



ACADIANTIMBER



Acadian Timber Corp. 2015 Second Quarter Results Conference Call Transcript

Date: Wednesday, July 29, 2015

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

Speakers: **Mark Bishop**
President & CEO

Brian Banfill
COO & Acting CFO

OPERATOR:

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

BRIAN BANFILL:

Before we get started, I would like to remind everyone of 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 second quarter financial and operating performance as well as our outlook for the remainder of 2015, 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 and on our website.

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

Acadian's operations performed very well again this quarter generating the highest second quarter Adjusted EBITDA since inception. While the second quarter, also known as mud season in Acadian's operating area, is typically our weakest, an extended winter allowed harvesting and hauling operations to continue well into April leading to above-normal sales volumes.

Net sales for the second quarter totaled \$15.4 million dollars, a \$3.3 million dollar, or 28 percent, increase compared to the same period in 2014. The year-over-year increase in net sales reflects a 20 percent increase in sales volumes and a 3 percent increase in the weighted average log selling price. Approximately one third of the sales volume increase is attributable to more volume carried over from the first quarter this year than last year under the log inventory management program with one of our major customers. The selling price improvement was spread across all of the log products produced by Acadian with hardwood pulpwood once again showing the biggest gain. Combined with variable

operating costs down 6 percent year-over-year, this strong top line performance resulted in Adjusted EBITDA doubling year-over-year to \$3.8 million dollars. Adjusted EBITDA margin increased to 25% from 16% in the same period of last year.

Net income totaled \$5.7 million dollars or 34 cents per share, up \$0.9 million dollars or 6 cents per share from the prior year with the strong gains in EBITDA being partially offset by a lower fair value adjustment on timber due to the increased harvest level.

Free cash flow was up \$1.7 million dollars from the second quarter of 2014 to \$2.8 million dollars, or 17 cents per share, pushing the first half payout ratio down to just 73 percent from 104 percent for the same period 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 second quarter totaled \$13.1 million dollars compared to \$9.3 million dollars for the same period last year. The weighted average log selling price was up 3 percent and sales volumes climbed 35 percent. As noted previously, a portion of the sales volume increase reflects more volume carried over in inventory from the first quarter in relation to the inventory management program with one of our major customers. This volume made up approximately 25% of the sales volume increase and added approximately \$1 million dollars of Adjusted EBITDA to the New Brunswick operations' results..

The weighted average log selling price was \$62 dollars and 66 cents per cubic metre in the second quarter of 2015, up \$1 dollar and 55 cents per cubic metre from the same period last year. This year-over-year average price increase reflects gains in softwood sawlog and hardwood pulp prices offset by more softwood pulpwood in the sales mix.

Costs for the second quarter of 2015 were \$9.6 million dollars, up \$2.0 million dollars from the comparable quarter of 2014 with a 6% decrease in variable costs per unit more than offset by increased harvest volume.

Second quarter Adjusted EBITDA for the New Brunswick operation was \$3.5 million dollars, up \$1.8 million dollars from the second quarter of 2014, again reflecting improved sales volume and prices. Adjusted EBITDA margin increased to 27 percent from 18 percent in the prior year.

The Maine operations didn't enjoy as good of operating weather as New Brunswick through the quarter with a very wet June slowing the startup from mud season. As a result, sales volumes slipped 33 percent year-over-year, but on the sales that did occur, the Canadian dollar-based log selling prices jumped 13 percent. Net sales for the second quarter of 2015 were down 18% year-over-year to \$2.3 million dollars from \$2.7 million dollars in Q2 of the prior year. The weighted average log selling price in Canadian dollar terms was \$76 dollars and 98 cents per cubic meter in the second quarter, compared to \$68 dollars and 34 cents in the same period of 2014. Weighted average log selling prices in US dollar terms was almost unchanged year-over-year as improved product-level prices were offset by a less favourable sales mix.

As we've noted previously, all of the foreign exchange driven good news on the top line has a downside. Canadian dollar based variable costs per cubic metre increased 6 percent year-over-year in Canadian dollar terms effectively hiding the impressive 6 percent decrease in US dollar terms. Total costs for the second quarter fell \$0.4 million dollars year-over-year to \$1.9 million due to lower harvest volumes.

Adjusted EBITDA for the Maine operation was unchanged from the prior year at \$0.4 million dollars with lower sales fully offset by lower costs. The Adjusted EBITDA margin climbed to 17 percent from 14 percent in the prior year.

Switching over from the operations to our cash position ...at the end of the second quarter Acadian had cash on hand totaling approximately \$15.6 million dollars, which is \$7.7 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 \$7.3 million dollars of free cash in excess of dividend payments over the last twelve months. The current cash balance is \$2.9 million higher than the balance at the end of 2014 reflecting significant free cash in excess of dividend payments during the first half of 2015.

As at June 28, 2015, Acadian had net liquidity of \$86.9 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.

As noted in our press release, we obtained a commitment letter in July from our existing lender, MetLife Timberland Finance, to refinance the existing five year debt facilities set to mature in March 2016. The terms of this financing are more favourable than the current agreement reflecting the high credit quality of our assets and the all-in interest rate, fixed at 3.01%, down from 3.97% currently, will result in interest savings of approximately US \$0.7 million dollars per year. As well, on July 20th, the US\$50 million stand-by equity commitment with Brookfield was extended for two years.

