Acadian Timber Corp.
2014 Fourth Quarter & Year-End Results
Conference Call Transcript

Date: **Wednesday, February 11, 2015**

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.

BRIAN BANFILL:

Thank you operator and good afternoon everyone. Welcome to Acadian's fourth quarter conference call. Before we get started, I would like to remind everyone of the following:

This conference call is being webcast simultaneously through our website at www.acadiantimber.com where you can also find a copy of the press release including the financial statements.

Please note that in responding to questions and talking about our fourth quarter financial and operating performance as well as our outlook for 2015, 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 and on our website.

I will start by outlining the financial highlights for the fourth quarter. Then Reid Carter, Acadian's Chief Executive Officer, will provide comments about our operations, market conditions, business development activities and our outlook for 2015.

Acadian's operations performed very well again this quarter delivering the highest fourth quarter Adjusted EBITDA since the inception of the company. Weather conditions were typical of the fourth quarter with no severe storms or temperature variations impeding the operations and solid customer demand for our key products drove meaningful price increases.

Net sales for the fourth quarter totaled $22.5 million dollars, a $0.7 million dollar, or 3 percent, increase compared to the same period in 2013. The year-over-year increase in net sales reflects a 10 percent increase in the weighted average log selling price partially offset by a 3 percent decrease in sales volume. The selling price improvement was spread across all of the log products produced by Acadian with softwood sawtimber and hardwood pulp wood seeing the biggest gains at 12 percent and 10 percent, respectively. This positive top line performance, with minimal per unit cost increases, drove Adjusted EBITDA up to $7.5 million dollars, a $1.3 million dollar improvement over the prior year. It also boosted the Adjusted EBITDA margin which climbed to 33 percent from 28 percent in the same period last year.

Free cash flow was up $1.0 million dollars from the fourth quarter of 2013 to $6.3 million dollars resulting in a payout ratio of just 55% compared to 65% for the same period last year and, for the year as a whole, the payout ratio dropped to 78%.

We are pleased to announce that in recognition of this strong performance, along with an expectation of continued strong performance over the next several years, Acadian's Board of Directors has reached the decision to increase Acadian's target annual dividend by approximately 9 percent to 90 cents per share. This new target dividend will be effective in the first quarter of 2015.

As I'm sure all participants on this call noticed, Acadian's net income spiked upwards significantly in the quarter. The increase is primarily attributable to the pre-tax $53.1 million dollar adjustment of the fair value of Acadian's timberlands compared to an adjustment of just $1.6 million dollars in the prior year. This fair value adjustment also contributed $13.6 million dollars to the deferred tax expense in the quarter and increased Acadian's book value per share to $14 dollars and 86 cents. As we've suggested on previous calls, the timberlands acquisition environment in North America was highly competitive throughout 2014. Evidence from the timberlands transactions that were completed during the year led Acadian's independent third-party appraiser to use significantly lower discount rates in the discounted cash flow models used as the primary basis to value Acadian's timberlands than had been used in prior years. This change in the discount rate was the primary driver of the valuation increase. While the change is material, we are comfortable that the resulting values fairly represent the value of Acadian's timberlands.

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 fourth quarter totaled $15.6 million dollars compared to $16.7 million dollars for the same period last year. A 7 percent increase in the average log selling price was more than offset by the 10 percent decrease in sales volume. The volume decrease reflects the fact that sales volumes in the fourth quarter of 2013 were exceptionally strong due to the catch-up from below-normal harvest levels in the first three quarters of that year. The 2014 volumes are more typical of long-term expectations for the quarter.

The weighted average selling price across all log products was $64 dollars and 57 cents per cubic metre in the fourth quarter of 2014, up $4 dollars and 44 cents per cubic metre from the same period last year. This year-over-year increase in the average log selling price reflects improved selling prices for all products with an 8 percent gain in hardwood pulpwood leading the way.

Costs for the fourth quarter of 2014 were $10.2 million dollars as compared to $11.7 million dollars in the comparable quarter of 2013. The decrease in total costs was due to lower harvest volumes. Variable costs per cubic metre increased just 1 percent from the prior year.

Fourth quarter Adjusted EBITDA for the New Brunswick operation was $5.4 million dollars, up $0.4 million dollars compared to the fourth quarter of 2013, again reflecting improved prices offset by lower sales volumes. Adjusted EBITDA margin increased to 35 percent from 30 percent in the prior year.

At the Maine operation, sales volumes were up 20 percent year-over-year and Canadian dollar-based log selling prices jumped 15 percent. As a result, net sales for the fourth quarter of 2014 were up significantly year-over-year, increasing $1.9 million dollars to $6.9 million dollars. The weighted average log selling price in Canadian dollar terms was $70 dollars and 32 cents per cubic meter in the fourth quarter, up $9 dollars and 6 cents per cubic metre from $61 dollars and 26 cents in the same period of 2013. Weighted average log selling prices in US dollar terms increased 6 percent year-over-year.

