

THE ECONOMIC PROBLEM - COSTING & FINANCE

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BACKGROUND

The statements made and views aired in this paper are based on my personal experiences over the past 10 years in relation to the subject of Limited Scale Logging on three fronts:

- (a) Assisting and advising existing or would be logging contractors on this type of operation.
- (b) Assisting and advising small woodlot owners, farmers and sawmillers wishing to carry out a limited scale logging exercise.
- (c) Co-ordinating and advising growers, loggers, carriers and sawmillers in carrying out a limited scale logging operation to mutual benefit.

I begin with a note of historic pessimism. I can recall over this period observing the end results of a number of limited scale logging operations which have been less than satisfactory.

- Loggers well out of pocket through underpricing or underestimating the nature of the woodlot in terms of degree of difficulty of extraction, recoverable and merchantable volume and piece size.
- Woodlot owners without a formal cutting agreement with the logging contractor waiting in vain for promised timber royalties or for reinstatement of fences and the full clean up promised by the logger prior to his commencement.
- Stockpiles without a market due to failure by the logger to tie up an outlet prior to commencing or being caught in a market downturn and finding his export, sawlog and pulpwood markets disappeared overnight with no immediate sign of resumption.

In balance, I can also recall over the same period a number of Limited Scale Loggers who have enjoyed a continuing and mutually productive relationship, usually with one of the major timber or pulpwood companies, for whom they have logged on a semi-permanent basis often under their negotiated terms, conditions and supervision and have thus avoided the resultant problems noted above.

Prior to addressing the specific subject of costing and finance,

I wish to define who and what is a Limited Scale Logger and outline the general basis of his employment. I believe that a clear understanding of these factors is fundamental to being able to overcome the problems peculiar to this smaller type of operation which cause great pain when trying to accurately cost and obtain finance assistance for Limited Scale Loggers.

DEFINITION OF A LIMITED SCALE LOGGER

In my view a Limited Scale Logger is an operator who is employed to carry out a logging exercise of small volume, short duration or low log supply requirement. I would contrast him with a term contractor holding a 3 to 5 year contract with a major industry employer such as N.Z. Forest Service, Tasman, N.Z.F.P. etc.

The Limited Scale Logger in the Bay of Plenty, which forms the majority of my experience in this subject, can usually be placed in one of three groupings :

- (a) A young logger making his first foray into contracting. He is hoping with his very limited capital availability to commence logging in a small way with one low capital machine and a 2 to 3 man crew and attempt to build up both his capital and his reputation as a stepping stone to obtaining a long term contract with a major forest industry employer.
- (b) A proven and experienced logger who has possibly held a long term contract with a major forest industry employer who has fallen on hard times perhaps through non-renewal of contract at expiry or term or through lay off due to restructuring or down turn in timber industry. He sees Limited Scale Logging as a means to retaining his experienced crew and maintaining his capital investment until he finds another long term contract position.
- (c) A proven and experienced logger employed on a semi-permanent basis by a sawmill or other parties such as professional Forest Managers to log a collection of smaller woodlots on their behalf. The continuity of this work is subject to forward woodlot availability on one hand and log requirement on the other.

However, in normal stable periods, this form of relationship provides the logger with far more financial security than the usual Limited Scale Logging operation will. It is encouraging to note a growing trend toward this type of logger/user relationship based on mutually beneficial and responsible lines.

Limited Scale Logging is often treated by both logger and the log buyer as a part time operation only due to compelling reasons of scarcity of volume, one-off logging blocks, adverse terrain and soil type perhaps preventing winter logging etc. Two such examples come to mind - one local contractor who logged and thinned farm woodlots during summer months and became a tree planting and silvicultural contractor involved in establishing and tending a variety of farm woodlots - the second case involved a summer logger with a partner who jointly became house builders

during the winter months.

The next factors I will cover relate to machinery and labour, both items being covered in far greater detail in this seminar by other speakers. My references are very general but continue to build a picture of the nature of a Limited Scale Logger and the problems he faces which become far more obvious when he attempts to cost and finance his proposed operation.

