

INTERVIEWS WITH INVESTORS AND FINANCIAL PROFESSIONALS
MAINE FUTURE FOREST ECONOMY PROJECT



CURRENT CONDITIONS AND FACTORS INFLUENCING THE
FUTURE OF MAINE'S FOREST PRODUCTS INDUSTRY

MARCH 2005

PREPARED FOR:

DEPARTMENT OF CONSERVATION – MAINE FOREST SERVICE
AND
MAINE TECHNOLOGY INSTITUTE



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Printed Under Appropriation 013-04A-5180-512-4099 FFE3

Developed Under a Cooperative Forestry Assistance Grant CFDA 10.664

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INTERVIEWS WITH INVESTORS AND FINANCIAL PROFESSIONALS

BY

PAN ATLANTIC CONSULTANTS



Interviews with Investors and Financial Professionals

With funding provided by the Maine Technology Institute, Innovative Natural Resource Solutions LLC hired PanAtlantic Consultants of Portland, Maine to:

“Conduct one-on-one interviews with financial professionals, venture capitalists, forest industry leaders and other private-sector individuals to determine what actions the state might take to make investment in new technologies for forest industries more attractive.”

This action was recommended by a number of industry participants at the November 2003 Blaine House Conference on Maine’s Natural Resource Based Industries. Pan Atlantic has extensive working knowledge of Maine’s investment and banking community, and was selected because of this expertise.

Pan Atlantic was hired specifically to gauge the attitudes and opinions of individuals who make financial decisions about forest product manufacturing in Maine. It is important to note that what is contained in this report is based upon perception; however, it is these perceptions that impact investment (or lack thereof) in Maine’s forest products sector.



REPORT TO
INNOVATIVE NATURAL RESOURCE SOLUTIONS LLC
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**MAINE FOREST PRODUCTS INDUSTRY INVESTMENT RESEARCH**

**PREPARED BY**  
**PAN ATLANTIC CONSULTANTS**  
**PORTLAND, MAINE**

**AUGUST 2004**

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**(207) 871-8622**



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## **I. INTRODUCTION**

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In June, 2004, Pan Atlantic Consultants of Portland, Maine (PAC) was contracted by Innovative Natural Resource Solutions LLC (INRS), of Antrim, New Hampshire and Portland, Maine, to conduct research on investment trends in Maine's forest products industry. This investment research project is one component of a larger research initiative which will provide a broad overview of the processing sectors within Maine's forest products industry.

The Maine Department of Conservation – Maine Forest Service commissioned the overall study in an effort to build a greater understanding of the forces shaping the industry, and ultimately Maine's overall economy.

PAC conducted interviews of industry experts and representatives during the period between June 15, 2004 and August 31, 2004. Analysis and reporting of results were completed during the same period.



## II. PROJECT OBJECTIVES

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Objectives for our research and analysis phase were relatively straightforward and focused, in order to be integrated within the framework of the larger study being conducted by INRS, on the future of the Maine forest products sector. They are:

1. Evaluate attitudes toward, and the level of propensity to finance companies in the following sectors (see below).
2. Determine how Maine can best encourage investment in new technology within the forest products industry.

PAC and Innovative Natural Resource Solutions LLC agreed upon the following key issues to be researched and evaluated with financing sources, during the course of the research project:

- Current and past level of company's financing in these sectors
- Historic performance (returns achieved) by financing in these sectors
- Recent trends in financing in these sectors
- Attitudes towards financing in these sectors
- Prioritization and rating of the attractiveness of financing within these sectors
- Level of awareness of potential deals in these sectors
- Perceived results (return levels) of financing in these sectors
- Major perceived deterrents to providing financing in these sectors
- Interest levels in financing future deals in these sectors
- How financing sources typically access information on potential deals
- The perceived utility of setting up an information clearing house on potential deals
- Information that financiers would like to have prior to deciding if they want to review potential deals
- Actions which the following need to take to stimulate investment in these sectors:
  - a) The industry
  - b) Relevant state agencies – Department of Conservation (DOC), Finance Authority of Maine (FAME), Maine Technology Institute (MTI), Department of Economic and Community Development (DECD), etc.



Research was focused on sectors involved in the production of forest products, or the consumption of wood products as a fuel. These included:

- Saw and planing mills
- Secondary wood products companies, such as furniture, wood components manufacturers, etc.
- Wood composites manufacturers
- Paper mills
- Biomass facilities

The evaluation of current investment attitudes was achieved through a thorough analysis of the past, present and future trends that shape the market and, by extension, the level of optimism or pessimism of investors. The determination of the best ways to encourage investment was achieved by posing direct questions to those in a position to lend or invest, as well as through analysis on the part of PAC.

*It is important to note that PAC's key research objective was to measure investment attitudes and perceptions among bankers, investors and industry executives. It was not within the scope of the project to conduct follow-up research into specific incidents or situations relayed by respondents, which may have led to their current attitudes or perceptions. For this reason, comments may not portray all of the subtleties or complexities of each situation, but show the information upon which interviewees base their opinions.*



### III. Project Methodology

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Pan Atlantic Consultants employed a two-part research methodology in order to build an understanding of current investment attitudes and strategies to encourage future investment:

- A. **Secondary Research** was conducted to gather and analyze industry and state information that was relevant to the financing topic, and to issues that arose during our primary research surveys.
- B. **Primary Research** comprised the most important and in-depth portion of our work. This research consisted of 37 in-depth, qualitative market interviews among:
  - Maine banking executives
  - Equipment dealers
  - Land owners
  - Lumber mill owners
  - Industry association executives
  - Paper company executives

Our primary research interviews were conducted both in-person and by telephone. In most cases, our discussions had durations of between 1-2 hours. Our survey instrument (included in Appendix H) probed past, current and future trends that define the market outlook, as well as investment source and industry recommendations, for the best ways to improve market conditions and the flow of capital to forest products sector.

All survey respondents were very engaged in the subject and fully aware of our survey goals. In exchange for their candid statements, some survey respondents requested that their ideas and recommendations be reported anonymously. For this reason, we have only identified quotes by the industry or sector of the respondent.

When all surveys were completed, Pan Atlantic Consultants analyzed findings, consolidated recommendations from respondents and provided further recommendations of its own.



