# Acadian Timber Corp.
# 2013 First Quarter
# Conference Call Transcript

**Date:** **Friday, May 10, 2013**

**Time:** **10:00 AM PT**

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

**Brian Banfill**
Chief Financial Officer

**OPERATOR:**

At this time, I would like to turn the conference over to Mr. Brian Banfill, Senior Vice President and Chief Financial Officer. Please go ahead, sir.

**BRIAN BANFIL:**

Thank you, Operator, and good afternoon everyone. Welcome to Acadian's First Quarter Conference Call. Before we get started, I would like to call your attention to the following. This conference call is being webcast simultaneously through our website at www.acadiantimber.com where you can also find a copy of the press release including the financial statements.

Please note that in responding to questions and talking about our first quarter financial and operating performance and outlook for 2013, we may make forward-looking statements. These statements are subject to known and unknown risks and future results may differ materially. For further information on known risk factors, I encourage you to review Acadian's Annual Information form dated March 28, 2013 and other filings of Acadian's securities regulatory authorities which are available on the SEDAR at www.sedar.com and on our website. I will start by outlining the financial highlights for the first quarter then Reid Carter, Acadian's Chief Executive Officer, will conclude with more general comments about our operations, market conditions, and outlook of the upcoming year.

The overriding theme of today's comments will be consistent year-over-year performance. Acadian's first-quarter net sales at $18.3 million slipped just $0.4 million, or 2% from the prior year. Adjusted EBITDA changed just $0.1 million, or 2%, coming in at $4.7 million, and the adjusted EBITDA margin was unchanged from the first quarter of 2012 at 26%. As it did in the prior year, Acadian operated a vendor managed inventory program for one of our larger softwood saw log customers. This program resulted in 54,000 cubic meters of softwood saw logs being held in inventory at the end of the quarter. The total volume is significantly less than the volume at the end of the quarter of 2012 but that volume included both softwood saw logs and softwood pulpwood.

All purchase commitments related to this inventory will be filled by the end of May and we expect to realize $1.6 million of adjusted EBITDA during the second quarter from these sales. At the end of the first quarter of 2012, $1.5 million of adjusted EBITDA was held in inventory. Softwood saw logs sales prices increased 5% year-over-year, primarily as a result of the new pricing mechanism and Acadian fiber supply agreement in New Brunswick.  However, the weighted average sales price across all softwood and hardwood log products increased by just 1% over the same quarter of 2012 as the price improvements for most primary products were largely offset by softwood pulpwood sales increasing to 13% of sales from 7% in the first quarter of 2012.  Net income for the quarter was $1.3 million, compared to $4.4 million in the same quarter of the prior year.

The primary driver of the decrease was the recording of a $1.8 million unrealized foreign exchange loss on long-term debt this year, compared to a $1.8 million gain in the prior year.  Other items affecting the year-over-year net income comparison included a $0.4 million year-over-year decrease in fair value adjustment and a $0.2 million decrease in the deferred tax expense.  None of these items are included in our calculation of adjusted EBITDA or free cash flow and we do not consider them to be reflective of the operating performance for Acadian during the year.  In line with the change in adjusted EBITDA, free cash flow slipped by $0.1 million over the first quarter of 2012 to $3.9 million resulting in a payout ratio for the quarter of 88%, slightly higher than the 86% payout ratio for the first quarter of 2012.

I will now briefly review the segmented results for Acadian's New Brunswick and Maine operations. The weighted average selling price across all log products at our New Brunswick operations was $57.77 per cubic meter in the first quarter of 2013, up 2% from $56.62 realized in the same period last year.  This year-over-year increase in the average log selling price reflects higher prices for softwood saw logs primarily due to the implementation of the new pricing formula under the fiber supply agreement with the New Brunswick operations major softwood saw log customer.  This was somewhat offset by a higher proportion of pulpwood in the sales mix.  Net sales were $12.2 million for the first quarter of 2013, down $1 million from $13.2 million in the same period of 2012.

The decrease reflects more typical volumes of sales from inventory as sales in the same quarter of the prior year benefited from the shipment of an unusually high inventory of hardwood logs held at the end of 2011.  Sales volume in the first quarter was comprised of approximately 27% saw logs, 53% pulpwood, and 20% biomass.  This compares to 31% sold as saw logs, 46% as pulpwood, and 23% as biomass in the first quarter of last year.  The low percentages of saw logs in the sales mix reflect the impact of the vendor managed inventory program during both quarters.  Total costs for the first quarter of 2013 were $9.2 million as compared to $10.1 million in the comparable quarter of 2012.  The difference is attributable to lower volumes sold during the period as variable cost per cubic meter were almost unchanged from the first quarter of 2012.

