



FLETCHER CHALLENGE  
FORESTS

# REVIEW

the year in review <<<

FLETCHER CHALLENGE FORESTS LIMITED  
ANNUAL REVIEW 2001

# REVIEW

During the year

- ◀◀◀ The company recorded very substantial losses of \$1.38 billion. These largely reflect the write down of its investment in the CNIFP (\$533 million) and the impacts of the new market value based approach adopted by the company for the valuation of its forest estate (\$752 million), which includes the elimination of value previously recognised at the Group but not the former Forests Division level
- ◀◀◀ The loss, calculated on an equivalent basis to the former Forests Division, was \$749 million, compared to \$498 million at the half year (31 December)
- ◀◀◀ The new market based approach brings the forest carrying value (\$1.12 billion) into line with the carrying value previously recognised in the accounts of the former Forests Division as at 31 December 2000 (\$1.11 billion)
- ◀◀◀ Operating revenue of \$648 million was up 4% despite difficult market conditions
- ◀◀◀ Operating earnings, excluding unusual items and accrued interest income, on an equivalent basis to the former Forests Division, were \$3 million compared to \$28 million last year
- ◀◀◀ Net cash from operating activities, before separation charges, on a similar equivalent basis, was \$60 million compared to \$72 million last year
- ◀◀◀ Sales to North America continued to grow – up 15% to \$125 million
- ◀◀◀ New products were added to the Origin™ range
- ◀◀◀ The company was awarded Forest Stewardship Council (FSC) environmental accreditation for its managed forest estate
- ◀◀◀ We further improved our industry leading performance in workplace safety
- ◀◀◀ We raised \$504 million in new equity and \$80 million from asset sales to facilitate separation from the Fletcher Challenge Group, which was completed on 23 March 2001

# LETTER

## Chairman's Letter

The company's annual result detailed in this Review is unacceptable but was largely unavoidable. It reflects the final wash-up of the Fletcher Challenge Group separation process, costs of restructuring, the change in forest estate accounting policy, the CNIFP receivership and the down cycle in major product markets faced over the past year.

Your new Board is confident that with this restructuring phase now behind us, the company can build an outstanding future.

To assist us to define that future we have initiated a strategic review of the company with support from external consultants. The review is an exhaustive "bottom up" evaluation of all fundamental issues affecting the company's profitability and future development. It includes:

- An evaluation of the best operational/ownership structures for the company's forest resource, processing and export activities.
- An identification of the key future investment/growth priorities by market and product.
- A review of the company's performance measurement processes, to ensure we are benchmarked to world best practice standards.

We are determined to be rigorous in our drive to clearly identify those strategies and processes that are effective and those that must be changed if the full potential of Fletcher Challenge Forests is to be realised.

The review has already confirmed the company has substantial competitive strengths as a global forestry and wood processing entity. In particular it has well advanced processing and market entry strategies in key markets, a highly cost effective infrastructure, and a world scale, environmentally attractive forest resource with a strongly rising harvest profile.

Despite the global downturn, Fletcher Challenge Forests is making solid advances in selected markets because of its successful added-value strategies.

The outstanding example is our performance in the US market, where there is continuing high demand for the company's processed product. This innovative strategy is an example of the company's true potential. It brings together our unique resource of pruned wood, our state of the art processing, market relationships with leading US distributors, and consumer demand for an environmentally recognised resource product.

The Board and management are very determined that this company will realise its true value and global potential through the further development of our North American and other added-value opportunities. This will require sound decisions based on our best evaluation of a complex and volatile global marketplace, New Zealand's maturing forest resource and the established substantive advantages of Fletcher Challenge Forests.

This is a demanding time for Fletcher Challenge Forests and its people, but also a point of substantial opportunity. We are determined to seize that opportunity.

Sir Dryden Spring  
Chairman

## Chief Executive's Report

## REPORT

Substantial losses have been recognised in the company's accounts this year, mainly as a result of the change in forest estate accounting policy and the CNIFP receivership, and at the operating level, results were impacted by the very difficult market conditions. Net cash from operating activities, excluding unusual items, on an equivalent basis to the former Forests Division, was \$60 million, compared to \$72 million last year. On a similar equivalent basis, operating earnings before interest and tax (EBIT), excluding unusual items and accrued interest income, were \$3 million compared to \$28 million last year.

Market conditions were extremely demanding. The period saw a sharp slowdown in building activity in both New Zealand and Australia – the post GST downturn in Australia of 40% was the most severe in recorded history – and the Asian log markets remained very competitive. Log prices in US dollar terms fell below the levels seen in the Asian crisis of 1998, and supplier discipline was poor.



One of the pleasing aspects of the year's performance was the continued increase in the demand for our products – lumber, finger-joint mouldings, solid mouldings and clear boards – in North America. Sales to that market rose by 15% this year to NZ\$125 million assisted by our ability to supply environmentally certified products, the acceptance of Radiata pine as a substitute for Ponderosa Pine, and the high standards of quality and service provided by our operations supplying this market. This year, distribution through our partly owned companies American Wood Mouldings and Empire has been complemented by our own operation in North America, FCF USA, which is taking clear boards and other products direct to customers in that market.

Fletcher Challenge Forests achieved another important milestone in October 2000 when it was granted Forest Stewardship Council (FSC) certification. FSC is an international non-government organisation dedicated to promoting environmentally responsible, socially beneficial and economically viable forest management. FSC certification is recognition that our forests are well managed and ensures access to high value markets, particularly in North America, as well as providing opportunities for pricing premiums.

The year also saw further gains from our value added processing strategy. We extended the Origin™ I-beam product range by the launch of the Origin™ I-floor system into New Zealand. This engineered timber floor system

incorporates the light, stiff and consistent performance of Origin™ I-beams and special Origin™ Plywood “long-span” floor panels. This innovative solution meets a particular market need and is being well received by our customers. Despite the building industry slump in Australasia, strong sales growth was achieved in Origin™ Plywood and Ramsey Roundwood products.

Still to be resolved is the future of the CNIFP, which was placed in receivership in February 2001 by the banking consortium after it breached loan covenants in December 2000. The Receivers have appointed Morgan Stanley to assist with the sale process and a sale of the CNIFP assets should be completed over the coming months. We have appointed Credit Suisse First Boston as advisers to the company and we are reviewing a number of options in relation to our potential participation in the sale process. Further details on CNIFP issues are provided on page 11 of this Review.

In the short term the company's financial performance will be highly dependent on the operating conditions in our key markets. With the exception of Japan, which remains in recession, the outlook is generally positive: in Australia housing activity is set to lift sharply as consumers take advantage of Government assistance programmes for new home buyers, in Korea construction activity is growing with the help of support measures from the Government, and price increases are being achieved for our logs, and in regional markets such as the Philippines and Malaysia the supply of non-plantation wood is being curtailed due to the enforcement of bans on logging old growth forests or to cost pressures.

Most importantly, exciting new markets for our softwoods are emerging in both China and India. A supplier agreement for servicing the market in India was reached in the final quarter of the year and may provide a model for similar initiatives in other export markets. In all, there are a number of indications that we may have passed through the trough of this price cycle and we are looking forward to improved operating conditions in most markets over the coming year.

The company completed a major overhead reduction programme during the year which will provide earnings impetus even without the benefit of improved market conditions. The company expects to trade at a small net profit in the coming year, prior to any movements in the value of the forest estate and any unusual or unforeseen items.

This has been a year of many changes for Fletcher Challenge Forests, all of which have better positioned the company for the future. We now have a more focused entity, an energised new Board and corporate management team, and a wonderful core asset in our Central North Island forests and associated processing activities.

While we have much to do, we are committed to reporting improved financial results to you in future periods.



Terry McFadgen  
Chief Executive

# HSE

Health, Safety and Environment

Fletcher Challenge Forests gives health, safety and environmental performance the same importance as it does the company's primary business objectives. By the nature of our business, we have a close link with the environment, and we are committed to effective management of the impact of our manufacturing and forest operations.

The extent to which our business will prosper in the future depends greatly on the quality of the natural and physical resources that provide the foundation for our business.

Meeting statutory or regulatory requirements is just one element of that commitment. The comprehensive systems we have developed ensure that we actively manage our responsibilities in the areas of bio-diversity, waterways protection, wildlife management,

recreation and public access, and protection of historically and culturally significant sites within the forest estate.

### Forest Stewardship Council

In October 2000, Fletcher Challenge Forests received Forest Stewardship Council (FSC) certification for the forest estate we own and manage in New Zealand. FSC is an international organisation founded to support environmentally appropriate, socially beneficial and economically viable management of the world's forests.

There are an increasing number of international forest and forest product certification systems available. Fletcher Challenge Forests chose FSC because it is the most credible and internationally recognised certification available for forests and forest products. At present FSC is the only certification standard recognised by The Home Depot, one of our key customers in the USA.

The 282,000 hectare area that has been certified under Fletcher Challenge Forests' management represents assets of world class quality and the largest



certified forest in New Zealand. Gaining forest certification has involved a rigorous assessment of our forest management practices by an international audit body, Scientific Certification Systems (SCS), over a number of months during 2000, and qualifies the forest estate to be certified as a Well-Managed Plantation.

FSC certification will assist the company to continue to access international markets such as North America, where verification of products is becoming essential. It will also give our products greater environmental credibility in the international marketplace – by use of the FSC logo, customers will have a way of identifying that the product they are purchasing comes from a forest that is managed according to internationally agreed social and environmental principles and criteria.

The forest certification, together with the chain-of-custody certificates that have been received for a significant proportion of our USA products, provide Fletcher Challenge Forests with the opportunity to position itself as a leading international supplier of solid wood products sourced from sustainable and environmentally certified resources.

