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Acadian Timber Corp. Third Quarter 2013 Conference Call Transcript

Date: Thursday, October 31, 2013

Time: 10:00 AM PT

Speakers: **Reid Carter**
President and Chief Executive Officer

Erika Reilly
Chief Financial Officer

OPERATOR:

At this time, I would like to turn the conference over to Ms. Erika Reilly, Acadian's Chief Financial Officer. Please go ahead.

ERIKA REILLY:

Thank you operator and good afternoon everyone. Welcome to Acadian's third 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 third quarter financial and operating performance and outlook for the remainder of 2013 and into 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, 2013, 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 third quarter. Then Reid Carter, Acadian's Chief Executive Officer, will conclude with more general comments about our operations, market conditions, outlook for the upcoming year and business development activity.

Acadian's operations performed well during the third quarter with solid demand for all our products and our customers continuing to have a positive market outlook.

Third quarter net sales totaled \$18.8 million dollars, up \$1.2 million dollars or 7 percent from the same period last year on 8% higher sales volumes and a 3% increase in our weighted average log price.

The increase in weighted average log price during the third quarter reflects product-level price increases being somewhat offset by a heavier mix of pulpwood relative to the same period last year. Softwood sawlog sales prices increased 4 percent year-over-year primarily as a result of the strength of softwood sawlog markets in the Maine operations. Prices for hardwood logs in both the New Brunswick

and Maine operations improved with selling prices for hardwood sawlogs increasing by 5 percent and prices for hardwood pulpwood also climbing 5 percent year-over-year.

Adjusted EBITDA was \$3.8 million dollars, down \$0.6 million dollars compared to the third quarter of 2012 due to increased hauling costs as a result of longer hauling distances and the timing of reforestation expenditures. The Adjusted EBITDA margin for the quarter was 20 percent compared to 25 percent in the third quarter of 2012.

Notably, on a year-to-date basis, Adjusted EBITDA was unchanged from the prior year.

Net income for the quarter totaled \$3.4 million dollars compared to net income of \$5.0 million dollars in the same quarter of the prior year. Operating earnings fell \$0.6 million dollars due to the increased costs noted previously and a \$0.9 million dollar decrease in the unrealized exchange gain on long-term debt drove the remainder of the difference. The unrealized exchange gain on long-term debt is a non-cash item and not included in our calculation of Adjusted EBITDA or free cash flow and we do not consider it to be reflective of the operating performance of Acadian during the period.

Free cash flow slipped \$0.7 million dollars from the third quarter of 2012 to \$2.8 million dollars resulting in a payout ratio for the third quarter of 123 percent.

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 \$55 dollars and 94 cents per cubic metre in the third quarter of 2013, down 1 percent compared to the same period last year. This modest year-over-year decrease in the average log selling price reflects lower prices for softwood pulpwood and a higher proportion of that lower value product in the sales mix. Net sales were \$13.6 million dollars for the third quarter of 2013, down \$0.1 million dollars from the same period of 2012.

Sales volume in the third quarter was comprised of approximately 33 percent sawlogs, 43 percent pulpwood and 24 percent biomass. This compares to 41 percent sold as sawlogs, 38 percent as pulpwood and 21 percent as biomass in the third quarter of last year. The higher percentage of pulpwood in the sales mix reflects a return to more normal levels of market demand for this product.

Total costs for the third quarter of 2013 were \$10.9 million dollars as compared to \$10.1 million dollars in the comparable quarter of 2012. Variable costs per cubic metre increased 4 percent from the third quarter of 2012 due to longer hauling distances for hardwood logs – as a greater proportion of that volume was sold to export markets – and in-yard sales decreased.

Third quarter Adjusted EBITDA for the New Brunswick operations was \$2.7 million dollars compared to \$3.6 million dollars in the third quarter of 2012 with the decrease driven by the timing of reforestation expenditures, higher hauling costs and decreased activity in the land management services business. Adjusted EBITDA margin was down 6 percent from the prior year to 20 percent.

Turning to our Maine operations, harvest and sales volumes of primary products were up 21 and 27 percent, respectively, from the prior year with hardwood sales being particularly strong. Net sales increased 35 percent over the same quarter of the previous year to \$5.1 million dollars. The significant improvement in net sales reflects the sales volume improvement and a 10 percent improvement in the average selling price across all log products to \$63 dollars and 39 cents per cubic metre compared to the third quarter of 2012.

Approximately 51 percent of Maine's volume was sold as sawlogs, 36 percent as pulpwood and 13 percent as biomass. This compares to 59 percent sold as sawlogs, 36 percent as pulpwood and 5 percent sold as biomass in the third quarter of 2012. The decrease in the percentage of sawlogs resulted from increased hardwood deliveries with their associated higher pulpwood component and biomass sales continuing to be well above historical norms, as the contractor engaged in the first quarter of the year to salvage material that had been left in roadside yards, continued his operations.

