RAIL LOG NETWORK

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"Pump & Dump"?

As the *PriceWaterHouseCoopers* "Global Forest & Paper Survey" confirmed again this year, public companies in our industry continue to destroy massive amounts of shareholder value. With one notable exception, Kimberly-Clark, very few public forest products companies have returned their cost of capital for a decade or more now.

Are shareholders content with these poor returns? Hardly! "Since you ascended to the role of Chief Value Destroyer when you…(became) CEO in 1999, the shares dropped over 45 percent, a destruction of shareholder value in excess of $520 million". So recently said Daniel Loeb, managing member of Third Point Management, an investment firm, in a recent, open letter to Potlatch's CEO, Penn Siegel. (*The Spokesman Review*, 5-8-03)

Investors like Mr. Loeb at Third Point Management and Southeastern Asset Management Inc. are becoming increasingly aggressive in their efforts to boost these sagging industry share prices with higher fee timber-sourced dividends.

"Earlier this year, Southeastern Asset Management Inc. accumulated 15.2% of Rayonier's shares and began pressing management to increase shareholder value. The shares were trading around $27 in March when Southeastern made its concerns public. The price climbed to more than $40 after (Rayonier announced it was putting its timberlands into a REIT and was boosting its dividend from $45 million to $110 million) in its first year as a REIT…Southeastern (realized significant profits when) it cut its stake to 4.8% of Rayonier's shares in late August…Dividend-hungry investors are also betting Potlatch could be next to make the REIT switch." (*Dow Jones News Service*, 9-18-03)

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"Our analysis indicates that timber is a significantly undervalued asset relative to the present stock prices and stated book values. Eighteen of the 22 largest forest products and paper companies have an estimated timber value per share (timber value <u>alone</u>) in excess of the present stock price…Crown Zellerbach and Longview Fibre have…estimated timber values that are 2.7-3.0 times the current stock price…Weyerhaeuser, International Paper, Potlatch, Pacific Lumber, and Willamette own timber with estimated values between 2.2 and 2.4 times the present price of their stock."

Thomas P. Clephane
Morgan Stanley Research Report
***June,* 1980**

Note: Sir James Goldsmith, assisted by "Chainsaw" Al Dunlap, raided Diamond International and Crown Zellerbach shortly after this was published. Dunlap, of course, then went on to Scott Paper. "Under his leadership Scott's stock rose 225%, adding $6.3 billion in value to the company…After less than two years work, Dunlap walked away with nearly $100 million…" (*Business*

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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*

"Scott Paper laid off more than 11,000 people during Dunlap's regime, and Scott Paper's stock price rose before its sale to Kimberley-Clark. But Kimberley-Clark, much to the chagrin of its executives and shareholders, had to take charges totaling $2.2 billion to integrate Scott Paper into its operations which had been hollowed out by Dunlap's restructuring. Further, Kimberley-Clark had to spend years rebuilding relationships with suppliers, customers and employees."

Asst. Prof. Harry Van Buren
Roberts Wesleyan College

"On behalf of its investment clients, Southeastern (the same) now plans to explore with management of Timberwest and with other interested parties a variety of strategic alternatives designed to maximize shareholder value." (*Market News Service,* 2-14-03)

> "If you want a friend, get a dog. I have two of them".
>
> Al Dunlap

Should we criticize these investment companies for their aggressive pursuit of undistributed timber dividends? For what some critics have derided as "pump and dump"? Don't public forest products companies themselves tend to ignore cut regulation goals and fee timber opportunity costs when their quarterly earnings begin to sag? Isn't it better (more socially "efficient") if these investors prompt *their* company managements to distribute *their* timber assets so they themselves can reinvest these funds in better performing companies? If the "hollowed out" companies that remain don't survive, isn't that the nature of the free enterprise system?