#### **ACC Partnership Programme**

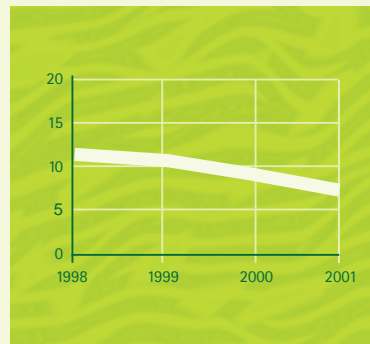
Fletcher Challenge Forests has continued to participate in the Accident Compensation Commission's (ACC) Partnership Programme. Following this year's mandatory external audit of our health and safety systems, the company was reconfirmed into the programme, and was elevated to the Tertiary level (highest level). The audit investigated Fletcher Challenge Forests' internal health and safety systems that not only address legislative requirements but also provide for a safe working environment. Continued participation in the ACC Partnership Programme allows Fletcher Challenge Forests to take responsibility for effectively minimising workplace risk and injuries, and managing the recovery and rehabilitation of its own workers, while at the same time achieving significant cost savings.

#### **Workplace Safety**

The number of workplace injuries has continued to fall with the lost time injury frequency rate improving to a new low of 7.5 injuries per million hours worked, compared with 8.8 last June. This represents a sustained and significant rate of improvement over the last four years, and the drive towards international best practice will continue.

#### **Lost Time Injury Frequency Rate**

Lost Time Injuries per Million Hours



Fletcher Challenge Forests publishes under separate cover a Health, Safety and Environmental Annual Report which contains more detailed information on policies, practices and achievements in these areas.

# ANALYSIS

## Management's Discussion and Analysis

### Results Overview

The second half of the financial year to 30 June saw a continuation of the mixed but generally difficult conditions that prevailed in the first half. Home building activity in New Zealand and Australia was very weak, negatively impacting on product prices and volumes, while the export log markets remained particularly competitive. The US market provided the highlight where, despite the general economic tightening, demand from the housing sector remained buoyant and sales and prices increased.

The Fletcher Challenge Group separation process was successfully concluded on 23 March 2001. Fletcher Challenge Forests remains as the continuing business of Fletcher Challenge Limited which has been renamed Fletcher Challenge Forests Limited. The financial statements for the year to 30 June 2001 for continuing operations represent the results of the former Forests Division based on the accounting policies formerly applied at a Fletcher Challenge Group level, modified by the change of accounting policy relating to the company's forest crop. The results of discontinued operations relate to the former Building, Energy and Paper Divisions.

The following summary reconciles the financial results calculated on an equivalent basis to the former Forests Division, to those of Fletcher Challenge Forests Group's continuing operations.

#### RESULTS SUMMARY

|  | Pro Forma<br>Forests Division |        | Group<br>Adjustments <sup>1</sup> |        | Fletcher Challenge Forests<br>Continuing Operations |        |
|--|-------------------------------|--------|-----------------------------------|--------|---|--------|
|  | Jun 01                        | Jun 00 | Jun 01                            | Jun 00 | Jun 01  | Jun 00 |
| Operating Earnings (EBIT)<br>before unusual items                      | 29                            | 70     | -40                               | -42    | -11   | 28     |
| Less Accrued Interest Income   | 26                            | 42     |                                   |        | 26  | 42     |
| Operating Earnings (EBIT)<br>before unusual items and accrued interest | 3                             | 28     | -40                               | -42    | -37   | -14    |
| Net Earnings<br>before unusual items and revaluations                  | -3                            | 23     | -50                               | -45    | -53   | -22    |
| Net Unusual Items/Revaluation  | -746                          | 58     | -578                              |        | -1,324  | 58     |
| Net Earnings   | -749                          | 81     | -628                              | -45    | -1,377  | 36     |
| Cash from Operating Activities   | 11                            | 68     | 61                                | 56     | 72  | 124    |
| Add Back Cash Separation Costs   | 49                            | 4      |                                   |        | 49  | 4      |
| Cash from Operating Activities<br>before separation charges            | 60                            | 72     | 61                                | 56     | 121   | 128    |
| Less Capitalised Interest  | 50                            | 52     | 61                                | 56     | 111   | 108    |
| Net Cash from Operating Activities                                     | 10                            | 20     |                                   |        | 10  | 20     |

(1) Group adjustments arise from the different interest capitalisation policy formerly applied to the Fletcher Challenge Group Financial Statements and the consequential effect on depletions, tax, revaluations and impairments.

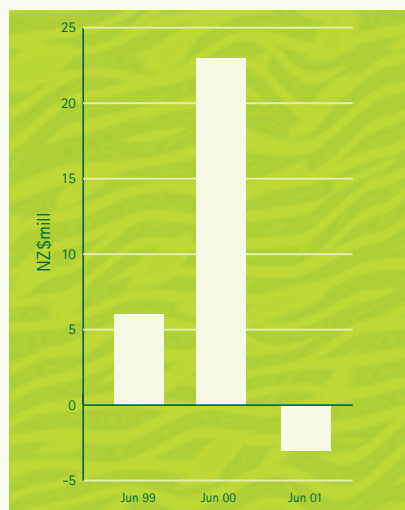
Fletcher Challenge Forests recorded a net loss for the year, calculated on an equivalent basis to the former Forests Division accounts, excluding unusual items and revaluations, of \$3 million, compared to net earnings of \$23 million in the previous year. A net loss of \$4 million was recorded in the second half of the year compared to earnings of \$1 million for the first half.

Net earnings for the period, calculated on the same equivalent basis, after unusuals and revaluations, were a loss of \$749 million, compared to earnings of \$81 million in the previous year. The result was dominated by unusual losses and revaluations of \$746 million, comprising:

- a write down of \$533 million (\$768 million before tax) for an expected shortfall in the realisable value of our investment in the CNIFP. The write down was \$529 million at December 2000.

### Net Earnings

excluding unusuals and revaluations  
Pro Forma Forests Division



- adjustments of \$174 million (primarily deferred taxation) relating to the revaluation from the historic carrying value of the forest crop to the new market based carrying value assessed as at 30 June 2001.
- separation related costs of \$55 million.
- a gain on sale of assets to Rubicon of \$25 million.
- \$9 million in other unusual items including provisioning for legal costs (\$5 million).

Fletcher Challenge Forests Group's continuing operations recorded a loss of \$1,377 million for the year, which includes an unusual loss and revaluation totalling \$1,324 million. The difference in unusual items, compared to the \$746 million referred to above, relates to the write downs from the historical carrying value of the forest crop at the Fletcher Challenge Group level to the new market based valuation, which total \$752 million compared to \$174 million. In the accounts this is represented by an impairment write down of \$197 million and a revaluation loss of \$555 million.

### Operating Results

Operating revenue rose 4% to \$648 million, from \$623 million in the previous year.

Operating earnings before interest and tax (EBIT), excluding unusual items and accrued interest income, calculated on an equivalent basis to the former Forests Division, were \$3 million this year compared to \$28 million for the previous year.

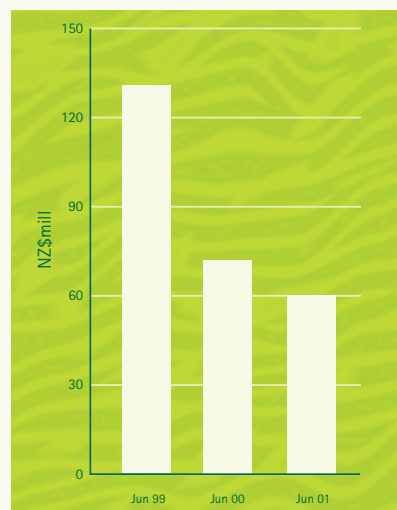
### Cash Flow

Net cash from operating activities (prior to cash separation charges of \$49 million), less capitalised interest, was \$10 million compared to \$20 million in the previous year. Despite the difficult trading conditions the company is maintaining positive operating cash flow as a result of good working capital management and lower overhead costs.

In December 2000 Fletcher Challenge Forests completed an equity raising of \$414 million (net proceeds) as part of a financial restructuring prior to the separation of the Fletcher Challenge Group. The sale of assets and an equity placement to Rubicon in March 2001 raised a further \$170 million. These proceeds significantly reduced the level of debt which at June 2001 represented a debt-to-capitalisation ratio of 18.8%. Further comment on the company's financial position is made below.

### Net Cash from Operating Activities

excluding unusuals  
Pro Forma Forests Division



## Review by Business Segment

### FOREST & LOGS

Revenue from Forest and Logs, excluding accrued interest income on loans to the CNIFP, rose 15% to \$272 million compared to \$236 million in the previous year. An 8% increase in sales volume and an average US/NZ exchange rate that was 16% weaker (year on year) were the primary contributing factors. Log sales volumes from the company's forests, net of intra-company sales, rose 5% while the volume from third party log and chip trading rose 9%.

The log export markets continued to suffer through the year from a combination of generally static demand and a competitive supply environment. US dollar prices tracked down over the last nine months of the year as both supplier and customer currencies weakened against the US dollar. Total managed export volumes were down 11% compared with the previous year. In the final quarter Fletcher Challenge Forests lifted market share in South Korea and generally held prices and sales volumes above expected levels. An efficient supply chain and appropriate production control have kept inventory at acceptable levels during this period.

The fall in the NZ dollar exchange rate (on average 16% lower than the previous year) helped lift returns in NZ dollar terms. Prices for the indicator grades for Asian log demand, A grade to Japan and K grade to Korea, increased 9% and 5% in NZ dollars respectively compared to the previous year.

EBITD, excluding unusual items and accrued interest income on the CNIFP loans, fell \$11 million from \$55 million in the previous year to \$44 million, on total log sales volumes from the company's forests which fell 5%. EBIT for continuing operations, excluding unusual items and accrued interest income, fell from a loss of \$45 million to a loss of \$53 million. EBIT calculated on an equivalent basis to the former Forests Division, was a loss of \$14 million this year compared to a loss of \$4 million last year.

