economic review

Economic Review

Economic achievements

The Commission works in partnership with industry, the community and other government agencies to establish a long-term, viable timber industry. This is achieved through the sound management of existing resources, actively pursuing future investment opportunities, and seeking new economic and policy mechanisms to support the industry in the longer term.

Our overall economic focus is to achieve sustained growth, profitability and longevity for the industry and the Commission.

New investment

Our expertise in commercial forestry attracted major investor CommSec which has contracted the Commission to establish and manage eucalypt plantations on a fee-for-service basis. A project team has been set up to manage the Premium Plantations Project '05 which will see Tasmanian blue gum and Sydney blue gum planted in 2006, with the scale of planting being finalised in October 2005.

LVL plant commissioned

Environmental and economic strategies are successfully combined in the newly commissioned laminated veneer lumber plant at Neerabup. The Commission will supply 4.12 million cubic metres of softwood logs to the plant over the next 26 years. Targeted harvesting from the Gnangara mound pine plantation will help control water table levels in a supply catchment.

New sawmill in Collie

The Commission entered into a 20-year supply contract with Pinetec. Pinetec is relocating its sawmill from Bassendean to Collie. With the clearfelling of Gnangara plantations, the relocation will allow the full utilisation of the sawlog resources in the South West. It is expected the new mill will be commissioned later in 2005.

Feature logs

A new tender process was announced for the purchase of feature grade and specialty timbers suitable for furniture manufacture and other high value end-users. Around 8,500 tonnes of logs were made available including jarrah, marri, WA blackbutt, WA sheoak, tuart and wandoo. The timber has to be used for local high-value manufacturing.

Financial Performance

The Commission's underlying operating financial performance for the 2004/05 financial year improved on previous years, however issues arising from the ongoing restructure of the native forest timber industry negatively impacted on the reported profit for the period.

The Commission's South West and Mature Plantations business segments made improvements to their operating performance during the year by close to $2 million each, whereas the Arid Forest business segment made only a slight profit impacted by lower harvest activity and less profitable product mix. The operating surpluses generated by these business segments support the State's contribution to the

National Action Plan for Salinity and Water Quality through the Commission's Strategic Tree Farming initiative, Infinitree™.

Revenue from ordinary activities increased by $4.2 million (4.3%) this financial year while expenses from ordinary activities increased by $3.7 million (3.4%) contributing to a small profit from the underlying operations of the FPC.

The Commission's 2004/05 reported financial performance was negatively impacted by a provision for claims against the FPC arising from the restructure of the Native Forest industry following the implementation of the Government policy Protecting our Old Growth Forests. Provision of the amount in no way indicates that the Commission is liable for the claims. However, the Commission has elected to adopt a conservative approach pending assessment of the validity of the claims.

The Commission continues to work with Government to review and improve the financial structure supporting the business to provide greater certainty and consistency of returns to Government.

