


Acadian Timber Corp.
2012 Fourth Quarter Conference Call Transcript

Date: Wednesday February 13, 2013

Time: 10:00 AM PT

Speakers: Mr. Reid Carter
President and Chief Executive Officer

Brian Banfill
Chief Financial Officer

Brian Banfill:

Thank you operator and good afternoon everyone. Welcome to Acadian's fourth quarter conference call. Before we get started, I would like to call your attention to the following:

This conference call is being webcast simultaneously through our website at www.acadiantimber.com where you can also find a copy of the press release including the financial statements.

Please note that in responding to questions and talking about our fourth quarter financial and operating performance and outlook for 2013, we may make forward-looking statements. These statements are subject to known and unknown risks and future results may differ materially. For further information on known risk factors, I encourage you to review Acadian's Annual Information Form, dated March 28, 2012, and other filings of Acadian with securities regulatory authorities, which are available on SEDAR at www.sedar.com and on our website.

I will start by outlining the financial highlights for the fourth quarter. Then Reid Carter, Acadian's Chief Executive Officer, will conclude with more general comments about our operations, market conditions and outlook for the upcoming year.

Driven by a 44 thousand cubic metre, or 15 percent, year-over-year increase in sales volume, Acadian's fourth quarter net sales increased to $18.4 million dollars from $15.1 million dollars during the same period in 2011. Adjusted EBITDA climbed $1.3 million dollars year-over-year to $5.1 million dollars and the Adjusted EBITDA margin rose to 28 percent of net sales from 25 percent in the fourth quarter of 2011.

The weighted average sales price across all softwood and hardwood log products fell by 2 percent year-over-year as declines in realized prices for softwood and hardwood sawlogs and softwood pulpwood were almost fully offset by gains in hardwood pulpwood pricing.

Net income for the quarter was $3.8 million dollars. Included in the quarter's net income was a $0.6 million dollar unrealized foreign exchange loss on long-term debt, a $1.5 million dollar positive fair value adjustment resulting from an increase in the appraised value of our timberland and a $1.3 million dollar deferred income tax expense. These items have not been included in our calculation of Adjusted EBITDA or free cash flow, and are not reflective of the operating performance of Acadian during the period.

Free cash flow improved by $2.1 million dollars over the fourth quarter of 2011 to $4.4 million dollars, however, the comparable year result was negatively impacted by $0.7 million dollars due to the processing of two quarterly interest payments on Acadian's long-term borrowing facility during the period. The payout ratio during the fourth quarter was 79 percent, a significant improvement from 116 percent in the same quarter of 2011 after adjusting for the non-recurring extra quarterly interest payment.

I will now briefly review the segmented results for Acadian's New Brunswick and Maine operations.

The weighted average selling price across all log products at our New Brunswick operations was $56 dollars and 3 cents per cubic metre in the fourth quarter of 2012, down 3 percent from $57 dollars and 62 cents realized in the same period last year. This decrease reflects lower realized sales values for softwood sawlogs and pulplogs somewhat offset by improved realizations for hardwood pulpwood. Net sales were $13.7 million dollars for the fourth quarter of 2012, up $2.4 million dollars from $11.3 million dollars in same period of 2011. The improved sales reflect a more normal sales volume for the period as compared to the fourth quarter of the prior year when harvesting activities were constrained to bring the annual harvest in line with the Long Run Sustainable Yield after having increased harvesting in the first three quarters of 2011 to capture market opportunities.

Sales volume in the fourth quarter was comprised of approximately 42 percent sawlogs, 42 percent pulpwood and 16 percent biomass. This compares to 39 percent sold as sawlogs, 35 percent as pulpwood and 26 percent as biomass in the fourth quarter of last year.

Total costs for the fourth quarter of 2012 were $9.7 million dollars as compared to $8.0 million dollars in the comparable quarter of 2011, with the difference attributable to higher volumes sold and increased hauling costs as a lower proportion of sales were from log sort yards.

