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Acadian Timber Corp.
2014 First Quarter Results
Conference Call - Q&A Transcript

Date: Tuesday, May 13, 2014

Time: 10:00 AM PT

Speakers: Reid Carter
President and Chief Executive Officer

Erika Reilly
Chief Financial Officer

OPERATOR:

Thank you for standing by. This is the Chorus Call Conference Operator. Welcome to the Acadian Timber Corp. Conference Call and Webcast to present the company's 2014 First Quarter Results to Shareholders. As a reminder, all participants are in listen-only mode and the conference is being recorded. At this time, I would like to turn the conference over to Ms. Erika Reilly, Acadian's Chief Financial Officer. Please go ahead Ms. Reilly.

ERIKA REILLY:

Thank you operator and good afternoon everyone. Welcome to Acadian's first 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 first quarter financial and operating performance as well as our outlook for 2014, 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, 2014, 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 first quarter. Then Reid Carter, Acadian's Chief Executive Officer, will conclude with more general comments about our operations, market conditions, outlook for the remainder of the year and business development activity.

Acadian's operations ran well during the quarter benefiting from favorable winter operating conditions. Frozen ground throughout the first three months of 2014 provided a solid base for our harvesting and hauling activities.

While harvest of 348,600 cubic meters, excluding biomass, was in line with the same period last year, financial results improved significantly due to the elimination of the vendor managed inventory program at the New Brunswick operation, improved market demand for many of our products and a stronger U.S. dollar.

First quarter net sales totaled $21.2 million dollars, up $2.9 million dollars or 16 percent from the same period last year on a 10 percent higher sales volume of primary products and a 9 percent increase in our weighted average log selling price. The expiration of the vendor managed inventory program resulted in the higher sales volume and an improved product mix, with a larger component of softwood sawtimber sold during the quarter compared to the same period last year.

Adjusted EBITDA was $6.7 million dollars, up $2.0 million dollars compared to the first quarter of 2013. And, Acadian's overall Adjusted EBITDA margin increased to 32 percent up from 26 percent compared to the same period last year.

Net income for the quarter totaled $0.7 million dollars compared to net income of $1.3 million dollars in the first quarter of 2013. The decrease in net income reflects a higher non-cash fair value adjustment to timber primarily due to an increased recognition of sales this quarter, as well as an increased unrealized exchange loss on our U.S. dollar denominated debt due to the weakening Canadian dollar.

Free cash flow increased $1.7 million dollars from the first quarter of 2013 to $5.6 million dollars resulting in a payout ratio for the first quarter of 62 percent, compared to 88% last year.

I will now briefly review the segmented results for Acadian's New Brunswick and Maine operations. Net sales from our New Brunswick operation for the first quarter totaled $14.4 million dollars compared to $12.2 million dollars for the same period last year, reflecting the positive impact – from a volume and product mix perspective – of not operating under last year's vendor managed inventory program that resulted in the deferral of softwood sawlog sales into the second quarter in 2013. We did however enter into a short term log supply agreement with Twin Rivers during the first quarter that resulted in a minor deferral of softwood sawlog volume into the second quarter of this year. In return, Acadian is earning a premium on this volume. This agreement ends on May 31, 2014.

The weighted average selling price across all log products was $60 dollars and 88 cents per cubic metre in the first quarter of 2014, up 5 percent compared to the same period last year. This year-over-year increase in the average log selling price primarily reflects a higher proportion of spruce-fir sawlogs in the sales mix. Other sales decreased as a result of lower operating activity on the Crown licensed timberlands managed by Acadian.

Costs for the first quarter of 2014 were $10 million dollars as compared to $9.2 million dollars in the comparable quarter of 2013. The increase in total costs was due to a 1% percent increase in variable costs per cubic meter resulting primarily from a higher hardwood harvest volume.

First quarter Adjusted EBITDA for the New Brunswick operations was $4.5 million dollars, up $1.5 million dollars compared to the first quarter of 2013. Adjusted EBITDA margin increased to 31 percent from 25 percent in the prior year.

Net sales for the first quarter of 2014 at Acadian's Maine operation were also up year-over-year, increasing $0.7 million dollars to $6.8 million dollars. While sales volumes decreased 5% year-over-year, the weighted average log selling price was $67 dollars and 75 cents per cubic meter in the first quarter of 2014, a 17 percent increase from $57 dollars and 95 cents per cubic meter in the same period of 2013 in Canadian dollar terms. Weighted average log selling prices in U.S. dollar terms increased 7 percent year-over-year as a result of stronger market demand for most of our products.

Costs for the first quarter were $4.3 million dollars, compared to $4.1 million dollars during the same period in 2013. This increase was driven primarily by adverse foreign exchange movements year-over-year.

Improved log prices compared to the first quarter of 2013 resulted in Adjusted EBITDA for the Maine operations increasing $0.5 million dollars from the prior year to $2.5 million dollars. Adjusted EBITDA margin, at 36 percent for the first quarter of this year, was up from 33 percent in the prior year.