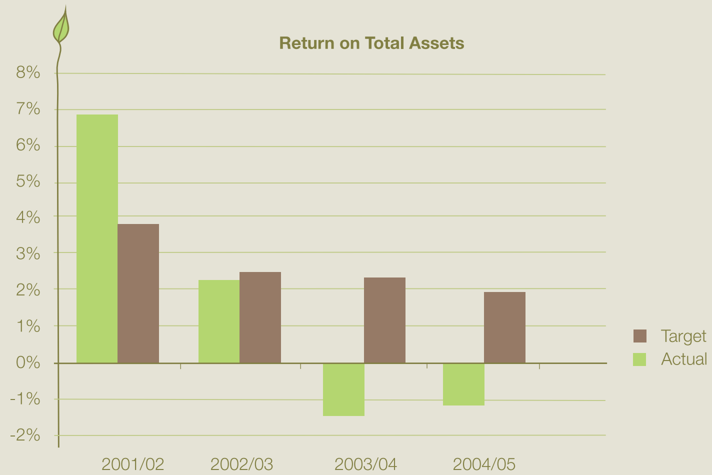
Financial overview

Financial performance:	2005	2004	2003	2002	2001
	($'000)	($'000)	($'000)	($'000)	($'000)
Revenue from ordinary activities (excluding movements in standing timber and in-forest infrastructure valuations)	**102,454**	**98,229**	**101,659**	**114,439**	**84,461**
Calculated as follows:					
Revenue from ordinary activities:	122,667	121,060	126,988	146,983	90,148
Less the following items included in revenue from ordinary activities:					
Revenue from natural resource assets and in-forest infrastructure valuations	20,213	22,831	25,329	22,339	5,687
Correction of prior year fundamental errors	-	-	-	10,205	-
Expenses from ordinary activities (excluding movements in standing timber and in-forest infrastructure valuations)	**113,150**	**109,454**	**99,390**	**107,950**	**74,518**
Calculated as follows:					
Expenses from ordinary activities:	135,986	112,430	106,866	131,514	90,500
Less: Expenses from standing timber and in-forest infrastructure valuations	22,836	2,976	7,476	23,564	15,982
Operating profit before interest and tax [1]	**(4,722)**	**(5,564)**	**8,600**	**23,098**	**19,539**
Profit/(loss) from ordinary activities (before tax and movements in natural resource asset valuations)	**(10,696)**	**(11,225)**	**2,269**	**16,693**	**14,741**
Financial performance including movements in natural resource assets valuations and fundamental errors:					
Profit before interest and tax	**(7,345)**	**14,291**	**26,453**	**21,873**	**4,446**
Profit/(loss) before tax	(13,319)	8,630	20,122	15,468	(352)
Profit/(loss) after tax	(8,920)	6,038	14,500	13,310	(2,415)
Summary of financial position:					
Assets:					
Current assets	27,731	21,448	28,095	31,462	25,531
Non-current assets	371,370	358,018	332,274	308,460	302,529
Total assets	**399,101**	**379,466**	**360,369**	**339,922**	**328,060**
Liabilities:					
Current liabilities	32,472	19,104	22,935	17,941	24,355
Non-current liabilities	111,334	100,232	83,287	82,195	78,958
Total liabilities	**143,806**	**119,336**	**106,222**	**100,136**	**103,313**
Net assets/total equity	**255,295**	**260,130**	**254,147**	**239,786**	**224,747**

[1] Operating profit before interest and tax is defined as profit/(loss) before interest, tax and movements in valuations of natural resource assets and in-forest infrastructure

Performance indicators

RATIO OF PROFIT BEFORE INTEREST AND TAX TO TOTAL ASSETS (RETURN ON TOTAL ASSETS) ☑.



The ratio of Profit Before Interest and Tax to Total Assets excludes the effect of Standing Timber and in-forest infrastructure valuations.

The ratio is below target this financial year, as mentioned in the financial overview, due mainly to the need to provide for claims against the Commission by parties who were not satisfied with the quantum of grants provided by the Government under the Government's Business Exit scheme and who have consequently lodged claims against the Commission for loss of profits under their contracts of sale and/or harvest. Provision of this amount in no way indicates that the Commission is liable for the claims. However, the Commission has elected to adopt a conservative approach pending assessment of the validity of the claims. In addition, the Commission's mature plantations business segment was negatively impacted by shortfalls in harvesting capacity and delays by customers in commissioning new plant.

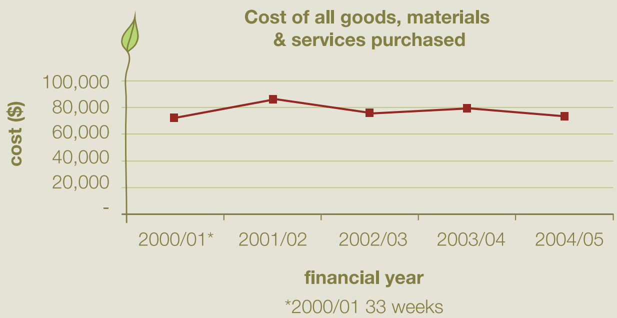
Sales of Native Forest timbers have continued in line with allowable harvest, this being the second year that the Commission has operated under the reduced harvest volumes provided for under the Forest Management Plan (2004/2013).

