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**Applicants' comments on Exporter Visit Report for Stora Enso Wood Products Plana S.R.O. and Stora Enso Wood Products Zdirec S.R.O. (of the Czech Republic)**

**1.0 Executive Summary**

C&BP has preliminarily determined that Stora Enso's exports of structural timber from the Czech Republic were at non-dumped levels of minus 0.7 per cent during the 1 July 2010 to 30 June 2011 investigation period.

The Applicants<sup>1</sup> have reviewed C&BP's Exporter Visit Report for Stora Enso Czech Republic ("SECR"). C&BP has determined that there were insufficient volumes of domestic sales of like goods upon which to determine normal values under s.269TAC(1) of the Customs Act for the exports by SECR. C&BP has therefore determined normal values for SECR based upon the exporters' CTM&S the goods under consideration ("GUC") (i.e. under s.269TAC(2)(c)).

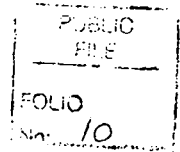
The Applicants have examined C&BP's Exporter Visit Report and retain concerns as to the allocation of costs by production process phase as verified by C&BP. Contrary to C&BP assertion that the costing methodology as verified with SECR is reasonable, the Applicants cannot agree with this preliminary view. The Applicants' hold reservations that the CTM&S for the GUC as verified by C&BP understates SECR's actual costs production for the GUC.

The Applicants' concerns with the SECR Report include:

- A failure to align log species used in the GUC with actual export sales;
- Absence of benchmarking of log costs;
- An absence of discussion on log classes used for GUC;
- No discussion with SECR on site and manufacturing yield calculations (including, separately, for domestic and export sales);
- The absence of the inclusion of Loss on B Grade product in the CTMS that arises from the production of the GUC;
- No reference to exclusion from log costs of material not involved in production of GUC;
- C&BP appear to have accepted untested SECR's explanation that it uses an "averaging approach to the cost of logs". This assertion must be challenged as the Applicants' are aware that the use of smaller diameter logs results in a higher cost for the GUC;
- Sufficient discussion on conversion costs is absent from the Report to understand how 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);
- Doubt as to whether full S,G&A and finance expenses have been properly identified and included in the GUC (e.g. there does not appear to be any corporate charges or central Stora Enso Wood Supply sales & marketing costs included in the CTM&S).

Whilst it is recognised that C&BP required SECR to "re-allocate" costs on the basis of activity associated with each subsequent stage of processing for the GUC, it would appear that little more than an addition of costs by further value-add process (without taking account of grossing up for losses on downgrade product) has been adopted to arrive at a CTM&S for the GUC. This methodology understates SECR's CTM&S for the GUC and does not accurately reflect the actual costs associated with each production stage.

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



## 2.0 Comments/Issues with SECR Exporter Visit Report

### 2.1 **Raw Material Costs**

The substantiation of the fibre cost is a central element of verification to SECR's CTM&S for the GUC. The SECR Report discusses the use of small diameter logs for the production of the exported GUC and that the diameter of the log is a "driver of log price variations" with "large diameter logs at greater prices per cubic meter". Whilst these comments are reasonably accurate, the use of smaller diameter logs involves lower yields (and hence higher losses) resulting in a higher cost per cubic meter than if larger diameter logs had been used.

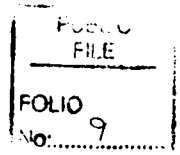
The explanation by SECR that for the reasons it outlined as being justification for using an "averaging approach to the cost of logs and is not concerned with distinguishing which logs are used in which final products or markets" is misleading and does not permit the proper allocation of costs for the GUC.

As a minimum, the Applicants would have anticipated that the species of log used and associated yield in the production of exported GUC would have been contrasted with domestic product incorporating the same species of timber.

