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Acadian Timber Corp. Fourth Quarter 2015 Conference Call Transcript

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Time: 1:00 PM ET

Speakers: **Mark Bishop**
Chief Executive Officer

Erika Reilly
Chief Financial Officer

OPERATOR:

Welcome to the Acadian Timber Corporation 2015 Fourth Quarter and Year End Results Conference Call. As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. To join the question queue, you may press star, then one on your telephone keypad. Should you need assistance during the conference call, you may signal an Operator by pressing star and zero.

I would now like to turn the conference over to Erika Reilly, Chief Financial Officer. Please go ahead.

ERIKA REILLY:

Thank you, Operator, and good afternoon everyone. Welcome to Acadian's Fourth Quarter Conference Call. 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 fourth quarter financial and operating performance, as well as our outlook for 2016, 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 24, 2015, 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 quarter; then Mark Bishop, Acadian's Chief Executive Officer, will provide comments about our operations, market conditions, business development activities, and our outlook for 2016.

Acadian's operations ran well during the fourth quarter, with some weather-related challenges, but good overall productivity. Net sales for the fourth quarter totaled \$21.7 million, a \$0.8 million, or 3%, decrease compared to the same period of 2014. The year-over-year decrease in net sales is attributable to a 14% decrease in sales volumes, offset by a 9% higher weighted average log selling price. The selling price improvement was spread across almost all of our log products produced by

Acadian, with softwood and hardwood sawtimber seeing gains at 7% and 11%, respectively, and hardwood pulpwood gaining 14%.

Solid top line performance with minimal per-unit cost increases kept Adjusted EBITDA effectively unchanged at \$7.4 million, as compared to \$7.5 million during the same period of 2014. It also drove an improvement in the Adjusted EBITDA margin, which climbed to 34% from 33% in the same period last year.

Free cash flow was up 1% from the fourth quarter of 2014, to \$6.4 million. For the year as a whole, free cash flow was up \$4.4 million, and the payout ratio fell to 70% from 78% in the prior year, even with a 12% year-over-year increase in dividends declared.

Acadian's net income totaled \$13.8 million, or \$0.82 per share, for the fourth quarter, down from \$38.4 million, or \$2.29 per share, from the same period in 2014. The year-over-year decrease primarily reflects a \$31.4 million decrease in fair value adjustment and a \$6.7 million decrease in the gain on revaluation of roads and land, partially offset by a \$14 million decrease in preferred income tax expense. The unusually large non-cash fair value and revaluation adjustment in 2014 reflected a significant year-over-year decrease in the discount rate Acadian's independent third-party appraiser used in the financial models that are the primary basis used to estimate the value of the timberland. In 2015, the discount rates were almost unchanged, and the changes to fair value primarily reflect updated long-term harvest plan and log price assumptions.

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 fourth quarter totaled \$15.2 million, compared to \$15.6 million for the same period last year. A 6% increase in the average log selling price was more than offset by the 11% decrease in sales volume. The volume decrease reflects reduced harvest during the quarter, in order to ensure the full year harvest aligns with the target annual allowable level. The weighted average selling price across all products was \$68.73 per cubic metre in the fourth quarter of 2015, up \$4.16 per cubic metre from the same period last year. This year-over-year increase in the average log selling price reflects improved selling prices for all products, with a 13% gain in hardwood pulpwood leading the way. Costs for the fourth quarter of 2015 were \$9.7 million, as compared to

\$10.2 million in the comparable quarter of 2014. The decrease in total costs was due to lower harvest volumes. Variable cost per cubic metre increased just 1% from the prior year. Fourth quarter Adjusted EBITDA for the New Brunswick operation was \$5.5 million, almost unchanged from \$5.4 million, compared to the fourth quarter of 2014. Adjusted EBITDA margin increased to 36% from 35% in the prior year.