☑ Audited key performance indicator

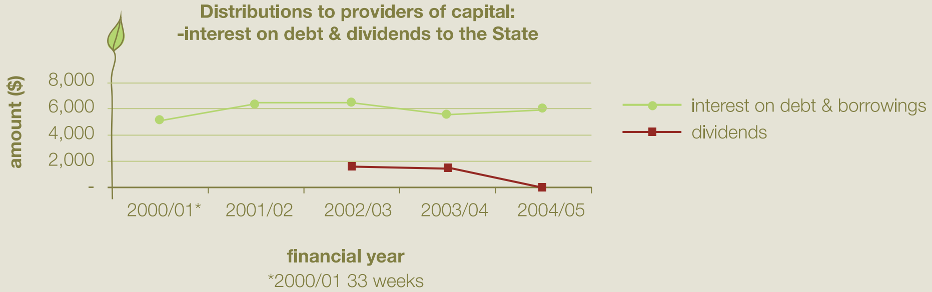
Sales from the Commission's Plantation Division has decreased as a result of the full-year effect of the reduction of *Eucalyptus globulus* (Tasmanian blue gum) 'fee for service' activities to Japanese and Korean owned plantation companies operating in the State's South-West.

An increase in revenues from the Plantation division remains a key strategic focus for the Commission; increases are projected in 2005/06 as the Wesbeam laminated veneer lumber plant completes its commissioning phase and commences full-scale production, as well as with increased 'fee for service' activities for Premium Plantations 05 and the National Action Plan for Salinity and Water Quality, a joint State and Commonwealth initiative.

Export sales increased to 9.9% of total sales, an increase of 0.7% over the 2003/04 financial year. The Commission's strategy is to ensure a maximum amount of its products are utilised for value-adding purposes in the local market. Products (predominantly sandalwood) are exported either where there is insufficient demand in the local market or where returns to the State from export products significantly exceed returns to the State for local value-adding activities. Volumes of exported product versus volumes of product retained for local value-adding are decided only after submission to public tender.



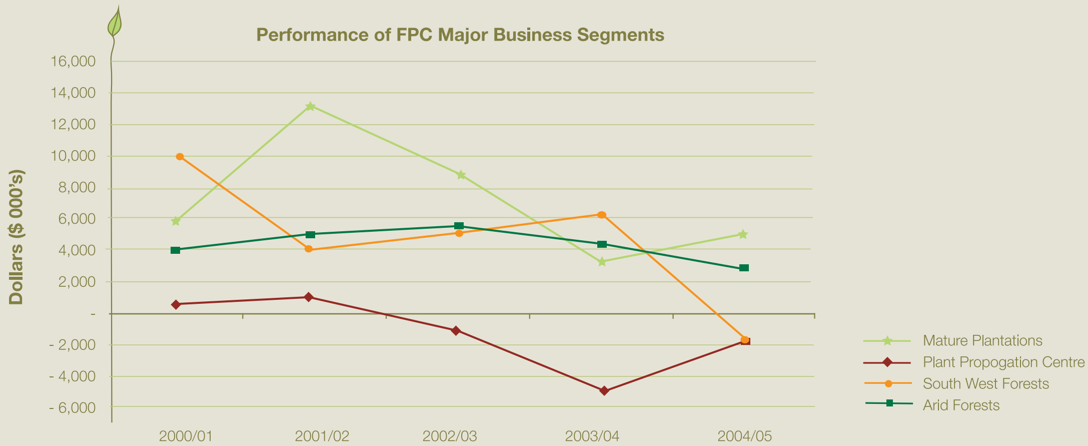
The Commission purchased approximately $76 million of goods and services, principally in the State's South-West, in the 2004/05 financial year. The decrease of five per cent over the 2003/04 financial year is due mainly to a reduction in the cost of activities associated with the Commission's Plantation Division.



The Commission's capital has been provided through a combination of debt and equity. The Commission pays approximately $6 million per annum in interest on its debt. No dividend was declared in the 2004/05 financial year due to insufficient cash from operations (refer cash flow statement). A primary driver of the poor operating cash from operations this financial year was the impact of a change in Government policy associated with the implementation of the FMP (2004/13) which allows deferred payment terms to qualifying customers. The impact of this dispensation was an increase in debtors of approximately $2 million, with a corresponding decrease in operating cash flow. This is a once-off impact that will not impact operating cash in the future, except for interest incurred/forgone.

The decrease in retained earnings in 2004/05 is due mainly to the need to provide for claims against the Commission by parties who were not satisfied with the quantum of grants provided by the Government under the Government's Business Exit scheme and who have consequently lodged claims against the Commission for loss of profits under their contracts of sale and/harvest (refer note 3 to the Statement of Financial Performance and commentary in the Financial Overview).