Total costs for the third quarter of 2013 of \$3.6 million dollars were up \$0.7 million dollars from the prior year. This increase was driven primarily by the 21 percent increase in primary harvest volume, but Canadian dollar based per unit variable costs did climb 8 percent due to an increased proportion of the hardwood harvest occurring in more distant stands.

The increased sales volume and improved log prices compared to the third quarter of 2012 resulted in Adjusted EBITDA for the Maine Operations climbing \$0.6 million dollars from the prior year to \$1.5

million dollars. Adjusted EBITDA margin, at 28 percent of sales for the third quarter of this year, was up from 22 percent in the prior year.

Capital expenditures across Acadian's operations during the third quarter of 2013 were \$0.2 million dollars compared to \$0.1 million dollars in the comparable period of 2012.

At the end of the third quarter, Acadian had a cash balance of approximately \$8.5 million dollars, which is \$2.1 million dollars higher than the cash balance of \$6.4 million dollars at the same time last year and \$3.1 million dollars higher than the balance at the end of the second quarter of 2013. The increases were primarily due to decreased working capital balances and borrowings on the revolving loan that were repaid at the beginning of October. As at September 28, 2013, Acadian had net liquidity of \$65.1 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, but there were five recordable safety incidents among contractors during the period. Four of these incidents were relatively minor, but one resulted in a broken foot and had the potential to be more serious. That incident was thoroughly investigated and all appropriate corrective actions have since been implemented. We continue to be committed to safe work practices and take each incident seriously, and are working with our contractors to ensure the highest standards of workplace safety are met.

The average realized sales price across Acadian's softwood and hardwood log products climbed 3 percent year-over-year. Prices for most of our primary products moved up, but an increased proportion of pulpwood in the sales mix relative to the same period last year limited the overall average increase.

Stronger softwood sawlog markets, particularly in the Maine operations, resulted in a 4 percent increase in softwood sawlog prices relative to the third quarter of 2012. Prices for hardwood logs in both the New Brunswick and Maine operations improved with selling prices for hardwood sawlogs and pulpwood both increasing by 5 percent year-over-year. Biomass markets remained stable, however, realized gross margins on this product climbed 17 percent year-over-year due to an increased proportion of the New Brunswick volume being sold to export markets and lower costs in the Maine operations due to the recovery of volumes stored in wood yards.

Our outlook for the remainder of this year and into 2014 remains positive. We believe the U.S. housing market has entered a period of stabilization where further improvements will be based on the availability of new homeowners rather than investors. While housing starts and pricing continue to improve year-over-year, the rate of increase and consensus expectations have moderated since the enthusiasm of the early part of this year. Housing affordability, after a decline in the second and early third quarter, has recovered as mortgage rates have eased in response to the U.S. Federal Reserve's decision not to taper securities purchases. We remain confident that the recovery of the U.S. housing market remains on track and see most of Acadian's solid wood customers demonstrating confidence through their increasing capital investments, strong log purchases and increased operating shifts. Softwood lumber prices have largely recovered from the weakness seen in the late spring and early summer of this year resulting in continued strong demand for spruce-fir sawlogs from Acadian's softwood sawmilling customers. Markets for hardwood sawlogs remain stable and appear to have a similar outlook for the foreseeable future.

After a modest recovery of regional softwood pulpwood markets in the second half of 2012 and early 2013, markets have softened as there has been an ample supply of sawmill residuals and raw material supplies at regional pulp mills have increased. This is particularly true in our New Brunswick operations where we expect markets for softwood pulpwood to be challenging for the foreseeable future. Fortunately, softwood pulpwood accounts for 6% of our New Brunswick sales and a much lower

proportion of our cash flow. Demand for spruce-fir pulpwood from pulp mills in Maine remains reasonably strong.

Markets for hardwood pulpwood have continued to be reasonably strong with Acadian's major hardwood pulp customers all operating and taking deliveries suggesting that prices should remain stable through the remainder of 2013 and well into 2014.

Domestic markets for biomass remain stable and export markets are growing. As a result, Acadian continues to be able to sell all of its biomass and the outlook for gross margins is stable to modestly improving.

Acadian benefits from a strong balance sheet and a very capable operating team who remain focused on improving our financial performance by minimizing costs at all levels in the organization while always seeking the highest margin market opportunities for the products we produce.

On the business development front, we have been actively pursuing several significant value-oriented opportunities in North and South America and Australia that we believe to be well suited to Acadian's recently announced broader growth strategy. These opportunities range from traditional pure-play timberland sales to monetization strategies by industrial owners that seek to redeploy capital in their operating businesses. We are targeting investments that meet our long-term total return targets of 10-15 percent and you should be very confident that we will remain very disciplined when allocating capital. Our investment strategy is focused on acquiring assets on a value basis by utilizing our operations-oriented approach to drive improved performance or using our strong structuring expertise to assist partners in monetizing assets. We are well positioned to benefit from Brookfield's broader platform and relationships when sourcing transactions and look forward to sharing our progress with you in coming quarters.

We thank you for your continued support of Acadian Timber Corp. and hope you share our enthusiasm for Acadian's long-term outlook and renewed potential for growth.