At the Maine operation, sales volumes were down 19% year-over-year, while Canadian dollar-based log selling prices were up 16%. The lower sales volumes reflect decreased access to softwood stands due to warmer temperatures in 2015 than 2014, and weaker markets for softwood pulpwood. The weighted average log selling price in Canadian dollar terms was \$81.52 per cubic metre in the fourth quarter, up \$11.20 per cubic metre from \$70.32 in the same period of 2014. Weighted average log selling prices in U.S. dollar terms decreased 1% year-over-year. With the decreased sales volumes almost fully offset by the log selling price improvement, net sales for the fourth quarter of 2015 fell just \$0.4 million from the prior year to \$6.5 million. Costs for the fourth quarter were \$4.2 million, compared to \$4.6 million during the same period of 2014. This reflects lower harvest volumes, partially offset by the foreign exchange impact of the weakening Canadian dollar on the Maine timberland U.S. dollar denominated cost, and 4% higher variable costs per cubic metre because of longer haul distances. Adjusted EBITDA for the Maine operation for the fourth quarter was \$2.3 million, compared to \$2.4 million for the same period of 2014. Improved log prices increased the Adjusted EBITDA margin to 36% from 34% in the prior year.

Now, switching over from the operations to our cash position, at the end of the fourth quarter Acadian had a cash balance totaling \$17.7 million, which is \$5.1 million higher than the cash balance at the same time last year. The primary driver of this increased cash balance was the generation of \$7.4 million of free cash in excess of dividend payments over the last 12 months, offset by an increase in working capital resulting from a decrease in the royalty-related amounts payable to the New Brunswick government and lower amounts payable to contractors as a result of decreased harvest levels in the fourth quarter compared to the prior year. The current cash balance is \$1.7 million higher than the balance at the end of the third quarter of 2015, reflecting the strong free cash flow generation during the quarter.

As at December 31, 2015, Acadian had net liquidity of \$98.5 million, including funds available under Acadian's revolving facility and our standby equity commitment with Brookfield. This compares to \$79.9 million as at December 31, 2014. The increased liquidity reflects the higher cash balance, along with the benefit of a weak Canadian dollar on the U.S. dollar-based revolving facility and equity commitment.

During the quarter, we declared a dividend of \$0.25 per share to our shareholders, an increase of \$0.025 per share, reflecting the strong cash generation during 2015, and the expectation of continued strong performance.

I will now turn the call over to Mark.

MARK BISHOP:

Thanks, Erika. During the quarter, Acadian's operations experienced two recordable incidents, one involving an employee and one involving a contractor. The resulting injuries were minor, but one did result in lost time. We continue to work with our contractors and employees to ensure the highest standards of workplace safety are maintained and are pleased to report that the employees at the Maine operations have now completed an incredibly impressive 15 years without a recordable incident.

As Erika mentioned earlier, Acadian's weighted average log selling price for the fourth quarter increased 9% year-over-year. Realized Canadian dollar prices, assisted by the impact of the weaker Canadian dollar on the results for the Maine timberlands, improved for all log products. Stronger markets and the weaker Canadian dollar resulted in a 7% and 11% increase in softwood and hardwood selling prices, respectively, relative to 2014. Prices for hardwood pulpwood in New Brunswick remain strong, with selling prices increasing by 13% year-over-year, while markets were less robust in the Maine operations, with the selling prices gaining just 1% year-over-year on a U.S. dollar basis. Softwood pulpwood continues to be our most challenging product, as the number of groundwood pulp customers operating in the region continues to decline, but as we've noted many times in the past, this product makes up only 6% of our total sales in 2015. Biomass markets were strong, particularly in New Brunswick, where the realized margin per tonne on this product increased 66% year-over-year.

Acadian's financial outlook for 2016 remains positive. While there are growing expectations of moderately slower global growth in 2016, the foundation for its steady U.S. economic growth remains strong, improving breadth of job growth across the US, a steady increase in household formations and meaningful reductions in excess housing inventories point to a continued steady recovery in housing starts. Consensus expectations are currently calling for a 15% year-over-year increase for 2016, and a further 10% for 2017. Although the home construction segment is expected to grow meaningfully in 2016, as a result, we expect benchmark lumber prices should remain flat, reflecting a combination of weak offshore export markets leading to export volumes being redirected in domestic markets, and U.S. lumber mill capacity additions. In addition, the combination of the weak Canadian dollar and removal of the softwood lumber duties due to the expiry of the Canada/U.S. softwood lumber agreement is expected to drive continued strong mill utilization rates in Canada.

