



ACADIANTIMBER



# **Acadian Timber Corp.**

## **2015 Third Quarter Results**

### **Conference Call Transcript**

**Date:** Wednesday, October 28, 2015

**Time:** 1:00 PM ET / 10:00 AM PT

**Speakers:** **Mark Bishop**  
President and Chief Executive Officer

**Erika Reilly**  
Chief Financial Officer

**OPERATOR:**

At this time, I would like to turn the conference over to Mr. Mark Bishop. Please go ahead Mr. Bishop.

**MARK BISHOP:**

Thank you operator and good morning or afternoon everyone. Welcome to Acadian's third quarter conference call.

I'd like to take a moment to welcome back Erika Reilly into her role as Acadian's Chief Financial Officer and note that Brian Banfill will continue on as Acadian's Chief Operating Officer. Erika returned from maternity leave at the beginning of October and is fully back up to speed. She will now proceed with the formal remarks then I will add my comments and take your questions. Erika...

**ERIKA REILLY:**

Thanks Mark. Before we get started, I would like to remind everyone of the following:

This conference call is being webcast simultaneously through our website at [acadiantimber.com](http://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 as well as our market outlook, 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 24th, 2015, and other filings of Acadian with securities regulatory authorities, which are available on SEDAR at [sedar.com](http://sedar.com) and on our website.

I will start by outlining the financial highlights for the third quarter. Then Mark will provide comments about our operations, market conditions, business development activities and our outlook for the remainder of 2015 and into 2016.

Acadian's operations continued to perform well this quarter generating the highest third quarter Adjusted EBITDA since inception. Operating conditions were typical of the summer season and the continued strength in hardwood markets contributed to improved financial performance.

Net sales for the third quarter totaled \$22.6 million dollars, a \$1.0 million dollar, or 5 percent, increase compared to the same period in 2014. The year-over-year increase in net sales reflects an 8 percent increase in weighted average log selling price partially offset by 4 percent lower sales volumes. The selling price for all products increased year-over-year, with the exception of softwood sawtimber which was impacted by a lower proportion of higher value logs from Maine. Hardwood pulpwood once again showed the biggest gain with prices up 18 percent year-over-year.

With variable operating costs up only 2 percent year-over-year in Canadian dollar terms, Adjusted EBITDA margin improved from 26 percent to 29 percent compared to the same period of last year.

Acadian's net loss for the third quarter totaled \$2.9 million dollars or 17 cents per share, an increase of \$2.3 million dollars from the prior year with higher operating earnings and a lower fair value adjustment to timber offset by a higher unrealized exchange loss on long-term debt.

Free cash flow was up \$600 thousand dollars from the third quarter of 2014 to \$5.2 million dollars, or 31 cents per share. This strong cash generation pushed the year-to-date payout ratio down to 72 percent compared to 91 percent for the same period last year.

We are pleased to announce that in recognition of this strong performance, along with an expectation of continued strong performance over the next several years, Acadian's Board of Directors has reached the decision to increase Acadian's annual dividend by \$0.10 cents to \$1.00 dollar per share. This new dividend will be effective in the fourth quarter of 2015.

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 third quarter totaled \$17.0 million dollars compared to \$16.3 million dollars for the same period last year. This 4 percent improvement was driven by a 6 percent increase in the weighted average log selling price, partially offset by 2 percent lower log sales volumes. Operations were focused on hardwood harvest given strong hardwood pulpwood market conditions which resulted in a modest increase in hardwood log inventories compared with the prior year. Overall, harvest volume in the third quarter of 2015 was in line with the prior year.

The weighted average log selling price was \$64 dollars and 98 cents per cubic metre in the third quarter of 2015, up \$3 dollars and 43 cents per cubic metre from the same period last year. This year-over-year average price increase reflects gains in hardwood pulpwood.

Costs for the third quarter of 2015 were \$11.1 million dollars, down \$700 thousand dollars from the comparable quarter of 2014 with the benefit of 5 percent lower variable costs per cubic meter offset by higher harvest volumes of primary products.

Third quarter Adjusted EBITDA for the New Brunswick operation was \$6.0 million dollars, up \$1.5 million dollars from the third quarter of 2014, again reflecting improved prices and lower per unit costs. Adjusted EBITDA margin increased to 35 percent from 28 percent in the prior year.

Like the New Brunswick operations, the Maine operations focused on hardwood harvest to take advantage of strong hardwood pulp markets. As a result, softwood harvest and sales volumes slipped 23 percent year-over-year.

