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# **Acadian Timber Corp. 2014 Third Quarter Results Conference Call Transcript**

**Date:** Tuesday, October 28, 2014

**Time:** 1:00 PM ET / 10:00 AM PT

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

**Brian Banfill**  
Chief Operating Officer  
and Acting Chief Financial Officer

**OPERATOR:**

At this time, I would like to turn the conference over to Mr. Reid Carter, Acadian's President and Chief Executive Officer. Please go ahead Mr. Carter.

**REID CARTER:**

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

As many of you aware, Erika Reilly, Acadian's Chief Financial Officer, is currently away on maternity leave and I am pleased to report that she and her new daughter are both doing very well. Erika is expected to return in approximately six months. During her absence Brian Banfill, Acadian's Chief Operating Officer, has assumed the CFO duties for Acadian. Brian is very familiar with this role as he was Acadian's CFO for several years prior to Erika taking over the CFO duties in the summer of 2013.

Brian will now proceed with the formal remarks then I will add my comments and take your questions. Brian...

**BRIAN BANFILL:**

Thanks Reid. 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](http://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 third quarter financial and operating performance as well as our outlook for the remainder of 2014 and into next year, 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, 2014, and other filings of Acadian with securities regulatory authorities, which are available on SEDAR at [www.sedar.com](http://www.sedar.com) and on our website.

I will start by outlining the financial highlights for the third quarter. Then Reid will provide comments about our operations, market conditions, business development activity and our outlook for the remainder of this year and into 2015.

Acadian's operations performed very well in the quarter delivering the second highest third quarter Adjusted EBITDA since the inception of the company. Good summer operating conditions and solid customer demand for our key products led to higher sales volumes and prices.

Net sales for the third quarter totaled \$21.6 million dollars, a \$2.8 million dollar increase compared to the same period in 2013. The year-over-year increase in net sales reflects a 7 percent increase in sales volume and a 9 percent increase in the weighted average log selling price. The majority of the sales volume and selling price improvement occurred in Acadian's higher margin spruce-fir sawlog sort. This positive top line performance with minimal per unit cost increases drove Adjusted EBITDA up to \$5.7 million dollars, a \$1.9 million dollar or 50% improvement over the prior year. It also boosted the Adjusted EBITDA margin which climbed to 26 percent from 20 percent in the same period last year.

After all of that positive news it seems strange to report a net loss for the quarter, but non-cash items including a larger negative fair value adjustment due to higher harvest volumes and a year-over-year difference of \$5.4 million dollars in the unrealized exchange loss on our U.S. dollar long-term debt resulted in a net loss of \$0.6 million dollars or 3 cents per share. This compares to net income of \$3.4 million dollars or 20 cents per share in the prior year.

Like Adjusted EBITDA, free cash flow was up \$1.9 million dollars from the third quarter of 2013 to \$4.7 million dollars resulting in a payout ratio of just 74% compared to 123% for the same period last year.

I will now briefly review the segmented results for Acadian's New Brunswick and Maine operations. Net sales from our New Brunswick operation for the third quarter totaled \$16.3 million dollars compared to \$13.6 million dollars for the same period last year. The increase reflects more favourable operating and market conditions.

The weighted average log selling price across all log products was \$61 dollars and 55 cents per cubic metre in the third quarter of 2014, up 10 percent compared to the same period last year. This year-over-year increase in the average log selling price reflects improved selling prices for most products and a higher proportion of sawlogs in the sales mix and, to some degree, location of the harvest area.

Costs for the third quarter of 2014 were \$11.8 million dollars as compared to \$10.9 million dollars in the comparable quarter of 2013. The increase in total costs was due to higher harvest volumes of primary products. Variable costs per cubic metre were unchanged from the prior year.

Third quarter Adjusted EBITDA for the New Brunswick operation was \$4.5 million dollars, up \$1.8 million dollars compared to the third quarter of 2013, again reflecting higher sales volumes and improved prices. Adjusted EBITDA margin increased to 28 percent from 20 percent in the prior year.