## IV. INVESTMENT OVERVIEW

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A strong future for the Maine forest products sector depends in large part on the willingness to invest in the industry. A willingness to invest, how to measure it, and how to encourage it, is in large part, akin to measuring and spurring consumer confidence – no single solution will suffice. Instead, strong levels of investment and a robust market will be driven by:

- An in-depth understanding of the complex set of global issues that drive the market
- Active management of the various market inputs which affect its overall direction.

Our investment survey provides a global view of these complex issues, which directly impact attitudes, optimism, and the propensity to invest among bankers, investors and company owners.

Ultimately, we found that there is a dichotomy of perspectives in the financial outlook for the forest products industry:

- **Lending:** Bankers in the state of Maine report no shortage of funding for well-managed forest products businesses. In fact, loans to the forest products industry are a very competitive business and bankers would like to see more deals in the future. Of course, borrowers must be well qualified, with strong collateral, just as in any other industry.
- **Investment/Borrowing:** The less-optimistic perspectives on the industry tend to come from the side of company owners and managers, who are often unsure if investments in their businesses will be secure over the long term.

Although we interviewed a diverse set of industry experts and representatives we were surprised at the cohesiveness of their views on the industry, and the most appropriate ways to strengthen it. In the following pages, we will explain how the most important drivers of investor confidence can be summarized in four key areas:

1. Legislative stability
2. Regulatory stability
3. Tax incentives
4. Infrastructure support

These are, of course, not insignificant issues for the state to consider, but they are critical to Maine's image among investors both inside and outside of the state. They also represent the key ways in which Maine can help to ensure some level of competitiveness for its businesses (and its overall economy), against foreign competitors.



## V. CURRENT MARKET SITUATION

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The Maine forest products industry can be characterized as a mature market, representing a wide range of commodity products, with a smaller number of non-commodity products. As such, the challenges faced by this industry are not unique among industries that have undergone the effects of maturation, hyper competition and commoditization of product.

*“Most commodity-based businesses have wide swings in prices. In commodity markets, you only need a 2-3% swing either way to make a significant impact.” Maine Banker*

In order to deal with market threats and opportunities most effectively, it is imperative that Maine businesses and Maine state government fully appreciate that they operate in a global marketplace, regardless of the local markets that they serve. Many of the market leaders that we interviewed pointed to the casualties of the market who did not understand the full impact that global competition would have on their operations.

*“A lot of the companies that went out of business were family owned, where management got tired and didn’t know how to find new markets. The ones that will survive will have very little debt and astute management.” Maine Banker*

*“The forest products playing field is truly an international one, so we have to do things in the same way that other countries do. It’s the purest form of capitalism – survival of the fittest – It’s a great theory, but not everybody is competing that way.” Maine Banker*

*“The Northeast region is part of a regional market. Canadians look at it that way, but I’m not sure that Maine looks at it this way. That’s why you see more Canadians investing in Maine than the other way around.” Maine Sawmill*

Despite the intense challenges that are faced by the market today, **many were quick to point out that contrary to popular belief, Maine’s industry is not dying.** It’s true that a tremendous amount of change has occurred, and that the extent of the challenges varies by sector, but the industry itself has good potential for future success.

*“People say this is a dying industry. It’s not the truth. We have a great story to tell about environmental balance and the strength of our communities. We have to focus on how to make Maine a better place to do business.” Patrick Strauch, Maine Forest Products Council*

*“There’s a big perception that we are a dying industry, because the environmental groups have promoted that. If you look at Lloyd Irland’s report Evergreen Industry, it says that Maine is producing 50% more softwood lumber and 200% more hardwood lumber, and there is more wood on the stump than in 1989.” Sawmill Owner*



*“This is not a dying industry, or one with no future. Our production and employment [at our mill] are growing.” Sawmill Owner*

The Maine forest products industry is currently in a stage of transition where many of the weaker, less flexible companies have been weeded out by market forces. Those who remain are in many cases, top-class businesses.

*“The truth is that if you are in business in Maine, you must be doing something right. We have a better quality business person here because of the challenges you have to deal with.” Maine Banker*

Even for these companies, market fluctuations and global competitive pressures will always require strong support from state government to help them to remain competitive. Additionally, a strong future for Maine’s forest products economy will require new entrepreneurs to be attracted to build the next phase of the industry.

*“We’re not seeing many new entrepreneurs in the industry. I’m truly concerned about the long term viability of the industry.” Maine Banker*

There are a number of key actions that must be taken by both industry and government in order to follow a path of continued success and strengthen investor confidence. These include re-investment in equipment, a close working relationship between industry and government, and strong incentives to attract investment in the industry.

We learned in the course of our research that business owners and bankers do not expect government to “solve” the problem for them. Instead, they want the government to create a stable and responsive environment in which businesses can succeed, and feel comfortable about investing.

*“We should not look to the state government for [industry] change. We should be looking for a response to what we ask.” Maine Banker*



## VI. MARKET TRENDS

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The most dramatic trend to impact Maine's forest products industry has been the globalization of wood products markets. All sectors within the industry have felt the effects of globalization, from the foreign supply of wood flooding US markets, to the manufacture of hardwood products in China which are shipped to the US and sold less expensively than Maine's producers can make them.

This intense competition has lowered prices and the perceived value of product, setting in motion a complex set of market forces that have had a ripple effect through all parts of the supply chain. Products from wood pulp, to turned hardwood, to furniture have become commoditized and purchased on a low-price basis.

*"Wood turning mills, primarily hardwood mills, have been devastated due to Chinese imports. They can import the wood, do the manufacturing, pay a middleman and still sell it for 20%-30% less. And fewer things are made out of wood now. Plastic is used for screwdriver handles, etc." Maine Banker*

*"You cannot buy domestic dowels anymore. There is a price difference of \$90 per thousand for the US product and \$25 per thousand for the Chinese product."*

The globalization of markets also brings the secondary effects of global currency fluctuations. The economic downturn of the past four years has had a dramatic impact on the valuation of currencies both in the US and abroad. In fact, slim margins from commodity products have created a situation where many companies, both foreign and domestic, make their profits directly from currency fluctuations.

