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Acadian Timber Corp. Annual General Meeting Transcript

Date: Tuesday, May 13, 2014

Time: 10 AM ET

Speakers: Sam Pollock
Chairman of the Board

Reid Carter
President and Chief Executive Officer

SAM POLLOCK:

Good morning ladies and gentlemen. It is my pleasure to welcome everyone here today. It is now just after 10:00 a.m. and time to start the Annual Meeting of Acadian Timber Corp. My name is Sam Pollock and as Chairman of the Company, I will chair this meeting. With me at the head table is Reid Carter, President and Chief Executive Officer and also a Director.

I now call the meeting to order and ask Leigh Tang, Corporate Secretary of the Company, to act as Secretary of the meeting. I would also ask CST Trust Company, by its representatives Carol and Charita (ph 00:36), to act as scrutineer.

Before we turn to the business before us, I would like to deal with a few procedural matters. For the purposes of running the meeting efficiently, arrangements have been made to have certain shareholders move and second the resolutions coming before the meeting. A presentation will be made following the formal business portion of the meeting, after which Management will be pleased to discuss any questions you may have.

The Notice calling this meeting and the Management Information Circular were sent to shareholders. I've asked Leigh to file Proof of Service of the Notice of Meeting with the records of this meeting and she has done so.

The minutes of last year's Annual Meeting, held on June 23rd, 2013, are available should any shareholder wish to review them.

Based on the scrutineer's preliminary report on attendance, the Secretary has confirmed that there is a quorum present. I therefore, declare the meeting properly constituted for the transaction of business for which it's been called.

I will now table the Corporation's 2013 Annual Report to Shareholders, which includes the 2013 financial statements together with the Auditor's Report. Copies of our Annual Report were mailed to registered shareholders and are also available here today.

We will now proceed with the election of five Directors, each of whom is to be elected at this meeting to hold office until the next Annual Meeting. Particulars of the five nominees are set out in the Information Proxy Circular which accompanied the Notice of Meeting sent to shareholders.

I will now call for nominations for the election of five Directors of the Corporation.

LINDA NORTHWOOD:

Mr. Chairman, my name is Linda Northwood, and I nominate the following persons: Messrs. Bud Bird, Reid Carter, David Mann, Sam Pollock and Saul Shulman, and move that they be elected Directors of the Corporation to hold office until the next Annual Meeting.

SAM POLLOCK:

Thank you, Linda. Are there any further nominations? As there are none, thank you ladies and gentlemen.

I declare the nominations closed.

As there are five persons nominated for the same number of positions, I now declare that those nominated have been duly elected Directors of the Corporation by acclamation.

I would now like to introduce you to the other Directors who, in addition to Reid and myself, are with us today, and ask them to stand as their names are called. Bud Bird, Saul Shulman and David Mann.

I'd also like to recognize some of our Management who are here today. Brian Banfill, Chief Operating Officer; and Erika Reilly, Chief Financial Officer.

The last item of business is the appointment of Auditors. As stated in the Notice of Meeting, it is the intention of the persons named in the Form of Proxy to vote in favour of a resolution appointing Ernst & Young LLP as Auditors of the Corporation, to hold office until the next Annual Meeting and authorizing the Board to fix their remuneration, subject to contrary instructions given in the Form of Proxy. Will someone please move a resolution for the appointment of auditors?

DAVID MANN:

Mr. Chairman, my name is David Mann and I am the Chair of the Corporation's Audit Committee. I move that Ernst & Young LLP be appointed Auditors of the Corporation until the next Annual Meeting and that Directors be authorized to fix their remuneration.

SAM POLLOCK:

Great. Thank you, David. May I have a seconder?

ANGELA MARIER:

Mr. Chairman, my name is Angela Marier and I second the motion.

SAM POLLOCK:

Great. Thanks, Angie.

