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Acadian Timber Corp. First Quarter 2016 Conference Call Transcript

Date: May 10, 2016

Time: 1:00 PM ET

Speakers: **Mark Bishop**
Chief Executive Officer

Erika Reilly
Chief Financial Officer

Brian Banfill
Chief Operating Officer

OPERATOR:

Welcome to the Acadian Timber Corporation 2016 First Quarter 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 first 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 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 the remainder of 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 30, 2016, 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 first quarter. Then Mark Bishop, Acadian's Chief Executive Officer, will provide comments about operations, market conditions, and our outlook for the remainder of 2016.

Acadian's operations ran well during the first quarter. Operating conditions in New Brunswick were typical for the winter season, but the Maine operations experienced warmer and less favourable conditions than in the winter of the prior year. Demand for hardwood continued to be strong, but markets for softwood pulpwood, particularly in Maine, remain challenging.

Net sales for the first quarter totaled \$21.4 million dollars, a \$3.2 million dollar, or 13 percent, decrease compared to the same period in 2015. The year-over-year decrease in net sales is almost entirely attributable to a 13 percent decrease in sales volume. The weighted average log price did increase 3 percent year-over-year, but this was offset by modestly lower revenue from Acadian's management services contract on the Crown licensed timberlands. The increased log price reflects stronger hardwood prices at the New Brunswick operations and the positive impact of the weaker Canadian dollar on U.S. dollar-denominated sales that offset weaker prices for our softwood logs in Maine.

Reflecting the decreased sales volumes, Adjusted EBITDA was \$7.0 million dollars compared to \$8.0 million dollars during the same period in 2015. Adjusted EBITDA margin was 33 percent, down from 35 percent same period last year as the increase in the weighted average log price was offset by some longer haul distances in Maine and the negative impact of the weaker Canadian dollar on U.S. dollar denominated costs.

Free cash flow was down \$1.4 million dollars from the first quarter of 2015 to \$6.2 million dollars and the payout ratio was 68 percent compared to 55 percent in the prior year after adjusting the prior result for the year-over-year increase in the dividend rate.

Acadian's net income totaled \$4.3 million dollars, or 26 cents per share, for the first quarter up from a loss of \$2.9 million dollars or 17 cents per share from the same period in 2015. The year-over-year increase is primarily due to the recording of a \$4.1 million dollar unrealized exchange gain on long-term debt this year compared to a \$7.7 million dollar loss in the same period of the prior year. Other factors affecting net income included a \$5.2 million dollar increase in deferred tax expense, mostly due to the 2% increase to the New Brunswick provincial tax rate enacted on April 1st, 2016 and a \$1.7 million dollar decrease in fair value adjustments due to lower harvest volumes.

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 \$13.9 million dollars compared to \$15.3 million dollars for the same period last year. A 12 percent decrease in sales volume was partially offset by a 6 percent increase in the weighted average log selling price. The 7% decrease in

harvest volume reflects more typical weather conditions this year that lead to an earlier reduction of operations due to mud season as compared to last year.

The weighted average selling price across all log products was \$69 dollars and 87 cents per cubic metre in the first quarter of 2016, up \$3 dollars and 97 cents per cubic metre from the same period last year. This year-over-year increase in the average log selling price reflects gains in hardwood sawlog and pulpwood prices, partially offset by modest declines in softwood prices.

Costs for the first quarter of 2016 were \$9.0 million dollars as compared to \$10.0 million dollars in the comparable quarter of 2015. The decrease was due to lower harvest volumes with variable costs per cubic metre increasing just 1 percent from the prior year.

First quarter Adjusted EBITDA for the New Brunswick operation was \$5.0 million dollars, down slightly from \$5.3 million dollars in the first quarter of 2015. Adjusted EBITDA margin increased to 36 percent from 35 percent in the prior year on the strength of hardwood sales prices.