During the period when the US dollar was strong, Maine companies suffered, as imports to the US increased. The market was flooded with low-priced raw materials and finished product from foreign markets.

*"Everybody talks about wanting a strong dollar, but that is what has really hurt this industry in the past few years. It wasn't until the dollar weakened that things started to turn around." Maine Banker*

As in earlier downturns, many suppliers cut back production, or let their machinery go idle, waiting for prices to rise.

*"In the old days, manufacturers would just ride out the hard times and wait till it came back." Maine Banker*

While this may be a strategy that can be followed by small operations, or independent contract loggers with a lower investment, today's larger, vertically-integrated logging operations must run their equipment continuously in order to achieve an adequate return on their investment.



*“There are far fewer loggers now, than in the past. Now, they are more vertically integrated. The logging industry has become fairly consolidated over the last 20 years, as the cost of equipment has become higher and a movement has been made towards harvesting systems rather than skidders. A new skidder will cost \$30,000, while a new harvester will cost \$450,000.” Maine Banker*

Many suppliers who were not positioned to weather the economic peaks and valleys did not survive.

*“Profitability allows companies to weather international events.” Maine Banker*

Finished product producers such as paper mills also decreased production in response to lower demand during the downturn. All of these measures put the industry at a disadvantage, making them slower to come back online when the dollar weakened and the potential for US suppliers was expanded - mills were caught with low inventories and many suppliers were unable to keep up with demand.

Among loggers that were better positioned, however, the market rebounded at the beginning of the year:

*“As of the 1st of January, a lot of things have come together to drive demand:*

- 1. A lack of production capacity (operators)*
- 2. A really wet fall: One of the rising hot-buttons in the industry is “green” certification. Part of that means you can’t operate where you create excess muddy conditions that lead to soil erosion. This significantly limited the amount of wood that could be cut last fall.*
- 3. Just-in-time inventory practices of mills that have dwindling onsite inventories and now need more product.” Maine banker*

*“In the past 3 years, we’ve had a record-breaking housing market, but everybody has been shipping product into the US. About 1 year ago, the dollar began weakening and we are now starting to make more money.” Maine sawmill owner*

Of course, improvements in the industry do not always affect all sectors equally: Increases in demand have raised wood prices and reportedly squeezed profits for product producers.

Uncertainty in the forces of market supply and demand led to lower overall levels of new investment and re-investment, creating fewer deals for lenders. One of the results of this lack of investment has been the aging of Maine’s plants and equipment.

This aging trend could not have come at a worse time: The tight margins of a commodity market require automated processes with fewer labor hours in order to produce product most profitably.



Here, Maine businesses have found themselves to be significantly behind their foreign competitors.

*“The machine we shut down in Westbrook in October was arguably the highest cost coated free-sheet paper machine in the world. We had a chart of all 87 of these types of machines and this one was number 87.” Sarah Manchester, General Counsel, North America, Sappi*

In all sectors, state-of-the-art equipment allows suppliers and manufacturers to produce more efficiently. This trend is dramatically changing the investment landscape in forest products production, from highly automated logging equipment costing hundreds of thousands of dollars, to sawmill equipment with optical scanners costing millions of dollars, to modern paper production machinery costing hundreds of millions of dollars.

Clearly, it takes a strong set of economic benefits and assurances to spur investment in any part of the industry. Globalization, commoditization, economic downturns and currency fluctuations are enough to make any investor become more cautious.

Unfortunately, the state of Maine has had other forces at work further weakening confidence in its business environment. Most significantly two key issues were mentioned in virtually every interview we conducted:

*“Maine is not a business-friendly state.”*

*“There is a lack of stability in the legislative process in Maine.”*

Company owners both inside and outside of the state perceive Maine to be non-business friendly as compared to other states. In the case of in-state company owners, or “captive firms”, they often do not have a choice but to reinvest in Maine. But, these owners report that their levels of investment would be significantly higher if Maine offered stronger incentives.

In some cases, Maine-owned businesses have chosen to expand with new branches outside of the state due to perceived benefits elsewhere, or due to absolute necessity.

*“We’re simple, hands on business owners. We look for 3 things:*

- 1. A product mix that could match the needs of the market*
- 2. A good management team*
- 3. Location*

*Across the board, New Hampshire is a much more friendly state. We explored Vermont, New Hampshire and northern Maine. Coos County, New Hampshire, and the town of Lancaster were very helpful.” Maine Forest Products Business Owner*



*“We needed to be in northern Maine, so we bought 100 acres in Bridgewater and told the state that we could provide 15 jobs. There are no handcrafters (logsmiths) in Maine, but we found one 10 miles away in New Brunswick. When we asked Augusta what we needed to do to bring him across the border to work for us, they said they couldn’t bring him in and that it could take 20 years to do it. So we moved 10 miles over the border and have 8-10 employees there now.”*  
*Maine Forest Products Business Owner*

Among out-of-state business owners of sawmills and paper mills, decisions on new investment are often based on the degree to which Maine compares to other areas in which the company owns mills. Here too, Maine often loses out.

*“The burden on labor is much higher in Maine than in Canada. In a labor-intensive operation such as a sawmill, you are at a major disadvantage in Maine. If all other things are equal, you would choose to invest elsewhere.”* *Maine Woodlands Owner*

*“The investment has a tendency to go where you will capture the highest return on investment. In the paper industry, they don’t talk about the competitiveness of one facility vs. another. They look at machines in each facility.”* *Paper Company Executive*

Key issues that lead to the perception of Maine as business-unfriendly, and investor-unfriendly include the following:

### **Instability of the Legislative Process**

The instability of the legislative process in Maine weighs heavily on the minds of investors. Maine is seen to favor legislation and legal action rather than pursuing collaborative negotiations between key stakeholders.

*“Mainers are different. If they have some sort of controversy, they solve it through legislation.”* *National Forest Products Association Executive*

*“It seems that everything is done through lawyers in Maine. Our legal bill in the US is 10-20 times higher than in Canada.”* *Bob Pinette, VP Woodlands Division, JD Irving*

**The key example of legislative instability, cited by investors and bankers interviewed, is the Business Equipment Tax Refund (BETR) program.** During its nine years of existence, BETR has directly influenced hundreds of millions of investment dollars in Maine. Although most would prefer that taxes on personal equipment were repealed altogether, BETR is seen as a critical incentive to investment in Maine.



