



ACADIAN TIMBER



Acadian Timber Income Fund Q3 2009 Conference Call Transcript

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Time: 10:00 AM ET

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

Mr. Joseph Cornacchia
Chief Financial Officer



OPERATOR: At this time, I would like to turn the conference over to Mr. Joe Cornacchia, Chief Financial Officer. Please go ahead, Mr. Cornacchia.

JOE CORNACCHIA: Thank you, Operator, and good morning, everyone. Welcome to Acadian's Third Quarter Conference Call. Before we get started I'd like to call your attention to the following. This conference call is being webcast simultaneously through our Web site at www.acadiantimber.com where you can also find a copy of the press release, including financial statements. Please note that in responding to questions and talking about our financial and operating performance and outlook for the remainder of 2009 we may make forward-looking statements. These statements are subject to known and unknown risks and future results may differ materially. For further information of known risk factors, I encourage you to review Acadian's perspective dated January 23, 2006 and subsequent regulatory filings which can be found at www.SEDAR.com and on our own Web site.

I will start by outlining the highlights of our third quarter operating and financial performance. Then Reid Carter, our Chief Executive Officer, will conclude with more general comments about our operations, market conditions and general outlook for the remainder of the year.

Acadian experienced very challenging market conditions in the third quarter with weak demand resulting in continued pressure on pricing across most products. As a result of these conditions Acadian generated net sales of \$14.4 million on consolidated log sales volumes of 331,000 cubic meters in the third quarter of 2009. This compares to net sales of \$17.2 million on consolidated log sales volumes of 319,000 cubic meters in the third quarter of 2008.

EBITDA for the quarter was \$1.3 million or 9% of sales as compared to EBITDA of \$4.3 million or 25% of sales in the comparable period last year. The year-over-year decline in EBITDA margin is a result of pricing pressure across most



products as well as limited activity on our Crown licensed timberlands in the current year.

During the quarter, Acadian generated a net loss of \$200,000 or a loss of \$0.01 per unit on a fully-diluted basis. Included in the quarter's net loss is a \$500,000 non-cash future income tax recovery. This recovery has not been included in our calculation of EBITDA or distributable cash from operations and is now reflective of the operating performance of Acadian. Distributable cash from operations in the quarter was negative \$300,000 or negative \$0.02 per unit on the fully-diluted basis, which compares to distributable cash from operations of \$3.3 million or \$0.20 per fully diluted unit in the third quarter of 2008.

For the nine months ended September 26, 2009 Acadian generated net sales of \$46.7 million on log sales volumes of 915,000 cubic meters which compares to net sales of \$48.2 million on log sales volumes of 944,000 cubic meters in the comparable period last year. EBITDA is \$10.1 million for the first nine months of operations in 2009. Is \$400,000 lower than EBITDA in the same period of 2008.

I will now briefly review the segment results for Acadian's New Brunswick and Maine operations. The New Brunswick timberland results reflect lower harvesting activity on our Crown licensed timberlands and continued weak market demand for softwood saw logs. Net sales were \$11.6 million on log sales volumes of 274,000 cubic meters compared to net sales of \$13 million on log sales volumes of 244,000 cubic meters in the third quarter of last year. Weighted average selling prices declined 12% to \$41.46 per cubic meter as the result of a lower value species mix and continued pricing pressure on most products. Other sales including the contribution of our Crown licensed timberlands decreased by \$1.2 million primarily due to lower harvesting activity which was largely attributable to the closure of the Fraser Paper Mills.



Net sales for the first nine months of 2009 were \$35.5 million or 3% lower than the comparable period last year due to continued softness of pricing. Approximately 29% of sales volumes were sold to sawlogs, 42% is pulpwood and 29% is biomass in the third quarter of 2009. This compares to 28% of volumes sold to sawlogs, 44% as pulpwood and 28% as biomass in the third quarter of 2008 demonstrating the operation's continued response to the weak spruce for sawlog market.

