Acadian Timber Corp.
Second Quarter 2013
Conference Call Transcript

Date: Thursday, August 1, 2013

Time: 10:00 AM PT

Speakers:

Reid Carter
President and Chief Executive Officer

Brian Banfill
Chief Financial Officer

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. Good afternoon, everyone. Welcome to Acadian's Second 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.arcadiantimber.com where you can also find a copy of the press release, including the financial statements.

Please note that in responding to questions and talking about our second quarter financial and operating performance and outlook for second half of 2013 and into 2014, 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 with the Securities Regulatory Authorities, which are available at SEDAR at www.sedar.com and on our website.

I will start by outlining the financial highlights of the second quarter then Reid Carter, Acadian's Chief Executive Officer will conclude with more general comments about our operations, market conditions and outlook for the upcoming year as well as discussing Acadian's growth strategy and some recent changes to Acadian's management team.

Acadian's results improved on a year-over-year basis with second quarter net sales of $15.6 million compared to $14.3 million in the same period last year. Adjusted EBITDA climbed $0.7 point million, or 32% coming in at $2.9 million, and the adjusted EBITDA margin improved to 19% from 15% in the second quarter of 2012. This was primarily due to a combination of higher log prices and an increased proportion of higher margin softwood sawlogs in the mix.

As in the prior year, results in a seasonally weak second quarter were boosted by the sale of logs harvested in the first quarter that were held in a vendor managed inventory program for one of our larger softwood sawlog customers. As for the terms of this agreement, purchase commitments relating to the full 54,000 cubic meters of softwood sawlogs held in inventory at the end of the prior quarter were realized, contributing approximately $1.6 million of EBITDA to the second quarter results. Weighted average log prices during the second quarter increased 6% year-over-year, mostly as a result of higher prices for, and a greater volume of softwood sawlogs in the sales mix.

Softwood sawlogs sales prices increased 6% year-over-year, mostly as a result of the new pricing mechanism and Acadian's fiber supply agreement in New Brunswick; although the general strengthening of softwood sawlog markets was also contributing factor. The net loss for the quarter was $0.9 million compared to a net income of $0.6 million in the same quarter of the prior year. While operating earnings improved by $0.6 million, the weaker Canadian dollar led to $2.5 million foreign-exchange loss on a long-term debt compared to a $1.4 million loss in 2012, and an increase in provincial tax rates in New Brunswick caused the deferred tax expense to rise $1.4 million year-over-year to $1.6 million. Neither of these items is included in our calculation of adjusted EBITDA or free cash flow, and we did not consider them to be reflective of the operating performance of Acadian during the period. Free cash flow slipped $0.3 million from the second quarter of 2012 to $1.8 million, resulting in a payout ratio in the seasonally weak second quarter of 195%. The free cash flow results for the current year would have been $0.7 million stronger than in 2012, were it not for the timing of cash interest payments in the prior year.

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 $56.12 per cubic meter the second quarter of 2013, up 7% from $52.68 realized in the same period last year. This year-over-year increase in the average log selling price reflects a general strengthening of markets and the implementation of the new pricing formula under the fiber supply agreement with the New Brunswick operation's major softwood sawlog customers. Net sales were $13.5 million for the second quarter of 2013, up $1.1 million from $12.4 million in the same period of 2012. The increase reflects the aforementioned price increases along with increased biomass sales volumes.

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Sales volume in the second quarter, were comprised of approximately 42% sawlogs; 34% pulpwood and 24% biomass. This compares to 39% sold as sawlogs; 44% as pulpwood and 17% as biomass in the second quarter of last year. The lower percent percentage of pulpwood in the sales mix is reflective of the fact that unlike in 2012, pulpwood volumes were excluded from the vendor managed inventory programs in 2013. As well, demand for this product was generally weaker as regional pulp mills are currently somewhat over supplied with byproduct chips and pulpwood.

Total costs for the second quarter of 2013 were $10.6 million as compared to $9.9 million in the comparable quarter of 2012. Variable cost per cubic meter increased 6% from the second quarter of 2012 as a greater percentage of the harvest during the period took place in more distant stands, leading to higher hauling costs.

Second quarter adjusted EBITDA for the New Brunswick operations was $2.9 million, up almost $0.5 million from the second quarter of 2012. Adjusted EBITDA margin was up 2% from the prior year to 22%. While harvest volumes of primary products were consistent with the prior year, sales volumes were up 9% of the operations delivered hardwood logs from inventory. Net sales increased 13% over the same quarter the previous year to $2.1 million. Some weakening of the realized softwood log prices was more than offset by strong realizations from hardwood pulp logs, causing the weighted average per unit log sales to climb 2% from the same quarter of the prior-year to $57.30.