> **"Many companies talk about creating shareholder value as an objective, but they really haven't figured out a way to operationalize that within the company. If you look back, in the 1980's there was a discipline placed on companies to increase value through the threat of hostile takeovers and leveraged buyouts and the like. Those pressures have gone away but <u>they have been replaced by the activist shareholder who is interested in stock market performance</u> (our emphasis). And, in response, companies at least have to pay lip service to the notion of creating shareholder value. But almost all of them still do not appreciate what it takes to bring that about…**
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> **Not every CEO is prepared to be as bold as Al Dunlap, and it certainly is not the right strategy for every company. But you know, when you have an industry that is mature, there is a tendency to invest their cashflow back into the business—to really over-invest in a business rather than to pay it out to their shareholders. You know, our capital market system is pretty good at allocating new capital to promising new companies and ventures. There is, however, a problem when capital is bottled up in (underperforming) companies…"**
>
> **Bennett Stewart**
> ***Off the Record***
> **Feb. 1, 1996**

"…in the long run…markets always win…Markets, lacking culture, leadership, and emotion, do not experience the bursts of desperation, depression, denial and hope that corporations face. The market has no lingering memories or remorse. It has no mental models. The market does not fear…It simply waits for the forces at play to work out…" (Foster & Kaplan, *Creative Destruction*, 2001)

Thankfully, some of our industry's CEO's are beginning to assert themselves. In a frank letter to his shareholders in January 2001, Pete Correll of Georgia Pacific reviewed four industry myths that he cited as contributors to our industry's persistent shareholder value destruction. Myth No. 1– *Companies have to own timber to compete in this industry.* "Fee timber is thought to provide a hedge against high wood prices. But in reality many forest products companies liquidate high-value fee timber, which is accounted for at historical low values, to prop up manufacturing earnings in times of low end-product prices. This destroys value." Myth No. 2– *The low cost producer…will be the winner.* "Low manufacturing cost doesn't help if the capital required to generate it can never earn…(an acceptable)…return…" Myth No. 3- *The faster you plow your free cash flow, and often new capital, back into new plant and equipment, the sooner you'll become the low-cost producer and preempt the competition.* "This first cousin to myth No. 2 is usually employed at, or near, the top of the cycle, which is the worst possible time to reinvest because everyone else in the industry is doing the same thing". Myth No. 4– *The last ton (or MBF or MSF) produced is the most profitable one.* His point, the same one we tried to make in last month's newsletter, is the need for marginal (versus average), economic business unit optimization.

If we carefully follow Mr. Correll's advice, will our industry once again return our risk-adjusted cost of capital? No, these comments highlight what we have continued to do wrong, not what we need to do right. On the other hand, this is a start. Why should we enrich those who are merely hastening our systematic dismantlement by market forces?

November 2003 "Distant Logs" Seminar

Machiavelli reportedly told his friend Francesco Guicciardini, "For a long time I have not said what I believe, nor do I believe what I say, and if indeed I do happen to tell the truth, I hide it amongst so many lies that it is hard to find."

Log Seller's Panel– From Left to Right– Jon Tweedale (Wa DNR), Dan Fisher (Fruit Growers Supply), Dale Roberts (Lone Rock Timber), Joe Matejka (Plum Creek Timber), Kevin Merritt (Guistina Resources) and Chris Waters (Broadway Timber)

Despite Ivan Erickson's repeated assertions to the contrary, the speakers at our November "Distant Logs" seminar eschewed Machiavelli's advice. Beginning with Bob Ragon (Douglas Timber Operators) discussing federal timber supply issues and continuing through Tom Foster (RailAmerica), Marty Huff (UP), Dave Callentine (Brusco) and Shawn Teevin, the later four all talking about logistics, you heard it "like it is".

Log Buyer's Panel– From Left to Right– Paul Beck (Herbert Lumber), Jay Francis (Collins Pine), Joe Miller (Trinity River Lumber), Joe Dillard (Sierra Pacific Industries) and Ivan Erickson (Roseburg Forest Products)

The log seller's panel was, if anything, more candid. Chris Waters made a quick tour of BC and the current trends shaping industry developments there. We heard detailed, revealing descriptions of a variety of timber and log marketing strategies, from Dan Fisher, Dale Roberts, Joe Matejka and Kevin Merritt to Jon Tweedale of Washington's DNR. None of these folks minced their words. The log seller's panel was no less forthright.