Switching to the Maine operation, net sales for the third quarter of 2014 were up modestly year-over-year, increasing \$0.2 million dollars to \$5.3 million dollars. The benefits of improved prices for all of our products and the stronger U.S. dollar were mostly offset by the lower total sales volume. The weighted average log selling price in Canadian dollar terms was \$69 dollars and 95 cents per cubic meter in the third quarter, a 10 percent increase from \$63 dollars and 59 cents per cubic meter in the same period of 2013. Weighted average log selling prices in U.S. dollar terms increased 5 percent year-over-year.

Costs for the third quarter were \$3.8 million dollars, compared to \$3.7 million dollars during the same period in 2013. The impact of lower sales volumes was more than offset by increased road construction and maintenance activity and the adverse foreign exchange impact on variable costs per unit. Variable costs per unit in U.S. dollar terms decreased 1 percent.

Adjusted EBITDA for the Maine operation was in line with same period of the prior year at \$1.5 million dollars. Improved log prices increased the Adjusted EBITDA margin to 29 percent from 28 percent in the prior year.

Moving away from operations and over to our cash position...at the end of the third quarter Acadian had cash on hand totaling approximately \$12.9 million dollars, which is \$4.3 million dollars higher than the cash balance at the same time last year. The primary drivers of the increased cash balance include the generation of \$2.7 million dollars of free cash in excess of dividend payments over the last twelve months and a short-term decrease in working capital as a result of delayed stumpage billings on our Crown Land operations. The cash balance is up \$5.0 million dollars from the end of the second quarter of 2014 reflecting the free cash flow generation in the quarter and the decrease in working capital.

As at September 27, 2014, Acadian had net liquidity of \$77.7 million dollars, including funds available under Acadian's Revolving Facility and our stand-by equity commitment with Brookfield. The balance sheet remains strong leaving Acadian well positioned for the future.

During the quarter we distributed \$0.21 per share to our shareholders, a dividend that is in line with previous quarters and supported by our steady performance.

I will now turn the call back over to Reid.

**REID CARTER:**

Thank you Brian.

During the quarter, Acadian's operations experienced one recordable incident involving employees and four recordable incidents among our contractors. While none of the incidents were serious in nature, mostly slips and falls, several did result in lost time. While we are somewhat disappointed with this performance, we will certainly continue to work with our contractors and employees to ensure the highest standards of workplace safety are maintained.

We are pleased to note that in late September, the Maine operation successfully completed a surveillance audit under the Sustainable Forest Initiative or SFI with an impressive finding of no non-conformances and I think more importantly, no opportunities for improvement.

Acadian's weighted average log selling price for the third quarter increased 9 percent year-over-year due to higher softwood and hardwood sawlog and higher hardwood pulpwood prices, a stronger U.S. dollar and a higher value sales mix. Stronger markets drove an 11 percent increase in softwood sawlog prices relative to the third quarter of 2013. Prices for hardwood sawlogs and pulpwood also improved, each increasing by 9 percent over the same period last year. Softwood pulpwood pricing has remained stable, however, the number of groundwood pulp customers operating in the region continues to decline. Biomass gross margin was down 20 percent year-over-year with the majority of the change coming from the New Brunswick operations where a smaller proportion of the volume was sold into the higher margin export markets than in the prior year.

Acadian's financial outlook for the remainder of 2014 and through into 2015 remains very positive. We believe U.S. consumers' net wealth is steadily improving and fewer homeowners are in distress as indicated by the steady decline over the past few years in delinquency rates, foreclosures and the share of mortgages in a negative equity position. This is expected to support continued increases in housing starts through 2016 and this optimism, along with supply-side challenges and continued strong exports, should keep North American lumber prices well above historical norms. Firm lumber prices are expected to encourage Acadian's key solid wood customers to continue to operate at full capacity and, as such, we expect to see ongoing strong demand for softwood sawlogs in the region.