### PROCESSING

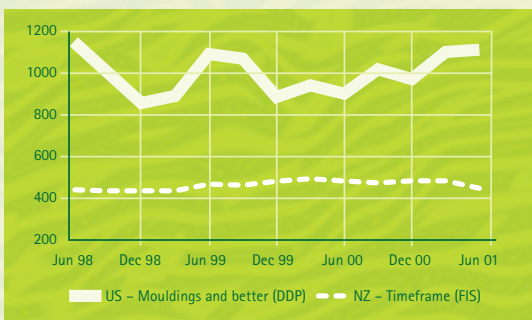
#### Processing and Distribution

The company's manufacturing operations continued to benefit from the diversified market base that has been created over the past five years, with steady demand and higher NZ dollar prices from the US market partially offsetting the depressed conditions in Australia and New Zealand. Processing and Distribution revenue increased to \$350 million compared to \$345 million in the previous year, on volume which fell 3% to 686,000 cubic metres. While own lumber sales volumes were down 4% to 498,000 cubic metres, total revenue was underpinned by an 8% increase in volume of remanufactured product.

EBITD fell from \$41 million in the previous year to \$30 million. Higher log costs were the main influence as higher NZ dollar returns to log exporters, together with the demand for pruned logs, flowed on to higher domestic prices. Log purchases comprise over 60% of sawmill costs. EBIT fell from \$31 million to \$15 million.

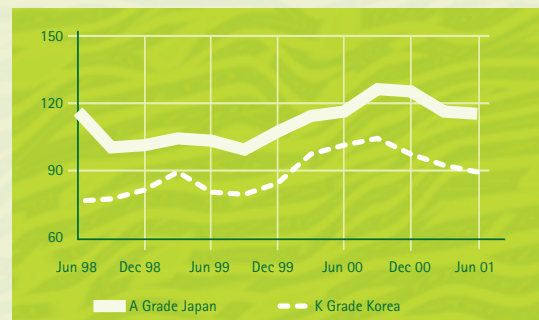
**Radiata Pine Lumber Prices**

NZ\$/m<sup>3</sup>



**Radiata Pine Log Prices**

NZ\$ FOB/JASm<sup>3</sup>



### **Australasian Consumer Solutions (ACS)**

The post GST downturn in the Australian building industry (housing consents down 40%) was the most severe on record and had a secondary flow on effect as local exporters looked to redirect production into the New Zealand market, where demand had also dropped (to 15% below long term levels). This resulted in downward price movements and downtime for many wood processors. Lumber sales for the Kawerau and Rainbow sawmills, which are focused on the structural market segment, were down 14% year-on-year.

EBITD fell 32% from \$22 million in the previous year to \$15 million, while EBIT fell from \$16 million to \$6 million.

Despite the prevailing conditions ACS achieved strong sales growth in Origin™ Plywood (up 11%) fuelled by the addition of new wall cladding and lining products and extending the Origin™ I-beam product range with the launch of Origin™ I-floor (a combination of Origin™ I-beam and long-span Origin™ Plywood). Ramsey Roundwood also performed well with revenue growth (up 21%) in the New Zealand rural and viticulture markets and in pole exports to Asia.

Operationally the focus has been on matching product mix with the shifting demands of the market, controlling inventory, and introducing a "Maintenance Excellence Programme", a long-term preventive and predictive maintenance procedure to improve overall equipment effectiveness.

### **North American Consumer Solutions (NACS)**

Sales to North America rose 15% this year to \$125 million, representing 36% of company manufactured product sales. This strong performance was assisted by steady demand and volumes, rising US dollar prices through the second half of the year, and the fall in the NZ dollar. Concerns over the economic slow down in the US and a likely flow on to reduced household spending, including housing, have not translated into reduced demand for our products.

EBITD, at \$18 million, fell \$1 million compared to the previous year, as margin pressure offset the sales growth, while EBIT fell \$3 million to \$13 million.

Demand for our products is benefiting from the increasing acceptance of Radiata pine as a substitute for Ponderosa pine, the relative stability of the additions and alterations market, and the growing preference for environmentally certified wood products.

NACS has broadened its customer base, supplying FSC certified moulding feedstock to a number of millwork manufacturers for further reprocessing. These sales will further increase the market penetration of Radiata pine. We have grown the sales of finished mouldings to customers other than the major home centres, and introduced a new product line of clear boards – a ready to use finished board manufactured from high-grade appearance lumber.

The production facilities supplying the US market have been operating near capacity most of the year, putting pressure on the pruned log supply which provides the feedstock for this market.

### **Japanese and Asian Consumer Solutions (JACS)**

This is a new business unit which combines the Japanese Engineered Wood Products business, the industrial lumber trading activities (NZ and Asian focus) and management of the CNIFP-owned Waipa sawmill.

The Japanese housing industry has continued to decline, reflecting Japan's general economic malaise. Wooden housing starts in the five months to May 2001 were down 5% compared to the same period in 2000.

In addition, this market has seen significant competitive pressures from European producers. EBITD and EBIT both fell \$3 million compared to last year, to a loss of \$3 million and \$4 million respectively, as a result of pricing pressure.

Despite these difficult conditions two new products were brought to market: "dodai", a treated laminated groundsill with very high performance specifications which is gaining increased acceptance with major Japanese housing companies, and "treated hashira" which offers the characteristics that are required for new high durability house designs. Layout and

equipment changes at the remanufacturing plant have further reduced costs.

The prospects for our Japanese housing business are enhanced by regulatory changes which favour re-engineered home building components (over solid). This will mean a growth in market share for the type of products on which we are focused.

### Corporate Finance

Net debt at 30 June 2001 was \$323 million compared to \$771 million as at 30 June 2000 for the former Forests Division. Net proceeds of \$414 million were raised through the Rights Offer of new preference shares in December 2000, and a further \$170 million was raised from the sale of the biotechnology business, the South American operations and a share placement to Rubicon (225 million shares at 40 cents per share) as part of the Fletcher Challenge Group separation process. The company's debt-to-capitalisation ratio is 18.8% based on current book values which incorporate the write down of the CNIFP investment and the adoption of market valuation for the forest crop.

Investing and operating cash flow for the year, prior to cash separation costs of \$49 million, was \$79 million compared to \$37 million in the previous year. This comprised \$10 million of cash from operating activities net of capitalised interest, compared to \$20 million in the previous year. Investing cash flow included capitalised forest maintenance costs of \$18 million (\$21 million last year) and a net cash inflow from asset sales/purchases of \$87 million (\$38 million last year).

At year end the company announced a change to the accounting policy relating to the forest estate. The company has adopted a market valuation policy for the forest crop which is now recorded at \$1.12 billion as at 30 June 2001. This valuation compares with the cost based carrying values of \$1.8 billion for Fletcher Challenge Limited and \$1.1 billion for the former Forests Division as at 31 December 2000. The new policy will provide investors with the information required to assess the worth of the forests on a market value basis, and

brings the company into line with Australian accounting standards. For supplementary forest information relating to the 30 June 2001 valuation please refer to page 16.

In view of the changes that have occurred in the business and in the mix of currencies that impact on our cash flow over a period of several years, the company has now determined that the functional currency of the business is NZ dollars as from 30 June 2001. As a result the company will migrate the long-term debt, which was previously all US dollar denominated, to NZ dollars over the next 12 to 18 months. In July 2001, US\$30 million was transferred to NZ dollars.

### Central North Island Forest Partnership (In Receivership)

Primarily as a result of low USD log prices the CNIFP breached certain loan ratios and covenants at 31 December 2000, putting the senior bank debt facility of approximately US\$640 million in default.

As a result of the default and the likely realisation of the CNIFP's assets, Fletcher Challenge Forests wrote off its equity and wrote down the carrying value of the subordinated loan to US\$225 million (as at 31 December 2000). Interest accruing on the company's loan to the CNIFP also ceased to be recognised as income from that date.

In February 2001 the lending banks appointed Mr Michael Stiassny and Mr Grant Graham of Ferrier Hodgson as Receivers to manage the sale of the CNIFP's assets and since that date the business has continued to operate under Fletcher Challenge Forests' management.

The carrying value of the subordinated debt was reassessed as at 30 June 2001, resulting in a further write down to US\$145 million, which represents the Directors' best estimate of realisable value.

The Receivers appointed investment bankers Morgan Stanley as advisers and in August 2001 released an Information Memorandum to potential bidders. Fletcher Challenge Forests

supports the process and is confident of an orderly and well managed international bidding process and strong interest in what is a world class asset. The company has also been approached by several parties and is reviewing a number of options in relation to the sale process.

### **CITIC Litigation**

In December 1999, CITIC New Zealand Limited (now in Receivership), Fletcher Challenge Forests' 50% partner in the CNIFP, filed significant claims against Fletcher Challenge Forests in connection with the CNIFP, not all of which have been formally quantified. The claims relate to a number of issues in connection with the management of the CNIFP and to the valuation of the assets purchased by CITIC from the Fletcher Challenge Group upon the establishment of the CNIFP. CITIC also sought a declaration that it has terminated the management contract between the CNIFP and Fletcher Challenge Forests.

In November 2000, CITIC purported to assign its interest in the claims to an associated company. This was prior to the appointment of Receivers in February 2001. In November 2001, the High Court will consider whether this assignment is valid, an important preliminary issue which will determine how, and possibly if, the litigation brought by CITIC will proceed.

It remains our view, supported by legal opinion, that these claims are substantially without merit and if they are pursued they will be vigorously defended. A provision of \$5 million was established at 31 December 2000 to cover the costs of that defence.

### **Dividend**

Wood product prices and demand remain at cyclically low levels, which together with the relatively low harvest volumes from a still maturing forest resource means that the company is not yet generating significant surplus cash flow. Therefore, no dividend has been declared in respect of the financial year.

