RAIL LOG NETWORK

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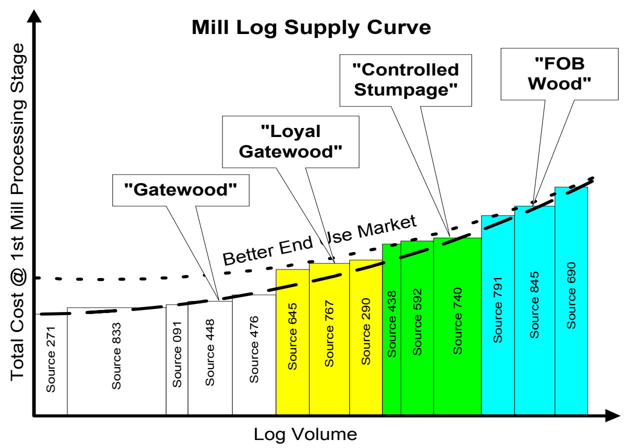
Log Source Segmentation Strategies

Two adjacent mills buying the same log but two different delivered log prices– is that really possible? It is not only possible, it happens all of the time. How can that be? The answer is log source segmentation strategies.

The exhibit on this page illustrates a hypothetical mill log supply curve. The width of each log source is its volume, its height is its total delivered economic cost. The bars are arranged in ascending delivered cost order.



Astute log buyers segment sources. For "gatewood", normally the lowest cost, least reliable source of wood, these buyers employ very aggressive buying tactics. Using the less correlated sources of supply for negotiating leverage, smart buyers minimize what they pay this segment.

The next segment of supply, "loyal gatewood", is normally the second least costly source. When times get tough, these suppliers don't immediately disappear like gatewood suppliers. They warrant less aggressive treatment. "Controlled stumpage" is just that– wood that the mill owns that can be drawn on when needed. Fully-costed, it is usually more expensive wood but it is a useful, "surge" source in a hot, "spot", end use market or when log buying is very weather or season-sensitive.

"FOB wood" is wood that might be purchased at a railhead. These sources are least correlated with other sources of supply and the local "gatewood" market is least affected by prices paid to this segment. Routinely participating in more distant log markets, astute log buyers have a much better sense for incremental buying opportunities.

Smart buyers segment their buying and maintain a portfolio of log supply categories. Assuming uniform quality amongst segments, the mill's tolerance for risk establishes the proper mix. Short term market changes (e.g. competitor log sales for earnings enhancement) may make the gatewood-dependent buyer today's hero but, over the longer term, segmentation is proven to yield lower delivered costs, the mill's desired log quality and acceptable log shortage risks.

PANELTECH RAIL LOG NETWORK

BUSINESS GUIDELINES

- *Learn all we can about what our customers need so we can do everything in our power to provide it*
- *Continuously reduce our costs of operation so we can pass cost savings on to our customers*
- *Safeguard the assets (logs) that our customers entrust us with*
- *While protecting genuinely proprietary information, serve as our customers' "eyes and ears" where we operate*
- *Reward loyalty with loyalty*
- *Grow the rail log network to improve network efficiencies, to enhance customer market power*

Price discrimination strategies are also employed by astute log sellers. While segmentation criteria are usually different, log sales and supply curves are similar and the company's tolerance for risk is equally important to the determination of the optimal segmentation portfolio. The nature of timber assets (normally appreciating vs. depreciating) permits sales timing flexibility/opportunism.

2002 Distant Logs Seminar

We held our second annual "distant logs" seminar on November 14th and 15th in Spokane, Washington. The seminar was held in Spokane to try to focus on our eastside customers and their challenges and we weren't disappointed.

Bruce Daucsavage of Ochoco Lumber

The winning mill team

The winning timberlands team

The first day of the seminar was a new offering, a simulation game that pitted five mills against five timberlands organizations. Lumber prices were simulated and log prices were determined via log supplier's supply curves and log buyers demand curves. Steve Grandorff (Rayonier) and his team (Bob Boeh of Riley Creek Lumber and Kari Qvigstad of the Port of Olympia) were the most successful timberlands team. They quickly determined that they had a surplus of financially mature timber and they set out aggressively to correct the situation!

Alan Harper (also of Riley Creek– a conspiracy?) and his winning mill team of Dave Kunert (Hampton Lumber) and Brett Black (Colville Timber Resource Company) were similarly aggressive, running their mill hard while exploiting declining log prices.

The Union Pacific sponsored a well-attended hospitality room Thursday evening that helped simulation exercise winners and losers "debrief" each other.

The second day of the seminar was led off with a thought-provoking presentation by Bruce Daucsavage of Ochoco Lumber. Bruce explained his company's global efforts to find and develop timber supply chains to meet the needs of their customers.