In addition to our positive outlook for softwood sawlogs, markets for hardwood sawlogs have been very positive and are expected to remain stable. Demand and pricing for hardwood pulpwood continues to be very strong. Acadian has been successful in selling all of its softwood pulpwood production, but this market continues to be challenged by the closure of the . Fortunately, this product represents only a small portion of Acadian's sales and an even lower proportion of our operating earnings. Biomass sales have begun to improve as the reduction of logistical challenges previously constraining exports from our New Brunswick operations have been largely relieved.

On the business development front, continue to actively pursue opportunities in support of Acadian's growth strategy in the U.S., Australasia and South America. We are witnessing increased transaction activity in all of these markets and worked on several opportunities in the United States, Brazil, Chile and New Zealand during the third quarter. Our goal is to build a balanced portfolio between current cash flow and capital appreciation with the ultimate focus being on our long-term total return target of 10 to 12 percent. Acadian's shareholders can be confident that we will stay focused and disciplined in our search for growth.

In closing, we are pleased with Acadian's operating performance year-to-date and look forward to continued improvement in Acadian's performance in the coming quarters.

We thank you for your continued support of Acadian.

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

**OPERATOR:**

Thank you ...The first question is from Paul Quinn of RBC Capital Markets. Please go ahead.

**PAUL QUINN:**

Yes, good morning or good afternoon, wherever you are. Just an impressive quarter, so congratulations on that and just one question in that we've seen a number of North American timberland transactions over the last quarter or so and I just wanted your comments on the relative valuation metrics and just your ability to be competitive in the current marketplace.

**REID CARTER:**

Well, I don't think things have changed too much since we commented in the last quarter. The US market in particular continues to be just exceptionally competitive, as we saw with Potlatch's announcement of the acquisition of 200,000 acres from RMS and the increases in deal flow. We're certainly seeing what we would consider to be very aggressive underwriting in the US in particular, but of course we've seen it in New Zealand and to a lesser degree—not so much less aggressive, but fewer examples, in Australia. In Latin America it's quite interesting right now. The capital markets are much less open, in fact, in many ways closed. Many of the larger timberland owners are integrated with their manufacturing businesses and there hasn't been much history of them disintegrating their business but certainly there's a lot more interest in exploring that, in Chile and Brazil and possibly in Uruguay. Although I believe you really have to be very patient and more importantly disciplined to get things done in this region. But we would suggest that cap rates are most certainly as low as we've ever seen them and that would be, I think, associated with pretty aggressive stars aligned, underwriting assumptions.

**PAUL QUINN:**

Great, thanks. Best of luck going forward.

**REID CARTER:**

Okay. Thanks.

**OPERATOR:**

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

**DAVID QUEZADA:**

Thanks. Hi guys. I guess just a quick question on—you hear a lot of stuff in the news about potentially declining demand for wood fibre in Asia. Not that that's necessarily your view or not but do you—should that come to pass, do you see that impacting log prices in New Zealand or Latin America or Australia, I guess?

**REID CARTER:**

Well certainly we saw a pretty significant inventory build up, probably just a little over 5 million cubic metres in China at the end of the first quarter of this year and that put a lot of the agents offside, the traders in Asia and particularly China and it's taken a long time for inventory rebalancing to really try to clean up that market. We've seen—after a pretty significant price decline, particularly for New Zealand pruned and unpruned radiata logs, probably came off both in absolute and percentage terms the most. The bottom was probably in early August and we've seen 5 - 10% price increases since then. I think that prices got ahead of themselves; certainly supply was getting ahead of itself. We really need to have a US market, and an Asian market to be a little less volatile but, you know, in our view we are believers in Asia. While we expected China to slow as it continues its adjustment to more of a service economy model from a heavy capital investment model the need for infrastructure is expected to continue. Most of the timber and lumber that is sold in Asia—not Japan but in China and Korea, and we expect in the future in countries like India, it's really going to be used for civil construction such as concrete forming and we believe there will continue to be very, very heavy demand for that over the long term.

So certainly, I mean this is a commodity; it's going to be volatile but we think that that will help tension Australasian, possibly Chilean, and certainly North American and Russian timber and lumber market opportunities.

