



LATVIJAS VALSTS MEŽI



JSC "Latvijas valsts meži"

Medium term operating strategy

SUMMARY



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INTRODUCTION

The Joint Stock Company “Latvijas valsts meži” (hereinafter LVM or the Company) was established in October 1999 pursuant to an order of the Republic of Latvia Cabinet. LVM’s operating objective is to provide sustainable management of state forests while simultaneously earning maximum revenue for its owner, the state.

LVM controls and manages 1.63 million hectares of land in the Republic of Latvia, including 1.60 million hectares of forest land, of which forest comprises 1.41 million hectares. In total 0.32 million hectares or 20% of all land under LVM are managed as nature conservation areas, including 0.23 million hectares of forest area. Business activities aimed at produced high value timber are planned for 1.17 million hectares, of which 0.18 million hectares are managed with additional conditions for environmental protection, recreation and environmental research.

LVM core activity is forestry, which is also the company’s main source of revenue – in 2015 it earned 96% or 251.2 million euros from sale of timber resources. In addition to forestry LVM provides hinting and recreation services, produces selected seeds and plants, and sells natural resources such as sand, gravel and peat. In 2016 it is planned to start a business system for sale of products and services for clients outside of LVM.

LVM'S OVERALL STRATEGIC OBJECTIVE

Ensuring sustainable (economically beneficial, environmentally friendly, socially responsible) management of strategic state assets given over to our control including state forests and their essential infrastructure, services and development of knowledge.

LVM'S MISSION, VISION, VALUES

Let's build a flourishing Latvia!

We are an honest, diligent, careful and caring manager of Latvia's state forests, and a leader in the Balti Sea region for effective and innovative management of forest land.

Based on the values of LVM, the core working principles for LVM employees have been established – an explanation of the company's values – employee action indicators:

- ✓ Pride in our organisation – We keep our workplace tidy. We present a common professional position to the outside;
- ✓ Honesty – We acknowledge our mistakes. We do not touch other people's property. We don't lie. We do not keep silent about unethical conduct – we point it out. We do not get involved in intrigues;
- ✓ Competence (professionalism) – We propose solutions. We express ourselves succinctly and in Latvia (without foreign words or jargon). We speak in a way that our listener understands. We act thoughtfully;
- ✓ Cooperation, friendliness and happiness – We support our colleagues. We are positive. We keep our promises. We do not denigrate other people's opinions and work, and if we criticise we do it respectfully. We listen, we don't interrupt, and if necessary we ask. We are open, polite and kind. We greet others!
- ✓ Achievements and results from our work – We place our common objectives above our individual goals. We show initiative. We evaluate what is offered rather than the person. We do our work on time.

STRATEGIC OBJECTIVES

1. Increasing long-term profits and ensuring positive cashflow from business activities
2. Increasing the value of assets and timber stands managed by the enterprise
3. Being a stable and predictable partner for clients, suppliers and service providers, creating a client-oriented attitude
4. Promoting and developing high value added products, services and knowledge
5. Developing a working environment which increases employees' loyalty and self-motivation
6. Promoting public participation and cooperation in forest management
7. Being a responsible and trustworthy member of society
8. Promoting responsible public attitudes toward forests
9. Increasing the contribution of managed forests to reducing global climate change
10. Providing nature diversity and recreation services in forest ecosystems

To ensure the balancing of objectives from a business process perspective, LVM employs *balanced scorecard* principles.

[TRANSLATION OF TABLE BELOW]:

Client – How do we wish to be evaluated by the client to achieve our vision?

Financial – What financial results does the owner expect?

Vision

Strategy

Development – How will we achieve development and the ability to change to achieve our vision?

Business processes – What business processes must be improved to meet our owner's and client's wishes?