The Commission paid $0.5 million in taxes this financial year consisting principally of payroll tax. An Income Tax refund of $0.3 million was received in the 2004/05 financial year due to an adjustment to the 2003/04 tax return for deferred income previously taxed in that financial year.



The South West Forest segment's performance this financial year was affected by the raising of a provision for claims against the Commission arising out of the Commission's inability to fulfill contractual commitments due to the impact of the Government's "Protecting our Old Growth Forests" policy. Except for the effect of this provision, the operating performance of the Division improved over 2003/04 by approximately $2 million.

The Mature Plantations segment's performance improved this financial year after having declined over the last few years. Despite a $1m decline in turnover, an improved margin delivered an additional $1 million to the operating results, while savings in supplies and services and employee costs contributed an additional $1m.

The performance of the Commission's Arid Forest segment continued to suffer the effects of a strengthening Australian Dollar as well as declining sales revenues from product mix. A project has been implemented in the 2005/06 financial year to address this situation, and the Commission will continue to hedge its exposure to fluctuations in exchange rates on forecast performance, although the overall strength of the Australian Dollar will continue to preclude the Division from realizing the level of profits that were previously enjoyed in a lower exchange rate environment.

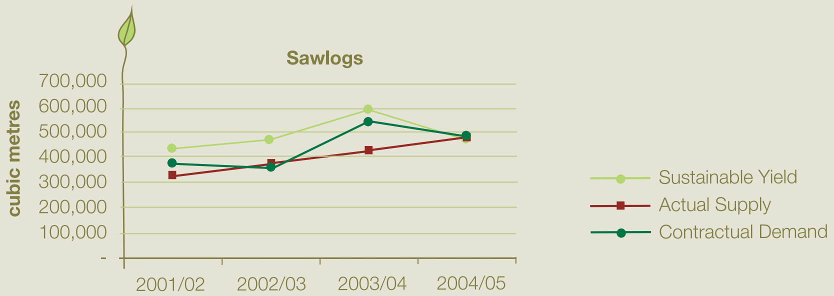
The Plant Propagation Centre, which was affected by the write-down of $3.8m in infrastructure valuation in the 2003/04 financial year, continued to make a loss this financial year due to low volumes through the nursery. The Commission's recent service arrangements with Premium Plantations 05 and with the National Action Plan for Salinity and Water Quality will positively impact this segment in the 2005/06 financial year.

PLANTATION LOG PRODUCTION IS CONSISTENT WITH CONTRACTED LEVELS OF SUPPLY TO INDUSTRY ☑.

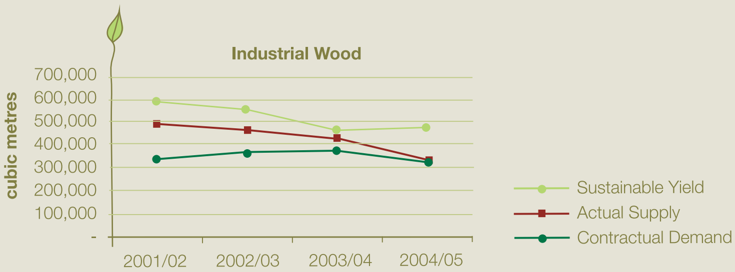
The contracted level is the quantity of timber of a particular specification that has been supplied under various contracts (including various State Agreements) in the current year consistent with achieving the planned long-term supply to industry. As the plantations mature, increasing quantities of logs become available and annual supply increases. Actual annual intake by industry will vary in accordance with the prevailing markets during that year.

Contractual supply levels indicate the current contractual commitments. Log production for each customer varies on an annual basis in accordance with the prevailing market conditions for their products.

Measure: A comparison between actual production levels compared to Commission's contractual commitments to supply.



Note, wildfires and consequently a backlog in second rotation establishment has slightly decreased the long term sustainable yield. Ninety nine per cent of contractual demand has been met.



Note the reduction in the sustainable yield in industrial wood is due to completion of harvesting of blue gum plantations.

☑ Audited key performance indicator.