### **Market Outlook**

In the last two months there have been clear signs of recovery in New Zealand and Australian residential building activity. Lead indicators such as loan approvals in Australia and existing house sales in New Zealand have moved up over the May/June period. Total inventories have fallen over the last six months, and upward pricing pressure is emerging in Australia.

After several very difficult years in the log markets there is reason for some optimism that conditions will improve over the next twelve months. Building activity is increasing in South Korea and price increases are being achieved, while the Chinese wood deficit is large and imports are growing rapidly. There are also new market opportunities in other Asian countries such as India and the Philippines.

The Japanese wood markets remain very challenging, with a decline expected in the long term demand for packaging as the Japanese manufacturing industries struggle to match their Asian competitors. Balancing this are the additional growth opportunities based on the substitution of Radiata pine for existing species, particularly in emerging Asian economies.

The robust nature of US housing expenditure even through the recent economic contraction underpins the outlook for US demand for our products. We anticipate continued growth in volume in the specialty segments in which we operate.

Our forest estate is still maturing and will benefit significantly from the over 60% increase in the sustainable harvest volume over the next seven years. The growing demand for wood from sustainable and environmentally certified resources combined with the quality and low cost base of our Radiata plantations, means that Fletcher Challenge Forests, with FSC certification and increasing volume availability, is well positioned to grow significantly.

*Footnote: Comments in the Market Outlook section above and also in the Chairman's Letter and the Chief Executive's Report, about anticipated market conditions and activities, are forward-looking and are made pursuant to the safe harbour provisions of the US Private Securities Litigation Reform Act of 1995. Refer to page 23 for an explanation of the factors that could cause actual results to differ materially from those expressed.*

# SEGMENTAL

## Segmental Information

### Sales Volumes

(000m<sup>3</sup>) 12 months to

Fletcher Challenge Forests<sup>1</sup>

|   | Jun 01       | Jun 00       | Jun 99       |
|---|--------------|--------------|--------------|
| <b>Log/Residue Sales</b>                      |              |              |              |
| <b>Managed Estate</b>                         |              |              |              |
| Pruned Radiata Sawlogs                        | 70           | 105          | 87           |
| Large Unpruned Radiata Sawlogs                | 486          | 549          | 547          |
| Small Unpruned Radiata Sawlogs                | 447          | 526          | 604          |
| Douglas Fir Sawlogs                           | 1            | 2            |              |
| Pulp Logs and Residues                        | 411          | 410          | 342          |
| Production Thinnings                          | 105          | 9            | 10           |
| <b>Total Managed Estate</b>                   | <b>1,520</b> | <b>1,601</b> | <b>1,590</b> |
| Third Party Trading <sup>2</sup>              | 2,602        | 2,296        | 1,984        |
| Intra-Company Sales                           | -535         | -578         | -555         |
| <b>Total</b>                                  | <b>3,587</b> | <b>3,319</b> | <b>3,019</b> |
| <b>Manufactured Product Sales<sup>3</sup></b> |              |              |              |
| Solid Lineal Mouldings                        | 26           | 26           | 23           |
| Laminated and Finger-Jointed Product          | 77           | 69           | 60           |
| Lumber  | 498          | 517          | 492          |
| <b>Total</b>                                  | <b>601</b>   | <b>612</b>   | <b>575</b>   |
| Third Party Lumber Trading                    | 85           | 96           |              |
| <b>Total</b>                                  | <b>686</b>   | <b>708</b>   | <b>575</b>   |

1. Represents 100% of the volumes from consolidated operations.

2. Includes logs, chips and residues.

3. Excludes 50% owned associate operations in Argentina (sold March 2001).

### Financial Information<sup>1</sup>

| (NZ\$million) 12 months to   | Forest and Logs <sup>2</sup> |        |        | Forest and Logs<br>Consolidation Adjustment <sup>3</sup> |        |        | Forest and Logs<br>Total |        |        |
|--|------------------------------|--------|--------|--|--------|--------|--------------------------|--------|--------|
|  | Jun 01                       | Jun 00 | Jun 99 | Jun 01   | Jun 00 | Jun 99 | Jun 01                   | Jun 00 | Jun 99 |
|  | Operating Revenue            | 298    | 278    | 243  |        |        |                          | 298    | 278    |
| Earnings before Interest, Taxation,<br>Depreciation and Depletions (EBITD) | -757                         | 93     | 72     | -193   |        |        | -950                     | 93     | 72     |
| less Depletions  | 47                           | 49     | 46     | 39   | 41     | 39     | 86                       | 90     | 85     |
| less Depreciation  | 11                           | 10     | 9      |  |        |        | 11                       | 10     | 9      |
| Earnings before Interest and Tax (EBIT)                                    | -815                         | 34     | 17     | -232   | -41    | -39    | -1,047                   | -7     | -22    |
| Unusual Items included within EBIT <sup>4</sup>                            | -827                         | -4     | -19    | -193   |        |        | -1,020                   | -4     | -19    |
| Cash Flow from Operations  | 28                           | 89     | 78     | 61   | 56     | 64     | 89                       | 145    | 142    |
| Capex – Forest Maintenance   | 18                           | 21     | 21     |  |        |        | 18                       | 21     | 21     |
| Capex – Other  | 7                            | 14     | 17     |  |        |        | 7                        | 14     | 17     |
| Assets   | 1,787                        | 2,296  | 2,045  |  | 641    | 555    | 1,787                    | 2,937  | 2,600  |

### Financial Information<sup>1</sup>

| (NZ\$million) 12 months to   | Processing and Distribution <sup>2</sup> |        |        | Processing and Distribution<br>Consolidation Adjustment <sup>3</sup> |        |        | Processing and Distribution<br>Total |        |        |
|--|--|--------|--------|--|--------|--------|--------------------------------------|--------|--------|
|  | Jun 01                                   | Jun 00 | Jun 99 | Jun 01   | Jun 00 | Jun 99 | Jun 01                               | Jun 00 | Jun 99 |
|  | Operating Revenue                        | 350    | 345    | 266  |        |        |                                      | 350    | 345    |
| Earnings before Interest, Taxation,<br>Depreciation and Depletions (EBITD) | 30                                       | 41     | 21     |  |        |        | 30                                   | 41     | 21     |
| less Depletions  |  |        |        |  |        |        |                                      |        |        |
| less Depreciation  | 14                                       | 9      | 10     | 1  | 1      | 1      | 15                                   | 10     | 11     |
| Earnings before Interest and Tax (EBIT)                                    | 16                                       | 32     | 11     | -1   | -1     | -1     | 15                                   | 31     | 10     |
| Unusual Items included within EBIT   | -1                                       |        | -8     |  |        |        | -1                                   |        | -8     |
| Cash Flow from Operations  | 15                                       | 38     | 29     |  |        |        | 15                                   | 38     | 29     |
| Capex  | 6  | 15     | 9      |  |        |        | 6                                    | 15     | 9      |
| Assets   | 245                                      | 236    | 188    | 5  | 6      | 7      | 250                                  | 242    | 195    |

### Processing and Distribution Total by Strategic Business Unit

| (NZ\$million) 12 months to   | Australasian<br>Consumer Solutions |        |        | North American<br>Consumer Solutions |        |        | Japanese and Asian<br>Consumer Solutions |        |        |
|--|------------------------------------|--------|--------|--------------------------------------|--------|--------|--|--------|--------|
|  | Jun 01                             | Jun 00 | Jun 99 | Jun 01                               | Jun 00 | Jun 99 | Jun 01                                   | Jun 00 | Jun 99 |
|  | <b>Financial Information</b>       |        |        |                                      |        |        |  |        |        |
| Operating Revenue  | 150                                | 161    | 139    | 147                                  | 131    | 117    | 53                                       | 53     | 10     |
| Earnings before Interest, Taxation,<br>Depreciation and Depletions (EBITD) | 15                                 | 22     | 24     | 18                                   | 19     | 9      | -3                                       |        | -12    |
| less Depletions  |                                    |        |        |                                      |        |        |  |        |        |
| less Depreciation  | 9                                  | 6      | 7      | 5                                    | 3      | 3      | 1  | 1      | 1      |
| Earnings before Interest and Tax (EBIT)                                    | 6                                  | 16     | 17     | 13                                   | 16     | 6      | -4                                       | -1     | -13    |
| Unusual Items included within EBIT   | -1                                 |        |        |                                      |        |        |  |        | -8     |
| Cash Flow from Operations  | 16                                 | 22     | 24     | 2                                    | 17     | 9      | -3                                       | -1     | -4     |
| Capex  | 3                                  | 8      | 4      | 2                                    | 5      | 4      | 1  | 2      | 1      |
| Assets   | 115                                | 121    | 107    | 105                                  | 99     | 79     | 30                                       | 22     | 9      |

(1) Excludes the South American operations (2000: EBIT \$11 million, Assets \$29 million).

(2) Forest and Logs includes the following amounts in the twelve months to June 2001 associated with the CNIFP. Operating Revenue, EBITD and EBIT include \$26 million (2000: \$42 million) of accrued interest income on the loans to the CNIFP. EBITD and EBIT include a write down of Fletcher Challenge Forests' investment in the CNIFP of \$768 million. Assets include \$357 million representing loans to the CNIFP. The segmental split for June 2000 has been restated for certain comparatives.

(3) The consolidation adjustments represent the reconciling entries between the pro forma Forests Division and the Fletcher Challenge Forests Group Financial Information from Continuing Operations.

(4) Forest and Logs includes non-recurring items of \$13 million in June 1999.

