

Thank you, Bill.

When Dr. Bowyer invited me to speak about hardwood business strategy over the next ten years, I asked to include Bill Luppold. Bill is the foremost expert on North American hardwood species growing in our forests. He knows better than anyone what species we will be harvesting in ten years time. It may be the only thing that we know for sure about the year 2016. The trees we will be cutting in ten years have already been growing for 30 years plus. The timber that is growing is a sure thing, the only sure thing. There are forces in place today we can use to get vision. Trends, that when coupled with experience, should help us understand what might happen as we go forward ten years. My part of the hour is all about forecasting.

We will first look at the environment our industry is operating in, then at some changes that might occur in the hardwood industry ten years from now, and finally, we will look at some profit generating strategies to be implemented over the next ten years. With that in mind, let's review the forces that grip business today and, in particular, the hardwood business. We will review these forces and the way they might develop, and then make some suggestions that could help us succeed in business during the next ten years and beyond.

The Hardwood Industry

First, let's look at the industry. Present trends will slowly change the market. The marketing of logs has always been a part of the hardwood business. Sorting for pulpwood, saw logs, and veneer logs has allowed timber owners greater returns with each log being broken down to its best use. This trend will continue with more logs being marketed to industries that will derive the greatest value. The North American pulp industry will continue to contract with the world's pulp production ever increasing in Brazil and Asia. Pulp timber will be increasingly used for fuel to generate energy. Saw logs will continue to be exported to higher value mill operations that convert those logs into the dimensions traditionally unique to each country. The trend of large sawmills selling their best logs to Wood Miser type small sawmills and to exporters will continue to expand. Thin curf, slower production mills can get more value out of a log than the larger mills can. The larger mills will increase volume as they produce lower grades for large export customers and specific domestic industries, like the flooring or tie industries. Veneer companies will increase their purchases of high-end lumber logs that may yield a flitch from only one side. International competition for veneer logs will become ever more intense. The overall volume of timber will increase as more long-term investors purchase and manage timberland for investment and recreational use. Timber will be more professionally managed, resulting in, without regard to economic cycles, a more consistent flow of logs to market.

With the loss of 55% of the furniture industry to China, North America also lost the primary market for #1 common Red Oak. Thirty to forty percent of our North American production has been Red Oak and it has generated the majority of the profits for our sawmills, wholesalers, and concentration yards. It is presently in a contraction mode that will eventually drive log costs down and profits will then return.

The Economic Environment

Let's look at our present booming economic environment. The housing market has reached the pinnacle of the present expansion and, as of February 2006, is on the downward slope. Inflation concerns are continuing, which have resulted in a series of 1/4% increases in interest rates each time the Fed meets. Health insurance continues to rise in the double digits. Fuel and energy costs are high and their volatility is a part of our life. Hedge funds are trading company stocks and international currency like real estate speculators are trading properties. TIBOs and REITs are accelerating this commercially and in hardwood timber holdings. The productivity gains of our present expansion have stalled and our present expansion has just started to stall. Consumer spending has begun to drop off and no wonder, since our personal savings rate is at a minus 4%. Consumer spending was driven in the late 1990's by the stock market. In this decade, it has been driven by booming real estate prices. Both wealth effect engines were turbo-charged by a continuous stream of low-priced consumer goods imported from nations that feed our consumption habit by propping up the dollar and creating an impossible balance-of-trade and current account problem. Meanwhile, the Hardwood Industry has been drifting from strong markets for U.S. built furniture to competing globally for the content of furniture now mostly built in China. Even in this present economic building boom, all the signs point to us heading into an economic adjustment period, most likely within the next three years. So, here we are in the present and economic clouds, of what may be a perfect storm, are on the horizon and moving toward us. What can we do?

Present Strategy for a Company in the Hardwood Industry

There is no strategy for the future; there is only strategy for the present. Let me explain. You are born in the present, live every day of your life in the present, and die in the present. You and your business never leave the present, yet the word "strategy" implies having a plan for the future. Here is how it really works; the future is not something you travel into, the future comes to you. Strategy is all about preparing yourself for the situations you will find yourself in when the future comes to you. You have no control over the future; it is what it is. However, you do have control over how well you are prepared. There is no such thing as status quo. You are either dealing with the changes as they come or they are dealing with you. Strategy is about being prepared to make the good things that come better and the bad things that come minimal. Here are nine tips for coping in the present:

- Employ the most capable and the best trained people
- Select your customers and suppliers to fit your company
- Receivables must be pristine; a loss comes directly off of your bottom line
- Pay attention to detail, everything is important
- Know your costs and don't do things that generate losses
- Contain your costs and constantly manage expenses
- Invest in efficiencies to lower your cost per thousand board feet
- Protect your margins, differentiate into niches that create value and support higher margins
- Protect your business from competition, get close to your customers