While we anticipate Acadian's regional sawmill customers will continue to operate at current strong utilization levels through 2016, most did start the new year with high log inventories, reflecting seasonally favourable logging conditions through the latter half of last year. While we anticipate some ongoing challenges for softwood sawmill residuals in May, we expect to see ongoing strong demand for softwood sawlogs in the region, with stable pricing.

Markets for hardwood sawlogs are expected to remain at current favourable levels, while demand and pricing for hardwood pulpwood may experience some moderation, at least in the near term, as the region adapts to announce no closures in May and transitions to alternative markets driven by new capital investment. Softwood pulpwood markets are expected to remain Acadian's most challenging in 2016. However, as we noted before, this segment continues to represent a minor proportion of operating earnings. The long-term outlook for biomass markets remains generally positive, although near-term headwinds are expected due to the reduced natural gas pricing and lower regional biomass plant operating rates in May.

We have continued to pursue business development opportunities in the U.S., Australasia, and South America, in support of Acadian's growth strategy, as we've noted on several previous conference calls. With continued aggressive competition for opportunities, many of which have been relatively small with an unattractive cash yield profile, our focus has shifted more aggressively to opportunistic, proprietary development opportunities. In an effort to surface value in this market, we announced on February 4,

2016 that a review of strategic alternatives was initiated by Acadian's Board of Directors, which may include, among other things, a merger or other business combination, a sale of all or parts of its business, or other strategic transactions. Regardless of the outcome of this process, Acadian's shareholders can be confident that we remain focused and disciplined in our efforts to protect and maximize shareholder value.

In closing, we're very pleased with Acadian's exceptionally strong operating performance in 2015. Despite the recent challenges in pulpwood and biomass markets introduced in late 2015, we anticipate that the region's diverse and resilient markets, Acadian's strong operating team and its balance sheet will drive continued strong operating results.

We thank you for your continued support of Acadian. That concludes our formal remarks. We're now available to take any questions, so I'll put it back to you, Operator.

OPERATOR:

We will now begin the question-and-answer session. To join the question queue, you may press star, then one on your telephone keypad. You will hear a tone acknowledging your request. If you are using a speaker phone, please pick up your handset before pressing any keys. To withdraw your question, please press star, then two. We will pause for a moment as callers join the queue.

The first question comes from Hamir Patel of CIBC Capital Markets. Please go ahead.

HAMIR PATEL:

Hi, good afternoon. Mark, as Acadian works through the strategic review, do you think there's a minimum amount of timberland that the Company needs to own if it ends up remaining in the public market?

MARK BISHOP:

That's a good question, Hamir. Clearly, we're looking at several different alternatives, and we believe we need a substantial platform. In any event, as is always the case, in our strategic initiatives, we're looking at scale opportunities and would always want to maintain a scaled platform wherever we operate in. So, hard to answer that question, because we're not able to get into any details of our

review, but I wouldn't expect we would operate a very small stub of an asset within Acadian, if that's your question.

HAMIR PATEL:

Okay, thanks, that's helpful, and just, I guess more of a higher level question on global timber markets, and you may not know the answer to this but I thought I'd run it by you. Do you have any sense as to what the real world impact has been for timberland transaction values in places where we've seen interest rates, like London and Sweden?

MARK BISHOP:

Yes, I mean, there's not been a whole lot of transactions in a lot of these areas that are (a) public or (b) of any scale that are really sort of indicative, so it's hard to say.

HAMIR PATEL:

Okay, fair enough, and just a final question for Erika. In the press release, you attributed the positive fair value adjustment as being largely driven by changes to the harvest plan and log price assumptions. How much of that uplift came from the harvest plan, and maybe if you could talk a bit to some of the major changes there, both in terms of region and maybe mix and volumes over the long term?

