

COMMISSION OF INQUIRY INTO
ASPECTS OF THE FORESTRY INDUSTRY

INTERIM REPORT NO 6

LOG MARKETING

VOLUME 3.
APPENDIX 5

STETTIN BAY LUMBER COMPANY PTY LTD.

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STETTIN BAY LUMBER CO PTY LTD

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APPENDIX 5

STETTIN BAY LUMBER CO. PTY LIMITED

INTRODUCTION

Nissho Iwai Corporation Limited (NIC) has been involved in the timber industry here since about 1963 when it commenced buying logs from Papua New Guinea. Its operational involvement began in about March 1970 when with the Development Bank of PNG it took over the logging and milling company Thomsen and Wright Pty Limited which was then operating in the Hoskins area of West New Britain Province. The name of the company was then changed to Stettin Bay Lumber Co Pty Limited (SBLC) and the company has expanded its involvement markedly from this small foundation.

In recent times SBLC has been the single largest exporter of logs from PNG, exporting from its concession areas in West New Britain. It has also engaged in the export of sawn timber to Australia and New Zealand and has been significantly involved in the establishment and maintenance of substantial reafforestation plantations in West New Britain. There are many aspects both positive and negative of SBLC's operations and activity which justified detailed study and reporting.

SBLC was particularly co-operative with the Commission and must be given full credit for that co-operation. It and its related companies Nissho Iwai HongKong Corporation Ltd (NIHK) and Nissho Iwai Australia Ltd (NIA) have endeavoured (with one notable exception) to promptly comply with every request made by the Commission for supply of information and

production of documents. This has included production of (six cartons of) invoices and shipping documents from Hong Kong for NIHK's resale of PNG logs between 1985 and 1987 and production of the bulk of like documents from Australia for NIA's resale of PNG sawn timber to Australia and New Zealand during 1986 and 1987.

The Commission could not have compelled production of these documents but SBLC arranged production voluntarily.

SBLC also arranged production of annual financial statements for NIHK which indicate the profitability of that company, its liability, to tax in Hong Kong and the tax rates applicable to it in Hong Kong.

The only exception has been production of NIHK invoices for resale of PNG logs during 1984 - a year when there was a good market and when SBLC showed a taxable profit in PNG.

CORPORATE BACKGROUND

Nissho Iwai Corporation Limited (NIC)

NIC is by any standards a massive corporation and is among the original and largest Japanese trading companies known as the Sogo Shosha. Its origins date back over 120 years.

The breadth of NIC's activities and magnitude of its international trading network and annual sales turnover are well outlined in its 1986 Annual Report (Schedule 1). NIC is said to be the seventh largest company in the world (outside the USA), is Japan's sixth largest trading corporation and is the largest timber trader among Japan's Sogo Shosha.

NIC's annual sales turnover in 1986 was USD52,809 million or in the order of fifty times the size of our National Budget.

Stettin Bay Lumber Co Pty Limited (SBLC)

SBLC was originally incorporated and operated as Thomsen and Wright Pty Limited. In March 1970 NIC in joint venture with the Development Bank of PNG made a takeover of Thomsen and Wright with NIC acquiring a 75% shareholding and the Development Bank a 25% shareholding. The name of the company was altered to SBLC.

Some time after this the shares held by the Development Bank became vested in the State which then became the 25% shareholder. In December 1987 SBLC was in a position where it required an injection of equity funds to provide an adequate capital base. Apparently its debt/equity ratio had risen to an unacceptably high level and capital was to be raised by a share issue which was proposed on a parity basis to preserve shareholder equities. The State was either not able or not willing to take up additional shares and the total capital injection was provided by NIC. As a result NIC increased its shareholding to 84.33% of the capital of SBLC and the State's share fell to 16.67%.

The additional shares available to the State were not offered to West New Britain Provincial Government or to a company representative of the landowners of SBLC's operating area and in this way an opportunity for local equity participation was lost and NIC increased its equity. SBLC bank borrowings in PNG are guaranteed by NIC alone and no guarantee has been sought from or given by the State.

Though the State has a representative on the Board of SBLC he is only a minority director and the State has no other involvement in SBLC's business affairs.

Nissho Iwai Hong Kong Corporation Ltd (NIHK)

NIHK was incorporated prior to 1960. Mr Simon Hirata the General Manager of SBLC (who began working for NIC in 1959) said NIHK had been established before he started working for NIC and he believed it was one of the first overseas subsidiary corporations established by NIC. NIHK is listed as a subsidiary in NIC's Annual Report for 1986 and from descriptions of its operational methods and its control by NIC Tokyo Office it is clearly controlled and probably 100% owned by NIC.

Mr Hirata described NIHK's role in NIC's lumber business as being the "financier and trade centre". He said that historically Japan had a tight and strict control system governing lumber imports. There was a system of quotas, credit restrictions, import licenses, controls on currency transactions and requirements for specifically obtained Japanese Government approvals which were not automatically given. At the same time Korean buyers only wanted to buy on credit terms (usually 90 days). These restrictions did not apply in Hong Kong where finance was readily available at comparatively lower interest rates. NIHK was established to take advantage of this position.

I did not test or examine the veracity of this explanation as Mr Hirata only asserted that it was historical and said these restrictions do not operate today and have not operated for some years.

All NIC purchases of South Seas logs were and are transacted through NIHK whether from PNG, Solomon Islands, Indonesia or the Philippines. It may be that Sabah and Sarawak purchases are now transacted through Singapore rather than NIHK.

As will be seen all SBLC sales are invoiced to NIHK which then reinvoices either to buyers or to its parent NIC. NIHK pays SBLC by prompt telegraphic transfer remittance. Mr Hirata says NIHK will load even if its buyers letter of credit is not in place and that this with prompt remittance gives SBLC security and assured cashflows.

Nissho Iwai Australia Ltd (NIA)

NIA is apparently a public listed company in Australia. It is shown in the 1986 NIC Annual Report as a subsidiary of NIC and is clearly controlled and at least majority owned by NIC. NIA is registered as a foreign company in PNG, has a branch office in Port Moresby, is NIDA registered and handles sawn timber sales for SBLC. Domestic sawn timber sales are handled by the Port Moresby branch office "at a nominal commission" and sawn timber exports to Australia and New Zealand were handled by the NIA office in Sydney Australia. Mr Hirata said SBLC commenced handling its own sawn timber exports from 1 April 1988.

MARKET POSITION OF NISSHO IWAI

In his report Ashenden (1983) described NIC as follows:

"Nissho Iwai" (Nissho Iwai Corporation)

- i) Sixth largest general trading company in Japan, with over 6000 employees and sales turnover around 8,000,000 million yen.
- ii) Largest single importer of milling logs in 1982 and third largest for South Seas logs.
- iii) Largest volume of PNG logs (with SBLC) and one of the largest for Solomon Islands from 1983. (Reported to have a 20 year exclusive contract with Integrated Forest Industries for 20,000 m³ per month from July 1983).
- iv) Active in selling PNG logs also to Korea, Taiwan and P.R. China. (In 1982 NIC volumes for SBLC logs were Japan 141,000, Korea 58,220 Taiwan 40,440, P.R.C. 10,580m³. They handled a further 15,000m³ into Japan from other producers, arranged by Weyerhauser, according to Mr Ohta),
- v) Reportedly has a joint venture agreement with Sanyo Kokusaku Pulp for afforestation in the Hoskins area of New Britain. (Ashenden Report (1983) Volume 2 page 86)

This proposed joint venture has not resulted but may explain SBLC's plantings in 1976 of trial plots of Kamarere in plantations which were intended for wood chips or pulp (see below).

Ashenden also reported that in 1982 NIC was Japan's largest log importer with total imports of 2,421,885 m³. It was Japan's third largest importer of South Seas Log Market logs with 931,463 m³ and the largest single importer of PNG logs with 161,656 m³ which represented 27.9% of PNG's total log exports for 1982.

(Ashenden Report (1983) Volume 2 page 87).

Thus in 1982 NIC's Japanese purchases represented 27.9% of PNG's total log exports but from NIC's point of view that represented only 17.36% of NIC's Japanese imports of logs from the South Seas Log Market and only 6.67% of NIC's total log imports.

In its 1986 Annual Report (Schedule 1 page 42) NIC says that it imported 2.7 million m³ of timber in 1985 with almost 1 million m³ coming from "Southeast Asia and other equatorial regions". In 1985 NIC purchased 184,567 m³ of PNG logs.

In round terms this represented 18% of NIC's tropical timber imports and about 6.8% of NIC's total timber imports.

These figures give an indication of the significance in volume terms of NIC to the PNG log market and of the relative significance in volume terms of PNG log exports to NIC.

NIC TRADING STRUCTURE

The corporate organisation of NIC is described in its 1986 Annual Report (Schedule 1 page 15). NIC is a trading corporation and its trading functions are divided into four main groups - Metals, Machinery, Energy and General Commodities. The Timber Division is one of five Divisions within the General Commodities Group.

The Lumber Division consists three Departments:-

- A. Softwoods
- B. Hardwoods
- C. Wood based building materials

Department C was only made part of the Lumber Division in 1986 (see Schedule 1 page 42).

The Hardwood Department (Department B) of the Lumber Division is divided into three Sections:-

- 1. Malaysia
- 2. PNG, Australia, Solomon Islands,
- 3. (Mr Hirata was not sure what this Division dealt with).

Log purchases from PNG are thus dealt with by Section 2 of Department B of the Lumber Division which forms part of the General Commodities Trading Group of NIC. In overall terms Mr Hirata says that NIC's lumber business accounts for about 3% of NIC's total sales turnover and that log exports from SBLC account for about 5 to 10% of the total NIC lumber business. These estimates appear quite accurate and this

means PNG log exports to NIC constitute about 0.15% to 0.3% of NIC's total sales turnover. Though SBLC log exports only represent a minuscule fraction of NIC's total sales turnover this does not mean that NIC regards SBLC as unimportant.

SBLC ranked a more than proportionate mention in NIC's 1986 Annual Report (Schedule 1 page 42) and like all the small elements which make up NIC's massive trading network appears to be accorded genuine importance by NIC. NIC's log sales business also involves two other Divisions of NIC. Mr Hirata said that NIHK and NIC do not just resell logs to anybody because most sales are made on credit. The creditworthiness of a proposed buyer of SBLC logs is thus carefully checked and established by the Credit and Investment Division of NIC's Finance, Accounting and Administration Group before the Lumber Divison receives permission to sell to that buyer.

SBLC sells its logs on an FOB basis to NIHK and shipping has to be arranged. The Lumber divison advises its shipping requirements to what Mr Hirata described as the "Shipping Department" which fixes log carrying vessels. In this organised way Mr Hirata says that SBLC obtains the benefit of the total corporate power of NIC in making its shipping arrangements. NIC itself clearly has interests in shipping and in shipping from the South Seas Log Market. One of its overseas joint venture companies Nippon Marine (of Panama) is a member party to the NANYOZAI Freight Agreement drawn up by regular ship operators involved in the South Seas Log Market.

All SBLC log exports are routinely invoiced by SBLC to NIHK and NIHK makes payment to SBLC. SBLC's communications on log sales are however made through or with NIC Tokyo and in particular with Lumber Department B Section 2. Price is fixed and shipping arrangements made through the Tokyo

Office. NIC does not itself utilise logs from PNG but resells them. Resales are also negotiated by the Tokyo office. SBLC sells to NIHK on an FOB basis but SBLC is liable for any demurrage charges incurred during loading in PNG. Any claims made by buyers are settled by Tokyo office.

It seems quite clear that NIHK is in effect a document clearing house which has an additional role in arranging finance. All agreements and arrangements for the purchase from SBLC, shipping, resale, claims etc are concluded by the Tokyo office.

Mr Hirata described the Hong Kong Office as being manned by one or two staff to deal with NIC's total lumber business transacted through Hong Kong. Mr Otah (SBLC's Marketing Manager) said there was only one Japanese Lumber Department employee and two or three local (Hong Kong) staff handling all NIC Lumber Department business in Hong Kong. All buyer documents are checked in the Tokyo office and it seemed clear Hong Kong staff merely performed "paper switching" tasks on the specific instructions of NIC Tokyo. A sequence of evidence from Mr Hirata underlines this:-

- A. We use Hong Kong for switching and because of cheaper finance;
- Q. Also because profit in Hong Kong is non taxable
- A. That reason was not explained to me

OPERATIONS IN PAPUA NEW GUINEA

Mr Hirata was involved from the beginning of NIC's contact with the PNG timber industry. He first came to PNG in 1963 and visited many times thereafter. As a result NIC (presumably through NIHK) began to import logs from PNG.

Operational involvement began in 1970 with the joint venture purchase of Thomsen and Wright which changed its name to SBLC.

Between 1970 and 1982 SBLC operated in the Talasea and Hoskins areas of West New Britain within the Hoskins Timber Rights Purchase Area (Bango, Witori, Mami, Galae, Malalimi, Mopili, Mosa, Wangore) of 69,080 hectares under Timber Permit 14-2 and then in the Kulu-Dagi Timber Rights Purchase Area (Bola, Honde, Laulimi, Kising, Keveloho) of 34,800 hectares under Timber Permit 14-21.

These early activities were not investigated.

In 1981 the very large Ania - Kapiura forest resource was advertised by DOF and SBLC lodged a proposal. That proposal was rejected by DOF but SBLC was invited to negotiate for the allocation to it of the Bilomi - Kapiura section of the Ania - Kapiura resource leaving the residue of that resource (which became known as Ania Fulleborne) for future allocation. The reasons for allocation of the Bilomi - Kapiura section to SBLC were said to be:-

- (a) to accommodate the Provincial Governments' desire for construction of the Ubae - Galai road through the Kapiura area including construction of the Kapiura, Aum and Fisi River bridges;
- (b) supplementing SBLC's diminishing resources "given the current rate of cut" and sustaining SBLC's processing operations at Buluma.

Negotiations for this arrangement commenced and it was proposed that Timber Permits 14-2 and 14-21 would be cancelled and a consolidated permit for the total areas to be operated would be issued.

Legal Basis of Operations - 1982 and Beyond

From the above sound legal basis of operations the operating base of SBLC deteriorated to an extent that can only be described as utterly illegal and totally ridiculous, particularly when the scale of operations is considered. This process began when, in advance of the preparation of the proposed consolidated Timber Permit, the then Minister for Forests, Lukas Waka, issued a "letter of intent" dated 8 September 1982 to SBLC (Schedule 2). The letter in its terms stated "As from the date you endorse this offer in this Letter of Intent the operational conditions stipulated in it will apply and supercede those of of Permits PT 14-2, 14-20 and 14-21".

The letter was accepted by SBLC on 15 October, 1982. Since this date no Timber Permit has been issued and this inadequate letter has been taken by SBLC as the basis for its operations.

That five pages of letter could be considered adequate to govern, even on an interim basis, the exploitation over 10 years of a resource of over 2 million m³ of timber to be cut at up to 250,000 m³ per year and with major local processing, road and bridge construction and reafforestation obligations is nothing short of irresponsible and incredible.

That, however, is what occurred and even today no Timber Permit has been issued.

The situation is a gross example of forest policy and procedures gone wrong.

The letter, as SBLC pointed out to the Commission, does not even deal with log marketing and imposes on SBLC no obligation to sell at "arms length" prices or to obtain the best available prices for its export logs. The lack of a Timber Permit issued pursuant to this "letter of intent" then became overwhelmed by events.

In June 1984 SBLC submitted a proposal for the Ania Fulleborne area to be added to the resource already "allocated" to it.

In February, 1985 another "letter of intent" was issued by Minister Lucas Waka which envisaged a project agreement to deal with this proposed massive project.

In April 1985 the matter was referred by Minister Waka to NEC (Schedule 3A) and in early May 1985 the NEC approved appointment of a State Negotiating Team to conclude a Project Agreement (Schedule 3B)

The long and arduous and, from SBLC's point of view, frustrating task of negotiations a Project Agreement began. In the meantime SBLC was conducting operations on the basis of the September 1982 "letter of intent". At the time SBLC witnesses gave evidence before the Commission in late April 1988 the Project Agreement was still in draft form with critical areas such as log export limitations, access to and ownership of trees in forest plantations, the Timber Permit, provision of a performance guarantee bond, termination provisions, a divestiture plan and periodic review procedures still not agreed between SBLC and the State.

At this time a "breaking point" in negotiations was the State's insistence that property in plantation trees was vested in the State despite earlier contrary indications to SBLC.

The history of negotiations, and the importance of the "breaking point" to SBLC is well described in SBLC's letter to Forests Minister Horik dated 13 April 1988 and its Annexures (Schedule 4) as is the magnitude of the total operation proposed.

The size, extent and complexity of SBLC's operations as at 1984 is well illustrated by its promotional brochure issued as at that date (Schedule 5)

The seriousness of such a large operation and undertaking continuing without a proper legal basis (ie a Timber Permit) cannot be underestimated. This situation continued from September 1982 to the present and even now, though it is understood that a Project Agreement has been concluded, no Timber Permit has yet been issued.

The project "informally" carried on involves:-

- (a) a 30 year project term with total expenditure of K244 million;
- (b) an area of over 400,000 hectares of land of which over 210,000 hectares is regarded as operable forest area
- (c) a gross natural forest resource of almost 7 million m³ of timber and extraction of over 5.1 million m³ of timber from natural forest and over 6.2 million m³ of timber from forest plantations over the 30 year term of which almost 2.3 million m³ will be processed onshore.
- (d) reafforestation involving planting 22,500 hectares of land at a cost of K75 million;

- (e) infrastructure in the form of roads, bridges, wharfing and public utilities estimated to cost almost K16 million in the first 13 years of the project.
- (f) revenue estimated at over K180 million to the National and Provincial Governments in the form of imposts over the project period.

The only operational control by DOF in the meantime has derived from the submission by SBLC to DOF and DOF approval of three (3) monthly Forest Working Plans, checking of road and bridge works and field monitoring supervision by the Provincial Forestry Staff.

SBLC, with an already substantial investment, has waited for 7 long years to obtain a legal basis for its substantial project. The situation is a disgrace. Less committed investors would surely have just walked away from the project.

OPERATING PERFORMANCE

SBLC has no follow up land use obligations, other than reafforestation, under any of the "letters of intent" or draft project agreement. It has substantial roadbuilding and bridging obligations, obligations over wharfage and berthing facilities, substantial onshore processing obligations and substantial reafforestation obligations. It also has very substantial log export entitlements.

SBLC claims that it has constructed and bridged over 60 km of the proposed Kimbe-Rabaul National Highway and some 700 km of provincial roads. Five permanent steel bridges have been constructed on the Bialla/Kimbe Highway. The highway and permanent bridges built appear to be well constructed and of good standard (See Schedule 5). In the draft Project Agreement SBLC is required to build further roads and bridges in the future (See Schedule 4 Annexure H).

SBLC has upgraded logging roads and constructed gravelled roads of good durable standard for palm oil development.

It contends that it has maintained access roads when they are no longer used for logging though this claim has been disputed.

It has constructed wharf facilities at Buluma and loading facilities at Bola and Lasibu and these are of reasonable standard. Further wharves and jetties are to be constructed at Amio and Uvul.

Within its Buluma complex SBLC has voluntarily constructed a Police Station and two houses (at a cost of about K30,000) and a Community School and four teachers houses (at a cost of about K84,000). Whilst it was not obliged to make these infrastructural contributions they doubtless served SBLC's interests in preserving law and order and providing education for children of its employees and their dependents. Mr Hirata spoke of SBLC having 1,000 employees and a community of about 9,000 people (through extended family structures) being dependent on SBLC's operations. He expressed a concern for the future and welfare of these people and a feeling of obligation towards them which I assessed as being genuine and well intended.

The "bush" operations of SBLC were not examined in any detail. SBLC has a very large scale operation with the extraction of about 20,000 m³ of logs per month and higher rates of extraction envisaged. This scale of operation would require very close monitoring and very careful planning to avoid large scale environmental damage.

SBLC is required to and does submit 3 monthly Forest Working Plans to DOF and these are discussed, negotiated and generally approved thus indicating a measure of planning. Sampling surveys of proposed logging areas are carried out and reviewed monthly to produce data for marketing and major roads are plotted in the Forest Working Plans. There is no marking either of trees to be felled or of residual trees - trees over 50 cm dbh are harvested. Snig tracks are not planned and the making of snig tracks is left to machine operators. I formed the impression that SBLC did as much operational planning and sampling as was necessary for its own commercial purposes but that if DOF had insisted on the marking of trees (either residuals or trees to be felled) and on a greater degree of "on the ground" planning of roads and snig tracks SBLC would probably agree to such requirements and be able to implement them. In operational respects SBLC's planning and controls appeared superior to those of most other companies. Local processing and reafforestation obligations are dealt with separately below.

LOCAL PROCESSING

Under its earlier Permits SBLC had constructed a large processing complex at Buluma consisting of an integrated sawmill, planer and a pressure treatment tank and was obliged to process timber locally. In 1981 it had produced an output of 14,653 m³ of sawn timber from this facility.

