

Statement of Corporate Intent
2011/12

June 2011



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Agreement

The *Statement of Corporate Intent 2011/12* outlines the business plan of the Forest Products Commission (FPC) and the corporate objectives for the 2011/12 financial year. The document complies with the requirements of the *Forest Products Act 2000* and represents an agreement between the Minister for Forestry and the FPC regarding the expected level of performance from the Commission over the twelve month period from July 2011 to June 2012.

The document may be amended by agreement from both parties such as where there are unforeseen circumstances. There is an onus on both parties to work collaboratively to address significant issues that arise.

In accordance with the *Forest Products Act 2000* and with the Treasurer's concurrence, the Minister for Forestry and the Commission agree to the content of this *Statement of Corporate Intent*.



Hon Terry Redman MLA
Minister for Forestry



Mike Gurry
Chairman
Forest Products Commission

Introduction

The charter of the Forest Products Commission (FPC) encompasses both commercial and non-commercial objectives. Since it was established in 2000, FPC has attempted to achieve a balance between the profitability of FPC and the viability of the broader timber industry. In 2010/11, FPC underwent a major organisational and financial restructure. This resulted in a realignment of its objectives to focus on the commercial aspects of its business. There has been a consolidation of FPC's commercial forestry business and a focus on the management and harvesting Western Australia's State owned timber assets.

As a result of the restructuring process, there has been a significant improvement in FPC's financial outlook and it is better positioned to deliver on its commercial forestry activities. FPC will continue to review its structure and operations to generate financial returns to Government. The Statement of Corporate Intent (SCI) details how the FPC will achieve these outcomes in 2011/12.

Nature and Scope of Functions

The functions of the FPC are specified in the *Forest Products Act 2000* and cover a broad array of activities. The scope of FPC's activities includes industry development such as the facilitation of private sector investment to support the longer term interests of the timber industry and the future timber needs for Western Australia. FPC also has a responsibility to generate a profit from the forest products it harvests, ensure the long-term viability of the forest products industry and apply ecologically sustainable forest management principles in the native forest sector.

The core business of FPC is the management and commercial harvesting of the State's timber assets. The timber resources include native and plantation timber species which are located in the South West of Western Australia and the rangelands.

FPC Objectives

The key objectives of FPC are to ensure that the:

- Business units are profitable, viable and sustainable; and
- State's timber assets are administered in accordance with ecologically sustainable forest management principles.

Business Context

The global demand for timber resources continues to grow. The benefits of timber as a renewable and sustainable resource will ensure that there is a long-term demand for the resource. Domestically, the demand for timber is driven by the construction industry in Western Australia. This sector has remained buoyant despite the downturn in the international economy and levels of demand will continue to increase in the future. These positive signs need to be balanced against the effects of the strong Australian dollar and competition from timber from the eastern states and overseas. The end use markets for timber products are evolving with changing customer preferences and product substitution. The prospect of a national carbon market has positive implications for native and plantation forestry in Western Australia, however, the delays in establishing a carbon market creates further uncertainty for the timber industry.

The timber industry is dynamic and continues to evolve over time. The difficulties facing the industry have contributed to a rationalisation of the sector and ongoing challenges for the hardwood timber industry. In October 2010, a major customer announced its intention to cease native timber operations in Western Australia. This may have flow-on effects for other customers.

The policy parameters have created some difficulties for the industry. The native timber industry operates subject to the Forest Management Plan (FMP). The current FMP expires in December 2013 and this has created uncertainty around timber supply. It has been problematic for the industry to make a long term investment where supply cannot be guaranteed. The successful renegotiation of the FMP will be critical to providing long term resource security and facilitate new investment in the sector.

FPC Restructuring

In January 2010, the government determined that the key objective of FPC was the economic sustainability of its core businesses in south west forests, mature plantations and arid forests. FPC has focused on consolidating its financial position and ensuring that FPC is financially sustainable in the future.