**DAVID QUEZADA:**

That's very helpful. Thank you.

**REID CARTER:**

You're welcome.

**OPERATOR:**

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

**ANDREW KUSKE:**

Thank you. I guess the question's for Reid and just continuing on the acquisition theme. What are you seeing just from a standpoint in Brazil in particular? Because there's been a pretty big devaluation of the Real versus the US dollar and obviously we've just had the election results earlier in the week. Like I guess what are your thoughts about that market in particular and is it becoming a much better place for you to invest on a longer term basis than say it was three to six months ago?

**REID CARTER:**

Well, Brazil's a very big country and timber in Brazil sells into very different markets as you move across the country. You know if you're in the southeast or Parana or Santa Catarina and you're in pine areas, that's used in some civil construction: a lot of furniture making, boards and panels, big MDF mills, and a very big export and domestic component to it. So in that more historic pine area, a weaker currency improves the competitive position of those timberlands. When you are in much of the eucalyptus for pulp production areas, most of those mills, despite having increasing fibre costs—at least in Real—are big enough, modern enough, and have low enough costs they're all going to run flat out and mostly are still very, very keen on adding capacity despite the significant capacity that has been added over the last two and half years.

So the demand for and the pressure on land prices and the like continues to be very, very strong, particularly in Mato Grosso do Sul. When you get up into the Minas Gerais and areas where much of eucalyptus growth is grown for charcoal production and that charcoal is used either in the pig iron or steel industries or industrial gases and silicon industries, they're really struggling with coking coal, met coal, iron ore and steel prices where they are really at absolute cyclical lows despite the weak Real, despite a very large domestic consumption of that product, there just aren't enough end consumers. On top of that, Brazil's experiencing a very significant drought which has really meaningfully impacted electricity prices, so many of the customers, whether they're big iron producers or, more importantly, some of the industrial gas and silicon producers have shut down and they're selling their power into the grid and are more profitable that way, so again reducing demand, so that part of the industry is really,

really struggling right now. The pulp side and I think the pine side are really running very well and the weaker Real will just reduce their costs and make their export margins stronger.

In addition, some of the biggest timber consumers in Brazil are struggling to find workers as unemployment rates are very, very low and many rural labourers may not be that skilled or have better employment opportunities. It's a big and complicated country and you need to pick your spots in it.

**ANDREW KUSKE:**

Okay, that's very helpful colour, and I guess just maybe just continuing on the theme of you mentioned in the quarter you looked at multiple things. Was that—were these transactions being looked at from the BAM funds and then you were looking at as a co-invest? Or is this just Acadian outright, I guess in conjunction with whether BAM was actually closing off anything or not?

**REID CARTER:**

Yes. I think the way we've explained it when we first came out with our growth strategy last summer in 2013 is that we were increasingly trying to create opportunities for Acadian to grow by co-investing alongside Brookfield Private Equity Timber funds with no duplication of fees or anything like this but just simply being able to participate more broadly rather than just regionally in timber opportunities. So, I think all of the opportunities we have explored to date were broader Brookfield Timberland acquisition initiatives related to our two active funds, a Brazil fund and a more global fund. We have probably never been busier in our timber underwriting in pursuit of growth, but as I said, we're just a little frustrated by the very, very aggressive underwriting that we're coming up against in many of these transactions.

**ANDREW KUSKE:**

Okay, that's very helpful. Then I guess a question either for yourself or for Reid—sorry, for Brian—just relating to New Brunswick. Is there any real update on just the forestry plan that was introduced, I guess, many months ago now and just is there an update on your view on what's happening in New Brunswick?

**REID CARTER:**

Well, you know, there was an election in New Brunswick back in September and we have a new Liberal government in New Brunswick, and the forestry plan was introduced by the Conservative government.

