quarter press release, can be found on the Investors section of our website.

I would like to remind the media and Internet users that they are in listen-only mode and can therefore only listen to the call. If you have any questions, please feel free to call us after the session.

I will now turn the call over to our CEO. Mario?

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

Thank you, Jennifer, and good morning everyone. We reported third quarter results earlier this morning that were below expectations. While both operating incomes and EBITDA increased on a consolidated basis year-over-year, our Tissue segment generated disappointed results within the context of a challenging environment of higher raw material prices and increased capacity in the market. Jean will provide you with greater details later during the call.

Looking briefly at the performance of our other operations, our Containerboard segment increased third quarter sales and EBITDA year-over-year, mainly reflecting the consolidation of Greenpac. Our European Boxboard segment delivered another good performance during the quarter as overall business conditions and internal optimization projects are positive. Lastly, lower third quarter EBITDA results from the Specialty Products segment reflected the lower contributions from recovery and recycling activity related to the stronger Canadian dollar.

Looking at our financial performance, third quarter sales totalled $1.1 billion, down 2 percent sequentially and up 8 percent year-over-year. On an adjusted basis, Q3 EBITDA of $106 million was essentially unchanged from the Q2 level, and was $3 million above prior year third quarter results.

On the KPI front, third quarter shipments increased by 11 percent year-over-year driven primarily by consolidation of Greenpac. On a sequential basis, future shipments decreased by a slight 1 percent, due mainly to European seasonality.

Our capacity utilization rate of 92 percent in the quarter decreased by 1 percent year-over-year, reflecting decreases in both Containerboard and Tissue, offset by a 4 percent increase in European Boxboard that was driven by positive demand trends. Sequentially, capacity utilization decreased by 3 percent. This reflects a lower utilization rate in Containerboard related to challenges with transport and logistics following weather disruptions during the quarter, and a 4 percent in European Boxboard due to unusual holiday downtime in August. The Tissue segment increased capacity utilization by 1 percent sequentially.

On the raw materials side, the average Q3 price index of OCC brown paper grades was up 9 percent from Q2 and 60 percent year-over-year. Virgin pulp price also increased. Hardwood virgin pulp was up 17 percent year-over-year and 5 percent from Q2, and softwood virgin pulp by 11 percent and 2 percent, respectively. After registering a recent high of $175 in March, OCC prices fluctuated quite substantially over the next several months. Most recently, prices fell by a total of $65 from September through November, ending at the new index level of $100.

Moving briefly to our financial positions, we are pleased to note that our total net debt decreased 17 percent from Q2 levels, following the sale of stake in Boralex (phon).

I will now pass the call over to Allan who will provide you more detail regarding the quarterly result and I will come back for the European operations and the near-term outlook. Allan?

Allan Hogg – Vice President and Chief Financial Officer, Cascades Canada ULC

Thank you, Mario. Good morning everyone. I will begin with sales as detailed on Slides 12 and 13 of our Third Quarter Conference Call Presentation which can be found in the Investors section of our website.

On a year-over-year basis, third quarter sales increased by $82 million or 8 percent. This reflects the consolidation of Greenpac, improvements in pricing and sales mix in all of our segments, and a stronger contribution from our recovery and recycling activities. Lower volumes and the appreciation of the Canadian dollar were offsetting factors in all segments with the exception of European Boxboard.

Sequentially, Q3 sales decreased by $27 million or 2 percent. Lower volumes in all segments except Tissue and a negative FX impact were the driving factors for this decrease. Improvement in selling prices and sales mix in Containerboard was the main positive contributor to sales sequentially.

Moving now to operating income and Adjusted EBITDA, as highlighted on Slide 14, our Q3 operating income was $1 million above last year while our Adjusted EBITDA of $106 million increased $3 million from prior year levels. The president of each of our segments will provide more details regarding their respective performance. On a consolidated basis, the benefits derived from the addition of Greenpac results and (inaudible) selling prices in Containerboard, a stronger performance in Europe and lower stock-based compensation expense in the Corporate segment were offset by higher raw material costs in Containerboard and a weaker performance from the Tissue segment. Depreciation expense was also higher due to the Greenpac consolidation.

Sequentially, Q3 Adjusted EBITDA decreased by a margin of $1 million. This reflects higher raw material costs, a weaker performance from the Tissue segment and a lower contribution from our European Boxboard operations related to usual summer down time. Offsetting these were stronger Containerboard performance driven by higher selling prices and a more favourable sales mix and lower stock-based compensation at the Corporate level.