Under the September 1982 "letter of intent":- SBLC was:-

- (a) allowed a total maximum cut of 250,000 m³ per year up to 31 December, 1985 (when it was to drop to 200,000 m³ per year)
- (b) granted a log export allowance of 200,000 m³ per year to 31 December 1985 (which was then to drop to 75,000 m³ per year plus 5,000 m³ for each 100 ha of land reforested in the previous year).
- (c) required to process 50,000 m³ per year until 31 December 1985 "when it may be reviewed upward depending on market demands for processed timber".

A major review was planned for 1986.

In 1984 the addition of the Ania-Fulleborne area was proposed and a Project Agreement was envisaged.

The Project Agreement even at April 1988 was not complete and was to operate in the future.

It envisaged:-

- (a) A total maximum cut of 330,000 m³ in Project Year 1, and 340,000 m³ per year in Project Year 2 (and SBLC was seeking 350,000 m³ per year thereafter)
- (b) Log export allowances of 300,000 m³ in Project Year 1, and 290,000 m³ in Project Year 2
- (c) Local sawmill input as follows:-

Project Year	Buluma (m ³)	Amio (m ³)	Total (m ³)
1	30,000	-	30,000
2	35,000	15,000	50,000
3	40,000	20,000	60,000
4	45,000	25,000	70,000
5 and later	50,000	30,000	80,000

The Amio mill is a new mill SBLC is to construct. Failure to achieve processing input levels is to result in a reduction of log exports.

With the Project Agreement proposed, the review which was to take place in 1986 under the September 1982 letter of intent did not occur. SBLC continued to operate on the levels of cut and log export levels permitted under the 1982 letter of intent - ie it was permitted to export in log form 200,000 m³ per year plus 5000 m³ for each 100 ha reforested the previous year and was obliged to input 50,000 m³ per year to the Buluma Sawmill. During 1986 SBLC also gained an improper increase in levels of log export by using Michael Cowan of FIC to interfere with the functions of DOF and gain direct approval of that increase from then Forests Minister Diro (See Interim Report No.3). SBLC's actual performance from 1981 to 1987, from information supplied to the Commission, was as follows:-

<u>YEAR</u>	<u>TOTAL CUT</u>	<u>LOG EXPTS</u>	<u>S/MILL INPUT</u>	<u>S/M OUTPUT</u>
1981	253,908	214,285	not known	14,653
1982	278,658	161,656	-	13,111
1983	243,513	198,961	-	13,213
1984	295,200	243,729	37,733	14,054
1985	225,613	184,567	41,046	14,533
1986	281,428	241,522	39,906	13,250
1987	292,924	243,705	49,219	15,594

In general terms SBLC appears to have achieved close to its "permitted" level of log exports but until 1987 was not even approaching achievement of its required levels of log input to the Buluma sawmill.

There is a quite amazing and serious defect in the proposed project agreement in regard to sawmilling levels. SBLC has achieved in 1987 close to its sawmill input ~~target~~ of 50,000 m³ per year at the Buluma mill. Under the draft project agreement log input to the Buluma mill is to drop to 30,000 m³ in Project Year 1 and then build by 5,000 m³ per year up to the original (and now achieved level) of 50,000 m³ of log input per year by Project Year 5.

This is illogical and absurd. SBLC was aware of this but Mr Hirata did not consider it has an obligation to point this out to the State Negotiating Team. Clearly SBLC is a reluctant sawmiller and welcomed the reduced obligation.

As can be seen from the above figures SBLC has not achieved the required levels of sawmill log input and appears to have a very low recovery ratio (ie net output of sawn timber from the gross volume of logs put through the mill). Mr Hirata said that the sawmill was designed in Japan and that in design terms it has the capacity to mill 50,000 m³ of log input in Japanese conditions.

In PNG the design fails to produce that capacity and the log input is limited essentially by the capacity of the breakdown saws and the pony saws. The design is not, in Mr Hirata's view, suited to PNG circumstances and this, combined with variation in species, log size, low efficiency and low labour force productivity levels, has kept input below required levels.

One function of the mill is to saw logs which are not suitable for export (because of hollows, twists, form defects etc) and these export log rejects, according to Mr Hirata, constituted up to 20% to 30% of total log input. I consider the proportion of rejects is probably higher than this (and see Schedule 7 introduced below).

The mill presently operates on a single or 1 1/2 shift basis and Mr Hirata said that it could not operate in practice on a two shift basis as the machinery is 11 years old and this would lead to more frequent breakdowns.

In 1987 input levels approximated required levels due to the introduction of two local contractors. SBLC did not assist these contractors by financing equipment. It made logs available to them which they then flitched using a forest mill and the flitches were then input to the sawmill. Utilisation of these contractors boosted gross input by 1992 m³ in 1986 and 7,210 m³ in 1987. The recovery rate of the contractors was poor due to design shortcomings in the forest mill and its use of wide and wasteful circular blades.

I have inspected the Buluma mill and was not impressed. It is of an outmoded design, is poorly maintained and operationally inefficient and there is low morale among its staff. It does not compare with modern facilities I have seen in Australia or which operate in Asia. Experts in a recent World Bank team share my view and explain that this is the sort of facility one expects to see where processing obligations are forced as operating conditions on an unwilling onshore processor.

The recovery ratio of the SBLC sawmill at Buluma is low and not competitive outside PNG. Detailed data on recovery ratios between 1984 and 1987 was supplied by SBLC (Schedule 6) and shows the net recovery ratio declining from 37% in 1984 to 32% in 1987. With such low recovery ratios and low efficiency levels a proportionately high wasteage rate arises from sawmilling.

The wasteage is utilised as roading corduroy, as firewood which is sold, as fuel for the generator and consideration is being given to utilising waste to ~~fuel~~ a ~~kiln~~ kiln dryer.

No consideration has been given to utilising wasteage in small local industries such as carving or lathing, though some waste material is used to produce pickets for reforestation by SBLC itself. A real chance to encourage a small local industry utilising waste has been lost.

It must be borne in mind that in terms of processing for export PNG must compete with the efficiency of modern integrated processing facilities in other countries.

In its operation SBLC is using on average 3 m³ of logs to produce 1 m³ of sawn timber and is producing 2 m³ of waste. Where the primary processing operation in an integrated processing facility is of such low efficiency one expects to find a secondary processing operation which utilises the waste. In this way it is said PNG's competitors in Asia are achieving out of integrated operations a recovery factor of in excess of 90% of log input. Mr Hirata conceded this and I have no doubt he is already convinced that secondary processing to produce zephyr board or medium density fibreboard is both appropriate and feasible and already has the figures to prove it. I found this in frank discussion with Mr Hirata and it is incredible:-

- (a) that large scale largely unused wasteage has been permitted at Buluma from 1976 to date; and
- (b) that for the same period of over twelve years SBLC has produced sawn timber without a kiln drying facility; and

(c) that even under the draft Project Agreement SBLC is given until Project Year 2 to produce feasibility studies on zephyr wood production and on kiln drying and seasoning facilities.

If pressed by the State it would be discovered that SBLC is well advanced in both these areas, knows that they are feasible and would probably be in a position to agree now to a timetable for their installation.

In the absence of any pressure from the State SBLC has spent funds on a moulder and planer in an attempt to add value to its processed products. It has found that the export market demand is for finished product and not for half finished mouldings even if they are kiln dried.

Low productivity and low efficiency are two problems which must affect SBLC's competitiveness in the sawn timber market. A third problem exists in the freight area. About 70% of SBLC's sawn timber production is sold in the PNG domestic market and about 30% is exported according to Mr Hirata. This is borne out by (and other useful information contained in) SBLC's Sawmill Manager's Report for 1987 (Schedule 7)

Domestic freight rates within PNG are very high. Freight rates between PNG and Australia (see below under Marketing of Sawn Timber) are also very high. The rates are compounded by the fact that sawn timber is shipped in bundles as "broken stowage" and is shipped in small quantities thus attracting "premium" rates of freight.

Unless drastic improvements are made in all these problem areas and Government requires such improvements, SBLC and similar operations will be at a competitive disadvantage in export markets, domestic sawn timber prices will continue to remain at high levels and local processing will remain a less attractive (even unprofitable) alternative to log exports.

REAFFORESTATION

SBLC began reafforestation planting in 1976 with the planting of 55 ha followed by 80 ha, in 1977 and 120 ha in 1978. Planting then ceased. Mr Hirata said that this planting was not a condition of operation but was a voluntary undertaking by SBLC. I suspect it in fact related to the joint venture arrangement with Sanyo Kokusaku Pulp reported by Ashenden but which has not eventuated. Under the September 1982 letter of intent SBLC was obliged to "use its best endeavours to secure sufficient land in the first two years of the tenure of this permit and thereafter to embark on a reforestation programme at an annual planting rate of at least 200 hectares". SBLC was given the incentive of an additional 5000 m³ in log exports for every 100 ha planted in the preceding year.

With the 1984 addition of the Ania-Fulleborne area the rate of reafforestation was to be markedly increased. SBLC offered a planting rate of 400 ha per year but the State asked for a rate of 750 ha per year and SBLC accepted that. In the draft Project Agreement reafforestation is required at a rate of 750 hectares per year in Project Years 1 to 20 inclusive - ie a total of 15,000 hectares of which 10,000 hectares is to be planted on State land and 5,000 hectares is to be within land acquired from customary owners.

Overall SBLC plans, to plant a total of 22,500 hectares to forest plantation during the life of the project. SBLC forest plantation plantings have been:-

Year	Hectares
1976	55
1977	80
1978	120
1979	-
1980	-
1981	-
1982	220
1983	500
1984	466
1985	453
1986	560
1987	513
1988 proposed	<u>750</u>
	<u>3717</u> hectares

Mr Hirata says that NIC sees the future as being in reafforestation plantations and that financial assistance can be obtained from Japanese Government agencies to assist with reafforestation. Growth rates in the natural forest are estimated to be at a rate of 1 to 3 m³ per hectare with a mean of about 1.6 m³ per hectare. Data from SBLC's afforestation plots with the faster growing species Kamarere, Erima and Terminalia Brassii indicates plantation growth rates in the order of 30 m³ per hectare per year. The natural forests in SBLC's concession area yield in the order of 30-40 m³ per hectare. At the indicated growth rates SBLC's plantations should yield in the order of 600 m³ per hectare after 20 years growth or in the order of 20 times the yield from natural forest.

Plantation forestry also offers additional advantages. Firstly, the species desired can be selected, thus overcoming the main complaint with PNG logs about diversity of species mix) and buyers can be offered regular supply of the one or two selected species with uniform log size and quality which facilitates processing.

Secondly, the concentration of the tree crops in a smaller land area facilitates management and tending. Thirdly, the plantation structure requires a good road system of a more permanent type which is established at the outset. Roading distances are much shorter than for logging in the natural forest. This results in large savings in roading costs and the roads are already in place at time of harvest. Fourthly, the harvesting cost from plantations is much cheaper not only because the roading is in place but because of the concentration of timber in a smaller area and because the operating conditions are much easier.

Fifthly, as plantations are usually on State land and planted by the harvester a saving in royalty payments could normally be expected.

SBLC has done studies of plantation growth patterns and soil chemistry in its plantation work and under the draft Project Agreement is to carry out feasibility work on the viability of enrichment planting in the natural forest.

It has selected four species covering various end uses. Originally Kamarere was selected because it is indigenous and fast growing. It was selected in 1976 as a wood chip species but tests have shown it is acceptable for plywood use and it is now planted with that use in mind.

Erima was selected because of its fast growth rate and as its standard use is for plywood.

Terminalia Brassii was selected for fast growth and for use as sawlogs and as veneer.

Teak, although a slower growing species, was selected for use as sliced veneer.

Though plantation forestry has many attractions SBLC's experience has shown that there are two problems associated with it in PNG. The first is the heavy capital cost and the second is the inability of the State to provide secure title to the requisite land. SBLC plans a 30 year project with a total estimated project cost of about K244 million. At the end of 1987 capital costs of K44 million had been incurred for buildings, vehicles, roads and bridges, reafforestation and like costs.

It has undertaken in the past and under the draft Project Agreement the obligation to plant 22,500 ha of forest plantations and it estimates reafforestation costs at K75 million by the end of the project period.

SBLC says that to justify the project expenditure and have a viable project it will need to extract at a rate of 350,000 m³ per year. Over the 30 year period it proposes to harvest 11.45 million m³ of logs with 6.27 million m³ harvested from plantation and 5.18 million m³ from natural forest. Of this total 2.29 million m³ will be processed onshore. It plans during this period to harvest 7,500 hectares of forest plantation which will leave 15,000 hectares of plantation standing at the end of 30 years.

Whether SBLC will replant what is harvested is not yet known and depends both upon research and land availability. Its present plan is not to cut from the natural forest after Project Year 20 (except for small quantities to produce struts for telegraph poles) and to limit its cut to plantations. Its soil chemistry tests indicate that after plantation forests are cut the soil would be sufficiently fertile to withstand a second planting on the same land area but it says, quite responsibly, that more research over a longer period is needed to check the decline, if any, in fertility. If a second planting cycle is not feasible then more land would be required for further plantations.

On SBLC's figures the cost of 22,500 ha of forest plantation is K75 million. That plantation area given a 20 year growth cycle and a mean annual increase of 30 m³ per hectare should produce about 13.5 million m³ of logs. SBLC's costings are thus K3334 per hectare or K5.55 per m³ which is quite a deal higher than the benchmark figure DOF uses in reafforestation calculations of K2,200 per hectare. Though the final average cost per m³ seems quite low the facts are that considerable "front end" capital is required to fund establishment, planting and tending of the forest plantation from which the planter gains no direct financial return for a period of at least 20 years. This fact is illustrated by the ambit and cost of SBLC's reafforestation programme in 1987 and its budgetted cost for 1988 (Schedule 8). SBLC as a subsidiary of NIC has been able to obtain assistance in the form of onlent "soft" loans from Japanese Government agencies to fund both its roading and reafforestation works. In projects of this type a large respectable Japanese company such as NIC is able to obtain Japanese Government sponsored lending assistance from the Import and Export Bank of Japan (IEB) and/or the Japan

International Co-operation Agency (JICA). These institutions lend on preferential terms to the Japanese parent company which then onlends to ~~its~~ overseas subsidiary. In this case IEB and JICA lent to NIC and NIC onlent to SBLC on the same terms according to Mr Hirata.

The IEB loan for roading was for a period of 8 years at 4.5% interest with a 3 year grace period. The JICA loan for roading was similar but at 1.1% interest. The JICA loan for reafforestation was for a period of 25 years at 1.5% interest with a 10 year grace period. Through these loans SBLC was able to borrow around K10 million paying only interest during the grace period and is not obliged to commence repayments until the grace period expires.

In April 1988 SBLC was also able to borrow K2 million from NIIK (as to which see below under Marketing) for a term of 7 years at an interest rate 0.5% above the international bank rate (about 6%) with a two year grace period. Mr Hirata said this loan was not for capital works but was used to reduce local overdraft borrowings for which SBLC was paying 14% interest.

It is this sort of funding arrangement which is available to SBLC (through NIC) coupled with the tax deductability of reafforestation expenditure in PNG which enables SBLC to undertake large scale reafforestation by supporting the "front end" expenditure.

The second problem of land availability is the largest factor working against reafforestation in this country. During this Inquiry many instances have been noted with the same theme:-

- (a) a reafforestation obligation is imposed as an important element of a proposed project;

- (b) the obligation is conditional upon the State indentifying and acquiring the requisite land and securing title to it;
- (c) the Permit holder is not serious about fulfilling the obligation and does nothing about it but relies utterly on the State to force his hand;
- (d) the State (usually) makes no determined effort to identify or acquire the requisite land or (in the few cases) where it makes the effort it encounters great difficulty in so doing;
- (e) the concession area cuts out with the reafforestation obligation unfulfilled.

Though SBLC's efforts in plantation forest establishment are outstanding within PNG and its commitment to its obligation to reforest appears to me to be sincere, some of the unsatisfactory elements of the theme described above were clearly present at earlier stages.

As at early 1988 SBLC had available to it for reafforestation:

- (a) 8318 ha of land on 40 year lease
- (b) 78 ha of land on 20 year lease
- (c) 120 ha of land on 15 year lease
- (d) 2421 ha of land on annual license
10,937 ha

(see Schedule 4 Annexure F for details)

During 1987 SBLC was planting and tending trees and during 1988 it planned to plant and tend trees (See Schedule 8) not only on land over which it had secure tenure but also on land over which it had only an annual license.

Whilst SBLCS's faith in the State's ability to secure tenure of the planted areas is admirable the situation is of justifiable concern. As Mr Hirata said in evidence, the cost of plantation establishment is high but the rewards in the long term are greater provided the company has a State lease or a legally binding lease with customary owners which secures for the company, for at least the project term and until harvest, tenure over the land on which the planting is carried out. Under the draft Project Agreement it appears to be implicit that within the Project area the State has title to over 15,000 ha of land - whether it is suitable for reafforestation plantations is not known. The Project Agreement requires 10,000 ha of this State land to be planted and 5,000 ha of customary land to be planted provided the State is able to acquire that land from the customary owners. If acquisition is not possible the total 15,000 ha is to be planted on the State land.

It is pleasing to note, at long last, that the State appears to have recognised the errors of the past and, in this case at least, to have ensured that the land required to fulfil the reafforestation obligation imposed is meaningful and capable of fulfilment.

There remains the problem of securing title for an appropriate term to the 2,421 ha of land available on annual license and on which SBLCS has already planted.

The final problem which arose for SBLCS was the question of ownership of forest plantation trees planted by SBLCS. The arguments of SBLCS for it having property in the trees is comprehensively set out in Schedule 4. It regards plantation trees as an agricultural crop in which it says the lessee or tenant of land has title because he has planted and tended that crop at his expense. The State (after earlier indications to the contrary) asserted that

The State should have title to the trees. I have not ascertained how this impasse was resolved but am impressed with the logic and merit of SBLC's arguments. It ~~suffices~~ to say that firm policy on this question should and must be formulated if private sector reafforestation plantations are to be encouraged.

I have dealt with reafforestation in this Appendix in some detail as it illustrates what is possible and it is the area where informed opinion considers the future in forestry lies.

In the view of visiting World Bank, Asian Development Bank and F.A.O officials PNG has a massive potential and potentially lucrative future in plantation forestry if title to appropriate large tracts of land can be secured for that purpose and if investors committed to advanced afforestation technology and possessed of the requisite capital can be attracted to invest here.

Those investors may be either commercial forestry operators or agencies prepared to fund State plantations on either a grant or long term "soft" loan basis.

The advantages of plantation forest logging over natural forest logging in terms of species selection, volume concentration, ease of management and tending, savings in roading and extraction costs and savings in "landowner" royalty payments are demonstrable. Subject to land being available it also enables plantation siting to be achieved in land areas which are best suited to reafforestation and which are strategically located in relation to processing and port facilities so as to achieve optimum savings in handling and haulage costs. This latter aspect was stressed by experts from Inchcape when discussing the prospect of commercial reafforestation in the Wawoi Guavi (Western

Province) and Turama (Gulf Province) concession areas. Both areas are remote and haulage of logs to export loading ports involves long expensive barge voyages in difficult river conditions. It was said that suggestions of reafforestation in these areas were absurd and that if reafforestation was required as an operating condition it should be required in a different area where operating advantages were optimised rather than in an area where acute and expensive operating disadvantages were perpetuated. The logic of this argument is irrefutable from the point of view of economics. The recent World Bank study team echoed the same sentiments and noted that team members had observed large sites in New Britain which they considered were excellent sites for large scale forest plantations.

They considered that with current and projected timber price levels forest plantations offered a better long term investment for landowners in appropriate areas than cash cropping for commodities such as copra and cocoa.

If reafforestation is carried out away from the logging area methods of ensuring that the owners of the logged resource share in the benefits need to be worked out.

I recommend that these aspects should be pursued further by the Government as it seems clear to me that the potential exists for PNG to gain immense benefits in the future if the right decision and commitment to encourage large scale forest plantations is made now.

As I stated above SBLC's efforts in the area of plantation forestry are outstanding by PNG standards and commonly so regarded in PNG. I am not an expert in this area so I asked the World Bank team how they regarded SBLC's efforts after they had visited SBLC's operations area. By world standards the team was not impressed. They described

the plantations as being of a standard one would expect from a log exporter which had forest plantation obligations imposed on it as an operating condition and which was reluctantly directing itself to the performance of that condition.

In particular they commented on the lack of application of modern genetic engineering technology for species improvement to generate faster growing higher yield seedlings. They stated that this technology has been employed for some years and is still being evolved, evaluated and improved in plantation enterprises in South America and that very significant advances had been made in terms of vastly improved growth and yield rates. They considered like results would flow from similar efforts here using known technology.

PNG has an enviable record in the generation of hybrid oil palm and hybrid cocoa species appropriate to local conditions. If the Government opts for a commitment to large scale forest plantations then a part of that commitment would, of necessity, involve acquiring the most up to date relevant technology that is available and maintaining a capacity to keep that technological knowledge up to date.

LANDOWNER BENEFITS

One final matter of more general concern arises out of the SBLC operation and the proposal at Project Year 20 to effectively cease extraction from the natural forest. SBLC has extracted literally millions of cubic metres of logs from natural forests in its total concession area and proposes to extract more. It has operated since 1970.