Costs during the third quarter were \$10.3 million which compares to \$10.4 million in the same quarter of last year. While costs were quite consistent on an absolute basis they did decrease 7% on a per cubic meter basis as a result of a higher proportion of sales to customers seeking delivery in our wood yards resulting in lower transportation costs. EBITDA in the quarter was \$1.3 million or 11% of sales which compares to the EBITDA of \$2.6 million or 20% of sales in the third quarter of 2008. On the year-to-date basis EBITDA of \$8.3 million is \$1.3 million higher than the EBITDA of \$7 million generated in the first nine months of last year.

Turning to our Maine operations, net sales in the quarter were \$2.8 million or 33% lower than the net sales of \$4.2 million generated in the third quarter of 2008. Sales volumes declined 25% compared to the third quarter of last year as a result of limited opportunities to sell to some markets and management's decisions to reduce harvest volumes in order to preserve the long-term value of our timberland.

On a per-cubic meter basis, net sales decreased 14% to \$46.33 as a result of continued pricing and pressure on those products. Net sales for the first nine months of the year were \$11.2 million or \$300,000 less than the first nine months of 2008 as a result of 13% lower sales volumes. Cost in the quarter excluding a one-time gain related to a successful land sale, were \$2.6 million which compares to \$3 million in the third quarter of 2008, excluding a similar gain in the



prior year. The lower variable costs associated with reduced harvest volumes on absolute terms were also 3% lower on a per-cubic meter basis in US dollar terms as a result of renegotiating contractor contracts and lower diesel prices.

EBITDA in the quarter was \$800,000 which is inclusive of the \$600,000 gain on the afore-mentioned land sale. This compares to EBITDA of \$1.8 million in the comparable period of 2008 which is also inclusive of a \$600,000 gain from a similar transaction. EBITDA margin of 29% in the third quarter of 2009 compares to 43% in the third quarter of 2008. Year-to-date the Maine timberlands have generated EBITDA of \$3.5 million which compares to \$4 million in the first nine months of 2008. At the end of the third quarter, Acadian had a cash balance of approximately \$2.3 million, a decrease of \$4.2 million from the cash balance as at the end of the second quarter.

During 2009 the fund has generated distributable cash from operations of \$6.8 million while paying out distributions of \$10.3 million within the context of exceptionally difficult market conditions. In order to make any of these distributions, Acadian has had to rely on cash reserves. While we have historically targeted a policy of stable distributions, we have concluded that the best strategy for maximizing total returns for unit holders is to temporarily reduce our harvest level for products currently experiencing very weak markets in turn preserving the long-term value of our timberlands. And as a result, we have decided to reduce our annual distribution to \$0.20 per unit or our monthly distribution to \$0.17 per unit starting with distributions to unit holders of record on November 30, 2009 and payable on December 15.

On a more positive note, we are pleased to note that following the end of the quarter Acadian lenders have approved the extension of the maturity of our Canadian dollar banking term and revolving credit facilities to February 27, 2011 pending the finalization and execution of the required legal documentation. This



is an achievement in the current credit environment and we believe a reflection of the quality and long-term value of Acadian's assets.

These facilities will continue to bear interest at floating rates based on the 30-day banker's acceptance rate plus the applicable margin reflective of today's credit environment. In addition to extending the maturity of these facilities, management has also been successful in increasing the available commitment under the revolving term credit facility by \$5 million. Based on the terms of the extension agreement, at today's market rates, Acadian will incur approximately \$500,000 in additional interest expense over this period as compared to the terms of the credit agreement in the current year. I will now turn the call over to Reid.

REID CARTER:

Thank you, Joe, and good morning. As you've likely come to appreciate, we always start with Acadian safety performance as we view this as a key operating indicator. Acadian had a mixed safety performance during the third quarter. While all safety issues were very minor the New Brunswick timberlands did experience one minor recordable safety incident among employees and two minor recordable safety incidents among contractors from which all have fully recovered.