Slide 16 and 17 of the presentation illustrate the sequential and year-over-year volumes of our Q3 earnings per share and the details of the specific items that affected our quarterly results. As reported, earnings per share totalled $0.35 in the third quarter which included specific items which I will detail in a moment. This compared to reported earnings per share of $0.21 last year. Our third quarter adjusted EPS decreased to $0.20 from $0.32 last year, reflecting stable EBITDA and higher depreciation expense due to Greenpac. However, while EBITDA was stable, the mix of contributors changed as Greenpac and Boxboard Europe segment represented a higher proportion of operating income. Consequently, net earnings attributable to noncontrolling interest in Greenpac and Reno di Medici was higher compared to last year, thus reducing our share of the net results. In the third quarter of 2017, we also recorded an income tax charge of $3 million related to prior year reassessment.

On a sequential basis, third quarter adjusted earnings per share decreased $0.05 from the adjusted earnings per share of $0.25 in the second quarter of 2017, mainly due to the variance in the effective income tax rates.

Slide 18 and 19 of the presentation illustrate the specific items recorded during the quarter. We recorded a net amount of $2 million of specific items in Q3 that negatively impacted our operating income. These included a decrease in the value of certain unused assets, a researching (phon) charge following the announcement of the closure of New York plant in Containerboard, and an unrealized gain on derivative financial instruments. With regards to net earnings, we also recorded an $18 million gain on the sale of our equity investment in Boralex and the related deferred tax asset reversal of $8 million, as well as an $8 million foreign exchange gain on long-term debt and financial instruments.

As illustrated on Slide 20, cash flow from operations decreased by $5 million year-over-year to $63 million. Free cash flow declined as well compared to last year, reflecting higher capital investments during the period.

Moving now to our debt reconciliation, in addition to the cash flow from operations and the $288 million of proceeds from the sale of our equity stake in Boralex, the appreciation of the Canadian dollar positively impacted our debt level during the quarter. These were offset by working capital liquidity requirements of $43 million in addition to $43 million of investments. Our net debt leverage ratio now stands at 3.6, down from 4.2 at the end the second quarter on a pro forma basis to include Greenpac.

Slides 23 through 28 provide details on our third quarter performance on a segment basis, and our near-term outlook is detailed on Slide 30.

Than you for your attention. I will now pass the call to Charles who will discuss our third quarter results from our Containerboard packaging group. Charles?

Charles Malo – President and Chief Operating Officer, Cascades Containerboard Packaging Group

Good morning everyone, and thank you, Allan. We are pleased to report a significant sequential improvement in results during the third quarter despite the existence of some logistical challenges within the U.S. Containerboard segment. Accordingly the third quarter shipments reached 369,000 short tons which represent a 2 percent sequential decrease. This lower Q3 volume is largely due to a 10,000 short ton decrease in external paper shipments that were the direct result of these logistical challenges. Therefore, to balance production level with our shipping capacity, we slowed down containerboard production in August and September. Accordingly, our operating rate decreased to 91 percent in Q3 which was 3 percent below the previous quarter.

Our Q3 integration rate increased to 55 percent which represents a 4 percent increase compared to the previous quarter when including shipments to Greenpac partners. Including paper sold to our associated companies, our Q3 integration rate totalled 67 percent compared to 64 percent in the previous quarter. On the converting side, shipments increased sequentially by 5,000 short tons or 3 percent. This outperformed the 2 percent increase reported for the Canadian market and the 1 percent increase for the U.S.

On the pricing front, our average selling price increased by $42 per short ton, or 4 percent on a sequential basis. This is a result of the full impact of the $50 per short ton price finally—price increase we started to implement during the second quarter.

On a segmented basis, our average Canadian selling price for containerboard increased by $12 per short ton or 2 percent, while our corrugated product average selling price in Canadian dollars increased by $36 per short ton or 2 percent. The favourable product sales mix also positively impacted our average selling price.

During the third quarter, the Containerboard group generated an EBITDA of $72 million which translates into a margin of sales of 16 percent. This represents a 3 percent improvement on a sequential basis and is stable compared to the same quarter last year. Our sequentially higher results were mostly driven by higher average selling price denominated in Canadian dollars which added $33 million to profitability. Also, lower SG&A costs added $4 million to profitability. Unfortunately, the raw material costs continued to negatively impact our results mainly due to higher OCC prices (inaudible) $15 million. Appreciation of the Canadian dollar and lower volume also reduced quarterly results by $2 million each.

With regards to the short-term outlook, we expect the fourth quarter demand to follow the usual lower seasonal trend. Despite these lower anticipated demand levels, we expect results to benefit from improved operating rates as the October production in our containerboard mills was greatly strong, and logistically, performance has normalized. Combined with this will be an expected beneficial effect from the recent OCC price reduction and the full beneficial impact from the median price increase that was implemented in the third quarter.

Finally, the work on the construction of our new corrugated plant in Piscataway, the construction is underway and we expect to start the operation in the second quarter of 2018 within the budget and on time.

Thank you for your attention, and I will now ask Mario to provide you with an overview of the Boxboard activities in Europe. Mario?