Between 1981 and 1988 SBLC has harvested over 2 million m³ of logs and under the Project Agreement it proposes to harvest a further 5.18 million m³ during the period up to Project Year 20. The only direct cash benefit which landowners have received is their 25% share of royalties on the timber harvested - they have received no share of profits on log sales in addition to royalties.

Indirectly the landowners have the benefit of roads and bridges and wharves which have improved opportunities for cash crop income, employment opportunities have arisen in the form of jobs in the logging operation, sawmill and reafforestation activities and some of them (at the Buluma complex) have the benefit of a Community school and a Police presence. It is important to note that SBLC provides jobs for 1000 citizens and through them is estimated to contribute to the support of some 9000 people (though the employees provide their labour and skills in exchange for their salaries).

The whole SBLC project, whilst it will turn to Forest plantations in the future, has been and must have been to a very large extent built on the base of logs extracted from the natural forest which are or were the property of the landowners and the return to them for their resource has not been great.

It is of concern, in my opinion, that at Project Year 20 operations will be limited to extracting small quantities of timber from the natural forest (for struts for telegraph poles). The whole operation will in effect then rely on forest plantations on State land in which the landowners will have no interest and from which they will obtain no royalty benefits.

The direct cash benefit to landowners of the whole massive 400,000 hectare area will then virtually cease even though the indirect benefits will continue and probably be enhanced.

Under the draft Project Agreement SBLC is obliged to conduct a feasibility study in relation to "development of appropriate designs and techniques to encourage the natural forest after selective logging". It is also obliged to assist development of local business enterprises, use local enterprises and appoint a Business Development Officer in terms common to most project agreements and directed to encourage local supply of goods and services to a project.

There is no specific plan or proposal for the natural forest resource area of 400,000 ha after the 22,500 ha of forest plantation is established. It seems to me that this a "blind spot" to which attention has not been directed.

The opportunity for equity participation by landowners in SBLC has been lost but there must be a way in which landowners could and should become meaningfully involved on an equity basis in their natural forest resource after Project Year 20. One possibility would be for landowners to promptly become involved in enrichment planting and tending of high value log species which could be processed in SBLC's processing facility. Mr Hirata said that though research would be necessary SBLC would be prepared to assist landowners to enrichment plant natural forest areas.

SBLC's plantation stock is of Kamarare, Erima, Terminalia Brassii and Teak. Landowners may well be able to obtain considerable and continuing income from the enrichment planting and subsequent selective harvest of indigenous high value species in the natural forest to which onshore value could be added in the SBLC processing

facility. I recommend that this whole question of use of the natural forest and landowner involvement after Project Year 20 should be examined in the interests of landowners of this large land area.

MARKETING

As indicated above there are three distinct facets of SBLC marketing being:-

- (a) Domestic marketing of sawn timber in PNG by the Port Moresby Office of NIA
- (b) Export marketing of sawn timber to Australia and New Zealand by the Sydney office of NIA.
- (c) Export marketing of logs to traditional log markets through NIHK

Sawn timber marketing was undertaken by SBLC direct, according to Mr Hirata, from 1 April, 1988.

Marketing Sawn Timber

Domestic Market

The domestic marketing of sawn timber was not studied in any detail although it accounts for about 70% of SBLC's sawn timber sales. In 1987 out of total sawn timber sales of 10,053 m³ some 7,219 m³ was sold on the domestic market and only 2,834 m³ was exported. Quality processed sawn timber (chemically treated and dressed and rounded) was sold at a price level of K340 per m³ but the average domestic market price was only K237.46 per m³. When one regards log prices obtained by SBLC in 1987, the poor recovery ratio in

SBLC's sawmill and processing costs average sales at this price level were destined to produce an operating loss (see schedule 7) and were not a realistic alternative to log sales but rather would be an avenue of making some recovery from export log rejects.

Sales were made by NIA Port Moresby office at what it described as "nominal Commission" but did not quantify.

One of the inhibiting factors in domestic sales, according to Mr Hirata is high coastal freight rates which run at approximately K55.00 per m³.

Australian and New Zealand Markets

During both 1986 and 1987 sawn timber from SBLC was exported to Australia and New Zealand.

SBLC and NIA have supplied detailed documentation and shipment by shipment breakdowns of all these sales (with some very few minor deficiencies which I am satisfied were due to documents being unavailable) showing SBLC selling prices to NIA, resale prices of NIA and in the case of export to Australia freight details.

SBLC has also explained the conversion methods used to convert from superfeet to cubic metres and the trade custom differentials arising from measurement in actual compared to nominal size (Schedule 9A). Using the materials and summaries provided (which filled two 3 inch lever arch files) the Commission been able to produce shipment by shipment summaries of one page each for sales to New Zealand and sales to Australia covering the years 1986 and '1987 (Schedules 9B and 9C respectively).

Levels of sawn timber export were:-

YEAR	NEW ZEALAND	Australia	TOTAL.....
1986	2457.488 M3	1625.634 M3	4083.122 M3
1987	<u>1220.322</u> M3	<u>1536.066</u> M3	<u>2756.754</u> M3
	<u>3677.810</u> M3	<u>3162.066</u> M3	<u>6839.876</u> M3

In 1987 SBLC's total sawn timber exports of 2834 m3 represented almost 80% of PNG's total sawn timber exports. The decline in SBLC's exports between 1986 and 1987 is indicative of the alarming decline on a national basis of sawn timber exports which has been the consistent trend in recent years.

On these sawn timber sales Mr Hirata said in evidence NIA receives a 6% commission.

What was not said in evidence is that SBLC in fact sells to NIA and then NIA resells to its customers. The better quality timber of good quality species appears to be exported. It is usually dressed and rounded and has sometimes been chemically treated. It is not kiln dried.

Sales to New Zealand are invoiced by both SBLC to NIA and by NIA to its buyer on an FOB basis and freight rates, though not known, are believed to be very high.

Sales to Australia are invoiced by SBLC to NIA on an FOB basis and by NIA to its buyer on a CIF basis though in most cases the invoice splits the CIF price into the FOB price, freight charges and insurance charges. In some sales to New Zealand NIA obviously sells to the buyers on credit at interest and in cases where the interest rate is shown it varied from 13.5% p.a to 19.25% p.a..

On sales to Australia from September 1986 NIA appears to have adopted a practice of adding into its price an itemised charge for clearance and delivery ranging between AUD 7.30 and AUD 8.06 per 100 superfeet. In Schedule 9C this was included in the "NIA PRICE PER m3 and" NIA MARKUP PER M3 columns.

In every case it seems NIA had previous contract arrangements with its buyers and that shipment was arranged direct from SBLC to those buyers without any intermediate handling by NIA.

NIA's New Zealand sales were made to two main Auckland buyers J.Scott and Co and C.Aicken and Sons (the latter through Tenaru Pty Ltd of Sydney) with one small sale to a third buyer.

NIA's Australian sales were made to one main buyer Maritime Timbers, three regular smaller buyers Australian Furniture Timbers, MMK Holdings and Tenaru with odd sales to a small number of other buyers.

The total range of buyers is quite small and limited. If, as I believe on the evidence, SBLC was paying NIA a 6% commission on its sale price to NIA then I would regard that as reasonable, though high, bearing in mind the small volumes being handled. I am not able to see, however, that a further profit (even though it be small in amount) on most New Zealand shipments can be justified.

The position disclosed on Australian shipments is more serious and reaches unacceptably high proportions in early 1987. A price markup of \$15,595.64 or \$34.61 per m3 on a shipment of 538 m3 in January 1987 and of \$28,570.99 or \$91.87 per m3 on a shipment of 311 m3 in March 1987 is far

beyond the bounds of what, on any basis, could be regarded as reasonable particularly when it seems that excessive markup was achieved not by a rise in the selling price by NIA to its Australian buyers but by a reduction in the levels of NIA's buying price from SBLC. Time has not permitted an explanation to be sought from SBLC or NIA. In the absence of an acceptable explanation such markups could only be classified as unreasonable and amounting to transfer pricing.

The rate of freight on shipments to Australia is very high with the documents disclosing rates approaching or in excess of AUD100.00 per m³ (ranging from AUD 91.10 to AUD119.92) for East Coast discharge but reducing to AUD 86.00 per m³ in October 1987.

Such high rates obviously constitute a large competitive disadvantage.

With such a small group of buyers SBLC should have been able to obtain a greater return than previously from its sawn timber exports when it took over that role in April, 1989.

Export Log Marketing Ambit of Inquiry

Export log sales is the main marketing business of SBLC which dwarfs its marketing of sawn timber. As with other log marketers SBLC was forwarded a marketing questionnaire for completion and asked to submit detailed marketing tables for 1986 and 1987. After it did so it was asked to supply further tables for 1984 and 1985.

This tables supplied are:-

1984 - Schedule 10A

1985 - Schedule 11A

1986 - Schedule 12A

1987 - Schedule 13A

As with some other exporters the Commission had been able to obtain copies of destination end invoices for ten of SBLC's 1986 Korean shipments.

In each case SBLC invoiced NIHK on an FOB basis and NIHK invoiced the Korean buyer on a CNF basis but did not show an apportionment between the FOB price and the freight rate. The data was compiled on a shipment by shipment basis and then tabulated according to the same work method described in other appendices. In this case differentials between PNG FOB prices and Korean CNF prices were calculated and then converted to a unit rate per cubic metre on a shipment by shipment basis.

The end invoices covered 77,559 m³ of logs which were exported from PNG.

The differential on a shipment by shipment basis varied between a low of USD11.95 per m³ and a high of USD31.46 per m³ with an average of USD23.88 per m³. Actual freight rates were not known but the range and average of differentials strongly suggested that the differential involved more than freight. It was clear and freely admitted that all SBLC log sales were invoiced by SBLC to NIHK.

SBLC, when asked to arrange production of NIHK's invoices on resale for 1984-1987 and shipping documents showing freight rates for those years, readily agreed to do so and in fact later did so except for documents relating to 1984 resales. These documents were supplied after the

Commission's hearing and to some extent render reporting on what occurred in the hearing unnecessary. The six boxes of documents supplied were then analysed and the results tabulated by staff of the Taxation Office who were assisting the Commission.

The tabulated analyses are:-

1985	Schedule 11B
1986	Schedule 12B
1987	Schedule 13B

Further analysis was then undertaken to extract and tabulate shipment by shipment margins above MEP prices disclosed in PNG, margins above MEP paid by NIHK's buyers, unit prices in PNG and FOB unit prices paid by NIHK's buyers as well as freight rates.

These analyses are:

1984	Schedule 10C
1985	Schedule 11C
1986	Schedule 12C
1987	Schedule 13C

Whilst the above analyses were taking place final submissions to the Commission on behalf of SBLC were prepared and submitted by its Counsel Mr Coady (Schedule 14)

PUBLIC HEARING

Various matters, as reported on above, were dealt with during the hearing. At the hearing SBLC called its Managing Director Shinichi (Simon) Hirata and its Marketing Manager

Mr Yasuo Otah as witnesses. Mr Hirata has worked in Nissho Iwai group since 1959 and has a comprehensive and broad knowledge of the timber industry. Mr Otah has worked for Nissho Iwai group in Japan from 1982 to 1986 (when he came to SBLC) and described himself as having been assistant to the officer in charge of PNG and Solomon Island logs within the NIC Lumber Division Department B Section 2 in Tokyo.

Market Diversification

Mr Hirata said that one of the great advantages which SBLC has is its access to the corporate power of NIC and the widespread coverage of the NIC worldwide network. He says NIC has a commitment to the promotion and sale of PNG logs. NIC, he says, was a pioneer in selling PNG Logs into the Korean market in 1977/78, pioneered the sale of PNG logs into the Taiwanese market and is pioneering sales into the Peoples Republic of China through NIC's office in Beijing and recently into the Thailand market (now that Thailand has a complete ban on logging).

SBLC itself was also involved (with FIC and Vanimo Forest Products) in steps to develop the Indian market.

India, according to Mr Hirata, is a potentially large and convenient market for PNG logs and SBLC logs in particular. Apparently it was commonly believed that up to 30% of India was forested but a study revealed that only 8% was forested. The Indian Government quickly reduced import tariffs on unprocessed timber from 100% to 10% to preserve its remaining resource and encourage unprocessed imports to sustain its timber processing industry. Mr Hirata says that India's diversity of species in its own forests and preference for dense, hard red species such as Kwila and Malas offers benefits to PNG. The resource of SBLC contains about 23% to 24% Malas which produces a dense sinker log

with a tendency to crack and about 5% *Celtis* which has similar properties. These species are not popular with buyers from Japan and Korea because they are ~~sinkers~~ (and must be handled on land rather than in log ponds) and because of their hardness. Their inclusion in SBLC shipments to these countries leads to a reduction in price.

These species are however well accepted in India.

Whilst there is little doubt that NIC has playeed a significant role in marketing PNG logs its claims are, to put it kindly, cast at the highest level possible.

Of the Korean market it has been reported that:-

"In June-July 1979 independent Papua New Guinea timber operator broke the Japanese marketing monopoly over Papua New Guinea logs by selling directly to Korea, and thereby received almost double the previous price for its logs. As a result of this marketing breakthrough, Papua New Guinea's guideline minimum export log prices were raised, in some cases, by almost 100%. The Japanese log exporting companies in Papua New Guinea crhse to accept the new guideline prices in order to restrict direct buying by Korean and Taiwanese agents" ("Transfer Pricing Manipulations in Papua New Guinea" Law Reform Commission of PNG Occassional Paper No 12. August 1980 at page 11)

The same publication also reports (at page 59):-

"Various high quality log species exported by one company in 1977 to Japan via a related company in Hong Kong: the selling prices increased by 100% and 130 percent between the Papua New Guinea - Hong Kong and the Hong Kong - Japan transactions".

The company involved in these transactions is not identified and cannot be said to be SBLC even though it was one of the few companies marketing to Japan in 1977 through Hong Kong companies corporately related to it.

Of the Indian market the initiator was Vanimo Forest Products. SBLC was later invited by Ron Gibbs to become involved and did so with Gibbs and with FIC.

The only follow up in the Indian market through NIC - according to NIHK invoices to the end of 1987 appears (See Schedule 13B) to have been the PAKARTI TIGA shipment in September 1987

The very substantial bulk of SBLC's log sales have always gone to Japan and Korea (as can be seen from Schedules 11B, 12B and 13B) though there is the occasional sale to Taiwan. Mr Hirata said that in rough terms 70% of SBLC's logs are destined for Korea and the balance for Japan and these Schedules tend to confirm this.

That said, SBLC's professed efforts to market into the potentially massive market in the Peoples Republic of China and the recently arising Thailand market and to use NIC's network for that purpose are constructive and merit encouragement.

The Malaysian Experience

In order to explain the attitude of Japanese buyers to marketing matters and the worth of NIC and NIHK to SBLC Mr Hirata spoke of the position in Malaysia which is a dominant log supplier in the South Seas Log Market. In Malaysia the logging concession operators are apparently Malaysian companies but are supported by loans from Japanese log

importers. Prices for Malaysian logs are generally higher than for PNG logs but are subject to much wider and more dramatic price fluctuations. Mr Hirata says this is because PNG is relatively a much smaller producer and that PNG logs are sold to a limited number of buyers and these factors tend to insulate against wide market fluctuations.

Generally when the market is good Malaysian producers are easily able to find buyers at good prices. When the market is bad those which have financial ties benefit because they receive buying support from the Japanese financier who has to support his borrower in adverse market conditions to preserve his cashflow.

In such a market the suppliers who are not so supported are unable to find a buyer and the buyers do not send ships for their logs.

Mr Hirata said this was the value to SBLC of NIC and NIHK. Even in adverse market conditions they will buy and they will send vessels and SBLC will continue to receive a cashflow from its log sales.

Whilst I appreciate the dynamics of what Mr Hirata was explaining the system he explains has very real dangers associated with it. A buyer/financier will necessarily support his supplier/debtor in all market conditions and particularly in adverse market conditions to retain his cashflow because, to put it quite cynically that is the source from which interest on the loan and loan repayments are made. In adverse conditions that is of mutual benefit (and of particular benefit to the supplier) but my main concern is that in healthy and boom market conditions the benefit flows the other way and the "tied" supplier sells to his buyer/financier on very preferential terms below market value and the result is that the producing country loses

out. This latter aspect is clearly illustrated by the relationship between United Timbers and Mitsubishi Corporation which operated initially in Kalamantan and was ~~then~~ transported here to exploit the Mussau Island Resource (See Interim Report No 4 Volume 2 Appendix 4)

Japanese Market

Mr Hirata and Mr Otah both explained the Japanese market in terms consistent with those reported on elsewhere and so well and comprehensively described by Ashenden (1983). They emphasised that the wholesaling and lower market structures in Japan are financially supported by the importers and trading companies, as are plymills and sawmills, and that the market is structured around that financing coupled with traditional loyalties and long term trading relationships. The importers or traders normally sell on 180 days promissory notes and financing then proceeds down the structure to the lowest levels. The cash receipts at the lowest level then meet the promissory notes and money flows back up the structure to the traders and importers. At each step a profit is taken. The bulk of the lower structure does not have the volume of consumption or financial capacity to buy direct from PNG producers on "at sight terms".

I have no doubt this accurately describes the Japanese market structure, that there are only a limited number of buyers who have the capacity to buy direct and that, as I have reported elsewhere, there are real obstacles to and constraints on "outsiders" seeking to penetrate the Japanese market by direct sales to end users (including wholesalers)

SBLC Marketing Procedures

It is clear that with the exception of ~~two~~ part shipments to India (through FIC) in October and November 1986 and a part shipment to Korea (through FIC in February 1987) all SBLC's log sales are transacted through NIC Lumber Division Department B Section 2 in Tokyo. Sales through FIC are reported on in detail in the Commission's Interim Report No 3 and were understandably and justifiably regarded by SBLC as quite unsatisfactory even though apparently good prices were obtained. The Indian shipments were of selected species mixes. The first (MV SITI MIDAH) was arranged and co ordinated by Ron Gibbs. It was experimental, at MEP prices and presented no problems. The second (MV MARITIME GARDENIA) was arranged by FIC and even though good prices were obtained (because of the high Malas content) it was a disaster in terms of delay, prevarication and finalising shipping and loading details. FIC cancelled a further shipment to India from SBLC.

The FIC sale to Korea (MV DOOYANG GUIDE) was an unmitigated disaster. The contract was made, yet it was months before the ship arrived. During loading the buyer's letter of credit expired, SBLC stopped loading, the ship lay idle incurring demurrage charges and then SBLC completed loading. The Korean buyer tried to use the expiry of the letter of credit to negotiate a lower price, his inspector was unnecessarily pedantic and FIC was forced to accede to a volume deduction claim to which SBLC was obliged to contribute (at FOB rates). FIC then sought to have SBLC contribute to demurrage charges which it correctly refused to do because the fault lay entirely with FIC.

On its other sales SBLC invoiced to NIHK (wherever the destination) and received payment by telegraphic transfer from NIHK. However, all SBLC's discussion, negotiations and arranging was with NIC Tokyo Office and not with NIHK.

The starting point for SBLC contact with NIC is SBLC's submission to NIC (in conjunction with its submission to DOF of a Forest Working Plan) of a three monthly projection of export log production. This projection is calculated from data on the area proposed to be logged during the three month period, including sampling data from that area and includes estimates of volume, species composition and log sizes.

Also at the beginning of each month the projected production for that month is calculated in the same way, though a greater degree of accuracy is achieved and revisions are made to the previous three monthly projections.

All this information on three monthly projections and monthly projected production is relayed by SBLC to NIC Tokyo which thus has full, and regularly updated, knowledge of SBLC's production in terms of volume, species mix and log size.

SBLC logs are (with the exception of sales through FIC when it was engaged in log marketing) offered by SBLC only to NIC and not to any other buyer.

When the next month's anticipated production is known NIC and SBLC negotiate price and when the price and shipment details are negotiated NIC arranges the vessel and gives SBLC loading instructions.

Although some end buyers of SBLC logs visit Papua New Guinea on occasions both Mr Hirata and Mr Otah said that they do not discuss price with these buyers.

A deal of time was spent examining how price was negotiated between SBLC and NIC Tokyo.

Mr Hirata said that in reality SBLC seeks to sell at the highest possible price and NIC Tokyo seeks to buy at the lowest possible price and that in the result a compromise is reached by finding a mutually acceptable "fair price".

He said that his role as Managing Director of SBLC is to maximise the benefits for SBLC as part of the Nissho Iwai group and that in the long term the success of SBLC is to the benefit of NIC because NIC benefits from having a prosperous SBLC as part of the group.

Mr Hirata considered SBLC obtained "fair" and best available prices from NIC.

Mr Otah generally agreed with Mr Hirata and added that SBLC benefitted from sale through the NIC network in that SBLC received prompt reliable clean telegraphic transfer of the sales price (saving heavy bank charges which attend sale by letter of credit) and that NIC attended to claims (particularly from Korean buyers) without recourse against SBLC. No evidence of particular claims was given.

Mr Otah was, however, in the unique position of having worked in Tokyo in NIC Lumber Division Department B Section 2 dealing with the purchase and resale of SBLC logs.