At the Maine operation, sales volumes were down 16 percent year-over-year and Canadian dollar-based log selling prices fell 1 percent. This combination of factors caused net sales for the first quarter of 2016 to drop \$1.9 million dollars from the prior year to \$7.5 million dollars. While hardwood volumes remained stable, less favourable weather conditions than in the prior year, along with the current challenges in the softwood pulpwood market in the region, resulted in a significant drop in softwood volumes. The weighted average log selling price in Canadian dollar terms was \$80 dollars and 63 cents per cubic meter in the first quarter, down \$1 dollar and 8 cents per cubic meter from \$81 dollars and 71 cents in the same period of 2015. Weighted average log selling prices in U.S. dollar terms decreased 11 percent year-over-year as improved hardwood sawlog prices were more than offset by lower prices for all other log products.

Costs for the first quarter were \$5.2 million dollars, compared to \$5.5 million dollars during the same period in 2015. The positive affect of lower harvest volumes was almost fully offset by a 16% increase in variable costs per unit in Canadian dollar terms. In U.S. dollar terms, variable costs per unit climbed 5%, primarily due to longer haul distances for hardwood pulplogs.

Adjusted EBITDA for the Maine operation for the first quarter was \$2.3 million dollars, compared to \$3.9 million dollars for the same period in 2015, reflecting both lower sales revenue and higher costs. Adjusted EBITDA margin fell to 30 percent from 41 percent in the prior year.

Switching over from the operations to our cash position ...at the end of the first quarter Acadian had cash on hand totaling approximately \$20.5 million dollars, which is \$4.0 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 \$5.2 million dollars of free cash in excess of dividend payments over the last twelve months offset by an increase in working capital resulting from higher log inventories at the New Brunswick operations. The current cash balance is \$2.8 million dollars higher than the balance at the end of the fourth quarter of 2015 reflecting the free cash flow generation in the quarter and a modest decrease in working capital as higher inventory levels were offset by lower accounts receivable and higher accounts payable balances.

As at March 26, 2016, Acadian had net liquidity of \$97.9 million dollars, including funds available under Acadian's Revolving Facility and our stand-by equity commitment with Brookfield, compared to \$98.5 million dollars as at December 31, 2015. The decreased liquidity reflects the higher cash balance offset by the impact of a stronger Canadian dollar on the revolving facility and equity commitment.

During the quarter we declared a dividend of 25 cents per share to our shareholders, consistent with the prior quarter.

I will now turn the call over to Mark.

MARK BISHOP:

Thank you Erika.

During the quarter, Acadian's operations experienced two recordable incidents, one involving an employee and one involving a contractor. Both incidents resulted in lost time, but the resulting injuries were relatively minor in nature. We continue to work with our contractors and employees to ensure the highest standards of workplace safety are maintained.

Acadian continues to benefit from strong hardwood markets and high operating rates among our softwood sawmilling customers supported by the steady recovery in the U.S. housing market. As Erika mentioned, Acadian's weighted average log selling price for the first quarter increased 3 percent year-over-year. Stronger hardwood prices in the New Brunswick operations and the positive impact of the weaker Canadian dollar on U.S. dollar-denominated sales more than offset weaker prices for softwood logs. Hardwood sawlog and pulpwood markets remained strong with weighted average selling prices for sawlogs increasing 13 percent and prices for pulpwood increasing 10 percent. Softwood sawlog prices in Maine weakened considerably, however, as customers struggled with lower lumber and residuals pricing.

Softwood pulpwood markets continue to be over-supplied and markets in Maine are effectively closed at the present time causing us to sell this product into the biomass market. This remains 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 a small portion of Acadian's sales and an even lower proportion of our operating earnings.

Biomass markets for the New Brunswick operations remained strong, with margins more than double those of the prior year, primarily reflecting continued sales to export markets.

