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Applicants' comments on Ilim Timber Germany Visit Report

1.0 Executive Summary

C&BP has preliminarily determined that Ilim Timber's exports of structural timber from Germany were at dumped levels (i.e. 15.7 per cent during the 1 July 2010 to 30 June 2011 investigation period).

The Applicants¹ have reviewed C&BP's Exporter Visit Report for Ilim Germany ("IG"). It is noted that the IG Report initially indicated that IG sold like goods domestically, however, it was subsequently considered this was not the case. The following comments are identified in relation to the issue of "like goods":

- The goods are derived from "different species of timber";
- Are of different dimensional size; and
- The majority of the domestic product is not planed, nor machine stress graded.

Similar to the Applicants submission on the Stora Enso Lithuania ("SEL") Exporter Visit Report, a specification adjustment to goods sold domestically (which are like goods – although not identical) could have been made for domestic sales by IG.

The Applicants' submit a specification adjustment is possible based upon properly verified Cost to Make and Sell ("CTM&S") for the GUC and the domestic selling price(s) for like goods sold by IG.

In the absence of domestic sales of identical products from another seller on the domestic market in Germany, C&BP determined normal values on the basis of CTM&S under s.269TAC(2)(c) of the Customs Act.

The Applicants have analysed C&BP's documented verification of IG's CTM&S records as detailed in the Exporter Visit Report (i.e. Section 9 of Report). The Applicants note their reservations in relation to the following items:

- Lack of discussion on log classes and quality of fibre used to target the GUC;
- Absence of site and manufacturing yield calculations. C&BP appear to accept untested IG's explanation that the log yield for the GUC is at the average site level, even though the GUC are a more highly processed, narrower section of higher specification;
- The conversion costs description is insufficient to provide any understanding that conversion costs have been correctly associated with fibre (i.e. grossed up for losses through process and reflect actual logs and associated recoveries used rather than site averages for the GUC);
- Verification of costs allocated on a "whole of site" basis within the process, without due consideration as to how these costs should be allocated to different products, e.g. kiln losses associated with the GUC's production have not been correctly associated with fibre cost of the GUC.
- The absence of the accounting for the loss on reject product in the GUC CTM&S; and
- Lack of reference to the exclusion from log costs of material not involved in production of GUC.

¹ Building Supplies Group Holding Pty Ltd (BSG), Hyne & Sons Pty Ltd, and Gunns Limited.

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2.0 Comments/Issues with IG Exporter Visit Report

2.1 Raw Material Costs

The substantiation of the fibre cost is a central element of the verification of IG's CTM&S for the GUC. This area warrants further consideration via Expert Review.

2.1.1 Material Costs - Fibre

Based on the limited discussion of the required fibre quality to meet Australian MGP standards, C&BP appear to have undertaken a partial evaluation of fibre used in the manufacture of the GUC. Expert review is required to ensure the cost to make was not constructed on a price of a non-representative lower cost log, size or quality:

- It is noted at Section 4.2 that IG purchases some log requirements from its related company in Russia. The Report further indicates that no evidence for the quantity purchased from the related party was provided. In the absence of documentation, C&BP should have rejected the purchases from the related party and relied upon purchase prices from unrelated parties. There is an absence of commentary to suggest that C&BP tested the purchase price in any manner.
- In section 5.2 it is noted that lower quality and reject product results from lower quality log. The Applicants contend the noted scanning capability and processes at IG would have identified said lower quality logs and excluded them from the manufacturing of the GUC. Therefore the use of average log costs understates the actual fibre cost in the CTM&S of the GUC;
- IG's sales to Australia included some product sourced from higher cost spruce, but no commensurate adjustment of the fibre cost based on volume sold into Australia is apparent in the discussion of the GUC CTM&S calculation
 - The applicant accepts the inclusion in the log cost of only those species and grades that are used for the GUC either by log scanning and grading methods, or by machine grading in production or by mill practice in species selection and end diameter selection. The applicant rejects the exclusion of any higher priced logs that are used to make the GUC, or the inclusion in the CTM&S of any lower cost logs by species, diameter or quality that are not used for the GUC by way of actual records of species shipped or actual records of grades shipped.
- It is unclear to the Applicants that the associated handling costs for merchandising of log into the sawmill described have been included in the GUC CTM&S; and
- No calculation appears to have been undertaken that compares the whole-of-site recovery with individual manufacturing yields on domestic products vs export products. This issue needs to be addressed via Expert Review particularly as the Report is generally silent on log diameter classes used for the GUC, the comparison to site averages and associated implications on conversion costs;

2.1.2 Material Costs - Residues

Similarly with the commentary on fibre, residue sales should be reviewed further to establish the possibility of over-crediting.

- There is an absence of comment on the exclusion of residue credits for logs chipped or sold, by-passing the manufacturing process. Any income from the sale of the pulp log and

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roundwood should be removed from the fibre cost of manufacture for structural timber as these products are not associated with structural manufacturing and sell for prices below saw log;

- The bark used in the in the energy plant has been correctly excluded from the residue credit of the net wood cost of the GUC; and
- The basis on which residues are sold is absent from the report and thus it is unclear to the Applicants how any associated transport charges have been accounted for and possibly resulting in an over-crediting.

2.2 Conversion Costs (i.e. sawing, kilning, planing, etc)

The isolation of the costs associated with the GUC should reflect the requirements of the product both in terms of processes and properties.