Fourth quarter Adjusted EBITDA for the New Brunswick operations was $4.0 million dollars as compared to Adjusted EBITDA of $3.3 million dollars in the fourth quarter of 2011. Adjusted EBITDA margin was unchanged from the prior year at 29 percent as modest per unit variable cost increases and declines in average log selling prices were offset by the higher contributions to fixed costs as a result of increased sales volume.

Supported by increased harvest volumes, net sales at our Maine Timberlands operations in the fourth quarter improved 20 percent over the same quarter of the previous year to $4.7 million dollars. More favourable weather conditions compared to the fourth quarter of 2011 and improved harvesting and hauling contractor availability were the primary drivers of the 33 percent increase in harvest volumes. Improved prices for softwood sawlogs resulted in the U.S. dollar-based weighted average per unit log sales value for the fourth quarter rising 9 percent to $56 dollars and 05 cents from $54 dollars and 85 cents in same period of 2011.

Approximately 51 percent of Maine’s volume was sold as sawlogs, 41 percent as pulpwood and 8 percent as biomass. This compares to 57 percent sold as sawlogs, 40 percent as pulpwood and 3 percent as biomass in the fourth quarter of 2011.

Total costs for the fourth quarter of 2012 of $3.3 million dollars were $0.3 million dollars higher than in the same period of 2011 with a 10 percent decrease in total costs per cubic metre almost offsetting the impact of higher sales volume.

The increased sales volume and reduced per unit total costs compared to the fourth quarter of 2011 resulted in Adjusted EBITDA for the Maine Operations climbing $0.5 million dollars from the prior year to $1.4 million dollars. Adjusted EBITDA margin, at 29 percent of sales for the fourth quarter of this year, was up 6 percent from the 23 percent margin realized in the same quarter of 2011.

Capital expenditures across Acadian’s operations during the fourth quarter of 2012 totaled $0.1 million compared to nil in the comparable period of 2011.

At the end of the fourth quarter, Acadian had a cash balance of approximately $6.1 million dollars, a $2.1 million dollar increase from the cash balance at the end of the same quarter of the previous year, but a $0.3 million dollar decrease from the balance at the end of the previous quarter. Net of amounts reserved to support the minimum cash balance requirement of its long-term debt facility, Acadian had $7.8 million dollars of available credit on its revolving facility at December 31st, 2012. The balance sheet remains strong leaving Acadian well positioned for the future.

I will now turn the call over to Reid.

Reid Carter:

Thank you, Brian, and good afternoon.

As you know, Acadian takes its commitment to safety very seriously reflecting our belief that emphasizing and achieving a good safety record is a leading indicator of success in the broader business. We maintained our solid safety performance record among employees and contractors in our New Brunswick and Maine operations during the quarter with the combined operations experiencing just two reportable incidents among employees and two reportable incidents among contractors. Importantly, the incidents that did occur were relatively minor. We are particularly proud to report that the employees of our Maine operations have now completed twelve accident free years. We remain very focused on employee health and safety performance and look forward to maintaining our excellent results in future quarters.

As Brian has noted, the average realized sales price across Acadian's softwood and hardwood log products fell 2 percent year-over-year. Realized softwood sawlog prices slipped 2%, however, this was primarily a reflection of a change in delivery point as markets were solid through the quarter, and, in fact have continued to strengthen into the first quarter. Softwood pulpwood prices fell 5% year-over-year as markets for these products continue to struggle with oversupply. Realized prices for our much more important hardwood pulpwood product increased by 4% helping offset the price declines in softwood pulpwood, however, like realizations for softwood sawlogs, prices were affected by changes in delivery points. Softwood sawlogs represented 38 percent of net log sales during the quarter while softwood and hardwood pulp represented 6 and 29 percent, respectively. Biomass markets remain challenging, but improved demand led to a 13% improvement in gross margins for this product year-over-year.