Mr Otah was closely questioned about "margins" and "profits" to NIC on resale and I considered that he prevaricated and was evasive in answering these questions. He did however concede two things:-

(a) that when working for NIC in Tokyo his aim was, like any good business man, to pay the seller the lowest acceptable price and to obtain from the buyer the highest acceptable price and thus to maximise profit for NIC

(b) that in price negotiation between SBLC and NIC, when his superior in Section 2 decided what the final buying price was to be that was the price at which SBLC was obliged to sell to NIC.

NIC Resale Customers

As stated above the bulk of SBLC logs were resold by NIC into the Korean or Japanese markets and were not utilised by NIC within its own business network.

Mr Hirata said the main Korean buyers were Taesung Lumber, Chungkoo Lumber (or its letter of credit opener Oriental Chemical) and Hanyang Plywood. The data in Schedules 11B, 12B and 13B confirms this and shows the odd "one off" sale to a few other Korean buyers such as Dong Ah Environmental and OK San Industrial.

The main Japanese buyers, according to Mr Hirata, were Maruni Mokko, Onahama Plywood, Shinei Plywood, Tonan Sangyo and Sanyo Kokusaku Pulp. Mr Otah added to this list buyers including Sanno Mokuzai, Osaka Mokuzai, Tsuda Sangyo, Minamata Gohan and one or two others.

The data in Schedules 11B, 12B and 13B does not assist in this respect as, except for certain resales by NIHK to Maruni Mokko, all other sales to Japan were ~~involved~~ by NIHK to NIC.

The situation appears quite clearly to be, as Mr Hirata indicated in describing Malaysia, that PNG logs are sold to a limited number of buyers and that NIC tends to concentrate its resales on a limited group of those buyers in both Korea and Japan. Its buyers tend to be purchasers of large parcels. In Korea they tend to buy full or sizeable part shipments and Mr Hirata said that in Japan the buyers tend to buy parcels of at least 1,000 m³ to 1,200 m³.

Marketing Tables

SBLC's Marketing Tables (Schedules 10A 11A, 12A and 13A) disclose details of log exports year by year and reasonably clear patterns are evident. These were put to Mr Hirata and he was asked to describe the market in each year and to make comments.

1984 (Schedule 10A)

SBLC exported 243,729 m³ of logs in 41 shipments for a total price of USD 13,391,276.00 or at an average USD54.94 per m³.

The MEP value was USD13,009,364.00 or at an average USD 53.37 per m³.

The price was in aggregate USD 381,912 (or 2.94%) above MEP and on average was USD1.57 per m³ above MEP. The shipment by shipment pattern of prices compared to MEP (ignoring a shipment of 4 logs aggregating 37m³ in December 1986) is quite clear:-

- (a) the first four shipments in January 1984 were at exact MEP prices
- (b) during February and early March four shipments were at 5% (two) and 3% (two) above MEP prices.
- (c) in March/April there followed five shipments four of which were at exact MEP prices and one of which was 5% above MEP prices
- (d) in April/May there were two shipments at 15% above MEP prices with one at exact MEP prices.
- (e) between May and July there were nine shipments the first eight of which were at prices ranging between 6.50% and 8.80% above MEP and the last of which was at a price 10% above MEP.
- (f) from August to November there were nine shipments at prices ranging between 0.5% and 0.7% above MEP with seven of those shipments at prices 0.6% above MEP.
- (g) in November and December six shipments were made at exact MEP prices.

Mr Hirata said that 1984 was a good year and that the market was good and he gaaged this, quite clearly, by the margin of prices above MEP levels.

1985 (Schedule 11A)

SBLC exported 184,566 m³ of logs in 30 shipments for a total price of USD8,986,804.00 or at an average USD48.69 per m³.

The price was an aggregate USD179,325 (or 1.96%) below MEP and on average was USD0.97 below MEP. The shipment by shipment pattern of prices compared to MEP is ~~as~~ in quite clear:-

- (a) the first six shipments between February and March were at exact MEP prices.
- (b) In March and April there were three shipments at prices varying between 4.7% and 7.0% below MEP
- (c) In May and June four shipments were made at exact MEP prices;
- (d) In July four shipments were made at prices varying between 8.81% and 10% below MEP;
- (e) From August to September 1986 there were thirteen shipments at exact MEP prices.

Out of a total of 30 shipments seven were below MEP prices and the rest (23 shipments) were at exact MEP prices. Mr Hirata said of 1985 that the year saw the worst market conditions he had ever known since he became involved in the log trade (ie since 1959).

Mr Hirata said that during 1984/85 the MEP levels had remained static for almost 18 months in falling and severely depressed market conditions and that he well recalled writing dispensation request letters to DOF seeking (and obtaining) approval to sell at below MEP levels.

1986 (Schedule 12A)

SBLIC exported 241,522 m³ of logs in 35 shipments for a total price of USD12,000,095.00 or at an average USD 49.68 per m³.

The MEP value was USD11,820,180.00 or at an average USD 48.94 per m³.

The price was in aggregate USD 179,915.00 (or 1.52%) above MEP and on average USD0.74 per m³ above MEP.

Again the shipment by shipment price pattern (ignoring two shipments through FIC) is quite clear:-

- (a) The first eighteen shipments between January and July 1986 were at exact MEP prices;
- (b) The next twelve shipments between July and December were, except for one in October which was at prices 2.994% above MEP, all at prices equal to (two shipments) or (in the case of the other nine shipments) varying between 0.411% and 0.673% above MEP prices
- (c) In November/December 1986 there were two shipments at about 6% above MEP prices and one at over 11% above MEP prices.

Ignoring the FIC shipments, in so far as price levels are concerned, appears justified. The shipments were not typical and species mixes were specifically designed for the Indian market. Useful comparisons are not really able to be made.

What is relevant however is the changed price pattern which came with FIC's involvement

Mr Hirata said that during 1986 the depressed market conditions had continued until about October and that the market began to "push up" from October to the end of the year when SBLC began to get prices well above MEP.

1987 (Schedule 13A)

SBLC exported 243,705 m³ of logs in 33 shipments at an aggregate price of USD 18,514,030 at an average of USD75.97 per m³.

The MEP value was USD16,192,922 or at an average USD66.44 per m³.

The price was in aggregate USD2,321,108 (or 14.33%) above MEP and on average USD 9.52 per m³ above MEP. The price pattern shows distinct and variant patterns of levels above MEP with only one shipment at exact MEP prices. The variations on other shipments were at price levels from 5.45% to 41.061% above MEP price levels giving the appearance that free and competitive market forces were operating during the year.

The sale at MEP price levels was on M.V Pakazti Tiga in September 1987 and was a shipment to India. The price had been negotiated with the Indian buyers by NIC and by NIC with SBLC. There was a delay in arranging the vessel, the Indian buyer tried to cancel the contract and in the meantime the MEP levels were raised with the consequence that the price payable to SBLC was below the applicable (new) MEP levels at the time of export. In these circumstances SBLC sought to increase its price with NIC. Though NIC agreed to accommodate SBLC by raising its price levels to the new MEP levels it would not agree to prices above MEP. This was put as an example of the type of beneficial accommodation which SBLC can obtain from NIC.

Mr Hirata said that in 1987 the market kept rising and there was a very good market with SBLC obtaining prices USD2.3 million above MEP levels.

In the course of the hearing the Forest Manager's Report of SBLC for 1987 comparing budgetted and actual figures was produced (Schedule 15) which illustrated what a good year 1987 was for SBLC. Its profit was about K2 million greater than budget and over 31/2 times budgetted profit. I will refer to this aspect further below.

SBLC Marketing Scenario

At the end of the hearing there were many aspects of SBLC's marketing which caused me real concern. I say that although I realise that SBLC receives very real benefits from its association with NIC. I also realise that if SBLC was not a subsidiary of NIC then SBLC would probably not have received its establishment and subsequent funding from NIC.

On the other hand SBLC's sale of its logs has been essentially uncompetitive.

SBLC only offers its logs for sale to NIC and to no other buyer. All its logs are resold by NIC. SBLC invoices to NIHK which is located in Hong Kong, a preferred tax area, and resales are invoiced out of Hong Kong to the end buyers, thus reposing price differentials in Hong Kong. Most NIHK sales to Japan are invoiced to NIC which handles the further sales of those logs in Japan.

SBLC has no information on or knowledge of end buyer prices because it does not discuss price with end buyers. The only information it had on price was gleaned from other exporters (most of whom I have found were themselves transfer pricing) and from information published by FIC on prices or in Japanese Lumber journals most of which is historical rather than prospective.

When FIC began its active involvement in traditional markets in October/November 1986 SBLC price patterns altered dramatically. Clearly up to October 1986 SBLC export prices were very closely tied to MEP prices and at that time log exports were essentially routinely approved as long as prices were equal to or in excess of MEP price levels. When it was put to Mr Hirata that up to October 1986 SBLC was generally content to receive MEP prices Mr Hirata replied:-

"I can't deny that but the best price I could get was MEP. We sometimes could not even get MEP prices and I applied for and obtained dispensation".

This answer underlines the problem. SBLC only made offers to NIC and it in essence was obliged to accept whatever price NIC was prepared to offer. SBLC was not at liberty to offer to other buyers to introduce competition. In negotiations with NIC and despite the best efforts and intentions of Mr Hirata and Mr Otah they, as part of the NIC Group, had to accept Tokyo office decisions. In reality they had no bargaining power in dealings with NIC. The only constraining factor was MEP and it appears clearly to be THE factor which governed price.

When FIC entered the marketing arena (and Mr Hirata was an FIC Council Member at the time) the previously absent threat of competition was introduced and even NIC agreed to co-operate with FIC. It was put to Mr Hirata that FIC marketing involvement had a dramatic effect on SBLC's marketing.

Mr Hirata said that altered price patterns after October 1986 were a reflection of an improved market and of greater demand for PNG logs but did add that he told NIC of FIC's involvement in log marketing and that he used (higher) price levels achieved by FIC as a weapon to negotiate for price increases for SBLC from NIC.

I was then advised that NIHK resale invoices would be produced and the hearing was concluded. Counsel undertook to produce written submissions.

Before that was done Mr Coady, Counsel for SBLC, had drawn two matters to my attention:-

(a) In the "letters of intent" under which SBLC had operated since late 1982 there was no provision requiring it to sell at "arms length" prices or to obtain best available prices, though standard requirements along those lines were included in the draft Project Agreement.

(b) That there was a contract between NIHK and NIC whereby NIHK only retained in Hong Kong (as a tax haven) a commission of 1% of the CNF price of log resales made by it and that any balance price margin on resale was remitted by NIHK to NIC in Japan (which was not a tax haven and which has high tax rates). Mr Coady said a copy of this agreement would be produced.

On the first point what Mr Coady says is quite correct and the omission is amazing. Mr Coady added that even in the absence of such a provision SBLC contended it had always obtained best available prices.

On the second point an agreement was produced and is dealt with below.

SBLC Tax Position

When asked about SBLC's tax position Mr Hirata referred initially to a summary for the years 1969 to 1985 which he said showed an aggregate profit for those years of K4.3 million with company taxes paid of K1.3 million and dividends paid of K3.4 million of which the State as a 25% shareholder received K850,000.

Of the marketing years examined Mr Hirata said SBLC showed a taxable profit in 1984, losses for tax purposes in 1985 and 1986 and that there would be a taxable profit in 1987.

The documents produced show that in the almost twenty year period between June 1969 and December 1987 SBLC paid income tax in only six years as follows:-

	K
1974	106,080
1979	203,998
1980	196,304
1981	135,253
1982	450,947
1984	<u>246,032</u>
	<u>1,338,614</u>

Although it made a gross taxable profit of just over K2 million in 1987 SBLC was able to use losses of K1.349 million in 1985 and K0.7 million in 1986 together with deductions and allowances to end the 1987 year not paying tax and claiming aggregate losses available for carry forward at the end of 1987 of K156,000.

On the matter of dividends the State has in fact received no cash dividend at all from SBLC. The dividends referred to by Mr Hirata were capitalised and issued as bonus shares - what the State thus received was an additional 850,000 shares in SBLC which because of pro rata bonus share issues to NIC merely retained the States 25% equity in SBLC.

NIHK RESALE RECORDS AND ANALYSIS

As stated above SBLC was asked to arrange production of NIIHK's invoices on resale of SBLC logs for 1984 - 1987 with related documents showing freight rates and financial statements for NIIHK for those years and agreed to do so. These documents were produced save for the invoices and freight documents for 1984 of which it was said NIIHK was having difficulty locating them and that they would be produced when located.

The documents relating to 1984 have not been produced to date.

The documents produced were analysed and tabulated in Schedules 11B (1985), 12B (1986) and 13B (1987).

From the "A" Schedules and "B" Schedules for each year Commission staff extracted details, on a shipment by shipment basis, of disclosed margins above MEP on the sale by SBLC to NIIHK and unit prices to SBLC (USD per m³) for each year (1984-1987) and margins above MEP on the resale by NIIHK and unit prices to NIIHK for each year (1985-1987).

These details are tabulated in Schedules 10B (1974), 11C (1985), 12C (1986) and 13C (1987).

In the process of this analysis it became necessary to separate the resales by NIHK to Japan as these were dealt with on a different basis, and as isolating the sales to Japan was desirable for analysis purposes.

Details of Japanese sales are contained in Schedules 11D (1985), 12D (1986) and 13D (1987).

With this data tabulated analysis was then possible on a year by year basis and generally that analysis, reported below, gives great cause for concern.

1984

NIHK resale documents for 1984 were not produced and I do not accept, for reasons indicated below, that in the one year period which has elapsed since they were requested, NIHK has not been able to locate them. It is generally considered that 1984 was a very good year in the log market preceding a very bad year in 1985.

During 1984 SBLC planted 466 ha of reafforestation plantation and though the cost of that planting was available as a deduction for tax purposes SBLC still made a profit of K1,922,072.00 attracting tax of K246,032. In its marketing table (Schedule 10A) SBLC discloses that its aggregate sale price to NIHK in 1984 was USD381,912 above MEP or 2.94% above MEP on average. The margins above MEP and unit prices on a shipment by shipment basis are set out in Schedule 10B and, as Mr Hirata agreed, are very closely and directly related to MEP levels.

Over the whole year SBLC's prices to NIHK only averaged a price USD1.57 per m³ above MEP levels.

In 1984 NIHK had its best year between 1984 and 1987. It made an after tax profit of HKD 12,981,769. A dividend of HKD 12 million was declared and issued as bonus shares increasing the share capital of NIHK to HKD 75 million.

When later evidence is considered and the market in 1984 is considered it all suggests the markups to NIHK and NIC on resales SBLC logs during this year were very high and that is the real reason why the 1984 resale documents have not been produced.

If the whole or part of those markups was considered excessive and improper by the Taxation Office the whole or such part of the markups would be added by the Taxation Office as taxable income of SBLC and as SBLC showed a taxable profit during 1984 would attract company tax and additional penalty tax due to non disclosure. This alone would afford a reason not to produce the documents from which the markup could be calculated and details made known to the Taxation Office.

In his submissions on behalf of SBLC Mr Coady has submitted that a return to NIC over the years 1985 - 1987 at an average of USD4.00 per m³ on resales of SBLC logs is reasonable bearing in mind costs and a reasonable profit margin. In coming to that premise Mr Coady has used the only available figures being those for:-

- (a) the 1985 year which Mr Hirata of SBLC described as the worst year on record during his involvement in the log market;
- (b) the 1986 year when Mr Hirata again said the market was depressed until October when it began to improve
- (c) the 1987 year when the State was vigilant, more than ever before, in monitoring log prices.

The calculation of USD4.00 per m³ is, as will be shown below, an invalid over simplification. There is every reason to believe that for these three years the NIHK markup would be at its lowest. If figures for 1984 - a good year with no real constraints operating - were added, the prospects are that the USD4.00 per m³ figure would increase markedly.

This prospect would afford another reason not to produce the 1984 documents.

In late 1986 the market was on the rise and a boom year was confidently predicted for 1987. State marketing by FIC was well established by then. SBLC budgetted for a sales profit of K759,569 for 1987 and with log prices being closely monitored achieved a sales profit of K2,752,458 - almost four times the budget.

In those circumstances, and as will be detailed below, NIHK still managed a markup over USD1.375 million in 1987 on resales of SBLC logs. The figures provide an interesting insight as to what may have occurred in the good market in 1984 when there were no constraints (other than MEP prices) and no vigilant monitoring, yet SBLC still made a profit of almost K2 million in PNG.

It also seems clear from the pattern of levels of log export that when the market is good and profits are good SBLC's production is at high levels and when it is bad SBLC's production levels drop. In 1984 and in good market conditions SBLC exported 243,729 m³ of logs. In 1985 when the market was poor it exported only 184,567 m³ of logs - a drop of almost 25%. In 1986 and 1987 with improved prices the level returned to over 240,000 m³.

For all these reasons and with the 1984 resale documents of NIHK not produced I consider that a very substantial markup was made on resale by NIHK of SBLLC logs in 1984. I cannot do other than guess at the range of the markup but a figure in the order of USD 1 million to USD 3 million (or between USD4.00 and USD 12.00 per m³) would not surprise me.

I am obliged to recommend that this question of the amount of, and justification for, NIHK markups on resale of SBLLC logs for 1984 and years prior to 1984 be referred to the Taxation Office for investigation and, if appropriate for reassessment of SBLLC's company tax liability. The reasons are amplified below.

1985

During 1985 SBLLC exported 184,567 m³ of logs in 30 shipments all but seven of which were at exact MEP prices. The seven exceptions were exported at well below MEP prices (Schedule 11A). Overall SBLLC obtained aggregate prices USD179,325 below MEP levels.

NIHK resold those logs as follows:-

i)	to various Korean and Taiwanese buyers	115,036.818 m ³
	(62.3%)	
ii)	to NIC Japan	65,805.240 m ³
	(35.7%)	
iii)	to Maruni Mokko Japan	<u>3,724.704 m³</u>
	(2.0%)	<u>184,566.762 m³</u>

In this worst year in Mr Hirata's involvement in the log trade it must be borne in mind firstly that NIC's export production levels dropped dramatically and secondly that SBLLC recorded a loss in Papua New Guinea for tax purposes of K1,349,067.00

On its resales NIHK suffered a loss on five of the 30 shipments, made a profit on sixteen of those shipments and made no margin on nine other shipments (all of which were resold to its parent NIC Japan). Overall NIHK made a gross margin of USD 350,205.89 in terms of markup and additionally received USD207,368.89 in interest on its sales to NIC. (Schedule 11B).

In 1985 NIHK made a profit of HKD3,239,262 which after tax of HKD2,265,000 yielded an after tax profit of HKD 974,262. The accounts show a tax rate of 18.5% and do not explain how the tax is so high other than a note saying "Taxation is provided on the estimated profit for the year".

In order to analyse what occurred it is necessary to split Japanese sales from sales to Korea and Taiwan and then to further split Japanese sales into those to NIC and those to Maruni Mokko.

Korean and Taiwanese Sales

During 1985 each resale by NIHK to a Korean or Taiwanese buyer except two was of a whole shipment of logs. The two exceptions were shipments resold in part to Hanyang Plywood of Korea and in part to Japan. There were thus not multiple buyers sharing part shipments. On the total 115,036.818 m³ sold to Korean and Taiwanese buyers the markup to NIHK was USD245,745.39 at an average of USD2.14 per m³ and at a rate per shipment to a single buyer of USD13,652.52.

In his submissions to me Mr Coady said there was an agreement between NIC and NIHK whereby NIHK only retained a commission of 1% of the CNF price on log resales and remitted the balance to NIC. He said a copy and translation

of the agreement would be produced. A copy agreement and translation was later produced (Schedule 16) but it governs only sales to Japan and not sales to Korea and Taiwan. The reason for this is apparent and is dealt with below.

Thus the whole of this markup was retained by NIHK. The aggregate amount of the markup (or loss) on a shipment by shipment basis can be seen in Schedule 11B under the heading "SURPLUS OVER FOB PRICE US\$". The rate of markup per m³ on a shipment by shipment basis can be seen in Schedule 11C by comparing the "EX PNG UNIT PRICE" with the "END UNIT PRICE"

The percentage above or below MEP of the price disclosed in PNG and the resale price out of Hong Kong can be seen in Schedule 11C by comparing the columns "EX PNG CF MEP" and "END FOB CF MEP". (When making these comparisons the sales to Japan should be excluded and they are indicated by names in Schedule 11B and by symbols in Schedules 11C).

The MEP comparison is most revelatory and shows that generally NIHK was obtaining on resale margins well above those disclosed in PNG.

What NIHK did to earn these margins was explained in evidence. It received full instructions from NIC Tokyo which checked all the documents. All that the few staff of NIHK (servicing the whole NIC Lumber Department) did was receive a letter of credit, pay SBLC by telegraphic transfer and then invoice the buyer and negotiate payment on his letter of credit. All this was done on instructions from NIC Tokyo. For this NIHK received a total USD 245,745.39 at rates of USD2.14 per m³ or USD 13652.52 per shipment. The per m³ margin represented 4.4% of SBLC's average log 'sale price for 1985.

Such a markup cannot be justified by cost and a reasonable margin of profit and amounts to clear transfer pricing.

