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Applicants' comments on Western Forest Products Canada Visit Report

1.0 Executive Summary

C&BP has preliminarily determined that Western Forest Products Timber's exports of structural timber from Canada were at non dumped levels (i.e. 15.1% per cent) during the 1 July 2010 to 30 June 2011 investigation period.

The Applicants¹ have reviewed C&BP's Exporter Visit Report for Western Forest Products Canada ("WFP"). It is noted that the WFP Report initially indicated that WFP sold like goods domestically, however, it was subsequently noted that there was an insufficient volume of domestic sales of like goods to determine a normal value under sub-section 269TAC(1).

In the absence of a sufficient volume of domestic sales of like products, C&BP determined normal values on the basis of Cost To Make and Sell ("CTM&S") under s.269TAC(2)(c) of the Customs Act.

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

- The lack of clarity that only Douglas Fir logs are used for the CTM&S for product exported to Australia;
- Whether the Douglas Fir log prices used in the CTM&S are effected by related party relationship;
- the use of mill averages when specific data was supplied and could be extracted;
- The lack of reference to the exclusion from log costs of material not involved in production of GUC;
- The conversion costs description is insufficient to provide understanding that costs, direct and indirect, have been correctly associated with fibre (i.e. grossed up for losses of dimensional saleable volume through the process);
- The absence of the accounting for the loss on reject product in the GUC CTM&S; and
- The apparent lack of inclusion of Group/corporate charges and finance and interest costs.

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

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2.0 Related Parties

C&BP appears to accept uncontested that WFP operates as an unrelated party with respect to purchases of log from an internal division. WFP are an integrated forestry enterprise processing logs substantively from Company controlled forests (Source: Company website – Investor presentation Nov 2011). The Applicants remain deeply concerned that the relationships between the internal divisions potentially influences the relevant price for the logs used to produce the GUC and that the nature of the relation warrants further Expert Review and adjustment to the CTM&S.

- An analyst (Raymond James Limited) covering WFP notes the Company actively merchandised log in its forestry division to maximize the value obtained from the log for its saw mills. Whilst it is a logical practice to merchandise log for sawn return during the harvesting process, such higher quality logs attract greater value in an open market. The Applicants remain concerned that logs sold externally may be non representative of those required to produce the GUC, being possibly of an inferior quality, thus attracting a lower price. Therefore, the reliance on a weighted average transfer price of all log purchased understates the true cost of fibre and provides benefit to a related party
 - C&BP's verification of the log supply price appears to be based on a single load of Douglas Fir (unspecified class and quality nor commented on for GUC suitability) with the balance of the verification based on Hemlock Fir not used to manufacture the GUC at sites uninvolved in exporting the GUC to Australia.

3.0 Comments/Issues with WFP Exporter Visit Report

3.1 Raw Material Costs

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

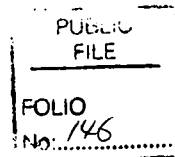
3.1.1 Material Costs - Fibre

Based on the limited discussion of the required fibre quality to meet Australian F5 or better 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:

- C&BP doesn't appear to have undertaken any benchmarking against published indices to establish bona fides of the fibre prices in the GUC CTM&S, in part commented on above
 - There is an absence of discussion on actual log quality and diameter class used for the GUC and how this compared with the site average and GUC CTM&S warranting further Expert review.
 - As noted above, verification of the log supply price appears to be based on a single load of Douglas Fir (unspecified class and quality nor commented for GUC suitability) with the balance of the verification based on Hemlock Fir not used in the GUC at sites not involved in export to Australia.

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- The Applicants note from the Investor presentation of Nov 2011 available from WFP's website that stumpage charge built into the fibre prices for the GUC are approximately \$Cxx/m³. On the surface this appears to be possibly less than market value and warrants further Expert review. The Global Benchmark Report 2010 assesses stumpage of ~\$USxx/m³ in the B.C. Coastal region
 - Additionally in the Report, C&BP remain silent on changes to the stumpage system effective April 1, 2011 and its impact on the CTM&S. WFP noted in its Annual report for 2010 *"There can be no assurance that future changes to the stumpage system or the Province's administrative policy will not have a material impact on stumpage fees payable"*
- C&BP have left unchallenged that the yield for Australian production is the same as the mill average yield
 - WFP uses the side boards cut from the log for the Australian market rather than the centre cant. The use of the side board as described is to maximize recovery against the F5 or better properties of strength and appearance and reinforces the Applicant's contention that the average log cost cannot be used as an input to the CTM&S for the timber exported to Australia.
- The report implies that C&BP calculated WFP's total log cost for the goods exported to Australia during the investigation by including species that were considered suitable for structural timber in the home market despite being commercially unsalable in the Australian market and not used in the manufacture of the GUC. The Applicants believe the effect of this inclusion understates the fibre cost in the GUC CTM&S and warranting further Expert Review
 - The Applicants accepts the inclusion in the log cost of only those species and grades that are used for the GUC by log scanning and grading methods, or by machine grading in production, or by mill practice in species selection and end diameter selection. The Applicants reject 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.
- WFP provided production information outlining return to log, but in the investigation C&BP appear to have subsequently failed to analysis the data for statistical spread, mean value and return against log used, including cost, to make the GUC. The Applicants contend that cost of log and specific product yield could have been calculated more relevantly from the supplied production data for the GUC; and
- The Report fails to comment on the associated yield of downgrade product (i.e. reject or out of specification product) associated with the production of the Australian grade (F5 or better). The sale of downgrade product, whether as a domestic or export sale, results in a loss that must be associated with the GUC CTM&S. Accounting for this loss is absent from the Report.