Net sales for the third quarter of 2015 increased 6 percent year-over-year to \$5.6 million dollars from \$5.3 million dollars in the third quarter of the prior year, with reduced overall sales volumes more than offset by improved hardwood pulpwood prices and the positive impact of the weaker Canadian dollar. The weighted average log selling price in Canadian dollar terms was \$79 dollars and 58 cents per cubic meter in the third quarter, compared to \$69 dollars and 95 cents per cubic meter in the same period of 2014. Weighted average log selling prices in U.S. dollar terms was \$60 dollars and 84 cents per cubic meter, 5 percent lower year-over-year. Strong hardwood pulpwood prices were offset by a lower proportion of softwood sawlogs in the sales mix.

Costs for the third quarter of 2015 were \$4.6 million dollars, up \$800 thousand dollars from the comparable quarter of 2014 reflecting the effect of adverse foreign exchange movements as harvest volumes were almost unchanged and variable costs per cubic meter were up just 4 percent in U.S. dollar terms.

Adjusted EBITDA for the Maine operation was \$1 million dollars, \$500 thousand dollars lower than the same period last year, and Adjusted EBITDA margin was lower at 18 percent compared to 29 percent in the prior year –reflecting the impact of a less valuable sales mix.

Switching over from the operations to our cash position ...at the end of the third quarter Acadian had cash on hand totaling approximately \$16.0 million dollars, which is \$3.1 million dollars higher than the cash balance at the same time last year. The primary driver of the increased cash balance was the generation of free cash in excess of dividend payments over the last twelve months. The current cash balance is \$3.3 million higher than the balance at the end of 2014 reflecting free cash in excess of dividend payments year to date.

As at September 26, 2015, Acadian had net liquidity of \$93.7 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.

As noted in our press release, we completed a five year extension of Acadian's loan facilities with more favourable terms than the prior agreement, including a lower fixed rate of 3.01 percent on the \$72.5 million U.S. dollar term facility, down from 3.97 percent. This results in an interest savings of approximately \$700 thousand US dollars per year.

During the quarter we distributed a dividend of twenty two and half cents per share to our shareholders. And, as I noted earlier, we will be distributing twenty five cents per share effective in the fourth quarter.

I will now turn the call over to Mark.

**MARK BISHOP:**

Thank you Erika and good afternoon everyone.

During the quarter, Acadian's operations experienced one recordable incident involving employees and one involving contractors. I'm pleased to confirm that the resulting injuries were limited to cuts requiring stitches, but they did have the potential to be more serious. The incidents were thoroughly investigated

and appropriate corrective actions were implemented. We continue to work with our contractors and employees to ensure the highest standards of workplace safety are maintained.

We are also pleased to note that in mid-September, the Maine operation successfully completed a surveillance audit to the 2015-2019 Sustainable Forest Initiative Standard with no non-conformances. The operation has been recommended for continuing registration to the SFI standard. We are also pleased to note that during the quarter the Maine operation became the third timberland owner in the state to enter into an Outcome Based Forestry agreement with the Maine Forest Service. The agreement provides an alternative to prescriptive regulation under the current Forest Practices rules. It allows landowners more flexibility to achieve objectives while achieving statewide sustainability goals and providing for the conservation of public trust resources and the public forest values

As Erika noted, Acadian's weighted average log selling price for the third quarter increased 8 percent year-over-year. Realized Canadian dollar prices were off 1 percent for softwood sawlogs, but up 3 percent for hardwood sawlogs, 8 percent for softwood pulp logs and 18 percent for hardwood pulp logs. While a big portion of the credit goes to the weaker Canadian dollar, the hardwood pulpwood price reflects the continued strong market for this product during the quarter.

While softwood pulp log prices have improved modestly year-over-year, this product remains our most challenging as the number of groundwood pulp customers operating in the region has declined over the last few years. As we've noted many times in the past however, this product makes up a small portion of our total sales, 5 percent in the third quarter, and an even smaller portion of our gross margin. Biomass gross margins continued to show strength with 49 percent year-over-year growth as the New Brunswick operations continued to sell to higher margin export markets as compared to the prior year.

After strengthening significantly early in the third quarter, North American lumber pricing declined to multiyear lows during August and September. Regional sawmills continued to operate on full shifts, but do appear to be carrying log inventories above normal seasonal levels. The combination of weak offshore export markets, the weak Canadian dollar, and the end of the Canada-US Softwood Lumber Agreement, resulting in a temporary removal of Canadian export taxes, is expected to maintain pressure on lumber prices into 2016. This has begun to put pressure on markets for softwood sawlogs although pricing has remained stable to date.

While near-term markets for Acadian's softwood sawlogs may experience modest headwinds, demand fundamentals remain strong. To date in 2015, U.S. housing starts are up 12% year-over-year and consensus expectations are for increases of a further 10 to 15% in 2016.