Japanese Sales

The system on Japanese sales was different and was different on sales to NIC and Maruni Mokko in Japan. Perusal of log export summaries indicates that the SBLC shipments to Japan were of better quality and more desirable species than shipments to Korea and Taiwan. Generally Japanese shipments from SLBC contained a good percentage of species such as Pencil Cedar, Taun and Calophyllum which are well known and popular in Japan. Generally also shipments resold to NIC were split into parcels for two or three port discharges with species separations made, presumably intended to take advantage of regional preferences and put desired and known species into a discharge port where they were popular. This would maximise resale prices. Maruni Mokko buys from producers other than SBLC and is a major customer of Gaisho NG (IR No 4 Vol 2). It is a large furniture manufacturer which buys quality logs for furniture making and which has a distinct preference for Taun and Pencil Cedar. In general terms in 1985 the system between NIHK and NIC was that NIHK did not apply a markup on its sales to NIC. Obviously the arrangement of price can be used as a device to transfer funds between the two companies as and when the need arises within the NIC group.

On nine of the thirteen shipments resold to NIC, NIHK resold at exactly the same price as it bought from SBLC . On the other four shipments resold to NIC, NIHK made a profit on two and a loss on two with the result that NIHK made an aggregate markup of USD14,913.96 on resale to NIC of 65,805.24 m³ at an average USD 0.23 per m³. (Schedule 11D).

With the two resales to Maruni Mokko, NIHK resold at a massive markup. The aggregate markup was USD89,547.24 on a volume of 3,724.704 m³ at an average USD24.04 m³ (Schedule 11 D).

If, as the Commission has been told, the agreement between NIC and NIHK was operative (the Agreement produced- See Schedule 16 dates back to October 1983) then whatever the markups between NIHK and NIC the arrangement is that NIHK only retains an amount equal to 1% of the CNF price of its resales to Japan and returns any funds in excess of that amount to NIC.

This is a perfectly understandable arrangement if NIHK is selling to NIC at cost price (ie at the same price as it buyers from SBLC) and is allowing 180 days credit at interest. It is also understandable that prices between NIHK and NIC could by manipulated so as to pay that commission by way of markups on price or interest charges. What I have difficulty understanding is why NIC or Maruni Mokko would pay money to NIHK and NIHK would then deduct its commission and return the excess to NIC in Japan which is where the money came from in the first place. That is the evidence however and despite the the lack of apparent logic it was not questioned.

Accepting the evidence, NIC receives the vast bulk of the markup gained on sales to Maruni Mokko and it would also receive any profit on its own resale to other Japanese buyers of logs sold by NIHK to it (less the 1% commission to NIHK). The level of mark up on sales to Maruni Mokko is absurdly high, could not be justified by reference to costs plus a reasonable margin of profit and clearly amounts to transfer pricing.

The position on NIC's further resales to other Japanese buyers of SBLC logs, resold by NIHK to NIC cannot be calculated as NIC's further resale prices are ~~not~~ known. Those logs, according to Mr Hirata, are resold according to the promissory note system (usually on 180 days credit) and the credit is provided by NIHK to NIC and the resultant interest is paid by NIC to NIHK. It must be remembered that the species mixes were good and that the sales involved two or three port discharges with species sorting to maximise prices. I consider that the massive margins for Maruni Mokko were indicative of true Japanese market prices and have little doubt that NIC would have made a handsome markup on these resales.

Whether that markup would amount to transfer pricing or could be justified by cost factors and a reasonable profit is not known. In making an assessment it would have to be borne in mind that NIC would have to recoup its cost and make a reasonable profit in relation to NIHK's total resales of SBLC logs because all resales (including those to Korea, Taiwan and Maruni Mokko) are in effect transacted by NIC.

Summary

The system used by NIC and NIHK is quite clear. All resales of SBLC logs are transacted in effect by NIC but in name by NIHK which performs "paper switching" tasks in Hong Kong. On resales other than to Japan NIHK retains any price markup and the amount of that mark up is known. On Japanese resales NIHK resells only to NIC or direct to Maruni Mokko and NIHK receives a commission of 1% of the CNF price which though high is probably within the bounds of what is reasonable. (NIHK also receives interest for the credit

period allowed on sales to NIC). Any markup above this 1% on Japanese sales is for NIC. On resales to Maruni Mokko the amount of the markup is known. On further resales by NIC to other Japanese buyers the amount of NIC's markup is not known but could reasonably be expected to be handsome.

In 1985:-

- (a) the markup by NIHK on non Japanese resales could not be justified by elements of cost and a reasonable profit and amounts to transfer pricing;
- (b) The 1% of CNF price to NIHK on resales to Japan is high but is within the bounds of what is reasonable
- (c) the markup to NIC on NIHK resales to Maruni Mokko is obscenely high, could not be justified by elements of cost and the right to make a reasonable profit and it amounts to transfer pricing.
- (d) the markup to NIC or its further resales to other Japanese buyers is not known, but I expect it is very high. I do not know whether it could be justified by costs and the legitimate need to make a reasonable profit on the full range of NIHK resales of SBLC logs which are transacted by NIC.

1986

During 1986 SBLC exported 241,522 m³ of logs in 35 shipments all but five of which were at exact MEP prices or less than 1% above MEP prices. Two shipments were made through FIC and they are excluded from this analysis for the purpose of calculating markup margins.

Overall (and excluding the FIC shipments) SBLC obtained aggregate prices USD111,101 above MEP levels.

NIHK resold the logs bought from SBLC as follows:-

i)	to various Korean buyers	186,271.310m	3,77.1%)
ii)	to NIC Japan	44,203.883 m3	(18.3%)
iii)	to Maruni Mokko	1,155.100 m3	(0.48%)
iv)	to another Japanese buyer	<u>1,496.320 m3</u>	(0.62%)
		233,126.613 m3	
	SBLC sold through FIC	<u>8,395,768 m3</u>	
		<u>241,522.381 m3</u>	

In this year SBLC's export production levels increased markedly over those in 1985 but SBLC still managed a loss before deductions and adjustments of K698,526 and after deductions and adjustments of over K2.7 million for taxation purposes.

On its resales NIHK suffered a loss on five of the 33 shipments to it (including small losses on resale of 3 of those shipments to NIC) and made a profit on the other 28 shipments. Overall NIHK made USD1,293,351 in terms of markup and additionally received USD127,684 in interest on its sales to NIC. (Schedule 12B)

In 1986 NIHK made a profit of HKD 2,654,114 which after tax of HKD1.9 million yielded an after tax profit of HKD 754,114. Again the accounts show a tax rate of 18.5% and do not explain how the tax is so high. There is the same note in the accounts as in 1985 "Taxation is provided on the estimated profit for the year".

Again for analysis purposes it is necessary to split Japanese and Korean resales by NIHK.

Korean Sales

During, 1986 there were 19 shipments to a single Korean buyer and six shipments to more than one buyer (four to two buyers and two to three buyers). Again therefore the great majority of shipments were one buyer shipments and the exceptions involving more than one buyer concerned very large shipments.

On the total 186,271.31 m³ sold to Korean buyers the markup to NIHK was USD 1,218,292 at an average USD 6.54 per m³ and at a rate per shipment of USD 49,726.

The whole of this markup was retained by NIHK. The aggregate amount of the markup can be seen in Schedule 12B on a shipment by shipment basis under the heading "Surplus Over FOB Price". The markups on the five shipments of over 10,000 m³ alone are USD 83,802, USD 139,334, USD 85,938, USD 111,369 and USD 111,723.

The rate of markup per m³ on a shipment by shipment basis can be seen in Schedule 12C by comparing "EX PNG UNIT PRICE" with "END UNIT PRICE". The percentage above or below MEP of the price disclosed in PNG and the resale price out of Hong Kong can be seen in Schedule 12C by comparing the columns "EX PNG CF MEP" and "END FOB CF MEP". (When making these comparisons the sales to Japan should be excluded and they are identifiable by reference to Schedule 12D).

The contrast of end buyer prices above MEP to prices disclosed in PNG is quite startling. Again NIC did no more to earn these margins in 1986 than it did in 1985.

For its very limited efforts NIHK received a total USD 1,218,292 at rates of USD 6.54 per m³ or USD 49,726 per shipment. The per m³ margin represented 13.16% of SBLC's average log sale price for 1986.

Such a markup cannot be justified by cost and a reasonable profit margin and is clearly transfer pricing at a very high rate.

Japanese Sales

The general position is as outlined above for 1985. In 1986 there were eight shipments resold by NIHK to NIC. Three were resold at essentially the same price as NIHK had paid SBLC; four were at a substantial markup on the NIHK buying price from SBLC and one was resold at a small loss by NIHK.

Overall NIHK made an aggregate markup on these resales to NIC of USD 39,685 at a average of USD 0.90 per m³ (Schedule 12D).

Only one part shipment was resold to Maruni Mokko and this was at a massive markup. The markup was USD 32,989.66 on a volume of 1155.1 m³ at an average USD 28.56 per m³. (Schedule 12D).

There was also a small part shipment of 1496.32 m³ resold by NIHK direct on an FOB basis to another Japanese buyer on which there was a markup of USD 2426.90 at a rate of USD 1.62 per m³.

NIHK would receive its 1% commission on Japanese sales and, of course, received the interest for the credit period on its sales to NIC.

The markup on the Maruni Mokko resale was obscenely high, could not be justified and amounts to clear transfer pricing.

On resales to NIC margins on further resales by NIC are not known but doubtless would have been very high. Whether they could be justified raises the same questions as arose in 1985 sales.

The small sale to the other Japanese buyer involves a high margin for what NIHK itself did but is within the overall bounds of what is reasonable.

Summary

The system was very much the same as in 1985 and the result for 1986 is simply expressed in the same terms as it was for 1985 with the addition that the NIHK markup on non Japanese sales was very much higher, indeed obscenely high.

1987

During 1987 SBLC exported 243,705 m³ of logs in 33 shipments with only one shipment (to India) at exact MEP prices and all others at variable margins above MEP. The FOB price pattern and MEP margins out of PNG are what one would expect to see if free market forces were operating.

One shipment was made through FIC and it is excluded from this analysis in calculating markup margins.

Excluding this FIC shipment SBLC obtained aggregate prices USD 2,221,320 above MEP levels.

In 1987 NIHK resold logs sold to it by SBLC as follows:-

i) to various Korean buyers	163,568.441 m ³	(67.15%)
ii) to NIC Japan	60,512.352 m ³	(24.8%)
iii) to Maruni Mokko Japan	6,907.519 m ³	(2.8%)
iv) to Indian buyers	<u>6,988.164 m³</u>	(2.9%)
The FIC shipment was of	<u>237,976.476 m³</u>	
	<u>5,728.909 m³</u>	
	<u>243,705.385 m³</u>	(2.35%)

In this very good market year SBLC retained its 1984 and 1986 production levels and, though it made a K2 million gross taxable profit after deductions and adjustments, it still managed to show a net loss for taxation purposes.

On its resales NIHK showed a loss of USD 34,092 on one shipment, a loss of USD 15.74 on another shipment and broke even on a third shipment. Resale figures are not available for one shipment. On the other 28 shipments NIHK made a profit.

A feature of 1987 was the resales by NIHK to NIC where on a total of 11 shipments or part shipments NIHK either broke even or made a loss which severely reduced NIHK's overall profits by almost USD149,988 (Schedule 13D). Overall NIHK made USD1,375,828 in terms of markup and additionally received USD172,155 interest on its resales to NIC.

In 1987 NIHK made a profit of HKD 3,887,941. There was no tax provided for the 1987 year but an adjustment was made for taxation for previous years. At the end of 1987 NIHK had (after the bonus share issue in 1984) profit available for appropriation of HKD 5,319,455 and an interim dividend of HKD 1 million was paid leaving unappropriated profits of HKD 4,319,455.

The whole question of tax on NIHK's taxable income appears quite strange. The rate of tax is said to be 18.5% but provisions are made at much higher rates and in 1987 a ~~very~~ substantial adjustment was made. The only logical explanations appear to be that some expenses claimed by NIHK have been disallowed for tax purposes or that its taxable income has been found to be higher than shown in the accounts.

Again for analysis purposes it is necessary to split Korean, Indian and Japanese resales by NIHK. The FIC shipment is dealt with earlier and in the Commission's Interim Report No 3.

Korean Sales

During 1987 there were nine shipments to a single Korean buyer, eight to two buyers, three large shipments to three buyers and two shipments shared between Nissho Iwai and Hanyang Plywoods. Again the shipments were essentially to one buyer with very large shipments having more than one buyer.

On the total 163,568.441 m³ sold to Korean buyers the markup to NIHK was not known for a shipment of 11,007.134 m³ thus reducing the volume for calculation purposes to 152,561.307 m³.

On this volume of 152,561.307 m³ the markup to NIHK was USD1,291,515 at an average USD 8.47 per m³ and at a rate of USD 61,500 per shipment.

The whole of this markup was retained by NIHK. The aggregate amount of the markup on a shipment by shipment basis can be seen in Schedule 13B under the heading "SURPLUS OVER FOB PRICE".

The markups on the five shipments of over 10,000m³ on which end figures are available taken alone, amounted to USD 99,953, USD 161,467, USD 161,154 USD 33,712 (because half the shipment was resold to NIC at no markup) and USD 30,149 (again because half the shipment was resold to NIC at no markup). The rate of markup per m³ on a shipment by shipment basis can be seen in Schedule 13C by comparing the columns "EX PNG UNIT PRICE" and "END UNIT PRICE".

The percentage above MEP of the price disclosed in PNG and resale price out of Hong Kong can be seen in Schedule 13C by comparing the columns "EX PNG CF MEP" and "END FOB CF MEP"

(Again when making these comparisons the sales by FIC, to India and to Japan should be excluded - the Japanese sales are identifiable by reference to Schedule 13B, the FIC sale is shipment 6 and the Indian sale is shipment 22).

The contrast of margins above MEP disclosed in PNG and end buyer price margins above MEP is quite startling and of great concern. In 1987 it was believed State marketing involvement and monitoring had minimised transfer pricing. The scatter and variety of SBLC selling prices and range of prices compared to MEP tended superficially to confirm this. When end buyer prices are considered it is clear the belief was fallacious and end buyer prices were still well in excess of prices disclosed in PNG as were end buyer margins above MEP.

Again in 1987 NIHK did no more to earn these large margins than it did in 1985 and 1986. Far from past practices being discontinued they were continuing, but at a reduced scale.

For its very limited efforts on Korean sales in 1987

For its very limited efforts on Korean sales in 1987 NIHK received a total of USD 1,291,515 at rates of USD 8.47 per m³ and USD 61,500 per shipment. The margin per m³ represented 11.15% of SBLC's average log sale price for 1987.

Such a markup again cannot be justified by cost and a reasonable profit margin and is clearly transfer pricing again at an obscene rate.

Indian Sale

This sale is described earlier. It was at MEP levels and was said to show how SBLC's relationship with NIC could operate to SBLC's benefit. It was said that NIC concluded a sale with Indian buyers and the purchase from SBLC was concluded. There were delays and the MEP rose resulting in the price to SBLC being below new MEP levels. NIC then agreed to rewrite its contract with SBLC to pay the new MEP levels of price.

I was clearly intended to infer that NIC incurred a substantial loss on the shipment by this conduct. The invoices produced still show NIHK made a markup of USD2,585.76 on this shipment.

From documents provided SBLC applied for an export licence in June 1987 to ship 6,000 m³ to India at specified prices said to average USD 58.58 per m³. The application was altered to add another 1,000 m³ on the same basis.

In August 1987 an amended application for export license was lodged to cover 7,000 m³ at the new MEP levels. The original (June) price for 7,000 m³ would have been USD 410,060 at an average USD 58.58 per m³

The actual shipment made in August was of 7000 m³ (in fact 6988.164 m³) and the FOB price at exact new MEP levels was USD 503,422.32. Even with this large rise in its buying price from SBLC NIHK made a markup of USD 2,585.76. What in effect had occurred, quite clearly, was that out of this "magnanimous" gesture in renegotiating price NIHK had been obliged to reduce its intended markup on this shipment from in the order of USD 95,000 to a mere USD 2,585.76.

One can only comment cynically that when its other 1987 markups are considered NIHK could well have afforded to make such a gesture.

Japanese Sales

The general pattern is as outlined during 1985 and 1986 but during 1987 there were two noteable changes. Firstly resales to NIC were made at a substantial aggregate price loss but at a low unit price loss by NIHK.

Secondly the direct resales to Maruni Mokko were significantly increased as were the margins on those resales.

In 1987 eleven shipments or part shipments were resold by NIHK to NIC. Four were resold at essentially the same price as NIHK had paid SBLC, one was resold at a substantial markup on the NIHK buying price from SBLC and six were resold at substantially lower prices than the prices paid by NIHK to SBLC.

(Interestingly five of these six "loss" shipments for NIC contained a part shipment to Maruni Mokko sold at a markup which far exceeded the "loss" on the part shipment on the same vessel resold to NIC).

Overall NIHK made an aggregate loss on the 60,512.352 m³ of logs resold to NIC of USD149,987.89 at an average loss of USD2.48 per m³. (Schedule 13D). Five part shipments were resold to Maruni Mokko at a massive markup. The markup was USD 279,138 on a volume of only 6907.519 m³ at an average of USD 40.41 per m³ (Schedule 13D).

NIHK would receive its 1% commission on Japanese sales and, of course, received the interest for the credit period on its sales to NIC.

The markup on the Maruni Mokko resales was obscenely high, could not possibly be justified and it amounts to clear transfer pricing.

With the "discounted" prices it paid to NIHK NIC was placed in a very advantageous position on further resales to other Japanese buyers but the margins made are not known. Those margins would clearly have been substantial. Whether they could be justified raises the same questions as in 1985 and 1986 sales.

Summary

The system was similar to 1985 and 1986 and in general the result is similar. In 1987 the markup on non Japanese resales and Maruni Mokko resales was much higher than in 1985 and 1986 and was incredibly excessive. NIC received discounted prices on resales to it and all indications are that it would have made very substantial markups on its further resales in Japan.

OVERVIEW

The Commission's study of SBLC was of great relevance as it involves insights into the largest log exporter in PNG, in which the State has a substantial shareholding. It provides insights into the marketing and financial conduct and practices of one of the world's largest and most diverse transnational corporations, Nissho Iwai Corporation. Partly because of the State equity, partly because of its perceived performance and partly because of its effective public relations, SBLC, is regarded as a "model" operation within PNG.

Superficially there is some basis for that view. SBLC appears to have a sound equity base and a good road and bridge building record. It has voluntarily constructed some public facilities and has planned and executed its operations better than other operators. It also appears to have a commitment to onshore processing and reafforestation and to be a responsible marketer, bearing in mind its widely publicised problems with unpopular major species such as Malas and Celtis.

It is only when that superficial appearance is subjected to question and analytical scrutiny that aspects of that facade begin to crumble.

Before turning to those aspects, however, certain positive things must be said.

It can hardly be questioned that the planned future direction of the SBLC operation indicates the path of the future in large scale forest operations in this country.

The plans for substantial reafforested plantations on which future reliance will be placed and on integrated onshore processing are steps in the right direction. The SBLC experience indicates that "soft loan" funding is available to support moves towards forest plantations and quality infrastructure construction and that the Japanese Government is committed to financially support spending in such ventures in which its own corporate citizens are involved.

The State was able to make available a very large area of natural forest to SBLC for a long term project and SBLC committed itself to a very heavy long term investment.

SBLC and its powerfull parent company obviously considered that the project was viable and it demonstrates the benefits which can be achieved through effective long term planning.

Unfortunately, after committing itself to this heavy investment programme SBLC came up against ministerial irresponsibility and bureaucratic ineffectiveness. Firstly the Minster issued inadequate and non binding letters of intent which started the expanded operation off on a non legal basis. Then, despite SBLC's efforts to regularise its situation and to gain secure title and guaranteed ownership of the trees it was to plant, it was left without such security, to operate on no formal basis except the 1982 and 1986 letters of intent. This situation continued for over six years until early 1989 when a project agreement was concluded.

Despite these incredible failures by the State SBLC has continued to operate and to pour in money. The fact that it has persisted for so long must reflect its confidence in the venture's long term profitability (topped up of course by its secret transfer pricing) and it is also partly explained by the fact that it had already committed such a high level of funds. Even now it still has no legal basis for operations because at last reports a consolidated Timber Permit had still not issued.

So far as the commission is concerned SBLC, unlike most other companies, has voluntarily provided all documents and information requested (except NIHK resale material for 1984) including documents the production of which could not have been compelled by the Commission. It must be given full credit for that, for the appearance of Mr Hirata and Mr Otah and for the assistance of Mr Coady, its Counsel, all at SBLC expense.

With that said the negative aspects which I have found must be mentioned.

(a) Basis of Operations

As indicated above SBLC has had no legal basis for its operations since September, 1982. The company has made genuine efforts throughout the period but Minister Waka issued "letters of intent" as an interim measure and the

State agencies have failed completely to show the will or ability to cope. Even in the draft Project Agreement, under negotiation when the Commission was sitting, there were startling and inexcusable deficiencies. Two examples suffice:-

- i) Even though in 1987 SBLC almost achieved its previous commitment to input 50,000 m³ of logs into its Buluma sawmill the new project agreement provided that such input could reduce to 30,000 m³ and then build up again at a rate of 5,000 m³ per year to the already achieved input target of 50,000 m³.
- ii) Even though SBLC already had detailed feasibility and costing data on Zephyr board and kiln drying facilities the agreement provided a period of 2 years to conduct feasibility studies in both these areas.