Costs for the fourth quarter were $4.6 million dollars, compared to $3.5 million dollars during the same period in 2013. Higher sales volumes and the foreign exchange impact of the strengthening US dollar on the Maine Timberlands US dollar denominated costs drove the increase. Variable costs per cubic metre in US dollar terms climbed just 1 percent.

Adjusted EBITDA for the Maine operation was up 51 percent to $2.4 million dollars. Improved log prices increased the Adjusted EBITDA margin to 34 percent from 31 percent in the prior year.

Switching over from the operations to our cash position …at the end of the fourth quarter Acadian had cash on hand totaling approximately $12.7 million dollars, which is $4.1 million dollars higher than the cash balance at the same time last year. The primary driver of the increased cash balance was the generation of $3.8 million dollars of free cash in excess of dividend payments over the last twelve months. The current cash balance is $0.2 million dollars lower than the balance at the end of the third quarter of 2014 reflecting the free cash flow generation in the quarter and an increase in working capital as accounts payable balances in New Brunswick returned to more typical levels

As at December 31, 2014, Acadian had net liquidity of $79.9 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 was in line with previous quarters and more than 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 three recordable incidents involving employees and no recordable incidents among its contractors. The resulting injuries were minor, but one did result in lost time. We continue to work with our contractors and employees to ensure the highest standards of workplace safety are maintained and are pleased to report that the employees of the Maine operations have now completed 14 years without a recordable incident.

Acadian's weighted average log selling price for the fourth quarter increased 10 percent year-over-year. Realized Canadian dollar prices improved for all log products with gains of 4 percent for softwood pulpwood, 7 percent for hardwood sawtimber, 10 percent for hardwood pulpwood and 12 percent for softwood sawlogs. While a portion of the credit goes to the stronger U.S. dollar, base currency gains were realized for all log products except for softwood pulpwood in Maine.

Softwood pulpwood remains our most challenging product as the number of groundwood pulp customers operating in the region continues to decline, but as we've noted many times in the past, this product made up only 6 percent of total sales and 4.5 percent of our gross margin in 2014. Biomass gross margin was down 27 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 to the higher margin export markets than in the prior year.

Acadian's financial outlook for 2015 remains positive. We believe there are several reasons to be optimistic about the housing sector in 2015. U.S. job creation has been very strong with employers adding an average of 246 thousand jobs per month in 2014, marking the strongest growth in 15 years. The rate of housing price increases has moderated and mortgage rates have fallen back below four percent with a complimentary easing of credit standards. All of these factors should support increasing rates of household formation in 2015. These demand-side factors, combined with the declining overhang of foreclosure housing stock and the fact that vacancy rates of houses for rent and for sale are now back to normal levels, leaves the U.S. housing market well positioned for recovery. This expectation of a continuously improving U.S. housing market and continued strong exports should keep North American lumber prices well above historical norms encouraging Acadian's key solid wood customers to continue to operate at full capacity. 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 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 closures of the Great Northern Paper facility in Millinocket Maine and Verso's Bucksport Maine facility. We are hopeful that planned efforts to convert a portion of pulp production to softwood at the Old Town and Woodland mills in Maine might provide some relief from current market softness for this product. Biomass sales have begun to improve as the reduction of logistical challenges previously constraining exports from our New Brunswick operations have been relieved.

Brian has discussed the impact of the year-over-year increase in Acadian's appraised value on our book value, net income and income tax expense. In addition to his comments I believe its worth noting that, as is common practice and with the full support of Acadian's Board, we decided to change professional appraisal firms in 2014 to bring a fresh approach to the appraisal process. We held a formal RFP process resulting in the selection of a firm with many years of operating and appraisal experience in Acadian's operating area. Acadian's Board and auditors have exercised appropriate levels of professional skepticism in reviewing this new appraisal and have concluded that it thoroughly and competently reflects an appropriate value in today's highly competitive current timberlands marketplace. As you know, Brookfield, as Manager of Acadian, is very actively involved in North American and global timberlands markets and we would note that the increase in Acadian's appraised value is also consistent with our experience in the timberlands marketplace over the past few years.

On the business development front, we 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 continued work on several opportunities in the United States, Brazil, Chile, Uruguay and New Zealand during the fourth 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 very pleased with Acadian's exceptionally strong operating performance in 2014 and look forward to reporting continued strong 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:

The first question today comes from Paul Quinn of RBC Capital Markets. Please go ahead.