First quarter adjusted EBITDA for the New Brunswick operations was $3 million, almost unchanged from adjusted EBITDA of $3.1 million in the first quarter of 2012. Adjusted EBITDA margin was up 1% from the prior year to 25%. Consistently favorable operating conditions at our Maine Timberlands operation throughout the first quarter along with steady customer demand led to harvest volumes of primary products climbing 9% compared to the same period in 2012. This drove an 11% increase in net sales over the same quarter of the previous year to $6.1 million. Modest price improvements for softwood saw logs were largely offset by a lower quality product mix from the hardwood operations, resulting in the U.S. dollar-based weighted average per unit log sales value being effectively unchanged from the prior quarter at $57.95 compared to $57.79 in the same period of 2012.

Approximately 56% of Maine's volume was sold as saw logs, 37% as pulpwood, and 7% as biomass. This compares to 63% sold as saw logs, 36% as pulpwood, and 1% as biomass in the first quarter of 2012. The decrease in the percent of saw logs resulting from increased hardwood harvest with its significantly higher pulpwood percent and a higher than normal volume of biomass sales; as we engaged a contractor with the correct equipment to salvage material that had been left in roadside yards. The sales volume as softwood saw logs was almost unchanged from the prior year. Total costs for the first quarter of 2013 of $4.1 million, or $0.4 million higher than in the same period of 2012, as a result of higher sales volumes and 3% increase in total cost per cubic meter. The increased sales volume compared to the first quarter of 2012 resulted in adjusted EBITDA for the Maine operations climbing $0.2 million from the prior year to $2 million.

Adjusted EBITDA of 33% of sales for the first quarter of this year was unchanged from the margin realized in the same quarter of 2012. There were no capital expenditures across Acadian's operations during the first quarter of 2013 compared to $15,000 in the comparable period of 2012.

At the end of the first quarter, Acadian had a cash balance of approximately $6.4 million, which is nearly equal to the cash balance of $6.5 million at the same time last year as free cash flow almost matched dividends paid over the last 12 months. The current cash balance climbed by $0.3 million compared to the balance at the end of the fourth quarter of 2012 as free cash flow in the first quarter exceeded dividends by $0.5 million, however, working capital increased by $0.2 million. Net of amounts reserved to support the minimum cash balance

requirement of its long-term debt facility, Acadian has net liquidity of $14.4 million at March 30, 2013. The balance sheet remains strong leaving Acadian well positioned for the future. I will now turn the call over to Reid.

**REID CARTER:**

Thank you, Brian, and good afternoon. We maintained our enviable safety performance record among employees and contractors in our New Brunswick and Maine operations during the quarter with combined operations experiencing no reportable incidents among its employees and just one reportable incident among contractors. The incident that did occur involved a contract log truck driver who overturned his fully loaded truck in poor weather conditions. Thankfully, his injuries were relatively minor and he is expected to return to work within the next week. We remain very focused on employee health and safety performance and look forward to maintaining our excellent results in future quarters.

The average realized sales price for Acadian's softwood and hardwood log products climbed 1% year-over-year. Prices across most of our primary products moved up but an increased proportion of softwood pulpwood in the sales mix had a dampening effect on average pricing. It's worth noting that while end product prices increase sharply through the quarter, our mix of log products and the backward looking nature of the fiber supply agreement for the majority of our softwood saw logs in New Brunswick operations tends to have a stabilizing effect on average log prices. We enjoy the benefits of these factors in declining markets, but our results don't respond as quickly to rising markets as some might expect. This being said, realized softwood saw log prices did gain 5% year-over-year, but as Brian noted, this was primarily the result of implementation of a new pricing arrangement under the aforementioned fiber supply agreement.

Softwood pulpwood prices gained 7% year-over-year as markets for these products recover from the very weak markets in the same quarter of the prior year. Hardwood saw log markets remained stable however, average realized prices for this product decreased 3% year-over-year as a result of changes in product mix. Prices for hardwood pulpwood increased by 1% year-over-year while biomass markets remain stable, however, realized gross margins decreased 15% year-over-year due to a change in customer mix for this biomass.

Turning to U.S. housing market for a moment, our optimism regarding recovery of this market continues to grow. With seasonally adjusted annualized starts for March coming in 45% above year ago levels and the CoreLogic and Case-Schiller house price indices showing 10.5% and 9% gains over the prior year, it's clear that we are well into a housing market recovery. As we've noted previously, we believe this recovery of home prices and homebuilding activity removes a major psychological impediment to home buyers standing on the sidelines and should support increased rates of household formation, household wealth, employment, and homebuilding.

