

TRIP REPORT
Lithuania Market Study
May 15-26, 2001

A. Travelers:

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B. Purpose of Travel:

The purpose of this trip was to meet with companies in the Lithuanian sawnwood industry in order to gauge their manufacturing capabilities and potential for growth.

C. Itinerary:

May 28th – Arrive in Lithuania: meet with Ochoco Lumber in Kupiskis, Lithuania.
May 29th – Travel to Vilnius, Lithuania to meet with Libra Group.
May 30th – Return to the U.S.

D. Comments and Observations:

Lithuania is located on the coast of the Baltic Sea, bordering Latvia to the Northwest; Belarus to the South; and Poland and Kalingrad, Russia to the Southeast. As a country located in Central Europe, Lithuania is considered as the crossroads between the east and the west. Lithuania is well situated for the import and export of forest products, with Klaipeda harbor located in the west of the country, and Belarus, along with its big neighbor Russia to the East.

The forest products industry in Lithuania is one of the most important sectors of its economy, accounts for approximately 5.4 % of total exports (according to the Lithuanian development agency). The primary forest products produced in Lithuania include sawnwood, plywood, chipboard, fiberboard, paper and cardboard.

Roundwood Supply of Lithuania:

Approximately 1/3 of the territory in Lithuania is covered by forests, totaling 1.976 million hectares, 77% of which has economic value. Coniferous forest account for 62% of the Lithuanian forests (source: Lithuanian Forest Cluster Association).

The process of privatization of Lithuania's forest resources is currently ongoing. Private forests play an increasingly greater role in roundwood supply. It is estimated that after full restitution of ownership rights (those prior to 1940), state owned forest made up only 48% of the total forest area. As of January 1st 2001, 81.1% of the total forested area was owned by state/government organizations with private forests accounting for 22.8%.

In 2000, 99% of the roundwood in Lithuania was sourced from local forests, the following table highlights the supply sourcing and trade of roundwood:

Table 1.1

Lithuania roundwood removals and trade (<i>Source MEC Statistics Lithuania</i>)					
	1996	1997	1998	1999	2000
Supply – Total*, 1000 m ³	4260	4100	3795	3920	4256
Removals, 1000 m ³	4241	4000	3709	3841	4196
Import	19	100	86	79	60
Sellers					
Sate Forest Enterprises, 1000 m ³	2920	2790	2620	2600	2761
%	69	68	69	66	65
Others, 1000 m ³	1340	1310	1175	1320	1495
%	31	32	31	34	35
Consumption – Total* 1000 m ³					
-export, 1000 m ³	952	764	786	937	1200
%	22	19	26	24	28
Sweden, 1000 m ³	257	373	384	506	620
Poland, 1000 m ³	73	26	93	205	285
Russia, 1000 m ³	442	273	213	148	221
Latvia, 1000 m ³	28	36	88	47	44
Apparent consumption* 1000 m ³	3308	3336	3009	2893	3056
%	78	81	74	76	72

Sawnwood Industry in Lithuania:

Lithuanian sawmills produce and export mainly green, rough lumber. As reported by a Lithuanian industry group, in 2000 there were approximately 500 sawmills operating in Lithuania. Most of these sawmills are very small, producing less than 10,000m³ a year. These sawmills account for 70-80% of Lithuania's total production of companies producing sawnwood. On average 77% of the products produced by Lithuanian mills is exported, half of which goes to Germany (See Figure 1.2).

In 1999, 14 Sawmills in Lithuania achieved a level of production higher than 10,000m³. These mills accounted for about 30%-20% of the total production in the country.

Sawnwood products are exported from Lithuania to a number of markets, including almost all the EU countries, the USA and even Asia. Lithuania's main port city, Klipeda, is well located for direct shipments to foreign ports or for transshipment through German port facilities.

Figure 1-2

Lithuania Sawnwood production and trade, 1000 m³ (Source MEC Statistics Lithuania)					
	1996	1997	1998	1999	2000
Production	1450	1250	1150	1150	1300
Import	47	141	211	265	283
Russia	14	53	77	202	220
Byelorussia	9	67	94	48	44
Latvia	18	14	25	9	8
Ukraine	2	1	3	4	5
Export	1104	986	670	719	829
Germany	617	559	411	399	367
Belgium	30	47	43	64	83
U.S.	3	7	19	40	74
UK	126	140	55	73	63
Canada	-	-	-	2	45
Denmark	33	40	26	36	43
Netherlands	76	54	43	36	36
Italy	11	8	19	18	21

Currency Repegging, European Union (EU) accession, and Foreign Direct Investment (FDI):

When discussing the future of the Lithuanian sawnwood industry, it is important to mention three factors that will play a major role in the development of this market sector.

Currency Repegging

As of April 1st 1994, the Lithuanian currency, the Litas, has been pegged to the US dollar at a fixed exchange rate of 4 to 1 (0.25 USD = 1 LTL). This was done in order to curb rampant

inflation during the early 1990s. This move helped to calm the turbulent economy and assist with Lithuanians steady growth. However, the recent devaluation of the Euro has put Lithuanian companies wishing to export their product to the EU at a disadvantage. This has caused the Lithuanian authority to rethink their Monetary Policy program.