Acadian's Maine timberlands experienced no recordable safety incidents among employees or contractors. We continue to take our safety performance very seriously and are working to ensure that we return to a no incident workplace. In terms of our environmental performance, there were no reportable incidents.

In terms of operating conditions, wet weather during the first half of the third quarter did lead to operability problems in the bush. However, the real challenge was in finding economic markets for our products. As reported during our second quarter call, many customers brought large inventories into the third quarter resulting in a slow start to the quarter.



Meanwhile, market rated downtime at most regional sawmills and many pulp and paper mills resulted in very weak demand and pricing across the board. While Fraser Papers did restart its Edmundston pulp mill at the end of August it did not take deliveries of brown wood during the quarter. Fraser's decision to not operate this mill between June and the end of August also made it very difficult for regional saw mills to sell the residuals further impairing their ability to operate and create demand for Acadian's higher margins spruce fir sawlogs.

One bright spot was that fuel costs continue to be modest positively impacting our variable costs. As I said, the prevailing weak market conditions resulted in a difficult pricing environment across all sectors of the business. Acadian's weighted average selling price across all products decreased 13% year-over-year as compared to a 15% decline in the Random Lengths Lumber index and a 30% year-over-year decline in hardwood pulp prices. This year-over-year decline in Acadian's weighted average selling price is largely attributable to a 13% decline in the selling price of hardwood pulpwood with hardwood pulpwood accounting for 36% of total sales during the quarter. I would note that the selling price of hardwood pulpwood bottomed in the second quarter and demand and to a modest degree pricing have firmed up as Domtar restarted its Woodland's Maine mill and other regional producers have operated more consistently to recovering global part pulp markets.

Markets for softwood pulpwood were also very soft but a 28% decline in prices year-over-year, although softwood pulpwood is a relatively less important product for Acadian accounting for only 5% of sales in the quarter. This weakness in softwood pulpwood largely reflects very difficult markets for ground wood producers.

Prices for softwood and hardwood sawlogs declined by 8% and 7% respectively in the third quarter of 2009 versus the same period in 2008. This decline in hardwood sawlog pricing largely reflected a change in product mix. Biomass



buckets were also softer in the quarter despite the enthusiastic interest we're experiencing from potential future biomass customers. Acadian has been unable to sell all of its biomass, although, this market has also been under pressure due to low demand for power, as a result of the cool, wet summer in the northeast as well as reduced gas and oil prices. Integrated biomass plants have seen greatly reduced supplies from mill residuals but increased supply of whole tree chips because other options of selling would have been limited.

Looking ahead to the rest of 2009 and early 2010, weak demand for softwood sawlogs is expected to result in soft pricing as US housing starts remain at levels less than half of long-run averages. While smaller, non-industrial timberland owners continue to withhold timber from the market an ample supply of Crown and private timber continues to place pressure on timber prices.

Fraser Papers, a key Acadian softwood sawlog customer is expected to begin limited operation of its Plaster Rock Mill during the fourth quarter which should provide improved regional demand and modest support for pricing. Markets for hardwood sawlogs and specialty products, remain relatively robust, particularly for Aspen. These markets are expected to remain stable into 2010.

Markets for hardwood pulpwood have improved since the first half of the year and Acadian's major hardwood customers continue to operate and take deliveries for the pricing improving modestly from the second quarter and early into the third quarter.

As Joe discussed, while Acadian has historically been quite successful in navigating difficult market conditions, our view that markets remain challenging well into 2010 has led us to our decision to reduce Acadian's distributions. While Acadian has historically targeted a policy of stable distributions, we have concluded that the best strategy for maximizing total returns for our unit holders



is to temporarily reduce harvest levels for those products currently experiencing very weak markets, our higher margin spruce sawlogs in particular.

As a result we've decided to reduce our distribution to \$0.20 per year starting with distributions to unit holders November 30, 2009 and payable on December 15, 2009. Acadian will continue to evaluate the appropriate level of cash distributions as business conditions improve and our objective will continue to be to provide the market with a high level of certainty around the level of distributions to be paid in any one year.

