



RAIL LOG NETWORK

Paneltech International LLC

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Market Outlook- 2003 and Beyond

Our log demand is, of course, derived from the demand for the products made from those logs. As we begin a new year, it is useful to reflect on final product prices, where they appear to be headed and what it could mean for all of us. We have learned the hard way that we are not forest product price projection experts! Furthermore, as we all know, those who profess to be are also frequently wrong.

Reid Carter of National Bank Financial is our favorite industry analyst. The chart on this page summarizes his most recent price projections. Reid's perspective is understandably "BC-centric" so we have also included a graph (page 2) that tracks W SPF 2x4 against the two most common U.S. PNW lumber benchmarks- Grn DF 2x4 and KD Hem-Fir 2x4.

As you can see, Reid projects SPF 2x4 prices in 2003 and 2004 to remain similar to those in 2002. **"It looks like the North American lumber market will only return to a balanced supply-demand situation after a prolonged shakeout period (i.e. 5 years)."** NBF, Dec. 2, 2002 He calls this a "Last Man Standing" situation!

As the comparative exhibit on page 2 illustrates, this probably does not bode well for hem-fir 2x4 producers and the log sellers who depend upon them. After tracking closely with SPF and hem-fir the first half of 2002, green Douglas fir prices have held up much better as 2x4 prices have continued to decline. Why? We suspect that non-2x4 competition for Douglas fir logs is putting a factor cost "floor" under Douglas fir 2x4 prices.



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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

Product	Detail	Pricing Last Mo.	Current Price	Pricing Year Ago	Average 2001	NBF Fcst 2002	NBF Fcst 2003	NBF Fcst 2004	NBF Trend Estimate
Lumber	W. SPF 2x4	\$198	\$188	\$223	\$250	\$240	\$240	\$240	\$310
	Baby Squares	\$623	\$623	\$592	\$595	\$580	\$580	\$570	\$575
Panels	NC OSB 7/16	\$162	\$147	\$144	\$159	\$160	\$165	\$165	\$180
	SYP Plywd 15/32	\$240	\$240	\$249	\$268	\$270	\$260	\$260	\$280
	W. MDF 3/4	\$360	\$350	\$365	\$369	\$375	\$375	\$375	\$360
Pulp	NBSK	\$500	\$490	\$500	\$557	\$490	\$500	\$540	\$575
	NBHK	\$480	\$470	\$430	\$492	\$460	\$490	\$520	\$525
Paper	Newsprint	\$480	\$480	\$520	\$583	\$465	\$500	\$550	\$550
	22 1/2# Directory	\$660	\$660	\$730	\$738	\$670	\$700	\$715	\$710
	50# Offset	\$710	\$710	\$660	\$706	\$700	\$720	\$720	\$720
	35# SC-A	\$700	\$700	\$725	\$783	\$700	\$720	\$750	\$775
Packaging	Linerboard	\$435	\$435	\$420	\$438	\$415	\$420	\$425	\$410
	26# Medium	\$390	\$390	\$385	\$399	\$370	\$380	\$395	\$375

Plum Creek Timber cut its dividend last month from 57 cents to 35 cents. "Plum Creek would have paid out \$420 million in dividends over the last 12 months against \$250 million in operating income..."

