   

Acadian Timber Corp.

2011 Fourth Quarter and Year End Results Conference Call Transcript

Date: Tuesday, February 7, 2012

Time: 1:00 PM ET

Speakers:

Mr. Reid Carter
President and Chief Executive Officer

Mr. Brian Banfill
Senior Vice President and Chief Financial Officer

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

BRIAN BANFILL:
Thank you, Operator, and good afternoon, everyone. Welcome to Acadian's fourth quarter and year end conference call. Before we get started, I would like to call your attention to the following. The conference call is being webcast simultaneously through our website at www.acadiantimber.com where you can also find a copy of the press release including the financial statements.

Please note that in responding to questions and talking about our financial and operating performance and outlook for 2012, we may make forward-looking statements. These statements are subject to known and unknown risks and future results may differ materially. For further information on known risk factors, I encourage you to review Acadian's annual information form dated May 28, 2011 and other filings of Acadian with Securities Regulatory Authorities which are available on SEDAR at www.sedar.com and on our website.

I will start by outlining the financial highlights for the fourth quarter then Reid Carter, our Chief Executive Officer, will conclude with more general comments about our operations, market conditions and outlook for 2012. Acadian's fourth-quarter net sales decreased $5.4 million over the same period in 2010 to $15.1 million. The total fourth quarter sales volume of 284,000 cubic meters was 26% below the 382,000 cubic meters sold in the comparable period last year as harvest levels were reduced in the Maine operations by unusually wet fall weather and in the New Brunswick operations in order to balance harvest levels with sustainable, full-year harvest levels.

Acadian generated EBITDA of $3.8 million, or 25% of sales, which was $2.6 million lower than the amount generated in the fourth quarter of 2010. Prices across softwood and hardwood products were relatively flat year-over-year with a 2% increase in the average selling price across all products primarily attributable to the higher sales realizations from biomass as a greater proportion of this product was sold on a delivered basis during the quarter. A consistent pricing environment was offset by reduced sales volumes and a lower contribution from the Land Management Services Agreement.

Net income for the quarter was $11.4 million. Included in the quarter's net income was the $12.5 million positive fair value adjustment reflecting the results of recent independent appraisals of Acadian's timberlands, a $0.5 million unrealized foreign exchange gain on long-term debt and a $4.5 million deferred income tax expense. These expenses have not been included in our calculation of EBITDA or free cash flow and are not reflective of the operating performance of Acadian during the period.

Although EBITDA was $2.6 million lower than the amount generated in the fourth quarter of 2010, free cash flow fell by $3.1 million over the same period as the cash interest payments for the third and fourth calendar payments were made in the fourth fiscal quarter. This was partially offset by a $0.2 million reduction in quarterly interest costs as a result of the refinancing completed earlier in 2011.

I will now briefly review the segmented result for Acadian's New Brunswick and Maine operations.

Pricing across most of the New Brunswick Timberland's primary products was flat compared to the fourth quarter of 2010 with the only exception being softwood pulp logs where prices rose by 8% on good demand. The weighted average selling price was $48.09 per cubic meter in the fourth quarter of 2011 consistent with the $48.10 realized in the same period last year. Net sales were $11.3 million for the fourth quarter of 2011, down $5.1 million from $16.4 million in the same period of 2010. The drop is primarily attributable to a decrease in sales volume to 214,000 cubic meters from 301,000 cubic meters in the fourth quarter of last year.

Above average harvest volumes in the first three quarters of 2011 aimed at capturing market opportunities resulted in reduced harvest levels in the fourth quarter as we brought our full-year harvest into line with long run sustainable yield targets. Contributions from the timberland's Management Services Agreement also declined as a higher proportion of the harvest on Crown Land was carried out by sub licensees.

Sales volume in the fourth quarter was comprised of approximately 39% saw logs, 35% pulpwood and 26% biomass. This compares to 36% sold as saw logs, 46% as pulpwood and 18% as biomass in the fourth quarter of last year. Total costs for the fourth quarter were $8 million as compared to $10.8 million in the comparable quarter of 2010 reflecting the lower sales volume. Average variable costs per cubic meter were in line with the fourth quarter of 2010.

Fourth quarter EBITDA for the New Brunswick operations was $3.3 million, or 29% of sales, as compared to EBITDA of $5.6 million, or 34% of sales in the fourth quarter of 2010. EBITDA declined as a result of decreased sales volume and the decreased contribution from the Land Management Services Agreement, while the decline in EBITDA margin is almost entirely attributable to the decrease in the contribution from the Land Management Services Agreement.