This decision to reduce our distributions while made reluctantly is based on a thesis underlying the positive benefits timberland's investing. This thesis is supported by the fact that timber grows independently of capital markets and macroeconomic factors with timberland's investments offering the opportunity to maximize total returns by targeting high levels of cash returns during strong markets and capital appreciation during weaker markets.

We expect to focus increasingly on capital appreciation in the near term as reduced harvest levels in our spruce fir forests and grow inventory for harvested future, more robust markets. I would point out that despite very challenging market conditions over the past several years, Acadian has generated more distributable cash than it has paid out for the period between our January 2006 IPO up until this most recent quarter.

This decision to reduce our distributions has not been taken lightly and remains very confident in Acadian's long-term ability to return to its historic level of distributions. This confidence in the value of Acadian's underlying assets and ability to generate future cash flow is shared by Acadian's lenders who have demonstrated this confidence by agreeing to extend the maturity of Acadian's Canadian-dollar bank term-facility on favorable terms.



We will continue to balance Acadian's harvest levels with demand and pricing for our major projects, anticipate that our decision to reduce production volumes of spruce fir sawlogs, particularly in our New Brunswick timberlands will leave us well positioned to maximize cash flows when softwood lumber markets recover.

During these weak market conditions our primary focus continues to be on merchandising all of our products for the highest value while keeping operating costs down. We remain committed to an operating style aimed at maximizing long-term value for unit holders and maintaining and relatively stable financial performance.

That concludes our formal remarks. We're available to take any questions from participants on the line. Operator?

OPERATOR: We will now begin the question-and-answer session. The first question is from Andrew Kuske with Credit Suisse. Please go ahead sir.

Andrew Kuske: Thank you. Good morning. I'm not sure who wants to field this one, but could you just give us a bit of the context and sort of the decision making process on reducing the distribution? I mean, obviously it's just a brutally weak market at this stage and time. But how did you settle in on \$0.20 as opposed to possible entirely eliminating the distribution at this point to having it at say \$0.40?

REID CARTER: There is no purely quantitative process to come to that answer. We made a decision that -- we felt that the housing recovery would be relatively slow, that demand for a higher margin of products, particularly spruce-fir sawlogs would be difficult throughout 2010. And as I mentioned in my talk, while not bringing good news, wanted to bring some certainty to investors on what they might expect. We've developed a very conservative, I'd say probably pessimistic plan for 2010 assuming continued weak demand, very soft pricing for sawlogs and just continued difficult markets for pulpwood. Based on that plan we felt we could



quite easily achieve a \$0.20 target. We felt it was very important, really for the stability of our unit price, not to announce repeated cuts. So I think we've chose to be conservative.

At the same time we believe that maintaining some level of distribution, albeit significantly reduced, would be of continuing importance to those investors that did believe in Acadian over the long term and were also owning it for yield. So it struck the right balance to try to help us avoid having to make a second cut and perhaps going to \$0.40 and then going to \$0.20, provided some yield. We believe that we will have a choice if it turns out that our forecasts are too pessimistic of either making special distributions, increasing our distribution or paying down debt. But our policy will absolutely continue to be to pay out the historically vetted 95% target payout ratio and there's been no change in that. We would aim to pay out those levels perhaps a little more intermittently in the near term.

ANDREW KUSKE: Okay, that's helpful. And was also the reduction in the distribution, was that tied to the extension of your credit facilities and the new terms on your credit facilities?

REID CARTER: No, it wasn't. Joe, why don't you take that one? I'll let you cover the details of that.

JOE CORNACCHIA: Sure. There is no impact on the renegotiation with our distribution payment date. The terms are very similar to what we've had in prior quarters or prior years. There was no direct link between the two.

ANDREW KUSKE: Okay, that's helpful. And then just if I may, one final question, how do you think about your normalized EBITDA? Should we be centering around a number, roughly say \$20 million per annum in a normal market?



