MANAGING THE ASIAN CRISIS - A COMPANY PERSPECTIVE

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I would guess there are not many people in this room who have not been affected by the Asian crisis. If anyone hasn't been, then please see me after this session so we can talk about swapping jobs.

I will plead New Zealand's unique fifth amendment – "Commercial Sensitivity" – on some detail, but by and large I'll cover the lead up, the wind down and, dare I say it, the recovery, from my company's perspective.

They say a lot of business is done on the golf course. My first indication that we were indeed facing a genuine problem occurred on the St Clair golf course in Dunedin in November 1997. At that time I was playing with some Korean buyers, when a news release came through that the Korean exchange rate had deteriorated to 1000 Korean won to the U.S. dollar from an historical base of about 850 won. If they were seriously concerned then – and they were – worse was to come. From that point the currency went into virtual free fall and within the month the Korean currency was trading at 1800 won to the U.S. dollar. There was a crisis!

THE LEAD UP

Wenita Forest Products' harvesting and marketing strategy has traditionally been heavily aligned to the export log market reflecting, in part, the distinct lack of domestic processing capacity in the Otago region. Concomitant with the change in our resource, the percentage being shipped in log form has been progressively reducing. However, by volume, export log trading remains the most significant individual component of our marketing strategies. Ordinarily, Wenita delivers about 20,000 m^3 per calendar month of various export log grades to Port Chalmers. With the exception of an Indian order scheduled for completion in January 1998 forward export orders had virtually dried up by mid December 1997.

The effect of the Asian melt down on export log trading particularly, and log production generally, is dramatically illustrated in the following table:

COMPARISON OF MONTHLY HARVEST VOLUMES *(Table 1)*

Month	**Total Cut 1997/98 (Expressed as a % of 1996-97 Cut)**	**Export Out-Turn % of Total Cut**
December	63%	78%
January	59%	38%
February	55%	19%
March	79%	32%
April	58%	4%

With the same number of dedicated crews (8) a production crisis was clearly looming. For much of the period, production was constrained by imposing gang stand-downs. Production was further constrained by salvage logging from stands hit by gales on December 01, 1997.

Low production salvage logging was creating the opportunity to maintain contract continuity but the margins were being squeezed, with low commodity prices and significantly higher unit production rates.

The situation clearly couldn't continue.

MARKETING STRATEGIES

The opportunity to substitute domestic processing options in lieu of the pre-existing export markets was very limited – at least in Otago. Company plans to develop a multi-faceted wood processing plant in 1996 foundered in the face of a hostile campaign to abort the project.

A number of domestic processing options were, however, confirmed:

- The Company's Rosebank sawmill was put on a double shift cutting strategy with effect from February 23, 1998 (staffed by assigned silvicultural workers). That strategy increased Rosebank's daily log requirement by 90% (from exclusively pruned grades to mixed log grades).

- A sale was negotiated with a local moulding company, that sub contracted a Milton sawmill to cut exclusively on their behalf.

- A substantial sale was negotiated with the region's major processor for un-pruned log grades.

The good news was that we achieved a marketing swing from 75% export sales to 100% domestic. The bad news was that our harvested volume had to reduce by 50%.

In the lead up to these traumatic events and decisions subsequently taken, one point was consistently overlooked. The imperative for companies to market is as equally compelling as the contractors' desire to harvest.

In the situation Wenita faced, there was no alternative but to make the hard call.

The decision was taken to halve our logging contract base for an indefinite period.

THE SELECTION PROCESS – LOGGING CONTRACTORS

For the first three months of the crisis production levels were manipulated by finishing up the 1997 year one week early, enforced stand downs, non-replacement policy applying to workers leaving (they were encouraged to leave if they could find alternative labour) and low productivity salvage logging. From Wenita's perspective eight gangs were slowly going down the gurgler. None were honouring their Payment Notes, although most were maintaining interest only payments. To some limited extent we were compelled to enhance normal contract rates, and in any event harvesting costs were running about 30% above budget forecasts (salvage operations).

For better or worse, management made the decision that we were committed to ensure the survival of four crews. They would be fully crewed and, within reason, no production constraints would apply.

The retained crews would have to match our normal production mix of 23% ground based and 77% hauler.

The ground based contract, which assured "guaranteed" production levels was internally tendered (two crews tendering for one contract) and achieved an excellent outcome.

For a number of reasons it was not practical to tender the hauler operations. Domestic markets decreed that we were compelled to harvest intensively treated stands and crews established within that resource got the nod. We were also committed to retaining crews that had the "best" plant for our conditions and avoid high transfer charges. No minimum production levels were implied.

So, the selection process identified one ground based and three hauler contracts and a like number were identified as "surplus to immediate requirements".

The die was effectively cast and one on one interviews with all the contractors produced a predictable response – total relief to total despair. Having gone through that I wouldn't wish it on anyone. I'm not worried about going to hell; I've already been there!

CARTAGE CONTRACTORS

Interviews with the three cartage contractors retained by Wenita confirmed their preference to ride the situation out. There was clearly an option available to tender cartage rights for the reduced volume available but this was not followed through. No rate concessions were requested, or offered!

During the course of that Black Friday (March 20, 1998) interviews were also held with log marshalling and stevedoring company representatives, finance institutions and roading contractors. It was a full-on day.

HOLDING MODE

The performance graph (attached) clearly shows the down turn for the three months April to June 1998 inclusive.

