Financing of Timber Operations

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An investment which was quite common several decades ago, was the purchasing of large tracts of timber land for speculative and business purposes.

Thirty years ago, many large tracts of timber could be bought at low prices; many wealthy men bought stumpage for speculative purposes--holding it till it could be disposed of advantageously at a good profit. This phase has mostly been relegated to the past as timber has probably attained nearly its ultimate price increase upon which the speculator was dependent.

Timber was purchased by loggers and lumbermen for their operations for the following reasons:

1. The timber operator and manufacturer must buy practically all his raw material at one time unless he is located close to an national forest from which it is possible to purchase timber in smaller quantities. Seventy-five percent of the timber operator's capital is in timber, the balance being in mill and equipment. This condition is unlike the average industrial where the principal investment is in the manufacturing plant, with the necessary raw materials used in manufacturing to be purchased at any time in the open market and only necessitating a small proportion of cash outlay until converted into the finished and marketable product.

2. The price of stumpage was advancing so rapidly that the operator thouroughly conversant with the situation knew that if he were to keep his business running for any length of time and receive the

benefit of the rise in price of lumber, he must buy at the then prevailing prices all the available stumpage which he could finance.

3. The day of economical mill operation without timber ownership was rapidly passing. Owners of small tracts of timber were practically all sold out, and the owners of large tracts would not sell piece-meal, if at all.

4. The easily accesible tracts of timber were rapidly being cut out. Some of the best timber was far removed from transportation and manufacturing centers. It would not be practicable to buy small tracts of such timber and build modern mills and railroads to cut, log, manufacture, and market the timber. The only profitable method was to buy the outlying timber in large tracts and thereby insure a long cutting for a large mill which could easily carry the construction charge of the railroad and the installation of modern logging and manufacturing equipment.

Promotion of the Project.

At times, the proprietor was sufficiently wealthy to handle the financing of the project himself, but more often it was necessary to resort to other means of securing capital such as issuing bonds or taking partners into the enterprise.

At present the main field of timber financing is concerned with the promotion of sawmills or logging operations. Due to the fact that a very large amount of money is necessary to build a sawmill or purchase logging equipment and stumpage, modern financing has entered the lumber field to make possible the large organizations now present in those fields.

The various methods of promoting the businesses are as follows:

1. Individual proprietorship--in this form one person supplies the capital and has full charge of the operation and policies of the company. The single partnership is easily formed; policies or business can be easily changed as the proprietor has to convince only himself about the desirability of making changes in the business or leaving it as it is; there is no division of profits among other persons, the proprietor gets all the profits which may accrue to the operation, and an especially great advantage of this method of formation is the fact that there are no special taxes upon the business as an organization, and it is generally free from governmental control. However, it has several disadvantages such as difficulty in raising very large sums of money for expansion of the business, unlimited liability of the proprietor for all debts of the business, lack of stability or permanence of the operation since it dissolves upon death, insanity, or bankruptcy of the owner, limitations upon the extent to which its powers can be delegated due to the fact that the owner is personally liable for all debts of the business.

2. General partnership--two or more individuals combine their assets to form a company. Like the single proprietorship, the general partnership is easy and inexpensive to organize, the unlimited liability of the partners for the debts of the firm makes it reliable, the direct gain to its partners is an incentive to close attention to business, it is generally free from governmental control, and it is free from organization and franchise taxes. Its disadvantages are: it has the danger and lack of stability that result from the ease with which the partnership may be dissolved, the authority of the company is divided among its several members which would tend to impair

the smooth operation of the business, personal liability for firm debts deters many from investing capital in it, and its borrowing power is usually limited.

3. The most common method of forming large operations is by incorporating and selling stock in the company. Usually control of the company is vested in a small circle of men due to the fact that a logging operation is considered too risky by the average man for him to invest any money in it and also the aforementioned small group of men are usually the only ones actively interested in the working of the company which they formed. The advantage of a corporation are: the possibility of aggregating large sums of capital through sale of stock to many people; limited liability of stockholders, stockholders are liable for firm debts only to the extent of the stated par value or the stated no-par value of the company's stock which they possess; continuous succession of ownership, owners may sell their stock without impairing the life of the corporation; and there is easy adaptability to efficient organization and flexibility of expansion and motion. The disadvantages are: the formation of a corporation is complicated and requires the services of an expert; non-uniformity of the corporation laws of the various states causes difficulty in conforming to the state's various provisions; and there is strict governmental control and usually heavy taxes levied on corporations.