ERIKA REILLY:

I don't have the numbers right in front of me in terms of the split between the amount attributable to the revised harvest plan and the amount attributable to the log pricing assumptions, but I would say about 60 or so percent is attributable to the revised harvest plan, and the rest, I would say—a lot of it is FX as well, driven, but I would say that the majority would be related to the revised harvest plan, and that revised harvest plan and details will be provided in our 2016 Annual Information Form, which will be made available shortly here. So, that should provide a bit more detail.

HAMIL PATEL:

Anything you can speak to on that, because we probably won't get that before—is that going to come out today, or ...

BRIAN BANFILL:

Hey Hamir, it's Brian, I can jump in a little bit on that. So, the revised harvest plan, it's really driven out of the New Brunswick operations, where during 2015, just as part of our really five-year process, where we go back and we take a good look at what our timberlands are yielding and what our plot samples are providing in terms of data about the growth of the timberlands, we completed that process in 2015 and found that the silviculture work that was done in the early '80s really had been contributing more to growth on a number of the stands that we had expected, and that's resulting in significantly higher productivity than we had built into our models, and that should really start to come in and start to benefit the business more in the 15- to 20-year timeframe, so it's not something—you know, you're not going to see the harvest volumes jump up in the next five years, but in longer term projections, it does make a difference, and they're definitely well within the modeling period that's used by the appraiser.

HAMIR PATEL:

Okay, thanks, Brian, that's helpful. I'll turn it over.

OPERATOR:

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

PAUL QUINN:

Yes, thanks very much, good morning, just a couple of questions. One is with respect to the strategic review and the timing of that. I mean, we've seen timber markets over the last number of years be quite strong and it seems like we've got a little bit of a softening, so maybe you could just discuss the overall—what you assess the overall conditions of the market, and then address the timing of why now for the strategic review and why isn't it something you guys looked at a couple years ago when markets were probably stronger?

MARK BISHOP:

Paul, it's Mark. I assume when you refer to markets, you're referring to timberland markets, and I would say that—and I think you're aware that timberland markets continue to be very robust. There are not a lot of scale properties on the market today, but there have clearly been several transactions recently completed at very high valuations that have been public—made public through various industry publications. So, we continue to see an awful lot of capital focused on the asset class, and while we

may have seen some tempering of North American softwood lumber markets, the timberland market continues to be very robust.

In terms of why now, we've spoken every quarter, I guess, for several quarters, and certainly all of you—all of the analysts have commented in various ways on our initiatives to grow Acadian through acquisitions aligned with the broader Brookfield timber initiatives. Clearly, we haven't been successful in finding those value opportunities. So, the transition is, I think, a natural one, one that we've broadened our view to encompass a number of potential initiatives and outcomes, including potential sales, but we believe the market remains very strong.

PAUL QUINN:

Okay, and then just following up, it looks like, from a transaction standpoint, there's quite a few timberland transactions that have happened in the state of Maine, so I suspect that piece of Acadian would be readily saleable. We haven't seen very many transactions at all in New Brunswick, even Eastern Canada. Is there a buyer for those assets in New Brunswick?

MARK BISHOP:

I'm not sure that's something I can answer, Paul. I mean, I think we are seeing buyers in most markets, you know, once we've seen transactions made public. It's hard to know. You're correct, there hasn't been a lot of recent transactions, but it's an interesting, very strong market, as you can see from our results, we continue to perform in a very steady, strong manner, so I expect there will be interest in both markets.

PAUL QUINN:

All right, that's all I had. Best of luck with the review.

MARK BISHOP:

Thanks, Paul.

OPERATOR:

As a reminder, if you have a question, please press star, then one. The next question is from Andrew Kuske of Credit Suisse. Please go ahead.

ANDREW KUSKE:

Hey, good afternoon—or, I guess, good morning for you still. Just on the strategic review, I know the press release said that the Board of Directors initiated the strategic review, but maybe some clarification on that. Did the BAM appointees on the Board, effectively, were they recused from it and was it the independent Board, or was it just the Board en masse?

