



ACADIAN TIMBER



Acadian Timber Corp. Second Quarter 2016 Conference Call Transcript

Date: August 4, 2016

Time: 10:00 AM PT

Speakers: **Mark Bishop**
President and Chief Executive Officer

Wyatt Hartley
Chief Financial Officer

OPERATOR:

Thank you for standing by, this is the conference operator. Welcome to the Acadian Timber Corp Q2 2016 Conference Call & Webcast. 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 * then 1 on your telephone keypad. Should you need assistance during the conference call you may signal an operator by pressing * and 0.

I would now like to turn the conference over to Mark Bishop, President & CEO. Please go ahead.

MARK BISHOP:

Thank you operator and good afternoon everyone. Welcome to Acadian's second quarter conference call.

As you will have noted in the announcement included in our second quarter press release, effective August 3, after three years as Acadian's Chief Financial Officer, Erika Reilly has left Acadian to take on new responsibilities within Brookfield Asset Management. In addition Brian Banfill, a member of the senior management team at of Acadian since his initial appointment as Chief Financial Officer in 2010, has left the position of Chief Operating Officer. He will continue to be involved in the Brookfield timberlands platform.

We have been very fortunate to have had such hard working, competent and diligent senior managers in Brian and Erika. On behalf of the entire Acadian team I want to personally thank them for their dedication and significant contribution to Acadian and wish them all the best going forward.

Effective August 3, Wyatt Hartley has replaced Erika Reilly as Acadian's Chief Financial Officer. Mr. Hartley has been a key member of Brookfield's infrastructure team for the past six years and has held a number of senior finance roles within the organization, including roles where he has an opportunity to gain significant exposure to our timberlands platform. Mr. Hartley is a Chartered Accountant and worked at one of the big four accounting firms prior to joining Brookfield. I am completely confident that Acadian will remain in very competent hands. Wyatt's transition to the CFO role will be immediate and seamless.

So with that introduction, I will pass the call over to Wyatt to proceed.

WYATT HARTLEY:

Thank you Mark and good afternoon everyone.

Before we get started, I would like to remind everyone that in responding to questions and talking about our second 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, which are available on SEDAR at Sedar.com and on our website.

I will start by outlining the financial highlights for the second quarter. Then Mark will provide comments about operations, market conditions, and our outlook for the remainder of 2016.

Acadian's operations performed well for the second quarter and continue to benefit from strong New Brunswick markets. Continued improvement in hardwood markets and favorable mix drove our weighted average log selling price up 11% compared to the prior year. While operating conditions were impacted by an extended annual spring thaw, which caused much of our harvest and hauling infrastructure to be inoperable for a longer than normal period, we anticipate a return to more typical harvest levels for the remainder of the year. For the first six months of 2016 our payout ratio was 94%, in line with our long-term target of 95%.

Acadian generated net sales of \$13.7 million in the second quarter compared with net sales of \$15.4 million in the same period last year. Higher selling prices for our products were more than offset by lower sales volumes as the prior year benefitted from better harvesting conditions due to extended winter weather and a shorter spring thaw.

Adjusted EBITDA for the second quarter of \$3.3 million was down from \$3.8 million in the comparable period due primarily to the aforementioned decrease in sales volume. Our Adjusted EBITDA margin of 24% was in-line with the same period in 2015 as the benefit of improved pricing was offset by higher costs that were mainly attributable to longer average haul distances.

Moving into segment results, net sales at our New Brunswick operation for the second quarter totaled \$11.7 million compared to \$13.1 million for the same period last year driven by a 25% decrease in sales

volume. Harvest volumes were impacted by an extended spring thaw and were lower than the same period last year, which had favorable winter operating conditions extending into the second quarter. The lower sales volume was partially offset by improved selling prices across all products. The weighted average log selling price was \$71 per m³ in the second quarter of 2016, a 13% increase from \$63 per m³ in the same period of 2015.

Adjusted EBITDA for the second quarter was \$3.9 million, compared to \$3.5 million in the second quarter of 2015, with our Adjusted EBITDA margin increasing to 33% from 26% in the prior year due to the benefit of higher realized log prices partially offset by a 6% increase in variable costs that were mainly attributable to longer average haul distances.