To achieve these goals, the agency has been involved in a restructure of the organisation. This process is nearing completion and has delivered the following outcomes:

- A new structure centred on the three core businesses of South West Forests, Mature Plantations and Sandalwood;
- Downsized staffing to match the future needs of the business;
- Termination of its 'fee for service' activities;
- Developed an exit strategy for a portion of the sharefarm plantation estate;
- Negotiated a 'hosting' arrangement with the Department of Agriculture and Food WA (DAFWA); and
- Transferred the science and industry development unit to DAFWA.

The restructure is expected to be completed in 2011/12. The activities that have not been finalised at this time include the transition and co-location to DAFWA, implementing the exit plan for the sharefarm estate and finalising the staff redeployment process.

Key Objectives 2011/12

For 2011/12, the strategic priorities of FPC will be the financial sustainability of its core business units and completing the restructuring process that began in 2010/11.

Key Objective 1: Profitable Business Units

The organisational and financial restructure of FPC that began in 2010/11 provides a foundation for a financially sustainable and commercially oriented business. FPC will focus on its native forest and pine log delivery businesses in the South West and the native sandalwood business in the rangelands. During 2011/12, work will continue on optimising FPC's operations by developing markets for under-utilised portions of the timber resource, improving the efficiency of sawlog harvesting and haulage and improving the financial viability of the FPC.

Key Objective 2: Complete the Restructure of FPC

FPC will continue to implement the organisational and financial restructure of the business that began in 2010/11. The key initiatives of the restructure include:

- divesting the sharefarm plantations that are no longer required;
- sourcing some its corporate services and other functions from DAFWA; and
- co locating FPC's head office at DAFWA's South Perth facility.

It is anticipated that the restructuring initiatives will be completed by the end of 2011/12.

Core Business Unit Strategies 2011/12

FPC will operate its three core business segments to ensure that each unit is profitable, viable and sustainable while meeting customer needs. The three business units are:

- South West Forests – the management, harvest and delivery of native forest hardwoods, Jarrah, Karri and Marri to mills and processing plants in the South West of Western Australia.
- Mature Plantations – the management, harvest and delivery of State owned/managed pine plantation resources to major sawmill and processing plants predominantly in Bunbury and Perth.
- Sandalwood – the management, harvest and delivery of wild sandalwood from the Goldfields and Murchison regions to customers in the South West and for export.

The strategic priorities of the business units are listed in the table below.

Strategies	Objectives	Initiatives
Strengthen the profitability of the business units	1. Maximise the gross profit of the business units	1. Review the log pricing structure
	2. Reduce direct and indirect operational costs	2. Review government charges
	3. Effective management of customer accounts	3. Divest the exit sharefarm estate
Maximise utilisation of timber resources		4. Review harvester and haulage contracts
		5. Implement debtor management plans
	1. Utilise more of each tree and each coupe	1. Identify new markets for low grade products
	2. Maximise value within existing products and markets	2. Increase the take-up of timber residue from mining operations
	3. Align resources with contract commitments	3. Maximise resource in mature plantations from thinning operations
	4. Improve yield forecasting	4. Improve data collection
		5. Conduct an inventory of resources
		6. Review contracts and State Agreements
	7. Second rotation program	
	8. Monitor yield in low rainfall areas	

Sustainability principles in forest management	<ol style="list-style-type: none"> 1. Protect the environmental values of the resource 2. Regeneration of native timber resources 	<ol style="list-style-type: none"> 1. Maintain and enhance AFS and EMS accreditation 2. Comply with FMP requirements 3. Improve supervision of harvesters 4. Regeneration program
Positive relationship with stakeholders	<ol style="list-style-type: none"> 1. Effective stakeholder communication systems 2. Stakeholder relationship development (government and non-government) 	<ol style="list-style-type: none"> 1. Develop and implement stakeholder management plans for customers, contractors, landowners and government 2. Provide input into the FMP for 2014
Corporate Governance	<ol style="list-style-type: none"> 1. Risk management 2. Legislative compliance 	<ol style="list-style-type: none"> 1. Internal audit program 2. Risk management incorporated into decision making processes 3. Resource support for the Board 4. Meet legislative requirements

South West Forest

The South West Forest segment primarily delivers Jarrah and Karri saw logs to sawmill customers in the South West and Karri logs for chip export. The demand for Karri wood chip and structural Karri timbers continues to be strong with the market returning to previous strong levels. The Jarrah sawlog industry continues to operate under difficult market conditions with sawmills operating at suboptimal levels in response to resource, market and cost issues and the exit of Gunns Limited from its Western Australian sawmill operations.