(b) Local Processing

The Buluma sawmilling facility is of inadequate design, is technically obsolete and is poorly maintained. In the 1980's the output has ranged from 13,111 m³ to 15,594 m³ of sawn timber with nowhere near required levels of log input except in 1987. The sawmilling operation involves in large measure sawing, and thus obtaining some return from, export log rejects. The milling operation is very inefficient, staff morale is low and the ratio of net sawn timber output from gross log input is very low (dropping from 37% in 1984 down to 32% in 1987). Though some planing is done and a moulder and chemical treatment plant are installed there is no kiln drying and air drying is not correctly carried out. The very high wasteage volume is not commercially utilised, except to a small extent, because there has been no secondary processing to date.

Visiting World Bank experts described the operation as what one would expect from a reluctant local processor who has had processing forced on him as an operating condition for his log export operation.

The further problem in selling sawn timber for SBLC is very high domestic freight rates and high freight rates to Australia and New Zealand. The results of SBLC's inefficient operation are, therefore, of no real assistance in gauging whether sawn timber processing could be viable in PNG, though some insight into the problems can be gained.

(c) Reafforestation

After trial plantings of 255 ha from 1976 to 1978 SBLC has accepted reafforestation obligations since 1982 as conditions of operation. At the end of 1988 its plantings were to be in the order of 3700 hectares and overall it proposes to plant 22,500 ha of forest plantation at a total cost of K75 million. Details of the benefits of forest plantations, growth rates, costings and financial aid obtained are set out above. The problem of land tenure and debate about ownership of plantation trees are also detailed. The benefits of plantation forestry against natural forest exploitation are manifold and the world trend is towards forest plantations where operating benefits and advantages can be optimised.

Whilst SBLC's reafforestation efforts are outstanding in PNG members of the recent World Bank team considering the matter against world standards were unimpressed. They consider SBLC's efforts are of the standard to be expected from a log export operator who has reafforestation obligations imposed as operating conditions and reluctantly performs them. Their main criticisms related to SBLC's failure to use available modern genetic engineering technology to improve growth rates and yield.

(d) Landowner Benefits

The SBLC operation involves over 400,000 ha of land. Landowners receive royalties and no other direct benefits. They receive indirect benefits from infrastructure and employment. With SBLC's operations intended to move from this massive natural forest area to forest plantations it seems no thought has been given by SBLC or the Government about the future of the owners of the exploited natural forest. Careful thought should be given to this problem.

MARKETING

SBLC exported sawn timber to Australia and New Zealand and logs to Japan, Korea, Taiwan and India. A large part of its sawn timber production is sold domestically.

Sawn Timber

There are apparently no price controls on domestic sales of sawn timber and no effective controls on export sawn timber sales. There is no minimum export price for

sawn timber and no export license is required. An export permit is required (as sawn timber is prohibited from export without permission of the Minister for Forests) but such permits are almost automatically issued without any apparent co ordinated attempt to control prices.

So little sawn timber is now exported from PNG that this is not a major problem - SBLC's exports of 2834 m³ of sawn timber in 1987 represented 80% of PNG's total sawn timber exports. Price controls must be put in place if export levels are to increase. Up to April 1988 SBLC sawn timber was marketed by its corporate relative NIA for "nominal" commission on domestic sales and 6% commission on export sales. In fact SBLC sold to NIA which then resold to its very small band of New Zealand and Australian importers. NIA's "markup" on resales to New Zealand was generally small and to Australia was greater reaching unacceptable very high levels on two shipments in early 1987. Any margin of price markup above 6% commission is dubious but markups of AUD 15,595.64 on a shipment of 538 m³ (at an average AUD 34.61 per m³) and of AUD 28,570.99 on a shipment of 311 m³ (at an average AUD 91.87 per m³) must, in the absence of an acceptable explanation, be considered transfer pricing. Time has not permitted an explanation to be sought.

Log Exports

This is the area on which attention focussed as SBLC is the largest exporter of PNG logs and all the evidence suggested and then confirmed that SBLC with its parent NIC and sister company NIHK is and has for years been involved in transfer pricing on a very large and systematic scale and on a continuous basis.

NIC is a trading company and arranges resales of SBLC log exports. SBLC "negotiates" price with NIC and NIC arranges all resales and makes shipping and like arrangements.

All SBLC logs are sold and invoiced by SBLC to NIHK and then resold by NIHK. All logs destined other than for Japan are reinvoiced by NIHK to the true buyer.

In general logs destined for Japan are reinvoiced by NIHK to NIC, NIHK sells to NIC on credit (usually 180 days) and NIC pays NIHK commercial rates of interest for the credit period. The exception to this is some resales to the Japanese furniture manufacturer Maruni Mokko where the resale is invoiced direct from NIHK to Maruni Mokko. For resales by NIHK to Japan there is said to be an agreement in force between NIC and NIHK whereby NIHK receives only a 1% commission based on its CNF resale prices and any additional resale price "markup" is for the benefit of NIC. That agreement does not extend to resales to destinations other than Japan so any resale price markup by NIHK is for the benefit of NIHK. All the "work" involved in buying from SBLC and reselling and in relation to shipping, buyer claims etc is carried out by NIC. The buying from SBLC is not difficult - it offers its logs only to NIC and despite the best efforts and intentions of SBLC staff it is obliged to accept the last price which NIC offers. The only constraint is the need to sell at or above MEP levels or to convince the PNG authorities that sale below MEP levels should be permitted.

The reselling would involve effort, time and expense even though NIHK only resells to a very limited number of buyers in large volumes and NIC only further resells to a very limited number of Japanese buyers again in substantial volumes. The role of NIHK is limited to obtaining payment on the resale, financing resales to NIC at interest and telegraphic transferring payments to SBLC. All the documents are checked by NIC staff in Japan and the very small NIHK staff perform their "paper switching" tasks on specific instructions from NIC Tokyo Office.

In broad terms the system is clear. Any markup on Japanese sales is for the benefit of NIC and NIHK receives a 1% "service fee".

Generally one would expect to see, with such arrangements, NIHK reselling to NIC at very much the same price as NIHK paid SBLC. That is the general pattern in the poor market conditions of 1985 (Schedule 11 D); in 1986 the pattern was similar but a small average markup to NIHK was imposed (Schedule 12D) and in 1987 the pattern changed somewhat with NIHK reselling to NIC at a substantial loss (Schedule 13D).

The explanation for these changes in pattern may be no more or less than using log prices to achieve the desired balance of funds and profit distribution between NIC and its Hong Kong subsidiary NIHK.

The cost to NIHK of "earning" its markups on resales of SBLC logs to destinations other than Japan would have been minimal. Its costs of earning its 1% commission on sales to Japan would be well covered by that commission. On Japanese resales NIC would have to recoup its costs for the "work" it did on all NIHK purchases from SBLC and all NIHK resales (to Japan and elsewhere) and would be entitled to a reasonable margin of profit.

The available evidence is quite clear and relates in detail to the 1985, 1986 and 1987 years.

In general terms SBLC selling prices to NIHK between 1985 and October 1986 were very closely tied to PNG MEP figures and only varied very slightly from MEP figures.

From November 1986 (when FIC became actively involved in selling to traditional markets) SBLC selling patterns changed. Its sale prices were at varying margins generally well above MEP levels suggesting that free market forces were operating and that any previous practices involving transfer pricing had stopped.

SBLC was very concerned about and opposed to the prospect of State involvement in marketing. It was well informed on the subject as its General Managers Mr Mori and then Mr Hirata were members of the Forest Industries Council

When FIC State Marketing was accepted by FIC Mr Mori voiced his concern but was reassured by Mr Gresham that if FIC rather than an independent body was involved at least a degree of control could be exercised (See Interim Report No 3 Vol 1 pages 16-17)

SBLC made losses for tax purposes in 1985, 1986 and 1987. NIHK in contrast made profits in each of these three years. Those profits were significantly contributed to by "markups" on resale of SBLC logs to destinations other than Japan.

The resale prices obtained by NIC on its further resale of SBLC logs within Japan are not known but all the evidence suggests considerable markups would have been available particularly during 1987 when NIC's buying prices were subsidised by NIHK reselling to NIC at a loss. The results for 1985 1986 and 1987 are known with certainty from documents voluntarily produced.

On NIHK resales to Korean and Taiwanese buyers the details were:-

YEAR	VOLUME (m3)	AGGREGATE MARKUP (USD)	UNIT MARKUP (USD/m3)
1985	115,037	245,745	2.14
1986	186,271	1,218,292	6.54
1987	<u>152,561</u>	<u>1,291,515</u>	<u>8.47</u>
	453,869	2,755,552	AV. 6.07

(A volume of 11,007.134 m3 resold to a Korean buyer in 1987 is excluded as the resale price is not known)

The margins cannot be justified and amount to clear transfer pricing.

On the one NIC arranged sale to India in 1987 delays, changes in MEP levels and a renegotiation of the SBLC selling price to new MEP levels reduced the NIHK margin on the shipment from in the order of USD95,000.00 to a mere USD 2585.76. On NIHK resales to Maruni Mokko (for which NIHK retained its 1% commission and NIC received the balance of the markup) the details were:-

YEAR	VOLUME (m3)	AGGREGATE MARKUP (USD)	UNIT MARKUP (USD/m3)
1985	3724.70	89,547.24	24.04
1986	1155.100	32,989.66	28.56
1987	<u>6907.519</u>	<u>279,137.74</u>	<u>40.41</u>
	11787.323	401,674.64	Av. 34.08

Such margins cannot be justified and amount to clear transfer pricing.

On NIHK resales to NIC (where again NIHK received 1% commission and NIC received any further markup) details were:-

YEAR	VOLUME (M3)	AGGREGATE MARKUP (USD)	UNIT MARKUP (USD/m3)
1985	65,805	14,913 (Profit)	0.23 (Profit)
1986	44,204	39,649 (Profit)	0.90 (Profit)
1987	<u>60,512</u>	<u>149,988 (Loss)</u>	<u>2.48 (Loss)</u>
	170,521	95,426 (Loss)	0.56 (Loss)

The margins achieved by NIC on further resale of these logs in Japan is not known but could reasonably be presumed to be substantial. It cannot be guessed whether the markup would cover costs and a reasonable profit for all the "work" carried out by NIC.

In overview whilst SBLC has made tax losses in PNG and sold at prices tied to MEP up to October 1986, and after October 1986 cast at superficially impressive levels above MEP, its parent NIC and sister company NIHK have cynically and continuously been benefitting from transfer pricing on a systematic and large scale, reposing a large part of the proceeds of that endeavour in Hong Kong. Equally cynically, when SBLC was suffering from high interest rates on large local bank borrowings in early 1988, NIHK lent SBLC a sum of

K2 Million, at interest, to assist in reducing its domestic borrowing interest charges. This loan represented, in effect, the return to SBLC in loan form of the ~~the~~ proceeds transfer priced to NIHK on resales of SBLC logs during 1986 and 1987.

The figures which are set out above probably reflect the levels of transfer pricing on SBLC logs at their lowest because:-

- (a) 1985 was probably one of the worst years the log market has experienced and SBLC accordingly reduced its log export levels to almost 25% below the levels of previous and following years.
- (b) the poor market conditions continued into 1986 and during 1986 Government attention was focussed on log price levels and saw the entry of FIC into the log market as a seller.
- (c) in late 1986 and 1987 FIC's market involvement continued (and DOF carried on that role when FIC ceased involvement) and log export licences were altered to a ship to ship basis to facilitate price surveillance and monitoring.

Those factors and the available evidence give rise to two real concerns.

- 1) When the pattern of SBLC export prices after October 1986 is studied there are clear but variant trends in unit prices and in margins above MEP. During this time MEP was being adjusted and the pattern is what one would expect to see if free market forces were operating in an active and at times volatile market.

This type of pattern in the marketing of a number of companies had led to a belief that due to State (including FIC) intervention free market prices were being obtained and remitted to PNG, that offshore "agents'" commissions had been trimmed to acceptable levels and that transfer pricing had been minimised if not eliminated.

When the end buyer prices of NIHK for SBLC logs, to the extent they are known, are considered it is clear that this impression and belief is illusory.

In general terms up to October 1986 SBLC had been selling to NIHK at or close to MEP prices (with minor trends either way depending on market conditions).

During this period NIHK had been generally reselling SBLC logs at well above MEP prices (or well above the prices it paid SBLC) and had effectively been reposing that part of the end buyer price above MEP levels in Hong Kong.

With active FIC involvement in traditional markets from October 1986 this past practice was altered. In its last three shipments in 1986 SBLC received in PNG almost the whole of the end buyer price margin above MEP levels. In 1987 this radical change was moderated. As can be seen in the clearest terms from Schedule 13C the moderation took the form of NIHK obtaining a margin above MEP prices dictated by market conditions and then sharing that above MEP margin with SBLC (by leaving a portion in PNG). The proportion of the sharing varied with SBLC generally receiving about one half to two thirds of the above MEP margin.

By this clever and quite cynically conceived practice the illusion described above was created.

Though the result was a reduction in previous levels of price transfer into Hong Kong (and perhaps into Japan on Japanese sales) the simple fact remained that "true" buyer prices remained substantially higher than the prices paid by NIIK to SBLC but that SBLC was receiving a greater share of margins above MEP than previously. The discovery of these facts indicates that State intervention to date has not been entirely successful in combatting transfer pricing and in producing "true" raw data on "true" market prices but rather that it has had an effect in reducing transfer pricing and in producing more accurate data on "true" prices than before.

2) The data analysed by the Commission relates to years when it was thought that State involvement in marketing and market factors had reduced transfer pricing to a minimum. As large scale transfer pricing was still continuing however, one wonders what occurred in previous years (1984 and earlier) when market conditions were reasonably good and there was no effective control on selling prices.

From previous reports (which are detailed in the main body of this Interim Report) it seems clear that:-

- (a) up to 1979 Japanese buyers dominated the PNG log market and in effect dictated price;
- (b) in mid 1979 the Japanese monopoly was broken by an independent producer selling direct to Korea at almost double previous prices;
- (c) MEP levels were adjusted upwards in response, in some cases by almost 100%;
- (d) Japanese buyers accepted new MEP levels to restrict direct buying by agents from Korea and Taiwan and to preserve their dominance;

- (e) in the result log prices almost doubled between 1979 and 1980;
- (f) the MEP system was not kept current and by 1983 was described as not reflecting market prices, historical and lagging behind market movements and out of phase with the market, resulting in MEP prices being cast at unrealistically low levels.
- (g) in early 1984 MEP prices were altered to USD and adjusted but again set at low levels without reliable market data - then MEP prices were not adjusted for a period of about 18 months.

In effect during the whole of this period that MEP was the only control mechanism on export prices, MEP prices were (quite deliberately) cast below what were perceived as market levels and were not reviewed with any regularity on the basis of any reliable market data.

During this period it could reasonably be presumed that SBLC log prices fitted the pattern described earlier of being tied to MEP prices or close to MEP prices (with minor trends either way depending on market conditions) and with NIIHK "hiving off" margins above MEP prices paid by its resale buyers and keeping those margins in Hong Kong (or on Japanese sales remitting them to NIC in Japan).

This presumed price pattern for SBLC is seen in 1984 (see Schedule 10B) and that price margins were available is clear from the profit sharing agreements between NIIHK and NIC operating in 1983 and 1984 (exemplified by Schedule 16).

During the relatively good market period from 1979 to 1984 SBLC's log export levels and declared profits in PNG were:-

YEAR	LOG EXPORTS (M3)	TAXABLE PROFIT (K)
1979		817,526
1980		616,209
1981	214,285	380,734
1982	161,656	1,255,172
1983	198,961	489,073
1984	243,729	1,922,072

Clearly, on the evidence, there was large scale transfer pricing from 1985 to 1987 when the climate for that practice was at its worst.

In the better climate for such practice between 1979 and 1984 SBLC made substantial onshore profits in PNG.

It follows that there would be every reason to expect that during those years NIHK (and NIC) were making even more substantial profits offshore as there was no effective control on prices to prevent them doing so.

For all the above reasons I am compelled to recommend that SBLC's log marketing from 1979 to 1984 inclusive be referred to the Chief Collector of Taxes for thorough investigation and, if justified, for the reassessment of SBLC's company tax liability.

CONCLUDING COMMENTS

Despite the disgraceful delays and bureaucratic failures it seems that the major and long term project to which SBLC is committed is on the verge of proceeding on a sound and appropriate legal basis.

As indicated above it shows the way to the future in large scale forest plantations and integrated onshore processing facilities.

It also illustrates the capital expenditure that is involved in such projects and the massive financial and commercial power of the type of transnational corporation which must be attracted to participate in such projects.

It must be said that up to date:-

- (a) SBLC's attention to reafforestation obligations has been less than impressive by world standards;
- (b) SBLC's commitment to local processing has been lacking and its attitude to local processing has been one of reluctance - in short it is not and cannot be competitive at its present levels of commitment and with sawmilling alone.
- (c) SBLC has not volunteered to Government negotiating teams the advanced nature of its research and feasibility data and has been content to allow agreements to be negotiated which initially reduce its sawmilling production obligation's and allow substantial time periods to assess the feasibility of further processing installations which it already knows are feasible.

(d) NIIK and NIC have been involved in large scale systematic transfer pricing on SBLC log exports on a continuous basis.

The lessons to be learned from these occurrences are important and the reasons underlying them are quite understandable. Transnational corporations are by their very nature commercially minded and commercially oriented and are motivated to maximise their income and profits in order to maximise the return on funds invested by their shareholders.

It follows logically that a transnational corporation will seek to minimise its investment in and maximise its return from a foreign investment to the extent that the Government of the host country permits it to do so. In these respects Nissho Iwai Corporation is not unique but typical. These attitudes and motives are widely and well known.

The constructive answer lies not in criticism, threats and retaliation after the event but in the host Government assessing how its own bureaucratic and administrative failures have permitted such abuses to occur and, then, in taking steps to correct and prevent undesired abuses and occurrences.

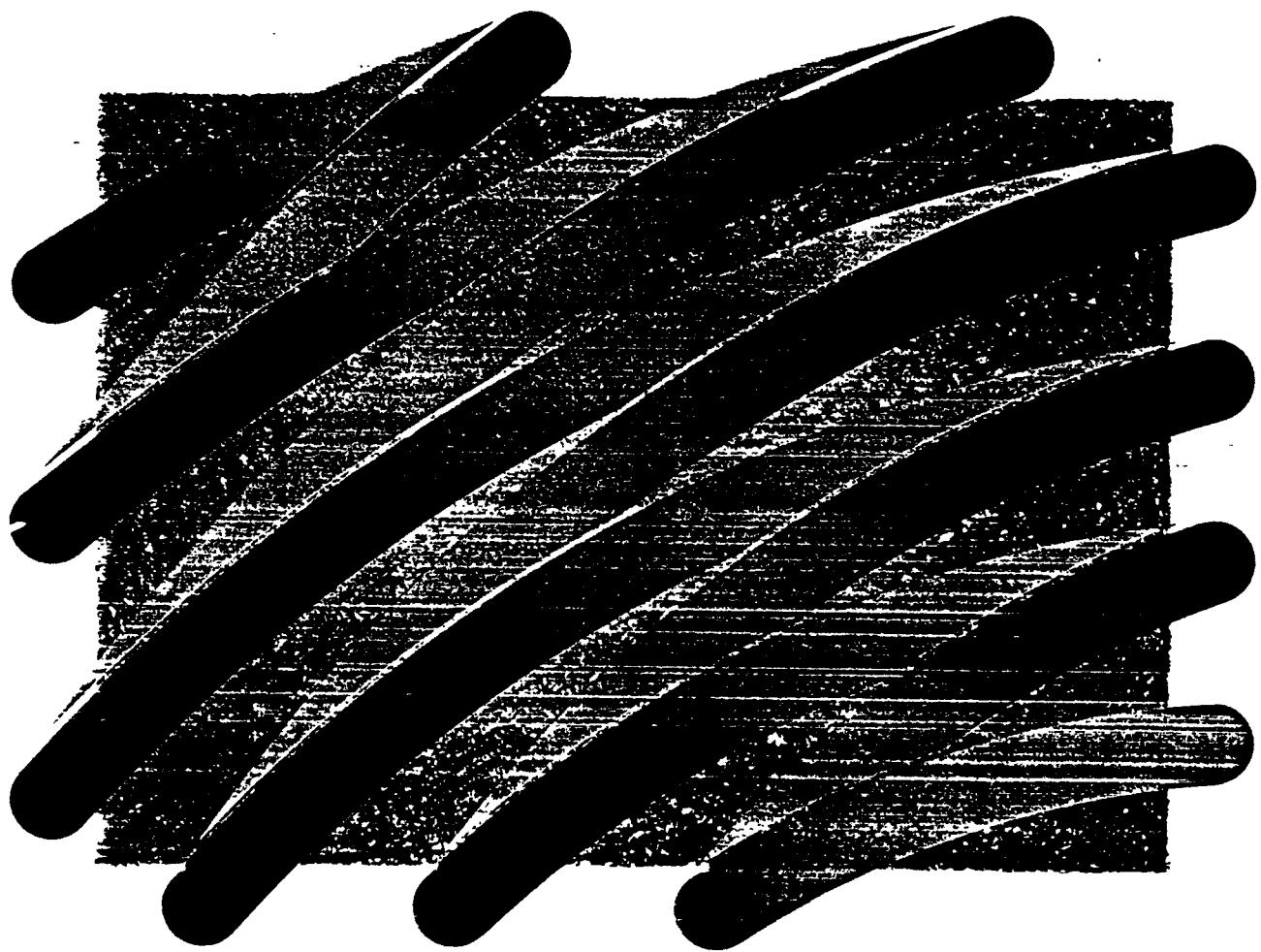
All of the abuses or occurrences described above are, as I have said, understandable and all of them were to a very large extent preventable. They have occurred only because the host Government has not taken care to ensure that its bureaucracy and administration is adequate and adequately equipped to protect its own national long term interests.