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

Thank you, Charles. The European Boxboard segment generated improved sales and EBITDA results year-over-year in the third quarter, driven by increases in both shipments and average selling prices which reflect continued strengthening of market fundamentals and a more favourable geographical sales mix.

On a year-over-year basis, recycled boxboard shipment increased by 8 percent during the third quarter, primarily driven by stronger demand in Western Europe while shipments of virgin boxboard decreased by 5,000 short tons, or 14 percent during the period. The average selling price increased by 1 percent in euro and increased by 2 percent in Canadian dollars, driven by a 14 euro or 3 percent increase in the average selling price in recycled boxboard. This was partially offset by a 14 euro or 2 percent decrease in the average selling price in virgin boxboard during the period due to unfavourable exchange rates with the U.K. market. A 7 percent increase in the sales in Canadian dollars reflects higher volume, higher recycled boxboard average selling prices and a 1 percent average depreciation in the Canadian dollar against the euro.

Third quarter EBITDA increased by $5 million year-over-year, largely due to lower energy costs and higher sales. Similarly, a shorter seasonal down time led to a lower labour and repair and maintenance cost during the period. Higher raw material costs, primarily for recycled materials partially offset these benefits during the quarter.

Sequentially, shipments declined by 4 percent after a strong second quarter, which translated into a 5 percent decrease in the sales during the period. This reflects the usual summer down time in Europe and a three-week planned shutdown of the La Rochette mill to complete an important rebuild of the boiler. Average selling prices were unchanged sequentially as higher recycled boxboard pricing was offset by a less favourable sales mix.

Adjusted EBITDA decreased by 33 percent sequentially to $14 million in the third quarter, reflecting the already mentioned factors and higher raw material costs.

The near-term outlook continues to be positive in Europe with other inflow and other backlog levels both stronger than prior year levels. In a similar vein, the macroeconomic forecast also remains positive, however, raw material pricing, most notably recycled fibre is expected to remain under pressure in the longer term but show some relief in the fourth quarter.

On the pricing front, the 20 euro June increase, the 40 euro September increase on recycled board and a subsequent 78 euro virgin board increase announced in November support a positive outlook in terms of future expectations.

I will now pass the call to Luc who will provide you with an overview of the performance of our Specialty Product Group. Luc?

Luc Langevin – President and Chief Operating Officer, Cascades Specialty Products Group

Thank you, Mario. Good morning. As reported today, the third quarter of 2017 was more difficult for the Specialty Products Group. Our sales totalled $180 million during this period, a decrease of 4 percent compared to Q2. This decrease was mostly due to unfavourable FX variations during the quarter and lower volume in the consumer packaging and recovery subsegments. However, it’s worth mentioning that this sales level represents a 14 percent improvement over the same period last year.

Consequently, our third quarter EBITDA decreased to $15 million from $20 million in Q2. Again, FX variations and to a lesser extent a lower volume explain most of this decrease.

Looking at (inaudible) on a segmented basis, the industrial packaging subsegment EBITDA decreased by $1 million due to lower spread and a less favourable exchange rate. We expect our spreads to revert back to normal or improve in Q4 as OCC prices recently decreased.

Our consumer product packaging subsegment also generated sequentially lower results. The exchange rate also contributed negatively to our performance, but lower volume in most of our markets and the (inaudible) production costs also lowered our EBITDA. Fortunately, our supply management and price increases deployed on finished product mitigated the impact of hurricanes on (inaudible) prices.

Finally, after four consecutive strong quarters, our recovery subsegment results were lower as the exchange rate had a significant negative impact during the third quarter. Volume decreased slightly by 3 percent compared to Q2, but the spread contribution remained favourable.

Regarding the near-term outlook, our recovery subsegment Q4 performance will be negatively impacted by recent declines in recovered paper prices, which represented an historical drop for OCC. Visibility for recycled fibre pricing remains somewhat blurry for the long term. As the Chinese situation becomes clearer, we will gain a better understanding of what we can expect next year. Until then, we do not expect major variation in OCC prices for the remainder of 2017. Domestic supply is more than sufficient as it’s smaller (phon). The white fibre market is balanced in the region where we are active.

On the industrial packaging front, we expect to benefit recent recovered paper prices decrease. Our converted plants continue to be busy and we expect demand for our products to remain solid.

As for our consumer product packaging subsegment, besides lower seasonal demand typically observed during the fourth quarter, we expect market conditions to return to normal after a stormy third quarter.

To conclude, despite seasonality in the ramp in the last part of the year, we expect the Specialty products group to replicate its solid 2016 performance.

Thank you for your attention. I will now pass the call to Jean who will present the results for our Tissue Papers Group.