Just moving away from Acadian's results for a moment, I thought I would offer our thoughts on the U.S, housing market. We are really quite optimistic in regard to the recovery of the U.S, housing market as evidenced by increases in starts during the fourth quarter, with seasonally adjusted annualized starts climbing

37% compared to the prior year. The December rate of 954 thousand starts was the highest since July 2008 and inventories of new homes available for sale remain at 50-year lows. U.S. home pricing has clearly moved off the early 2012 bottom with the most recent Case-Schiller 20-City Home Price Index showing a national increase in home prices of 5.5% year-over-year while the most recent statistics from CoreLogic show home prices nationwide, including distressed sales, moved up 7.4% year-over-year. This represents the biggest increase since May 2006 and the ninth consecutive increase in home prices nationally year-over-year.

We believe this recovery of home prices removes a major psychological impediment to home buyers standing on the sidelines and should support increased rates of household formation. Additionally, mortgage rates remain at record lows and housing affordability is at near-record highs with mortgage underwriting standards becoming more accommodative. While the consensus U.S. housing starts forecast is somewhat of a moving target, risks to the forecasts are expected to be on the upside, it appears a reasonable collection of forecasters are now projecting 925,000 housing starts for 2013, 1.15 million in 2014 and 1.42 million in 2015 – levels expected to result in very strong markets for timber aimed at solid wood products markets.

Separate from these market dynamics, Acadian's New Brunswick operations moved to a new pricing mechanism under the fibre supply agreement with Twin Rivers Paper Company at the beginning of 2013. This change is resulting in improved sales realizations for spruce-fir sawlogs as the updated mechanism better reflects open market log prices in the region.

The above noted factors have lead us to become more optimistic with regards to the outlook for softwood sawlog markets for the upcoming year. With current prices for lumber in North American markets, Acadian's softwood sawmilling customers are earning the best margins they've seen in many years which should ensure that current levels of operation are maintained or even increased leading to increased demand for spruce-fir sawlogs. We are seeing this born out in today's markets with all of our softwood sawlog customers being very hungry for logs.

Markets for hardwood sawlogs remain stable and appear to have a similar outlook for the foreseeable future.

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Markets for hardwood pulpwood continue to be strong with Acadian's major hardwood pulp customers maintaining high operating rates and actively competing for deliveries suggesting prices will remain stable well into the year.

Markets for softwood pulpwood, a relatively minor product for Acadian, remain adequate, however, we don't expect markets for this product to improve materially in 2013. This is not expected to significantly affect Acadian's financial performance as softwood pulpwood typically accounts for less than 8 percent of total sales and a much smaller proportion of free cash flow.

Biomass demand and pricing is expected to continue to face challenges owing to depressed prices for electricity and decade-low prices for natural gas. Despite this challenging market environment, Acadian continues to be able to sell all of its biomass with a stable outlook for gross margins generated from sales of this product.

In summary, while we expect volatility during the upcoming year, we expect it to be the first full year of recovery for the wood products industry since the economic downturn in 2008 and we are confident that the adeptness of our operating team in identifying and accessing market opportunities will ensure returns from all opportunities that arise are maximized.

We thank you for your continued support of Acadian Timber Corp. and remain confident in Acadian's long-term outlook and the quality of our asset base.

That concludes our formal remarks and we are available to take any questions from participants on the line. Operator…?

OPERATOR:

The first question comes from Graham Meagher with TD Securities. Please go ahead.

GRAHAM MEAGHER:

Thanks. Good afternoon, Reid. Your free cash flow to dividend payout ratio in 2012 was close to 100% and a little over that in 2011. So as we look ahead to 2013 and 2014, markets are improving and theoretically, earnings will go with that. How do you think about that payout ratio and in balancing that with CapEx needs and the current liquidity position?

REID CARTER:

Thanks Graham. Since we established Acadian and our target payout ratio has been 95%. Clearly, the last four or five years, that's been a challenge. We don't believe we have created any significant liabilities in terms of catch-up capital expenditures, but our goal would be to get back down to -- to make sure that if there are any, is any small catch-up, that that takes place over this next couple of years and we would like to target a 95% payout ratio. So, if our cash flow does improve materially, I mean, the board would have to of course consider dividend changes and the like.