The bank of Lithuania recently released the following statement:

“In light of the trends in development of Lithuanian economy, the increased sensitivity of the international and domestic markets to changes in the economic and monetary policy and signs of the euro/dollar exchange rate stabilization, the bank of Lithuania has resolved...that during the second half of 2001 the Bank of Lithuania will repeg the litas directly to the euro during the second half of 2001 without going through the intermediate peg to the currency basket composed of equal shares of the Euro and the US dollar...”

This will assist Lithuanian sawmills exporting to EU countries, as well as making their products more cost competitive in the North American and Asian markets.

EU Accession

Lithuania along with the other Baltic States is currently going through the necessary civil, political and economic reforms in order to be admitted into the EU. In February of 1998, the EU concluded a Trade Cooperation agreement with Estonia, Latvia, and Lithuania. The European Agreement establishes free trade areas between the EU and associated countries. According to a recent report published by the USDA, Foreign Agricultural Service, the ultimate objective of the Agreement is to prepare countries for EU accession by getting them to align their legislation with that of the EU.

According to most estimates, full admission of Lithuania to the EU partnership is still some years off, as much work is still needed in areas such as agriculture, taxation, and administrative capacities. As Lithuania continues to open its economy to EU member countries, it will encourage both foreign direct investment in the Lithuanian economy and avenues for export of Lithuanian goods. Full access to the single market will help make Lithuanian companies more competitive. Currently, Lithuania is seen as lagging behind the other Baltic states of Estonia and Latvia. Still, it is largely recognized that the three countries will join the EU together.

Foreign Direct Investment

According to the Lithuanian Development Agency, the 2000 total stock of FDI investment in Lithuania reached the level of US\$2.3 billion and is estimated to reach US\$2.7 billion in 2001. In 2000, Lithuania received more FDI than Latvia's US\$1.9 billion, but less than Estonia's US\$3.2 billion. Major North American Investors who invest in Lithuania's forest products industry include Ochoco Lumber from the United States and Terminal Forest Products from Canada.

Summary of Meetings:

1. Visit with Ochoco Lithuania

Ochoco Lithuania is a wholly owned subsidiary of Ochoco Lumber Company, a U.S. forest products company based in Oregon. The facility in Lithuania started production in 1995. Ochoco Lithuania is a remanufacturing facility, located in the town of Kupiskis in northeast region of Lithuania, on the mainline rail between Russia and the satellite state of Kalingrad. Ochoco purchases rough-cut spruce and pine lumber from Russia, Belarus, Poland, neighboring Baltic countries, as well as some local mills. Lumber is then transported by train to Kupiskis, where it is planed and dried in American-built dry kilns. The lumber is then graded, and packaged for shipment in 40' foot ocean containers. The facility has an approximate production capacity of 75,000 m³ per year.

Currently 90% of the products that Ochoco Lithuania produces are shipped to the United States, with the remainder going to the local market, Western Europe, and Japan.

Some of the products that Ochoco Lithuania produces include:

- Spruce kiln dried (KD) 10-12% for the European laminating industry;
- Spruce KD 18% SS/GS, graded and stamped under Trada certificate for UK construction;
- Pine and Spruce KD 16% 4/4" 5/4" x 4', 6', and 8', planed S4S selects, and common boards for the USA home center market;
- Spruce KD 12% profiles for garden houses;
- Spruce KD 10%, planed bed components for the furniture industry; and
- Spruce KD 12% Genban and Lam grades for the Japanese laminating and construction industries.

I had a chance to meet with John Rowell, the plant manager of Ochoco Lithuania. Mr. Rowell explained the history of the operation and some of the advantages and disadvantages with regard to doing business in Lithuania.

According to Mr. Rowell, some of the main advantages of conducting business in Lithuania are:

- The highly skilled and educated Lithuanian work force, combined with the lower cost of Lithuanian labor when compared to the U.S.;
- The availability of reliable access to low-cost, high-quality raw material;
- The existence of a well-developed infrastructure roads, posts, and communication services; and
- The availability of comparatively low construction costs.

Some of the general disadvantages of conducting business in Lithuania are:

- Many companies in Lithuania lack the necessary capital, not only for the maintenance and up-keep of production facilities, but also for customer credit, inventories, advertising, and research and development. Compounding lack of capital is an ailing finance and banking system;

- Lack of marketing knowledge and sales in the sawmill industry in Lithuania cause an absence of advertising and promotion of sawn production domestically and internationally; and
- Outdated machinery and equipment.

Ochoco Lithuania is different from the typical sawmill in Lithuania. Ochoco was able to take U.S. style management practices and ideals and integrate those with a Lithuanian work force. It has taken Ochoco much time and energy to achieve their current level of success. They now have a proven distribution network, reliable supply base, and long-term customers. Ochoco has taken advantages of Lithuania's relative political and economic stability, strategic location between eastern and western Europe, and highly skilled low-cost labor force. By utilizing these advantages and applying proven U.S.-style management, ethics, equipment, and business standards, Ochoco has carved out a "value-added" niche. The ability to follow the market and produce a market-driven mix of products has contributed to the success of Ochoco's operation. The most important key in the success of the operation, however, was Ochoco's ability to work through initial communication difficulties to establish working business relationships built upon trust.