The government continues, in fact even today, to make announcements as to who the deputy ministers will be and I think there are six deputy ministers that have stepped down or are no longer in place that were announced today. So there's been considerable change but I think the government's official position is that they are reviewing the Forestry Plan. There hasn't been any new announcements since since before the writ was filed. To my knowledge, we still haven't seen any clear definition as to where the extra volume that was offered to a number of major licensees or manufacturers in exchange for significant capital investments. We really haven't seen more details on where and under what terms that will come from, and we haven't seen any changes in regard to the some of the conservation areas that are being modified or reduced. So, we're waiting for the government to get its team in place and look through this and make some plans and let us know where it stands.

**ANDREW KUSKE:**

Okay. That's exceptionally helpful. Thank you so much.

**REID CARTER:**

Yes, you're welcome.

**OPERATOR:**

The next question is from Mark Kennedy of CIBC. Please go ahead.

**MARK KENNEDY:**

Hi Reid and Brian. So I guess one question: just, you had a line in your release where you mentioned that your biomass sales have begun to improve in New Brunswick as a reduction of logistical challenges. Can you just expand on that a bit, and will that become a bigger line item in 2015?

**REID CARTER:**

Brian, do you want to start with that one or do you want me to take it? Either way.

**BRIAN BANFILL:**

No, I can take that. So the export facility is located up on the Gaspé on the St. Lawrence River and they were just—really, they were having operational problems in their facility in terms of being able to process the material and get it loaded onto ships and they've got all of that sorted back out so that

they're now more able to take the volume we can send towards them. I wouldn't expect it to have a significant impact in 2015 because it's not like we have a lot of extra volume of biomass waiting around to go out to customers. We are getting most of it processed, as it stands, so we might have a little bit of a backlog that's built up this year that we'll catch up next year but it won't be material and isn't a big contributor to EBITDA in any case.

**MARK KENNEDY:**

Okay. Then...

**REID CARTER:**

Mark, I think the hope, Mark, might be that that market might be at least aggressive enough that it helps tension the markets, so that we may see better pricing for biomass, but as Brian said, we wouldn't expect that to have a meaningful impact as biomass is such a small product for us.

**MARK KENNEDY:**

Right. Right, okay. Then as you look at your options for softwood pulpwood, you know, as paper demand continues to erode, what other options are there for that product?

**REID CARTER:**

Well, other than biomass, there really aren't great opportunities. I mean, as much as is possible you try to merchandise your logs down to the smallest top diameter and minimize that pulp volume. The New Brunswick crown has provided much of the relief right now over the last probably—I guess it's about two years where they have reduced or eliminated waste penalties for leaving softwood pulpwood in the woods, and so much of the softwood pulpwood on crown lands is left in the woods and that has reduced supply and allowed softwood pulpwood prices to be more or less maintained. Acadian also has a very strong relationship with Twin Rivers through our fibre supply agreement and they are one of our principal markets for softwood pulpwood. Softwood pulpwood doesn't travel very far as it doesn't have enough margin so it's not really something that we can ship to much more distant mills. So, you know, I think it either gets left in the woods if we don't have a margin opportunity for it, or it gets hauled to roadside and gets included in the biomass pile, but the key thing is it's a very small volume product for us. I think, Brian, it's about 6% of harvest volume?

**BRIAN BANFILL:**

Yes.

**REID CARTER:**

6 to 8% of our harvest volume and, close to 1% of our EBITDA.

**MARK KENNEDY:**

More of a rounding error than it is, you know...

**REID CARTER:**

It's a rounding error but, you know, it's always challenging to—to leave things in the woods is never a popular decision. Waste is always an issue and silviculture becomes more difficult and things like this, so in some stands they were heavy into softwood pulpwood; those are the ones you have to work to find some alternatives for.

**MARK KENNEDY:**

Right. Right, okay. No, that was it for me. Thanks.

**REID CARTER:**

Okay. Thank you.

**OPERATOR:**

This concludes the question and answer session. I will now hand the call back over to Mr. Carter for closing comments.

**REID CARTER:**

Well, once again, thanks very much for your interest in Acadian. We certainly appreciate you participating in our calls and paying attention to our releases, and we'll look forward to continuing strong performance in the fourth quarter and going into 2015. Thank you very much. Enjoy the rest of your day.

**OPERATOR:**

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