Additionally, mortgage rates remain at record lows and housing affordability is at near record highs with mortgage underwriting status becoming more accommodative. While the consensus U.S. housing starts forecast is somewhat of a moving target, risk to the forecast remain on the upside with the reasonable selection of forecasters now projecting 1 million housing starts in 2013, 1.28 million in 2014, and 1.42 million in 2013. These levels should result in very strong markets for timber aimed at solid wood products markets.

The above-noted factors have led us to become more optimistic with regards to the outlook for softwood saw log markets for the upcoming year. Acadian's key wood products customers have benefited from exceptionally strong lumber and panel prices over the past six months encouraging them to increase production, supporting

demand and pricing for softwood saw timber. This improved market dynamic is expected to continue through 2013. Markets for hardwood saw logs remain stable and appear to have a similar outlook for the foreseeable future. Markets for hardwood pulpwood continue to be reasonably strong with Acadian's major hardwood pulp customers all operating and actively competing for deliveries, suggesting price will remain relatively stable through 2013.

Global demand trends for market pulp appear to be positive with relatively balanced inventories and these markets are expected to tighten in the near-term as demand continues to improve and supply is restricted over the seasonal maintenance. Demand for hardwood pulpwood in Acadian's operating region is further supported by the current strong OSB demand and prices as these operations rely on the aspen component of our hardwood pulpwood. Prices for softwood pulpwood, a relatively minor product for Acadian, recovered on a year-over-year basis as demand came back into better balance. But the market for this product remains fragile. This is not expected to significantly affect Acadian's financial performance as softwood pulpwood typically accounts for less than 8% of total sales and a much smaller proportion of free cash flow.

As we stated before, biomass demand and pricing is expected to continue to face challenges owing to depressed prices for electricity and decade low prices for natural gas. Despite this challenging market environment, Acadian continues to be able to sell all this biomass with stable outlook for customer level prices. We're beginning to feel the benefits of the first full year of recovery for the wood products industry since the economic downturn in 2008, and we are confident that the adaptiveness of our operating team in identifying and accessing market opportunities will ensure returns from all opportunities that arise are maximized. We thank you for your continued support of Acadian Timber Corp and remain confident in Acadian's long-term outlook and quality of asset base. 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. First question comes from Graham Meagher of TD Securities.

**GRAHAM MEAGHER:**

Hello. Thanks for taking my questions, Reid. I guess first one, as we're seeing improved lumber demand, what is your ability to ramp up the softwood saw log harvest to feed the lumber demand? And to that point as well for OSB on the hardwood pulp log side?

**REID CARTER:**

I think we may have talked about this a bit last quarter, Graham. It's relatively limited. Under our fiber supply agreement in New Brunswick operations, we've been harvesting effectively our, in very close to our long run sustained yield. We could certainly take it up for a short period of time. But it has not been our objective to dramatically increase harvest level in New Brunswick with regards to operation.

We do have a little more flexibility in our Maine operation, but it should be, really, it's very modest. You shouldn't expect swings of more than 10% in any period going forward.

**GRAHAM MEAGHER:**

Got you. And then on the contractor costs; any major changes coming up in 2013 that you're seeing?

**REID CARTER:**

No, I think our contractor costs are really quite stable. We, as we have mentioned in the past, had to make some relatively significant increases in contractor payments particularly as the Eastern Township Quebec labor was no longer able to work in Maine for a number of reasons going back in 2009 and 2010, we found ourselves quite short on the labor force in our Maine operations and in order to attract contractors and to also meet increased diesel costs, our rates went up by probably over a couple of years plus or minus 5%. But I think now that's pretty much behind us. We've got a very good access to contractors as demonstrated by the improving harvest volumes in Maine in this quarter versus last year, and I think you should assume probably something no more and likely not even cost of living.

**GRAHAM MEAGHER:**

Great. And last one just on the operations, as we're into mid-May how did the breakup season shakeout?

**REID CARTER:**

It was, actually, as Brian stated, had a very good operating climate in the first quarter and we were fortunate in that it allowed us to harvest right into, in some cases, particularly New Brunswick, right through the end of the quarter to the start of this quarter. So, we brought some inventories, we also had the VMI program, which Brian has pretty much covered the contribution that we expect to have for that this year.

It's stayed quite cold in the East until just very recently, so breakup is still with us, but we would expect to start operations here at our drier operating sites in this third, fourth week of May and certainly be running during June. And I think the most important thing just is that our wood products customers are -- it's not so much that they were short of logs, but they will take all of ones they can take. They are hungry for logs and we have had very good margins during in the first quarter and should do very well.

In terms of aspen for OSB producers, that's clearly been a spectacular market for those producers. We are looking at whether there is a possibility of scheduling some additional stands, aspen stands to serve that market. It's not as though we really have big operating areas of aspen, it is part of our hardwood mix. So, it is hard to specifically go out and get that. But we're certainly aware of the margin opportunity there.

