



The Rail Log Network

The Paneltech Rail Log Network

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Look Out Industry, Here Comes Koch and 'MBM'!

'For heaven's sake, forest products industry, let the market in!' Those who have been reading our newsletters for the past few years will recognize our frequent suggestion. We believe that only by constructively engaging empowered employees who understand the realities of their factor, capital and output markets, will our companies begin to once again regularly add economic value. This is, of course, the real key to secure, well-paying jobs.

Weyerhaeuser recently announced that they were shutting down their large log

sawmill and dissolving pulpmill here on Grays Harbor. The loss of 345 well-paid jobs will be very painful and some public venting of employee frustra-

tions is understandable. But we have been struck by the letters to our local editor, letters totally focused on Weyerhaeuser. And, given the way

the company has apparently insulated their employees from the realities of their markets, these folks may be justified in their assignment of blame! They seem to have very little understanding of why their businesses are failing and why they are losing their jobs.

'Creative destruction' happens, whether we like it or not. Our employees can help us adapt to it

every day in small, manageable ways or it will happen, as it has here, suddenly and catastrophically causing great personal turmoil and pain.

"...(Koch) has been able to weather the cyclical nature of commoditised businesses...better than many publicly listed companies...'By being private we've been willing to take tough decisions. We absorb volatility. And this is very important,' says Mr. (Charles) Koch. But under the former graduate of the Massachusetts Institute of Technology, the company has also adopted an unusual business philosophy, known as market-based management (MBM). Koch and his employees say this is central to the company's steady growth, seeing it through troubled times in the 1990's. The thinking behind MBM is rooted in the free-market, anti-command philosophies of economists Friedrich von Hayek and Ludwig von Mises (two of our old favorites!)...who believed that societies encouraging entrepreneurial behavior and individual responsibility would create wealth...Koch employees are encouraged to be entrepreneurial., to earn 'decision rights' that allow them to make important business choices...There is no employee salary structure, with employees instead earning according to how much 'value' they create for Koch and its customers...The company even dispenses with formal job titles for all but the top executive positions....Koch appears able to combine a measured approach to growth with one that is at times highly risky and opportunistic- a rare luxury for publicly listed companies. Charles Koch refers to this as part of the 'creative destruction' espoused by the economist Joseph Schumpeter (our favorite!) - a kind of internally generated continuous revolution of business processes...'To survive and prosper long term, you have to create value, not the illusion of value. A lot of companies have failed to see that. '

Jeremy Grant
Financial Times
January 30, 2004



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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

"The famous Hawthorne works experiment over fifty years ago, led organization theorists to abandon the notion that an organization was like a 'machine' that could be programmed and tightly controlled by top management, and to recognize explicitly that an organization is a social system...management cannot 'choose' what is to be done in any detailed way, and has only broad control over what is done, and how well."

Richard R. Nelson
The Sources of Economic
Growth
1996

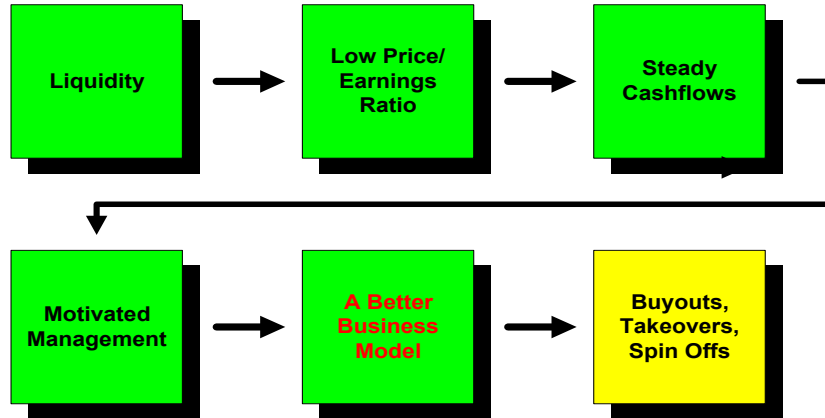


This brings us to Koch's purchase of Georgia Pacific. Why is Koch taking GP private? As this flowchart illustrates, the conditions were very favorable for doing so. GP was what

Stefan Selig of Banc of America Securities calls, 'LBO-able'. The company had steady cash flows and a low price earnings ratio. 'Until the Koch deal was announced, Georgia Pacific's shares largely languished, trading at an average of \$34.17

over the previous 52 weeks before tumbling to a low of \$30.35 on Oct. 14. The price-to-earnings ratio on those shares...was at or near five-years lows, according to Thomson Financial. And the shares traded at a wider-than-usual discount to those of industry peers.' Robert Luke, *Atlanta Journal and Constitution*, November 18, 2005) This was apparently the second buyout offer GP received in 2005.

ance...Correll's share of that: \$15.5 million.' (Robert Luke again) Now that's motivation!