Methods of Financing.

1. Short term financing--practically all businesses make use of some working capital obtained from short term sources; some of these sources available to the lumber industry are as follows:

<u>1.</u> Bank loans, usually made for a short period of time, such

as ten days, for purposes of meeting payrolls, etc., are used very much by many lumber companies.

2. Commercial paper, i.e., promissory notes of large denomination but of short duration, is useful for obtaining fairly large sums of money for short intervals of time. These notes are usually sold to banks or commercial paper houses at a slight discount.

3. Discounting of trade acceptances, customer's promissory notes, and selling of accounts receivable. These assets may frequently be converted into cash at the bank at a slight discount. Although the firm loses a small percent of the accounts due to the discount exacted by the bank, they gain much by getting the cash much quicker than if forced to wait till the customers paid their accounts and notes. This practice results in the working capital being kept more liquid. The Lawrence Warehousing System advances money to many operations on their lumber inventories. A lien is taken on certain portions of the lumber yard as security for the loan; these liens must be repaid to the Lawrence Warehousing System before the lumber can be legally released and sold.

2. Government loans--in 1935 the government proposed to set up a fund to lend to lumber operators for periods of one to five years but the system wasn't set up. The Reconstruction Finance Corporation has made large loans to several lumber firms, for example, The Pickering Lumber Company of California, about $2,500,000, and the Carlton and Coast Railroad Company of Oregon, $500,000. These loans are usually of too large a minimum amount to benefit the smaller

lumber companies on the security that they can offer.

3. Mortgages--for purposes of securing permanent working capital, making improvements to equipment, or purchasing additional equipment, mortgages are sometimes given for this purpose. This type of financing isn't very common as when a large amount of money is desired to be secured, either bonds are issued rather than a single mortgage, or sufficient stock is sold to care for future needs that may arise.

4. Stock--the main types of stock issued are common, preferred, par, and no-par value. A far greater proportion of common stock is issued than preferred, preferred stock being mostly confined to the very large companies.

To form a corporation, three or more persons of full legal age are required; they formulate the plans of the company and file the certificate of incorporation with the Secretary of State together with the proper organization tax and filing fees. Contents of the certificate of incorporation contains approximately the following data:

1. The name of the proposed corporation.
2. The purpose or purposes for which it is to be formed.
3. The amount of capital stock and the number and par value of the shares of which it is to consist; or if there is to be stock without par value, the information concerning it required by law.
4. If the shares are to be classified, the number of shares to be included in each class, and all the designations, preferences, privileges, voting powers, restrictions, or qualifications of the shares of each class.
5. The city, village, or town and the county in which the office

of the corporation is to be located, and the address to which the Secretary of State shall mail a copy of process in any action or proceeding against the corporation, which may be served upon him.

6. Its duration.

7. The number of directors (usually three or more).

8. The names and post-office addresses of the directors until the first annual meeting of the stockholders, and if such an address is in a city, the street and number and other particular description thereof. The number of directors so named must be the number stated in the preceding paragraph.

9. The name and post-office address of each subscriber of the certificate of incorporation, and a statement of the number of shares of stock he agrees to take.

10. The statement that all of the subscribers of the certificate are of full age, that at least two-thirds of them are citizens of the United States, that at least one of them is a resident of the state in which the incorporation is to take place, that at least one of the persons named as a director is a citizen of the United States and a resident of the state in which incorporation is to take place.

11. The Secretary of State is hereby designated as the agent of the corporation upon whom process in any action or proceeding against it may be served.

12. If the meetings of the board of directors are to be held within the state only, the certificate or by-laws must so provide.

If a small mill company is formed, the usual custom is to issue stock of a no-par value, but for large companies par value common stock and preferred stock are often issued.

Control of the companies is usually closely held due to the fact that usually a few men are the main operators of the company and the average man isn't sufficiently acquainted with the lumber industry to risk his money in it.

5. Bonds--bonds compose the largest proportion of long term indebtedness of the lumber industry. They have several advantages over other forms of financing such as commercial paper; these advantages are:

1. They are business insurance protecting the operator against variations in the money market. Interest rates fluctuate widely through a period of years, and short term notes would be often subject to renewal during periods of high interest rates and the resulting high costs. Bonds can be issued during a period of low interest rates and thus secure the long time use of low cost money.