At the Maine operation, net sales for the second quarter totaled \$1.9 million compared to \$2.3 million for the same period last year. Reduced sales volumes across all products and weaker U.S. dollar selling prices due to weaker markets for softwood pulpwood were partially offset by the positive impact of the stronger U.S. dollar. In Canadian dollar terms, the weighted average log selling price was \$75 per m³ in the second quarter of 2016, a 3% decrease from \$77 per m³ in the same period of 2015. In U.S. dollars, the weighted average log selling price was \$58 per m³ a 7% decrease from last year.

Adjusted EBITDA for the second quarter was a loss of \$200 thousand, compared to earnings of \$400 thousand in the same period in 2015, with the Adjusted EBITDA margin decreasing to (9)% from 17% in the prior year reflecting a weaker U.S. dollar log selling price and lower sales volumes.

Looking at our balance sheet, Acadian's cash position continues to be strong with \$19 million of cash on hand at the end of the second quarter. This represents a \$1 million increase from year end as our operations generated free cash flows in excess of dividends paid. Furthermore, our financial position is solid with net liquidity of \$95 million, including funds available under Acadian's Revolving Facility and our stand-by equity commitment with Brookfield.

During the quarter we declared a dividend of 25 cents per share, consistent with the prior quarter and up 11% from prior year.

I will now turn the call over to Mark.

MARK BISHOP:

Thank you Wyatt.

During the quarter, Acadian's operations experienced five recordable incidents, one involving an employee and four involving a contractor. Both incidents resulted in lost time, but the resulting injuries were relatively minor in nature and the individuals have already or are expected to make a full recovery. We continue focus on maintaining our strong commitment to safety performance.

As Wyatt mentioned, Acadian's weighted average realized log selling price during the second quarter increased 11% year-over-year as stronger prices and higher hardwood log proportion in New Brunswick and the positive impact of the weaker Canadian dollar on U.S. dollar-denominated sales more than offset weaker prices for softwood in the Maine market. Softwood sawlog markets remained relatively stable, with a 1% increase in softwood sawlog prices relative to the second quarter of 2015. Hardwood sawlog markets were strong, with weighted average selling prices increasing 18%, primarily reflecting strong pricing from the New Brunswick operations. Selling prices for hardwood pulpwood increased 6% year-over-year while softwood pulpwood decreased 9% year-over-year. Continued strength in hardwood pulpwood markets was partially offset by weaker softwood pulpwood markets in Maine. Biomass markets remained strong, with margins increasing 56% year-over-year, primarily reflecting an increase in the proportion of sales to export markets.

US economic growth has been somewhat uneven over the first half of the year, but the economy continues to expand, led principally by consumer spending. Wage growth is accelerating as the labor market continues to move toward full recovery with employment openings remaining close to record highs. Reflecting post-Brexit related volatility, elevated downside risks to the global economies and strengthening US dollar, expectations for the current low interest rate environment have been extended. These fundamentals continue to support an on-going gradual recovery in US housing starts and strong residential improvement activity. Consensus expectations continue to call for a 10% year-over-year improvement in total housing starts for 2016 and over 12% for 2017. Industry forecasters predict that U.S. lumber and sawtimber demand will need to continue to grow at over 5% per year over the next few years to support expanding domestic construction needs.

Uncertainty over the lumber pricing environment remains heightened with the Canada-U.S. softwood lumber dispute moving towards the end of the "cooling-off" period in October 2016 and paving the way

for potential imposition of countervailing duties. While the timing, and ultimately the terms of any settlement of this latest dispute are unclear, there is no evidence to suggest treatment of Canada's maritime lumber producers during the current dispute will be materially different from past experience where the region experienced lower relative countervailing and anti-dumping duties than the rest of Canada during the litigation period, followed by export tax and quota exemption during the 2006 Softwood Lumber Agreement. This differential treatment is due primarily to the significantly greater proportion of their log supply sourced from private lands in the Atlantic region relative to the rest of Canada.