The realities of commercial life cannot be ignored.

Papua New Guinea needs Nissho Iwai Corporation and companies like it to be involved in the future forest industry in this country. If we are going to accommodate them and to endeavour to obtain full benefit from their involvement then PNG must also protect and promote its own national interests. It must by ensure that there is appropriate legislation, clear policy and an effective, vigilant bureaucracy and administrative system to prevent undesired abuses and occurrences.

NISSHO IWAI

Annual Report 1986



CORPORATE PROFILE

Nissho Iwai Corporation is among the world's largest international trading companies and a leader in managing large-scale natural resource and industrial development projects. In Japan, we're called a "sogo shosha," or integrated trader, due to the vast range of products we handle and services we provide.

Our expertise comprises more than trading, marketing and distribution, and trade finance and risk aversion alone. We provide a host of services to meet the needs of customers and our complex global business environment. These include transportation, communications, international project management and finance, direct investment, resource development, development and transfer of advanced technology, and offshore trade. New business areas such as computer software, consumer electronics, and publications further expand our worldwide marketing capabilities.

Both in Japan and abroad, we handle the import, export, offshore, and domestic trade of more than 10,000 different commodities roughly divided into four major categories: metals, machinery, energy, and general commodities.

Nissho Iwai's activities are carried out by 7,303 skilled employees — 1,674 foreign nationals and 5,629 Japanese — through a global network of 45 domestic and 137 international offices linked by one of the world's most sophisticated communications systems.

About the cover

On our cover is a lithograph by a Tokyo artist, Takeshi Hara, which reflects the theme chosen for 1986: New Currents. Nissho Iwai continues to excel at our traditional strengths in generating trade flows, but these now join with growth opportunities provided by advanced technology and new applications of existing product and service lines. Just as the print conveys bold movement beyond spatial confines, Nissho Iwai's expansive strategy will enable us to move in new directions and ride future currents.

"Strokes" lithograph by Takeshi Hara
used by arrangement with the Tolman
Collection, Tokyo

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FINANCIAL HIGHLIGHTS

Nissho Iwai Corporation and consolidated subsidiaries
(Fiscal year ended March 31)

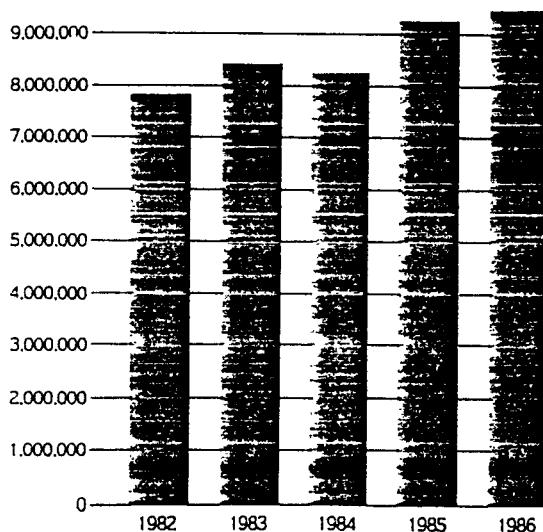
	Millions of yen		Millions of U.S. dollars
	1986	1985	1986
Total trading transactions	¥9,484,528	¥9,202,963	\$52,809
Operating income	35,770	36,170	199
Net income	7,711	10,829	43
	Yen		U.S. cents
Net income per share	13.17	19.56	7.3
Dividends per share	5.00	6.00	2.8

Transactions by type of trade	(U.S.\$ millions)	
Import	28.4%	\$15,010
Export	14.5	7,627
Offshore	25.8	13,637
Domestic	31.3	16,535
Total	100.0	52,809

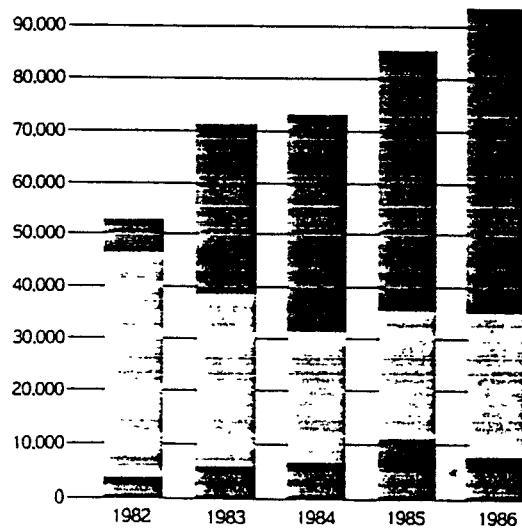
Transactions by commodities	(U.S.\$ millions)	
Metals	29.5%	\$15,596
Machinery/Construction	18.0	9,509
Energy	28.5	15,058
General Commodities	24.0	12,646
Textiles	4.6	2,436
Lumber/Chemicals/		
General Commodities	12.2	6,406
Foodstuffs	7.2	3,804
Total	100.0	52,809

Five-year summary

Total trading transactions
(¥ millions)



Shareholders' equity
Operating income
Net income
(¥ millions)



U.S. dollar sums were translated from yen in the original statement at
\$1 = ¥179.60 as of March 31, 1986. See Notes to Consolidated Financial Statements
(Note 1) for details and basis of computation.

TO OUR SHAREHOLDERS



I am pleased to report that Nissho Iwai's consolidated total trading transactions increased by 3.1%, to ¥9,484,528 million (\$52,809 million). We recorded an impressive rise in offshore trade, although this was partially offset by negative growth in exports. Gross trading profits remained at roughly last year's level, decreasing by 0.6% to ¥169,564 million (\$944 million). Operating income of ¥35,770 million (\$199 million) was off by 1.1% over fiscal 1984.

Our company-wide drive to boost profitability showed some visible results, with current profits reaching a record high of ¥36,473 million (\$203 million), 77.7% higher than the previous fiscal year. This enabled us to take substantial historical write-offs, with the result that net income fell by 28.8%, to ¥7,711 million (\$43 million). A full discussion follows.

Offshore trade hits new highs

A volatile world economy confronted Nissho Iwai in fiscal 1985. Increased trade friction, the huge U.S. current account deficit, and the apparent vulnerability of many Pacific Basin economies painted a dim global trading picture, while

fluctuating currencies and plunging crude oil prices added to the uncertainty. Most serious for Japan was the drastic appreciation of the yen and its crippling impact on exporters, although long-term economic effects should be positive.

Despite this instability, offshore transactions increased by a robust 11.3% in fiscal 1985, largely due to expanded trade in crude oil, aircraft, and general commodities. Imports were also up, by 4.4%, thanks to growth in domestic demand for non-ferrous metals and machinery.

The strong yen curtailed exports, especially of Japanese machinery and steel products. Exports were off by 4.0% for the fiscal year. Domestic trade was also sluggish, with sales decreasing by 0.8% for fiscal 1985.

Results for the product groups were mixed. Expanded trade in crude oil and nuclear fuel reprocessing contributed to a 12.0% rise in Energy transactions, and brisk trading in gold helped Metals to 3.8% growth. Aircraft and heavy machinery deals showed steady growth in fiscal 1985, highlighted by All Nippon Airways' decision to purchase 15 Boeing 767-300 aircraft, with an option for ten more: Nissho Iwai is Boeing's sales consultant in Japan. A decline in ship and chemical plant exports resulted in a net drop of 2.7% for Machinery. General Commodities were hurt by the yen's rise: Trade in textiles and foodstuffs fell by 12.8% and 7.6%, respectively, but other commodities recorded a gain of 5.3%.

Steps taken to enhance future results

With current profits at a new high, we took some financial measures that would put the company in a strong position for future growth. One step was an historical write-off of ¥69 billion (\$384 million), primarily for a shipping company operating foreign flag-of-convenience vessels. This trimmed net income considerably. In consequence, the Board of Directors voted to issue new dividends at ¥5 (2.8c) per share, or 10% of face value, slightly reduced from last year's dividends.

We also announced our difficult decision to withdraw from the Canada LNG project. Although we were favored with excellent cooperation from both Canadian suppliers and Japanese buyers, the recent energy situation has made continued participation financially untenable.

Management changes occur

We have promoted four Managing Directors to Senior Managing Directors: Shigetomi Kitamura, Masayuki Murata, Shoji Ushiki, and Sokichi Ikeda. Five Directors have become Managing Directors: Teruhiko Nakanishi, Tetsuro Sugiyama, Takehiko Tsuchiya, Akira Sugihara, and Fujio Umetani. At our General Meeting of Shareholders in June 1986, the following executives were selected as new Directors: Kunio Komatsu, Toshiaki Tanimoto, Shinichi Shirai, Tsunemitsu Itayama, Hidefumi Asuka, Susumu Yoshida, Yuzuru Fukui, Tatsuo Hirata, and Tamotsu Otake. Kunio Komatsu was later appointed Executive Vice President. Tamotsu Kuroda and Seiji Katagi were elected to the post of Statutory Auditor. Retiring during the year were Executive Vice Presidents Takeo Nagasawa and Sozaburo Tsuji, Senior Managing Director Ryoji Kobayashi, Managing Directors Moriyuki Suekane and Kengo Iwasaki, Director Jiro Kawamura, and Statutory Auditor

Toyosuke Okuda. The Board extends to these men many thanks for their long and faithful service.

In order to further expand offshore business, we are strengthening our overseas deployment policy. To this end, Executive Vice Presidents Eiichi Koizumi and Ryo Nishiura were named Chairman of Nissho Iwai (UK) Ltd. and President of Nissho Iwai American Corporation, respectively, in June 1986.

We note with sorrow that Nissho Iwai's Chairman from 1969 to 1972, Masaichi Nishikawa, passed away on June 4, 1986. Mr. Nishikawa played a critical role in the 1968 corporate merger which produced our current structure.

New investments prove noteworthy

Several promising new investments and ventures added excitement to the fiscal year. We launched a feasibility study for a new commercial international telecommunications carrier for Japan, and we established the N.I.F. Corporation (Network Information Forum) jointly with Fujitsu Ltd. and Compuserve Inc. of the U.S. to provide personal computer users with access to advanced information. We also made a ¥300 million (\$1.67 million) investment in the VAN joint venture SECOM NET, in conjunction with other Japanese companies.

We are pursuing a range of business agreements in the biotech-

nology field. Our partners include Bioscot, Simbec Research, Toxicol, TPL, and Porton Products of the U.K., and PAA-Labo Gesellschaft m.b.H. of Austria. A consultancy agreement concluded last fall with British research firm General Technology Systems Ltd. will keep us abreast of European technological developments.

Encouraged by the profitable results of our financial subsidiary, Nissho Iwai International Finance plc, U.K., we capitalized a new subsidiary in Rotterdam, Holland in April 1986. We expect these ventures to further enhance our financial capabilities in Europe.

The future

In October 1985 we unveiled a company-wide strategic planning program ("Challenge '88") which furthers our thrust into such new business areas as computers, communications, and electronics and aims to boost gross trading profits significantly by fiscal 1988. It is my firm belief that trading profit is a key measure of managerial capability; achieving higher levels will lend new credibility to Nissho Iwai's claim to excellence.

The activities mentioned here are just a few of the new business opportunities we are pursuing — the "new currents" which form the theme of this year's Annual Report. We invite you to join us in realizing their potential.



Masaru Hayami
President



August, 1986

INTERVIEW WITH PRESIDENT HAYAMI



Why did you decide to launch "Challenge '88," Nissho Iwai's profitability drive, this year?

This past year, after extensive company-wide managerial discussion, we formulated a long-term plan to make Nissho Iwai a premier company. Since our greatest assets are people, goodwill, and capital procurement power, we decided on a joint business/personnel strategy.

The plan reflects the importance of increased profitability, especially for the trading activities that generate our gross profits. In the past five years, gross trading profits have hovered at the ¥160-170 billion mark, while total trading transactions have increased by 4-5% per year. As a result, our profit ratio has decreased from 2% to 1.8%. We must enhance gross profits if we wish to maintain constant dividends, and increase salaries and bonuses. We also need to strengthen our internal contingency reserves.

Given current global economic conditions, it will take two to three years to achieve a higher profit level, and we'll have to write off non-performing areas among some of our 296 subsidiaries and affiliates.

These mainly came about due to our rapid expansion in the 1960s and '70s. For example, we had guaranteed the loans of shipping companies at that time, but with the global slump in shipping, our financial commitment became a burden. We made the difficult decision to take a ¥69 billion write-off, including losses for Metals transactions, to eliminate this drag on revenues.

Our action was helped by the strong yen, which let us refund dollar borrowings advantageously, and by a current profit of ¥36.5 billion, up by nearly 78% from the previous year. So we were able to maintain a ¥5-per-share dividend, only 2% lower than last year's in face value. After we announced the write-off in February, our stock price shot up from ¥260 to over ¥400 per share. We're now leaner and stronger than ever.

What will be the strategic impact of the strong yen?

Our strategy will parallel the shift in the Japanese economy from export-oriented to domestic-oriented business. We also plan to increase direct investment overseas. The strong yen will effect changes in Japan's economy similar to those seen earlier in the U.S., with the emphasis moving from hard to soft goods, from manufacturing to services. Cheaper imports will improve the trade balance in the long run and eventually boost the economy, but for now it's rough going.

For the sogo shosha, our leading edge consists of value-added trade, comprising attractive financing and new technologies, and compound trade packages which integrate several different departments.

Localizing overseas offices is another way to boost trade on many fronts. In the coming years we'll need to make our overseas operations more efficient — by expanding both local and international transactions and by relying on our expert non-Japanese staff.

How will you expand into new business areas?

Our New Ventures Group will develop new kinds of business, seeding long-term projects with special R&D funding. We're reorganizing our four business groups for better growth, and have introduced autonomous management for our Osaka operations. We've also moved our personnel functions from the Administration Group to the Corporate Planning & Coordination Group as part of our efforts to integrate the two areas.

Today our management foundation is stable, but we're hampered by the slow pace of world economic growth. We're enjoying low inflation, interest rates, and oil prices, but global oversupplies, while great for consumers, raise new challenges for us as traders and marketers. Demand is no longer constant; we need to offer consumers added attractiveness to sell our goods. That calls for creativity.

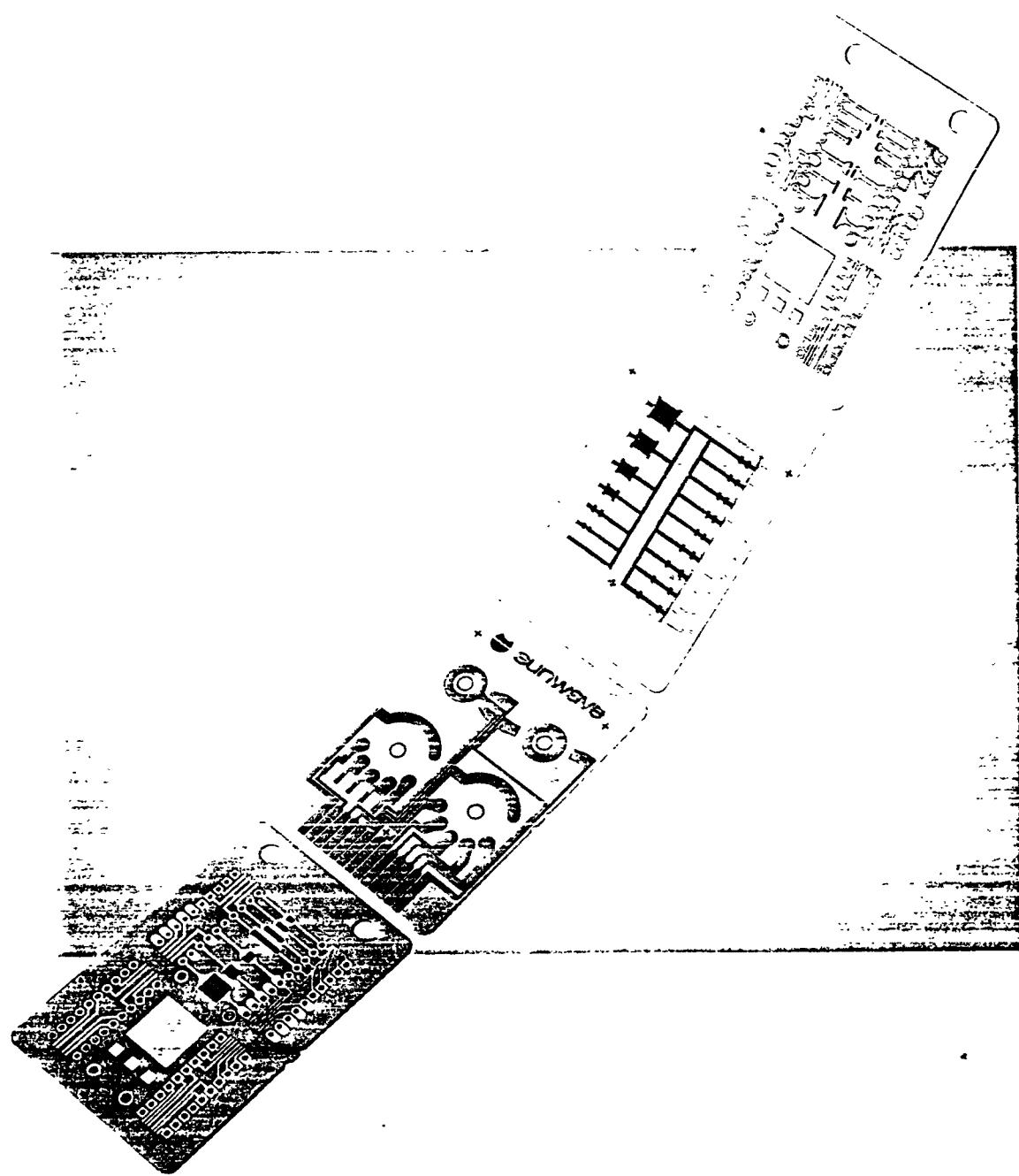
While our basic business will always be trading, we expect service and consumer marketing ventures as well as financial operations to contribute increasingly to revenues.

It's terribly important for us to integrate these widely diverse business lines and global functions. That's something that only a sogo shosha can do, and it's what makes Nissho Iwai such a unique entity.

Nissho Iwai's new business currents include state-of-the-art ceramic substrates utilizing RCA's unique circuit board printing technology. More information on pages 19 and 32.

CORPORATE PROFILE

- History
- Services
- Global network
- Corporate organization
- Board of Directors



HISTORY



One of our predecessor companies, Suzuki & Co., became a world-class trader in the early 1900s under the leadership of Naokichi Kaneko (left) and Seiichi Takahata.

1868

Japan emerges from more than 250 years of isolation sorely lacking in commercial and industrial knowledge. What little trade it does is mainly under foreign control and financed from foreign sources. To maintain national economic autonomy, Japan's leaders call upon domestic commercial interests to establish trading companies able to compete with foreign traders. Soon, companies with a knowledge of foreign markets, technologies, business practices, and languages — called sogo shosha — arise to fill the bill.

Among these are Iwai & Company (established in 1862 by Bunsuke Iwai, and later renamed Iwai Industries) and Suzuki & Company (begun in 1877 by Iwajiro Suzuki). These corporate precursors of Nissho Iwai will play an essential role in importing modern technology, plant, and equipment for the developing nation.

1901

Japan's first step into the secondary sector came with the establishment of modern cotton spinning plants in the 1890s. The trading firms import the raw cotton. In 1901 Yawata Steel ignites its first blast furnace and sparks the birth of heavy industry. Iwai & Company becomes one of Japan's top steel trading firms.

As Japan industrializes, sogo

shosha come to manage a growing volume of the country's goods. By 1874, trading firms handled 1% of Japan's external trade; by 1900 they accounted for 38%, and their share will reach 80% by the end of World War I. The sogo shosha of the 1980s will still handle more than half of Japan's foreign trade — or about 3% of the entire world's trade.