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3.1.2 Material Costs – Residues

Similar to 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 roundwood should be removed from the fibre cost of manufacture for structural timber as these products are not associated with structural timber manufacturing and sell for prices below saw log;
- The allocation of woodchip credits appears to be on an average cost basis, where as the credit per m3 of log input needs to be related back to the species and grade of log used in the production of the Douglas Fir export product; 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.

3.2 Conversion Costs (i.e. sawing, 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.

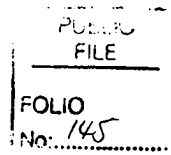
3.2.1 Process Costs (including Conversion costs)

Sawing and Planing

- Expert Review of conversion costs based on actual yield from log associated with the production of GUCs is required for contrasting with reported site averages and consideration of the CTM&S;
- Absent from the discussion on costing in the Report is the treatment of increased waste as the Australian product progresses through the production process and the reduction in the measured and sold volume of timber. It is not clear that the costs incurred in the sawmill are adequately grossed up for dimension losses in heat treating and rough heading. The failure to correctly to gross up the fibre and early stage processing costs has significant impact on the GUC CTM&S warranting further Expert Review.
- The costs associated with the GUC CTM&S appear to be based on the production volume of all grades (i.e. averaged) irrespective of the grade outturn or yield of sideboards for Australian production versus Belgium production. Critically the production costs needed to be associated with the specific yield for the GUC and thus require further Expert Review.

Other Process Costs

- The Report is silent on the extent of any end-trimming of the GUC and the associated allocation of cost, direct and indirect costs, to the process;
- The Report remains silent on maintenance costs, i.e. their adequacy and the extent of any provisions/capitalising. If depreciation is minimal then this points to likelihood of higher maintenance costs and lower yields based on plant capability. Expert Review is required to assess the adequacy of the maintenance charges used in the CTM&S and linkage to yield and processing cost; and



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- Whilst C&BP were able to match the total depreciation expense at income statement, the Report remains silent on the methodology for allocating the depreciation charge back to production. Expert Review is required to assess the adequacy of the depreciation apportionment to production, e.g. according to how much of the plant capital investment was used and stage of product manufacture.

3.3 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; and
- 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.

3.4 Administrative & Other Manufacturing Costs

The Applicants are concerned that:

- Finance and interest charges are absent in the CTM&S for the GUC; and
- Group management fees appear to be absent in the CTM&S for the GUC.

3.5 Profit

- C&BP included a level of profit determined for domestic sales of Douglas Fir and Hem Fir (excluding sales of product with a diameter greater than 120 cm²). However, WFP doesn't sell like goods of Douglas Fir timber domestically, and its domestic sales of Hem Fir are not of like goods (P.22);
- The Applicants consider a level of profit should be applied to the constructed CTM&S for the goods exported to Australia, however, the basis of selection for a level of profit requires further examination by Expert review (for better comparison purposes).

3.6 Domestic Selling Prices Ex-mill

- Sales of structural grades below F5 or associated reject graded material in Australia by WFP distributors are at prices below that achieved on F5 or better rated production. The differential gap for in-market selling prices suggests a dumped margin on sale of said products at a greater quantum than the preliminary un-dumped margin
 - the Applicants consider that the CTM&S for the GUC exported to Australia may be understated as average costs have been included in the CTM&S composition;
 - The failure to include grossed-up losses from each manufacturing process for the GUC undervalues the CTM&S for the exported goods;

3.7 Other general concerns:

- Units of measure (UOM) and conversion to actual m³ at each stage of process are not easily identifiable or absent. The UOM and conversion factors should be detailed at each step of process; and

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- The actual exchange rates used to convert back to AUD across the investigation period are omitted.

4 Conclusions

The WFP 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 (including losses) provided for by the exporter, and verified by C&BP.

The Applicants have formed the view from the examination of WFP Exporter Visit Report that the verified CTM&S for the GUC remains understated. C&BP's verification is vulnerable in the key areas of Fibre cost, residue credits and conversion cost.