At the end of the first quarter, Acadian had a cash balance of approximately $11 million dollars, which is $4.6 million dollars higher than the cash balance of $6.4 million dollars at the same time last year and $2.4 million dollars higher than the balance at the end of the fourth quarter of 2013. This increased cash balance reflects Acadian's seasonally strong operating performance and the ability to sell our New Brunswick spruce-fir sawlog production as we were no longer encumbered by the vendor managed inventory program.

While it may appear that Acadian is holding significantly more cash than the prior year, it should be noted that immediately subsequent to the end of the first quarter of 2013, Acadian borrowed U.S. $4.0 million dollars on its revolving credit line to fund dividend and interest payments effectively bringing the cash balance up to $10.4 million. No such borrowings were required this year.

I would also add that, as is typical for Acadian, first quarter performance is generally followed by significantly lower levels of activity in the second quarter owning to spring mud season. We expect to return to historic average levels of cash holdings by mid-year.

As at March 29, 2014, Acadian had net liquidity of $74.9 million dollars, including funds available under Acadian's Revolving Facility and our stand-by equity commitment with Brookfield. The balance sheet remains strong leaving Acadian well positioned for the future.

During the quarter we distributed $0.21 per share to our shareholders, a dividend that is in line with previous quarters and supported by our steady performance.

I will now turn the call over to Reid.

REID CARTER:
Thank you Erika, and good afternoon everyone.

During the quarter, Acadian's operations experienced no recordable incidents involving employees and one recordable safety incident among contractors. This incident was relatively minor resulting in no lost time. We are pleased with this performance during the difficult winter season and continue to work with our contractors and employees to ensure the highest standards of workplace safety are met.

Acadian's weighted average log price for the first quarter of 2014 increased 9% year-over-year reflecting changes in product mix owing to the elimination of the Vendor Managed Inventory program in our New Brunswick operations and increased prices across most products. Stronger softwood sawlog markets and a strengthening of the U.S. dollar resulted in a 7% increase in the weighted average softwood sawlog price relative to the first quarter of 2013. Most of this benefit came from the Maine operations. Hardwood sawlog markets improved for both the New Brunswick and Maine operations with weighted average selling prices increasing by 16%. Prices for softwood and hardwood pulpwood decreased 7% and increased 10%, respectively, year-over-year. While market conditions for hardwood pulpwood continued to be strong, softwood pulpwood markets were challenged during the quarter due to a limited customer base. Biomass markets remained stable, however, our modest realized gross margins on this lower value product decreased 23% year-over-year due to fewer export customers.

Our outlook for 2014 is positive in light of a struggling U.S. housing market. While severe winter weather is almost certainly behind much of the slowdown, underlying demand remains weak as traditional buyers continue to defer home purchases in the face of lower affordability, tight mortgage credit and concerns over continued employment recovery. Although the current housing outlook is uncertain, almost all industry watchers are forecasting year-over-year increases in total housing starts of approximately 15% in 2014 with increases of the same magnitude forecast for 2015.

Meanwhile, Acadian's key solid wood customers continue to operate at high levels and, following the New Brunswick government's announcement of its Forestry Plan in mid-March, there have been announcements of significant capital investments and additional operating shifts at Irving's St. Leonard and Kedgwick sawmills and Twin Rivers' Plaster Rock sawmill. This is in addition to last summer's announcement of Irving's new sawmill in Portage, Maine. As a result, we expect to see continued strong demand for softwood sawlogs in the region going forward.

In addition to our positive outlook for softwood sawlogs, markets for hardwood sawlogs have been positive and are expected to remain stable while demand and pricing for hardwood pulpwood continues to be strong. While Acadian has been successful in selling its softwood pulpwood production, this market continues to be challenging owing to the closure of regional groundwood mills. Fortunately, this product represents only a small portion of Acadian's sales and an even lower proportion of our operating earnings. Biomass markets are mixed owing to a slowdown in export markets, with demand and pricing expected to remain reasonable offering modest margins.

On the business development front, we continue to actively pursue business development opportunities in support of Acadian's growth strategy in the U.S., Australasia and South America. After a prolonged period of limited investment opportunities, we are currently seeing an increasing number of owners willing to test the market. We are optimistic that Acadian will be in a position to participate in attractive opportunities during 2014.

In closing, I'd like to remind everyone that Acadian benefits from a strong balance sheet and, more importantly, a very capable operating team who remain focused on improving our financial performance by minimizing costs at all levels in the organization and always seeking the highest margin market opportunities for the products we produce. We look forward to continued improvement in Acadian's performance in the coming quarters.

We thank you for your continued support of Acadian.

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

OPERATOR:

The first question is from Andrew Kuske of Credit Suisse. Please go ahead.

ANDREW KUSKE:

Thank you, good afternoon. I guess it's a question for – well either Reid or Erika – you could take this. Are you sort of stuck in a little bit of a chicken-and-egg game from the standpoint of your valuation relative to a lot of other players in the industry is – is it's just – it's not as good so you don't have the yield on a tight spread basis that, say, CatchMark or others do, and you know, in part, others in the industry have actually been out doing acquisitions. Whether they're really value-added over a period of time, they've managed to have distribution growth; whereas, that really hasn't been the case with Acadian. So, I guess, the thrust of the question is, you haven't had the acquisition history and so you've got paper which is a little bit – I wouldn't say distressed, it's not the right word – but not as advantaged as others. So, does that put you in a little bit of a conundrum as far as doing anything, especially in the North American market?