Native forest operations

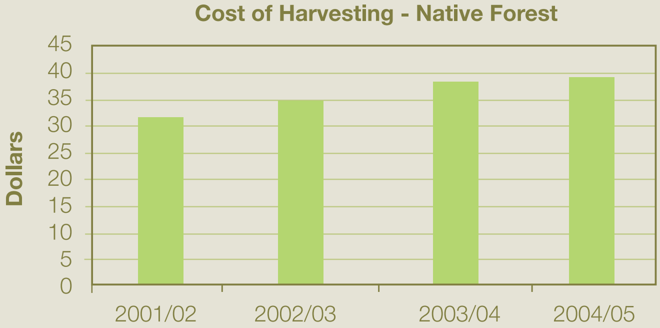
Native Forest Operations is responsible for the planning, harvesting and sale of forest products from re-growth indigenous forest on State-owned land. The output of this division is the harvesting of native forest hardwood and sandalwood.

Cost of harvesting - Native forest hardwood

The major elements of this cost relate to payments to contractors for harvesting and delivery, road construction and maintenance.

Measure: The cost per tonne harvested was $39.07 (2003/04 $38.63), an increase of 1.14 per cent per tonne ✓.

This increase reflects additional costs required to manage harvesting activity in accordance with the Forest Management Plan 2004/13.

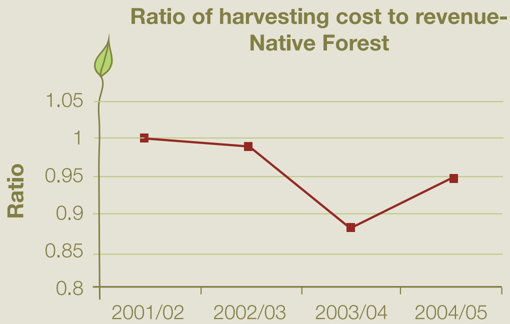


Ratio of Harvesting Cost to Revenue

Harvesting costs incurred in managing the harvesting, delivery and sales of native log timber compared with the related revenue generated.

Measure: The harvesting cost was $23.9 million compared to revenue of $23.8 million. The ratio was 1:1 (2003/04 1:0.90), an increase of 10 points (11 per cent) ✓ .

Additional harvesting costs have been incurred over the last two years relating to the implementation of the Forest Management Plan. The bulk of the additional costs were necessary to meet the new soil management guidelines which included the cording of landings and snig tracks.



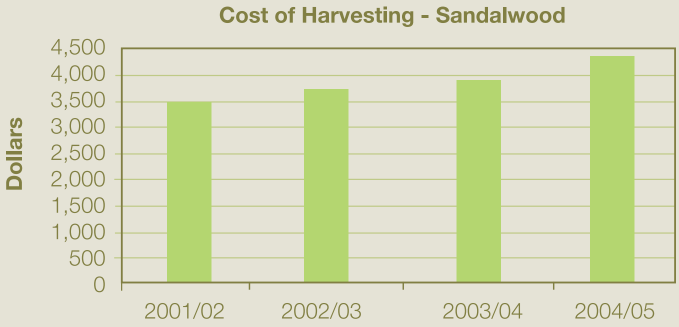
✓ Audited key performance indicator

Cost of harvesting - Sandalwood

The gross cost per tonne of harvesting sandalwood includes greenwood and deadwood. The major elements of this cost relate to payments to contractors for harvesting, delivery, regeneration and associated research.

Measure: The cost per tonne harvested was $4,349 (2003/04 $3,920), an increase of $428 per tonne (11 per cent)✓.

This increase reflects the effect of a decrease of 214 tonnes in harvesting volume and costs associated with value-adding. The additional cost of value-adding is recovered by increased sales revenue.

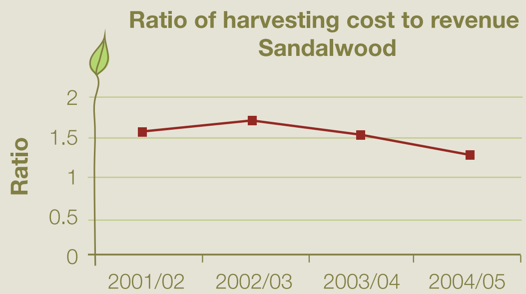


Ratio of management and harvesting cost to revenue - Sandalwood

The total combined cost of managing and harvesting sandalwood expressed as a ratio of the related revenue generated.