Acadian's financial outlook for 2016 remains positive. While U.S. economic growth was relatively flat during the first quarter of 2016, most observers do not consider this weakness as signaling the start of deteriorating U.S. economic activity. A healthy labour market, evidenced by a solid hiring trend seen during the last few months and stronger household incomes are expected to support a pick-up in consumer spending that should drive improved economic performance through the remaining quarters of 2016. The fundamentals for a continued recovery in residential construction activity, including low interest rates, a sustained improvement in the labour market and rising personal incomes among young adults should continue to draw more potential homebuyers into the housing market. Consensus for 2016 U.S. housing start expectations remains strong at 10% year-over-year growth although construction labor supply and availability of new building sites are noted as potential constraints.

Benchmark softwood lumber prices for the first quarter remained flat from the previous quarter and are generally expected to remain flat on a full year-over-year basis. Housing start momentum has been

positive, but ongoing weakness in offshore export markets and recent U.S. lumber mill capacity additions continue to be a drag on pricing. In addition, the combination of the weak Canadian dollar and the absence of softwood lumber duties due to the expiry of the Canada-U.S. Softwood Lumber Agreement in late 2015 is expected to drive continued strong mill utilization rates in Canada.

Almost all regional sawmills continue to operate on full shifts and appear to be carrying inventories at or near typical seasonal levels. While we expect softwood sawlog demand to remain stable through 2016, ongoing challenges for softwood sawmill residual demand in Maine has negatively impacted softwood sawlog pricing in that market, although prices appear to have stabilized. The softwood pulpwood market continues to be challenging.

Hardwood sawlog markets remained strong during the first quarter and are expected to remain at current favourable levels. While we continue to expect hardwood pulpwood markets to experience moderation in 2016 as the region adapts to announced paper mill closures in Maine, they have remained resilient.

Biomass markets remain generally positive in New Brunswick. However, with the recent loss of renewable energy certificates from Massachusetts and Connecticut, Maine's commercial biomass energy generators significantly curtailed operations during the first quarter. Recent legislature backing public subsidies may assist on or two of these facilities to restart, but remains a temporary solution. While an increase in investments in regional domestic and export bound pellet capacity may provide relief over the medium term, there is minimal visibility on market-based catalysts to more broadly support the curtailed biomass generators.

As we've noted prior quarters during which we've been very active in the pursuit of growth opportunities, Acadian has been challenged with very aggressive competition for timberland investments. In this context, we believed it was prudent to take a step back to review a range of strategic alternatives and initiatives, including a possible sale of all or parts of the business, a merger or other business combination or other strategic transactions. Our process which included a detailed internal review with management and the board was initiated in late October, but as you know was press released in early February. This process, which has now been concluded, allowed us to re-evaluate and confirm that Acadian was on the right path to maximize value to shareholders over the

long term. The Special Committee has determined that it is in the best interests of Acadian's shareholders to continue to seek growth on an opportunistic basis while management continues to operate the company with a disciplined focus on maximizing value.

In conclusion, we would like to take this opportunity to remind our investors that Acadian benefits from a strong balance sheet, diverse markets and an experienced and dedicated operating team with a clearly demonstrated track record that remains committed to continuously improving our financial performance. These factors, give us considerable confidence that Acadian is well positioned to continue to deliver solid financial performance and meet its dividend target for 2016 and beyond.

We thank you for your continued support of Acadian and remain committed to continuously improving our financial and operating performance.

That concludes our formal remarks and we are available to take any questions from participants on the line. 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 speakerphone, 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 is from Paul Quinn of RBC Capital Markets. Please go ahead.

PAUL QUINN:

Yes, thanks, and good morning. I can appreciate you had difficult weather on a year-over-year comparison. I'm just wondering if the weather effect that you primarily experienced in Maine, are you going to make up that volume for the rest of year, or, i.e., are you going to get back to somewhere around 300,000 metres?

MARK BISHOP:

Yes, Paul, I think you'll see that the weather certainly [washad](#) an impact in the first quarter, and a significant part of that volume, as you're aware, was softwood pulp. I wouldn't expect us to make up all of that volume in the remaining quarters, unless certainly we see a significant change in the markets.