## Fletcher Challenge Forests – FORESTS DIVISION PRO FORMA FINANCIAL INFORMATION

The following Statement of Financial Performance has been prepared on a pro forma basis to provide comparative information to the Forests Division financial statements previously published in the Fletcher Challenge Group Financial & Operating Report.

| STATEMENT OF FINANCIAL PERFORMANCE | For year ended 30 June |                      |                      |
|------------------------------------|------------------------|----------------------|----------------------|
|                                    | 2001<br>NZ\$ million   | 2000<br>NZ\$ million | 1999<br>NZ\$ million |
| Operating Revenue                  | 648                    | 623                  | 545                  |
| Operating Expenses                 |                        |                      |                      |
| Recurring                          | -619                   | -553                 | -413                 |
| Unusual Items                      | -828                   | 7                    |                      |
| Operating Earnings                 | -799                   | 77                   | 132                  |
| Forest Crop Revaluation            | -56                    |                      |                      |
| Earnings before Taxation           | -855                   | 77                   | 132                  |
| Taxation                           | 125                    | 106                  | 22                   |
| Earnings after Taxation            | -730                   | 183                  | 154                  |
| Minority Interest                  | -5                     | -2                   |                      |
| Equity Earnings                    | -14                    | -100                 | -99                  |
| Net Earnings <sup>1,2</sup>        | -749                   | 81                   | 55                   |

(1) The Pro Forma Forests Division Net Earnings include the following non-trading adjustments:

|   |      |     |     |
|---|------|-----|-----|
| Net Earnings  | -749 | 81  | 55  |
| Less Write down of investment in Central North Island Forest Partnership                          | 533  | 42  | 21  |
| Less Other unusual items and write downs (net of taxation)  | 39   | -7  | -70 |
| Less Forest Revaluation adjustments (net of taxation)   | 174  |     |     |
| Less Taxation allowance adjustment  |      | -93 |     |
| Net Earnings before write downs, unusual items and forest revaluation on a Forests Division basis | -3   | 23  | 6   |

(2) Included within Operating Earnings are the following Unusual Items:

- Gain on Disposal of Affiliates in June 2001 relating to the gain on the sale of biotechnology and South American assets of \$26 million (\$25 million net of taxation).
- Restructuring Costs in June 2001 of \$63 million (\$55 million net of taxation) and in June 2000 of \$4 million associated with the separation of the Fletcher Challenge targeted share structure.
- Permanent Impairment in June 2001 relating to the investment in the Central North Island Forest Partnership of \$768 million (\$533 million net of taxation), the New Zealand forest estate of \$14 million (\$11 million net of taxation) and Tasman KB of \$1 million.
- Other Gains/(Losses) for June 2001 relating to provisions established to cover costs for defending the claims of CITIC New Zealand Limited of \$5 million and the write off of a debtor of \$3 million related to the Chilean forestry operations. Other Gains/(Losses) for June 2000 relating to the receipt of Chile forest fire insurance proceeds of \$11 million.

## Supplementary Forest Information

### Forest Valuation

A market based valuation of the company's forests was undertaken by the Directors as at 30 June 2001 and incorporated in the Statement of Financial Position.

The Directors' valuation is determined for different age classes, as follows:

- *Age Class (1-5 years)*  
Compound current standard growing costs.
- *Age Class (6-15 years)*  
Progressive weighting of compound costs and net present value of future net cash flows.
- *Age Class (16+ years)*  
Net present value of future cash flows.

The net present value is calculated using a real after tax discount rate of 7.5% and costs are compounded at an annual rate of 5%. This produces an equivalent value to discounting the future cash flows for all age classes using a discount rate of 8.4%.

The valuation includes an annual charge for the holding cost of land equal to the discount rate of return. The land value used is the current Government valuation less an allowance of 10% for an expected decline in land values as a result of the lower product prices that have prevailed over the last three years.

Other key assumptions on which the valuation is based are that:

- the existing tree crop only is valued. No account is taken of the revenues or costs from re-establishment following harvest.
- cash flows are fully taxed at the corporate rate, taking into account the deductions that would be available to a purchaser.
- prices are based on the average NZ dollar prices achieved in the current and the preceding 11 quarters, for each of the main log grades.
- all prices and costs are expressed in current dollar terms and no allowance is made for changes in future prices or costs due to inflation or any other factor.

### Valuation by age class

The following table summarises the valuation by age class:

|               | ha (000) | 2001<br>NZ\$mill | NZ\$/ha <sup>1</sup> |
|---------------|----------|------------------|----------------------|
| 1-5 years     | 19       | 23               | 1,200                |
| 6-10 years    | 16       | 45               | 2,800                |
| 11-15 years   | 24       | 180              | 7,300                |
| 16-20 years   | 32       | 376              | 11,900               |
| 21-25 years   | 20       | 386              | 18,900               |
| Over 25 years | 5        | 113              | 22,900               |
|               | 116      | 1,123            | 9,700                |

(1) Weighted Average

### Projected Harvest Volumes

The following table summarises the projected harvest volume from the existing crop (millions m<sup>3</sup>):

|                | 2002-2006 | 2007-2011 | 2012-2016 | 2017-2021 | 2022-2026 | 2027-2031 | Total |
|----------------|-----------|-----------|-----------|-----------|-----------|-----------|-------|
| <b>Radiata</b> |           |           |           |           |           |           |       |
| Pruned         | 0.9       | 2.6       | 2.5       | 1.8       | 1.8       | 0.3       | 9.9   |
| Structural     | 0.9       | 2.0       | 3.1       | 2.2       | 1.5       | 0.2       | 9.9   |
| Utility        | 4.0       | 3.8       | 4.1       | 4.1       | 3.5       | 0.4       | 19.9  |
| Industrial     | 1.5       | 2.3       | 2.5       | 2.2       | 1.9       | 0.2       | 10.6  |
| Pulp           | 2.5       | 2.7       | 2.8       | 2.5       | 1.9       | 0.2       | 12.6  |
| Other Species  | 0.2       | 0.2       | 0.1       | 0.0       | 0.0       | 1.1       | 1.6   |
|                | 10.0      | 13.6      | 15.1      | 12.8      | 10.6      | 2.4       | 64.5  |

### Log Prices

The following table summarises the delivered prices (at wharf/mill) adopted for the valuation:

| Grade                  | 12 Quarter<br>NZ\$/m <sup>3</sup> | June 2001<br>Quarter <sup>1</sup><br>NZ\$/m <sup>3</sup> |
|------------------------|-----------------------------------|--|
| <b>Radiata</b>         |                                   |  |
| Pruned                 | 177                               | 168  |
| Structural             | 108                               | 107  |
| Utility                | 102                               | 100  |
| Industrial             | 61                                | 54   |
| Pulp                   | 56                                | 54   |
| Other Species          | 116                               | 105  |
| Weighted Average Price | 100                               | 96   |

(1) Included in 12 Quarter series

### Sensitivity of Valuation to Changes in Key Assumptions

| Impact on Crop Valuation |       | NZ\$mill |
|--------------------------|-------|----------|
| <b>Price</b>             |       |          |
| 10% increase             | plus  | \$168    |
| 10% decrease             | minus | \$152    |
| <b>Discount Rate</b>     |       |          |
| 50 basis points increase | minus | \$36     |
| 50 basis points decrease | plus  | \$45     |

## Fletcher Challenge Forests Group – CONDENSED FINANCIAL STATEMENTS

(Extracted from Audited Financial Statements)

| STATEMENT OF FINANCIAL PERFORMANCE                     | For year ended 30 June |                      |                      |
|--|------------------------|----------------------|----------------------|
|  | 2001<br>US\$ million   | 2001<br>NZ\$ million | 2000<br>NZ\$ million |
| Operating Revenue                                      | 263                    | 648                  | 623                  |
| Operating Expenses                                     | -683                   | -1,680               | -588                 |
| Operating Earnings (EBIT) <sup>1</sup>                 | -420                   | -1,032               | 35                   |
| Forest Crop Revaluation <sup>2</sup>                   | -254                   | -625                 |                      |
| Earnings before Taxation                               | -674                   | -1,657               | 35                   |
| Taxation   | 116                    | 285                  | 102                  |
| Earnings after Taxation                                | -558                   | -1,372               | 137                  |
| Minority Interest                                      | 4                      | 9                    | -1                   |
| Equity Earnings <sup>3</sup>                           | -6                     | -14                  | -100                 |
| Net Earnings from Continuing Operations                | -560                   | -1,377               | 36                   |
| Net Earnings from Discontinued Operations <sup>4</sup> | 161                    | 396                  | 533                  |
| Taxation from Discontinued Operations                  | -102                   | -252                 | -187                 |
| Gain on Disposal of Discontinued Operations            | 458                    | 1,126                |                      |
| Net Earnings   | -43                    | -107                 | 382                  |

## PER SHARE INFORMATION – CONTINUING OPERATIONS

|   |       |       |      |
|---|-------|-------|------|
| Basic Net Earnings per Share (cents)                              | -30.0 | -73.9 | 4.3  |
| Diluted Net Earnings per Share (cents) <sup>5</sup>               | -30.0 | -73.9 | 4.0  |
| Net Assets per Fletcher Challenge Forests Share (\$)              | 0.20  | 0.50  | 2.24 |
| Share weighting used for – Basic Net Earnings per Share (million) | 1,864 | 1,864 | 846  |
| – Diluted Net Earnings per Share (million)                        | 1,864 | 1,864 | 897  |
| – Net Assets per Share (million)                                  | 2,789 | 2,789 | 848  |

(1) Included within Operating Earnings are the following Unusual Items:

- Gain on Disposal of Affiliates in June 2001 relating to the gain on the sale of biotechnology and South American assets of \$26 million.
- Restructuring Costs in June 2001 of \$63 million and in June 2000 of \$4 million associated with the separation of the Fletcher Challenge targeted share structure.
- Permanent impairment in June 2001 relating to the investment in the Central North Island Forest Partnership of \$768 million, the New Zealand forest estate of \$207 million and Tasman KB of \$1 million.
- Other Gains/(Losses) for June 2001 relating to provisions established to cover costs for defending the claims of CITIC New Zealand Limited of \$5 million and the write off of a debtor of \$3 million related to the Chilean forestry operations. Other Gains/(Losses) for June 2000 relating to the receipt of Chile forest fire insurance proceeds of \$11 million.