While near-term markets for regional softwood sawlogs may experience modest headwinds, we should also remind you that pricing for much of Acadian's softwood sawlog supply is determined on up to six month contracts, so the timing and magnitude of any log pricing volatility will not typically match the indications in the broader market. And as you know, consensus expectations are for year-over-year increases of 10 to 15% in US Housing starts for 2016, so underlying demand fundamentals for softwood sawlogs remain healthy.

Markets for hardwood sawlogs are expected to remain stable at their current positive levels, while the current very favourable demand and pricing for hardwood pulpwood may experience some softness as the region adapts to the recently announced pulp and paper mill closures and bankruptcy proceedings.

Biomass markets remain positive and we anticipate demand to remain stable, supporting improved margin levels. Interestingly, a small portion of our biomass volume is exported to Turkey where it is used in the production of composite panels rather than for fuel. We do note that there are also positive developments in the region which include the startup of two new tissue machines in 2016 are expected to increase pulp demand from the mill, as well as a newly announced track rehabilitation project that will allow the state of Maine's railroads to offer faster and more reliable freight service to its customers, which include a meaningful cross section of the pulp and paper and forest products sector in the Northeast region.

On the business development front, we continue to actively pursue opportunities in support of Acadian's growth strategy in the U.S., Australasia and South America but continue to face aggressive competition and have thus far been challenged to effect a transaction for Acadian. During the third quarter we worked on six opportunities across these regions. We will remain active in this pursuit and Acadian's shareholders can be confident that we will stay focused and disciplined in our search for growth.

In closing, we remain very pleased with Acadian's exceptionally strong operating performance over the past several quarters and look forward to reporting ongoing strong 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:**

Our first question comes from Daryl Swetlishoff of Raymond James. Please go ahead.

**DARYL SWETLISHOFF:**

Thanks and good morning. Mark, first question, just on operations, I was a bit surprised by the strength in the hardwood pulp price as—can you remind us just on your flexibility to quickly change your log moves to take advantage of relative price moves when they occur quickly?

**MARK BISHOP:**

Daryl, within the year, we certainly have a fair bit of flexibility and have focused on the stronger hardwood pulp markets, so we certainly can respond and change our harvest plans. Clearly, over the longer term, we have a long-term, sustained harvest level and profile that we need to harvest to, but we can certainly within fairly short periods of time move our harvest plans and respond to those markets. So, you certainly did see that activity thus far in year-to-date 2015.

**DARYL SWETLISHOFF:**

Makes sense. Switching gears a bit, you mentioned some of the impacts from the duties coming off. Could you hazard a view on the softwood lumber agreement, mostly with potential outcomes and how that might impact Acadian's business?

**MARK BISHOP:**

Daryl, our expectation is really similar to the last round of softwood lumber. In terms of the next year, we do expect a full year of no duties to proceed until we see the two sides ultimately try to get back together and negotiate a new agreement. At this point, we don't expect to see a different outcome with



respect to the Atlantic Provinces, so we would expect to see ultimately a similar outcome with not a significant change in the impact to our customers.

**DARYL SWETLISHOFF:**

Okay, that's fair. Lastly, Mark, on the business development front, we've seen quite a few changes, currency-driven and other that have affected log prices, especially in North America. Has that really changed your view on where you're focusing and where you're looking for growth opportunities?

**MARK BISHOP:**

As we've continued to indicate in our materials, we continue to look both in North America and outside of North America, particularly in Australasia and in South America. I'm not sure if you mean within the U.S., if we had specific interests, but clearly we're continuing to find a very challenging acquisition environment, particularly in the U.S. with the size and quality of the offerings.

**DARYL SWETLISHOFF:**

Okay, that's fair. I'll turn it over, Mark. Thank you.

**OPERATOR:**

The next question comes from Andrew Kuske of Credit Suisse. Please go ahead.

**ANDREW KUSKE:**

Thank you. Good morning. I guess the question is, just to start off with, on the payout ratio and how you think about the payout ratio on either a normalized EPS basis or on a cash flow basis and how we should think about that as we go forward.

**ERIKA REILLY:**

We calculate our payout ratio based on free cash flow. I think free cash flow is a meaningful measure for Acadian. Our net income or losses are always impacted by non-cash items that really are FX-related and not an indicator of the business and the business performance, so I'd encourage everyone to continue to look at our free cash flow generation and calculate payout ratio as such.

As was stated, since inception of the Company, and in our prospectus, our payout ratio target is 95%, but due to the strong cash generation over the past 12 months, we've certainly outperformed that target.