Adoption of this motion requires the favourable vote of a majority of the votes cast at the meeting by shareholders. Management has received proxies representing approximately 66% of the Corporation's shares. These proxies direct Management to vote over 99% of these shares in favour of this resolution. Since the votes against this resolution are minimal, I propose to take the vote by a show of hands, unless a shareholder requests a ballot. Would anyone like a ballot?

As there's not, I will now take this vote by a show of hands. All those in favour of the motion? Against?

I declare the motion carried.

Thank you, ladies and gentlemen. This concludes the formal part of today's meeting.

Before I turn things over to Reid, I just want to make a Safe Harbour statement. Please note that during the course of our presentation and in responding to questions about our financial and operating performance, 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 our risk factors, I

encourage you to review Acadian's Annual Report and Annual Information Form which are posted on our website.

With that, I will now ask Reid to make some comments on the Corporation.

REID CARTER:

Thank you, Sam, and good morning. Thank you for joining us. So, this morning I'd like to provide you with an overview of our operations and discuss the Company's achievements and performance in 2013, provide an update on events so far in 2014, and offer our outlook for 2014.

Let's begin with a look at the Company's operations to-date. Now, we use this slide most years – it's really just to remind everybody of what Acadian's business is comprised of. Acadian is a leading supplier of primary forest products in eastern Canada and the northeastern United States. We have approximately 1.1 million acres of private timberlands, about two-third in New Brunswick and one-third in Maine, and this makes Acadian the second largest private timberland operator in the New Brunswick and Maine region. Our timberlands have been under active management for over a hundred years and Acadian's business includes all aspects of forest management, from plantation establishment to timber harvesting, marketing and selling of timber.

Now let me turn to a review of Acadian's performance in 2013. Acadian continued to focus on operations in 2013, while also moving to develop a more aggressive growth strategy with a broader mandate. We continue to benefit from strong demand and pricing for our hardwood pulpwood products and improving markets for softwood saw logs, especially in our Maine operations. These improving market conditions and careful attention to costs allowed Acadian to generate net sales up 8% year-over-year. Costs were also very well contained while we increased production in response to improved market conditions.

I'm also very pleased to report that Acadian maintained its solid record of positive safety performance among employees and contractors in our New Brunswick operations and, in fact, posted our 13th accident-free year for employees in our Maine operations. Importantly, those few reportable accidents that occurred were relatively minor and resulted in little lost time.

Acadian takes its sustainability of its forest practices very seriously and we are pleased to report that we are, once again, successful in recertifying our operations under the widely recognized Sustainable Forestry Initiative.

Acadian benefits from a deep mix of customers serving broadly varied markets, as demonstrated on this slide. Our sales mix is relatively unchanged year-over-year with the softwood saw log and hardwood pulpwood markets driving most of our sales and operating earnings. Hardwood saw logs, a relatively small but profitable segment of our business, also benefited from very strong market conditions. Softwood pulp continued to be challenging, a challenging business segment, owing to a decline in the regional groundwood paper industry. Fortunately, this is a very small business segment for Acadian.

Comparison of Acadian's year-over-year performance demonstrates our continued improving performance. Sales increased by almost \$6 million while our Adjusted EBITDA increased by \$1 million, while EBITDA margins remained effectively unchanged. Probably more importantly, our free cash flow was effectively equivalent to our declared dividends, resulting in a payout ratio of 100%. I would note that the apparent little change year-over-year here belies our year-over-year improvement in financial performance as 2012 benefitted from a timing issue in regard to an interest payment on Acadian's trim credit facility. So, the 2012 in here looks a little better than it actually was and, as a result, masks the improved performance in 2013.

Turning to our first quarter performance in 2014. As reported yesterday, Acadian had a very strong quarter. Revenue increased by 16% to \$21.2 million, and our EBITDA and free cash flow increased significantly as well, resulting in a very strong payout ratio of 62%. It's important to note that some of this year-over-year improvement reflects the discontinuation of a vendor-managed inventory program with our main softwood saw log customer. This program, which ran in 2012 and 2013, resulted in a lower value sales mix and deferrals of some first quarter sales into the second quarter in those years. This solid first quarter in 2014 puts Acadian in a very good position for the remainder of the year.