2. Visit With Libra Group

Libra Group is a consortium of 9 companies that produce furniture, edge-glued panels, wood dowels and pins, oak lumber, and oak components. The company was founded in 1991 by 5 students from the Vilnius University. The group now boasts over 800 employees, an annual growth rate of 30% and a yearly revenue of approximately 25 million. There are currently two foreign share holders, one from Norway and another from the U.K.

I met with Ardris Gaidys, Director of Dalinta, one of the member companies of Libra Group. His company is located in the city of Vievis, approximately 30 minutes outside the capital city Vilnius. Dalinta manufactures edge-glued panels from Birch and European Beach. Their production capacity is 6,000m³ (150 x 40' containers per year).

Dalinta sources most of their birch lumber from local Lithuanian sawmills, and beach lumber is imported from Poland and Ukraine. The finished products are shipped to Germany, Denmark, Switzerland, Austria, Norway, Sweden, Canada, and the USA.

Dalinta has recently completed a 1.1 million-dollar investment project, which more than doubled its capacity. The onsite equipment includes three Austrian built wood-drying kilns, Weinig moulding and planing machines, Grecon dimiter joining machines, German and Italian sanders, and Gluing presses. The steam for the facility was generated by two sawdust-fired boilers.

Mr. Gaidys explained that the Dalinta and other companies associated with the Libra Group are different from the typical forest products companies in Lithuania. The management of Libra Group is relatively young (average age 33) and receptive to new ideas and production techniques. Libra Group aggressively markets itself directly to their target audience. For example, Dalinta was the only Lithuanian wood working company participating at the recent Interzum furniture supplier trade show held in Koln, Germany.

After touring the Dalinta facility, Mr. Gaidys and I then traveled to the town of Elektentz. There we met up with Irmantas Rajuncius, CEO of Dominga Mill. A hard wood sawmill, in operation

since 1992, Dominga Mill specializes in the processing of oak and beach logs. The main production of the company is high-quality oak and beach kiln-dried strips and elements for the furniture industry. Currently 95 % of the total production is exported to Western Europe, the major markets being Norway, Sweden, Germany, and the Netherlands.

The raw material for Dominga Mill, oak and beach logs, are bought both locally and imported from Russia. Dominga Mill has a subsidiary company in the Kalingrad district of Russia which organizes the harvesting and supply of logs from both the Kalingrad district and “mainland” Russia. The annual production of the facility is approximately 12000m³ of oak strips and elements and 2000m³ of beach. The product mix breaks out to 65% of the companies products going to parquet, and 35% going to furniture.

Dominga Mill has Italian sawmilling equipment, and both European and American dry kilns. The facility employs 201 workers.

CEO Irmantas Rajuncius, mentioned that currently the biggest obstacle to trade with Europe is the exchange rate of the Lithuanian currency, the Lita, to the Euro of the EU. During the mid-1990's the Lita has been pegged to the US Dollar at 4 Litas to 1 USD. The strong dollar and relatively weak Euro effected Lithuanian companies' ability to sell their product into the EU countries. Mr. Rajuncius was optimistic for the future, due to the future plans of the bank of Lithuania to repeg the Litas directly to the Euro during the second half of 2001, thus eliminating the currency issue.

When asked about environmental certification of their products, Mr. Rajuncius said that there was some interest from customers, but currently he did not see a need for it. He did mention that the facilities at the mill were ISO 9002 certified.

E. Principal Contacts:

John Rowell	Ochoco Lumber Company Lithuania
Renata Katelyte	Ochoco Lumber Company Lithuania
Vingaudas Sarmaitis	Ochoco Lumber Company Lithuania
Vytautas Kupciunas	Ochoco Lumber Company Lithuania
Vilmantas Petrauskas	Domingos Prekyba
Andrius Zuzevicius	Singlis
Irmantas Rajuncius	Dominga mill
Janis Staris	Verems
Audrius Gaidys	Dalinta

F. Conclusions and Recommendations:

The Lithuanian forest products industry seems poised for growth. Despite a recession during 1998 and 2000, the forestry and forest-products-based sector continued with steady growth. The sawnwood industry in Lithuania increased production output by 15% to 1.3 million m³ in 2000. Sawn timber export increased by 15%, despite the unfavorable exchange rate to the Euro.

The Lithuanian Sawmill industry has access to low cost fiber supply, skilled low cost labor, and a functioning transportation infrastructure. The potential for increased exports of sawnwood and other forest products from Lithuania does exist. As Lithuanian free market economy matures, we can expect to see higher levels of exports from Lithuania.

Factors such as the repegging of the Litas to the Euro, EU partnership accession, and increased foreign investment, will all play a role in the Lithuanian forest products industry. Lithuania will become an even stronger player in the international forest products field.