### 2.2 Material Costs - Fibre

The Applicants are concerned that the cost of fibre for SECR is understated. Specifically:

- SECR indicates that large diameter logs have a higher selling price than small diameter logs
  - However, small diameter logs have higher losses and produce sawn product at a lower rate;
  - No account appears to have been taken of the losses associated with the small logs;
  - The allocation of the smaller diameter logs to the GUC results in higher losses and higher manufacturing costs of the CTM&S for the GUC;
  - The grossing up of fibre and processing costs make smaller logs a less attractive proposition;
  - C&BP appears to have accepted SECR's claims that the average log cost balances out all differences – in the Applicants' view this is incorrect and warranting Expert Review.
    - C&BP have accepted SECR's proposition of average costs for logs – is this the average for all species and diameters (and grades) included in the CTM&S?
- C&BP appear to have undertaken limited evaluation of log prices and benchmarking against published indices to establish bona fides of prices in the GUC CTMS
  - There is an absence of any indication that C&BP verified the profile or quality of logs and associated waste process flows used for MGP production;
  - Associated handling costs through to sawmill.
- There is an absence of discussion of required fibre quality required to meet Australian MGP production and availability of sufficient representative log to meet the quantity supplied;
- No calculation appears to have been undertaken that compares the whole-of-site recovery with individual manufacturing yields on domestic products vs export products (for either Plana or Zdirec plants). This issue needs to be addressed via Expert Review and would leave C&BP better positioned to assess the creditability of the data provided
  - The Report is generally silent on site averages implications of efficiency and yield;
- 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 manufacturing and sell for prices below saw log prices.



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Expert Review is critical to ensure the CTM&S did not include an "average" log cost for whole of site and that appropriate losses and grossed-up values have been included in CTM&S at each subsequent manufacturing stage for the GUC.

### 2.3 Material Costs – Residues

The SECR Report is silent on residue credits and whether the values attributed to credits are representative of market prices. Similar to fibre, residue sales should have been benchmarked to establish the possibility of over-crediting.

- The Report fails to discuss the nature of residue sales and the associated benchmarking and the income earned, thus Expert Review is required;
- There is an absence of comment on the exclusion of residue credits for logs chipped or sold by-passing the manufacturing process;
- There is no discussion on the allocating of costs associated with selling the residues that would result in a lower net income as presented;
- There is an absence of any confirmation of any related activity relying on the consumption of chips and residues outside timber consumption e.g. powerplant.

The apparent absence of an appropriate assessment of credits from residues of logs (i.e. bark, sawdust, woodchips, shavings) and whether these have been accounted for at market prices, are fundamental to the CTM&S for the GUC.

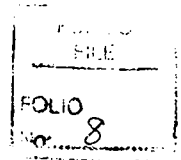
### 3.0 Conversion Costs (i.e. sawing, kilning, planing, etc)

The isolation of the costs associated with the GUC should reflect the requirements of the product both in terms of processes and properties. SECR's SAP system records costs by process. However, the Exporter Visit Report contains little discussion as to the costs included in each production phase.

#### 3.1 Process Costs (including Conversion costs)

##### Sawing

- The Report is silent on the UOM used in the calculation of the CTM&S for SECR. In the conversion process it should be possible to understand how the recovery through planing has been calculated (i.e. note the input and output unit of measures, e.g. sawn/nominal/actual cubic metres with each stage of the process).
- Expert Review is required to validate how the cost of the raw material has been grossed up to account for the recovery loss including direct & indirect associated costs;
- The lack of conversation on log class prevents the applicants from commenting on the appropriateness of log recovery/yield ex the sawmill. This requires Expert Review. In particular, this requirement is important in understanding overall site yields.
- Expert Review of conversion costs based on yield from log associated with the production of GUCs is required for contrasting with reported site averages;
  - The Applicants contend that separate to yield, conversion cost penalties from processing smaller log add to significant burden of CTM&S for the GUC. (Refer CHHWPA Confidential Attachment as per submission re SEL)
  - Conversion penalty is likely to be up to XX per cent when compared with average costing through the same machine centres.
- The extent to which the manufacturing process for GUC results in co-products of low value and a resultant loss on sale of co-product needs to be applied to the raw material costs of the GUC. Whilst this understanding and inclusion of the loss is fundamental, comment by C&BP on its inclusion in the Report is absent and requires Expert Review.



