**Applicants' comments on Vaagen Bros Lumber Inc Exporter Visit Report**

## 1.0 Executive Summary

C&BP has preliminarily determined that Vaagen Bros. Lumbers' exports of structural timber from USA were at non-dumped levels during the 1 July 2010 to 30 June 2011 investigation period.

The Applicants[1] have reviewed C&BP's Exporter Visit Report for Vaagen Bros. Lumber, Inc (VB).

Based on the two methods of establishing normal value (using domestic sales of selected grades & species and using CTMS), C&BP's preliminary assessment is that there was a negative dumping margin of 9% based upon domestic selling prices, and a negative dumping margin of 5% based upon VB's CTM&S.

The Applicants strongly contest C&BP's basis for normal values for VB. The Applicants have a range of concerns with the VB Exporter Visit report including:

- C&BP acceptance of the inclusion of "Appearance" grade timber used in applications such as decking;
- Similarly, the inclusion of "Hampton" grade timber as "like goods" is considered erroneous given that the product is neither stamped or graded and is thus not suitable for sale as structural product domestically or export as GUC. The product is most likely to be an "Appearance" grade.
- VB's inability for its Accounting System to differentiate between domestic and export sales (Section 7.6) raises reservations as to the classification of goods considered to constitute "domestic sales";
- C&BP's acceptance of the single Cost of Production ("COP") for timber (refer Section 10) and the subsequent use of this *average* value for normal value purposes
    - VB states that it includes "want & wane" in domestic sales of like goods – this further affirms that MGP grade product exported to Australia involves further processing to what is sold domestically and should not be contrasted with an average COP for timber;
    - VB also concedes MGP grade product exported to Australia involves additional kiln drying time than product sold domestically – further evidencing an average COP for the GUC is inappropriate;

The Applicants do not consider that normal values for VB have been determined in a manner that:

(i) Correctly aligns domestic sales of like goods with the exported GUC; and
(ii) Accurately records the CTM&S the GUC.

Normal values for VB as per Section 10 of VB's Exporter Visit Report are potentially understated and <u>do not</u> reflect true dumping margins for VB's exports of the GUC.

Further, the VB Exporter Visit Report indicates that costs have been allocated on a "whole of site" basis, and C&BP has not sought to appropriately allocate costs to each production phase of manufacture for the GUC.

The calculated margins are sensitive to the comments of the Applicants' detailed in this submission. It is the Applicants' view that a margin above positive 2 per cent applies.

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

## 2. Comments/Issues with VB Exporter Visit Report

### 2.1 Raw Material Costs

The Applicants' query the assertion by VB that "Materials cost represents over 90% of the COM" (Pg 28). By inference, total processing costs are less than 10%. This is inconsistent with publicly-available information (i.e. Global Benchmark Report) and draws into question VB's processing costs and whether these are accurate for the GUC given their use of small log and associated fibre cost. VB's claims re the cost of raw materials as a percentage of the total cost of manufacture warrants examination by Expert Review.

<u>2.2.1 Material Costs - Fibre</u>

C&BP was unable to determine the log costs for the MGP GUC exported to Australia due to VB using average log costs. The Applicants' concerns re fibre costs are as follows:

- 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;
    - What is the purchased basis of logs (whether delivered or stumpage prices) – VB's website comments on sourcing both billet and whole stems and appearance to undertake some of the forestry task (Source: VB website – Video titled "Capabilities"); and
    - There appears to be <u>no</u> differentiation between species consumed and alignment to actual export mix for GUC CTM&S purposes.

- Given the significance of fibre as an input cost, the Applicants consider C&BP should have reviewed the market price carefully and given the dumping margin estimate suggests prices for fibre below market as identified in the Application and Global Timber/ Sawmill/ Lumber Cost Benchmarking Report.

- It is evident from the Report that logs with small diameter are used, hence, lower yields are expected to be achieved (than with larger sized logs)
    - No calculation appears to have been done that compares the whole-of-site recovery with individual manufacturing yields on domestic products vs the GUC. This issue needs to be addressed via Expert Review and would leave C&BP better positioned to assess the creditability of the data provided and subsequent conversation regarding the processing of small log.

- The visit report discusses at length the required quality of the Australian MGP product and the fact that it exceeds local requirements. Logs required to meet the MGP spec are a function of fibre quality, taper and size and likely to attract a premium over a standard saw log providing lower yield. It appears the CTMS is based on an average basket cost rather than true reflection of fibre and handling costs of merchandised log required to meet the grade requirements - i.e. targeted log. Therefore, the cost to make could have been a constructed price based on a non-representative low cost log.