Jean Jobin – President and Chief Operating Officer, Cascades Tissue Papers Group

Thank you, Luc. Good morning everyone. The Tissue Group faced challenging market conditions during the third quarter. Despite positive market seasonality, our third quarter result came in below expectations as we generated an Adjusted EBITDA of $24 million or a margin of 7.4 percent, which was below the $35 million and a margin of 10.3 percent in Q2. When compared to last year, which was the strongest Q3 in our history, this year's Q3 was a challenging quarter.

Despite both operational efficiency and fixed cost level that were comparable sequentially and year-over-year, our overall performance was negatively impacted by higher raw material prices, slower than expected sales penetration achieved by our new Oregon converting facility, lower hand towel, parent roll and converted product volumes and higher logistics cost. I will touch on each of these key drivers one by one.

In terms of volume, favourable Q3 market seasonality positively impacted performance in the away-from-home segment and also benefitted parent roll volumes on a sequential basis. This is reflected in the 4 percent increase in our overall shipments sequentially. However, on a year-over-year basis, shipments were down 4 percent. The primary challenge in this regard remains parent roll volume where shipment decreased 14 percent compared to last year, reflecting overcapacity in the hand towel market and a slower sales of converted hand towel products, which forced us to shut down during Q3 to manage inventory.

We are actively evaluating solutions to manage the situation. These may include exporting to very select markets and planning targeted additional markets-related shutdown to help manage inventory levels going forward. Longer term, the increase in our integration rate as the new Oregon converting volume continues to be ramped up, will reduce our exposure to the external hand towel jumbo roll market, as will strategic investment in modernizing converting equipment to enhance product quality.

The start-up of our new Oregon facility is now behind us and the west coast market development is progressing. While new market penetration always takes time, the quality of the product produced by this state-of-the-art facility makes us confident that we will succeed.

In terms of pricing, our third quarter average selling price decreased by 8 percent on a sequential basis. This was mainly driven by the weakness of the Canadian dollar and the less favourable product mix due to the lower percentage of converted products.

On the positive side, we announced price increase of up to 10.5 percent for the Canadian consumer product segment during the third quarter, which should start positively impacting our results in the fourth quarter.

On the materials side, the significant price increase is seen in both recycled fibre and virgin pulp, coupled with our higher utilization of virgin pulp in our products to enhance quality, also negatively impacted our performance. The 16 percent increase in our average raw material cost, negatively impacted our spread despite the increases in selling price that were announced in some markets over the last 12 months. I would also note that while the current competitive market condition makes it more challenging to implement price increases in full, we are seeing a positive impact. However, these benefits are not enough to offset the important negative impact of higher raw material prices.

Lastly, I would note that our growing use of virgin pulp supports the important growth of one of our key Canadian customers while also helping us to increase the quality of our products, making us more competitive.

Touching briefly on transportation, overall cost have increased over the last 12 months. These increases reflect longer delivery distance for our customer and current disruption within the North

American transportation network, in part due to the recent weather episode. In addition, changes in our customer product mix has resulted in higher outsourcing costs.

On a more positive note, we are seeing a very positive impact from our Fluff & Tuff brand re-launch, which has delivered results that are above expectations. On a year-over-year basis, our branded product sales have increased by 50 percent in the product (phon) market. We are very happy with the market response.

Looking forward to Q4, which is typically a softer demand season for tissue, we expect lower volume, primarily in the away-from-home market and in the parent roll segment. As a result of the usual seasonality, we would also expect pressure on the hand towel segment to remain high.

As already mentioned, some year-over-year—some year-end paper machines, sorry, shutdown will be necessary to manage inventory levels. In terms of raw materials, we expect a reduction in OCC given recent index pricing changes, while virgin fibre prices are expected to remain high. During this challenging period, we will stay focused on execution, efficiency, managing our fixed cost base and continuing to augment our west coast market penetration.

Thank you. I will now turn the call back to Mario for the conclusion. Mario?

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

Thank you, Jean. To briefly review what has been discussed during today's call, we expect near-term Containerboard performance to benefit from solid industry trends within the context of the seasonally slower Q4, the addition of Greenpac and the recent price increases. While we anticipate fluctuation on OCC to continue, our Q4 average price is expected to be sequentially lower given the September and October decrease in the index price.

Results from our European Boxboard activity are expected to benefit from continuing positive demand trends through the end of the year, a better geographical sales mix and the rollout of announced price increases. Much like North America raw material prices will be favorable in Q4, but remain a potential headwind for the future.

Specialty product performance will reflect raw material pricing variance and its recovery and recycling activities, and continue positive momentum and its other packaging activity.

Finally, we expect near-term Tissue result to remain under pressure from higher raw material pricing, weakness in the hand towel jumbo roll market and seasonally weakness in the fall and the winter. The slower than expected sales ramp up of our new tissue converting operation in Oregon is also expected to dampen results over the upcoming quarters.