In terms of our outlook for 2014 and the medium term going forward, we are optimistic in regard to this outlook. We have a positive outlook for softwood saw timber and hardwood products. While recovery of the US housing market continues to face many challenges, almost all industry watchers continue to

forecast a steady recovery. Our softwood lumber producing customers appear to share in this outlook as they announced new capital investments and add additional shifts in their mills. Markets for hardwood saw logs and pulpwood are currently stable and are expected to remain so through 2014. We expect markets for softwood pulp products to remain challenging, but as I said earlier, we are fortunate that this product accounts for only a small portion of Acadian's sales and a much smaller proportion of our operating earnings.

Finally, after a weak start to the year, largely related to freeze-up of the port facilities, biomass markets are expected to improve with the export markets providing additional attention. Recent announcements of government support for new or very large biomass facilities in the UK are expected to further tighten this biomass market.

As some of you may be aware, the New Brunswick government released its strategy for the forest – for crown lands forest management – in mid-March of this year. This strategy is aimed at securing a more competitive future for the forest sector in the province and includes the supply of an additional 600,000 cubic metres of crown timber. The forest industry has responded to this initiative by announcing capital projects at Irving's large St. Leonard and Kedgwick sawmills and Twin Rivers Plaster Rock sawmills, with further announcements expected, most likely on the hardwood saw logs side. We've also seen a significant announcement of – an announcement – of significant capital investment in Irving St. John groundwood mill. We view this strategy to be positive for Acadian. It's expected to result in continued strong regional demand for softwood saw logs and hardwood products.

As I mentioned in my opening remarks, Acadian announced a renewed growth strategy at the end of the second quarter in 2013. Historically, Acadian's focus on growth has been limited to eastern Canada and the northeastern United States. We have now moved to position Acadian to participate in larger transactions on a more global basis that are sponsored by Brookfield, and importantly, will still suit Acadian's profile. We've been very active in this regard since this announcement, pursuing opportunities in the United States, South America and Australasia. We are excited about this strategy and remain confident that it'll be successful in growing Acadian accretively while improving the attractiveness and liquidity of Acadian shares. Acadian's shareholders should be very confident that all such potential investments will be subject to review and approval by Acadian's independent Directors.

In terms of our 2014 objectives, our objectives continue to be to maximize value for Acadian shareholders. We benefit from the diversity of our product mix and will continue to optimize our harvest mix in accordance with market opportunities. As always, we'll focus—as always, we'll continue to work to maximize our margins by focusing on reducing costs and improving timber selling prices with a goal of steadily improving our free cash flow. Finally, as I've just described, we plan to be successful in growing Acadian.

That concludes my formal remarks. We'd now welcome any questions you may have. Mr Chairman, do we have any—yes?

PAUL DURAN:

Paul Duran's (ph 14:43) my name. What—okay, I see EBITDA is up nicely but net profit is down very sharply and can you comment on the reasons for that, for the year? My second question, I'd like to know where the ultimate destination of your product is. Is it primarily on the eastern seaboard of the US and the Maritimes? Where's the product distributed to in the end?

REID CARTER:

As you may know, we report under the IFRS accounting standard, and net income under this standard includes a number of non-cash items. Acadian has \$72.5 million of US dollar denominated debt and because of changes in the Canada-US exchange rate of approximately 10% there's an impact in the Canadian dollar translated value of this debt that hits our bottom line. So that's, by far, the dominant reason for the year-over-year decline. As I say, these are non-cash items and we really believe that the focus in trying to understand Acadian's performance should be on our cash items.

MALE SPEAKER:

The EBITDA is much more important.

REID CARTER:

Yes, that's why we focus on free cash flow.