*“When the BETR program was originally passed, a \$110 million investment was made in our mill, but that was nine years ago.” Paper Company Executive*

*“There’s an old truism that says: Capital goes where capital is loved.” Maine Banker*

Despite the program’s success in attracting investment, it is reported to be under attack each year by members of the state legislature. Any goodwill created by the actual refunds is overshadowed in the big picture by continued attempts to reduce or eliminate it. While the program has remained intact despite some attempts to cut it, word of any negative legislative action quickly makes its way to potential investors, causing concern and uncertainty.

*“My own personal observation is that things in Maine are not that bad right now, but Maine is seen as an unpredictable state. Every program is constantly under review, under attack.” Paper Company Executive*

There is strong support for the current discussion of eliminating the tax altogether, which would provide the type of incentives and stability most desired by the market.

*“I would like to see an elimination of tax on personal property. Mills have so much personal property, it’s a huge burden and may keep them from further investment. BETR goes halfway by refunding the tax, but it would be better if the tax was not charged up front.” Paper Company Executive*

*“Keep taxes down. The BETR program gives tax refunds for production equipment. Governor Baldacci is trying to eliminate the tax altogether which would be better than the refund.” Maine Sawmill Owner*

## **Strict Regulatory Environment**

Similar to the frequent legislative battles over BETR, are ongoing citizen referendums and strong regulatory rulings which are perceived by some to limit the production of wood in the state.

Although many of these referendums have not passed, and rulings such as the liquidation harvesting rule do not impact all suppliers, the strict “first-in-the-nation” regulatory situation in Maine is seen as a contributor to an unstable situation.

*“Forestry referendums did a lot to impact the industry in 1996, 1997 and 2000. None of them passed, but they cost the industry \$8 million to fight them and spooked a lot of people away.” Paper Company Executive*

*“Maine is desperately trying to pattern itself after California. It’s the tail wagging the dog – the southern part of the state wants to regulate the northern part of the state.” National Forest Products Association Executive*



The Maine regulatory process is viewed as contentious and not based in reality. Stakeholders are not seen to be on equal footing, and the solutions are not designed to match the scale of the problem.

For example, we heard numerous concerns about the contrast between the relatively small ratio of Maine forest land affected by clear cutting, and the broad reach of the liquidation harvesting regulation. Additionally, many in the industry feel that this regulation penalizes the wrong group of people:

On the liquidation harvesting issue:

*“90% of the wood I saw comes from small landowners. This whole liquidation harvesting regulation was started to stop sprawl. Real Estate developers can clear cut and sell the land. They just declare a ‘change of use’.”* Maine Land Owner

Industry experts would like regulators to know that by being proactive, it is possible to be both pro-environment and pro-business.

*“The EPA is generally pretty contentious - they’re born to regulate. It’s the opposite in Nordic countries: They have the same commitment to the environment. But where the EPA says ‘This is the type of device you need to install to reduce emissions, Nordic regulators say ‘This is the goal. We don’t care how you do it.’”* National Forest Products Association Executive

### **High Costs of Doing Business: Taxes, Healthcare, Electricity**

Not far behind the perceived instability of Maine’s legislative and regulatory policies, are concerns about the state’s high costs of doing business. Corporate tax rates, healthcare costs and electricity costs are all among the highest in the nation. All are key considerations for investors.

*“Workers comp is more of an issue in Maine. Our people are at a competitive disadvantage when compared to states like New Hampshire. We take home 15% less.”* Maine Banker

In a commodity market, tax rates can make the difference between gaining business and losing it.

*“Our measure is: What is the cost of tax per ton? In Maine we pay \$12 per ton (minus \$2 from BETR). In Arkansas, we pay \$7 per ton and in Wisconsin we pay \$5 per ton. That’s not a particularly big spread, until you look at the number of contracts lost at \$1 - \$2 per ton.”* Paper Company Executive



An issue compounding these high costs is the fact that many foreign competitors are not operating “on a level playing field”. In countries such as China, environmental and worker’s protection measures are simply not cost factors, making price competition simply impossible.

*“The average paper mill costs approximately \$1 billion to build. If you have a choice to build in a country with low labor rates and low taxes, vs. the US, which would you choose?” National Forest Products Association Executive*

*“Throw the same regulations at them: OSHA, DEP, EPA, so we’re on the same playing field.” Maine Sawmill Owner*

### **Lack of Availability of Qualified Workers**

Layoffs and business closings have significantly changed the makeup of the forest products workforce in Maine. Maine’s rural landscape has also contributed to the problem historically, as the livelihood of many towns revolved around a single mill. When the mill closes, employees must move elsewhere for work, often changing occupations in the process.

*“As mills close and rural communities shrink, the biggest issue we face is a labor pool of capable workers.” Sawmill Owner*

The instability of work in parts of the industry has led many workers to steer their children to alternative, and hopefully more stable careers. The results of these changes are a declining and aging workforce – a situation which could have even more serious repercussions when these workers retire.

*“Harvesters are getting squeezed at both ends. The younger generation doesn’t want to go into the logging business.” Maine Banker*

*“Right now, there is a huge bulge of workers with an average age of 48-55.” Paper Mill Executive*

A secondary qualification challenge related to the mechanization of the industry is the need for employees with college or technical degrees – something often in short supply in new recruits to the forest products industry.

*“By and large, we give a preference to those with a degree.” Paper Mill Executive*

A final issue relating to the lack of qualified workers, was the inability of Canadian loggers to enter the state due to this year’s cap on H2B visas. Although the issue is federal in nature, some of those interviewed feel that state government could have done more to work towards a timely solution.



*“We had a huge problem getting people to cut wood this year during the season. The problem may be eased in October with the new federal government calendar, but the woods industry doesn’t operate on a federal government cycle.”*  
*Paper Company Executive*



## VII. BANKING PERCEPTIONS AND ATTITUDES

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In the course of the project, we solicited the opinions of 14 leading lenders in the state. These banks are strongly committed to the forest products industry, as the sector comprises a strong part of the economy in Maine, and also a strong part of their portfolios.