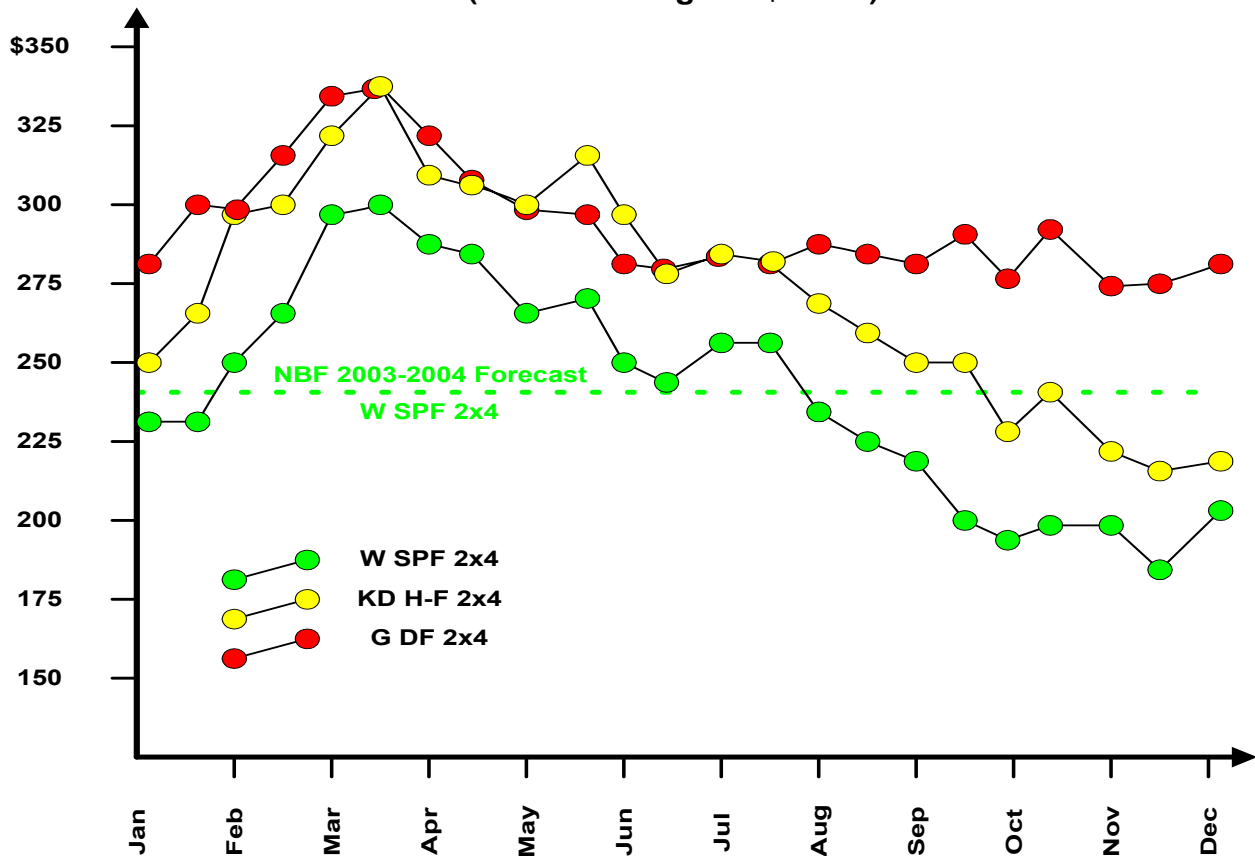
Forbes, 12-23-02



As Reid's chart illustrates, virtually every forest and paper end use market is currently in a funk. Analysts (including Reid, as you can see) continue to predict a near term recovery in pulp, paper and packaging (PPP) demand and we are hopeful that they are finally right in the second half of 2003. Better residual wood chip markets would definitely help our customers but **that is not our chief concern**. With disgruntled shareholders, leveraged balance sheets and very limited options to maintain earnings and cashflows, integrated companies with timberlands are currently pushing more and more logs onto the market. This pushes down log prices so they are also tend, at times like this, to push more timberlands onto the market. Remember the early 1980's? The 1982 formula: **Growing timber supply-push pressure + weak PPP demand = shakeout (or involuntary reconfiguration) of both large and small forest products firms with weak balance sheets.**

Moving to wood-based panels, there is a considerable range in the cost structures of OSB mills and, for the older, higher cost producers, the next 2 years could be very difficult. The next 2 years will also continue the painful shakeout in sheathing softwood plywood production. This will put increased supply-push pressure on the most accessible, least differentiated specialty plywood markets. We continue to believe that our commitment to North American overlaid plywood producers and the North American market and our ability to rapidly bring better products to the market will pay off for us and our treated webs customer-partners. New, lower-cost, non-traditional, international sources of supply will increasingly plague all of us in all of our markets. MDF demand continues to grow but, as the EWP (LVL, etc.) industry has recently demonstrated, we seem to be capable of over-supplying all but the hottest spot markets!

2002 Lumber Prices (Random Lengths- \$/MBM)





The Japanese Export Log Market- Will It Ever Come Back?