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 with Credit Suisse. Please go ahead.

ANDREW KUSKE:

Thank you. Good afternoon. I guess the first question is just on the safety front, and what really happened if you could just give us a bit of color on it. We have routinely gone through calls where you have had absolutely no incidents, and now you've had a couple with contractors. Just give us a bit more color, I know you mentioned in the MD&A, but what happened and what has really been done to rectify?

REID CARTER:

Sure. The minor accidents, literally were cuts and sprains, which occur, particularly during seasonal silviculture work. I won't say they're unavoidable, but they are more common place, and not as concerning.

The more major accident that I mentioned was a situation where a truck driver was removing the strapping from a fully loaded logging truck, and the logging truck was overloaded, so it had logs above the stakes on the side of the truck. Removing the strapping, one of the logs fell off the side of the truck to where the operator was standing. He managed to get out of the way, although, it struck his foot, and, as I mentioned, broke his foot. If this had hit him on the head, it could easily have killed him.

We understand, there's always been a tendency to fully, and sometimes overload, logging trucks. We have met with all of our logging contractors, not just the contractor involved, and made it very clear that we won't accept any overloading of logging trucks, any logs above stakes. And we have a record keeping system, basically a weigh scale, to allow us to determine what the loading of trucks are.

It's a wakeup call for ourselves, and for our contractors, that we have to be more proactive in identifying these potential problems before they occur. As I say, we took it very seriously and we are quite confident that we won't have logs falling off the sides of logging trucks going forward.

ANDREW KUSKE:

Okay. That's very helpful. Then Reid, on to the new business focus you have with the broader geography you are looking at.

Do you have thoughts on recent deals we have seen in the market? Obviously there is a big parcel that traded earlier in the week with Plum Creek. Do you have any market observations you can share with us on transactions you've seen go away from you and where you think pricing is?

REID CARTER:

It's been an interesting marketplace over the last few years particularly I'd say the last 18 months. The market continues to be very thin. There are few offerings. There have been quite a number of offerings that have been withdrawn. We have seen a number that were, after first or second rounds, pulled from the market place, some to then actually complete a transaction many months later. So my broad observation would be that sellers' expectations are very high and they view it as a seller's market. There is a lot of capital pursuing timberland acquisitions, but, I think, there continues to be a bid-ask spread with the ask being quite aggressive.

Having said that, the transactions we have seen complete, we would say were very full-priced in the U.S. I think it's a little different situation in some of the other markets. Australia has been very full priced, there's been nothing really going on in New Zealand.

It is not fair for me to comment on the Plum Creek transaction early this week. That process really never became an open process. To my knowledge there were no parties other than Plum Creek that were really given enough definitive documentation to properly value that timberland. On its surface it appears to be full value, but it's not fair until you actually see the nature of the stocking, age, pasture, distribution site quality. There are just too many other variables that can drive timberland values.

My broad concern is that it's a small and thin market right now with a lot of competitive interest in the U.S. market. We are seeing some very attractive opportunities, particularly in Latin America, where there are not as much capital targeting timberland markets at this time.

ANDREW KUSKE:

Okay. That's very helpful. Just some color on the industrials looking to sell. Is that along the lines of some of the things we see in South America that can range from either eucalyptus plantations for pulpwood or eucalyptus plantations used for pig iron? Is that really the focus you are looking at?

REID CARTER:

It's broader than that and it certainly includes that. What we are seeing, as a generalization, capital markets, both the equity markets for public companies and financing opportunities for many of the industrial companies. Not just pulp and paper and pig iron and steel, but iron ore and the whole suite of larger industrial companies in Latin America, are finding it much more difficult to raise capital today. We have seen a number of integrated forest products companies that own their own timberlands and manufacturing facilities, really, almost for the first time, looking at various strategies around monetizing some portion of their timberlands. We are trying to understand how we can create good opportunities for our broad timberlands platform in that situation.

ANDREW KUSKE:

Okay. That's very helpful. Thank you.

OPERATOR:

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

PAUL QUINN:

Yes. Thanks very much. Good morning. Happy Halloween. Just a question on EBITDA margins; Erika, you mentioned that they're flat year-to-date, and just trying to understand why they're flat year-to-date, because we've seen lumber prices pick up and log prices. Is that a function of mix really that's causing that or is it on the cost side?

ERIKA REILLY:

The major change was timing on costs so we're flat year-to-date. During the third quarter, we did experience higher reforestation costs, and were focused, given good weather conditions, on operating in our more distant stands. Our operations decided to harvest in those distant stands, which was ultimately higher cost, lower margin to us. We hope to see better margins in fourth quarter.

PAUL QUINN:

Okay. That's helpful. Great. That's all I had. Thanks.

REID CARTER:

Thank you.

Operator I don't hear any more questions. Again, I would again like to thank you for your continued support of Acadian Timber, and we look forward to reporting improving results with the quarter's end, and hopefully some success in Acadian's growth strategy. We look forward to talking to you in coming quarters. Thanks very much.

OPERATOR:

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