REID CARTER: Normalized cash flow is always an interesting concept. That is certainly consistent with the level. I mean, I think that we would expect to cross normal market cycles consisting with our historic performance that our EBITDA would range probably between \$18 million and \$24 million and I think in between \$20 million and \$22 million is our view of normalized EBITDA.

ANDREW KUSKE: Okay, that's very helpful. Thank you.

OPERATOR: Your next question is from Graham Meagher of TD Newcrest. Please go ahead sir.

GRAHAM MEAGHER: Good morning, just a couple of question. The first one on the Plaster Rock restart; Fraser, in their press release they had mentioned that they'd begin buying logs this week, assuming it's all softwood sawlogs. So two questions on that, is that coming from private timberland or Crown? And in their press release they noted predefined price levels to support the restart of the mill and just wanted to know what if any impact that was on you guys.

Reid Carter: Yes, they will be buying logs from Acadian. It will be a combination of logs from their Crown license as well as logs from -- or timber from Acadian and other private timberland suppliers. They have been I would say negotiating very aggressively to achieve good pricing for their products. We, as we've discussed in the past, have a fiber supply agreement with Fraser that sets pricing based on the average price they've paid their five largest suppliers, excluding Acadian during the prior six-month period. So we have had, as you can imagine, some pretty serious conversations with Fraser around pricing, around the fiber supply agreement. But I believe we will be achieving, I would say, very fair prices relative to the market and we'll be selling to Fraser.

GRAHAM MEAGHER: Okay, great.



- REID CARTER: But I do say "Relative to the market." Pricing in the market is tough right now.
- GRAHAM MEAGHER: Of course. The biomass crop assistance program and thinking specifically on the biomass sales from the Maine timberlands, are they eligible and can they -- do you have contracts in place with or some of your customers eligible? And are you able to ramp up any sales volume, they're realizing it's only been \$0.5 million per year, but is there some incremental there that you can work with?
- REID CARTER: There's a couple issues. First of all, Canadian fiber will not be eligible under the B-Cap program. So the vast majority of our biomass has come from our more hardwood focused Canadian timberlands. So although our customers, one of our largest customers is Boralex, US operations in Maine, Canadian fiber in those operations won't be eligible for that. There's still a tremendous amount of uncertainty in the B-Cap program in terms of exactly -- almost all of our US customers have qualified under the B-Cap program. There's still some uncertainty about exactly what products, for instance, will chips be eligible under that program. And we believe that our Maine operations will be a supplier, a qualified supplier in the program. Though one of our largest customers has been the Katahdin Paper Company which is owned by Brookfield and will likely be viewed as a related party and you aren't able to qualify to that program, in selling to a related party. So we may have to shuffle our customer mix. So our view is that while we're going to make sure we position it the very best we can, I think it's likely a relatively small opportunity for Acadian.
- GRAHAM MEAGHER: Okay, great. And finally, just any updates on 2011 taxability and some options there for you.
- REID CARTER: Joe, do you want to speak to that?
- JOE CORNACCHIA: Yes, Graham, I think we are starting to look at some of the alternatives as management, our Board of Trustees acknowledged that the time is coming on us.



And we've started to look at some opportunities but we're not at a position where we can announce anything at this point. We're still considering our alternatives as we move forward to the date.

GRAHAM MEAGHER: Okay. Thanks. That's all I had.

OPERATOR: There seems to be no further questions at this time. I will turn the call back over to Mr. Reid Carter, President and CEO.

REID CARTER: Well, thank you, Operator. Well, once again, thanks for joining us on our third quarter conference call. As always, we welcome any further questions you may have. We recognize that a number of the decisions that we've made and covered in this third quarter release have a significant impact on Acadian's unit holders and we would certainly hope that you'll continue to believe that we will operate in all the unit holders' best interests going forward. So, again, we would welcome further questions and thanks so much for joining us.

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