During the quarter we distributed a dividend of twenty two and half cents per share to our shareholders, a rate that is fully supported by our increasingly strong performance.

I will now turn the call over to Mark.

MARK BISHOP:

Thank you Brian.

During the quarter, Acadian's operations experienced two recordable incidents involving its employees and no recordable incidents among contractors. I'm pleased to be able to confirm that none of the resulting injuries were serious, although one did result in a small amount of lost time. 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 early June, the New Brunswick 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.

As Brian noted, Acadian's weighted average log selling price for the second quarter increased 3 percent year-over-year. Realized Canadian dollar prices improved for all log products with gains of 3 percent for softwood sawlogs, 4 percent for hardwood sawlogs, 2 percent for softwood pulp logs and 12

percent for hardwood pulp logs. While a big portion of the credit goes to the weaker Canadian dollar, base currency gains were realized for all log products except for hardwood sawlogs in New Brunswick which were impacted by a mix change.

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 second quarter, and an even smaller portion of our gross margin. Biomass gross margins continued to show strength jumping 55 percent year-over-year with the majority of the change coming from the New Brunswick operations where a larger proportion of the volume was sold to the higher margin export markets than in the prior year.

Acadian's financial outlook for 2015 remains positive. Lumber pricing weakened considerably through the first half of the second quarter reflecting the combination of increased production and difficult spring building conditions, as well as weakness in export markets, but improved through the latter half of the quarter. In Acadian's regional markets, pricing for softwood sawlogs remained strong and stable throughout the quarter with almost all regional mills continue to operate on full shifts and appearing to be carry inventories at or below historic seasonal practices. We expect softwood sawlog markets to remain positive throughout the summer, with a potential for further improvement as lumber prices respond to potential log supply shortages in western North America due to harvesting restrictions caused by severe fire conditions.

In addition to our positive outlook for softwood sawlogs, markets for hardwood sawlogs are expected to remain positive, while demand and pricing for hardwood pulpwood continues to be robust. Biomass markets have remained positive and we anticipate recent improved demand to remain stable, supporting improved margin levels. While this product makes a modest contribution to our operating results, we believe there is an opportunity for improved margins over the next few years as there are many indications of increasing demand and relatively tight supply.

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. During the second quarter we worked on several opportunities in each of these regions and we expect to see increases in timberlands

investment activity over the remainder of this year. Our goal continues to be building a balanced portfolio between current cash flow and capital appreciation with the ultimate focus being on our long-term total return target of 10 to 12 percent. 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:

Thank you. We will now begin the question and answer session. If you would like to ask a question, please press star and one on your touch-tone phone. You will hear a tone to indicate you're in queue. For participants using a speaker phone, it may be necessary to pick up your handset before pressing any keys. If you wish to remove yourself from the question queue, you may press star and two. There will be a brief moment while we poll for questions.

The first question comes from Daryl Swetlishoff with Raymond James. Please go ahead.

DARYL SWETLISHOFF:

Thanks. Hey, Mark, just a question about current inventories relative to historic levels for this time of year.

MARK BISHOP:

Now, you're talking our customers' current inventories in their log yards, or ...

DARYL SWETLISHOFF:

Yeah, just how you're stacking up relative to what might be this—you know, are we at normal levels or tight or ...

MARK BISHOP:

We're at or perhaps even slightly below. I mean, we're not certainly in a position where we see over—inventories that are over where they should be at this time. So, I would say really we're typical inventories for this time, Daryl.

DARYL SWETLISHOFF:

Okay. Then, what are you seeing today in your various regions about logging conditions?

MARK BISHOP:

In our regions I mean, we had a wet start to this quarter in New Brunswick, so that was a little bit slower to get started, but certainly we're back on track and where we should be for the quarter, and really the same for Maine. So, logging conditions are certainly fine. We're certainly not seeing any issues like western North America with fire conditions or any unusual weather at this time.

DARYL SWETLISHOFF:

Okay, and just on that, Mark, it's encouraging to see log prices moving higher in your regions. What sort of impact—is there any follow-on impact in your regions from the intense fire conditions out West, are you seeing any inflation because of that?

MARK BISHOP:

I wouldn't say we have seen anything yet, Daryl, and, you know, I would say it may be a remote possibility to see any direct impact. I think the impact would really be if you saw shortages in the West that led to higher lumber prices than they would otherwise be, you might see a little bit of upside in our log prices, but I don't think we're really expecting to see any direct immediate impact, and certainly we're not seeing anything here now.

DARYL SWETLISHOFF:

Okay. So, in terms of the inflation you've seen, other than the currency, is there any additional colour on what you're seeing on why are prices moving higher in your regions right now? Is it just lumber prices, or what?