Switching to our Maine Timberlands operations, net sales in the fourth quarter were $3.9 million on sales volume on 70,000 cubic meters, 7% below net sales of $4.1 million on sales volume of 81,000 cubic meters in the same period of 2010. Wet weather during the early part of the quarter constrained harvesting opportunities but improved pulp log prices brought the average realized U.S. dollar sales prices up 8%, largely offsetting the effective decreased sales volume on total net sales. The average selling price across all products in Canadian dollar terms was up 9% to $54.84 per cubic meter in the fourth quarter of 2011 from $50.44 in the same period last year.

Approximately 57% of Maine's volume was sold as saw logs, 40% as pulpwood and 3% as biomass. This compares to 57% sold as saw logs, 35% as pulpwood and 8% as biomass in the fourth quarter of 2010.

Total costs for the fourth quarter of 2011 of $3 million were $0.1 million higher than in the same period of 2010. Savings from reduced harvest volumes were offset by higher variable cost per cubic meter due to renegotiated contractor rates in 2011 and unfavorable foreign exchange rate movement. The drop in sales volume compared to the fourth quarter of 2010, along with higher per unit variable costs, caused EBITDA for the Maine operations to fall 27% to $0.9 million from $1.2 million in the prior year. EBITDA margin in the fourth quarter of 2011 was 23% of sales compared to 29% of sales for the fourth quarter of 2010.

There were no material capital expenditures in either of Acadian's operations during the fourth quarter of 2011 or 2010. At the end of the fourth quarter, Acadian had a cash balance of approximately $4 million, which is $3.3 million lower than our net cash position of $7.3 million at the same time last year, and is $3.7 million lower than our cash position at the end of the third quarter of 2011, primarily due to increased working capital. At December 31, 2011, Acadian had the full balance of US$10 million of available credit remaining on its revolving facility. Our balance sheet remains strong, leaving Acadian well positioned for the future. I will now turn the call over to Reid.

REID CARTER:
Thank you, Brian, and good afternoon. Our strong commitment to safety showed positive results throughout the year with Acadian maintaining its solid record of safety performance among employees and contractors. During the fourth quarter, we recorded just one minor safety incident among our contractors and none among our employees. We're particularly proud to report that the employees at our Maine operations have now completed 11 accident-free years. As you know, Acadian takes its commitment to safety very seriously as we believe the emphasizing and achieving a good safety record is an important leading indicator of success in the broader business. We remain very focused on safety performance and look forward to further improving our performance in future quarters.

I'm also pleased to announce that our Maine operations obtained certification under the Sustainable Forestry Initiative during the fourth quarter. The SFI standard is based on 14 core principals that promote sustainable forest management, including measures to protect water quality, biodiversity, wildlife habitats, species at risk and forest with exceptional conservation value. In achieving this certification, the Maine operations adherence to these standards was verified by a third-party audit. Our New Brunswick operations have been SFI certified since 2000.

Acadian's operations were challenged in 2011 by an unusually wet summer and fall. This resulted in a significant reduction in the operating window for harvesting and hauling operations, which exacerbated the already tight contractor availability in our Maine operations, ultimately leading to lower harvest levels and sales volumes. We've initiated strategies to address the contractor availability issue in Maine and expect these strategies to result in improved harvest levels in 2012.

Variable cost per unit for the full year of 2011 increased by 1% over 2010 due primarily to increases in fuel costs and higher contractor rates in the Maine operations.

These operating challenges during the year, along with the continued depressed log pricing environment, decreased free cash flow causing Acadian's payout ratio to climb to 111% for the year. Although this exceeds our 95% target level, we are comfortable with the current dividend rate as it continues to reflect our long-term view on sales volumes and a return to normalized prices.

Turning to the log markets, prices across Acadian softwood and hardwood products were relatively flat year over year with softwood and hardwood saw logs and hardwood pulpwood increasing 1% and prices for softwood pulpwood improving by 8%. Despite the regional markets for softwood saw logs being reasonable, realized selling prices for Spruce-fir saw logs in Acadian's New Brunswick operations remained weak as a result of the pricing terms and a fiber supply agreement for those operations that no longer reflected market pricing as a result of changing industry dynamics. Subsequent to the fourth quarter, Acadian agreed to amendments to this agreement that will ensure that contract prices are more reflective of market prices. These amendments will become effective in January 2013.

Markets for hardwood saw logs and specialty products improved slightly or were stable through 2011 with similar outlook for 2012. Global pulp and paper markets continued to be under pressure during the fourth quarter. However, pulp production appears to have come into alignment with demand resulting in more balanced inventories with today's stabilizing prices suggesting pulp prices may have bottomed. Acadian's pulp customers continue to have high operating rates, and markets per Acadian's pulpwood continue to be very positive providing a nice offset to the weaker softer saw log markets.