Measure: The management and harvesting cost was $8.5 million compared with revenue of $11.5 million. The ratio was 1.34 (2003/04 1.52), a decrease of 18 points (12 per cent)✓ .

This decrease reflects lower value product mix achieved 2004/05 and decrease in harvesting levels which led to higher fixed costs per unit produced.



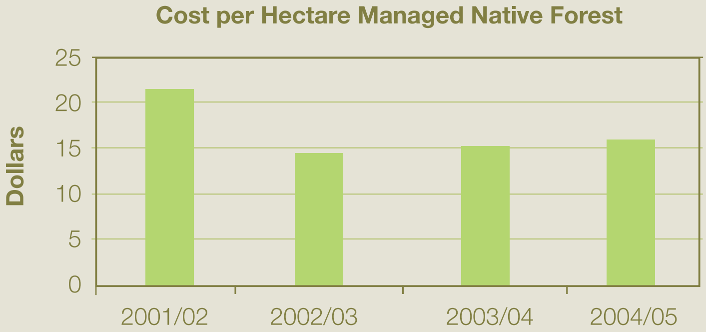
✓ Audited key performance indicator

Silvicultural cost per hectare managed of native forest ☑.

The Commission has access rights to a total State forest estate of 847,950 hectares (2003/04 848,380 hectares). The decrease from last year's figure is the result of minor changes from the final reserve boundaries adopted for the new national parks and the finalisation of some fauna habitat zones.

Measure: The cost per hectare managed was $15.95 per hectare (2003/04 $15.29 per hectare) an increase of four per cent ☑.

The increase in cost per hectare managed reflects the compliance costs of the Forest Management Plan 2004/2013 and an increase in employee costs.



Plantation Operations

The Plantation Operations has three main operating arms:

1. Plantations section, which covers State-owned plantations;
2. Share farms section, which has the responsibility of share farming agreements with landowners; and
3. Plant Propagation section, which produces seedlings for internal needs as well as for external customers.

The functions of Plantation Operations are:

(a) harvesting of all species of plantation timber; and

(b) management of the Commission's plantations.

Cost of harvesting

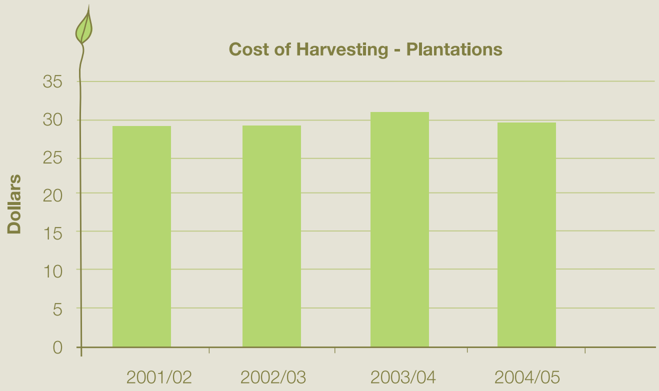
Gross cost per tonne harvested for all species of plantation timber. The major elements of the costs comprise payments to contractors for harvesting, delivery, and roading.

Measure:

The average cost per tonne harvested (all products) from 1 July 2004 to 30 June 2005 was $29.65 (2003/04 $31.27), a 5.2 per cent decrease ☑.

The decrease is mainly due to changes in product mix (refer appendix 5).

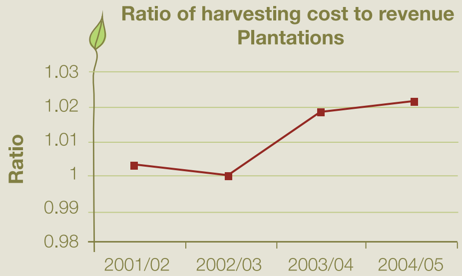
☑ Audited key performance indicator.



Ratio of harvesting costs to revenue

Harvesting costs incurred in managing the harvesting, delivery and sales of plantation log timber compared with the related revenue generated.

