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Acadian Timber Corp. Q3 2011 Conference Call Transcript

Date: Friday, October, 28, 2011

Time: 12:00 PM ET

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

Brian Banfill
Senior Vice President & Chief Financial Officer



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OPERATOR:

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

BRIAN BANFILL:

Thank you Operator and good afternoon, everyone. Welcome to Acadian's Third Quarter Conference Call. Before we get started, I would like to call your attention to the following. The 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 financial and operating performance and outlook for the remainder of 2011 and into 2012, 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, 2011, 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 third quarter, then Reid Carter, our Chief Executive Officer, will conclude with more general comments about our operations, market conditions, and outlook for the remainder of 2011 and into 2012. Acadian's third quarter net sales decreased \$0.3 million over the same period in 2010, to \$17.5 million. The total third quarter sales volume of 341,000 cubic meters was nearly equal to the 346,000 cubic meters sold in the comparable period last year as decreased production in the Maine operations was fully offset by an increase in the New Brunswick operations. Acadian generated EBITDA of \$3.8 million, or 22% of sales, which was \$0.9 million lower than the amount generated in the third quarter of 2010.

Prices across softwood and hardware products were relatively flat year-over-year, with a 2% increase in the average selling price across all products, attributable to higher biomass pricing. Prices for hardwood pulpwood which accounted for 34% of consolidated sales volume, decreased 1% year-over-year while prices for softwood pulpwood improved by 4% over the same period. Prices for softwood and hardwood saw logs decreased by 3% and increased by 1% respectively, in the third quarter of 2011, as compared to the third quarter of 2010.

However, this consistent pricing environment was offset by a lower contribution from the land management services agreement, and the effect of an increased proportion of hardwood harvest, which typically generates lower margins than softwood operations. The net loss for the quarter was \$0.3 million. Included in the quarter's net loss was a \$0.2 million negative fair value adjustment, a \$2.9 million unrealized foreign exchange loss on long-term debt, and a \$0.2 million deferred income tax expense.



These expenses have not been included in our calculation of EBITDA or free cash flow, and are not reflected on the operating performance of Acadian during the period.

Although EBITDA was \$0.9 million lower than the amount generated in the third quarter of 2010, free cash flow fell by only \$0.4 million over the same period, due to a \$0.1 million decrease in capital spending, and a \$0.3 million reduction in interest paid under the new financing arrangements.

I will now briefly review the segmented results for Acadian's New Brunswick and Maine operations; even though pricing across the New Brunswick timberlands primary products was relatively flat compared to the third quarter of 2010, a reduced proportion of biomass and the sales mix resulted in 6% year-over-year increase in the average selling price across all products. The weighted average selling price was \$46.10 per cubic meter in the third quarter of 2010, as compared to \$43.47 in the same period last year.

Net sales were \$14.3 million on sales volume of 279,000 cubic meters, compared with net sales of \$13.3 million on sales volume of 263,000 cubic meters in the third quarter of last year. Sales volume in the third quarter was comprised of approximately 34% saw logs, 44% pulpwood and 22% biomass. This compares to 35% sold as saw logs, 39% as pulpwood and 26% as biomass in the third quarter of last year.

Total costs in the third quarter were \$10.9 million, as compared to \$9.7 million in the comparable quarter of 2010. Variable costs per cubic meter were 6% higher than in the third quarter of 2010 primarily as a result of an increased proportion of hardwood in the sales mix. The delivered cost of hardwood logs is typically higher than softwood because these products are delivered to more distant markets.

Third quarter EBITDA for the New Brunswick operations was \$3.4 million or 24% of sales, as compared to EBITDA of \$3.6 million or 27% of sales in the third quarter of 2010. Increased average selling prices helped to offset a decreased contribution from the land management services agreement.

Switching to our Maine timberlands operations, net sales in the third quarter were \$3.3 million on sales volume of 62,000 cubic meters, 28% below net sales of \$4.6 million on sales volume of 83,000 cubic meters in the same period of 2010. Abnormally wet weather throughout the quarter, and continuing challenges with contractor availability, due to the Maine governments effort to limit Canadian laborers access to work in the state constrained harvest opportunities.