Joe Dillard managed to carefully dissect the shortcomings of every constituency represented in the room, especially (as we might expect) the log sellers! Equally candid, Joe Miller gave us insight into the unique challenges he and his company face. Jay Francis and Paul Beck also gave enlightening talks. Ivan Erickson was...well, Ivan! He blasted anyone Joe Dillard missed.

Our own Scott Olmstead wrapped up our third, and perhaps most outspoken, "distant logs" seminar.

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"Even as Kimberley-Clark executives spent hundreds of millions of dollars to clean up the mess Dunlap had created, Scott investors were singing his praises for enriching them. At the same time, a new breed of activist investors were beginning to target under-performing companies, not for hostile takeovers, but for drastic makeovers. "

Knowledge @ Wharton
Wharton School, U. of Penn.
Dec. 10, 1999

Recent Paneltech Developments

LOGS The new yard in Fontana, Ca is up and running and, as this is being written, Scott is continuing to look at new, potential transload sites yards in So. California. We are completely sold out on our log cars and we are again looking for new, high capacity log cars. 2004 looks to be a very busy year for our logs business with more and more interest from log buyers and sellers who have only recently discovered the merits of a marginal (versus average) log price orientation.

LOGISTICS Tacoma's development is still, for the most part, on hold until the site environmental clean up is completed there. Neither the class 1 nor the shortline that serve the new Centralia facility have been very helpful thus far and progress there has been very slow. We are ready and open, however, for logs!

WEBS We purchased a new overhead crane, sheeter and stacker system and installation will begin in December. We are also proceeding with plans to construct a new resin lab/plant in Hoquiam. There is still considerable work to do before ground is broken on this major project but everything still looks very positive. We have also applied for a new air permit so we can continue to expand our production.

CONSULTING Once again, we trying our best to kick this awful habit!

New Truck Hours-of-Service Regulations Go Into Effect January 4th

On January 4, 2004 the first substantial change to the trucking hours-of-service-rule (HOS) since 1939 will be initiated. According to the U.S. DOT, the new rule will "... improve highway safety and help reduce the number of truck crashes and related fatalities and injuries by addressing….driver fatigue." The estimates of the likely impacts upon commerce vary depending upon who you listen to. The American Trucking Association (*Transport Topics*, Nov. 17, 2003) suggests that more freight is likely to switch from truck to rail-truck intermodal. They cite Kirk Thompson, president of J.B. Hunt, who has stated that Hunt now plans to use truck-rail intermodal for more trips between 500 and 1,000 miles.

A Few of the New HOS Regulations

1. **Driver's workday reduced from 15 hours to 14 hours.**
2. **Allowable driving time increased from 10 hours to 11 hours per day.**
3. **The driver's required rest period during a day will increase from 8 hours to 10.**

From our research, the Grocery Manufacturers of America (GMA) were the most outspoken opponents of the new rules. They suggested that the rule changes will add costs to our economy of $4.5 billion per year which they predicted will be passed on to consumers. The GMA (*GMA Industry Affairs*) predicted the new rules would "...likely result in more trucks, driven by less experienced drivers, (who would be)...on the highways during major morning and afternoon rush hours…"

The Journal of Commerce (Nov. 10-16, 2003) quoted Wal-Mart (Wal-Mart reportedly is planning to add 275 additional drivers and 300 tractors to its truck fleet because of the new rule). Wal-Mart estimates their driver productivity loss at .8 hours or 48 minutes per day. A transportation consultant, Mike Behnke of SK Consulting, said (in the same article), "I don't think (the 48 minute Wal-Mart estimate) is out of the ballpark".

Trucking costs are about to be ratcheted up again.