MARK BISHOP:

You know, markets in this region are really, really quite tight, and certainly, I mean, we've seen, as you've observed over the last couple of quarters, hardwood—well, more than that, but hardwood pulp prices continue to be very strong and there is a tight market here, and certainly hardwood pulp competes with OSB in this region, as well, so it's quite a tight supply/demand dynamic here. We're not suggesting we're going to see a significant continued growth in prices for the rest of this year. Certainly, we see strong and stable pricing, and we certainly have a continued expectation for the volumes that we had planned for the remainder of the year.

DARYL SWETLISHOFF:

Okay. Well, thanks, Mark. That sounds encouraging. I'll turn it over.

MARK BISHOP:

Thanks, Daryl.

OPERATOR:

As a reminder, if you wish to ask a question, please press star and one on your touch-tone phone. The next question is from Paul Quinn with RBC Capital Markets. Please go ahead.

PAUL QUINN:

Yes, thanks. Good morning, guys. I just had a question on—it sounds like your Q2 results were really a benefit of good weather in the quarter. Does that lift your sort of annual harvest targets for both New Brunswick and Maine, and if so, what do you expect to do this year?

MARK BISHOP:

I would say, Daryl—or sorry, Paul. Paul, we're pretty much expecting to come in and around the same level as we had expected. I mean, some of that higher performance, yes, was weather related, but also was a shift in that log supply volume that swung into the second quarter. So, we're really expecting it to come in more or less on our planned volume.

PAUL QUINN:

And that planned volume, is that up significantly from last year?

MARK BISHOP:

No, it's very much in line from last year.

PAUL QUINN:

Okay, and just on growth initiatives, I mean, we've seen a pretty quiet North American timberland market. Maybe you could give us some colour on what's happening in South America and Australasia.

MARK BISHOP:

Yeah. I mean you're correct, Paul, we've seen a fairly quiet first half in the U.S. In the second half, we do expect to see a little bit more activity. The first half was characterized by smaller and, I guess, in many cases, lower quality sales, and we do expect to see some larger opportunities come onstream for the second half that we'll be looking at, both in the U.S. and in Australia. I mean you're probably aware there's been a lot of talk for several years on the next potential state sale, we don't know what that timing might be, but New South Wales may be coming up, and we're certainly interested in continuing to be looking at both opportunities there and in New Zealand. We don't see the second half of the year being as busy in New Zealand.

Latin America continues to be very busy for us, and both Latin America and in U.S., I think you're aware that we really are focused on creating and generating proprietary investment opportunities, and on that note, continue to have dialogue with several of our key targets. On that, we've been involved in proceeding through a number of promising opportunities in both, but specifically in Brazil, and while we don't have anything to report at this time, we're encouraged by some of the progress we're making and what we're seeing. You know, Brazil, the dynamic in Brazil, particularly in the steel sector, is becoming more difficult, but the pulp sector, as you're probably aware, continues to be very strong and quite an interesting dynamic. But, Brazil is not the only opportunity. We are continuing to look at some of the other Latin American countries, particularly in the Uruguay area, and less so in Chile, but there's still some smaller opportunities there that we remain interested in.

PAUL QUINN:

Okay. Then, just following up on Daryl's question, we've seen a lot of volatility on softwood lumber prices in North America. It seems like you're—that hasn't come back to you at all in terms of softwood log prices, and you're describing it as a dynamic in your area but very tight supplies. Do you think that holds forward, and what's the expectation once the SLA expires in October?

MARK BISHOP:

You know, our softwood saw logs, an awful lot of that is through long-term supply, which remains much less volatile, certainly, than the broader market. But, you know, again, we continue to see this market dynamic being quite stable. We do see a slow progression of lumber pricing, positive lumber pricing through the second half of the year, and while we don't expect to see a significant amount of upside in saw log pricing, we certainly expect to see, you know, stability to slightly stronger pricing.

PAUL QUINN:

Okay, and expectation of what happens with lumber prices on the expiry of the SLA and whether that affects you at all?

MARK BISHOP:

Whether it affects us? I wouldn't say there's going to be any real immediate impact to us, Paul. I mean, I guess I'm hoping at the same time that there's an expiry of the SLA that we've got much stronger indications of housing markets and that we do see some strength in lumber pricing, but I wouldn't see a marked change in our log pricing in the fourth quarter as a result of that.

PAUL QUINN:

All right. Great results in the quarter. Good luck.

MARK BISHOP:

Thanks, Paul.

OPERATOR:

The next question is from Paul Tan with Credit Suisse. Please go ahead.

PAUL TAN:

Hi, thanks. I just wanted to confirm, in terms of the Brookfield equity backstop, you did mention that it was renewed for another two years; is that correct?

MARK BISHOP:

Yes, that's correct, it was extended.

PAUL TAN:

Is the amount similar, it's the same, it's the \$50 million, or has that changed?

MARK BISHOP:

Same amount and same terms.

PAUL TAN:

Okay, great. No, thank you very much. Those are my questions.

MARK BISHOP:

Okay.

OPERATOR:

That concludes the question and answer session. I'll turn the call over to Mr. Bishop for closing comments.

MARK BISHOP:

Thank you, Operator, and thank you all again for your ongoing support of Acadian. I hope you all enjoy the remainder of your summer and I look forward to speaking to you again at the end of next quarter. Thank you.

OPERATOR:

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