PAUL QUINN:

Yes, thanks very much, and great Q4 results. I have just a couple of questions. One, in terms of Q4, were the really strong results partly attributed to pulling forward some of the volume from Q1? Then, just when I take a look back at your reporting since when you started in basically 2005, sort of the split in EBITDA among quarters used to be a lot stronger in Q1 than the remaining quarters, and now it seems to be more balanced between Q1 and Q3, Q4, with Q2 lightest. Is there a material change in that, as well?

BRIAN BANFILL:

Hi Paul, it's Brian. To your first question, no, I don't think the Q4 results do represent any pulling forward of Q1 volume. It was a good operating period, we had good contractor productivity in the Maine operations, and it just allowed us to get a lot of volume moved. So, there should be nothing coming out of next quarter's results.

In terms of the kind of smoothing out of the quarterly results, I think most of what you're seeing over the past few years is—in 2012 and '13, we reported that we ran a vendor managed inventory program with the Twin Rivers Group and that did change the timing of cash flows between Q1 and Q2. In 2014, we ran a modified version of that which was actually helpful to us from a bottom line point of view, and helped them to manage their inventory as well, and they've asked us to run a similar program in 2015, so you will see again a bit of that pattern, where some of the Q1 EBITDA is being pushed over into Q2.

PAUL QUINN:

Okay, great. Thanks, Brian. Then, you've done a great job sort of managing cost inflation. It seems to be up only 1% year-over-year in both operations. Do you have kind of quick thoughts on the drop in oil prices, and I guess lesser drop in diesel, and how that's going to affect you in '15, and maybe not see any cost inflation across your operations?

REID CARTER:

Hi Paul, it's Reid. I think we're quite confident in our ability to keep costs down through 2015. At the very least, the decline in diesel prices will keep cost inflation pressures down as fuels are upwards of 20% of our total logging and hauling costs, so they're very significant. These low fuel cost will certainly take pressure off contractors pressing for better overall payments or pricing. Some of it is negotiated annually with our contractors. In some, we actually have fuel surcharges built in, where we'll actually see a direct decline in prices with declining fuel costs. But, I think, certainly, you'll see reduced cost pressures owing to lower fuel costs here through 2015. I don't know that we'll see lower overall costs. FX alone will move around costs, but certainly it will also move around our Canadian dollar translation of our Maine operation's US dollar income.

PAUL QUINN:

Okay, thanks for that. You referenced sort of increased softwood pulp production at Old Town and Woodlands. Maybe you could just sort of dive into that a bit. How much extra production do you expect? Is that going to shore up that softwood pulp market for you and is that material at the end of the day for you?

REID CARTER:

I'll do my best. The good news is we've been able to sell all of our softwood pulpwood so far, which has been a positive. Now, admittedly, it's been at lower margins. My understanding is the Old Town Maine mill is restarting, or has, actually, I think restarted just in this last month or two, and that they have an intention to use softwood pulpwood. I don't have any accurate understanding of what volume of softwood pulpwood they expected to consume. The Woodland Maine mill has the ability to swing between hardwood and softwood to some degree. To my knowledge they have done softwood trials over the last several years, and the number that I heard from our operating people is that they may be moving to something like 20%. The Woodland mill is a large mill by New England standards capable of producing approximately 440,000 tonnes a year. So, they could be using a substantial amount of softwood, but all of that to be verified, Paul. We'll try to dig around and send you a note.

PAUL QUINN:

Great. That's all I had. Best of luck.

REID CARTER:

Thanks.

OPERATOR:

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

ANDREW KUSKE:

Thank you. Good afternoon. I guess the question just relates—you know, you're on the path of dividend growth, which is positive, and the shares have re-rated, and I just want to get some kind of context on how you think about just the acquisition environment. I know, Reid, you gave some colour on it in your comments, but, in particular, how do you think about acquisitions now? With just some of the FX moves that we've seen globally, are you really tilting your bias towards Australasia and South America at this point and contrasting that with the US, if you think of the stock is and the Company is a Canadian company, and just with the FX moves that we've seen?

REID CARTER:

Certainly, we have always had a stated strategy of a target payout ratio of approximately 95%. We've got tremendous confidence in our business outlook over the medium term, and we've got a very strong balance sheet, so I don't think we have changed our strategy in terms of dividends. We've simply got the cash to support that dividend increase and confidence in the medium term to maintain it.

In terms of our business development, we have always expected that for Acadian to make any kind of transformative acquisition, it would require going to the market. We've got our line of credit, it gives us $60 million or $70 million of room for a smaller acquisition, but we had always envisioned going to the market creating an opportunity to present an enthusiastic view of what the acquisitions look like and the impact on repositioning Acadian and issuing shares to do so.