Before turning the call over for questions, let me finish with the following. The North American landscape remained competitive and our recent results have reflected this. Historical fluctuation in raw material prices, new capacity addition, challenges with logistic following the recent hurricane and temporary additional demands of our internal transformation initiatives have also combined to dampen results. I will note, however, that these and other shifting fundamental in our business segment are the reason why we are optimizing our internal business process, implementing an ERP platform and why we successfully restructured our operation and improved on our financial profile over the past several years. While these changes can be disruptive at the operational level, Cascades will be more agile once they are completed.

It is for this reason that we remain both committed to and confident of the steps we are taking to reinforce our platform and transform Cascade into a company that it is more competitive, better equipped, and well positioned for the long term.

We will now open the line for the questions. Operator?

Q & A

Operator

Merci. Si vous voulez poser une question, veuillez s'il vous plaît composer l'étoile suivie du un sur votre clavier téléphonique. Si vous voulez retirer votre question, composez le carré.

Thank you. If you'd like to ask a question, simply press star, then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. Again, if you have a question, please press star, then the number one on your telephone keypad. We will pause for just a moment to compile the Q&A roster.

Your first question comes from Hamir Patel from CIBC Capital Markets. Your line is open.

Hamir Patel – Analyst, CIBC Capital Markets

Hi. Good morning. I wanted to our start on the Tissue side. Jean, historically your Q4 EBITDA has been a fair bit weaker than Q3. Given the weakness in the third quarter, how should we think about the drop off in Q4 this year?

Jean Jobin – President and Chief Operating Officer, Cascades Tissue Papers Group

Well as you know, Hamir, Q4 is a question of volume normally and we are very exposed to the hand towel market, so I would expect that it will follow usual pattern on us.

Hamir Patel – Analyst, CIBC Capital Markets

Okay. Jean, you mentioned something about looking at some potential export opportunities. So, I was just curious where. Which markets were you looking at?

Jean Jobin – President and Chief Operating Officer, Cascades Tissue Papers Group

Well, we're still evaluating that right now, but it's going to be limited. This is not a game that we plan to play heavily; only if it's profitable for us to do that versus shut down.

Hamir Patel – Analyst, CIBC Capital Markets

And then that will be parent rolls.

Jean Jobin – President and Chief Operating Officer, Cascades Tissue Papers Group

Yes.

Hamir Patel – Analyst, CIBC Capital Markets

Parent rolls. Okay. Then could you speak to the timing of the customer bid processes that have sort of held back the filling out of the Oregon facility?

Jean Jobin – President and Chief Operating Officer, Cascades Tissue Papers Group

Well, you know in our plan, it was kind of the three-year plan to fill the plant, and honestly, we were into bids everywhere. We have people there pushing hard to find volume. It's very tough to define when we're going to be full or not or not at this point, but I can tell you that we're pushing hard and all of our attention is to fill that plant right now.

Hamir Patel – Analyst, CIBC Capital Markets

Okay. Great. Thanks. That's helpful. I just wanted to turn to our Containerboard, Charles, I was curious to get your thoughts with—it looks like China is on track to increase their domestic recycling rate. Curious what sort of reduction you think we'll see in their import permits next year. What do you think that means for OCC prices? How does that influence how you think about perhaps growing your own recycled containerboard capacity?

Charles Malo – President and Chief Operating Officer, Cascades Containerboard Packaging Group

Okay. So, I'll let Luc answer the first part of the question on the Chinese permits.

Luc Langevin – President and Chief Operating Officer, Cascades Specialty Products Group

Good morning, Hamir. For the OCC we do expect that China will come back in the market, but not in the same way that they did in the past. We see them looking for much higher quality OCC at this moment, so with the typical OCC that you would find in the North American will be less impacted than it used to be in the past. So, we see the volume increasing in early 2018, but not the same way that it happened in the past.

Charles Malo – President and Chief Operating Officer, Cascades Containerboard Packaging Group

Hamir, your second fold of the question, capacity to …

Hamir Patel – Analyst, CIBC Capital Markets

Just curious where do you think—what that means for OCC prices next year. Do you think will be flat, or down year-over-year in '18? If your trajectory suggests lower OCC prices because China is not buying as much, does that perhaps accelerate how you think about growing the Containerboard (inaudible)?

Charles Malo – President and Chief Operating Officer, Cascades Containerboard Packaging Group

Obviously, it wouldn't be prudent talking about long-term pricing on the recycled (inaudible). For the short term, let's say until the end of the year, honestly, we don't expect any significant movement, neither downward or upward, and we'll see with early next year and the issuance of more permits to imports, how much of an impact it will have on prices. But we don't expect something like what happened last year. The environmental conditional was significantly different. The inventory levels are high at mill levels at this moment. The supply is good, which is significantly different than what happened last year. There could be pressure on pricing early next year, but we don't expect to be close to what it was last year.