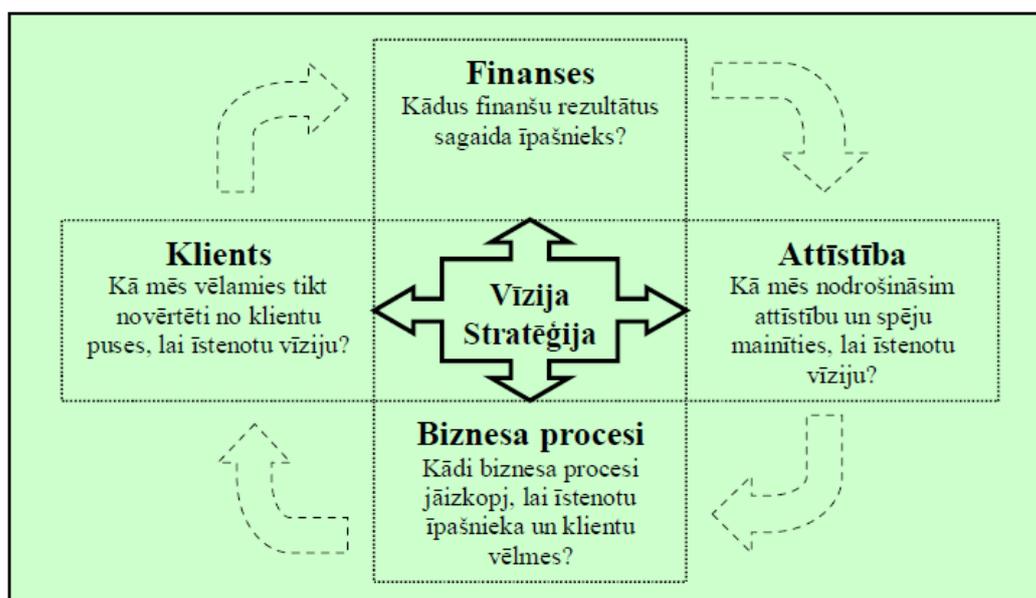
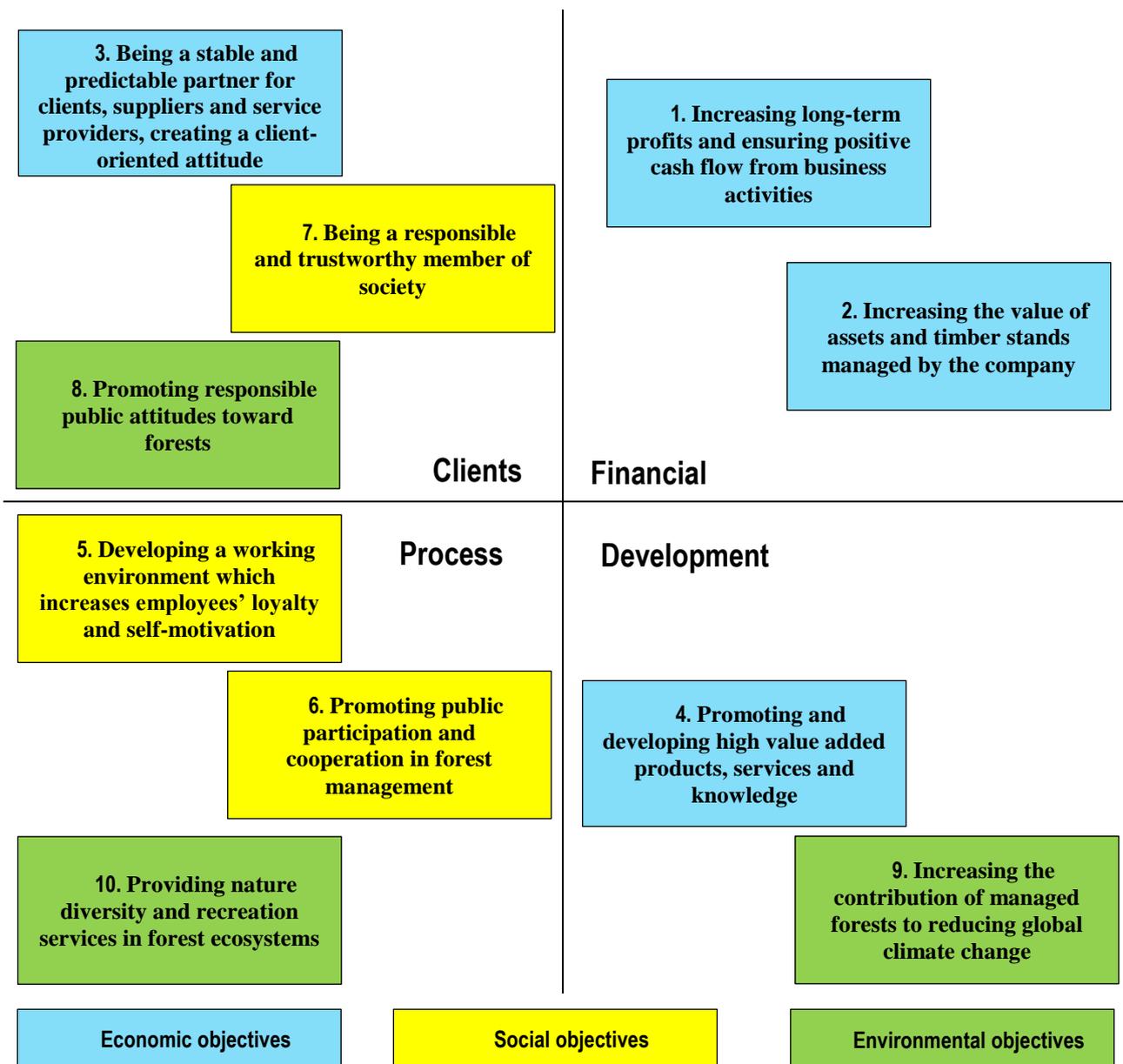


