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Applicants' comments on Teal Jones Canada Visit Report

1.0 Executive Summary

C&BP has preliminarily determined that Teal Jones Timber's exports of structural timber from Canada were at non dumped levels (i.e. negative 9.1% per cent) during the 1 July 2010 to 30 June 2011 investigation period.

The Applicants¹ have reviewed C&BP's Exporter Visit Report for Teal Jones Canada ("TJC"). It is noted that the TJC Report initially indicated that TJC 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 TJC'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;
- The use of mill averages from the production spreadsheets when specific data was supplied and could be extracted;
- 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 an 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;
- Lack of allowance for Profit; and
- 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 Comments/Issues with TJC Exporter Visit Report

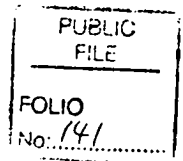
2.1 Raw Material Costs

The substantiation of the fibre cost is a central element of the verification of TJC'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 F7 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 appear to omit any benchmarking against published indices to establish bona fides of the fibre prices in the GUC CTM&S
 - In a letter to the BC Minister of Forest, Pat Bell, TJC noted they "continually face log shortages, particularly the right lengths and sorts, for its offshore lumber programs. The company actively puts in offers to purchase logs destined for the export market to ensure it obtains log supply for its own mill. The Teal Jones small log mill has current order potential that would consume an additional 250 thousand cubic metres annually even in this depressed market". (Source: <http://tealjones.com/WhatsNew.htm>). It is the Applicants view that TJC may be paying premiums for suitable logs for the export program and this is not reflected in the Report by way of any discussion or the GUC CTM&S.
- The report notes that TJC calculated the total log cost for the goods exported to Australia during the investigation period by multiplying the total log consumption in m³ by the log price. Calculating log cost in this manner results in the inclusion of hemlock fir, a lower priced log not used in the manufacture of the GUC, thus understating the fibre cost in the GUC CTM&S;
 - The Applicants accept 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.
- 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. C&BP have left unchallenged that the yield for Australian production is the same as the mill average yield warranting the use of an average LRF.
 - It was noted in the Western Forest Products(WFP) Visit Report (visit preceded the TJC visit) that 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 F7 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 production spreadsheet provided by TJC details all the runs used for making Australian production including the actual log used. Specific product yield could have been calculated more relevantly from the supplied production data; and



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- 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 (F7 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.

2.1.2 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.

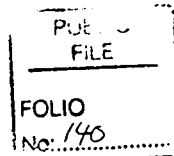
2.2 **Conversion Costs (i.e. sawing, planing, etc)**

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

2.2.1 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;
- Whilst the Report (Section 8.1) notes the apportioning of cost based on hours worked in each section of the plant (activity based costing), C&BP fails to explore the basis of the standard hourly charge and how the cost of idle hours are treated in the calculation. In activity based costing, the cost of idle hours also needs to be allocated to the production to fully absorb all the costs. Thus it is important that the cost allocation to Australian production include a share of idle and maintenance hours. Section 8.3.2 provides a more complete description of the allocation of cost by hours, verifying that the divisor for hourly cost is only the production hours used. Therefore contrary to the ACS conclusion, the Applicants are not in a position to agree that this process fairly apportions all the cost to the Australian production. To produce the volume required for the Australian sales, more hours of production are required than represented by volume sold to adequately allow for product that does not meet the grade requirement.
 - C&BP noted in the production data spreadsheet that the hours for the goods exported to Australia was calculated by dividing the total Australian sales volume by the production rate XXX fbm per hour for the XXX/Australian cut as calculated in the production data spreadsheet.



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- 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 cost incurred in the sawmill on an hourly costed basis and the fibre cost at the exit of the sawmill are adequately grossed up for dimension losses in heat treating and rough heading. The failure to correctly gross up the fibre and early stage processing costs has significant impact on the GUC CTM&S, warranting 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, that is 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
- Whilst C&BP were able to match the total depreciation expense to the small mill 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.

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; and
- The Report remains silent on the adequacy of any information associated with the dispatch costs incurred in the mill for export sale and accordingly this should be subject to further Expert review.

2.4 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.

2.5 Profit

- The Applicants *strongly* contest the absence of profit from the GUC CTM&S. C&BP noted the absence of sufficient domestic structural sales by TJC for a normal value calculation and from the information available in the Report appears not to have pursued an understanding of the costs or associated profits with selling structural timber domestically.
- The Report indicates that logs purchased by TJC were at near historic low prices (if not lowest). In the event TJC cannot make a profit on domestic sales at these low input cost levels, it is likely it will never make a profit on domestic sales. The Australian market should not be penalized for this discrepancy.

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- It is noted by the Applicants that a level of profit was included for Western Forest Products in its constructed normal value.
- Further, the Global Benchmark Report 2010 noted that an EBITDA margin of xx% in B.C. coastal region for an average mill and this should be applied as a minimum;
- It is therefore reasonable to apply a level of profit on the constructed normal value for TJC's exports to Australia.

2.6 Domestic Selling Prices Ex-mill

- Sales of structural grades graded below F7 or associated reject graded material in Australia by TJC distributors are at prices below that achieved on F7 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 calculated.

2.7 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.
- The actual exchange rates used to convert back to AUD across the investigation period are omitted; and
- Allocation of SG&A expense based on hours worked has the same inherent issues as noted under the section 2.2.1 and the allocation to GUC CTM&S should be adjusted accordingly.

3 Conclusions

The TJC 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.

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