Male Speaker

Just to complete on that, for our mills, we have worked with our sourcing group to secure a good relationship also with suppliers.

So, depending on the movement of the market, our first goal also is to make sure that we are going to get supply to be able to continue our growth on the Containerboard. The second part, also on this is the quality of the product that is coming in and we're well prepared for that.

So, markets will move up and down, but the sourcing is what we have worked out, really focused on to make sure that the supply will be there to support servicing our customers.

Hamir Patel – Analyst, CIBC Capital Markets

Great. Thanks for that Luc and Charles. That's all I had for now. I'll get back in the queue.

Operator

Our next question comes from Paul Quinn from RBC. Your line is open.

Paul Quinn – Analyst, RBC Capital Markets

Yeah, thanks very much and good morning.

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

Good morning.

Paul Quinn – Analyst, RBC Capital Markets

It seemed like a relatively challenging quarter and when I take a look at your guidance provided last quarter, it seems like the misses were really in Tissue and European Boxboard. What happened in the quarter that you didn't expect with your guidance?

Jean Jobin – President and Chief Operating Officer, Cascades Tissue Papers Group

Well in Tissue, for sure, honestly, the raw material prices hit us a lot more than what we thought we would be hit, drastically, and also the price that we have in the market at this point in jumbo roll but also in cases, you know we have challenges, but the exchange rate also hit us very drastically in the sales price on our side for Tissue. That's pretty much it.

We knew that hand towel was under pressure, but normally, Q3, we are able to unload a lot of volume, which we were unable to this time. That's what I would say for Tissue, and honestly, the west coast penetration is not going at this speed that we would like, so this is where we're going to push extremely hard in the next quarters. But as you know in Tissue, hand towel and away-from-home, the worst time of the year is Q4 and Q1. So, nothing will be very nice in the next two quarters on those two aspects. That's for Tissue.

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

On Europe, probably Q3 was quite positive overall because demands for our product was pretty good. We take less down time than what expected except for La Rochette where we had to do a major rebuild on the boiler, so that obviously had an impact.

The price of virgin pulp had an impact on our result, and the exchange rate with the U.K. also had an impact, but other than that, the rest of the business is really positive. The order backlog, the order intake is remaining very strong and it looks the same for Q4. Those are the main things that affected Q3.

Paul Quinn – Analyst, RBC Capital Markets

Okay. When I take a look at some of your peers in the Tissue side, everybody seems to have a very challenging Q3 and a lot of cost inflation that, especially in the U.S. that nobody seems to have put back. Have you heard any price increase announcements on the U.S. side? I note that you moved up the Canadian price, but on the U.S. side have you seen any price increase announcements by others or do you see any?

Jean Jobin – President and Chief Operating Officer, Cascades Tissue Papers Group

No, I did not hear anything about that.

Paul Quinn – Analyst, RBC Capital Markets

Then last question I had, just on a high level, I view this Containerboard market across North America as probably one of the best markets I've seen in my career here. How would you assess that market, and what do you expect going forward here?

Charles Malo – President and Chief Operating Officer, Cascades Containerboard Packaging Group

We're very positive on the Containerboard. We see that the demand is there. We know what has been announced for new capacity in the market. We also predict the growth for, the demand for the box. So, we're pretty confident that this is a good market condition for us. Also, we're well positioned also to service the customer.

So, demand is going up on the box and we have some capacity to supply. The OCC, yes, right now is at an advantageous level, but even it does move up a bit, still for us these are the conditions for our Containerboard. So, we're optimistic on the overall, in the market and what we see for the predictable future.

Paul Quinn – Analyst, RBC Capital Markets

Great. That's all I had. Thanks again.

Operator

Our next question come from Benoit Laprade from Scotiabank. Your line is open.

Benoit Laprade – Analyst, Scotiabank

Thank you. Good morning, gentlemen. A few housekeeping questions. Have you changed your plans in terms of CAPEX for this year?

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

No. Not at all. We stayed focused on the CAPEX we had determined at the beginning of the year.

Benoit Laprade – Analyst, Scotiabank

So, should be around $200 million.

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

Yes.

Benoit Laprade – Analyst, Scotiabank

And I know it's a bit early, but what about 2018?

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

We're in the budget session right now. We have not finalized all the CAPEX, but it should be in the same area as 2017, but we need to finalize the revision of each business unit, so it's a little early to give you a good guidance. Probably in Q4, we'll be in a better position, at the end of the year.

Benoit Laprade – Analyst, Scotiabank

Okay. Allan maybe a few quicker ones. In term of cash taxes, what should we expect for 2018?

Allan Hogg – Vice President and Chief Financial Officer, Cascades Canada ULC

Cash tax, I think it will be—remain on the low side for 2018. We don't expect having a big jump except that the fuel contribution of Greenpac, (inaudible) from Greenpac that might increase slightly the cash tax, but nothing significant compared to this year.