While the business environment continues to slowly improve, some of Acadian's significant softwood pulpwood customers have struggled with challenging market conditions for an extended period of time resulting in a weakening of their financial position. We recognize that the ongoing financial viability of these customers is dependent on their continued access to capital and an improved market environment. We continue to monitor these situations closely while exploring market alternatives for our logs in the event that sales for these customers decline, experience interruptions or come to an end.

Markets for biomass are expected to be stable, although weak, owing to a continued low power prices and very low prices for natural gas. Despite this challenging market environment, Acadian continues to be able to sell all of its biomass with stable price outlook. We expect 2012 to present improving although uncertain conditions and we are confident that Acadian will continue to demonstrate its adeptness in identifying and accessing market opportunities while keeping costs low.

We thank you for your continued support of Acadian Timber and remain confident in Acadian's long-term outlook and the quality of our asset base. That continues our formal remarks, and we're available to take any questions from the participants on the line. Operator.

OPERATOR:
The first question comes from Graham Meagher of TD Securities. Please proceed.

GRAHAM MEAGHER:
Hi, thanks, good morning, or good afternoon. Reid just wanted to get a little bit of color on the long-run sustainable yield at New Brunswick. You mentioned in the text and the comments that you had pulled back the Q4 harvest levels and it looks like the year ended around 1.1 million cubic meters. Is that the -- are we to think about the LRSY as about 1.1 going forward?

REID CARTER:
Yes, that's actually a little higher than the LRSY. As most of you know the long run sustained yield is a very long-term concept around the sustainable harvest level. We actually have some surplus mature volumes, particularly hardwood volumes, that would allow us to harvest above that for a period of probably a decade. But under our loan agreement, we also have restrictions on just how much we can harvest relative to that number. So it was in the New Brunswick operations only, it was really a matter of making sure that we remained in compliance with our loan agreement harvest levels.

GRAHAM MEAGHER:
Okay. And then on the Maine contractors, you had talked about initiating some strategies to alleviate some of the tightness in the market there. Can you expand a little bit on that?

REID CARTER:
Sure, so there's several things that went on. I mean contractors, owing to the bonded labor issue work, French Canadians, primarily French Canadian or Quebecois laborers haven't had ready access to work in the Maine

market which has been going on for the last couple of years. There's been a reduced number of contractors in Maine and when you put that together with the very wet weather, what happened is the few times when you could get on the ground and could reactivate your harvesting operations or hauling operations, everybody wanted the smaller number of contractors at the same time, so it exacerbated the whole situation.

So we've done a couple of things. We're actively seeking to include a greater number of contractors in our operations, but we have also increased our contractor rates, so there will be some cost creep in the Maine operations. And really that was to ensure that we were competitive with some of our peers. There hadn't been a large -- any real increase in contractor rates in the previous four years in the Maine operations, we had to make sure we're competitive. So I think dryer normal weather should relieve much of this issue, but having additional contractors and making sure that we're competitive in contractor rates really encompass most of our strategy.

GRAHAM MEAGHER:
Great, thanks. And then on the log yard inventory, in the last couple of quarters you had mentioned your customers were keeping relatively low inventories do you have a sense now on where they are as we enter into the winter months here?

REID CARTER:
I would say inventories are certainly not high, but they are normal, I think, for this time of year. Normally, as I think you're probably aware, Graham, during the first quarter, in preparation for spring breakup, we see very significant inventory building and that's really just starting right now. Typically January is sort of a normal consumption -- harvest what you consume, and then February, March significant building of inventory in preparation for an inability to harvest and haul during the April, May period. But no, I wouldn't say inventories were unusually low and they're certainly not high.

GRAHAM MEAGHER:
So your expectations for Q1 in terms of volume then you're feeling pretty good obviously if you can get the contractors in Maine?

REID CARTER:
Yes, I think we're off to a good start and we'd expect it to be a relatively normal first quarter.

GRAHAM MEAGHER:
Great. And then another question, you mentioned some market alternatives for the softwood pulp logs, assuming those are -- if they were not to go to some of your ground wood customers, what sort of strategies are you thinking of there?

REID CARTER:
Well, we're fortunate, we've got a large number of customers. So an awful lot of our work is really just looking at regional alternatives, different -- if it's softwood/pulpwood, which is what I mentioned, it would be looking at alternative softwood/pulpwood consumers. We have spent quite a bit of time studying and talking to biomass consumers whether they're potential wood pellet plants in the area or just simply offshore shipments of biomass. I think that looks to becoming a more viable alternative. Right now the pulpwood customers are still the favorite, so we're really talking to alternative pulpwood customers.