2.2.1 Process Costs (including Conversion costs)

Sawing and Planing

- The lack of discussion on log quality and diameter class prevents the Applicants from commenting further on the appropriateness of log recovery/yield associated with the sawmill (INT). This requires Expert Review as it is unclear to the Applicants how C&BP attempted to identify if a higher grade of pine log is required for the Australian production or the typical log used for the GUC is of a smaller diameter than the site average. These examples would necessitate further adjustment for cost increase and loss in yield in the GUC CTM&S.
- Expert Review of conversion costs based on yield from log associated with the production of GUCs is required for contrasting with reported site averages and consideration of the CTM&S:
 - The extent to which site average and recovery benefits from producing large section product for the domestic market are not representative of the CTM&S for the GUC;
 - Consideration of conversion cost adjustments from processing smaller log, given small log incurs significant conversion cost burden and should be reflected in the GUC CTM&S. (CHH Confidential Attachment as per submission re SEL);
 - Conversion penalty when processing smaller log is likely to be up to xx per cent when compared with average costing through the same machine centres; and
 - Yields from machine grading of the GUC in the planing mill will be less than what is recorded for the average site outcome. The grading standards associated with the GUC will result in greater grade loss than would be normal for domestic or other export product.
- The manufacturing process for GUC generates co-products of low value and the resultant loss on sale of the co-product needs to be accounted for in the GUC CTM&S. Whilst it is noted that pine based products are unacceptable in the domestic market and other timber exports are made from spruce logs, the understanding and inclusion of the loss reject product in the GUC CTM&S appears to the Applicants to be absent;
- The visit report is silent on the treatment of costs incurred in producing planed material that does not meet the grade specification and is diverted to a domestic grade. The divisor for the unit production cost of the MGP grades should be the MGP volume and not include the volume of fall down product that was planed but downgraded.
- No allowance in the CTM&S of the GUC has been made for the impact of fibre volume reduction through the drying process (i.e. a higher fibre cost presented to the planer mill);

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- Whilst C&BP note the initial omission of the administration (finance expenses?) costs in the CTM&S, it is unclear that their subsequent inclusion adequately accounts for the recovery loss through the manufacturing process (i.e. it appears nothing more than a simple allocation across total output has been accepted). Expert Review is required to validate the methodology for the grossing up of the raw material cost with associated administration and other indirect costs through the manufacturing stages.

Other Process Costs

- Discussion on the allocation methodology of overheads to machines centres is absent from the report and should be the subject of Expert Review. For instance the treatment of higher planning losses for the GUC than the site average needs to be accounted in the allocation of overheads.
- The Report is silent on the extent of any end-trimming of the GUC and the associated allocation of direct and indirect costs to the process.
- The adequacy of packaging costs for export sale to Australia appears to go un-reviewed by C&BP, e.g. if domestic production isn't fully wrapped to the same specification as export materials, domestic production would need to be excluded from the allocation of packing costs including associated labour to the GUC CTM&S.
 - Export product is both wrapped and containerised. Domestic product in some instances maybe just strapped and/or possibly wrapped with a lower grade packaging material than used for export. CTM&S for the GUC must include costs associated with exporting to Australia.

2.4 Delivery costs – Freight ex Mill

- There appears to be no review by C&BP on the inclusion of demurrage costs incurred on Australian destined orders being allocated back to the CTM&S.
- The Report remains silent on the adequacy of any information associated with the dispatch costs incurred in the mill for export sale and should be subject to further Expert Review.

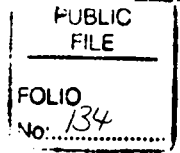
2.4 Administrative & Other Manufacturing Costs

The Applicants are concerned that:

- The depreciation may be reported correctly in total, but its allocation to the production centres may not necessarily be appropriately grossed up for processing loss and carried through the manufacturing process.
- Group management fees appear to be absent in the CTM&S for the GUC.

2.5 Domestic Selling Prices Ex-mill

- Sales of F5 graded structural material in Australia by xxxxxxxx (xxxxx exclusive customer) are at prices substantially below that achieved on MGP10 or better rated production. The differential gap for in-market selling prices suggests a dumped margin on F5 of a greater quantum than the preliminary dumped margin.



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2.6 Other general concerns:

- Related party purchases
- Units of measure (UOM) at each stage of process are not easily identifiable or are absent. The UOM should be detailed at each step of process.
- The actual exchange rates used to convert back to AUD across the investigation period are omitted;
- Other common production costs may include costs that relate specifically to the MGP GUC, and if included in a "common" category and allocated across all site production, will result in a lowering of the CTM&S for the MGP GUC.

3 Conclusions

The IG Exporter Visit Report partially details the extent to which appropriate production costs by stage have been 'tested' by C&BP. The absence of detail on log size and quality, yield, etc prevents the Applicants from adequately commenting on the Report. Expert Review is required to express views on the adequacy of cost identification and associated allocations provided for by the exporter, and verified by C&BP.

Although the revised CTM&S information for the GUC includes administrative costs and interest/finance charges, the Applicants have formed the view from examination of IG Exporter Visit Report that the verified CTM&S for the GUC remains understated (particularly given the absence of accounting for the loss on reject product). The Applicants anticipate further Expert Review of the fair assessment of costs applied to the MGP GUC having been appropriately allocated.