During this period a number of positives did arise:

- Workers had been leaving progressively since January 1998 and the impact on contractor employees as at the time of laying off crews was ameliorated. From December 15, 1997 to March 20, 1998 employee numbers reduced from 68 to 30 (56%) and, almost without exception, all found alternative work. The impact on workers was therefore minimal and that was a very surprising outcome.

- Two crews that were suspended sourced alternative work in the wood-lot sector. They were only operating in survival mode but it was an opportunity that we had not anticipated.

- I must pay tribute to the financial institutions who, without exception, stood by the contractors and took a very flexible approach to managing payment terms, and ensuring their ultimate survival. The cynics would say they had little choice but having had continual dialogue with them over the past six months I was conscious of their personal concern for the contractors.

- From June 1998 we contracted one hauler crew back into our strength, operating as a three-man crew. This option worked particularly well and although they were only generating about $1,600.00 / day from a physical achievement of 90m^3, that was sufficient to at least honour interest only payments on their borrowings. The option maintained core skill levels within the gang, ensured their medium term viability and when things started to move, this crew subsequently achieved record monthly production volumes. I would emphasise that no contract rate relief was conceded.

- The wood-lot sector, predictably, started to deteriorate quite quickly and one crew was contracted back to log road lines from early July 1998. Again, it was in survival mode but they were meeting minimum re-payment obligations.

Traditionally our hauler crews have come in after ground based operations have been completed. We were now road lining to set up hauler crews in advance of ground based crews and the concept is encouraging.

So, we had moved from four retained crews on 27 March 1998, to six by mid July 1998. A recovery was imminent.

THE WIND UP

Export log marketing opportunities started to develop from mid July 1998 and the hauler crew engaged with limited personnel geared up to full strength (8 men) from July 01, 1998. Another hauler crew was re-engaged in late July 1998 and, starting from scratch, they had problems in sourcing skilled labour.

The second ground based crew re-started in August 1998 and at that time all eight crews were effectively operating without any production constraints.

The volume harvested in September 1998 was the third highest recorded in the company's history and that will almost certainly be exceeded for the October month and again in November. Not a bad effort! The volume recovery in the export sector is illustrated below:

Month (1998)	**Export as at % of total cut**
April	4
May	19
June	24
July	47
August	54
September	67
October (est)	68

We have come through what has been arguably the most traumatic period in New Zealand's recent forestry history with our harvesting base intact.

WHAT WOULD WE DO – NOW?

Given the same set of circumstances, and with the benefit of hindsight, I believe we would handle the situation differently – and with more sensitivity.

We would almost certainly internally tender the ground based contract again and, given that there has been a significant recent relocation within the hauler crews, simultaneously tender a hauler volume.

Those two selected crews would not be constrained by volume quotas. The six remaining crews would be allocated residual volume on a pro-rata basis and would be effectively committed to operating with reduced crew levels. That option would at least maintain operation viability in the medium term, and allow key personnel to be retained within all crews.

I am well aware of the fact that one of the suspended hauler crews was within one week of selling their hauler and effectively abandoning their contract. In the context of the recovery we have experienced that could have been disastrous for us.

Contrary to some views, I don't believe there is a surplus of contractor expertise within New Zealand. There is a considerable increase in the Otago harvesting level projected within the next three years and a real responsibility for Wenita Forest Products to maintain the current infrastructure to build on it when those cuts do increase. There will be change, but timing is critical and now, in my opinion, is not the time. That doesn't imply that we are subsidising contract rates to achieve any regional objective – quite the contrary.

In opting for the status quo, I am very conscious of the fact, as are my Directors, that the major Corporates have chosen the timing (that might not be fair) to introduce radical new contractor structures – the so called key supplier concept.

I don't intend to comment on the concept but it would be alien to our production philosophy and , without the necessary "support" of a domestic processing base, largely unworkable. There is daily contact between Wenita staff and the contractors and there is an implied assurance that the prime contractor will be present on site.

If there are cost savings, what is the base from which they are being made? I am certainly aware that within the changed structures, some planning and administration costs are being moved sideways. Did I say I wasn't going to comment on the concept!

One positive thing I can say; our production philosophy has remained constant – we didn't change anything during the 1993 boom either!

But changes have evolved during the past six months of stress:

- A specialised contract felling crew is now sub-contracting to four hauler gangs.
- Trucking companies have become much more active in sourcing new cartage opportunities, with some excellent results accruing back to us (and them).
- We are, as a company, constantly reviewing marketing strategies and reacting quickly and positively to new opportunities - absolutely nothing is constant.
  - the only constant is change

Confidence has returned; is it sustainable? Economists are predicting there is still more pain to come but given that they have successfully predicted seventeen of the last two world recessions what credence do we give them.

You can think negative and say that Korea is struggling with 15% unemployment or you can think positive and say that 85% are employed.

There is confidence. Within the last month there has been new plant investment within our contracting base to the approximate level of one million dollars. I will be eternally thankful that we have come through the crisis with our infrastructure remarkably intact. I am conscious of the fact I am referring to the crisis in the past tense. In the meantime we are flat out and, returning to the session theme of thinking smarter, we have evolved a new production strategy. The 'just in time' production strategy has become "just about in time".

What else changes!

GRAPH 1: Comparison of Monthly Harvest Levels
Wenita Forest Products Limited