The South West forest resource is governed by the Forest Management Plan (FMP) which is due for renewal by the end of 2013. The conditions of the new FMP are crucial to providing industry with ongoing resource security to encourage new investment. FPC will continue to promote that the settings for the new FMP post 2013 by highlighting the benefits of multiple uses of the South West forests.

Table 1: Summary of Proposed Outcomes for South West Forest

ONE YEAR OUTCOMES (2011/12)	FIVE YEAR OUTCOMES (2011/12-2015/16)
<ol style="list-style-type: none"> 1. Undertake a review of native timber policy and the Forest Management Plan. 2. Review timber sales contracts. 3. Maximise resource utilisation of the resource 4. Evaluate log production processes with a view to greater operational and regulatory efficiency. 5. Increase the take-up of jarrah residue from mining operations. 6. Maintain and enhance AFS and EMS accreditation. 	<ol style="list-style-type: none"> 1. Increase the gross profit margin from the native timber business 2. Increase tree utilisation. 3. Provide input into the Forest Management Plan for 2014-23. 4. Maintain EMS and AFS certification. 5. Improve stakeholder management with key stakeholders.

Mature Plantations

The Mature Plantations segment provides pine sawlog and pine chip logs predominantly to three major processing plants (two in Bunbury and one in Gngangara). The sawlog resource, sourced from State owned pine plantations, is fully committed under State Agreements with these customers. The

lower grade resource, primarily from plantation thinnings and from harvest residues, is not fully committed. FPC is actively seeking markets for this resource.

Funding has been provided for new and second rotation planting programs to ensure that there is a timber industry in the future. The funds will be used for reestablishment works from 2011/12 to 2014/15.

Table 2: Summary of Proposed Outcomes 2011/12 and Five Year Outcomes

ONE YEAR OUTCOMES (2011/12)	FIVE YEAR OUTCOMES (2011/12-2015/16)
Mature Plantations Segment	
<ol style="list-style-type: none"> 1. Undertake an inventory to ensure that resource supply meets contractual obligations. 2. Implement improved fertiliser and thinning programs to optimise plantation growth. 3. Conduct a review of harvester and haulage contracts 4. Develop a plan for mid west (and other) plantations to minimise drought risk. 5. Enhance AFS accreditation. 	<ol style="list-style-type: none"> 1. Increase the quantum of gross profit. 2. Increase the proportion of tree utilisation from plantation harvest. 3. Maintain EMS and AFS certification. 4. Reduce the backlog of plantation thinning and second rotation re-establishment. 5. Second rotation plantings at a level to provide for long-term contracts. 6. Improve stakeholder management with key stakeholders.

Sandalwood

A strong domestic and export market exists for the State's wild sandalwood resource. It is a highly valued commodity for local and overseas buyers. Most high grade sandalwood product suitable for oil extraction is supplied under a long-term contract to a major customer in the Great Southern with the remaining product supplied to smaller domestic processors or into Asia. The annual available resource is constrained so growth in this segment is limited. FPC is continuing to develop its sandalwood regeneration programs in the WA rangelands based on results from scientific research and monitoring projects. Ongoing access to wild sandalwood is critical to the future of this segment.