Reductions in the number of loans provided to Maine businesses have been the result of fewer business starts and expansions, and a shift in the overall composition of the banking community in Maine.

*“Now, a lot of small country banks are lending in areas where big banks have pulled out. Fleet and Key have moved to areas with higher population and more diversification. Unfortunately, a lot of them don’t have the commercial lending expertise.” Maine Banker*

Our banking and investment survey contained many in-depth questions about the ways in which lenders view forest products deals, the issues that are most important to them, and the factors that build their confidence in the industry.

### **Key criteria for lenders**

Bankers apply standard industry lending metrics to the evaluation of any deal, whether in the forest products industry, or outside of it. While there is no specific formula, the ultimate goal is to achieve an acceptable level of return while managing an acceptable level of risk.

The most common indicators of risk and associated return are measured through due-diligence research and an analysis of:

- Cash flow
- Collateral
- Prior performance in terms of revenue profitability
- Experience and character of the management team

*“You look at: How smart is the management team? Do they know what they’re doing?” Maine banker*

The maturity of the forest products industry, coupled with the fast pace of change in the marketplace, drive bankers to consider the entrepreneurial nature of the management team and their ability to meet new challenges with innovation.

*“Since it is a mature industry, you look at: What are they doing to stay viable - such as investing in new technology?” Maine Banker*



*“It’s not enough to just look at one year’s performance. The companies moving forward are positioned to get large volumes that make the small margins pay off.”  
Maine Banker*

Natural resource investments do not help bankers achieve additional objectives outside of their normal lending objectives. They do, however, help the bank to build and strengthen communities in Maine. Since forest products sectors have traditionally been labor intensive, the related community benefits have been a strong added incentive to lending.

*“Job creation in our market area is a key motivation. If we had limited options to make our decision – manufacturing vs. commercial real estate, we would choose manufacturing.” Maine Banker*

Likewise, the criteria for lending in the forest products industry are not any different than lending in any other industry. Bankers we interviewed use a consultative approach, taking a strong interest in the management of the company to insure the future of the company and a return on their investment.

Market trends during recent years have caused bankers to become more critical of deals in the forest products sector, but again, that is not unlike the increased attention given to any business seeking a loan in an uncertain business environment.

*“Over the past 6-7 years, we’ve sharpened our pencils on this industry and tightened our standards because of the overall weakness of the market.” Maine Banker*

In cases of a higher level of perceived risk, bankers may turn to loan-guarantee programs offered by the Finance Authority of Maine (FAME) and the Small Business Administration (SBA) in order to guarantee portions of the loan. It was reported in a number of interviews, however, that these programs have recently tightened their standards to bank levels, making it sometimes more difficult to secure funding for a riskier candidate.

*“You only bring FAME in if you really need to get supported. Those government programs are a pain since they generate a lot of paperwork. FAME credit has become as strict as a bank. If you are going to go through that much effort with your client, to get them turned around, you don’t want them to get beaten on by FAME.” Maine Banker*

All bankers interviewed are well aware of the loan-guarantee programs that are available to them and their clients. Despite their limitations, most bankers find them to be good tools for managing risk.

*“I sense FAME and the SBA are looking at these businesses like the banks are – they’ve done a pretty good job.” Maine Banker*



## Level of awareness of potential deals

The lending community relies strongly on the use of networking and personal sales efforts to identify and close new deals. A commercial lender's success is directly related to his or her connections to the business community. The bank itself often supplements direct selling efforts with lead development programs. These may include hosting breakfast, lunch or dinner meetings that feature an industry expert who can provide information and or training to customers and prospects. In this way, the bank can further its brand while developing a portfolio of networked clients.

Commercial lenders do not take the selling process for granted. They spend a significant portion of their time calling on business owners and managers, as well as their business advisors, such as lawyers and accounting firms. The overall view is: If a deal becomes available in the market, you should know about it as it happens (preferably having had a hand in its creation).

*“The difference between a successful lender and an unsuccessful one is people that have a network. An information clearinghouse wouldn't be helpful. If there is a deal happening, the company should know your name. It's your job to be out there in front of them. Our referrals come from the company's executives, or their accountant or lawyer. They should know you.” Maine Banker*

For these reasons, the idea of an information clearinghouse to share potential deals was not of interest to bankers. The idea represented a low level of perceived utility, since many potential lenders would not want sensitive company information readily available to the market, and most would already have a banking relationship where they would begin their search.

*“Very few people are involved in the production aspect of the forest products industry. Word-of-mouth is all you need. Once in a while, you get a call from a broker, but they're more of a hindrance than a help. You usually know the company name on the application when you see it.” Maine Banker*

## Acceptable Collateral

A more recent and significant shift in the way loans are processed is in the attitudes about acceptable collateral. In the past, equipment, along with cash flow, was a typical source of collateral accepted by lenders. During the period in which many suppliers have gone out of business, foreclosures have dumped a great deal of equipment on the used market.

When this occurs, the used market becomes flooded with equipment, and the overall value of both new and used equipment declines. As a result, many bankers are now less likely to accept equipment as a major source of collateral. Instead, they look to cash flow as the best guarantee of their money.

Ultimately, this change is a positive one for the industry, since cash flow is a much more accurate measure of a company's health and market position. Equipment may be sold to the



company under less stringent lending standards than what a bank would normally require of the borrower.

### **Levels of Bank Lending to the Forest Product Industry: Past, Present and Future**

Most banks report fewer deals in recent years than they have seen in the past, but this change has been driven primarily by trends in the external market, rather than by internal changes in lending practices.

Due to the nature of forest products deals in Maine (e.g. long-term lending, and modest returns), banks, rather than venture capitalists, are the natural choice for borrowers. In most cases, the percentage of forest products loans in a bank's portfolio is roughly equivalent to the percentage of forest products businesses in their region vis-à-vis other business sectors. This is in marked contrast to the portfolio of a venture capitalist who typically chooses deals in specific industries to guarantee specific levels of return.

*“The economy of Northern and Eastern Maine is primarily driven by the Forest industry, so that’s where we invest.” Maine Banker*

All of the bankers that we spoke to described a strong, continuing commitment to the industry and a strong interest in future lending.