'...Steve Kaplan, a finance and corporate governance expert at the University of Chicago's business school, reckons that it is best not to read too much into deals such as this one, since there is so much liquidity sloshing around

America's capital markets.' (*Economist*, November 19, 2005) But abundant credit- and the other previously mentioned factors that were also inherently favorable to the GP buyout- won't assure the new company's success. Koch also seems confident that they have a superior business model- MBM.

Motivated management? You bet! Pete Correll apparently wasn't one of Wall Street's favorites. "The company...can't seem to decide what it wants to be when it grows up', chided analyst Carol Levenson of Gimme Credit. He will undoubtedly now enjoy pointing to the nearly 40% premium that Koch paid for GP shares. Furthermore, 'Correll...stands to collect nearly \$65 million...Add in another \$84.2 million that he will collect from an additional set of stock awards--plus...shares held by him and his family that are valued at \$20.4 million--and his windfall will be nearly \$170 million...And there's yet another sweetener...If (GP executives)...are terminated without cause or resign for 'good reason' on Dec. 31, they will collectively get \$71.9 million in sever-

"... Tuesday, Koch begins instructing 80 top executives at Georgia Pacific Corp. the intricacies of a central tenet at the new corporate parent: market-based management, or MBM for short...MBM encourages employees to think like entrepreneurs and rewards them financially for their initiative...All of Koch's 30,000 employees undergo training sessions complete with lectures and exercises on the MBM philosophy. The company has already sent Georgia Pacific's 55,000 employees background of Koch and its philosophy. "

Roxana Hegeman
The Associated Press
 November 15, 2005

We have read everything we could find on Koch's MBM philosophy and, frankly, we couldn't find much. What is most interesting about Koch is the background of the family members.

'Founding father Fred..., the MIT-trained engineer, was an original member of the anti-communist John Birch Society in 1958. The sons, who also graduated from MIT, inherited

his politics. David...ran for Vice President of the Libertarian Party ticket in 1980. Both Charles and David are directors of the free-market advocating Cato Institute and Reason Foundation." (Michael Arndt, *Business Week*, November 16, 2005) This much seems obvious- these folks philosophically embrace 'creative destruction', employee empowerment and organizations that are very open to factor, capital and output markets. Should be interesting!



Annual Paneltech Seminars

On November 3rd and 4th we held two seminars in Portland, Oregon, our 5th Annual "LOGS" Seminar and our first, hopefully annual, 'Overlaid Plywood Seminar'. Our LOGS seminar began with another interesting industry outlook presentation by Kevin Bynam of the WWPA. Kevin took the attendees through the industry's drivers and their trends and suggested that we will soon see a turn down in our business that will be moderated by the impacts of the recent hurricanes. Kevin's talk was followed by talks by Chris Waters of Broadway Timber (his typical, no-holds-barred overview of the BC forest products industry and its current trends) and Jon Tweedale of the DNR who talked about DNR timber supply issues. Lloyd Pederson of Pederson Management Ltd., utilizing an amazing sawmill equipment simulation model, then gave attendees a very interesting and provocative review of current small log sawmill technology advancements.

After the break, industry leaders in Class 1 rail (Mel Sanders of the BNSF), shortline rail (Tom Foster, formerly with RailAmerica), barging (Dave Callantine of Brusco Towing and Peter Brown of SeaLink) and trucking (Tracey Lutton of Lutton Trucking) reviewed trends in their businesses, focusing on the impacts of their recently higher fuel costs. While every speaker did a very good job, Mel Sanders of the BNSF (see also page 4) probably gave the most thought-provoking talk. Mel reviewed the BNSF's recent efforts to better understand the costs of servicing different customers and explained why the

is focusing their system development on 'hook and haul' opportunities, opportunities that better exploit the railroad's competitive advantages. Tom Foster, also in his typical, candid, 'tell it like it is' way, tried to put Mel's talk in practical perspective for the attendees.