Benoit Laprade – Analyst, Scotiabank

Okay. Lastly, in terms of corporate elimination (phon), it was up $14 million year-over-year, $3 million quarter-over-quarter. Is there anything else there than the share-based compensation you alluded to in your remarks?

Allan Hogg – Vice President and Chief Financial Officer, Cascades Canada ULC

On the EBITDA you mean?

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

No, corporate level. Yes.

Allan Hogg – Vice President and Chief Financial Officer, Cascades Canada ULC

At corporate level?

Benoit Laprade – Analyst, Scotiabank

Yes.

Allan Hogg – Vice President and Chief Financial Officer, Cascades Canada ULC

Last year there was—if you look at our report last year, we had costs related to a fire at the Mississauga mill, so that's a positive variance for this quarter. Also, we are starting to run down the cost of the program, as we say. So Q4 we should see a bit of that. No, that's all. If you compare to last year, it's share-based compensation and the fire in Mississauga. These are the mains.

Benoit Laprade – Analyst, Scotiabank

Okay. Thank you very much.

Operator

Our next question comes from Hanbo Xiao from Desjardins Securities. Your line is open.

Hanbo Xiao – Analyst, Desjardins Securities

Hi. This is Hanbo on for Keith. Thanks for taking my questions, and good morning. Could you just tell us what the current integration rate is in the Tissue segment, and how much you expect it to increase as you ramp up with the Scappoose plant? Thanks.

Jean Jobin – President and Chief Operating Officer, Cascades Tissue Papers Group

The integration rate actually is around 70% and Scappoose is planned to get that up by 7%.

Hanbo Xiao – Analyst, Desjardins Securities

Okay. Great. Thanks. Just a few quarters ago you guided to a targeted EBITDA margin in the Tissue segment of 13 percent to 14 percent. Just given the current market conditions, are you still maintaining that target, and what is the timeframe you are thinking of achieving that. Thanks?

Jean Jobin – President and Chief Operating Officer, Cascades Tissue Papers Group

Short term, certainly not with the competitive landscape we have, but this is our goal and this is what we're going to achieve, but this is going to be further away based on what we see at this point.

Hanbo Xiao – Analyst, Desjardins Securities

Okay. Thank you very much.

Operator

Our next question comes from Kasia Kopytek from TD Securities. Your line is open.

Kasia Kopytek – Analyst, TD Securities

Hi. Good morning everyone. It's Kasia. I'm filling in for Sean. Reading in OCC (inaudible) rather recently that OCC export prices in China have picked up over the past month. Just wondering if that's consistent with what you're seeing. Also it sounds like there is some talk around potentially import licenses, new import licenses being issued in China this month. Just wondering if you could comment on those two.

Allan Hogg – Vice President and Chief Financial Officer, Cascades Canada ULC

Okay. For export price, we've seen in the last publications the price going up on the West Coast, but when you look at the overall market it's pretty much in line now with the rest of the country.

When we look at the inland export prices now, it's also aligned with the domestic price. So, there is no pressure in the inland OCC prices from export. And as I said earlier, we do see a slowly increase of OCC, but the type of OCC is of a much higher quality than the typical OCC you would find in the market.

Kasia Kopytek – Analyst, TD Securities

Okay. Thank you for that. Just turning to Europe, your commentary mentioned some pressure on virgin grades but you also mentioned there is a November virgin grade price hike on the table; if you could just comment on that. If I understand correctly, the June hike is probably full in at this point; I'm just wondering how that September hike is expected to roll out throughout Q4?

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

It's pretty tough in Europe to pinpoint exactly what will be coming out of the price increase. We know that we've been under pressure with the price of pulp all year along. So, I'm expected this to go through from now on till the end of the year, but at what level it would be I would be guessing to give you good numbers. But in my opinion, the market, the way it is right now, a good or a substantial portion of this should go through. But it needs to be seen because in Europe the price increases tend to take longer to be implemented, but the context is positive at the moment.

Kasia Kopytek – Analyst, TD Securities

Okay, got it. That's with respect to both the virgin and the recycled grades, correct?

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

Yes exactly. Demand has been strong for the last, I would say close to 18 months right now. The backlog is way above what it was last year, so the dynamic in the market right now is positive, in both recycled and virgin.

Kasia Kopytek – Analyst, TD Securities

Okay. Thanks for that. Just finally, turning back to Tissue, you mentioned a three-year plan to fill up the organ machine. I am just curious to what extent the recent weakness was anticipated on your part versus just being something that was little bit maybe more pronounced than you had expected? If you could also comment on how much success you expect with the Canadian retail tissue price hike. I believe there is an away-from-home hike as well that's being implemented?