PAUL QUINN:

Okay, and then just on the strategic review, we've seen some strong timberland sales, especially in the U.S. Maybe you can comment on the level of interest you received on both the Maine and New Brunswick timberlands?

MARK BISHOP:

I think that was two questions, Paul. The first question was strong activity in the market, and you're right, I guess. Rayonier announced very recently its acquisition, and I guess subsequent sale. Certainly, there's continued interest and it looks like 2016 may be a busier year for some segments of the timberland market in terms of transactions.

I can't really comment specifically on any of our activity. As we've indicated, we had a range of potential alternative strategies that we reviewed, but I can't really comment on any specific activity or details within that, other than the fact that we're going to continue to communicate with all of you as we progress in implementing those initiatives.

PAUL QUINN:

Okay, the last question I had was just on softwood lumber. New Brunswick received an exemption last time. I'm just wondering if you expect a repeat of that.

MARK BISHOP:

I do. I mean, as you know, the structure really of the industry in the Atlantic Provinces and in New Brunswick has not changed from the last go-round. I think most of our peers in the East, in the Maritimes, would certainly expect that we're going to be treated in a similar fashion since the last go-round. Certainly, there's a lot of uncertainty heading into this, and I've talked about it very recently, but we do expect to see very similar treatment of the Maritime Provinces.

PAUL QUINN:

All right. Best of luck.

MARK BISHOP:

Thanks, Paul.

OPERATOR:

The next question is from David Quezada of Raymond James. Please go ahead.

DAVID QUEZADA:

Thanks. Hi, guys. My first question—I know in the release you mentioned longer haul distances for hardwood logs. Is that something that you expect to be a relatively temporary impact or is that something that we should expect to see going forward?

MARK BISHOP:

That's a good question, David. I think we've seen—particularly, one of our customers who's implementing a couple of tissue machines and our volume heading in that direction has increased. So, overall, I think we're going to see, at least for the remainder of the year, a likely similar impact on hardwood margins due to the transportation in Maine, but that really reflects what we've seen in the last couple of quarters is an increase in operations in certain areas and the curtailments in other areas have caused a shift in fibre flow, and so far, that's likely to be a more stable shift, I guess, over the next several quarters, unless we see any new developments. Obviously, we saw Rumford announce that it was opening up an additional machine again on some specialty paper and that will create some additional volume, but incrementally, it's a fairly low amount of volume and certainly will not provide a significant offset for us.

DAVID QUEZADA:

Okay, great, that's helpful, thank you. I know in New Brunswick, you saw some good results from the export markets. I'm just wondering, I know it's not a huge portion of your overall volumes, but how big is the opportunity there and do you see the potential to increase that as a proportion of shipments going forward?

MARK BISHOP:

You're right, it is a small part of our business, although it has been increasing. I think this year over last, we're seeing—Brian, I think we were targeting at least a couple of additional shipments.

BRAIN BANFILL:

Yes, I'm assuming the reference is to biomass.

MARK BISHOP:

To biomass.

DAVID QUEZADA:

Biomass, that's right, yes.

MARK BISHOP:

So, no, we certainly continue to expect to see exports, and while we called it biomass, I think we have stated on prior calls that a fair amount of that volume was actually going into a panel market in Europe. So while it's biomass, it was actually being—it wasn't being burnt and used for energy. Some of it was, but certainly where our growth was coming from was actually targeted at a different market for us, which certainly is continuing to get more interesting for us.

DAVID QUEZADA:

Okay, great, thank you. My last question, just very broadly on the outlook for M&A, I know in the past you've commented that you were looking at Latin America, and I believe Australia and New Zealand. Are there any broad trends globally for timber M&A that, I guess, maybe you could comment on as it relates to potential opportunistic growth for you?