Almost all regional sawmills continue to operate on full shifts and appear to be carrying inventories at typical seasonal levels. In isolation of any imposed duties, softwood lumber prices are expected to improve modestly on a full year-over-year basis. While softwood sawlog markets for New Brunswick remain steady, Maine sawmills continue to face challenges with demand for softwood sawmill residuals. Hardwood sawlog markets remained strong and steady during the second quarter and are expected to remain near current levels. Strength in hardwood pulpwood pricing has persisted, although Acadian is experiencing longer average haul distances to maintain shipment levels, resulting in modest margin impact. Biomass markets remain stable in New Brunswick, with Acadian able to benefit from ongoing growth in export markets. Maine biomass markets are still in transition following the idled pulp mill and biomass generator capacity over the past year. However, markets have seen some stabilization following recent State sponsored assistance which saw the re-start of a portion of the previously idled biomass generation capacity.

In conclusion, we would like to take this opportunity to remind our investors that Acadian benefits from a strong balance sheet, diverse markets and a strong operating team that remains committed to continuously improving our financial and operating performance. We thank you for your continued support of Acadian Timber Corp.

That concludes our formal remarks and we are available to take any questions from participants on the line. Operator...?

OPERATOR:

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

ANDREW KUSKE:

Thanks. I guess, the first question, it's to you, Mark, just on the Management shuffle. This is pretty consistent with what you guys have done in the past so we really shouldn't read anything into that, really beyond just the typical rotations. If I go back, say, 10 years ago, you know, Bryan Davis was CFO at that point in time and now the CFO of BPY so this is a fairly typical rotation from how you've done things in the past.

MARK BISHOP:

Thanks, Andrew. Yes, no, you're exactly right and I appreciate your comment. I know, your coverage of BIP probably gives you, relative to some of the other analysts, a little bit more insight into Brookfield and how the Company is operated. But you're right, following Bryan Davis, Joe Cornacchia was CFO, and Joe moved onto other opportunities within Brookfield, and clearly that's the case with Brian and Erika.

The infrastructure platform within Brookfield, as you're probably aware, has broadened into several different segments. The Transportation segment is now established in Vancouver, and Erika has moved into a role within that group, and it's a great opportunity now that that team is established here was a natural transition. Clearly, now we've moved Wyatt in—something I'm very excited about, Wyatt's a North Shore, Vancouver boy and now is obviously based in Toronto, but we're very happy to have him part of the Team. He's very familiar with timber, so it's another natural transition to provide others within Brookfield the public company experience at a senior level.

So, that's exactly what happened and I wouldn't read, really, anything more into it than that.

ANDREW KUSKE:

Okay, that's very helpful. Then maybe just more specifically on New Brunswick, if you could give us any update on just the general regulatory environment in New Brunswick? I believe, a month or so ago we had a group of aboriginals launch a lawsuit against the government, and then just finally, if you've had any infestation issues with budworm or anything else in the stand?

MARK BISHOP:

Right. On the regulatory front, we're really not seeing anything dramatically changing. The government is always looking at tweaking rates under their Crown Services Agreement and those changes move

very, very slowly and have a very small impact on us, obviously, and how we operate. We, over time, will adjust our level of staffing and activities around those rates, but really there's not any major impact to us at this time.

On the aboriginal front, again, no impact on us. Clearly the government is seeking opportunities to accommodate in various ways, but I would say there's no visibility on any impact to our operations at this time at all, at least not that I'm aware of.

The Spruce budworm; there was some media coverage of a flight in late July that crossed from Quebec into the north of Maine and also touched down in Campbellton, in an area about 50 kilometres to 60 kilometres away from our operations. So it was somewhat of a spectacular event and an unusual event, given the sort of density of the flight. But we continue to monitor it, and as you're probably aware, we participated in the program sponsored by the New Brunswick government as most or all of the producers do and many of the public do, in terms of sampling and alerting the officials and industry participants as to where infestation and defoliation activity looks like it's rising.

But we don't have any major impact in our operation at all. We've seen a little bit of a higher defoliation rate but really, the nearest episode or infestation is about 60 kilometres away and the government program is fairly intensively attacking that with Mimic aerial spray activity. We continue to build into our expectations, our Management expectations, the activity around harvesting mature fir and spruce in any areas that would be impacted, but at this point we're really not seeing anything to be overly concerned about.

ANDREW KUSKE:

Okay, that's very helpful, thank you.

OPERATOR:

As a reminder, if you have a question, please press star, then one.

The next question is from Hamir Patel of CIBC Capital Markets. Please go ahead.