(2) On 30 June 2001, the Group changed its accounting policy in respect of the carrying value of forest crop from a historical cost to a market value basis. This change in accounting policy resulted in a pre tax devaluation to the forest crop of \$625 million. Refer to "Supplementary Forest Information – Forest Valuation" on page 16.

(3) Included within Equity Earnings for June 2000 is a \$62 million write down in the carrying value of the investment in the Central North Island Forest Partnership.

## Fletcher Challenge Forests Group – CONDENSED FINANCIAL STATEMENTS

(Extracted from Audited Financial Statements)

| STATEMENT OF MOVEMENTS IN EQUITY                                       | For year ended 30 June |                      |                      |
|--|------------------------|----------------------|----------------------|
|  | 2001<br>US\$ million   | 2001<br>NZ\$ million | 2000<br>NZ\$ million |
| Total Group Equity and Capital Funds at the beginning of the year      | 3,834                  | 9,431                | 7,451                |
| Opening adjustment on adoption of SFAS 133                             | -69                    | -169                 |                      |
|  | 3,765                  | 9,262                | 7,451                |
| Net Earnings   | -43                    | -107                 | 382                  |
| Revaluation of Investments   | -76                    | -187                 | 714                  |
| Net Movement in Cash Flow Hedges                                       | -7                     | -18                  |                      |
| Reversal of Revaluation Reserve upon Disposal of Investment            | -128                   | -316                 |                      |
| Movement in Currency Translation Reserve                               | 302                    | 745                  | 708                  |
| Total Recognised Revenues and Expenses for the year                    | 48                     | 117                  | 1,804                |
| Disposal of Fletcher Challenge Building, Energy and Paper <sup>4</sup> | -3,132                 | -7,706               |                      |
| Movement in Minority Equity  | 24                     | 59                   | 266                  |
| Movement in Reported Capital   | 225                    | 553                  | 119                  |
| Movement in Capital Funds  | -311                   | -766                 | -56                  |
| Dividends and Distributions  | -38                    | -90                  | -153                 |
| Total Group Equity and Capital Funds                                   | 581                    | 1,429                | 9,431                |

- (4) In April 2000 the Board of Directors of Fletcher Challenge announced that it had entered into an agreement to sell Fletcher Challenge Paper to Norske Skog. Subsequent to 30 June 2000, the transaction was approved by Fletcher Challenge Shareholders, final orders were granted by the High Court and settlement occurred on 28 July 2000. In October 2000 recommendations were announced for the remaining Divisions: Building, Energy and Forests; the Separation process. With an effective date of 23 March 2001, Fletcher Challenge Building became a newly created stand-alone publicly listed company, Fletcher Building Limited; Fletcher Challenge Energy was sold to Shell and Apache Corporation; and a new publicly listed company was created, Rubicon Limited. Holders of Fletcher Challenge Building Shares received, in exchange for each Fletcher Challenge Building Share, one fully paid share in Fletcher Building Limited. The former operations of Fletcher Challenge Building, Energy and Paper are referred to as Discontinued Operations. Fletcher Challenge Forests remains as the continuing business of Fletcher Challenge Limited, renamed Fletcher Challenge Forests Limited. Fletcher Challenge Forests Shareholders continue to hold existing Fletcher Challenge Forests Ordinary and Preference Shares.
- (5) Capital Notes and Options, convertible to shares, are considered dilutive securities for the purpose of calculating Diluted Net Earnings per Share under SFAS 128 "Earnings per Share".

In the year ended 30 June 2001, the Group changed its accounting policy in respect to the carrying value of the forest crop from a historical cost basis to a market value basis. In addition, the Group adopted SFAS 133 "Accounting for Derivative Instruments and Hedging Activities". SFAS 133 requires existing derivative financial instruments to be recorded at fair value and for deferred gains and losses previously recognised in the Statement of Financial Position to be reversed. The financial impact of adopting SFAS 133 on Discontinued Operations was a \$187 million reduction in Group Equity and an immaterial impact on the Statement of Financial Performance. There was no impact on the Statement of Cash Flows. The adoption of SFAS 133 has not had a significant impact on Continuing Operations. The remaining accounting policies used in these Financial Statements are consistent with those used in the previously published Annual Financial & Operating Report.

## Fletcher Challenge Forests Group – CONDENSED FINANCIAL STATEMENTS

(Extracted from Audited Financial Statements)

## STATEMENT OF FINANCIAL POSITION

|   | As at 30 June        |                      |                      |
|---|----------------------|----------------------|----------------------|
|   | 2001<br>US\$ million | 2001<br>NZ\$ million | 2000<br>NZ\$ million |
| <b>Assets</b>                                 |                      |                      |                      |
| Cash and Liquid Deposits                      | 21                   | 51                   | 6                    |
| Stocks  | 31                   | 77                   | 66                   |
| Debtors                                       | 20                   | 50                   | 83                   |
| Current Assets – Discontinued Operations      | 23                   | 56                   | 3,333                |
| <b>Total Current Assets</b>                   | <b>95</b>            | <b>234</b>           | <b>3,488</b>         |
| Fixed Assets                                  | 146                  | 358                  | 338                  |
| Plantation Forest Crop                        | 456                  | 1,123                | 1,648                |
| Investments                                   | 154                  | 378                  | 1,067                |
| Term Assets – Discontinued Operations         |                      |                      | 9,916                |
| <b>Total Group Assets</b>                     | <b>851</b>           | <b>2,093</b>         | <b>16,457</b>        |
| <b>Liabilities</b>                            |                      |                      |                      |
| Short Term Loans                              |                      |                      | 1                    |
| Creditors                                     | 44                   | 108                  | 104                  |
| Provision for Current Taxation                |                      |                      | 1                    |
| Current Liabilities – Discontinued Operations | 23                   | 56                   | 1,896                |
| <b>Total Current Liabilities</b>              | <b>67</b>            | <b>164</b>           | <b>2,002</b>         |
| Term Debt                                     | 152                  | 374                  | 776                  |
| Provision for Deferred Taxation               | 51                   | 126                  | 387                  |
| Term Liabilities – Discontinued Operations    |                      |                      | 3,861                |
| <b>Total Group Liabilities</b>                | <b>270</b>           | <b>664</b>           | <b>7,026</b>         |
| <b>Group Equity</b>                           |                      |                      |                      |
| Reported Capital                              | 587                  | 1,443                | 2,864                |
| Reserves                                      | -18                  | -44                  | 3,633                |
| <b>Group Equity</b>                           | <b>569</b>           | <b>1,399</b>         | <b>6,497</b>         |
| Group Capital Funds                           |                      |                      | 766                  |
| <b>Group Equity and Capital Funds</b>         | <b>569</b>           | <b>1,399</b>         | <b>7,263</b>         |
| Minority Equity                               | 12                   | 30                   | 2,168                |
| <b>Total Group Equity and Capital Funds</b>   | <b>581</b>           | <b>1,429</b>         | <b>9,431</b>         |
| <b>Total Group Liabilities and Equity</b>     | <b>851</b>           | <b>2,093</b>         | <b>16,457</b>        |

In December 1999 the following significant contingent liability arose: CITIC New Zealand Limited (CITIC), the Group's 50% partner in the Central North Island Forest Partnership (the CNIFP) filed significant claims against Fletcher Challenge Forests in connection with the CNIFP, not all of which have been formally quantified. The claims relate to a number of issues in connection with the management of the CNIFP and to the valuation of the assets purchased by CITIC from the Group upon the establishment of the CNIFP. CITIC also sought termination of the management contract held by Fletcher Challenge Forests. It remains Fletcher Challenge Forests' view that these claims are substantially without merit and they will be vigorously defended. A provision of \$5 million was established at 31 December 2000 to cover the costs of that defence.

## Fletcher Challenge Forests Group – CONDENSED FINANCIAL STATEMENTS

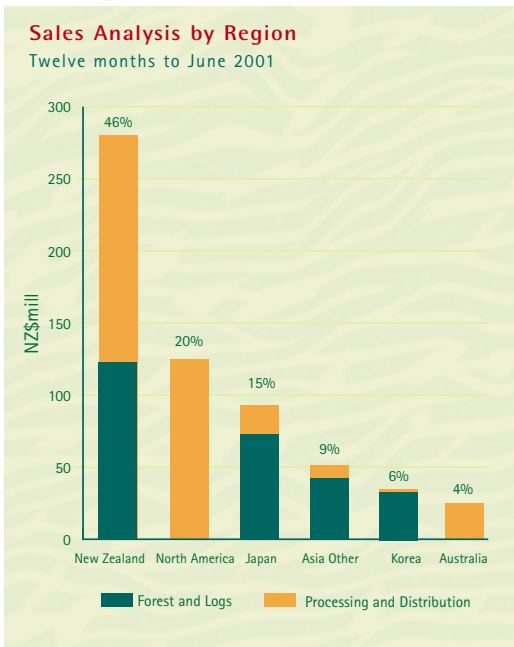
(Extracted from Audited Financial Statements)