    - In the cost to make calculation there is the potential for cheaper classes of logs to be included in the log cost bundle because the raw fibre meets some narrow structural strength characteristics without regard for all the other appearance, handling and rot resistance characteristics that are necessary to sell structural timber in the Australian market understate the true fibre cost.

- As pointed out to C&BP previously, there are distinctly different price points associated with different sourcing strategies and cost to handle through the manufacturing process e.g.

whole trees or controlled billet classes. The lack of comment on the purchase basis and associated costs identified limits the Applicants' ability to understand if all appropriate costs have been accounted for and assigned appropriately.

- Income from the sale of the pulp log and WLC line has been removed, but it is unclear as to the exclusion of roundwood which should be removed from the fibre cost of manufacture for structural timber as these products are not associated with structural manufacturing and likely to understate the CTM&S.

- The different actual finish sizes in mm noted for the domestic common sizes (38x89, 38x140 and 38x184) compared to export sizes for Australia (70x35, 90x35 and 90x45) suggest logs being cut in the sawmill specifically for the GUC. The Applicants request C&BP seek clarification of the sizing and logs used to ensure representative costs are used in the construction of the GUC CTM&S.

- Further expert review is required into the treatment of different species for log and impact on processing costs for the GUC sgiven in the log yard VB separates by both diameter and species to maximise yield and grade out turn.

Expert assessment is critical to ensure the cost to make was not constructed on a price for non-representative low cost log, size or quality, and that credits for by-products are consistent with market prices.

2.2.2 Material Costs – Residues

The Applicants contend that residue sales should have been benchmarked to establish the possibility of over-crediting. The following concerns are raised:

- The realisation that the "*actual production of chips from the sawmill is not known*" and "estimates" have been used should have alerted C&BP to the requirement to compare data with the Global Benchmark Report and undertake independent valuation – this task appears not to have been undertaken.

- There is an absence of references to log yields and site yields in the report to permit validation of claimed credits for revenues generated from sales of timber by-products;

- The assumptions regarding separation of chip revenue from the WLC line and sawlog requires Expert Review for the avoidance of over-crediting.

- There is an absence of any discussion of related on-site activity relying on the consumption of chips and residues outside timber consumption and basis on which product may be transferred e.g. powerplant. For the avoidance of doubt and potential impact on the GUC, this should be commented on within the report as the VB website comments on the presence of co-generator (Source: VB website – Video titled "Capabilities").

- There is an absence of discussion on the allocating of costs associated with selling the residues that would result in a lower net income is presented.

## 3. 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.

<u>Process Costs (including Conversion costs)</u>

***Sawing***

The VB Exporter Visit Report appears to have verified the costs allocated on a "whole of site" basis, but has not considered how these costs should be allocated to different products.

- The total grade out tum of the combination of domestic and Australian export structural is not clear especially with respect to the loss on target grades and output that falls below the lowest target structural grade (1400F or MGP10) – refer Pg 14 "For this reason VB explained it did not include in the "like goods" in its exporter questionnaire response timber with a grading 1400F-1800F, which although comparable to the MGP grades in terms of strength rating, is not likely to meet visual specification requirement for export product."

- Separate to yield, conversion cost penalties from processing smaller log also result. Saw milling is a linear process and the breaking down of small logs results in far fewer pieces being processed for the same machine time as a large log. Reduced conversion efficiency would have significant impact on CTMS for VB if the logs used for the GUC are not representative of the average
  - Using only small logs for structural production will impact the yield rate whilst incurring additional processing cost above site averages, particularly when producing MGP structural planed timber with tighter specification. Reduced yield has significant impact on the CTM&S for GUC.
  - Modelling supplied in xxxxxxxx Confidential Attachment 1 supports this position and critically highlights the need for C&BP to both end to end costing by product as opposed to averages.

- The extent to which the manufacturing process for GUC results in co-products of low value and generate a loss on sale needs to be reviewed with the loss applied to the material costs of the GUC. This process is <u>**absent**</u> from C&BP in its consideration (or discussion) and the method for accounting for this appears to be a top line adjustment in the balance sheet and thus not reflected in GUC CTMS.

- 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;

***Other Process Costs***

The Applicants' note that VB's Accounting System does record costs by production phase (i.e. "departmental" costs at P.24). However, C&BP has accepted generally unchallenged VB's position that it only uses average costing (i.e. a single COP – P.40). The acceptance of average costing for VB represents a significant short-coming of the VB verification process and challenges the credibility of the margins determined.