Fig.1. Balanced objectives scorecard (adapted from *The Balanced Scorecard* by Kaplan & Norton)

The company uses the balanced objectives scorecard for a number of reasons. By defining the company’s strategic objectives with a common form and terminology, the objectives are clearly understandable and describe a common planning level. One of the most important requirements is that the objectives are measurable, therefore a certain level of control is possible for progress toward the objective. To ensure that the company’s mission and vision are balanced and encompass significant development dimensions for the company, the objectives are placed in four balanced dimensions:

- clients;
- financial;
- process;
- development.

The balanced objectives scorecard approach means that objectives are mutually applicable and interchangeable, thus they are simple to plan down to the lowest company planning level.



Breakdown of objectives in accordance with the Helsinki Resolution H1.

INDICATORS DESCRIBING THE OBJECTIVES

The strategy text encompasses the most significant indicators used by LVM to supervise implementation of strategic objectives, measure achievements and provide an overview of activities both within the company and outside LVM. Instead of providing an extensive, detailed system of activities and resulting indicators, the strategy text only includes those indicators which the owners of LVM processes consider as especially important for reflecting progress toward the set development vision until 2020 for each strategic objective section.

In setting objectives and indicators, LVM balances the objectives for all spheres – economic, environmental and social – to ensure that various interests are achieved. One of the annexes is a financial plan offering a detailed insight into all financial indicators. EBITDA is currently the most precise method for describing the results achievable in the planning period. Changes in this indicator will also affect changes in any other indicator.

In the case of LVM, the use of, for example, net profit and return on own capital indicators for comparison with similar companies or others working in the sector would not be possible for several reasons. LVM's main assets are land and forest stands, which it manages rather than owns, therefore they do not appear on the balance sheet. A second important factor is depreciation. In traditional production enterprises, amortisation comprises a significant amount of the company's costs. In the case of LVM the accrual of capital assets (roads, melioration systems, tree nurseries) was begun only after the company commenced operations. Initially almost fully amortised capital assets were used, often accrued in the Soviet era, or in the case of forest infrastructure they were invested with zero value. Work is currently continuing realisation of the investment program to forecast what will be required over ten years to achieve the desired level. Therefore, depreciation is at a much lower level than is really required. This is why measurement of EBITDA is proposed.