**ANDREW KUSKE:**

So then that segues into my second question. Obviously, currency had a big impact on some of the numbers, and so how do you think about maybe a “normalized dollar,” how do you think about that relationship and how that affects the payout ratio?

**ERIKA REILLY:**

I guess two things. FX had a significant impact on the presentation of our financial statements, but a lot of that presentation is not cash—they're non-cash items, so we don't get too stressed about those types of movements. We see them quarter-over-quarter, but they don't impact cash.

As it relates to our business and the cash generation, we've always stated and believed that there's a bit of a natural hedge between FX movements and the way our operations are able to perform under different FX levels. So while, for example, our Maine operation that operates in U.S. dollars is currently facing a bit of pressure because Canadian dollar logs are now viewed as cheaper, when we convert the Maine operations financials or profits into Canadian dollars and report them, they still look quite strong. So there's a bit of a natural hedge there. So that's kind of how we view the business today.

**ANDREW KUSKE:**

That's helpful. Then, continuing with the FX theme, but in a different lot of questions just on the acquisitions—I know, Mark, you mentioned about the aggressive competition for deals and the number of things you looked at in Q3. Are you seeing less competition in places like Brazil where there has been massive devaluation of the BRL and really capital flight? Like is that market looking more attractive now and less competitive?

**MARK BISHOP:**

Andrew, I think you've got a couple of things still happening in Brazil. The currency has, I think, attracted some additional interest in Brazil and in the timber sector, but there's still an awful lot of uncertainty with some of the smaller or newer timber investors, uncertain still about the foreign

ownership environment in Brazil, and that certainly has an influence. But I would say we've seen some new entrants and some of the same parties competing, and the environment does remain competitive in terms of valuation and certainly in some segments of the industry, other than pulp which remains very, very strong in Brazil, as you know. Some of the other segments have had some particular challenges, which we remain hopeful that we'll see some additional properties onto the market, but at the same time make the cash flow profile of some of those properties in the short term look somewhat more challenged.

So I would say certainly there's some new competition in terms of financial buyers, but it's overall not substantially different than what we've been facing over the last couple of years.

**ANDREW KUSKE:**

Okay, that's very helpful. Thank you.

**OPERATOR:**

As a reminder, if you'd like to ask a question, simply press star and one on your phone. The next question comes from Paul Quinn of RBC Capital Markets. Please go ahead.

**PAUL QUINN:**

Thanks very much and good morning. I just had an easy question just on—the lumber markets have been under a lot of pressure through 2015 here. Your log prices seem to have stayed up, especially on the softwood side. Is that typical for you guys in past business cycles and what's your expectation going forward?

**MARK BISHOP:**

Well, a couple of things, Paul. I mean, you're aware of in New Brunswick of the agreements we have with our customers—a major customer there that does allow us to have less volatile pricing given our six-month contract period. But we are seeing generally very stable pricing, a little bit of short-term impact from the pulp mill closure which has resulted in fewer opportunities to find sawmill residuals homes in an established market, so there has been a little bit of impact from mills needing to offset some of the impact of that, we think that's short term, and clearly we're seeing a recovery now in lumber pricing in North America which hopefully more broadly supports log pricing through 2016.

There's no question we haven't yet seen the wall of wood that was expected from Canada since the expiry of the softwood lumber agreement. Whether that starts to ramp up remains to be seen. Clearly, we've seen a recovery in lumber pricing here and it looks like inventories, at least on the lumber side, are well positioned for the mills to continue to build for the construction season in the spring.

So, all in all, I think we're seeing stable, maybe some slight downward pressure in the beginning of the year, but generally stable log pricing on the softwood side for the year.

**PAUL QUINN:**

Okay, and just on the M&A side, just looking at the U.S. market, you know, U.S. south prices on the log side have been flat for it seems like a year-and-a-half or more now, and we've seen some pretty high transaction pricing, but some of the stuff that's been closing lately seems to be a little bit softer for various reasons. Are you seeing any kind of drop in the market in the U.S. south, sort of apparent drop, or less competition in that market at all?

**MARK BISHOP:**

In terms of the timberland acquisition environment?

**PAUL QUINN:**

Yes.

**MARK BISHOP:**

I would say we haven't really seen much change, Paul. It's still a very competitive market, not just in the southeast but all over the U.S. There's obviously not an awful lot of transparency or detail in terms of some of the inventory information in particular that is associated with some of these transactions, but I wouldn't say we're seeing any real change in the landscape in that market.

**PAUL QUINN:**

Okay, that's all I had. Good results. Thanks.

**OPERATOR:**



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

**MARK BISHOP:**

Thank you all again for dialling in and we look forward to talking to you again at the end of our next quarter.

**OPERATOR:**

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