Further concems with process costs include:

- In the conversion process the reviewer should understand how the recovery through planing has been calculated. (i.e. noted the input and output unit of measures, e.g. nominal BF with each stage of the process).

- The Australian timber is dried for a longer period and as such should be attracting an approximate xx% (xx hours additional on xx hours for domestic) extra cost per unit in kiln costs and the incremental time should then relate proportionately to other cost factors in this process e.g. depreciation.

- Grade loss – 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.

- The Report remains silent on maintenance costs, adequacy and the extent of provisions/ capitalising in what may be a heavily depreciated plant (i.e. the age of the facility is key). If depreciation is minimal then this points to likelihood of higher maintenance costs and lower yields based on plant capability (i.e.: older technology). Expert Review is required to assess the adequacy of the maintenance charges used in the CTMS and linkage to yield and processing cost for the GUC as result of utilising aged equipment.

Other Process Costs – Species Grade & Verification

- Pg 12 asserts that "prices between species over the past 3 years have been consistent and that all timber species are sold domestically and exported to Australian and that its Australian customer does not differentiate between species." This is inconsistent with the Applicants experience. It was noted by C&BP in the Canadian visit reports that Hemlock fir was unacceptable to the Australian market. This highlights the need to establish a CTMS based on product sold as GUC, not the site average.

### 4. Delivery costs - Freight ex Mill

- The report remains silent on the adequacy of any information associated with the dispatch costs incurred in the mill for export sale.

### 5. Administrative & Other Manufacturing Costs

The Applicants are concerned about:

- Whether corporate charges have been included (Colville sawmill being named as the corporate headquarters location on Pg 8), admininstration & despatch costs assigned as they are not specifically referenced as included in CTMS;

- The extent to which SG&A costs (no specific comments regarding what makes up selling expenses) are being allocated to domestic sales.

### 6. Profit

- A level of profit was included in the normal value methodology based upon VB's CTM&S data

- The Applicants query whether an average level of profit should have been used;

- The concern is that C&BP had been told by VB that its Accounting System did record costs by production stage, however, C&BP did not pursue a fully-absorbed CTM&S for the like goods or the GUC;

- Had a CTM&S been determined for the domestic sales of like goods, C&BP could have used a more representative profit (rather than average for the timber species used).

## 7. Domestic Selling Prices Ex-mill

The Applicants' hold further concerns:

Pricing

- Lengths – "VB claimed that length of the timber did not influence the price significantly." In the Applicants' experience with the Australian market, this is contradictory and it is therefore requested C&BP test if there is not a length differential price arrangement with their Australian customer. Pg 16 referring to pricing appears contradictory to the Applicants – "Prices . . . have been generally consistent over the past 3 years. Prices are subject to change to reflect changing production costs or market conditions. VB provide examples of pricing negotiation via emails." The Applicants request C&BP review evidence of these negotiated price changes to ensure they are properly reflecting in the sales data for the GUC CTM&S based on invoices provided by VB on their Australian product sales.

- Whilst Pg 13 provides a table of conversion of nominal MBF to actual millimetres, it is not clear how this size translation has been applied to product value and specifically calculation of product value in a unit measure. This needs to be clarified by C&BP. It was stated that VB's Australian export customer orders in AUD but the unit of quantity measure and conversion back to MBF cost for margin calculations is not clearly evident in the report comments. It merely states that "VB further provided calculations demonstrating how these formulas were applied to its domestic and export sales spreadsheets".

## 8. Other general concerns:

- At the bottom of Pg 17 the report references a "discrepancy in overall volume and value between exporter and import records" and attributes this to "timing differences". The applicant companies would suggest that each importer verified shipment should match the exporter documentation precisely and does not understand how timing impacts this.

- The actual exchange rate adjustments are noted as minimal for VB during the investigation period. The report also states that all transactions are invoiced in AUD and that VB accepts the foreign exchange risk. At a minimum the cost of hedging should be fully attributed to the MGP exports to Australia.

## 9. Conclusions

The VB Exporter Visit Report does not disclose key costing methodologies for each stage of the MGP production process. The Applicants have raised concerns for each production cost stage. The Expert Review needs to express an independent view as to the appropriateness (allocation methodology, and whether understatement may have occurred) of the costs provided by VB.

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. Thus, it is unclear given VB's advice that its accounts do not differentiate between export and domestic sales how this has been addressed in their CTMS for the GUC. The Applicants have formed the view from the examination of VB'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.