



# MANAGING RISK AND LOG FLOWS WITH WOOD SUPPLY AGREEMENTS (WSAS)

**Editor’s Note:** Often we hear from BC’s major licensees that their mills can’t operate without tenure because tenure gives them the fibre security they need to run a successful business. So we thought we’d take a look at the US South—currently the epicentre of forestry in North America and the receiver of many investment dollars including those from Canadian forest products producers. The irony is that these Canadian forest products producers who claim to rely on tenure in BC to run their mills in Canada are also happy investing in the US South—a place without public tenure where most timber supply agreements are business-to-business. So, is tenure really providing critical fibre security? Or is it just propping up an oligopolistic marketplace?

In the United States, wood procurement managers and foresters do not access logs through tenure such as their BC counterparts; rather, they rely on a range of private and open market transactions to supply raw material to sawmills and pulp mills. Forestry professionals in the US juggle, at a minimum, stumpage contracts (direct purchases of standing trees from mostly private landowners), fee harvests (trees cut from lands owned by their own company), and gatewood (logs delivered by truck “to the gate” and woodyard at the mill) to manage wood flows and log inventories. With clear skies, a flexible group of foresters and loggers, and a well-running mill, these managers may enjoy periods of relative calm as wood flows and mill needs match perfectly.

However, Mother Nature and Mr. Market rarely consider the needs of the forest industry when shaking their giant snow globes. During periods of stormy weather, when loggers and log trucks stay out of the woods (in the US) and uncommitted logs hold out for higher prices, procurement managers spend days at the mill counting truck loads and watching the wood pile shrink. Many a mill manager has ominously said to the procurement team, “You’re the best group of foresters I’ve ever had...’til we run out of wood.” And many a procurement manager has paid dearly for those final loads of logs that let the mill complete its final shift.

Therefore, wood procurement managers sometimes employ wood (for roundwood logs or for chips) supply agreements (WSAs). These WSAs help manage the costs and flows of wood raw materials

to manufacturing facilities and mitigate operational impacts of timberland divestitures by integrated forest products firms who previously owned substantial acreages of company forests. A typical WSA comprises a contractual obligation by a supplier to provide agreed-to volumes of wood to a buyer, who commits to purchase this raw material at the contract price for a set number of years.

We can picture WSAs as part of a portfolio of activities, or menu of alternatives, used by mills to procure their wood supplies. The Wood Supply Matrix below highlights the fact that mills balance the cost and control of the wood they buy over time based on the situation in each local market.

- Domtar’s sale of its northern New York lands to Lyme Timber (a timber investment management organization or TIMO) and The Nature Conservancy included a long-term fibre supply agreement supporting its papers mills in Quebec.
- Fraser Papers’ sale in Maine to The Forestland Group (a TIMO) involved assets once held by James River, and included a long-term wood supply agreement.
- Boise’s 2.2-million acre sale for \$1.65 billion to Forest Capital Partners in 2004 included long-term wood supply agreements for the former Boise plants. Forest

Wood Supply Matrix

	Less Expensive	More Expensive
Full Control	<b>Portfolio with financial contracts</b> , such as supply agreements	<b>Direct purchases</b> , such as buying stumpage from landowners
Less Control	<b>Gatewood</b> , such as setting a price where loggers can choose to deliver logs	<b>Indirect purchases</b> , such as providing loggers a price in advance to buy logs

Source: Forisk

For all of the challenges they can present—establishing viable volumes against verifiable specifications, implementing and maintaining pricing mechanisms—WSAs provide a useful risk management and negotiating tool. Forest industry sellers of timberlands often included wood supply agreements of 10 years or more in transactions with institutional buyers. The following transactions over the past 15 years, for example, included a range of supply agreements:

- Capital Partners has since sold these timberlands.
- International Paper’s sale of over five million acres in multiple large-scale transactions between 2004 and 2008 to TIMOs including GMO, Forest Investment Associates, TimberStar and RMS were all subject to long-term WSAs, many of which still influence today the terms, management and marketability of the underlying timberlands.

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for Mobile Logging Equipment in British Columbia.”

WorkSafeBC also developed an inspectional checklist, “Traction-Assist Logging Equipment Inspection Checklist,” for our occupational safety officers, which is also available on our website so employers can know what to expect.

FPInnovations, in addition to their guide to best management practices, have produced a guide for conducting a basic cable inspection: “A guide to wire rope handling and inspection for machine operators.”▲

*John Ligtenberg participated in the panel “Steep Slope: Climbing Higher” at the January TLA Convention & Trade Show. This report is drawn from his presentation.*

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In sum, timberland-owning firms and investors may work with sufficiently long time horizons—typically 10 years or more—to mitigate log price exposure by adjusting harvest levels with log price levels. However, these same firms may require short-term regular cash flows or wood

flows, and WSAs can support these objectives. This is especially true for wood procurement operations, where daily, weekly and monthly wood material needs drive the schedule.▲

*Brooks Mendell is President and CEO of Forisk Consulting, which conducts research of timber markets and forest operations. This article includes data from the Forisk Research Quarterly (FRQ), which includes forest industry analysis and timber price forecasts for North America.*

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