Pricing on a U.S.-dollar basis was relatively stable across all products compared to the same quarter in 2010. However, the significant year-over-year change in the Canadian U.S. dollar exchange rate resulted in the average selling price across all products in Canadian dollar terms falling 6% to \$50.12 per cubic meter in the third quarter of 2011, from \$53.38 in the same period last year. Approximately 60% of Maine's volume was sold as saw logs, 34% as



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pulpwood, and 6% as biomass. This compares to 54% sold as saw logs, 42% as pulpwood, and 4% as biomass in the third quarter of 2010.

Total cost for the third quarter of 2011 of \$2.7 million, were \$0.6 million lower than in the same period of 2010.

Decreased harvest volumes were the primary contributor, although variable cost per cubic meter did decline 4% in Canadian dollar terms, as changes to contract rates made late in the second quarter and increases in fuel costs were offset by foreign exchange. The drop in harvest volumes compared to the third quarter of 2010 caused EBITDA for the Maine operations to fall 56% to \$0.5 million, from \$1.2 million in the prior year. EBITDA margin in the third quarter of 2011 was 17% of sales, compared to 27% of sales for the third quarter of 2010.

There were no material capital expenditures in Acadian's operations during the third quarter of 2011, as compared to \$0.1 million during the same period in 2010.

At the end of the third quarter, Acadian had a cash balance of approximately \$7.7 million. Which is \$5.7 million higher than our net cash position of \$2.0 million at the same time last year. And is \$1.2 million higher than our cash position at the end of the second quarter 2011, primarily due to decreased working capital. At September 24, 2011, Acadian had the full balance of \$10 million U.S. of available credit remaining on its revolving facility. Our 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. Acadian performed well in the third quarter despite very wet weather conditions and continuing challenges of the labor supply in Maine. After a long spring mud season and a cool, rainy June, the volume and frequency of rain during the third quarter created real operating challenges in our Maine operations, keeping us out of the woods, and in some cases, closing roads. These wet conditions are expected to negatively impact production in Acadian's Maine operations into the fourth quarter, until winter freeze up takes place in December. Despite these difficulties, Acadian generated \$3.2 million of free cash flow which was a modest \$0.4 million decrease from the third quarter of 2010.

Safety performance was somewhat disappointing in the quarter, with four reportable incidents among employees and one minor recordable incident among our contractors. We're pleased to say that all these employees have, or will shortly return to work, and are confident this increase in accident frequency is not related to any systemic operating issues. As you know, Acadian takes its commitment to safety very seriously, as we believe that emphasizing and achieving a good safety record is a leading indicator of success of the broader business. We remain very, focused on safety performance, and look forward to improved performance in future quarters.



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Prices across Acadian's softwood and hardwood products were relatively flat year-over-year, hardwood pulpwood prices decreased 1% year-over-year while pricing for softwood pulpwood improved by 4% over the same period. Prices for softwood and hardwood saw logs decreased by 3% and increased by 1% respectively in the third quarter of 2011, as compared to the third quarter of 2010. Acadian continues to benefit from most of its softwood saw milling customers maintaining active operations, and low, in-yard log inventory levels. As a result, demand for spruce fir solid continues to be really reasonably strong, causing our outlook to remain cautiously optimistic for the remainder of 2011, and into 2012.

Markets for Acadian's other softwood species are mixed, with demand for hemlock being relatively strong, while markets for white pine and cedar are softer. Although I'd would note that spruce fir comprises the majority of softwood saw log sales. Markets for hardwood saw logs remained stable, and appear to have a similar outlook for the foreseeable future. Markets for softwood, and hardwood pulp logs remained strong despite softening global pulp markets. Acadian's major pulpwood customers are currently operating and actively competing for deliveries.

The expected start-up of the East Millinocket ground paper mill by Great Northern Paper Company should add further attention to softwood pulpwood markets in Maine, suggesting prices will remain stable through year end. Biomass markets continue to face significant market challenges. Co-generation plans associated with manufacturing facilities are generally in good shape, while stand-alone wood-to-energy plants continue to suffer for depressed plus for electricity and renewable energy credits. Despite this challenging market environment, Acadian continues to be able to sell all of its biomass with a stable price outlook.