Approximately 37% of Maine's volume sold was sold as sawlogs; 43% as pulpwood; and 20% as biomass. This compares to 52% sold as sawlogs; 35% sold as pulpwood and 13% as biomass in the second quarter of 2012. The decrease in the percent of sawlogs resulted from increased hardwood deliveries with their associated higher pulpwood component and biomass sales continuing to be well above historical norms. The contractor we engaged in the first quarter of the year continued to savage material that had been left in roadside yards. Sales volume of softwood logs was almost unchanged from the prior year. Total cost for the second quarter of 2013 of $1.9 million were unchanged from the prior year as delayed road construction activity due to wet weather conditions during the quarter offset harvest cost increases.

On a per-unit basis, variable costs for the first quarter increased 3% compared to the prior year in U.S. dollar terms due to longer haul distances for hardwood pulpwood. The increased sales volume and improved log prices compared to the second quarter of 2012 resulted in adjusted EBITDA for the Maine operations climbing $0.2 million from the prior year to $2.1 million. Adjusted EBITDA margin at 10% of sales for the second quarter of this year was up 10% from nil in the prior year. Capital expenditures across Acadian's operations during the second quarter of 2013 were $0.3 million compared to $0.1 million in the comparable period of 2012.

At the end of the second quarter, Acadian had a cash balance of approximately $5.4 million, which is $0.7 million lower than the cash balance of $6.1 million at the same time last year, primarily due to an increase in accounts receivable due to the timing of payments from the New Brunswick government.

Current cash balance fell by $1 million compared to the balance at the end of the first quarter of 2013 as free cash flow in the second quarter was $1.7 million less than dividends due to the impact of mud season on operations during the quarter. This was partially offset by a working capital decrease of $0.4 million. Net of amounts reserved to support the minimum cash balance requirement of its long-term debt facility, Acadian has net liquidity of $13.6 million at June 29, 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, a good afternoon everyone. Our record of strong safety performance among employees and contractors in both our New Brunswick and Maine operations continued throughout the quarter with the combined operations experiencing no reportable incidents among employees and just two reportable incidents among contractors. The incidents that did occur with relatively minor with the resulting injuries related to an ankle sprain and a bruised elbow. Our focus on employee health and safety performance is unwavering, and we look forward to maintaining our excellent results in future quarters.

The average realized sales price across Acadian softwood and hardwood log products climbed 6% year-over-year. Prices across most of our primary products moved up and an increased proportion of softwood sawlogs in the sales mix added additional strength. While end product prices fell back compared to the prior quarter, our mix of log products and the backward looking nature of our privacy supply agreement in New Brunswick for the majority of our softwood sawlogs had it's typical stabilizing effect on average log prices. As we have noted before, our sales realizations and results may not respond as quickly to rising markets as some might expect, but we enjoy the benefits of these factors in declining markets.

As Brian noted, we continue to find the new pricing arrangement under the aforementioned fiber supply agreement to be more reflective of market conditions with realized sawlog prices gaining 6% -- sorry, 7% year-on-year. Softwood pulpwood prices were stable year-over-year, although markets for these products have become over supplied, so sales volumes have declined. Hardwood sawlog markets remain stable, however, average realized price for this product decreased by 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 remained stable with realized gross margins unchanged from the prior year.

Before moving onto the discussion of our outlook for the remainder of this year and into 2014, I would like to highlight some changes in our management team and provide an update on Acadian's growth strategy. Effective today, Erika Riley will be assuming the role of Chief Financial Officer for Acadian and Brian Banfill will take on the newly created role of Chief Operating Officer. Erika has been intimately involved with Acadian since its inception and has 10 years of financial experience. In addition, as a senior member of Brookfield Timberlands team, Erika has played a leading role in identifying, underwriting and financing a large portfolio of Timberland's investments.

As most of you are aware, Brian brings over 30 years of operational and financial expertise and experience in the industry including the past three years as Chief Financial Officer of Acadian. This move positions Brian where he can play larger role in bringing his operational expertise to Acadian's current and future operating businesses. For those that might be concerned that we are adding overhead expenses to Acadian, I would note that Brookfield as manager bears the sole responsibility for provision of management and administrative services to Acadian with no new corporate overhead being added to Acadian itself.

These management changes are in support of our announced a strategy to broaden Acadian's acquisition focus to include interest in timberlands outside of eastern Canada and the northeastern United States. An integral part of this more global strategy will be Acadian's participation alongside institutional investors in Brookfield sponsored partnerships which should enable Acadian to diversify its holdings and grow meaningfully. The focus will be on investments that suit Acadian's profile where Brookfield can bring its operations, financing and structural expertise to create value. Any such investment will be subject to review and approval by Acadian's independent directors.