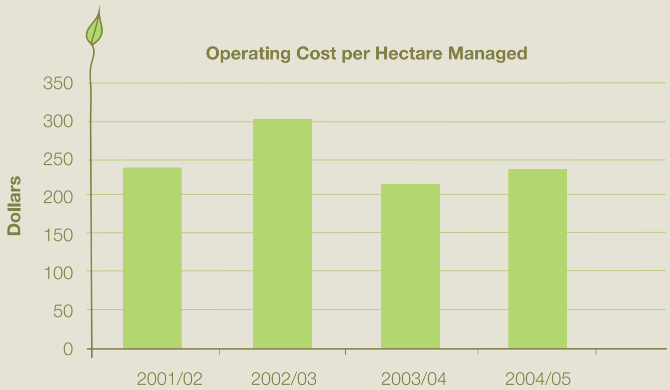
Measure: Harvesting costs were $23.8 million compared to harvest revenue of $24.3 million. The ratio therefore was 1.021:1, a marginal increase in recovery compared to 2003/04 ☑.



Operating cost per hectare managed

Measure: The average cost for the year ending 30 June 2005 was $233.77 (2003/04 $216.19), an increase of eight per cent per hectare managed ☑.

The unit cost increase reflects increased corporate activity focus on the plantation business segment as well as increased operational resources to service the plantation mature estate.



☑ Audited key performance indicator.

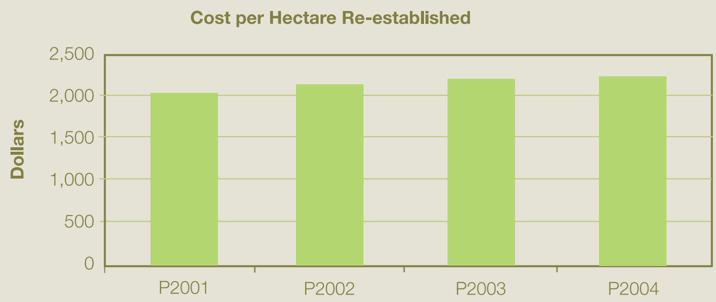
Cost per hectare re-established

The Commission planted 1,391 hectares of new plantations to the end of December 2004 (1,479 hectares to the end of December 2003).

The Afforestation program establishment areas for the 2004/05 financial period was 1,786 hectares (1,568 hectares in 2003/04) however, the direct costs associated with the afforestation program are capitalised and therefore do not form part of this measure.

Measure: The establishment cost was $2,248 per hectare (2003/04 $2,222 per hectare) an increase of 1.19 per cent ✓.

The increase in cost per hectare re-established reflects indexation of re-establishment planting contracts.



NOTE: this key performance indicator was changed in 2004/05 to reflect actual cost per 'planting year' (period from 1 October to 30 September each year). Comparative figures for this key performance indicator have been re-stated for all prior years.

EXTERNAL INVESTMENT*

The SCI target is 75 per cent of new investment funded externally by 2007. External investment funding of $2.4 million (Premium Plantations), $2.9 million from NAP and $0.1 million from BP Australia was received to establish plantations across the South West.

The overall investment was $7.54 million which equals an external investment factor of 71.5%.

PORTION OF AREA OF PLANTATION ESTATE PRIVATELY FUNDED*

The SCI target is to achieve 25 per cent of privately funded re-investment by 2005.

In 2003/04 the Commission entered into an arrangement with a customer for prepayment of stumpage at beneficial interest rates. The Commission therefore has access to these funds for plantation investment and enhancement. These arrangements will continue to 2015 at approximately $1m per annum.

✓ Audited key performance indicator.

* SCI indicator

INDUSTRY DEVELOPMENT*

The Commission contributed to community and industry development through ministerial advisory committees, promotional events such as the Royal Show and wood shows and research and development such as Timber Technology Harvey and other timber industry promotions (including the development and role-out of Tree Farming and Industry development plans to community groups). These non-commercial activities are undertaken for the social, economic and regional development benefits for WA. A total of around $1.2 million of salaries and direct expenditure was spent on these activities.

RESEARCH AND DEVELOPMENT*

The SCI target was that five per cent of investment be directed to research and development. This SCI is monitored against a target of five per cent of the agreed investment into new plantations. The current investment into plantations is $7.19 m (not including land purchase) against an investment into research and development of $2 million. This equals 28 per cent, significantly higher than the five per cent target.

* SCI indicator