As the graph on this page indicates, the volume of logs exported to Japan from the PNW continues to decline year-by-year. Is there any hope for a rebound in this historically important market? To answer this

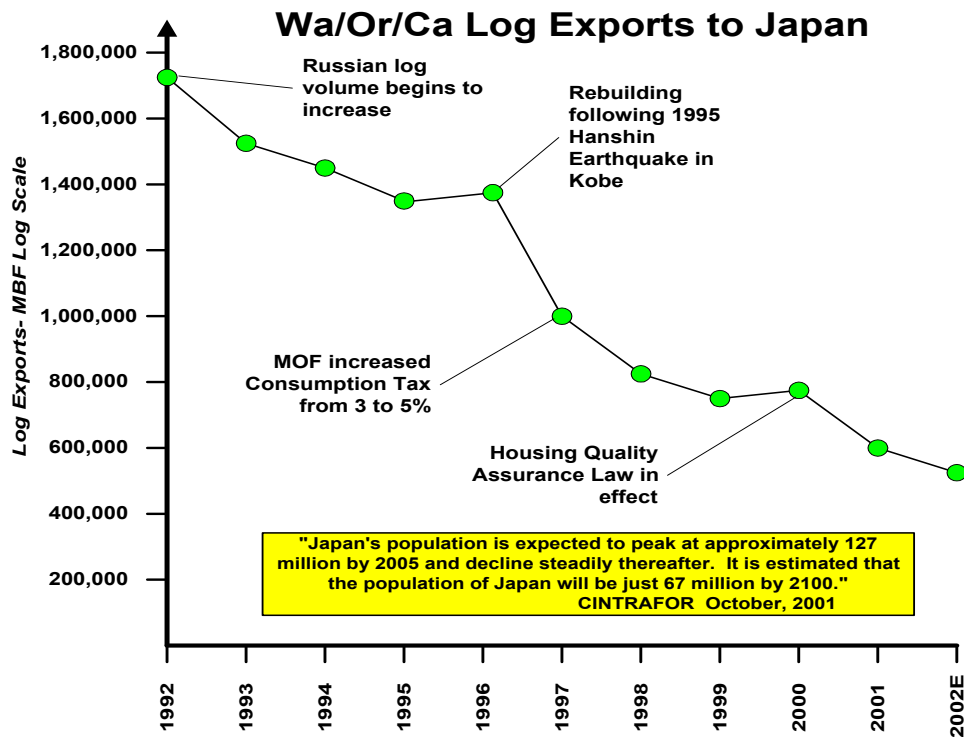
question we recently went to two authorities, McKinsey and Co. and a U.S. log sales expert who works in Japan.

McKinsey's on-line report on the Japanese economy (available at www.mckinsey.com/knowledge/mgi/reports/japan0700.asp) dated

July 2000 gives an in-depth analysis of the demand-side of the residential housing market in Japan. They describe why the Japanese consumer has always gotten such a poor housing deal for their money and why, in the current deflationary environment, housing will likely continue to languish.

Fundamentally, Japanese construction companies (like the majority of Japanese companies that are insulated from international competition) are globally uncompetitive. The industry is less than 50% as productive as the U.S. housing industry! Overdue efforts to correct this problem, a problem that plagues 80% of Japan's economy, might eventually rekindle demand but better-informed buyers would then be far more price-conscious than they have

been in the past. Barring another earthquake (the 1995 Kobe earthquake displaced 400,000 households), dramatic near term demand recovery doesn't look very likely.



The log sales expert that we talked to gave us more insight into the supply side of the Japanese market. He pointed out the rapidly increasing volume of Chinese lumber, much of it Russian log-sourced, that is making significant inroads into the Japanese market. He also told us to keep our eyes open to the competi-

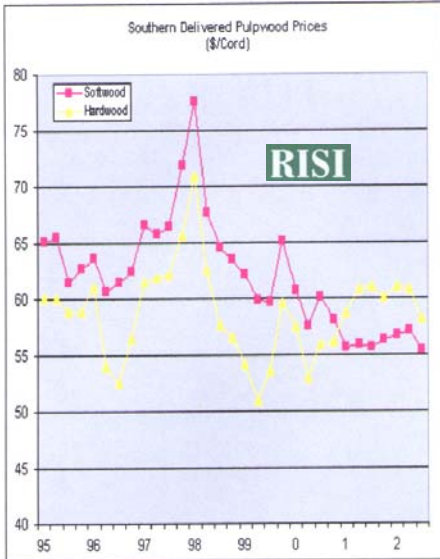
tive consequences of improving quality, Russian-milled, Japanese specification lumber.