| STATEMENT OF CASH FLOWS  | For year ended 30 June |                      |                      |
|--|------------------------|----------------------|----------------------|
|  | 2001<br>US\$ million   | 2001<br>NZ\$ million | 2000<br>NZ\$ million |
| Cash Provided from Operating Activities                        | 290                    | 713                  | 625                  |
| Cash Applied to Operating Activities                           | -261                   | -641                 | -501                 |
| Net Cash from Operating Activities                             | 29                     | 72                   | 124                  |
| Sale of Fixed Assets   | 33                     | 80                   | 1                    |
| Sale of Subsidiaries   |                        |                      | 84                   |
| Sale of Taxation Benefits                                      | 13                     | 33                   |                      |
| Interest Paid Capitalised in Fixed Assets                      | -45                    | -111                 | -108                 |
| Forest Maintenance   | -7                     | -18                  | -21                  |
| Purchase of Fixed Assets                                       | -6                     | -14                  | -29                  |
| Purchase of Investments  | -5                     | -12                  | -18                  |
| Net Cash from Investing Activities                             | -17                    | -42                  | -91                  |
| Issue of Shares  | 205                    | 504                  |                      |
| Net Debt Settlements   | -197                   | -485                 | -29                  |
| Dividends  | -2                     | -4                   | -2                   |
| Net Cash from Financing Activities                             | 6                      | 15                   | -31                  |
| Net Cash from Discontinued Operations                          | -425                   | -1,046               | 20                   |
| Net Movement in Cash Held                                      | -407                   | -1,001               | 22                   |
| Add Opening Cash and Liquid Deposits                           |                        |                      |                      |
| – Continuing Operations  | 3                      | 6                    | 4                    |
| – Discontinued Operations                                      | 426                    | 1,047                | 897                  |
| Effect of Exchange Rate Changes on Net Cash                    |                        |                      |                      |
| – Discontinued Operations                                      | 18                     | 46                   | 130                  |
| Closing Cash and Liquid Deposits – Discontinued Operations     | 19                     | 47                   | 1,047                |
| Closing Cash and Liquid Deposits – Continuing Operations       | 21                     | 51                   | 6                    |
| Net Earnings   | -560                   | -1,377               | 36                   |
| Adjustment for Items not involving Cash:                       |                        |                      |                      |
| Depreciation, Depletions, Amortisation and Provisions          | 703                    | 1,729                | 106                  |
| Interest Capitalised from Discontinued Operations              | 25                     | 61                   | 56                   |
| Taxation   | -117                   | -288                 | -106                 |
| Minority Interest  | -4                     | -9                   | 1                    |
| Equity Earnings  | 6                      | 14                   | 100                  |
| Less Gain on Disposal of Affiliates and Fixed Assets           | -11                    | -26                  | -10                  |
| Cash Flow from Operations before Net Working Capital Movements | 42                     | 104                  | 183                  |
| Net Working Capital Movements                                  | -13                    | -32                  | -59                  |
| Net Cash from Operating Activities                             | 29                     | 72                   | 124                  |

The US dollar amounts have been included solely for convenience, and are converted from NZ dollars at a rate of US\$0.4065 : NZ\$1.00.

# GLANCE

Forests at a Glance



**New Zealand**

Logs, lumber, panels and outdoor treated products for building/ construction and industrial use. Wood chips for industrial use.

**North America**

Mouldings, appearance grade lumber and other products for the housing and do-it-yourself markets.

**Japan**

Logs for packaging. Logs and laminated lumber for housing/construction.

**Asia Other**

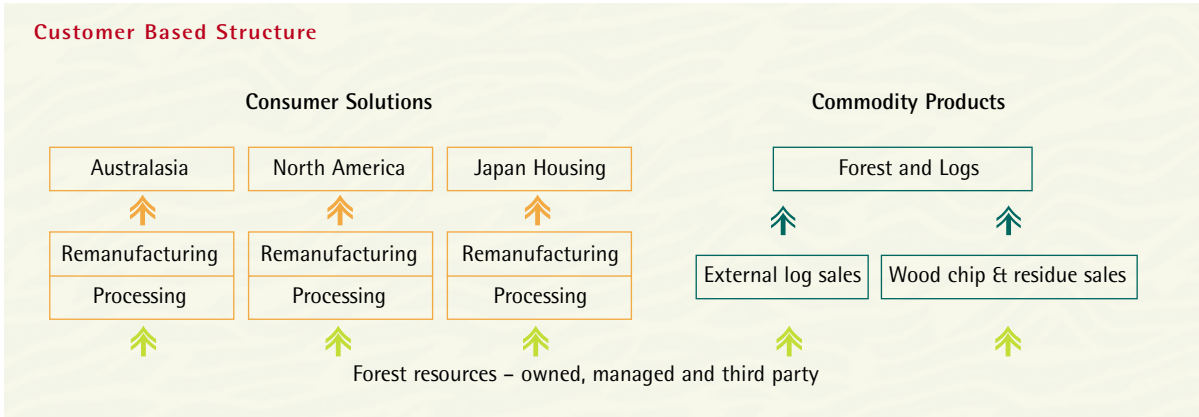
Logs and lumber for packaging, temporary construction and furniture.

**Korea**

Logs and lumber for packaging and temporary construction.

**Australia**

Lumber for building/construction.



## Manufacturing

| Processing                        | Products   | Capacity (m <sup>3</sup> /year) |
|-----------------------------------|--|---------------------------------|
| <b>Fletcher Challenge Forests</b> |  |                                 |
| Kawerau Sawmill                   | Kiln-dried stress-graded framing for New Zealand and Australia.<br>Feedstock for Kawerau and Waipa Remanufacturing Plants.<br>Other structural lumber.   | 240,000                         |
| Rainbow Mountain Sawmill          | Kiln-dried stress-graded framing for New Zealand and Australia.<br>Outdoor treated lumber products.  | 200,000                         |
| Taupo Sawmill                     | North American appearance grades. Feedstock for Taupo Mouldings Plant.   | 180,000                         |
| Mt Maunganui Plywood Mill         | Standard and treated structural plywood. Dried veneer. Joist I-beams.  | 29,000                          |
| Kawerau Remanufacturing Plant     | Finger-jointed and laminated lumber for Japanese housing markets.  | 38,000                          |
| Taupo Mouldings Plant             | Solid lineal mouldings for North American homes.   | 32,000                          |
| Ramsey Roundwood                  | Posts and poles, landscaping and outdoor treated products.   | 60,000                          |
| <b>CNIFP (in Receivership)</b>    |  |                                 |
| Waipa Sawmill*                    | Structural Douglas fir lumber. Feedstock for finger-jointed millwork and Kawerau Remanufacturing Plant. Australia and New Zealand appearance and remanufacturing grades. New Zealand and Asia packaging. | 250,000                         |
| Waipa Remanufacturing Plant*      | Solid and finger-jointed kiln-dried studs and components for structural applications.  | 44,000                          |
| Mt Maunganui Wood Processing*     | Blanks and finger-jointed mouldings.   | 24,000                          |

\*Fletcher Challenge Forests manages these plants.

## Forest Growing

| Forest Estate              | Thousand hectares |           |            |
|----------------------------|-------------------|-----------|------------|
|                            | Owned             | Managed   | Total      |
| Fletcher Challenge Forests | 110               | 6         | 116        |
| CNIFP (in Receivership)    | 81                | 81        | 162        |
| <b>Total</b>               | <b>191</b>        | <b>87</b> | <b>278</b> |
| Total in thousand acres    | 472               | 215       | 687        |

| Annual Harvest              | Thousand m <sup>3</sup> |              |              |
|-----------------------------|-------------------------|--------------|--------------|
|                             | Owned                   | Managed      | Total        |
| Fletcher Challenge Forests  | 1,400                   | 100          | 1,500        |
| CNIFP (in Receivership)     | 1,800                   | 1,800        | 3,600        |
| <b>Total</b>                | <b>3,200</b>            | <b>1,900</b> | <b>5,100</b> |
| Total in million board feet | 640                     | 380          | 1,020        |

## Investor Information

# INVESTOR

The company publishes Annual and Interim Reviews and an Annual Financial & Operating Report. The Annual Review for the year to June 2001 contains:

- Summary financial statements for Fletcher Challenge Forests Limited (formerly Fletcher Challenge Limited) which includes discontinued (Paper, Building and Energy) operations; and
- Pro forma financial statements for the former Fletcher Challenge Forests Division. These pro forma statements represent the results for the year to June 2001 on a consistent basis to the former Forests Division.

Copies of the Reviews and Financial & Operating Report are available on the Fletcher Challenge Forests Limited website, [www.fcf.co.nz](http://www.fcf.co.nz).

### 2001–2002 Calendar:

- Mailing of Annual Financial & Operating Report: September/October 2001
- Proxy Deadline: 2.00pm 12 November 2001
- Half Year End: 31 December 2001
- Interim Results Announcement: February 2002
- Financial Year End: 30 June 2002

### Annual Shareholders' Meeting:

The Annual Shareholders' Meeting of Fletcher Challenge Forests Limited will be held at Eden Park, ASB Bank Stand, Walters Road, Auckland, New Zealand, at 2.00pm on Wednesday 14 November 2001.

**Dividend:** There is no 2001 dividend for Fletcher Challenge Forests shareholders.

**Preference Shares:** Fletcher Challenge Forests Limited has two classes of shares: Ordinary and Preference. The Preference shares rank equally with the Ordinary share in all respects (including dividend and voting rights) except that the Preference share has prior ranking (to the amount of NZ\$0.25 per share) in the event of a liquidation of the company, for a period of five years from allotment (15 December 2000).

### Shareholder Transactions:

Shareholders with enquiries about share transactions, changes of address or dividend payments should contact the share registry in the country in which their shares are registered.

### Removal from Annual Review

**Mailing List:** Shareholders who do not wish to continue receiving the Interim or Annual Reviews should advise their share registry in writing. The Annual Financial & Operating Report will continue to be mailed to all registered shareholders in line with statutory requirements.