MARK BISHOP:

I think, as you can see from the press release, there was a special committee that had been struck ahead of this review, and that special committee is comprised of independent directors. They were the group that put forward their support to go ahead with a review.

ANDREW KUSKE:

Okay, I appreciate that. I guess, just looking at this very broadly, arguably, you've traded at a discount to a number of the other players who have gone a different kind of path of growth, whether that works out for them on a longer term basis or not remains to be seen, but I guess when we look at your large shareholder, you know, they sold Island, they've sold Longview. Acadian's been in the portfolio, really, the longest of everything, and obviously there's a private funds business. So, is this really a broader reassessment from their activities in—that, combined with just the valuation disconnects on Acadian shares?

MARK BISHOP:

Sorry, what did you say, their activities ...

ANDREW KUSKE:

So, broadly, if you look at just the BAM, through the BAM lens, like obviously they've divested of a bunch of things over the years, most notably Island and Longview. They still have the private funds business, they still have Acadian. Is this just trying to reconcile the public/private market divide and surface value from Acadian? I mean, I guess that's the gist of it, but is there something more broader, from a BAM standpoint, of exiting this class of assets altogether?

MARK BISHOP:

Yes, no, that's a good question, Andrew. I think as we've noted in all of the sort of previous conference call, we continue to remain active in our initiatives to grow our platforms, both in North America and in South America, and continue to have private fund capital available to do so. So, we're still very active in Latin America and we're still very interested in pursuing, as we characterized in our press release for the quarter, pursuing opportunistic, larger transactions that are more proprietary oriented. You know, participating in smaller auctions is costly and we don't think so far that it's going lead us to where we want to be in the near to medium term. We do expect that there will be very interesting opportunities in timberland, and BAM certainly is very supportive of continuing to maintain an active pipeline and continue to look for those opportunities, but, clearly we have surface value, you've noted that track record, and we'll continue to do so on either side of the trade, where it's appropriate.

ANDREW KUSKE:

Okay, that's helpful, and then maybe just some questions as it relates to New Brunswick. Looking at just, I guess, the overall harvest portfolio, the harvests that you did in Q4 in New Brunswick and Maine, were there any changes in what you were harvesting, was there any high grading efforts, or was it really just you were able to harvest less and you just had much better pricing at the end of the day and there wasn't really any high grading of that actual—what you were cutting down.

MARK BISHOP:

Yes, no, that's right. It's an interesting word, but, no, I mean, we're very focused on harvesting our sustainable profile and very obviously focused on surfacing value in any way we can within the year, we have some flexibility to do that, but we're always coming back and our teams are always coming back to making sure we're harvesting the profile. So, I certainly wouldn't suggest there's any high grading of any sort going on.

ANDREW KUSKE:

Okay, and then just finally, in New Brunswick, there's been some media reports about the drop in royalties to the government and there's a debate on what that quantum is, some people citing a glut of wood in that marketplace. I guess, what are you seeing on the ground in New Brunswick and how do you look at that region for the next few quarters?

MARK BISHOP:

The market, as a whole, in New Brunswick still remains very strong. I think as we've noted, there is higher inventories than we'd like for this time of year, but we're certainly working through that, and we're seeing all of our customers continue to operate at high utilization levels. So we're seeing, surprisingly, still very strong conditions given those high inventory levels, and, clearly, we need to see a pretty robust and active construction season to continue to see that offtake, but, you know, that's certainly what we're expecting to see so far.

With respect to the royalties, I think you've seen the same information we have, and I'll just remind you that they're actually quite a small part of our overall business, so any minor change there—and so far they don't look to be substantial—we don't expect to be impacting us in any significant or material way.

ANDREW KUSKE:

Okay, that's great. Thank you.

OPERATOR:

This concludes the question-and-answer session. I would like to turn the conference back over to Mr. Mark Bishop for closing remarks.

MARK BISHOP:

Okay. Well, thank you again all for dialing in and for your support of Acadian, and we look forward to talking to you next quarter. Enjoy your day.

OPERATOR:

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