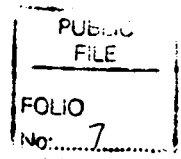
#### **Other Process Costs**

- It is unclear from the SECR Report whether the CTM&S for each individual process stage costs have been passed to the subsequent stage (and grossed up for losses accordingly);
- It appears that the depreciation and overheads have been assigned to production at the final stage and not allocated to the individual processes and grossed up for losses in the subsequent stage;
- The apparent lack of proper treatment of costs is a contributor to the higher costs being recorded against B grade production which is then sold on the domestic market at a book loss. The lower apparent cost of the exported GUC (due to the failure to gross up for losses at subsequent stages) is due to the failure to correctly allocate the full burden of processing and fibre costs;
- Discussion on allocation of overheads to machines centres (i.e. from start or at end) is absent from the report and should be subject to Expert Review. For instance,
  - There appears to be an absence of discussion on the treatment of end-trimming;
- As stated above, the lack of a manufacturing yield calculated for MGP and compared back to whole of site is a significant omission in the verification process.
  - Grade loss – The Applicants based their submission on the knowledge that SECR achieves a high grade outturn based on fibre quality available to them. However the grading standards associated with the GUC will result in greater grade loss than would be normal for domestic product. This grade loss needs to be specifically accounted for in the evaluation of the GUC and reinforces the need for end-to-end product cost as opposed to working site averages;
  - Does a small log provide sufficient fibre for the quantity of GUC supplied to Australia this includes an assessment of any wide board GUC product (ie> 120mm) from this mill. If not, costings will need to be adjusted further for higher priced fibre in the end-to-end product cost;
- The Report is silent on maintenance costs, adequacy and the extent of provisions/capitalising. Expert Review is required to assess the adequacy of the maintenance charges used in the CTMS and linkage to yield and processing cost;
- The Report silent on the extent of value-adding process such finger-jointing and associated placement. It is the Applicants understanding that remanufacturing capability exists at Zdirec and its treatment in the CTM&S requires clarification.

#### **4.0 Administrative & Other Manufacturing Costs**

The Applicants note that C&BP has verified administration, selling and general expenses. However:

- There appears to be no discussion as to how SG&A costs have been allocated between domestic and export sales
  - For example the depreciation may be reported correctly in total, but its allocation to the production centres grossed up for processing loss through the process remains unclear.
- How SE Wood Supply's central Sales & Marketing function is reflected in the CTM&S the GUC needs to be considered in Expert Review?
- There is a lack of any discussion on re Interest and treatment of working capital funding in the CTMS.



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## 5.0 Profit

- C&BP has used profit on SECR's CTM&S based upon costs allocated in an incorrect manner. The correct allocation of costs would likely result in an alteration of the level of profit achieved on domestic sales of like goods. Expert Review is required to confirm.

### 5.1 Domestic Selling Prices Ex-mill

- The high level of unprofitable sales (97 per cent for Plana, and 98 per cent for Zdirec) should have raised concerns about cost allocations for the exported GUC (i.e. allocated costs too low, hence domestic CTM&S too high). Given the targeting of small logs for GUC purposes, the Applicants strongly contend that the losses associated with B Grade or reject material must be associated with the GUC CTM&S.
- It would appear that sales of **B grade** (export reject material) by SECR are at prices substantially below that achieved on MGP10 or better rated production. The differential gap on in-market selling prices appears to exceed the noted preliminary un-dumped margin.

## 5.0 Conclusions

The SECR Exporter Visit Report is absent on detail as to the extent to which production costs by stage have been verified and 'tested' by C&BP. The absence of detail on log size and quality, yield, etc concerns the Applicants that costs associated with each production phase of the GUC have not been accurately identified.

Expert Review is required to express views on the adequacy of fibre yields used for the GUC, cost identification by production stage, and associated allocations and losses arising from the manufacture of the GUC as provided by the exporter.

The Applicants note that following the receipt of Exporter Questionnaire responses, C&BP advised exporters that average costing for the GUC would not be accepted. Whilst it is evident that SECR revised CTM&S information for the GUC, the Applicants have formed the view from the examination of SECR's Exporter Visit Report that the verified CTM&S for the GUC remains understated. The Applicants anticipate that the Expert Review enable a fair assessment as to whether costs for the MGP GUC have been appropriately allocated.