Table 3: Summary of Proposed Outcomes 2011/12 and Five Year outcomes

ONE YEAR OUTCOMES (2011/12)	FIVE YEAR OUTCOMES (2011/12-2015/16)
<ol style="list-style-type: none"> 1. Full implementation of sandalwood regeneration operations. 2. Increased volume of 'dead' sandalwood collected. 3. Continue stakeholder engagement with pastoralists to access sandalwood resource. 	<ol style="list-style-type: none"> 1. Confirm the policy settings for wild sandalwood harvesting beyond 2016. 2. Establish a successful regeneration program. 3. Full resource utilisation. 4. High level support from pastoralists for sandalwood harvesting. 5. Achieve international export parity pricing in domestic sales of sandalwood.

Sharefarms

FPC is progressing with its sharefarm divestment strategy and the closure of its sharefarms business unit. The Sharefarms unit will continue to manage the divestment process while maintaining its contractual obligations to landowners.

FPC released a Request for Tender (RFT) to identify potential buyers for the sharefarm estate in November 2010. The RFT closed on 28 January 2011 and its outcome will assist in planning the divestment strategy with the possible sale of the sharefarm estate or by individual negotiations with landowners.

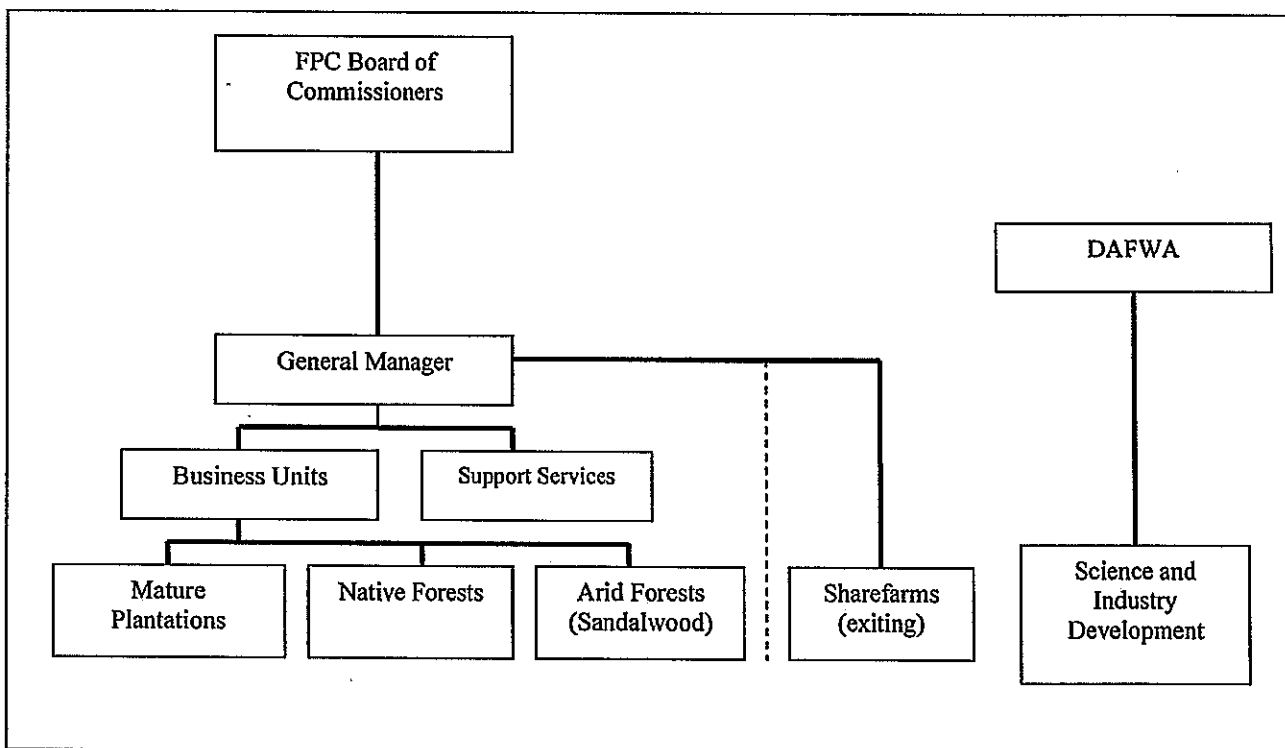
FPC's Manjimup Nursery and Seed store has been an integral part of the sharefarm program, however, its future will be determined in 2011/12 based on the future seedling needs of the FPC, alternative supply options and possible options for asset sale.