REID CARTER:

As you know, we know the North American timber market extremely well. I mean, and when I say "we", as everybody knows, Brookfield is the manager of Acadian and Brookfield has a very large longlived timber program and we participate in virtually all major timber acquisitions in the United States, Canada, Brazil, Uruguay, Chile, New Zealand, Australia, so we've got a tremendous familiarity with these markets. The strategy for Acadian to grow has been to participate really through Brookfield's other timberland acquisitions, really with a free option to be vetted by the independent members of the Board as to whether it can be accretive or not to Acadian. We—I understand completely what you say. I guess whether the acquisitions made by some of the others, most notably Plum Creek, Rayonier and CatchMark, the other US timber REITs in the last couple of years, you know, turn out to be accretive to the distributions or not, time will tell.

I think we do understand what Acadian's investors are looking for in owning Acadian. We know that they appreciate yield. We know that Acadian's is also challenged by its liquidity - its relatively small float - and we're trying to look across appropriate –acquisitions that have an appropriate risk–return to that sort of Acadian profile and see if we can match it to the value of Acadian's currency. I think we're really quite optimistic we can achieve this. Whether it ends up being a normal bread-and-butter US private timberland offering, those are extremely competitive right now and, frankly, are trading at yields that are not attractive or accretive to Acadian. I mean, it's quite easy to look at, say, NCREIF, the National Council of Real Estate Investment Fiduciaries, various indices and their cash yields and you can see that most timber, private timber operations, in the US are having cash yields of less than 2%, where Acadian's is currently at 6.5%.

So, there's lots of challenges but we have a big platform. We have a lot of transactional experience, and we actually do believe we have some opportunities, a number of which we're currently working on that will provide Acadian with accretive growth.

ANDREW KUSKE:
Does that, in part, steer you into places like Brazil, where obviously the group, the broader group has been very comfortable for more than a century? I say that in part just because of currency devaluation and just interest rates in general there that makes it much easier to do an accretive transaction, obviously, still competitive but much easier to do an accretive transaction in South America, Brazil primarily.

REID CARTER:

While, you know, we look at everything on a risk-adjusted return basis and so making an accretive acquisition in Brazil, meaning it generated a cash yield above Acadian's current cash yield, it only has utility or real value if that cash yield is, on a risk-adjusted basis, greater than Acadian's current yield. What we really look for is markets that provide competitive opportunity which, for one reason or another, whether it's a relationship, whether it's a familiarity with a company, whether it's some unique attributes that Brookfield may bring to a transaction. As you mentioned in Brazil, for instance, we have a tremendous presence and have been there for 110 years. In Chile, we've got very a large non-timber infrastructure presence – we understand the country and also actively explore opportunities there; same true of Australia. I think that we would like to view this as a portfolio – ideally, we'd be able to find a way to grow Acadian where it had a much more balanced suite of assets so it wasn't anywhere near as exposed to any single region and still provided the same kind of risk-adjusted returns that it can provide today.

So, it's a portfolio construction project and I think it will take some time to achieve, but what we don't intend to do is sort of run out and get overwhelmingly exposed to any single area out of the gate.

ANDREW KUSKE:

Okay, that's helpful. Then, if I may, just one final question on—have you had any conversations with power companies, predominantly in Europe, that have been really seeking wood supply and any colour you can provide around that?

REID CARTER:

Over the last probably seven or eight years, we've had just an uncountable number of conversations with pellet producers, pellet consumers, biomass consumers, all the energy companies, regulators, etc. I think we understand the UK and Northern European biomass and pellet industries extremely well. We also own I think it's 29 or 30 bulk ports in UK and Europe which also handle the supplies for a number of these facilities, and we have an interest in those products from that perspective. When I say "we", I'm talking about Brookfield. We haven't found, whether it's in the US south, in Eastern Canada, the northeastern United States or in northern or eastern Brazil, any opportunities where we could acquire, own and operate timberlands for fuel wood production that would meet any seller's underwriting requirements. So at this point we have concluded that you can't buy timberlands just to produce biomass or pellets – and we've looked at a number of structures that might add additional value where you might have a campus, where you had a CHP facility in a campus-type arrangement with a pellet production and export facility. So, you own timberlands, you produce power and your pellet production is your steam client for that, where ideally you'd have all the economies stemming fromthe integration and we still haven't been able to make sense of that. When you put sort of the legislative risk - the uncertainty around the longevity of the current legislation that supports these investment - it's still a very, very challenging initiative to buy timberland for that.

ANDREW KUSKE:

Okay. No, that's very helpful colour. Thank you.

OPERATOR:

There are no more questions at this time. I will hand the call back over to Mr. Carter for closing comments.

REID CARTER:

Once again, we'd like to thank you for participating in Acadian's First Quarter Conference call, and as always, we remain available to answer any of your questions if you have anything you'd like to follow up on. So, thank you for your time and enjoy the rest of your day.

OPERATOR:

This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.