Table 1. The company's operational indicators

Strategic objectives	Indicators describing strategic objective	Unit	Base level 2015	Level achievable in 2020	Average annual impact of indicator, mil. EUR*
Financial indicators					
1. Increasing long-term profits and ensuring positive cash flow from business activities	Earnings before interest, tax, depreciation and amortisation (EBITDA) from business activities	mil.EUR	98.6	≥76.3	-
	Profits payable in dividends ¹	%	90%	≥50%	-
2. Increasing the value of assets and timber stands managed by the company	Balance sheet value of forest infrastructure (roads, bridges, melioration systems)	mil. EUR	234.4	≥243.3	-
	Maximum capital value of forest (TTV) in any 5-year period over 120-year cycle	mil EUR	2 451	2 451	-

Non-financial indicators					
2. Increasing the value of assets and timber stands managed by the company	Forest area for timber production and extraction as a proportion of forest	%	83.80%	>84%	n/a
	Acquired forest tracts 2016-2020	ha		+6 000	1.8
	Proportion over 5-year period of forest renewal with selected reproductive materials	%	48%	55%	1.0
	Renewed and reconstructed forest melioration systems (total volume)	thousand ha	154.4	246.8	3.1
	Increasing the density of LVM timber transportation roads (in accordance with LVM methodology) ²	km/100 ha commercial forest	0.99	1.04	7.9
3. Being a stable and predictable partner for clients, suppliers and service providers, creating a client-oriented attitude	Average annual volume of most significant timber products over 20-year cycle:				
	- conifer saw logs at least	mil. m ³	2.41	2.41	172.2
	- birch veneer at least	mil. m ³	0.33	0.33	22.6
4. Promoting and developing high value added products, services and knowledge	Research funding as a proportion of net turnover in reporting year	%	0.38%	0.30% - 0.50%	0.9-1.5
5. Developing a working environment which increases employees' loyalty and self-motivation	LVM employee involvement measurement (employees involved in the LVM involvement study)	%	70%	>70%	4.9 ³
6. Promoting public participation and cooperation in forest management	Investment in public involvement and information about forest ecosystem services as a proportion of annual turnover	%	0.2%	0.15-0.25%	0.46-0.77
	Membership fees in NGOs for supporting company interests as a proportion of annual turnover	%	0.04%	0.04-0.05%	0.1-0.2
	Number of teachers educated about sustainable forest management	quantity	250	300	0.01
	Number of children and youths educated about sustainable forest management	quantity	6 000	8 000	0.07
7. Being a responsible and trustworthy member of society	LVM reputation indicator	Index points	41.5	>40	n/a
	Donations to socially beneficial organisations as a proportion of reporting year profits before tax	%	6.50%	5% - 10%	4
8. Promoting responsible public attitudes toward forests	Audience reached by the campaign "Don't trash the forest" at least	thousand pers.	500	550	0.1

9. Increasing the contribution of managed forests to reducing global climate change	CO ₂ attracted by forest growth (in accordance with LVM methodology) ⁴	mil. CO ₂ t	9	9	n/a
	Attracted CO ₂ in forestry products supplied by LVM (in accordance with LVM methodology) ⁵	mil. CO ₂ t	4.51	4.95	n/a
10. Providing nature diversity and recreation services in forest ecosystems	Area of forest and forest land for nature conservation, not more than:				30 ⁶
	- from forest,	%	10.7%	10.7%	
	- from forest land	%	20%	20%	
	Funds invested in social infrastructure as proportion of annual turnover	%	0.8%	0.5-1.0%	1.5-3.1

*The forecast must not be used for setting objectives

¹ The 2016 State Budget Law: law (2016) [viewed 23 March 2016]. Accessible at: <http://likumi.lv/ta/id/278623-par-valsts-budzetu-2016-gadam> and Order in which state-owned companies and publicly private companies in which the state is a partner (shareholders) forecast and calculate the proportion of earnings payable in dividends and make payments to the state budget for use of state capital: Cabinet Regulation No 806 of 22 December 2015 [viewed 23 March 2016]. <http://likumi.lv/ta/id/278921-kartiba-kada-valsts-kapitalsabiedribas-un-publiski-privatas-kapitalsabiedribas-kuras-valsts-ir-dalibnieks-akcionars#n2&pd=1>

² The road network of LVM and other owners (roads which abut LVM managed forest areas), which is applicable to forest areas in which the main management objective is timber production and extraction. The optimum road network density is determined based on the lowest costs and highest earnings.

³ Total sum which raises both long and short-term employee motivation.

⁴ The calculation calculates the accrued carbon in tree roots, trunks and branches. Calculations for each tree are applicable to accrued timber in LVM managed forests.