The afternoon session was devoted to another industry simulation exercise. This was a complex contest that forced each team to analyze their relative competitive advantages in both inbound and outbound markets. It also required a

great deal of negotiation with each other and with transportation services providers. The winning 'mill team' is shown. The winning 'timber team' included Larry Spencer of Probyn, Chris Clay of the BNSF, Jim Dudley of Roseburg Forest Products and Tom Hawksworth of the CORP Railroad.

Our overlaid panels seminar featured talks by Ed Elias of the APA and Ben Horn of Evergreen Harwoods on the competitive threats of plywood imports. Phil Antush of Berschauer Phillips gave an excellent overview of overlaid conform issues from the contractor's perspective and Jeff Lynn gave his usual, highly informative talk on conform field problems and issues. Lisa Bailey of the APA reviewed the technical realities of the new formaldehyde issues and Kent Goodyear of Eco-Trust discussed 'LEED' and green building trends. The late afternoon was given over to the two industry technical 'gurus', Doug Honeyford and Krishan Sudan.



This Year's 'LOGS' Seminar Winning 'Mill Team'- Joel Nelson of Plum Creek Timber, Andy Munsey of Kinzua Resources, Larry Mason of the University of Washington, Jerry Keck of GP, Dan Bruner of Pacific Forest Resources and Chris Waters of Broadway Timber

Recent Paneltech Developments

More 'Extrapolationism'

"...if trends continue as they have, 95 percent of all private forestland in the United States will be in parcels smaller than 100 acres by the year 2010."

Janean Creighton &
Keith Blatner
Western Forester
November/December 2005

LOGS

We have now reallocated virtually all of our unspoken-for log railcars to long term agreements all across this great country. That doesn't mean that we won't have an ability to respond to short term, 'spot' business opportunities and crises (e.g. forest fires, etc.) but it does mean that, if we were to decide to do so, we would need the cooperation of our current customers and the railroads.

WEBS

Our webs and resins operations are now running virtually 'full out', a rarity for this time of the year, and we are making plans to install our second treater and another, bigger resin reactor next year.

COMPOSITES

We now have *Forest Stewardship Council*-certified composites, even a new FSC-certified conform MDO. We are responding to a flurry of new business opportunities (a number of which surfaced at last month's *GreenBuild* conference in Atlanta) and we are making plans to expand our composites operation.

The Paneltech Rail Log Network

Over the past 9 years or so we have made some great friends in the wood products industry. We aren't leaving the industry and, with or without this newsletter, they will remain our associates and friends.

Our Last 'Rail Log Network' Newsletter

As we wrapped up our 5th Annual "LOGS" Seminar in November, I warned the attendees that this might be our last 'LOGS' seminar and that in December we might distribute our last *Rail Log Network*. I have offended everyone that I can imagine offending (especially the big, public forest products companies and the Class 1 railroads!) and I have just about run out of important industry issues to muse over. Furthermore, our industry has changed and our company has changed forcing me, in turn, to adjust my time usage.

While the need for distant logs and distant log markets continues to grow, the Class 1 railroads— due to the rapid growth in their intermodal and coal business— are no longer as 'hungry' for our kind of specialized, carload business. Mel Sanders of the

BNSF gave our recent seminar attendees some very pointed and useful advice that needs to be heeded. This tighter supply/demand balance is prompting the Class 1's to: 1) be much more attentive to the

costs of serving each of their customers and 2) focus business development on 'hook and haul' opportunities, opportunities that avoid the Class 1's competitive disadvantages in switching and 'accumulating'. Our customers need to get engaged with the railroads to help shape this trans-

portation network evolution or they can expect new obstacles and new players to emerge between their companies, their suppliers and their customers.

In January, a new newsletter, *Practical, Responsible Composites*, will be distributed. Let Lynne know if you want a copy.

The Lesson We Learned: If You Want to Better Understand a Complex Subject

1. Make friends with bright, well-informed, well-connected, generous people
2. Write a newsletter to express your current views on the subject and send it to them
3. Revise your opinions based upon abundant, (usually) constructive criticism
4. Repeat step no. 1