2. They allow him to pay off his indebtedness at convenient and stipulated periods. The operator knows in advance how much and when it will have to be paid so there isn't the necessity of operating under unfavorable conditions to pay off his debt in a short time no matter what condition the lumber market is in. This relieves the operator of the necessity of running his mill at a loss to get enough money to retire notes, etc., which are of a short term nature.

3. They make possible the development of previously inaccessible tracts of timber by furnishing the large sums of money needed for railroads and sawmills and equipment. Many miles of expensive

railroads and sawmills and other expensive equipment are needed to develop a tract of timber, and a bond issue furnishes the necessary capital.

4. They allow the manufacturer to carry a large supply of timber thus insuring adequate supply for long term operation.

When a timber company desires to issue bonds for any of the preceding reasons, the following steps are necessary:

1. An investment company is contacted which has had some experience in the issuing of timber land bonds.

2. The investment company makes a complete cruise of the timber lands determining the species and amount of timber available, the ease of logging, hazards present such as fire or insects, and other features such as farm lands or water power sites available. The cost of logging in this area is also estimated.

3. The mill is looked over and its efficiency and suitability of operation is determined.

4. After all the property is appraised, the investment company ascertains if the outfit is likely to prove profitable and how large a loan it is possible to grant and give good security.

The total of the bonds for an operating company are usually 40 percent timber and 60 percent on the plant. 6percent is the usual interest charge, but with brokerage charges and discounts, it usually amounts to approximately 7 percent.

Two types of bonds are issued; serial and straight term. Serial bonds, that is those that have a certain amount of them redeemed at recurring stated periods are used most often by operating concerns. Under this system, a "sinking fund" is set up to redeem the bonds as they fall due. Due to the fact that there is a large ratio, at least least two to one, of assets to liabilities, the security per bond gets larger as the bonds are redeemed. An illustration of the working of sinking fund is given below.

year	bonds out-standing	amount of timber pledged for loan	value of timber security	value of timber pledged per $1,000 bond
1914	$2,750,000	1,275,000,000	$5,950,000	$2,163
1918	1,857,500	1,002,436,000	4,763,028	2,564
1922	988,100	839,816,000	3,814,001	3,860
1926	--- ---	573,663,000	2,550,100	- ---

Operation of timber-bond sinking fund for the

Carpenter-O'Brien Company $2,750,000 First 6's

Security: 850,000,000 ft. Pine @ $4 per M ft.---$3,400,000
425,000,000 ft. Cypress @ $6 M ft.--- 2,550,000
Total: 1,275,000,000 ft. (Average $4.66 M ft.)-$5,950,000

Straight term bonds are more common for timber lands that are to be held for long periods of time for speculative or for future operations. Straight term bonds require only the payment of interest till the whole issue falls due, which is far enough in the future to allow the sale of the timber and the redemption of the bonds.

Instead of paying into a sinking fund, some operators use a "releasing list". By this method the timber land is divided into suitable areas which the operator may cut by paying to the bond trustee the value of the timber shown on the "releasing list". This method isn't quite as good as the sinking fund method, as by using the releasing list method, a dishonest operator could cut off the most valuable timber and leave the less valuable timber for security.

Practically all bond issues are backed by the security and also by some third party such as a trust company.

Although the fact cannot be denied that during the recent depression, many bondholders were forced to foreclose to protect their interests, timber bonds have maintained a higher ratio of safety than many so-called "gilt edge" bonds.

A good "set-up" for mills would be to locate adjacent to government timber where they would be assured of an adequate timber supply and at the same time would not have to pay the carrying charges for their timber. Probably in the near future the government will make loans available to lumber companies at a lower cost of financing.

July 1929 Quotations on Timber Issues

	Due 1931	
	Bid	Asked
Algoma Lumber Company	6.75	6.00
Bear Creek Logging Company	6.75	6.00
Bladon Springs Lumber Company	6.75	6.00
Bloedel Donovan Lumber Mills	6.75	6.00
W.P. Brown & Sons Lumber Company	6.75	6.00
Connor Lumber & Land Company	6.75	6.00
F.P. Cover & Sons	6.75	6.--
Dorchester Lumber Company	6.75	6.00
Glendale Lumber Company	6.75	6.00
W.F. Ingham	6.75	6.00
Oregon-Kalama Lumber Company	6.75	6.--
Owen-Oregon Lumber Company	6.75	6.00
Umpqua Mills & Lumber Company	6.90	6.00

(Quoted by Baker Fentress & Co.)

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5. Timber Bonds As Investments--Calvin Fentress.
6. Timber Land Bonds--Clarke L. Poole & Co.