⁵ Calculated on the basis of the coefficients indicated in pp 21-22 of a study by the Latvian state forestry science institute "Silava" titled "Development of a reference level calculation model for carbon dioxide (CO₂) attraction and greenhouse gas (GHG) emissions caused by management of Latvian forests". Coefficients used: volume of carbon accumulated in leaf tree timber 0.34 GgC/1000m³, in conifer timber 0.23 GgC/1000m³. Other coefficients from carbon to CO₂ – 3.67.

⁶ Areas where the main management objective is nature conservation. Unharvested timber is calculated in monetary terms.

SUPERVISION OF THE IMPLEMENTATION OF LVM STRATEGY

The most important method for supervising strategy implementation is comparing the achieved level with the set level.

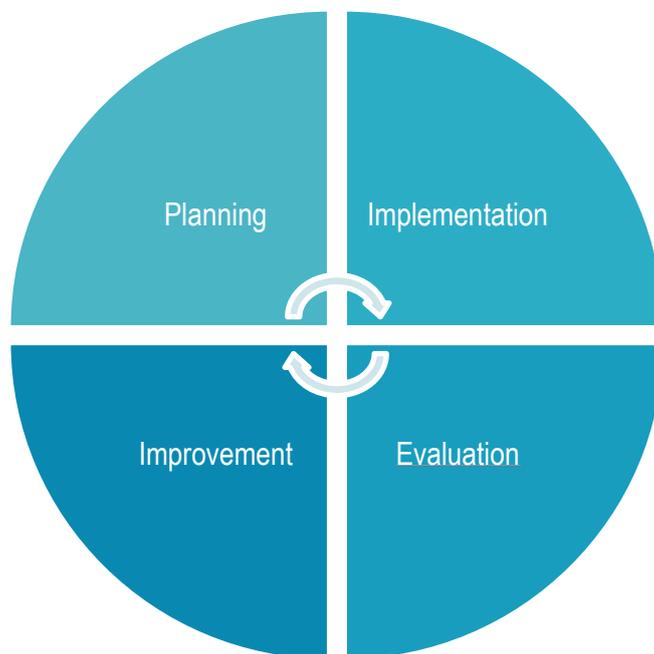


Fig. 2. LVM planning supervision system

In order to ensure the set objectives are achieved, there must be timely and qualitative cascading of tasks and delegation to responsible employees.

Therefore, lower planning levels, including tactical and operational planning, are also important for supervising the implementation of strategy.

Planning of strategy.

The strategic objectives align with the owner's sector policies. The objectives are harmonised with and do not contravene laws and regulations. The strategy must be approved by 31 March.

Implementation of strategy.

Tactical objectives are set in accordance with strategic objectives. They are set under conditions of greater certainty, are more precise and detailed and have shorter timeframes. Concrete responsible persons are assigned for the objectives. The tactical plan is approved by 30 June.

Operational planning is conducted in accordance with the tactical plan. Budgetary tasks are set defining objectives and achievable results for a period of one calendar year. Budgetary objectives are prepared and assigned by 31 August.

A detailed budget plan with a high level of detail and comparatively high conditions if certainty is prepared in accordance with budget tasks and objectives. The budget is prepared by 1 December.

Evaluation of strategy.

Evaluation begins with assessment of lower level plans. Assessment is made of how budgetary tasks and tactical objectives have been realised. Implementation of budgetary tasks is evaluated every month while implementation of tactical objectives is evaluated every year by 1 March.

Following evaluation of tactical objectives, an assessment is made regarding compliance of the level achieved with the strategic positions. Evaluation shall be made 1 April.

In the event that serious deviations are found, decisions shall be made on measures to correct the objectives.

Improvement of strategy.

Improvement of strategy is primarily conducted at the tactical and operational level. When deficiencies in objective implementation are found, corrections are usually made to lower level plans in order to achieve the set objectives within the operational period for the strategy. For this reason the tactical plan is updated every year, as is the case with operational plans, which can be reviewed even more frequently.

Changes to strategy may be adopted in the event of significant changes.

The company board is the institution responsible for implementing strategy. The board cascades objectives and sets them out in detail to achieve the strategic tasks.

The strategy implementation supervision set out here is closely tied to the planning process. The board's main competence is planning. As a result, this management model is logical and integrated with the overall planning and control (supervision) process.