It is never too early to be as good as you need to be. In the 1960's, Xerox University identified the four profit drivers of every business. It was their contention that if you focused on these four, your business would prosper. The four profit drivers are: volume, gross margin, efficiency, and expense administration. These fundamentals are key to a successful long term strategy. The two that always confuse people are efficiency and expense administration. To clarify, think in terms of employees' output (efficiency) not being in relationship to their salaries or wages (expenses). In fact, it is all about making sure that each of your four fundamentals is always at the top of your management priorities. Today's business must be operated in accordance with all the government regulations, OSHA, Human Resources, tax laws, and environmental laws. You must also be in compliance with the business fundamentals; if you're sloppy, then you're out of business.

Who Cares?

If you go out of business or lose your job tomorrow, who cares? Be truthful. Who would care? If you are running your business correctly the first group that should be grieving is your customers. If your customers are not at the top of your list of "who cares," then there is a fundamental problem in your business. The first order of business in a business-to-business industry and the only reason a business exists is to help its customers to make money. If you are not creating value for your customers then you are vulnerable to being taken out in the next down turn, if not sooner. Make sure your customers want you to be their supplier because, with you, they will make more money. Without you, they would be forced to buy from one of your competitors and make less money. If you are managing your business correctly, your customers would suffer if you went out of business. That is why they would care.

It is difficult to differentiate yourself in the hardwood business, but it is possible. The first rule is to sell to customers that understand what makes you unique. If your customers are sending you signals that you are "like everyone else," then find new customers that value your relationship. Find customers that appreciate your uniqueness. If you are not unique, become unique. Do not waste time with the "commoditizers" of the world, the ones that try to make you feel that your products or services are like everyone else's. If you cannot find customers that want you to stay in business, then you have a problem that needs fixing and the first place to look is at the credits you issue.

When a customer makes you write a credit, that customer is telling you that you are doing something wrong. If you do not understand what is right, ask the customer. If you cannot meet the customer's needs, find a different customer. Get customers that run their businesses similar to the way you run your business. Match the culture of your customers with the culture of your business as closely as possible. The premise of the book, *The Discipline of Market Leaders: Choose Your Customers, Narrow Your Focus, Dominate Your Market*, by Michael Treacy, is that three cultures drive business and the success of a business depends on how focused the culture of that business is on one primary driver. The three drivers are: marketing, process excellence, and innovation. Each of you should know which one of these three most identifies how you create value for your customers. Focus on your primary driver and find customers that appreciate what you do. Find customers that would care if you went out of business.

Remember, you are always in the present. Your customers only care about what you are doing for them right now. They do not make money with your dreams or aspirations. The more you do to enhance your present value to your customers, the more they will care if you go out of business. Even with customers that love what you do for them, you must be prepared for what outside forces will throw at you. In order to be ready, here are some forecasts for the next ten years.

Ten Years Forecasts

- The pace of business will accelerate exponentially
- Fragmentation will increase
- Increasingly, a greater percentage of kiln dried lumber will flow through concentration yards
- Niche marketing and small mill technology will make every small mill viable
- Distribution will become an ever more important path to an ever growing number of small custom shops through value added milling
- Great export emphasis, with increased sophistication of worldwide customers
- Continued profit margin erosion due to extreme competition
- Continued increase in the volume of standing timber inventory
- Improved communications and increased business sophistication for all businesses, big and small; the internet being the great equalizer
- Companies will have survived one significant recession and one slight correction
- No paper pulp, to speak of, will be manufactured in North America; the chips will be used as fuel
- Markets will open for lesser species that are now thrown in the pallet log pile
- Due to better education and communication, logs and lumber will move more efficiently to the most lucrative markets
- Transportation costs, due to fuel and labor, will become a much greater percentage of delivered cost of lumber and logs accentuating the need to have the best suited raw material and grade for each end product
- Escalating employee costs, including health insurance and worker's compensation, and government compliance will drive great efficiency in all hardwood processes
- The cost of a mistake will escalate. We will be going into an age of "no mistakes."

In closing: the only reason you exist in a business-to-business enterprise is to help your customers make money. That is a constant, whether it was 50 years ago, today, or ten years from now. Your customers' prosperity is the only thing that counts because without it, there is no reason for you to be in business. That relationship is only healthy if your customer prospers. Choose your customers wisely, focus on your customers, give them the best ingredients and services to make their products, and in any market, at any point in time, you will always prosper.