### Forward-Looking Statements:

Except to the extent that they relate to historical information, there are statements included in this document which are "forward-looking statements" as

defined in the U.S. Private Securities Litigation Reform Act of 1995, and they are included herein in reliance upon the safe harbours created by that Act. These forward-looking statements include, but are not limited to, statements under the headings "Chairman's Letter", "Chief Executive's Report" and "Management's Discussion and Analysis". As forward-looking statements are predictive in nature, they are subject to a number of risks and uncertainties relating to Fletcher Challenge Forests, its operations, the markets in which it competes and other factors (some of which are beyond the control of Fletcher Challenge Forests). As a result of the foregoing, actual results and conditions may differ materially from those expressed or implied by such statements. In particular Fletcher Challenge Forests' operations and results are significantly influenced by the level of building and export activity in the various sectors of the Australasian, Asian and North American economies in which it competes. Fluctuations in industrial output, commercial and residential construction activity, public sector spending on infrastructure, relative exchange rates, and interest rates in each market, can have a substantial impact on Fletcher Challenge Forests' results of operations and financial condition. Other risks include competitor product development and pricing, and losses due to fire, adverse weather or biological factors.

### American Depository Receipts:

Fletcher Challenge Forests Limited shares are traded in the USA on the NYSE in the form of American Depositary Shares (ADSs) and held in the form of American Depositary Receipts (ADRs). Each ADS represents 10 Forests ADR shares.

Fletcher Challenge Forests Limited has two ADR programmes:

- (a) CUSIP No. 339324420  
Ratio: 10 Forests common shares to 1 Forests ADR
- (b) CUSIP No. 339324704  
Ratio: 10 Forests Series A shares to 1 Forests ADR

The ADR programmes are administered by Citibank N.A.

To obtain further information about the programmes please contact:

Citibank, N.A.  
Depositary Receipts Services  
20th Floor, 111 Wall Street,  
New York, NY 10005, USA  
Telephone in USA or Canada:  
1 877 citi adr (1 877 248 4237) (toll free)  
E-mail: citibank@em.fcncd.com  
Website: www.citibank.com\adr

### Other Registry Enquiries:

*New Zealand*  
Computershare Registry Services Ltd  
Private Bag 92 119,  
Auckland  
Telephone: 64 9 488 8777  
Facsimile: 64 9 488 8787  
E-mail: crsnz@computershare.co.nz

*Australia*  
Computershare Registry Services Pty Ltd  
GPO Box 7045,  
Sydney, NSW 1115  
Telephone: 61 2 8234 5478  
Facsimile: 61 2 8234 5050

### Other Investor Enquiries:

*New Zealand or Internationally*  
Investor Relations Manager  
Fletcher Challenge Forests Limited  
Private Bag 92 036,  
Auckland 1030,  
New Zealand  
Telephone: 64 9 571 9800  
Facsimile: 64 9 571 9871  
E-mail: investor-relations@fcf.co.nz

*North America*  
Telephone in USA and Canada:  
1 866 289 5391 (toll free)

### General Enquiries:

Fletcher Challenge Forests Limited  
Private Bag 92 036,  
Auckland 1030,  
New Zealand

### Share Listings:

|            | New Zealand | Australia | New York |
|------------|-------------|-----------|----------|
| Ordinary   | FFS         | FFS       | FFS      |
| Preference | FFSPA       | FFSPA     | FFS.A    |

### Issued Share Capital (millions of shares):

|                     |              |
|---------------------|--------------|
| Ordinary shares     | 922          |
| Preference shares   | 1,859        |
| <b>Total shares</b> | <b>2,781</b> |

Fletcher Challenge Forests Limited is the residual entity of the former Fletcher Challenge Group, which previously consisted of four separately listed Divisions: Forests, Building, Energy and Paper. The Board of Directors announced in December 1999 its intention to dismantle this share structure, and in July 2000 the first stage of separation was completed with the sale of Fletcher Challenge Paper to Norske Skog. In March 2001, the separation of the remaining divisions – Building, Energy and Forests – was completed. This resulted in:

- Fletcher Challenge Building becoming a stand-alone company called Fletcher Building Limited;
- The sale of Fletcher Challenge Energy to Shell and Apache Corporation;
- The creation of a new company, Rubicon Limited; and
- Fletcher Challenge Forests remaining as the sole business of Fletcher Challenge, renamed Fletcher Challenge Forests Limited.

**Board of Directors:**

**Sir Dryden Spring, DSc (Hon), Chairman of Directors**  
*Committees:* Audit

Initially appointed 1999. Last re-elected 1999.

Sir Dryden, 61, is Chairman of WEL Energy Group and Ericsson Communications, and NZ Chairman of the APEC Business Advisory Council. He is Deputy Chairman of Goodman Fielder, and a Director of Nufarm, the National Bank of New Zealand, Fletcher

Building, Ericsson Synergy and Maersk New Zealand. Sir Dryden is a member of the New Zealand Business and Parliament Trust and Deputy Chairman of the Asia 2000 Foundation. He is a Distinguished Fellow of the Institute of Directors and a member of the Washington DC based International Policy Council on Agriculture, Food and Trade. Sir Dryden was Chairman of the New Zealand Dairy Board from 1989 to 1998, having been a Director since 1983 and was Chairman of the New Zealand Dairy Group from 1982 to 1989. He has also served on the Boards of the Rural Banking and Finance Corporation, Ports of Auckland and Affco New Zealand.



**Terrence Noel McFadgen, LLB (Hons) (Auckland), LLM (Harvard), Executive Director**  
Initially appointed 2001.

Mr McFadgen, 54, was appointed Chief Executive of Fletcher Challenge Forests in October 2000. He was previously Chief Executive of Fletcher Challenge Building, a position to which he was appointed in 1996. Mr McFadgen has held the position of

Commercial Director of the Construction and Property Division of Fletcher Challenge, Chief Executive Officer of Jennings Group (Australia) and he also headed the Fletcher Challenge Group's Executive Offices Department. Mr McFadgen was, until 1990, a senior partner at Simpson Grierson in Auckland and has worked with international law firms in New York and London.



**Michael John Andrews, MNZIF,**  
Non-Executive Director

*Committees:* Audit, Due Diligence, Remuneration  
Initially appointed 1990. Last re-elected 2000.

Mr Andrews, 61, retired as Chief Executive Officer of Fletcher Challenge in April 2001. He was acting Chief Executive Officer of Fletcher Building until July 2001. He was previously Divisional Chief Executive of

Fletcher Challenge Energy, Fletcher Challenge Forests and Fletcher Challenge Paper and previously Chief Executive Officer of the Solid Wood Forestry sector and before that of the former Energy and Resources Group. He is Chairman of Rubicon, the New Zealand Business Council for Sustainable Development, the New Zealand Wool Board Implementation Project Team and Industry New Zealand.



**Rodger Herbert Fisher, FCIS, Non-Executive Director**  
*Committees:* Audit, Due Diligence, Remuneration

Initially appointed 2001.

Mr Fisher, 55, practises as a business consultant. Prior to that he was Managing Director of Owens Group between 1987 and 1999. He is Chairman of the Civil Aviation Authority and the Aviation Security Services.

Mr Fisher is Deputy Chairman of WEL Energy Group and a Director of Waste Management (NZ). Mr Fisher is a Fellow of the Chartered Institute of Secretaries, the Chartered Institute of Transport, the Institute of Directors and the New Zealand Institute of Management.



**Stephen Nash Hurley, BA, MBA (Hons) (Harvard),**  
Non-Executive Director

Initially appointed 2001.

Mr Hurley, 58, has been an investor in the global forest products industry for over 25 years. He is the Founder, Chairman and Chief Executive of Xylem Investments, Inc., an international forestry investment firm based in Boston, Massachusetts. Prior to found-

ing Xylem Investments, Inc. in 1994, Mr Hurley was Principal, Director and Investment Committee Member of Resource Investments, Inc (RII – now know as UBS Brinson Resource Investments). Mr Hurley is a Director of Evergreen Forests, Wenita Forest Products Company and four South American forestry companies. Mr Hurley was previously a fund manager at Fidelity Investments, and prior to that he was a Vice President of JP Morgan Investment Management, Inc. Mr Hurley is a member of the Association of Investment Management and Research, the New York Society of Security Analysts and the New York Forests Products Analysts Group.



**Warren Arthur Larsen, MAgSc (Hons), BBS, CA,**  
Non-Executive Director

*Committees:* Audit, Remuneration

Initially appointed 2001.

Mr Larsen, 55, was Chief Executive of the New Zealand Dairy Board from 1992 until June 2001. He previously managed New Zealand Dairy Board's Protein Division, until his appointment as Chief

Executive in 1992. He was Chief Executive of Bay Milk Products until 1991, and received the New Zealand Dairy Industry Fellowship Award in 1985. Mr Larsen is a Director of Richmond Meats, Vending Technologies and Owens Group and a former director of PDL Holdings, Bonlac Foods and several dairy industry companies.



**Michael Carmody Walls, BA, LLB (VUW), LLM**  
(London), Non-Executive Director

*Committees:* Audit, Due Diligence

Initially appointed 2001.

Mr Walls, 56, practises as a business consultant.

He was previously the Managing Director, Investment Banking, for BZW New Zealand, and then for its successor, ABN AMRO New Zealand, from 1997 to

2000. Prior to that Mr Walls practised as a commercial lawyer at Chapman Tripp, where he was a partner from 1972 until 1996 specialising in mergers and acquisitions, international finance and corporate law. Mr Walls is a former Chairman of Directors of BHP NZ Steel Holdings, and a former Chairman of Directors of the listed Independent Press Communications (now Wilson & Horton Holdings). In addition, he has been a Director of a number of unlisted companies. He is the Chairman of the Board of the New Zealand Institute of Economic Research.

**Websites:**

The Fletcher Challenge Forests Limited website is located at: [www.fcf.co.nz](http://www.fcf.co.nz)



For Origin™ brand product information go to [www.origin.co.nz](http://www.origin.co.nz)