Contributions from the land services agreement declined slightly compared to the same period in 2010. However, these contributions are expected to continue at comparatively high levels through 2011, as licensees maintain increased harvest levels aimed at utilizing unused harvest volumes from the 2008 - 2009 period in the final year of their five-year cut control period. We are encouraged by the relative stability of operations across almost all of our customers, which has supported a relatively stable demand in pricing. As demand improves, we'll focus on harvesting and merchandising to meet market opportunities, while actively seeking to improve prices. We thank you for your continued support of Acadian Timber and remain confident in Acadian's long-term outlook and the quality of our asset base. That concludes our formal remarks, and we're available to take questions from participants on the line. Operator?

OPERATOR:

Thank you, Mr. Carter. Your first question comes from Graham Meagher of TD Securities. Please go ahead.

GRAHAM MEAGHER:

Good morning, Reid. Just a couple of questions for you. First one, on the three Irving sawmills that have gone down recently, is there any impact to Acadian from those?



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REID CARTER:

The impacts are largely regional. Irving is still taking log deliveries at the two most recent closures, the announced closures -- the Doaktown and Kendrick Mills that were announced this week. As you know, those are indefinite -- well, call it short-term closures through -- into the early new year. As I say, they continue to take deliveries, and I think it's mainly being a law of supply issue for those mills. So you know, they aren't a negative impact for us. The three indefinite closures they have -- aren't -- they really weren't direct customer for us but

anytime we take mills out impact the regional supply demand dynamic. So far, we, really, are very confident that we'll be able to move our volumes, particularly our spruce fir stud wood, and our both softwood and hardwood pulpwood. They weren't a major customer of ours on the hardwood saw logs side.

GRAHAM MEAGHER:

Okay, great. Next question on the Maine labor issue; can you give a little bit more color on that and what you think might need to change there?

REID CARTER:

Well, it's -- without speaking out of school too far here, I think we view this as largely a political issue. Where it's to protect -- it's sort of a protectionist issue in Maine, where a large amount of the labor in the Maine north woods was carried out by -- particularly Quebec -- certainly Canadian workers. And there had to be a belief that if you restricted Canadian labor to Maine, which is what's been going on over the last year and a half here, that you would create more employment in Maine. The problem is the unemployment in Maine isn't in the Maine north woods so much, as it tends to be a more in southern Maine, and work mobility hasn't -- clearly give our labor shortage -- hasn't been solving our problems or otherwise. So I think it's relatively well understood in Maine, but I think the politics are difficult. And with an election next year, I think this will probably take some time to be resolved. But as I say, I think the issues are well understood, and we do expect to see it resolved.

We are concerned about the more permanent loss of labor; many of these Canadian laborers are going off and doing other things. They may not be seeking to return. Certainly for us, one of our key initiatives is to broaden our contractor workforce, so we don't see business disruptions of the kind that we saw late in the first quarter. Really this quarter was not so much a labor issue it was much more of a wet weather issue for us.

GRAHAM MEAGHER:

So, have you been able to find other contractors? Like are they available, it's just a question of coming to terms?

REID CARTER:

Well, it's always a question of available at what cost? We are actively working, so the answer is yes. We can find more contractors. I think we still have work to do to find more good contractors a reasonable price, and that's a key initiative for us, as I said.



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GRAHAM MEAGHER:

Great. And then the operating conditions in Maine, and specifically the weather there, sounds like it's still pretty muddy. Do you expect a catch up in volumes toward the end of Q4, or Q1, or probably not a catch up at all?

REID CARTER:

I think you could expect relatively normal Q4 type volumes in both our New Brunswick and our Maine operations. I think our ability to catch up the volumes that -- we fell behind in the first three quarters this year, particularly the third quarter, won't be there. So, we don't expect to catch up. We do expect to operate relatively normally in the fourth quarter. But you know with issues -- the problem is when you go into late September, October, with wet soil, nothing dries up. It just stays wet. And where we take our concerns around site disturbance and soil degradation fairly seriously, so we shut down the woods if there's problems or potential for site degradation coming from operating on wet grounds. So we have a number of areas that are drier and rockier soils, and we're able to operate on, but not enough to catch up.

GRAHAM MEAGHER:

Okay, great. And just last question, on diesel prices we can track what's going on through the Energy Administration? Are you seeing surcharges now and are they sort of stabilized at this level?

REID CARTER:

Yes. I think they peaked back in the summer, and have been coming down. Diesel is still expensive. But the peak is behind us, and I don't think we should expect any really meaningful reduction in fuel surcharges. But fortunately, they've stopped going up, and have started to moderate.

GRAHAM MEAGHER:

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

REID CARTER:

Thank you.