MACHINERY REQUIREMENTS

In my experience, the Limited Scale Logging operations will not stand the cost of new or near new logging machinery unless the logger is fortunate enough to enjoy a well rewarded semi-permanent position as outlined previously. Thus in the main, the loggers in this type of operation operate older used skidders, tractors, loaders etc. Age usually also means diminished reliability with associated increased downtime and repair cost.

The daily log volume expectation on Limited Scale Logging does not perhaps require new or near new equipment as compared to a highly geared operation in a long term contract situation with a major forest industry employer, and perhaps this lower production operation is an ideal place to "retire" an aging machine. But who can afford the crippling effect of lost production utilisation and heavy overhaul costs, especially when based on an insecure cashflow from a non-permanent or small scale operation with minimal operating margin.

The Limited Scale Logger will attempt to own and operate multi-purpose logging equipment in an attempt to cover as many varieties of logging operations and their specific requirements as possible. Thus often tractors are seen where skidders would be ideal or vice versa. In other instances a tractor is required to carry out basic roading and tracking which, except in the simplest situations, is impossible to carry out with a skidder alone. Other examples may be where machinery size and horsepower is totally mismatched to piece size as a Limited Scale Logger tries to make do with the equipment in hand.

LABOUR

In areas such as the Bay of Plenty where there is an established logging industry, the Limited Scale Logger, due to the non-permanent nature of his work, his low level of capital investment and used equipment tends to only attract the less experienced and less skilled logger employees. Often he will have to fully train personnel who are new to the bush and when this training is complete and these employees now have some value to the logging industry, they give notice to the Limited Scale Logger and migrate to a permanent position with an established long term logging contractor.

This factor becomes both an operating problem and production restriction to these smaller operators who already have a large inventory of obstacles to overcome to make their activities viable.

SUMMARY TO DATE

I have indicated to date that the Limited Scale Logger probably demonstrates some or all of the following problems :

- Semi-permanent employment only
- Low capital investment in older machinery
- Low level of logging experience in his crew

Having accepted the above factors, the Limited Scale Logger must now attempt to accurately cost the operation he has selected or been offered to assess its overall viability to himself and perhaps compute log royalty or timber stumpage rates for woodlot owner if these have not been already dictated to him by other market forces in the area etc.

COSTING

Regardless of whether he is an on going logging contractor with existing equipment about to commence a new block or a new contractor starting out to set up a crew and machinery, the Limited Scale Logger must carry out a full costing exercise to ascertain his various projected operating costs in relation to this specific logging area. This often will not occur, the Contractor using the operating costs from his last job which seemed to give the right result there, although the factors of piece size, terrain, volume etc may differ considerably in this new area.

The Limited Scale Logger probably does not have the background required to accurately cost the operation he proposes to carry out and because of the sporadic and perhaps marginal nature of his activities, does not seek professional assistance from an accountant or consultant who would advise him of both his costs, likely levels of production and overall financial viability. The Limited Scale Logger can also obtain from these professionals a base daily cost format to which he can relate his proposed target production levels at any stage and assess viability in its simplest form whenever desired. The danger of this is that he will continue to use this base costing format long after cost increments have rendered it extinct.

These type of operations have far more cost variables involved than most long term production operations for major industry employers who usually carry out all roading, metalling and skid preparation work prior to the contractor moving on to the new block.

Thus this costing must reflect, in addition to a basic statement of owning and operating factors, the cost of obtaining and maintaining access to log truck standard throughout the intended logging period, plus perhaps cover farm fence reinstatement and a full clean up of cutover, slash etc at termination of logging.

To accurately produce a costing to cover all the normal and extraordinary factors is one thing, but to relate it to a realistic daily production target when the operation is probably

governed to a major extent by the weather, the purchasing sawmills log requirements, the mechanical condition of the contractors equipment plus a level of attendance and logging experience of his crew, is often impossible and a number of assumptions and generalisations thus enter the calculation. Too often I have noted a contractor's original production estimate at commencement of operations collapses when actual output in tonnes is compared with number of days of logging input at any point.