*“About ½ of our investments are in Forest Products sectors. Unlike a lot of other lenders, the health of our organization is directly tied to the health of the industry.” Maine Banker*

### **Historic Performance of Loans to the Forest Products Industry**

Financial returns of forest products loans have been directly related to the peaks and valleys of the market, as well as specific market forces driving individual sectors. For instance, manufacturing businesses have performed at lower levels than retail-related forest products businesses since they have had deeper structural issues to contend with. These include the aging of plant and equipment, and the lack of availability of qualified workers.

*“You have to separate the manufacturing side of the business from the retail side. The retail side has been phenomenal.” Maine Banker*

*“Mills have had problems because:*

- The supply of raw materials has been fairly constant due to all of the import.*
- Land owners have been holding off on selling at low prices due to import.*
- Retail is consuming the supply”*

*Maine Banker*



It is important to note, however, that most bankers have found the forest products industry to perform in a similar fashion to other Maine industries. The major market drivers – economic downturn and global competition – have had a significant impact on all industries. In general, the risk related to forest product loans is not reported to be higher than average, and most feel that their loans have performed well.

Deterrents to lending in the industry include macro-market issues such as regulatory and legislative instability, and micro-market issues such as poor cash-flow management or lack of a cohesive business plan.



## VIII. Investor Perceptions and Attitudes

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Company owners have become much more pragmatic about when, how and why to make new investments due to the global challenges they face in the marketplace. In the case of well run enterprises, reinvestments are made to increase the overall competitiveness of the company. This type of reinvestment is often a life-or-death requirement for survival in the long run.

*“If we don’t modernize, we won’t make money. The mill we just bought never made money, and that’s what you need to do: modernize.” Sawmill Owner*

The importance of equipment upgrades and modernization cannot be overstated. Some of the most optimistic market outlooks are from manufacturers who are the most innovative. They have taken advantage of new technologies and lean manufacturing processes which allow them to “China-proof” their business to some extent. Highly automated equipment allows manufacturers to decrease the labor component of their product, thereby striking directly at the most competitive component of foreign manufacturers.

*“Our product might be more competitive with a Chinese entry into the market – My labor is only 7% of sales. If a Chinese competitor came in with a 6% labor cost, it wouldn’t make a big difference in the retail price of the product.” Forest Products Business Owner*

It should be noted, however, that the other key driver of one’s market outlook is the company’s position in the market vis-à-vis its competitors. High-end, high-quality wood products such as furniture or cabinets are holding their own, and some of the mass-manufactured products with little labor cost such as machined wood buttons are also surviving. In most cases, the mid-range product with some element of hand-labor is being hit the hardest by imported competition.

*“When I started business, I had 85 US vendors, now I have 5.” Wood Products Distributor*

Investment incentives are very important to businesses of all sizes to help initiate the initial investment and to get the new investment paying for itself in the shortest amount of time possible.

Company owners and managers are cautious about new investments in Maine, partly based on industry trends, and partly based on what they perceive to be Maine’s unfriendly business environment. Long term investments, such as large land purchases for wood supply are fewer, and much more apt to be influenced by changes in legislation or regulation.

*“Forest products investors are gun-shy with the continued referendums on cutting. I know of at least 2 deals that have fallen through. One investor walked away from a \$500,000 down payment because of it. It’s inconsistent, the way regulations change in the state over a 5-7 year period. The economics of a deal could change significantly.” Maine Banker*



At the paper mill level, investments in Maine have become less frequent, and the overall size of investments has trended significantly downward. There are some notable exceptions, such as the recent \$110 million investment in International Paper's Jay mill, but with the cost of new equipment in the hundreds of millions of dollars, the most common approach is smaller, incremental upgrades of existing equipment. This of course breathes new life into a mill for the short term, but leaves long-term survival in question.

*"China is not the problem in Maine. The problem is that they had the first mills built in the US, and it's not like there has been a lot of reinvestment." Investment Firm Executive*

When interviewed about the key issues and trends driving the investment picture in Maine, company owners' and managers' attitudes are directly in line with bankers. The top concerns on their minds are the instability of Maine's legislative and regulatory process, the lack of strong tax incentives for investment and the perception of higher costs of doing business in Maine.

There are some success stories, however, where the state has worked creatively with business to spur this investment. One example is the recent partnership between the state and Georgia Pacific, in which the mill needed competitive energy costs and the state needed solid-waste landfill capacity. Georgia Pacific sold its solid-waste facility to the state and is using the proceeds to build a new co-generation plant.

*"We will invest in our new boiler-power plant over the next nine months and that will grease the skids for modernization in \$1 million, \$2 million, \$5 million dollar chunks, rather than \$200 million investments. That doesn't happen often anymore.*

*The self-generation plant will allow us to get our operating costs down and make this plant competitive with its sister plants." Rick Douglas, Georgia Pacific*

It was clear to see from this example, how state cooperation and incentives to invest in infrastructure will lead to additional investments in the future in two ways: First, through the development of a more competitive plant, and second, through increased confidence in the credibility and reliability of state government.

*"Georgia Pacific did not have a favorable view of Maine and that came from the executives in Atlanta. The governor worked diligently to save the mill and did very positive things that astounded our executive management. Jack Cashman [Commissioner, DECD], Alan Stearns [Senior Policy Advisor to Governor Baldacci], and Governor Baldacci have been huge friends to us." Rick Douglas, Georgia Pacific*



## IX. BANKER AND INVESTOR RECOMMENDATIONS

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*“The biggest change needed is an attitude change.” Maine Banker*

We asked all of the bankers, company owners and market experts to comment on what they would recommend as solutions to the problem. To be fair, we asked both what the state could do to improve the situation, and what the industry could do. Despite their different vantage points in the market, respondents spoke with a singular voice.