Table 4: Summary of Proposed Outcomes for Closing Sharefarm activities

ONE YEAR OUTCOMES (2011/12)	FIVE YEAR OUTCOMES (2011/12-2015/16)
<ol style="list-style-type: none"> 1. To complete sale of the 'exit' share farm estate through tender process. 2. To progress various alternatives to negotiate exit strategies with sharefarm landowners where estate cannot be sold. 3. To develop options for the FPC's future seed and seedling requirements, including future alternatives for the FPC's Manjimup Nursery. 	<ol style="list-style-type: none"> 1. FPC 'exit' sharefarm successful divested with no future liability to State. 2. FPC's ongoing seedling requirements being met.

FPC Organisational Structure

The structure for the Forest Products Commission is as follows:



Performance Measures

FPC's key priorities in 2011/12 will be the consolidation of the organisational and financial restructure of the FPC. FPC's performance will be measured by its delivery of the one year outcomes under each business segment and the achievement of a financial outcome consistent with the Financial Forecasts.

Business Management

Basis of Financial Forecasts

The financial forecasts contained in Appendix 1 are based on conservative assessment of the future of the industry. It is also assumed that the financial restructuring plan that was endorsed in November 2010 is fully implemented.

As announced by the Government on 19 May 2011, FPC will be enacting a series of savings initiatives designed to meet a 5% efficiency dividend. The savings targeted for 2011-12 is displayed below.

	2011-12
Reduction in Expenses (\$'000)	1,304

An implementation plan detailing where savings will be made will be provided to the Minister and Treasurer by 30 June 2011. A progress report will then be provided by 10 October, with this information used for the Government's 2011-12 Mid Year Review (MYR).

The tax and dividend implications resulting for the above reductions in expenditure will be modeled between now and the October progress report.

Revenue

Forecast sales revenue is determined by a range of factors including customer demand, market information and broad economic indicators. It is assumed that customer demand will remain steady over the forward period to reflect market conditions and, in particular, the local housing market.

FPC's major customers, Wespine and WAPRES, and other pine customers are forecast to be at contracted levels. Revenue from the South West Forest segment is forecast to be subdued based on difficult operating conditions and the decision by Gunns Limited to terminate its operations in Western Australia from early 2011. Karri sawlog revenues are based on the annual harvest levels imposed through the Forest Management Plan.

The revenue forecasts assume that the Forest Management Plan will continue post-2013 at similar levels to the existing FMP. Potential markets for Jarrah and Marri residue have not been included in the forecasts.

Arid Forest sales revenues are forecast to be steady as forecast export price increases are offset by the impact of the strong Australian dollar.

Expenses

The forecast for expenditure reflects the business plan which is to refocus on core business, restructure FPC and exit the sharefarm business segment.

Direct Forest Management Expenses are forecast at normalised levels with annual fertiliser and second Rotation plantation reestablishment levels returning to the level necessary to maintain the future plantation resource. The forecast for Employee expenses reflects a downsizing in employee numbers to 110 FTE. The forecasts assume that the downsizing will be complete by 30 June 2012,

however, there are provisions for delays in exiting the sharefarms business and redeployees. The forecasts assume that FPC will maintain the sharefarm estate until it is divested.

Pricing Arrangements

Pricing arrangements are determined by a variety of factors including requirements under the Forest Products Act. Section 59 prescribes the costs that are to be factored in to a price for forest products. More recently, contracts have been negotiated based on a "fixed" price. This has presented a degree of financial risk to FPC although most contract prices include indexation or an alternate escalation mechanism.

Dividend Policy

FPC has forecast a dividend payment of \$1.5 million to be paid in 2011/12. The payment was negotiated with the Department of Treasury and Finance as part of the discussions on the financial restructuring of FPC.