HAMIR PATEL:

Hi, good morning. Mark, it looks like Brazil is soon going to lift some of the foreign land ownership restrictions that I guess have been in place there for the last 15 years. Do you think that might open up some new sort of growth opportunities for Acadian?

MARK BISHOP:

Thanks, Hamir. Well, I guess, on the first part of your comment, I guess we're somewhat cautious towards what any of the latest kind of announcements or discussions might indicate, because we've seen iterations of this before. Certainly, we are expecting to see at some point some better conditions for foreigners to invest in Brazil. Whether it makes it any easier really comes down to finding the attractive investment opportunities in Brazil. We'd like to think that there will continue to be attractive opportunities of scale.

As you know, we're in the market today; we continue to have a good visibility on our pipeline. How Acadian will participate in any of those really does depend on several factors, including the foreign exchange regulations, but also on the profile of the asset that we're looking at, and ultimately the valuation on whether it's appropriate for Acadian or not.

So, as again you're aware, Brazil's not the only region outside of North America that we consider having Acadian participate in investments, but it's certainly the area that we're most active in today outside of North America. I hope your optimism is well-founded and that we do see better opportunities, but it's too early to really say that we should get excited about Brazil for Acadian yet.

HAMIR PATEL:

Great. Thanks, Mark. That's all I had, I'll turn it over.

OPERATOR:

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

PAUL QUINN:

Yes, thanks, good morning. It's been a busy one, so I might have missed some of the stuff. But just on the Management shuffle, I can understand the CFO change, that's pretty normal. But Brian's departure from COO level, is that—what's the reason for that, or is that a belief on your part that you don't need that position and it's just a cost-cutting move from Acadian?

MARK BISHOP:

I would say it's sort of a mix of both, Paul. As you're aware, Brian's—the COO role was added a couple of years ago at the same time we shifted Erika into the CFO role. He's been involved with Acadian for several years, he continues to be on the Brookfield Timberlands Team, so I wouldn't look at it as overall a removal of that resource at this time, but it was and it has been for a period of time, I would say, more than we needed at Acadian at the time. But we all work on a Team basis and we can draw on the resources whenever we need them.

It isn't really a significant move in terms of the actual time involved and Bryan's contribution to Acadian, and with Wyatt coming in as well, some of that work is transferred to Toronto with Wyatt and his Team, so there is a few other people behind Wyatt that are now involved. So it's probably not quite as significant a move as it may appear.

PAUL QUINN:

Okay, and not to put down the Senior Management, but it's really that Operational Management strength that really gives Acadian its power. Is there any changes on that side?

MARK BISHOP:

Any changes in Acadian's Operational Management?

PAUL QUINN:

Yes.

MARK BISHOP:

Not at all. Luc is still running the New Brunswick operations and Marcia, the Maine operations. I believe you've met them both, but we have very strong leadership and very deep capabilities in their Teams in both locations.

PAUL QUINN:

Right, okay. Just lastly, you probably made a comment but I was on another call, but just overall North American timberland markets and activity levels, we haven't seen that much, but apparently there's lots

of deals out there in the pipeline that should close in Q3 and Q4. Is that your expectation, and can you comment on what you're seeing in terms of pricing?

MARK BISHOP:

Yes, you're right, Paul. This year is shaping up to be a stronger year, transaction-wise, than last year. In the typical or the larger regions, Pacific Northwest and the U.S. South in particular, but some of the other smaller regions as well. I think if you read some of the industry reports that follow timberland activity, you will see that there's several pending transactions in these areas.

We're continuing to see the same kind of transaction market conditions and processes, quite frankly. So a lot more of these processes are one round processes, still quite widely attended is our understanding.

It can be difficult to read into actual valuations, as you're probably aware, based on the lack of visibility that outsiders may have to inventories that are part of, typically a significant part of a lot of these transactions. But valuations continue to be, I would say, wholesome, and discount rates continue to be very aggressive.

PAUL QUINN:

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

MARK BISHOP:

Okay. Thanks, Paul.

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:

Thanks operator and again thank you all for attending the call. I know it's a busy time with several other companies reporting, so I appreciate your attention and hopefully you can enjoy the rest of the summer after reporting season. Thanks again.



OPERATOR:

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