To provide Acadian with additional funding flexibility to implement this strategy, Brookfield has agreed to provide Acadian with an equity commitment in an aggregate amount of $ 50 million for a two-year duration. Subject to regulatory approvals, Acadian will then be able to call on its equity commitment in exchange for the issuance of a number of common shares that corresponds to the amount of the equity commitment called divided by the volume weighted average of the trading price for Acadian's common shares on the Toronto Stock Exchange for the 20 trading days immediately preceding the date of the call. Acadian and Brookfield have also agreed to certain amendments to Acadian's existing management service agreement to reflect this new strategy.

Turning to our outlook for the remainder of this year and into 2014, I have to say that while our outlook for U.S. housing continues to be very positive; our optimism regarding the recovery of this market during 2013 is somewhat more muted than at the time of our first quarter report. Seasonally adjusted annualized starts for June came in 10% above year-ago levels at 836,000 and permits were up 16% year-over-year to 911,000. These results are well below the gains witnessed earlier in the year. We do, however, continue to believe that with the low inventory of new homes available for sale, improving rates of household formation, near record low mortgage rates and home prices up approximately 12% year-over-year that the recovery is well underway. We also believe the first half of 2013 has offered a very positive indication of how we might expect markets to respond to the continued recovery of the U.S. housing market with Acadian softwood sawlog customers seeking additional deliveries and supporting improved log prices during these periods of strong end product pricing.

Despite the recent decline in softwood lumber pricing, Acadian's softwood sawmilling customers continue to maintain very active operations and appeared to share our positive outlook for U.S. housing. Markets for hardwood sawlogs 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 prices remain relatively stable throughout 2013.

Global markets for pulp are currently relatively well-balanced; however, these markets are expected to soften as production levels increase with the seasonal maintenance period now completed in most operations with additional significant new capacity coming online in addition to capacity that is being restarted.

After recovery in the second half of 2012 and early 2013, recovery of the regional softwood pulpwood market in those times are relatively – sorry -- after the recovery of softwood pulpwood markets, which is a relatively minor product for Acadian, these markets have softened again as there's been ample supply of sawlog residuals and pulpwood inventories at regional pulp mills. This is particularly true in our New Brunswick operations were we expect markets for softwood pulpwood to be challenging throughout the remainder of 2013. This isn't expected to significantly affect Acadian's financial performance as softwood pulpwood typically accounts for less than 8% of total sales at 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 weak, though modestly improving, prices for natural gas. Despite this challenging market environment, Acadian continues to be able to sell all of its biomass with stable outlook for customer level prices.

Acadian benefits from a very strong balance sheet and a very capable operating team. We are confident of the operating team's ability to identify and access market opportunities and that this will ensure returns from all opportunities are realized and maximized. We thank you for your continued support of Acadian Timber Corp. and hope you share our enthusiasm for Acadian's long-term outlook and reviewed potential for growth. As concludes our formal remarks, and we're available to take any questions from participants on the line. Operator?

OPERATOR:

Your first question today is from Paul Quinn of RBC Capital Markets. Please go ahead.

PAUL QUINN:

Yes, thanks very much, good morning. Just a question on growth strategy, really, the timberlands that Brookfield will be acquiring and made available to Acadian, they're outside of the current operating area, but are they within North America, or will they be outside as well?

REID CARTER:

Well, Brookfield has recently raised two funds. We have a follow on, a second Brazil Timber Fund, and it’s quite a large fund for such a specific geography. And then we have a much larger Timber Fund 5. The Timber Fund 5 is focused primarily on the United States. It's focused on Brazil as well. But jurisdictions such as Canada, Australia, New Zealand, Chile and Uruguay are included. So, we expect a significant portion of the capital on that larger fund to be invested in the U.S. But these aren’t assets that have already been acquired this is part of our business development pipeline. So, it's uncertain exactly where these investments will be. It's Brookfield that has made the commitment to these funds along with institutional investors, and Acadian will be offered the option of taking Brookfield's participation. But it's really at the full discretion of the independent members of Acadian's Board. So, it's an option to look at those opportunities for Acadian to invest alongside these funds in those investment opportunities that suit Acadian's capital structure and dividend requirements.

PAUL QUINN:

Okay, so just if you can, take me through example where Brookfield buys a timber track for $100 million, what does that optionality mean for Acadian and what is it --?

REID CARTER:

In either of these funds, Brookfield represents 25% equity commitment. So, if that fund was a straight fund investment, there was no co-investment, Brookfield would be making a $25 million investment in that, and Acadian would have an option of making the investment in the fund. So, they would have a $25 million opportunity. In larger transactions we would that there could be a co-investment opportunity in addition to the fund level investments and Acadian would have the opportunity to have that participation as well. We should be clear, when we mentioned that there was some changes to the management agreement with Acadian, the most important change was to ensure that Acadian is not paying any new fees or any duplicate fees as a result of participation in Brookfield's funds. So, any concerns that this could be in expensive strategy for Acadian, Acadian will still have its same management overhead that it has always had.