This expert's advice? The Pacific Rim seller who can consistently sell whitewood logs to these markets (e.g. Korea, China, Japan) at between \$75-85/m³ C&F, will likely do business. Those who are unprepared to consistently do so likely will not. While the Weyerhaeuser-Chugoku supply chain is still dominant from the PNW, there are still apparently a few opportunities to sell Douglas fir in Japan at prices slightly above these numbers.

A sick economy, more price-conscious buyers, unfavorable demographics, abundant traditional supply, growing non-traditional supply- it doesn't look good.

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Recent Paneltech Developments



Last wet Southern winter was in 1998

LOGS

Scott is now spending most of his time in Arizona and activity there is really begin to pick up. Log cars that aren't planned for a first quarter movement have been repositioned in Arizona or, in a limited number of cases, they are being allocated to new business development projects. Roy will spend his available time over the next 6 months looking at new opportunities to redeploy the new railcars and associated resources that we have recently assembled (after Arizona winds back down). Several opportunities currently look promising.

WEBS

Activity is winding down for us as we approach yearend with several customers taking extensive downtime. We have some exciting improvements planned for our process for next year.

CONSULTING

Notwithstanding a potential new East Coast pulp & paper project for Roy, we are continuing to wind this product line down.

PEOPLE

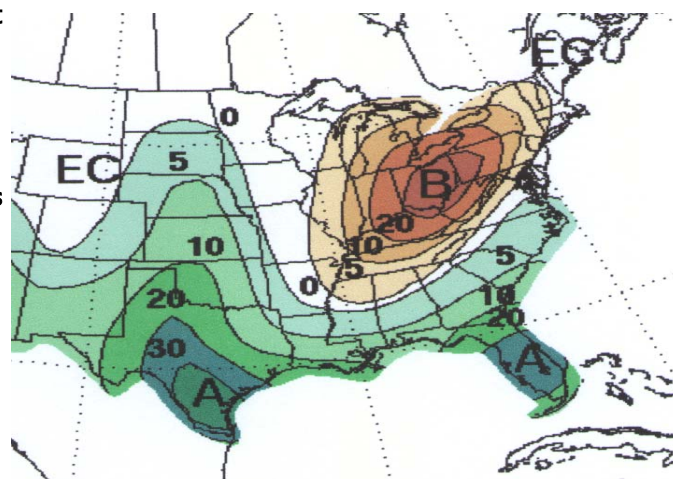
To keep pace with the recent rapid growth of our business, we have made a number of new personnel additions- **Bryan Miller** (Log Yard Supervisor), **Leslie O'Hanen** (Operator), **Jimmy Ruden** (Operator), **Ralph O'Hanen** (Operator), **Glyn Loya** (Yard-Maintenance), **Robert Solberg** (Yard) and **Heather Foster** (Expeditor).

Wet Down South

The precipitation forecast on this page is not welcome news for our log buyer friends in the South. We are getting numerous calls either looking for log railcars to move identified sources of more distant wood or looking for new sources of more distant, non-traditional sources of wood. "Record wet weather over the last two months, including the damaging winter storms last week, now 'guarantees' numerous US South pulp and paper mills should run out of woodfibre over the Christmas holiday and into January..." (*International Wood Fiber Report*, December 9, 2002)

Our log buyer recommendation last month (maintain a balanced portfolio with less correlated wood sources) could not be better illustrated. Prolonged, depressed pulp and paper pricing has prompted many buyers to pull back buying to

less-costly, nearby sources. These sources are not only strongly correlated with one another (when one runs out of wood, they all tend to), spot prices in heavily-contested "micro-areas" usually soar when market supplies get tight. Faced with this situation,



December 2002-February 2003 Precipitation Forecast

no ready options and working for mills that can't afford the more costly wood now, many log buyers are in a real jam.

Unplanned pulpmill shutdown costs can cost \$500,000 or more. They are so significant that there is an old adage amongst log buyers in the South, "If you run the mill out of logs you had better have a good employment option." A sizeable number of southern log buyers may soon find out if this old adage is true.

"Significant volumes of wood chips are reportedly traveling 'hundreds of miles' further than normal, landing with costs...50-75% above normal." (IWR again)