MARK BISHOP:

Yes, I wouldn't suggest there's any sort of significant developments in trends in M&A, although some of the Australasian activity I would suggest maybe has slowed down somewhat, and you're going to see a pickup, I think this year as I mentioned, and through the year, a pickup in U.S. transactions. So, there's certainly—we would expect to see potentially larger scale transactions in 2016, and as TIMOs are continuing to approach or extend their fund lives, they are needed to come back to the market, so, we

will see, I think, an increase in activity in 2016 in the U.S. market. So, those are really the key trends. Brazil really remains an interesting market from many perspectives, and while we're very active there, we wouldn't expect at this point to see Acadian participate in Brazil transactions, I think, for some of the reasons we talked about before.

DAVID QUEZADA:

Okay, great. Thanks very much. That's all I had.

OPERATOR:

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

ANDREW KUSKE:

Thank you. Good morning. It's actually Andrew and Paul. Maybe if you could give us a little bit of colour just on the public/private market valuation divide that tends to exist, where we're seeing certain assets embedded within private funds maybe having more aggressive valuations, and then also enabling them to go out and be more aggressive in the bidding process, versus what we're seeing embedded within public company valuations?

MARK BISHOP:

That's a good question, Andrew. The public company valuations obviously get clouded by a combination of factors, including the overall market and broader market, and trading activity, and we've certainly seen that being relatively volatile for the U.S. REITs this year, and obviously the implied valuation on the non-timber assets. I think the Weyerhaeuser recent transaction with IP on the pulp assets is an interesting one. I think that probably had a range of values that many of the followers would have attributed to, that would have ultimately had an influence on the residual timber value approaching it from a sum-of-the-parts method.

I guess, when we do—and we continue to do a lot of work on the U.S. REITs. We look at them obviously from a public information perspective, but we look at them in the same way we would look at any other timberlands. We wouldn't generally believe that or feel that there is a significant discount in the public market to timberlands. In fact, I think, again, depending on a specific name, we would probably have a different perspective completely. So, it's very difficult to compare the two because

you're comparing—and certainly for analysts using public market information, you're really not comparing assets at a detailed enough level, including knowledge of inventory and growth in yield, to be able to compare them appropriately.

ANDREW KUSKE:

Okay, thanks very helpful. Then, I guess, maybe carrying that thought process through on just the results of the strategic review and the conclusions that you and the Board have obviously drawn for Acadian's value, what should we extrapolate? Then I guess the follow-up to that is you do have a clear path or view to growth for Acadian in the future?

MARK BISHOP:

Well, I guess, first of all, I think I'll go back to one of the comments that I sort of alluded to is that we're quite proud of our track record and the fact that we've been able to grow the dividend quite nicely with the assets that we have, and we continue to have a best-in-class payout ratio, very competitive with many, if not better than many, of our peers.

As we mentioned, we're to maintain a focus on opportunistic growth. We think in certain markets we can be very competitive. Obviously, we need to demonstrate that, and understand that we've not been doing that so far with respect to transactions, you know, closing any transactions, but we do think we can be competitive in certain markets.

In the meantime, we do have other opportunities and initiatives that we will focus on, some that are—obviously, we're not specifically identifying in our materials but there are initiatives that we're focusing on with Management and we'll be able to talk about them once we are closer to achieving them, but there are significant—small but significant initiatives that we can embark on, and have, I think that we'll see have their positive impact on our cash flow and our performance.

ANDREW KUSKE:

Okay, that's helpful, and then maybe, if I may, just one final question, probably to Erika, on the comment around longer haul distances affecting a bit of the economics. Are you at the point now where you feel like you're lapping just better conditions, as far as the gas prices are generally off



versus, say, a year ago. Are you getting more favourable trucking rates from a hauling perspective that could improve economics in the future?

ERIKA REILLY:

No, not materially, no.

ANDREW KUSKE:

Okay. Thank you.

OPERATOR:

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

MARK BISHOP:

I just want to again thank you all for participating in our call and your ongoing support of Acadian, and we look forward to speaking with you at our next quarter.

OPERATOR:

This concludes today's conference call. Thank you for participating. You may now disconnect your lines.