*“Focus on ways to make Maine a better place to do business.”*

Specific recommendations fall under four key headings:

1. Develop stability regarding referendum process
2. Develop regulatory stability
3. Create investment incentives
4. Strengthen infrastructure and provide business support

### 1. Develop Stability Regarding Referendum Process

- Raise the bar on requirements to put a referendum on the ballot

One of the major sources of instability is seen to be the referendum process. Those interviewed agree with the democratic principle of citizen referendums, but they would like to see requirements for:

- A larger number of signatures to initiate a referendum
- A higher percentage of signatures from areas that will be affected by the vote
- An evaluation of stakeholders, and the value of their stake in the proposed referendum

*“When regulations are proposed, bring in all of the stakeholders. Limit the stakeholders to those who have an investment in the outcome. Environmental groups have nothing to lose.” Sawmill Owner*

- Guarantee stability of raw materials supply

Maine’s forests are at the beginning of the supply chain, and many in the industry feel that the state needs to build a greater understanding of the need for industrial forestry practices which will guarantee a steady, well-priced source of wood.



*“We have real concerns about the Department of Conservation and the Maine Forest Service. There is a lack of understanding about industrial forestry. They favor a low-intensity management approach. This is European-style forestry, a light-touch approach.”*

*“The intensity of forest management is much lower in Maine than in Canada or other parts of the US. The Forest Products Act limits forest management to a small part of your land.”*

*“The US federal tax system does not allow the intensive depreciation of your investment. In Canada, tree planting can be deducted as an expense. In the US, it’s an investment and you pay taxes on it.”*

- Solve problems cooperatively with industry, rather than through legislation

The legislative process is seen as just another example of the litigious environment in the state. Some in the industry noted a dangerous precedent being set with bill LD 1318, in which the state has intervened in collective bargaining between loggers and landowners. The overall industry would prefer to settle its own disputes from within, without intervention from the state.

*“It gets dangerous when government intervenes and starts to set industry rules.”  
Maine Banker*

## 2. Develop Regulatory Stability

- Streamline the environmental permitting and regulatory process

The length of time it takes to move through the environmental permitting process is cited as a major deterrent to investment. **In fact, we heard numerous stories of other states whose economic development teams had courted companies who were having challenges with Maine’s strict laws.**

*“Permitting is a problem on the environmental side. Anything to speed the process. If someone wants to invest today, they may need to wait until next year to get environmental approvals.” Maine Banker*

- Develop a strong economic analysis of the problem and its solution before deciding on new regulations

Industry leaders do not always see Maine’s regulatory authorities as having a strong understanding of the economic repercussions of regulations before they set them.



*“If they are going to throw regulations at us, they need to do an economic analysis and pay attention to it.*

- *Do a scientific analysis of the problem*
- *Develop an economic analysis of the issue*
- *Develop a true understanding of who the stakeholders are”*

*“The DEP needs to make a fundamental change. They need to look at the costs of ‘nice to do things’ vs. the things that truly need to be done.”*

*“The forest industry is out of balance in terms of where state government stands. They’re focused on more preservation, so a smaller group can enjoy it recreationally. It’s policy by outdoor enthusiasts, rather than those who manage the woods.”*

*“Maine is not looking at manufacturing from a business point of view, they’re looking at it from a tourist’s point of view.”*

### **3. Create Investment Incentives**

- Provide tax and investment incentives and eliminate the personal property tax on business equipment

The elimination of personal property taxes is the key target to provide incentives for re-investment and to attract new investment.

*“If you’re considering a \$50 million investment, you can factor in a \$600,000 difference on your pro forma with the BETR program. But I have to tell my management: ‘there’s a bill pending to eliminate BETR but it’s not going to pass’. They still have concerns that something is pending. The bottom line is that there is no certainty. Legislators may put a bill in to raise discussions, but it raises hairs on the backs of investors.” Paper Company Executive*

*“Maine has a TIF (Tax Increment Financing) program where the town rebates taxes paid on new buildings. We got approval for it and we are planning on building a new plant.” Sawmill Owner*

*“What often happens in Maine is that the mill shuts down, someone comes in and restarts it, and then the mill shuts down again. It’s a boom and a bust. That’s because the technology is old. There needs to be some tax incentive for re-investment.” Paper Company Executive*



- Promote existing business development incentives and programs more effectively

Banks feel that most investors do not have a strong enough knowledge of the programs that *are* available to them from the state. Although banks advise their customers of these programs, more loans may be initiated if borrowers knew of their options up front. A greater promotion of available state incentive programs by the DECD is recommended.

*“There should be a centralized area in the state that explains markets that are unusual or attractive. We have empowerment zones where companies get \$3,000 for each new employee. We’re 2 years into it and the average company coming into Maine doesn’t know about it. This type of information needs to get to prospective companies early on.”* Maine Banker

*“The DECD needs to play a greater role in business development.”*  
Maine Banker

#### **4. Strengthen Infrastructure and Provide Business Support**

- Support the development of infrastructure

Maine’s infrastructure is widely regarded to be lacking for an industry that is as transportation-intensive, capital-intensive and labor-intensive as the forest products industry. The development of infrastructure is no small request, but it is a key differentiator between markets that investors may choose from.

*”I think that the Maine government has to be responsible for the infrastructure to create a fertile environment where businesses can succeed:*

- *Power costs*
- *The condition of roads*
- *The capacity of roads*
- *Labor laws to hire and retain employees*
- *Rail, air and shipping access”*

*Work with the Federal Government to allow heavier truck use on highways. Our best roads have the strictest limits. Our costs increase when we have to use secondary roads or reduce our loads.”* Sawmill Owner

- Become an advocate for investors – like your competitors do

*“I would like to have the Department of Economic and Community Development walk permits through the departments. You go to other states like New Hampshire, and the Carolinas, and it’s almost like they have a consultant working with you.”*



- Provide training programs and incentives to guarantee the quality of the workforce and the management

*“What may be brought to the industry is some sort of advocacy or consulting. We’ve done suppers for sawmill owners with a consultant that gives a presentation on issues specific to them.” Maine Banker*



## X. INDUSTRY ACTIONS

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Bankers, company managers and market experts all recognize that they, too, have a large responsibility when it comes to rebuilding the health of the industry. In many ways, Maine's individualist, go-it-alone approach to business is good for the entrepreneur in a new market, but it can be a liability in a mature industry.