**GRAHAM MEAGHER:**
Great. Thanks, very much, Reid, appreciate it.

**OPERATOR:**
Next question comes from Andrew Kuske of Credit Suisse. Please go ahead.

**ANDREW KUSKE:**
Hello, thanks. If you could just give us some context on what you are seeing in the transactions market? And to some of your earlier comments, we've seen such a dramatic turnaround in housing and that data looks like it's quite good and looks like it will continue for the foreseeable future. So, are you seeing any kind of reevaluation upwards as far as the timber packages that are out there on the marketplace?

**REID CARTER:**
Well, there has been a real dearth of transactions certainly over the last four years. And even in, aside from the Hancock-Molpus acquisition of Forest Capital Partners, which was never fully disclosed in terms of selling price. There was only one transaction last year that was over 100,000 acres in the U.S. and that was the Forest Capital Partners transaction. The previous year, there were two.

So, we have seen a few more offerings last year and for the first half of this year, but it is still very, very quiet and in our pretty significant investor outreach to our Brookfield activities, most of the timberland owners seem quite happy to be owners. So, I would certainly expect -- there's quite a bit of committed uninvested capital that are looking to invest in timberlands. The public timber REITs have a cost of capital now that is the lowest that they have had in certainly more than a decade and they have a very, very competitive currency for timberland acquisition. So, I'd say there is very little available. And I think that, I wouldn't say that prices are likely to go back to as rich as some of the marquee transactions done in the 2006, '07, early 2008 period, but we certainly will see very, very strong prices for timberlands going forward.

**ANDREW KUSKE:**

And then just related to that, you mentioned the broader Brookfield, they clearly, late last year sold some island in the marketplace and then in the recently filed prospectus for Brookfield Infrastructure Partners, they announced yet another transaction of those lands. Do see some opportunity for Acadian to really broaden its mandate and be not just Northeast Regional Atlantic-Canada and then really have a broader mandate out of say, North America or even more global?

**REID CARTER:**

Certainly. We recognize Acadian as a small company with a relatively small float. It's got an increasingly competitive currency itself. I think as manager we would certainly like to improve that situation with Acadian. And the fact that Acadian has exclusive agreement in the Northeast, the ten most Northeastern states in the U.S. and state provinces East of Ontario, anything Brookfield in timber has to be done through Acadian. I don't think in any way that will limit Acadian's ability to have opportunities outside of that. These are Board decisions. I think that our expectation is that we, has always been, we haven't had a good opportunity to grow Acadian yet but we're certainly exploring those kinds of opportunities among others.

**ANDREW KUSKE:**

Okay, that's great and one final one if I may. What percentage of your total volumes is Twin Rivers?

**REID CARTER:**

It's about between 20% to 25% of sales, not of volume, of sales. So by volume, it would be something around 30%, Andrew, I can get you that number but it does, it certainly varies from quarter to quarter. And with the VMI program in the first quarter, it has come down a little bit lower than it would have normally been as a result of holding that inventory over.

**ANDREW KUSKE:**

Okay. That is very helpful, thank you.

**OPERATOR:**

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

**PAUL QUINN:**

Yes, thanks. And good morning, Reid and Brian, just one question, just trying to get evidence of the recovery in the U.S. housing market that recovery seems to be full away. What have you guys seen in terms of the mill operations, especially on the sawmill side in your areas in terms of production increases; have you seen evidence of mills coming back, adding shifts? That type of color would be much appreciated.

**REID CARTER:**

We have seen very, I can't think of any wood products, sawmills or OSB mills, that have restarted an operation and I think that is correct. But we have certainly seen the manning of the mills that we, who are customers, having gone from barely a full shift to quite a number of them, the majority certainly of the competitive largest sawmills moving to two shifts.

Some at times have had short additional shifts, but I think just these mills like almost all North American mills have issues. Attracting adequate fiber supplies has been relevant. And labor and the like, capital to get their mills restarted and really fully ramp up. But certainly every indication we have is that almost all of the mills would like to be running more aggressively than they are and we are moving that direction as fast as we can.

**PAUL QUINN:**

Great, that's all I had, thanks.

**OPERATOR:**

There are no more questions at this time. I will now turn the call back over to Mr. Reid Carter for any closing comments.

**REID CARTER:**

I would like to thank all of you again for joining our conference call and your interest in Acadian and, as always, we're available to answer any further questions if you have any.  Just feel free to contact Brian or myself.  As you can probably tell, we are at an airport right now so we will be a little hard to get a hold for the next couple of hours, but certainly send us emails or give us a call.  Thank you very much, goodbye.

**OPERATOR:**

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