Yes. In regard to your second question, well, we do produce a broad range of products. So, to go through them, our two largest products are softwood saw timber and that goes under a supply

agreement almost exclusively to the Plaster Rock sawmill owned by Twin Rivers and they sell into dimension lumber markets primarily in the northeast, so that—those solid wood products end up primarily, in New Brunswick and much more in the northeast of the United States.

Our hardwood pulpwood goes to two large customers, in particular; our maple pulpwood goes to a mill called AV Nackawic in New Brunswick, and that's a viscose dissolving pulp producer that's mostly used for rayon for clothing fabric material. It's owned by an Indian company, its products sell into a global commodity market. It's used for mainly clothing and medicinal gown masks and in some cases even cigarette filters. So, a number of purposes very global in its end use.

The other pulp customer is the Woodland Maine mill, it is really more of a market pulp producer with its end product used used in a variety of paper grades and other applications. I would guess that most of it ends up in the United States and Europe, but it is a global commodity.

We sell to some structural panel producers. The hardwood specialty producers are mostly aimed at furniture, interior finishings and those are still primarily a North American market; some blocks and simple manufacturing, may end up being remanufactured in Asia.

Yes?

FRANCOIS:

My name is Francois and I have two parts to my question. Since we have seen since the first quarter of 2014, Acadian's share price just keep on losing in the first quarter, so any negative pattern to the Company? Secondly is just as I mentioned, for this acquisition, you want make acquisitions in the US and also in Canada. Why you just not focus on Canada? Like we have the main log (inaudible 18:28) focused on the eastern part of Canada? Why don't we go to the west part of Canada? Just focus in Canada. It may be better for performance just going forward? Going abroad, right?

REID CARTER:

Sure. So, we really can't comment on our share price; that's beyond our control. It's broad market trends that generally impact that and, we compete against a number of other segments across the broader market, all the other segments and capital gets allocated for reasons that if I understood I'd be

a very wealthy man. But the—to answer your second question, we do look at Canada. Acadian, historically, has had a mandate of eastern Canada and northeastern United States for its growth. Brookfield, as the manager of Acadian, has managed very significant assets in British Columbia for the last decade. The big challenge in Canada is the majority of the timberlands is owned by the Crown, so there are very, very few timberland acquisition opportunities of any kind of industrial scale available in Canada, I mean there really are four. We have the private ownership of the Irving's. There's Acadian, and then on the west coast there's Timber West and Island Timberlands. In between, there may be some seemingly large opportunities in terms of acres or hectares, but the actual value is extremely small and the cash generated is very small.

So really, in order to grow Acadian in any kind of meaningful way that would impact its overall performance we have to focus on timberland opportunities other than those limited Canadian opportunities. We're very familiar with the US market and this large market is still one of the most attractive markets. It's very competitive. So, we look at these on a risk-adjusted basis and we don't look everywhere. We do limit our growth opportunities to those jurisdictions that have characteristics that we think are consistent with Acadian's overall risk profile. So, we tend to be in countries that have good property rights, good legal systems, deep markets, these types of things.

SAM POLLOCK:

Maybe one thing you can do is just talk about how we view our own relative valuation to our peers?

REID CARTER:

Sure, when you look at Acadian's valuation relative to its peers, which we do often, as you would expect, the primary peers are the US publicly-traded timber REITs; the Timber Real Estate Investment Trusts, and those are Plum Creek, Weyerhaeuser, Rayonier, Potlatch, Pope, and there's a new small one called CatchMark. When you look at the most appropriate comparative valuation metrics, you're looking largely at enterprise value against EBITDA which is a measure of our operating earnings against enterprise value or enterprise value over EBITDA less CapEx to try to get a measure of real free cash flow. We also look at our dividend yield. By both these measures we look very attractive. Particularly on the dividend yield, those, US timber REITs I mentioned, on average, have a dividend yield of around 3.2% to 3.5%. Acadian has been averaging plus or minus 6.5, and the real challenge for Acadian really comes back to our liquidity challenges. Acadian has a very small float and it's difficult

to trade Acadian shares because of its small size, and that is one of the drivers that I, among others, certainly, why we think it's important to grow Acadian, if we can do it accretively.