GRAHAM MEAGHER:
Great, and then just one question maybe for Brian. The interest, the cash interest paid, did I hear you mention you paid the Q3 and the Q4 in Q4?

BRIAN BANFILL:
That's a bit of an anomaly in timing because our fiscal quarter ends are not lined up with the calendar quarter ends, so I think our fiscal quarter end for Q3 was September 24th, and the interest payment for that quarter was actually made on September 30th. So we ended up having two cash interest payments. And we -- then the way that we present free cash flow, we present the actual cash interest payments as opposed to the interest expense.

GRAHAM MEAGHER:
Got you.

BRIAN BANFILL:
And that's an anomaly that the calendar will take care of in 2012.

GRAHAM MEAGHER:
Got you. Okay, great, thanks.

REID CARTER:
Thank you.

OPERATOR:
The next question comes from Paul Quinn of RBC Capital Markets. Please proceed.

PAUL QUINN:
Yes, thanks and good day. Just a question on the amendment to your major saw log agreement; effective 2013, have you done any analysis on what that might be able to do in terms of higher saw log prices?

REID CARTER:
I don't think, Paul, that -- yes, of course, we've got analysis. I think it's -- suffice it to say that we sought to amend it and you can imagine we would have liked to have amended it immediately and it was one of the considerations associated with having the counter party to make that amendment that it became a year off. They were being disadvantaged by it and prices would be higher, the market price is higher today. It's -- I don't think we really want to go into the details, but it will be -- it's a relatively meaningful number.

PAUL QUINN:
Okay and just secondly if you could give additional color on North American timberland markets, what you're seeing in activity levels I guess the amount of money sitting on the sidelines waiting to invest?

REID CARTER:

Well, the best estimate that we have of committed un-invested capital for a lot of -- on the part of timber investment managers is somewhere between $4 billion and $5 billion of capital available for timberland's investments and I think that's a relatively global number. There's a tremendous amount of interest right now in New Zealand and Australia on the part of investors and managers in a very small marketplace. We've seen a number of transactions over the last four months in the U.S., particularly in the U.S. South, Rayonier making two acquisitions. And it just seems to be lots of interest.

The recent NCREIF values have come out, the year-over-year performance as well just this last week, and it looks that timberland values in the U.S. South, I don't have the number off the top of my head, there was capital depreciation in the U.S. South and the Pacific Northwest saw a very robust capital appreciation. I think it was in the neighborhood of 12%, reflecting a much more excited outlook about the opportunities both in the recovery of North America, but most importantly with China becoming an increasing market. So I would say that in both investor interest in timberland seems to be relatively high, we've got lots of committed capital and timberland values are certainly appearing to be maintained in all jurisdictions except the U.S. South right now, and that's relatively modest declines in the south.

PAUL QUINN:
Okay and just lastly, any color on timberland markets in Maine, New Brunswick areas, has there been any change in the last, I don't know, it seems like there hasn't been change in the last couple years, but anything in the last quarter?

REID CARTER:
The most recent large sale that I'm aware of was the sale to John Malone, almost 1 million acres, which is I guess nine months ago, or longer. But I think the fact that our appraisal of our timberlands increased this year. Certainly all the various comps and with no change in discount rates, our timberland value did go up which was primarily based on impressive sort of regional and North American precedent transactions.

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

REID CARTER:
Thanks.

OPERATOR:
The next question comes from Paul Tan of Credit Suisse. Please proceed.

PAUL TAN:
Thank you, good afternoon. With Acadian's footprint in Eastern North American, could the Company benefit from an expanded geographical footprint much like the same way that the old, I guess Brookfield Renewal Power Fund, recently expanded their Canadian mandate to a global one by forming an LP structure?

REID CARTER:
We're always exploring what the best structure is for Acadian. This is a Board decision. There's certainly been no Board decisions made on this, but there are times across the market cycle where private equity have a better currency time where public equity has better currencies. One thing that we clearly do recognize, and

we've stated in the past, is that Acadian is a small company and suffers from limited liquidity, particularly with the large holding of Brookfield relatively so small float. So these are situations that we're always monitoring and our goal will always be to maximize the value for our shareholders. So I think the -- you'll have to stay tuned and we'll just watch those opportunities and which decisions are best.

PAUL TAN:
Okay, great, thank you very much.

OPERATOR:
There are no more questions at this time. I will now turn the call back over to Mr. Carter for concluding comments.

REID CARTER:
Well thank you once again for attending. We always appreciate your interest in Acadian and we look forward to working hard and producing a good first quarter and talking to you in early May. So thank you very much, enjoy your day.

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