In many situations, the Limited Scale Logger is a pawn in the overall game when it comes to costing. He is usually fired with enthusiasm to do a job or alternatively desperately needs this job to fill a gap in his cashflow and thus retain his machinery. He thus believes, rightly or wrongly, that he thinks he can do it at the stated price without reference to anything further than his "Park Drive" costing system and verbal undertakings as to the normal going price for this type of work in the district.

The price may already be set for him by market forces and he is left to attempt to operate productively within the constraints the other parties to this total proposal have set down. In my experience, the costing chain for logging of small woodlots goes as follows :

- (a) What is the sale price per tonne at the sawmill (usually set by supply and demand market restraints)?
- (b) What is the cartage contractors rate for delivery to the sawmill?
- (c) What is the log royalty or timber stumpage demanded by the grower (often set by market restraints and offers made by other sawmills etc)?

Having deducted all these stated costs from the sale price, the logger is left with a balance to fully cover all his owning and operating costs in winning access to the block, extracting and loading out the logs and cleaning up afterwards.

Example : (N.B. Figures indicative only)

| | | |
|---|-----------------|----------------------|
| Sale price delivered to Sawmill | | \$35.00/tonne |
| Less : Cartage Cost | \$10.50/tonne | |
| Weighbridge Cost | .50 | |
| Royalty on sawlogs uplift to owner | <u>8.00</u> | 19.00/tonne |
| Balance available to cover access, logging and loading costs plus post logging clean up if required | | <u>\$16.00/tonne</u> |
| Estimated daily production = 2.5 loads x 25 tonnes = | 62.5 tonnes/day | |
| Projected daily income 62.5 tonnes @ 16.00/tonne = | \$1,00.00/day | ===== |

Is this residual amount based on estimated daily production sufficient to meet all operational outgoings and capital

repayments plus the heavy cost of machine transport which has a notable cost on short duration logging operations in distant areas.

The Limited Scale Logger, in most cases, will be responsible for negotiating cutting rights on his intended block plus all the associated logging and roading planning, target setting etc without the assistance of any concrete mensuration data as usually supplied by major forest industry employers. Limited Scale Logging does not produce the economies of scale which allow for the costs of logging professionals who would carry out all these functions on his behalf and avoid the usual stop/start problems involved in completing one block and tying up the next which takes its toll on both the logger's cashflow and attendance continuity of his employees.

It is encouraging to see more sawmill buyers or professional forest managers recognising these problems and carrying out a number of these functions on behalf of or in conjunction with the logging contractor thus avoiding costly delays, disturbance to log supply and in some cases entering woodlots where an economic return cannot be made.

To summarise costing :

- (a) Limited Scale Loggers need to seek or be offered professional advice in the costing of their operations both on operational cost, target setting and logging planning.
- (b) Log buyers need to recognise the many responsibilities and problems a Limited Scale Logger has in negotiating, winning and delivering log supply to their sawmills etc and assist in these processes for mutual benefit or in some way allow the contractor to seek professional assistance, which in the long run should assist both logger and log buyer.
- (c) Limited Scale Loggers need to keep accurate records of costs versus production on an extremely regular basis so that any disturbing trend of either cost or production level is noted as soon as physically possible and acted upon at an early stage rather than when his already lean operating margin is totally engulfed and his meagre capital investment further diminished.

FINANCING

With all the previously noted problems in general already known by finance houses, banks etc, the Limited Scale Logger in many instances faces an uphill battle to obtain finance for either his initial machinery purchases or replacements thereafter.

The established Limited Scale Logger with a semi-permanent relationship with a sawmill will, however, fare much better, being able to both demonstrate this relationship through letters of intent or undertaking from recognised purchasing sawmills plus past stable and productive financial operating statements.

A financier looks for, in any proposal, the following pointers prior to deciding if his investment is warranted.