GRAHAM MEAGHER:

Okay, great. Thanks. And then just second question on current logging conditions, what you've seen this quarter through mid-February in both New Brunswick and Maine.

REID CARTER:

I think we've had quite a good operating -- we had a very good December that finished the fourth quarter, where it was, got cold. We've had mixed weather, but good solid operating conditions so far in the first quarter. We have had some warming in Maine in the last couple of weeks, although it's cooled back down over the last 10 days, I guess, but generally good operating conditions. We're expecting to have a very strong operating quarter.

GRAHAM MEAGHER:

Great. Thanks very much. That's all I had.

OPERATOR:

The next question comes from Paul Quinn with RBC Capital Markets. Please go ahead.

PAUL QUINN:

Yes, good morning, Brian and Reid. Question on, just, overall harvest level; Looks like you logged about 1.3 million meters between New Brunswick and Maine in 2012. And just want to have an idea, so what would you expect to do in 2013 and then what availability do you have for upside in, say, later years, 2014 and 2015?

REID CARTER:

So that number, the 1.3 million includes our biomass.

PAUL QUINN:

Yes.

REID CARTER:

And we would expect that 2013 would be approximately the same number. We don't really have any opportunity to increase this. Because of the fiber supply agreement that we have at our New Brunswick operations, we have in that larger operation, less flexibility to move our harvest levels up and down with market conditions. So, I think you should expect that we can't increase harvest level materially as market conditions improve.

PAUL QUINN:

What about your flexibility within Maine; do you have the ability there to move it up and down?

REID CARTER:

We do have full flexibility in Maine, but it's a much smaller operation. And I don't think you should expect to see any material changes in our harvest levels in Maine.

PAUL QUINN:

Okay, and then just on the Twin Rivers pricing mechanism, you mentioned that could be a positive going forward, just trying to quantify how positive.

REID CARTER:

Well, the changes, it's a trailing six-month basis for calculating that, the pricing mechanism used in that fiber supply agreement. And we have moved up about $4 to $5 a cube cubic meter from the last half of last year**.** And any further changes would just reflect market changes in the region**,** again, on a six-month trailing basis.

PAUL QUINN:

Okay and that $4 to $5 a meter is on what volume?

REID CARTER:

Spruce-fir saw logs.

PAUL QUINN:

And --

REID CARTER:

So, spruce-fir saw logs volume sold to Twin Rivers.

PAUL QUINN:

Okay, and what kind of volume was that last years' that, like, 0.25 million meters?

REID CARTER:

I don't have that number right in front of me, Paul**.** But it's in the neighborhood I believe of 200,000 to 250,000 cubic meters.

PAUL QUINN:

Okay. So it's incrementally positive. It should be more than a million, but less than 2 million?

REID CARTER:

In very, round numbers, yes.

PAUL QUINN:

Okay. And then just on timber line transactions, what -- if you could give us a recap of what you have seen out there since the last call; anything of note that would push up the value of Acadian's timberlands?

REID CARTER:

No, there's been really, no, material transactions in the Northeast to speak of. The larger transactions in the US that we have been involved in, a number of U.S. southern transactions, and the large Forest Capital Partners transaction back in October. From the evidence we're seeing is that these are, using our kind of underwriting assumptions, going for unlevered real discount rates, sort of 5.5%-ish. So the market seems to be very hungry, but there's very little product available for sale.

PAUL QUINN:

Great. Best of luck, guys. Thanks.

OPERATOR:

There are no further questions at this time. I will now turn the call back over to Mr. Carter for concluding comments.

REID CARTER:

Thank you, Operator. We would like to thank all of you for joining us at our Fourth Quarter Conference Call. We look forward to talking to you in the future. Thank you. Enjoy the rest of your day.

OPERATOR:

Ladies and gentlemen, this concludes today's conference call.