The issues that the industry feels are most important to address itself, are the following:

- Companies need to work cooperatively to strengthen the overall industry

*"We need to work together better to put deals together. I recently talked with a company out of Quebec about putting in a new sorting system. They brought in a Canadian electrical contractor and an installer to provide a complete package of services. They look out for each other more than we do." Sawmill Owner*

- Promote training programs – partner with technical colleges and universities

JD Irving has taken the challenge of qualified workers into its own hands by partnering with Maine colleges to develop forest products educational programs – a move that is viewed as a good model for the industry.

- Build a strong working knowledge of the global forest products market

Companies who compete in a global fashion are well aware of the ways in which their competitors are innovating. It is acknowledged that not enough competitive research is being done in the market. Industry tradeshow attendance and the trade missions offered by the Maine International Trade Center are seen as critical steps to encourage business development and flexibility.

- Develop value-added product niches and innovate continuously.

The development of new product niches is critical to success in a commodity market. In fact, this is the strategy that most of the existing paper mills in Maine have taken to compete, offsetting the liability of their aged equipment. Production has been shifted from a "push" operation, where the mill produces large quantities and then finds markets for them, to a "pull" operation, where product is made to order. This is known as a demand-driven supply network.

*"It's certainly a global marketplace and the industry is redefining itself. It's more into specialty products now, and filling customer orders. The industry needs to move quickly to meet the specifications of the specialty customer." Paper Company Executive*

- Support good forestry practices



This effort was noted by many as a way for the industry to help reduce its own costs by avoiding costly regulatory litigation and injury claims that could result from unsafe working conditions.

## **XI. ANALYSIS AND RECOMMENDATIONS**

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The forest product industry is a huge contributor to Maine’s Gross State Product, but it is an industry facing serious threats. Market fluctuations have historically contributed to a boom or bust environment, but the commoditization of the industry along with intense global competition has strained businesses in unprecedented ways.

Maine has always prided itself on being a resource-based economy, and therefore the Maine state legislature and state government must make a concerted effort to understand the unprecedented challenges facing the industry, and the potential loss to the state if it is allowed to decline.

This industry is much too large to be ignored, as it represents the largest manufacturing industry in Maine, at over \$6 billion in annual revenues – far more than agriculture or fishing.

We conclude our analysis of the industry investment situation by distilling our findings and recommendations into a workable set of recommendations that can be followed to provide the right type of support to existing businesses and future investors.

### **1. Follow through with the Governor’s plan to eliminate personal property taxes on business equipment**

This one step would make a huge impact on the confidence of investors from within, and outside of Maine. The elimination of this tax would create the ultimate level of stability in taxation that investors base their decisions on.

**“There’s a lot of iron in the state. It just needs to be upgraded.” National Forest Products Association Executive**

*“If we received tax incentives, we’d spend it right back into the mill modernizing equipment.” Sawmill Owner*

### **2. Review the concept of an additional tax credit for new technology development and sharing**

We recommend strong state-level support for Maine forest products businesses that develop globally competitive technology that can help others in its sector to become more efficient and therefore more competitive. The goal of this recommendation is to foster innovation and cooperation between Maine forest products companies, to strengthen entire sectors instead of just individual companies.

### **3. Develop a state-level business development action plan to provide industry support for each component of the forest products sector**



The proposed business development action plan would be similar to strategic plans created by major corporations for each of their divisions. This process would ultimately provide a greater understanding of the industry for state legislators and regulators, while strengthening the working relationship between state and industry. We believe that this type of strategic planning would lead to greater stability in the legislative process as a result.

Ideas for the action plan include:

- Setting goals for contribution to state GSP, that each industry sector should provide

*"The state needs to determine over time: What kind of state do we want to be? They need to develop a strategic plan to position themselves for the next 50 years and ask: Are we in those sectors now? If not, what do we have to do to get into them?" Investment Firm Executive*

- Cataloging the age of paper mill machinery to identify vulnerabilities, and developing strategies to encourage reinvestment where needed – these may include tax credits
- Creating a fast-track approval program for environmental permits by considering all possible scenarios in advance
- Coordinating government trade missions to other states and countries that are renowned for regulatory stability and strong working relationships between state government and industry
- Supporting infrastructure enhancements to help lower costs in key trade corridors
- Developing cost effective options and group buying plans to lower healthcare and electricity costs

**4. Support federal efforts that level the playing field with foreign competitors, including the use of countervailing tariffs and similar measures**

*"If the state creates an equal playing field for companies to compete globally, the rest will take care of itself." Sawmill Owner*

*"Whether anyone wants to admit it or not, we do need protections."*

**5. Develop an industry-sponsored awareness and brand-positioning campaign to educate Maine citizens on the importance of the industry to the state's economy – similar to the American Beef Producers' "Beef. It's What's for Dinner."**

This type of campaign would provide a very important show of solidarity and strength in the industry, which is critical to helping Maine citizens understand the impact of their votes on key



industry issues. A branding campaign would also draw all related constituencies together toward a common goal for the common good.

**6. Ensure Maine state government support for:**

- a. Actively soliciting proposals for specific new technologies that can further the competitive position of the industry
- b. Keeping the industry regularly apprised of global innovation and technology developments
- c. Helping to find new markets for Maine companies both within and outside the US
- d. Providing marketing assistance and training for Maine forest products companies, rewarding those that have developed new value-added niches
- e. Promoting Maine and its forest products companies at industry tradeshows

*“At the International Woodworking Fair (in Atlanta), Kentucky, Louisiana and West Virginia all had big booths at the show to encourage people to do business in their states. Kentucky will almost give you a building if you move there. They were advertising 1%, 10 year loans because they realize it means employment for their people.” National Forest Products Association Executive*

- f. Hosting Governor’s conferences on global forest technologies to attract global experts to the state

**7. Support, strengthen and develop industry training programs through the departments of Labor and Conservation.**

Provide active support for safety and certification programs which helps to improve efficiency and lower costs

Partner with Maine colleges and universities to develop forest products business programs that can complement technically-oriented forestry programs

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“Because I’m a forester and a conservationist, the thought of losing our industrial base terrifies me – there will be no incentive to maintain our forest land.”

John Heisenbuttel, American Forest & Paper Association

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***“Our goal is to create a sustainable, balanced, multi-use forest.”***

*Patrick Strauch, Maine Forest Products Council*