- (a) Security offered for advance sought - i.e. the machine under purchase, equity in business, availability of collateral mortgage over contractors house etc.
- (b) Security of Employment - will the job exist at least as long as the finance repayment term? Often impossible to predict in Limited Logging scene. Finance houses, for obvious reasons, are loathe to lend on a proposal that only has 6 months work up front with the future after that in doubt.
- (c) Cashflow - probably the most important factor and comes back to the contractors ability to accurately forecast his production volumes, costs and continuity of employment. If the cashflow statement offered is inadequately prepared, too brief or vague and shows a minimal margin, the application for finance is unlikely to succeed.
- (d) Reputation of the Applicant - most new Limited Scale Loggers will have perhaps nothing but a few work references, a Loggers Certificate, a ton of enthusiasm and a handful of woodlot logging agreements. This is obviously nowhere near as attractive to a financier as a 5 year logging contract with a major forest industry employer.

Finance houses, when advancing money for purchase of capital equipment, demand higher cash deposit percentage on used equipment, especially where this machinery may be over 5 years old. They back up their claim for this higher deposit with sound statistics derived from past case histories on their records of operators in this Limited Scale Logging area who have run into financial difficulties for one reason or another or who have failed in total and the equipment, when repossessed for resale, has not rendered, due to excessive age or run down condition, anywhere near its used purchase price paid out perhaps only 6 - 12 months previously.

Often the Limited Scale Logger's only financial equity is tied up in his family home or car. It is thus a massive risk he takes in committing these personal assets to a venture based on perhaps marginal returns at best and of a non-permanent nature.

Banks, likewise, when assisting with overdraft facilities for basic working funds, seek in the majority of cases collateral mortgage security to cover their risk.

Most financiers, with reference to past problems they have encountered in this area of operation, will either seek to obtain security which renders their financial risk to the minimum and in addition check the reputation of the log buyer, verify the term of log supply, terms of cashflow from log sales and any other relevant matters prior to committing themselves to assisting a logging contractor.

Again, I can recall where Limited Scale Logging operations have been effectively "torpedoed" by a very few log purchasers who have for various "sound" reasons offered delayed payment to the contractor for logs supplied way past normal and acceptable terms of credit. True, they have paid in full but most belatedly and perhaps too late to prevent termination of fuel supply, default on machine repayments and perhaps even wages. This will further strain the relationship between contractor and his financiers and make his next approach for assistance more difficult.

Happily, the majority of log buyers are prompt in processing log delivery details and thus maintain the contractor's all important cashflow.

SUMMARY

In the view of most, my address so far probably seems over pessimistic and negative towards the chances of a Limited Scale Logger surviving. I wish to stress that in general terms I hold no fears for the survival of contractors working in semi-permanent relationships with sawmillers, log buyers or professional forest managers who see Limited Scale Loggers as a vital and most useful part of their log supply program and are prepared to assist the logger in negotiating and planning woodlots for supply to produce viable financial returns to all parties concerned on a continuing basis.

My comments in the main are directed at loggers who are supplying logs on a short term basis, either as a fill-in job for the contractors, or additional supply for the sawmill over and above their normal allocations from their main resource or wood supply agreement. These are the loggers who are most vulnerable to changes in demand, do not have the basis of continuity to establish a well capitalised operation with experienced employees to generate regular and adequate cashflow which financiers can hang some confidence on in meeting their requests for assistance.

It is obvious, that with the large area planted over recent decades in small holdings either as well maintained woodlots or Agroforestry blocks on the dirty back acre, that we will see a growth in the requirement for Limited Scale Loggers. In order that these new contractors can succeed and supply this future log volume to sawmillers and other utilisers on a viable basis, the latter groups in my view must be prepared to assist in providing better than casual employment arrangements to ensure the continuity of both the contractor and the log supply.

Recognizance of the contractors operating costs and physical problems is vital and any assistance that can be offered by way of logging planning and financial costing will be rewarded by better contractors with better equipment and better employees producing better grades of logs on a regular basis.

If we are to efficiently utilise the volumes available from these small blocks which collectively form a most valuable resource, we need to foster and encourage the Limited Scale Logger so that he can prosper and obtain the necessary finance assistance he requires. The benefits will be mutual.