In terms of where we see opportunities, we have always felt that Acadian's growth could include Australasia and Latin America, but we've always felt that given that we're located today in New Brunswick and Maine, and we have a significant retail holding, I think that we can only move the investment thesis so far at any given point in time. I mean, I think to turn up—I may have said this in the last call—to come up with a large Brazilian transaction and tell Acadian shareholders that about two-thirds of their equity is in Brazil and one-third is in northeastern US and Canada, it might be a little more aggressive than those investors might expect. So, we're trying to find the balance of those outside North America jurisdictions and North American opportunities, and find the scale where we can dramatically improve Acadian's liquidity.

As we've stated in the past, we have private equity funds targeting Canada, the US, Brazil, Chile, Uruguay, New Zealand and Australia, that's our large Timber Fund V, and we have a second Brazil

Fund, and what we've offered Acadian is the ability to participate—effectively, a free option to participate in those acquisitions. So, I think what we would expect is that the Board will look at these opportunities as they come up and will decide, when they've got the right, I'll call it portfolio of opportunities, to be aligned with Acadian's current yield and within an appropriate rate of change in terms of geographic jurisdictions that would gain the support of Acadian's shareholders.

So, all that said, we're looking in all jurisdictions and we're trying to find the right opportunities for Acadian in a very, very competitive global timberlands marketplace. It's not just the US that's competitive, it's extremely competitive in Latin America and New Zealand, Australia, and, frankly, I'd suggest all global jurisdictions. It's very hard to be a first mover or early adopter in timberlands globally today.

ANDREW KUSKE:
Okay, that's very helpful. Then, I guess, just on the transaction pipeline, are you seeing just a better potential deal flow from funds that bought assets, whether they be five or 10 years ago and they're coming up to effectively termination dates or extension periods—that's one bucket—versus, say, corporate sellers of assets? Then, I guess the final two buckets are really private sellers that own timber and then governments that may have timber or effectively leases that they're looking to effectively dispose in the marketplace.

REID CARTER:
I would say we're seeing all of the above, in regard to financial sellers and maturing funds there is lots of anticipation. What we're seeing more than anything with those sellers, particularly, I guess, those that have separate accounts rather than commingled funds, is we're seeing a large number of very small transactions. So, when you look at the average transaction size, of approximately 53 transactions in the US last year, the average transaction size was approximately $25 million, and certainly when those funds made the acquisitions, I haven't done the math, but I would expect that they were much, much larger on average. So, we're seeing many of these small transactions.

We've also seen a big change in who the buyers have been. If you look at all US transactions between 2001 and 2012, TIMO's accounted for just under about 78% of the total transactions by value, with all others being the remaining 22%. If you look at it in 2013 and '14, you saw that the US publicly-traded Timber REITs, the Mormon Church and the Muckleshoot Indian Tribe in Washington accounted for about 80%, and TIMO's only about 20%. So, we've got a very broad group of potential buyers, the publicly-traded Timber REITs being much more aggressive, and, admittedly, a few large transactions such as our sale of Longview, and the MeadWestvaco sale to Plum Creek skew those numbers by value. But, as I say, the key thing has been a large number of very small transactions, which really isn't our key focus area as these are too heavily sought after. We participate in those larger transactions that we're interested in, but the transaction costs are high in the smaller offerings and there's a tremendous amount of competition in that price range.

ANDREW KUSKE:

Okay, that's exceptionally helpful. Thank you.

OPERATOR:

As a reminder, if you would like to ask question, please press star, then one on your touchtone phone.

Our next question comes from Rob Farquharson of Panoply Capital. Please go ahead.

ROB FARQUHARSON:

Thank you. Hi, Reid. It's Rob Farquharson. I just wanted to also ask about costs. Paul covered off the variable cost question. Maybe you could talk about the pleasant development in SG&A, how that happened and whether it's likely to be sustainable.

BRIAN BANFILL:

It's Brian, I can respond to that. I'll admit that some of last year's costs were due to us getting a little bit overly aggressive on accruals at year-end, so some of that, it's just an adjustment of that backing out, and we also had a couple of special projects going on in the year related to reviewing acquisition opportunities that increased some of the overhead costs, as well. I think the level that you're seeing in 2014 is reasonably reflective of where we'd expect to be, probably within 10% of what we would see as the long-term trend for admin costs, subject to periods where we were actually involved in acquisition opportunities.

ROB FARQUHARSON:

Okay, great. Thanks.

OPERATOR:

There are no further questions at this time. I'll now hand the call back over to Mr. Carter for closing comments.

REID CARTER:

Thank you, Operator, and thank all of you for attending our fourth quarter conference call. As always, we remain available if you have any further questions, and we look forward to what we believe will be a very successful 2015. Thanks again. Take care.

OPERATOR:

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