Yes?

MALE SPEAKER:

I'd like an idea—I'll just bounce it off you. Historical strategic medium-term outlook; 38,000 New Brunswickers work in Alberta and some kind of a number of the same kind of thing throughout the Maritimes, and they come home to their house only every third week. They get a free flight home. What happens on a day when they wake up one morning and they say, "Why am I keeping up two places in two provinces? It's pretty expensive and I'm listing my Maritime property and assuming full-time residence in Alberta." In fact, I talked to a guy that has a Charlottetown house and he lives in Fort Saskatchewan and he comes home every third week. So, is that maybe a negative outlook for housing in the Maritimes and Newfoundland?

REID CARTER:

You know —not having the statistics right at hand, I think if you looked at certainly new home construction but even repair/renovation in the Maritimes broadly and the utilization of wood products, particularly dimension lumber, I think you'd find that the size of the market in the Maritimes is so small that it's de minimis. It's close to being irrelevant to the market that, say, Plaster Rock or Irving's dimension sawmills are selling into. I think you look at the Canadian and, more importantly US market...

MALE SPEAKER:

And is only a piece of your market – the big market – because it's...

REID CARTER:

Absolutely, yes. Canada is about 10% the size of the US market although today it's bigger than that because the US has not been not very active over the last six years. But for Acadian's customers, solid wood sales, Canada – regionally eastern Canada – is an extremely small part of it. What you're saying is never good news because it also impacts the broad ability of a region to provide services and

attract labour to work in our operations but I don't think in terms of our customers and product demand, it's a big concern.

MALE SPEAKER:

Okay, the other question I have is I'm under the impression – I don't know whether I read it somewhere or maybe you guys said it last year – that you have an advantage selling into the US that BC doesn't, of some kind, and can you explain that to me?

REID CARTER:

Yes. Under the Softwood Lumber Agreement between Canada and the United States, there's an export tax that Canadian lumber producers, other than the Maritimes, must pay to access the US market if lumber prices are below various thresholds. So, when a published well-known index goes below various levels, the tax increases. Right now, the lumber markets have been strong enough that for most of the past – top of my head – year and a half there really been almost no tax paid.

MALE SPEAKER:

That's only for the west coast.

REID CARTER:

Well, no. It impacts Ontario and Quebec, through a slightly different calculation but they—the Maritimes have definitely been advantaged. There was recognition that the Maritimes had, at the time of this negotiation certainly, an active pricing system for an active wood market between private lands and crown lands and particularly, between the eastern townships in Quebec and New Brunswick and Maine, which meant a significant log flow. So, it was viewed as not being necessary to impose export taxes on those producers.

MALE SPEAKER:

This could be a big quantification on...

REID CARTER:

About a 15% tax.

MALE SPEAKER:

So BC; if prices fall sharply on lumber prices, BC's looking at 15% tax to sell into the US.

REID CARTER:

Yes, the tax is graded across various thresholds, but that's where, in a weak market, BC works at an additional penalty, yes. This is why British Columbia has been so focused on developing an Asian export market for its lumber; or at least one of the many reasons.

MALE SPEAKER:

Thank you.

REID CARTER:

Yes. Any further questions?

Mr. Chairman?

SAM POLLOCK:

Okay. Well, ladies and gentlemen, as there are no further questions, I'd just like to thank you all for showing up. We had a better turnout this year and a lot more questions. So, on behalf of Reid and myself and the Directors, we appreciate the interaction and I hope you all found it informative.

So, that brings the end of today's meeting and as a result, since there's no further business, I declare the meeting terminated.

Thank you.