PAUL QUINN:
Okay, I think I've got it. And then just for example, on that $100 million transaction it's a $25 million optionality for Acadian and they take that up, they decide to take that up, they are borrowing the money from Brookfield, they're issuing shares off the 30-day weighted average to Brookfield; right?

REID CARTER:
In small transactions, and the example you are using I think we would call a small transaction, Brookfield tends to focus on larger transactions. What we're doing is we're ensuring that Acadian has access to capital. And in this case, it is Brookfield sponsored equity capital. We will have other sources of funding for Acadian; really, what we are doing is Brookfield is offering to backstop this growth. But certainly, in what we expect will be larger opportunities we would expect we would have a much broader market offering. The intention here is to grow Acadian and improve its liquidity, not to simply have a larger position owned entirely by Brookfield.

PAUL QUINN:
Okay. That's clear. And then just on the management change with Erica joining. Is this to give you some -- Acadian a little bit more depth in management; or does this signify a change down the road for yourself?

REID CARTER:
No, no, it does not signify any change for myself. It is really a function of, our intention is to grow Acadian, and Erica has been very, very involved in developing this growth strategy for

Acadian. And Brian brings a awful lot of operational expertise, and we would like to free Brian up to have a little more opportunity for working on the integration and restructuring of acquisitions and making sure that our new businesses performed extremely well. So, it is really, I think it's just normal growth within Acadian and among the roles played by senior members of Brookfield's timber team.

PAUL QUINN:
Great, that's all I had. Best of luck.

OPERATOR:
The next question comes from Andrew Kuske of Credit Suisse. Please go ahead.

ANDREW KUSKE:
Thank you. I guess the first question is just along the lines of the new growth strategy. Do you see this as being conceptually very similar to what we have seen with BIP, BREP and then also BPY?

REID CARTER:
Yes. I think in simple terms, yes, it is very similar.

ANDREW KUSKE:
And then the extension of that is, it does not look at this stage -- you've rolled out in your growth strategy, but it doesn't really look like you're domiciling to Bermuda. It’s technically not an LP at this point in time. So, are you headed down that path; is this really just the first step that you are announcing a concept, but they're more details to follow?

REID CARTER:
These things are always an evolution, Andrew. I think Acadian -- as you know, the timber investment world is relatively small, it's relatively liquid. If we were to create an opportunity where there was a transformative acquisition; we could consider those kinds of changes. Listing other jurisdictions, or a re-domiciling change in the corporate structure, it's too early to commit to those things at this time. We would have to see how these opportunities evolve.

ANDREW KUSKE:

Okay. That's very helpful. And I guess just maybe some context around the sales that were done from BIP of the West Coast timberlands, both in Canada and the U.S. Did that really help, so to speak, clear the decks for Acadian then to really broaden its outlook and to really grow; is Brookfield -- Brookfield and related entities did not really have interest in North America to a great degree?

REID CARTER:

There are a lot of factors that interact across the whole range of questioning. The sale of our Longview operations was not necessarily instigated by BIP. BIP was an investor in that Longview -- they had a direct investment of about 23% in that business and they had 7% through our Global Timber Fund. The sale was opportunistic. We had a buyer who was uniquely positioned to create value through the acquisition, and they offered us a purchase price that we found very attractive and we thought it was well-timed. We chose to do that independent of any Acadian strategy. But as BIP has announced, starting at the end of July in 2012 where they announced that they were focusing on assets that had higher return attributes than timber. BIP was really no longer suited as a timber related growth vehicle, and we believed that many Acadian investors would like to have seen Acadian grow, would like to have seen Acadian be faced with broader opportunities and certainly with improved liquidity. So, this strategy has evolved, I think to meet all of those needs, among others.

ANDREW KUSKE:

Okay, that's helpful. And then I have two questions left, if I may. The first one is, given that you aren't going to have a broader scope, do change the name from Acadian to Brookfield Global Timber or Brookfield Timber Fund or something along that lines?

REID CARTER:

That will remain to be seen. It is Acadian for now.

ANDREW KUSKE:

Okay. And then the last question just on the operations, just in the last month, have operations in July, were they really affected by a lot of the wet weather that we saw in the northeast?

REID CARTER:

They were in late June, early July, but I would say have stabilized. I think July in the end will have proven to be a pretty average month, maybe on the somewhat wet side of an average month. But we are still early in the quarter, and we aren't ringing any alarm bells at this time. That's for sure.

ANDREW KUSKE:

Okay thank you so much.

REID CARTER:

Thank you.

OPERATOR:

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

REID CARTER:

I would like to thank all of you your interest in Acadian. Clearly, we have made some announcements that we believe are going to be very beneficial to Acadian's future and that we look forward to reporting on our progress in coming quarters. Once again, thanks very much, and enjoy the rest of your day.

OPERATOR:

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