Capital Works

The FPC's capital works programme is comprised of second rotation plantation establishment and minor plant and equipment. The capital works programme for 2011/12 consists of:

- \$0.8 million sourced from FPC funds;
- \$4.7 million for second rotation establishment sourced from government appropriation; and
- Miscellaneous equipment purchases.

Expenditure on forestry roads and bridges is funded from the recurrent budget and are planned in conjunction with harvesting operations.

Accounting Policy

The FPC's financial statements are prepared in accordance with Australian Accounting Standards and the provisions of the Financial Management Act. Further information on FPC accounting policies can be found in FPC's annual report.

Community Service Obligations

The Forest Products Commission has undertaken a variety of non-commercial activities. These activities include forest industry development, forestry research and development and forest policy development. Timber research and development was transferred to the Department of Agriculture and Food WA in 2010.

Performance Reporting to the Minister

The FPC monitors its performance based on the business activities listed in the SDP and SCI. The Minister is provided with an assessment of performance and financial outcomes in the Half Year and Annual Reports. The Minister is provided with updates throughout the year where there are material variations.

FPC is introducing an additional reporting structure via the Minister to the Department of Treasury and Finance. FPC will submit quarterly reports on its budget and the progress of the financial and organisational restructure.

Copies of FPC's publications, including the annual report and SCI, are available on the FPC website at www.fpc.wa.gov.au.

Appendix 1 - Financial Forecasts

The following forecast does not include the impacts of the recently announced efficiency dividend required by Government . Refer to comments on page 10 under 'Basis of Financial Forecasts'.

Profit and Loss Statement

(\$ millions)	FY012
	<i>Forecast</i>
Revenue:	
- Harvest Revenues	100.3
- Production and Delivery Expenses	(54.0)
Gross Margin	46.3
Other Revenues	0.8
Less Expenses:	
- Direct Forest Management Expenses	(11.0)
- Employee Expenses	(15.0)
- Restructuring Costs	(2.5)
- DEC Expenses	(11.5)
- Fixed Expenses	(7.7)
EBITDA	(0.5)
Capitalisation	3.3
Other Non Cash Items	(0.9)
EBIT	1.8
Nominal Tax	(0.6)
Net Profit After Tax (NPAT)	1.3

Cash Flow Statement

(\$ millions)	FY012
	<i>Forecast</i>
Net Cash flow from:	
Operating activities (adjusted EBITDA)	(1.0)
Investing activities	
- Second rotation re-establishment	(4.9)
- Other Capital works	(0.6)
Financing activities	
- Equity Injection (Restructure)	2.5
- Interest Revenue	0.4
Other Cash	
- CSO's	4.7
- Other Cash	1.0
Dividends	(1.5)
Total Cash for period	0.5
Opening cash balance	2.7
Closing cash balance	3.1

Balance Sheets

(\$ millions)	FY012
	<i>Forecast</i>
Current Assets	28.0
Other Non Current	12.1
Plant property and equipment	16.3
Natural Resource Assets	336.2
Carbon Asset	21.9
Total Assets	414.5
Current Liabilities	15.9
Provisions	4.1
Contracted Obligations	66.1
Total Liabilities	86.2
Equity	328.3
Total Liabilities and Equity	414.5

Statement of Corporate Intent 2011-12

ADDENDUM

The Treasurer has provided his concurrence to the Statement of Corporate Intent 2011-12 on 5 July 2011 provided the following be inserted as an addendum to the Statement of Corporate Intent:

"The parameters within this document contain capital expenditure, net debt impact and net flows to and from government. Prior to undertaking any new commitments and/or actions which materially affect these parameters, full details and justifications will be provided to the Minister and the Department of Treasury. Should this occur, the Minister will be requested to consider these modifications to the Statement of Corporate Intent, in accordance with sections 27 and 36 of the *Forest Products Act 2000*."

In accordance with the *Forest Products Act 2000* the Minister for Forestry agrees to this addendum to the Statement of Corporate Intent 2011-12.



TERRY REDMAN MLA
MINISTER FOR FORESTRY