Brian McDonald of the Union Pacific Railroad explained his company's forest products strategy and Dick Krase of the BNSF explained unit train concepts. Tom Foster of Rail America gave the shortlines' perspective. John Wolfe and Kari Qvigstad of the Port of Olympia gave their port's perspective. Our own Scott Olmstead discussed the massive Arizona fire-recovery project that Paneltech and others are about to embark upon.

Alan Harper of Riley Creek and Brian Luoma of LP discussed their respective log procurement challenges and philosophies. Chris Waters (Broadway Timber) discussed current B.C. timber industry fundamentals and B.C. log challenges and opportunities. Chris Lunde of Port Blakely Tree Farms discussed his company's timber marketing philosophies.

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PNW Timber Trends

Courtesy: Paul F. Ehinger & Associates

	Year	Or	Wa	Ca	Id	Mt	Total
Timber Harvest (All Ownerships)	1989	8,420	6,851	4,722	1,909	1,313	23,215
	2000	3,854	4,176	1,966	1,192	744	11,932
	2001	3,440	3,710	1,620	1,040E	670E	10,480

	Year	Or	Wa	Ca	Id	Mt	Total
Timber Harvest (Federal Lands)	1989	4,442	1,142	2,036	826	565	9,011
	2000	324	93	245	146	110	918
	2001	173	68	105	73E	59	478

	Year	Or	Wa	Ca	Id	Mt	Total
Timber Harvest (Private Lands)	1989	3,721	4,582	2,638	819	636	12,396
	2000	3,167	3,176	1,701	792	574	9,410
	2001	2,905	2,791	1,475	726	550E	8,447

	Year	Or	Wa	Ca	Id	Mt	Total
Softwood Log Exports	1989	676	2,597	74	0	0	3,347
	2000	110	695	12	0	0	817
	2001	120	503	10	0	0	633

	Year	Or	Wa	Ca	Id	Mt	Total
Softwood Lumber Production	1989	8,512	4,274	5,320	2,133	1,567	21,806
	2000	5,927	4,384	3,173	1,896	1,177	16,557
	2001	6,056	4,257	2,731	1,833	1,080	15,957

	Year	Or	Wa	Ca	Id	Mt	Total
Softwood Plywood Production	1989	6,775	1,462	94	590	726	9,647
	2000	3,696	989	0	339	579	5,603
	2001	3,348	836	0	206	562	4,952

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"The U.S. duty didn't kill Canfor, Slocan, West Fraser and other modern cost-efficient operations. Instead, it made them stronger, forcing mills to seek new ways to cut costs, such as forging new deals with unions...At the same time, the mountain pine beetle infestation...has led to a glut of beetle-attacked timber, pushing down prices for the 20 percent of the Interior timber sold on the open market."

Gordon Hamilton
Vancouver Sun
October 22, 2002

Recent Paneltech Developments

LOGS **Arizona, here we come!** Those of you who attended the "distant logs" seminar last month heard all the details (from the Union Pacific, the BNSF and Scott) about the ambitious undertaking that we are about to join. We are about to make a maximum commitment to unit train log trans-loading in Snowflake and Globe, Arizona. Scott will likely spend the majority of his time down there over the next six months or so. We won't abandon our regular customers but every one of our log cars that isn't committed will likely be headed south soon and, with the help of the UP, the BNSF and BC Rail, many more will soon join our fleet. We will also add new office help to dynamically track this massive fleet of cars.

WEBS Prompted by our competitor, extensive pour tests were completed this past month by a very credible, independent industry expert and they confirmed what we previously believed– our HDO simply outperforms our competitor's product in the field! We continue to expand our customer base and sales.

CONSULTING We are now gearing back our consulting activity. We will finish up existing commitments but we will be very selective in evaluating new projects. With Arizona and continued webs business expansion, we just don't have the time.

2002 "Distant Logs" Seminar Continued

Continued from page no. 2 Jon Tweedale of the Washington DNR wrapped up the second day, the final day of the seminar. He gave a review of the unique challenges that the DNR faces in meeting the needs of its various stakeholders and trust holders. He went on to explain their sophisticated marketing strategy. Jon's presentation included a great deal of useful data and his handout was very informative.

Chris Waters describes B.C. industry fundamentals

We will likely hold our seminar in the Medford, Oregon area next year. The area is accessible to I-5 and Medford has a commercial airport. A meeting in this area should be more convenient for our customers from both the Medford and Klamath Falls areas. It should also be more convenient for our Northern California customers. We will continue to pick a new area each year and we will focus the annual meeting agenda on issues that are uniquely important to customers in that particular geographic area.

We received a number of calls following our seminar asking for more information on the practical implementation of log buying and selling segmentation strategies. Our front page article responds, in a general and broad way, to those requests. Feel free to give us a call if you want more information and we will: 1) Send you a much more detailed Paneltech treatise on this subject and 2) Offer confidential advice as to how you might better segment your specific log markets/procurement areas.