OPERATOR:

Next question is from Andrew Kuske of Credit Suisse. Please go ahead.

ANDREW KUSKE:

Thank you, good morning. I think is a question for Reid. I guess we have seen Brookfield Asset Management do a number of transactions with some of its privately held assets or assets held within funds, and some of the listed vehicles and most recently, its private hydro portfolio and Brookfield Renewable Power. Just sort of wondering, from a growth opportunity standpoint for Acadian, and despite the mandate that you've got is pretty restricted in the Northeast and Atlantic Canada, do you see any kind of opportunities in the future to really look more broadly or be say, a co-investor in some of BAMs funds?



REID CARTER:

Well, certainly Acadian's currency in terms of the value of its shares has made Acadian somewhat more competitive. I would point out that Acadian's currency isn't as strong as a number of the U.S. timber REITs, or probably private equity in the timber markets. So, it's

Still -- if you compare our multiples to the Rainiers and Plum Creeks, Weyerhaeuser, Potlatches, you'd find that we traded higher multiples, which -- sorry, we traded lower multiples, which makes our currency a little less competitive still. We're always looking I think. The real issue right now it is there's been very little product available in the market, a tremendous dearth of transactions over the last three years.

We're always looking, we are very active in the marketplace, and you know, we do view Acadian has quite a nice vehicle and we certainly think it will be much better it Acadian have more bulk in terms of its market capitalization, and frankly, it's geography of operations. These things have to come together to make an accretive transaction. Today, I think that's still a very challenging equation, but we would hope there will be periods where there are opportunities and the currency is strong enough where it can make good sense for Acadian to participate. We certainly haven't ruled it out. It's still challenging today.

ANDREW KUSKE:

Do you see the potential, or at least greater potential, for transactions in the future given the fact that several years ago, we saw a lot of very peaky kind of deals done with very high valuations in the market several years ago. Some of the returns on those deals have been somewhat lackluster, and if the credit environment deteriorates a little bit, do you believe that you would see some assets come in to the market?

REID CARTER:

Well, I mean there has been a bid-ask-spread over the last several years as I say, very few transactions, so valuations have been pretty opaque. It's hard to -- we certainly have our views on what timber values are. Sellers have tended to have theirs, and they've been higher. I think that the marquee type transactions, these peak transactions took place in the 2000 -- particularly the 2005 to late 2007 period, I think those are behind us. But there is still quite -- we believe that there is probably \$4 billion or more of committed, un-invested private equity capital looking for timberland acquisitions. I think that the seller's expectations may not have to come down very far to find a buyer. So, I think there will be more transactions going forward, starting -- really going right through 2012. We've seen some more this year, although Rainier has been the big buyer, and that's been for probably reasons other than -- it may have been some tax driven reasons. I think we will start to see more opportunities, and we're hopeful that Acadian may find something to participate in.

ANDREW KUSKE:

That's very helpful. Just switching gears a little bit on biomass, I believe in the outlook statement you stated that the biomass market looks to be a little bit challenged. Do you view it as being challenged just where natural gas pricing is today? And then the other factor really



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in the Northeast from a biomass production standpoint, where the hydrology conditions are just so good right now and probably as there were flooding conditions earlier on, that depresses or dampens, no pun intended, but dampens down the biomass market in the near term?

REID CARTER:

I think those are all factors. Natural gas I think is the big driver. The price is so low and expected to stay so low that -- and it's so easy to build new natural gas capacity, inexpensively and quickly, that without a significant new sort of carbon subsidy green energy driven marketplace, the excitement about growth in biomass of a couple of years ago with things like the BCAP program and others -- it's very muted today. There's no momentum in that direction in the United States. I think it can turn around very quickly, should the subsidy environment change. But the way it is today as you say, there's lots of water for hydro. Gas is cheap if you -- demand is relatively -- has been lower. So, there just haven't been drivers to build new biomass power plants here. You can't get a PPA for a biomass plant that would be compelling.

ANDREW KUSKE:

Okay, that's very helpful. Thank you.

OPERATOR:

There are no more questions at this time. I will turn the conference over back over to Mr. Carter.

REID CARTER:

Well as always, we thank you for your interest in Acadian Timber, and we certainly look forward to having improving performance going forward here. And we look forward to talking to you in the coming quarters. Thank you very much.

OPERATOR:

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