Jean Jobin – President and Chief Operating Officer, Cascades Tissue Papers Group

There is a CP announcement that we made in October. This is gradually implementing right now. Some was very successful. Some we're still negotiating first for this part. The first part of your question, I am not sure that I got it very well, but I think what you're asking me is how much of that was planned to be postponed like on the sales side. We are behind our schedule of sales by approximately six months right now. When I look at where we are, where we should have been, we're behind by six months at this point.

Kasia Kopytek – Analyst, TD Securities

Okay. That's really helpful. Okay, those are my questions. Thanks very much.

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

Thank you.

Operator

Again, if you would like to ask a question, please press star, followed by the number one on your telephone keypad. Our next question comes from Hamir Patel from CIBC Capital Markets. Your line is open.

Hamir Patel – Analyst, CIBC Capital Markets

Thanks. I just had a few follow-ups, Jean, could you comment on what the Tissue EBITDA and EBITDA margins would've been excluding the Oregon facility?

Jean Jobin – President and Chief Operating Officer, Cascades Tissue Papers Group

No, we don't want to go, as you know, Hamir, we never disclose mill by mill EBITDA, so I could not answer that, but we're still not making money. We are in the negative at this point, that's all I can say.

Hamir Patel – Analyst, CIBC Capital Markets

Okay. When would you expect to hit that breakeven threshold?

Jean Jobin – President and Chief Operating Officer, Cascades Tissue Papers Group

Oh my God, I don't have that crystal ball at this point. Not in the next six months for sure, because volume in the away-from-home, it's very slow in Q—it's going to be tough to get where we want to be. Honestly, I stopped sleeping at night because of this non-profitability at this point, so all my attention is on that. So, we're going to work hard on this.

Hamir Patel – Analyst, CIBC Capital Markets

Okay. Fair enough. Charles, just following up on the Containerboard side, I know you're looking at export opportunities on the Tissue side. Curious whether given the increase we've seen in export containerboard realizations whether there might be opportunities there on the containerboard side as well. I know you currently don't export but just curious if that's maybe an option for you to fill out the machine?

Charles Malo – President and Chief Operating Officer, Cascades Containerboard Packaging Group

Yes, we are looking at the export, and as you mentioned, the conditions for exporting right now are a lot better than they were at the beginning of the year. Again, we see this as a very positive sign should we need to export for any reason, like lack of orders or anything like that, which we don't see, but we would have another option to do. So, we keep valuating. Even if we're not exporting, we do maintain our relationship to some customers and brokers also, so should that become a need for us, we would use that.

Hamir Patel – Analyst, CIBC Capital Markets

Great, that's helpful. Luc, I was just curious to get your perspective on, there has been a lot of talk about China requiring recovered paper imports to meet, I think the latest is a 1 percent contaminant threshold. Just curious to understand how that compares to what you currently are able to deliver in your own recovered operations?

Luc Langevin – President and Chief Operating Officer, Cascades Specialty Products Group

Well, it depends on the different grades. When we look at the grades that's coming from the retail business, so picking directly from the stores or from the distribution centre, we're very close to that quality.

When it's coming from a sorting line, obviously we're not there. We're closer to an 8 percent, 9 percent, 10 percent contaminant. When they speak about contaminants they speak very often about non-fibre contaminant. So, there is two things there; it's the nature of the fibres and then non-fibres contaminant. With regards to non-fibre contaminant, what we're picking up from other retail business we have is very close to that quality.

Hamir Patel – Analyst, CIBC Capital Markets

Great, thanks. That's all I had.

Operator

Our next question comes from Hanbo Xiao from Desjardins Securities. Your line is open.

Hanbo Xiao – Analyst, Desjardins Securities

Hi. Thanks, my questions have been answered. Thank you.

Operator

We have another question from Paul Quinn from RBC. Your line is open.

Paul Quinn – Analyst, RBC Capital Markets

Thanks. Just want to sneak in a last one, just on ERP benefits expected in 2018.

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

As we stated before, Paul, we expect about $50 million coming out of the implementation starting in 2018, and from 2018 and 2019. We're ramping down as we speak now. The program we will be ending at the end of the year, and as you heard Allan's, we already are ramping down in terms of costs so this will be beneficial for us. So, yes, the $50 million is still there and it will be starting in 2018.

Paul Quinn – Analyst, RBC Capital Markets

Great. Thanks very much. Cheers.

Operator

Thank you. There are no further questions at this time. Mr. Plourde, please continue.

Mario Plourde – President and Chief Executive Officer, Cascades Canada ULC

Thank you very much everyone and I wish you a very good day. We'll talk to you on the Q4. Have a good day. Thank you.

Operator

Merci, mesdames et messieurs. Cela met fin à la conférence d'aujourd'hui. Vous pouvez maintenant raccrocher.

Thank you, ladies and gentlemen. This concludes today's conference call. You may all disconnect.

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