1909

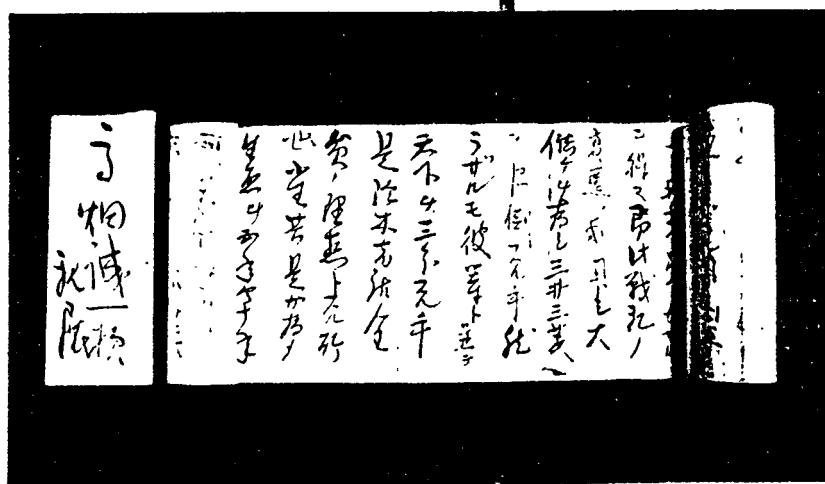
Suzuki & Company has offices in far-flung locales like the City of London, a bustling center of world trade and finance. Suzuki, now known primarily as a sugar trader, has signed huge import contracts with the world's top sugar broker, and maintains close ties with relevant British government agencies. On the strength of this business, Suzuki becomes the second Japanese member of London's Baltic Exchange, a shipping and commodity exchange that finances and transacts the goods streaming in from every outpost of the British empire.

1919

Almost from their inception, sogo shosha carry out more than importing and exporting alone, and their product lines are extensive. Suzuki's list of goods and services now includes iron and refined metals, woolen goods, celluloid, fertilizer, dyes, leather, sugar and flour, beer, matches, oil refining, mining, shipbuilding, rubber cultivation in Borneo, and life insurance. Suzuki is especially well known for grain trading: On behalf of the world's three top grain traders it buys grain in bulk from Japanese producers and provides extensive information on the Japanese market. The company's trading volume this year totals ¥ 1,600 million, making it the biggest shosha in Japan. As a novel of the time notes: "One-tenth of all the ships passing through the Suez Canal are said to belong to Suzuki of Japan, and its symbol covers the seven seas."

Suzuki & Co. is an originator of third country trade, too, selling Chilean sulphur to Russia and Ukrainian wheat on the Baltic Exchange and transporting it all with a 20-ship fleet of 5,000dwt-plus carriers. The company's shipbuilding division produces trampers for Suzuki's use and for sale.

1917: Kaneko brushed a 21-foot-long scroll to Takahata in London, setting out Suzuki & Co.'s strategy to secure world dominance in trade.



1935

With Japan's economic shift from light industries to capital-intensive sectors like steel, shipbuilding, and machinery, new business functions gain importance. The sogo shosha hone such affiliated skills as transportation, trade finance and risk aversion, marketing and distribution, and information-gathering and communications between offices flung across the globe. This year Suzuki, now renamed Nissho Limited, opens offices in Los Angeles and New York, followed two years later by a Calcutta office.

1946

By the end of World War II, Japanese business is in shreds, and the sogo shosha are no exception. U.S. Occupation forces dissolve the two largest general traders, Mitsui & Co. and Mitsubishi Shoji (they are reorganized in the 1950s), allowing smaller firms like Nissho and Iwai to fill the vacuum and supplement their strengths in steel and commodity trading with expanded business in metals and machinery.

1952

The Korean War stimulates expansion of all sectors of Japanese business, and soon heavy and chemical industries predominate. Fueling industrial growth becomes a major headache for resource-poor Japan, and the sogo shosha step in there as well, becoming involved in large-scale energy recovery projects abroad and transferring technology to the developing source countries. The shosha play a major role in sup-

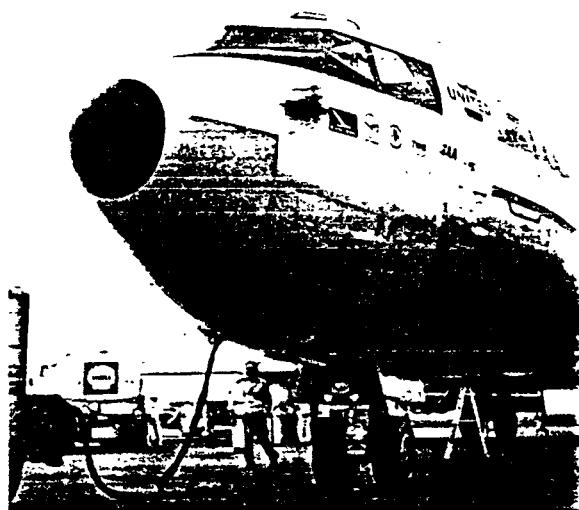
plying Japanese industry and exporting and distributing its output. This year marks the largest post-war plant export yet recorded, as Nissho ships a modern spinning plant to Turkey.

The shosha organize domestic and foreign firms into joint ventures to obtain and process iron ore, nickel, copper, and other metals in Australia, Latin America, Africa, and elsewhere. They also enlarge their presence in developed nations by setting up subsidiaries. Nissho's first, Nissho American Corporation, opens its doors in New York in 1952.

By the early 1960s, Japan's industrial machine is in high gear. The shosha expand business lines to cater to the growth in steel, machinery, and construction sectors and the rise of a mass consumer market in Japan. Involvement in large-scale foreign construction projects abroad helps stimulate demand for the former, and the shosha's long-standing ties to banks and the Japanese government enable them to secure finance for these huge projects at very competitive rates. Catering to the consumer market, the trading companies establish downstream marketing subsidiaries, housing construction and realty ventures, and specialized companies offering such services as engineering and consulting.

1968

Diversification remains the dominant strategy through the late 1960s and 1970s. What were once support services for primary trading and distribution become new profit centers, as information and communication expertise assumes significance in business. Greater size helps; the 1968 merger of Nissho and Iwai allows the combined corporation to realize the benefits of a large capital base, a widespread network, and broader business lines.



1963: Japan's first demonstration flight of the Boeing 727.

1986

The sogo shosha have served Japan well for over a century, but as Japanese companies shift their attention offshore, trading companies increasingly work to benefit the dozens of host countries where they operate. It's little known, for example, that among the ten largest exporters from the U.S. are several sogo shosha, including Nissho Iwai. Offshore trade is an obvious area of increasing importance, as is direct investment. Nissho Iwai's equity participation and technological assistance is helping developing nations set up their own ventures, as well.

As the world's business needs have evolved, Nissho Iwai's capabilities have expanded. Although today's competitive environment makes it more challenging to increase profitability and deal with flux in currencies, pricing, and conditions, the attitudes that have seen Nissho Iwai through a century of leadership should steer us safely through the years ahead.

SERVICES

Nissho Iwai offers an extensive repertoire of services to serve the needs of every client and every transaction in an increasingly sophisticated and knowledge-intensive global business environment. These business tools include:

International trading

Import, export, and domestic transactions have always represented a major share of Nissho Iwai's business. We match buyers with sellers, document the sales process, and oversee transport of goods from pick-up to delivery.

Transportation

Nissho Iwai specializes in safe, on-time delivery worldwide. Our enormous volume of transactions, coupled with an advanced central booking system that pools information and shipments, enables clients to benefit from economy of scale and maximum shipping efficiency.

Marketing and distribution

Our network of offices around the globe lets Nissho Iwai provide established marketing channels for small exporters, while offering larger manufacturers ample coverage of small markets that don't warrant autonomous sales/service networks.

Trade finance and risk aversion

Besides moving goods, sogo shosha specialize in moving money. In fact, trade finance and risk aversion figure among Nissho Iwai's most utilized services.

Communications

Well before computers — and even telephones — were invented, communication was a Nissho Iwai forte. Today our 182 offices around the globe are linked by the NICOMEX III computer, making exchanges between, say, Tokyo and Tulsa, as quick and easy as intra-office conversations.

International project management and organization

Nissho Iwai is experienced at convening and directing diverse international teams to implement multi-billion-dollar projects, anywhere in the world.

International project finance

The ability to put together complex financial packages for international projects is a valuable adjunct to such basic finance services as credit extension and risk absorption.

Direct investment

The ranks of Japan's leading investors in world markets include Nissho Iwai. We invest our own money at home and abroad, as well as arranging finance for others.

Resource development

Our role in developing the world's resources ranges from feasibility studies to shipping, and everything in between.

Development and transfer of advanced technology

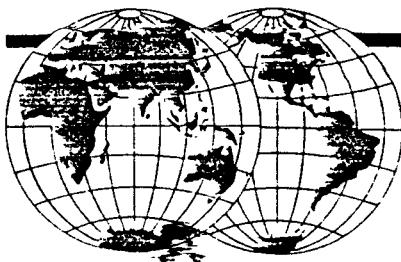
Since the 1970s, Japan has been an active exporter as well as importer of technology. Today, technology transfer is one of Nissho Iwai's fastest-growing business sectors.

Offshore trade

Hand-in-hand with our capabilities in international project organization and investment comes our burgeoning offshore trade activities, which equip Nissho Iwai to respond readily to diversified global market needs.



GLOBAL NETWORK



Most large corporations today claim to have a global network, but few can make the claim with the authority of Nissho Iwai. Nissho Iwai's physical network of 182 offices stretches from Abidjan to Auckland to Anchorage and includes every major commercial center in between. Our human network is international, too, encompassing 1,674 foreign nationals working side-by-side with 5,629 Japanese employees both overseas and in Japan. And we're global in terms of communication capabilities.

The brain behind our seven-days-a-week, 'round-the-clock international communications is NICOMEX III, a vast network of leased voice-grade and telegraph

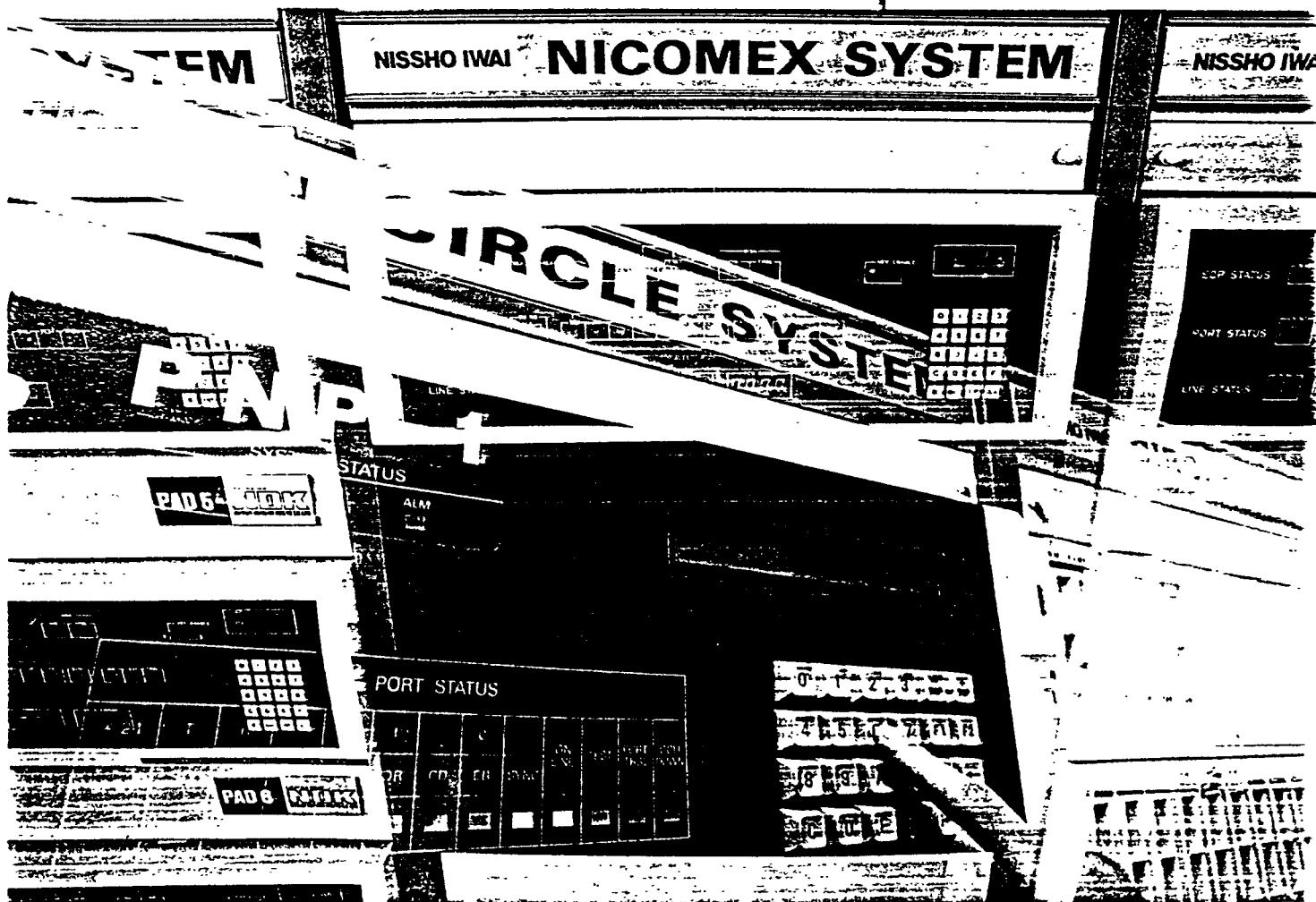
circuits linked by a fully automated message switching system. NICOMEX III zips some 36,000 messages per day around the world, and can send a single message to 24 places simultaneously. The leased circuits can handle facsimile machines and word processors, as well as telexes. With multi-million-dollar transactions hanging in the balance, it's no surprise that Nissho Iwai's information access and retrieval abilities are advanced. What is surprising, perhaps, is that our reputation for gleaning breaking news in far-flung locales sometimes brings the Japanese news media to our door to request overseas updates.

Nissho Iwai is global in terms of something more fundamental than physical structure: our perspective. Today 69% of our revenues derive from nondomestic transactions, and with flows of funds and processed goods transcending national boundaries, it's a rare trade

with absolutely no foreign input. More typical is a recent deal in which a Nissho Iwai-led multinational consortium financed the purchase and leveraged leasing of American aircraft to a Brazilian airline.

Given the increasingly international nature of our work, a range of product sourcing, financing, and marketing options worldwide can provide a critical competitive edge. To do their job well, our staff need a solid grasp of local business conditions, customs, and language; that's why the typical Nissho Iwai Japanese employee stationed overseas is there for five to six years, longer than most corporate transferees. And the 45% of our male Japanese staff who have experienced an overseas stint bring a global awareness home with them.

Newest in Nissho Iwai's information technologies is the CIRCLE world-girdling information management system.



Canada

Environment:

Administered by Nissho Iwai Canada Ltd. (NIC), with offices in major cities. Mainly exports coal, non-ferrous metals, foods, asbestos, and machinery; and imports steel and textiles. With Investment Canada Act — an open foreign investment policy — coupled with anticipated U.S.-Canada Free Trade Agreement, expect more diversified business opportunities.

Strategy:

Expand exports of coal and foods to Japan and textiles, machinery, and general commodities to third countries.

Highlight:

Shipments of Bullmoose coal from British Columbia began 1984, averaged two million tons/year.

Transaction volume:

US\$253 million

Subsidiary branches:

U.S.: Anchorage, Atlanta, Bellevue, Chicago, Cleveland, Detroit, Houston, Los Angeles, Nashville, New York, Philadelphia, Portland, San Francisco, Seattle, St. Louis, Tampa, Washington, D.C.; Canada: Calgary, Montreal, Toronto, Vancouver



South America

Environment:

NIC has strong presence in Brazil — coordinates trade in iron ore; participates in petrochemical ventures; manages exports of textiles, chemicals, steel, foodstuff, and machinery to Japan and third countries. In other countries, provides steel, textiles, machinery, automobiles, and chemicals, and purchases copper, iron ore, coffee, and marine products.

Strategy:

Promote expanded exports; participate in projects financed by the World Bank, Inter-American Development Bank, and Japanese government loans; arrange project financing packages.

Highlights:

Brazil: shipped iron ore of Carajas Mine to Japan from April '86, contracted with USIMINAS for hot strip mill renovation. Ecuador: contracted for oil refinery construction for counterpurchase of Ecuadorian commodities. Trinidad-Tobago: are supplying and installing ammonia plant equipment. Chile: arranged financing for construction of methanol plant.

Transaction volume:

Brazil: \$454 million; Venezuela: \$35 million; Argentina: \$21 million

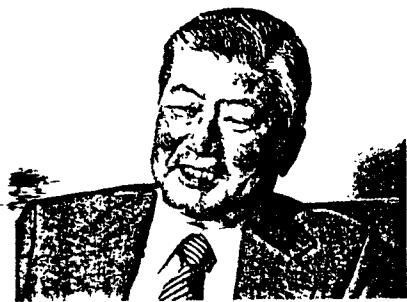
Subsidiary offices:

Central America — Mexico: Mexico City; Panama: Panama City
South America — Argentina: Buenos Aires; Brazil: Rio de Janeiro, São Paulo, Belo Horizonte; Venezuela: Caracas

Offices:

Central America — Costa Rica: San Jose; Cuba: Havana; Dominican Republic: Santo Domingo; Guatemala: Guatemala City; Mexico: Monterrey
South America — Bolivia: La Paz; Chile: Santiago; Colombia: Bogota; Ecuador: Quito; Peru: Lima





Eiichi Koizumi, Chairman,
Nissho Iwai (U.K.) Ltd.

What area does Nissho Iwai U.K. cover?

Our territory is Europe and Africa. But Europe itself includes many completely different languages, as does Africa, which contains some oil-producing countries and some which consume oil. Region-wide policies, while important, don't always work here — so we must establish country-specific strategies as well. From London, we manage and administer more than 30 different offices — it's quite a challenge.

What are important new business areas?

Crosstrade continues to be very significant in Western Europe and finance is an increasingly important profit center as well. Future financial bases for us will include London, Brussels, and Rotterdam. London, of course, is one of the world's leading finance marts, and we plan to strengthen our abilities to act here, and our relations with European banks and securities companies.

Another exciting new area for us is in high technology. We are enhancing our capacities in London by fielding a team of specialists in such areas as communications and biotechnology. These experts will bolster our work in importing technology and technology transfer — the "soft" goods that are becoming as important as trade in conventional goods.

How will you increase business with Africa?

When we consider the considerable political clout as well as the economic potential represented by the 51 African states, we realize how vital it is to develop means of cooperating to help them solve foreign exchange and other problems. We will continue to trade in oil and petroleum products, since even with lower prices they provide stable profits, but we are also studying ways to develop offshore trade, for example, and to increase ODA from Japan. Of course, we are also eager to export more African goods to Japan and other nations. And we intend to promote more cooperative projects to improve the continent's infrastructure.

How can Nissho Iwai work to stem further trade problems?

Both Japan and Europe are basically mature markets in terms of many hard goods, and it's unrealistic to expect a remarkable increase in merchandise trade. But we can emphasize promoting technology transfer, from Europe to Japan for instance. And we can encourage Japanese companies, many of whom are now manufacturing in the U.S., to include Europe in their direct investment strategies. Small and mid-sized Japanese companies, in particular, may find some extremely appealing opportunities for manufacturing in Europe. To improve the information flow as well, we will be sponsoring regular regional conferences on investment opportunities.



EUROPE/AFRICA

Europe

Environment:

Large trade deficits, high unemployment exacerbating trade relations with Japan. Low oil prices are improving economic outlook, though. NIC's exports include shrimp from Denmark, wood pulp from Finland, fish and paper from Norway, pasta from Italy, airships from the U.K., textiles from Italy, and nuclear power expertise from France.

Strategy:

Focus on finance and high tech business; promote technology transfer between Europe-Japan; strengthen links with European financial ventures; encourage Japanese manufacturing investment.

Highlights:

Coordinated local capital and Japanese technology for stainless steel and auto spring manufacturing joint ventures in Spain.

Transaction volume:

U.K.: \$3,295 million; West Germany: \$312 million; France: \$689 million; Italy: \$51 million; Spain: \$29 million; Belgium: \$413 million





Masao Araki Executive Vice President,
Energy Group

***Oil prices are often in flux.
How can you undertake strategic
planning?***

Obviously, oil is a crucial component of our business. Oil prices affect demand for other fuels, so we can't rely on a portfolio of energies for steady income. And since the price of oil tends to be quite volatile — often determined more by psychological and speculative factors than pure market factors — planning can be difficult.

Our policy is to create trade flows in oil, not just react ad hoc to prevailing conditions. We rely on both in-house and outside professionals to inform us of domestic and foreign conditions. We also maintain direct contacts with oil producers, oil majors, refineries, and other major oil traders. We're enhancing our capabilities in overall international oil trading, and offshore oil trade, in particular, looks to become an increasingly important focus.

Because Japan is almost completely dependent on outside energy sources, we hope to continue to maintain a diversified energy portfolio, no matter how low the price of oil goes. And amassing oil reserves now, for resale when prices go up, is obviously part of our strategy.

***With LNG prices relatively high,
is it still a viable energy form?***

LNG may not be currently competitive with petroleum for industrial or electric power generation use, but this is a stable, clean energy, easily transportable by available ships, and we'd like to develop new applications to enable us to maintain a steady flow. Although cost factors terminated the Canadian LNG project, we would still like to diversify our supply sources.

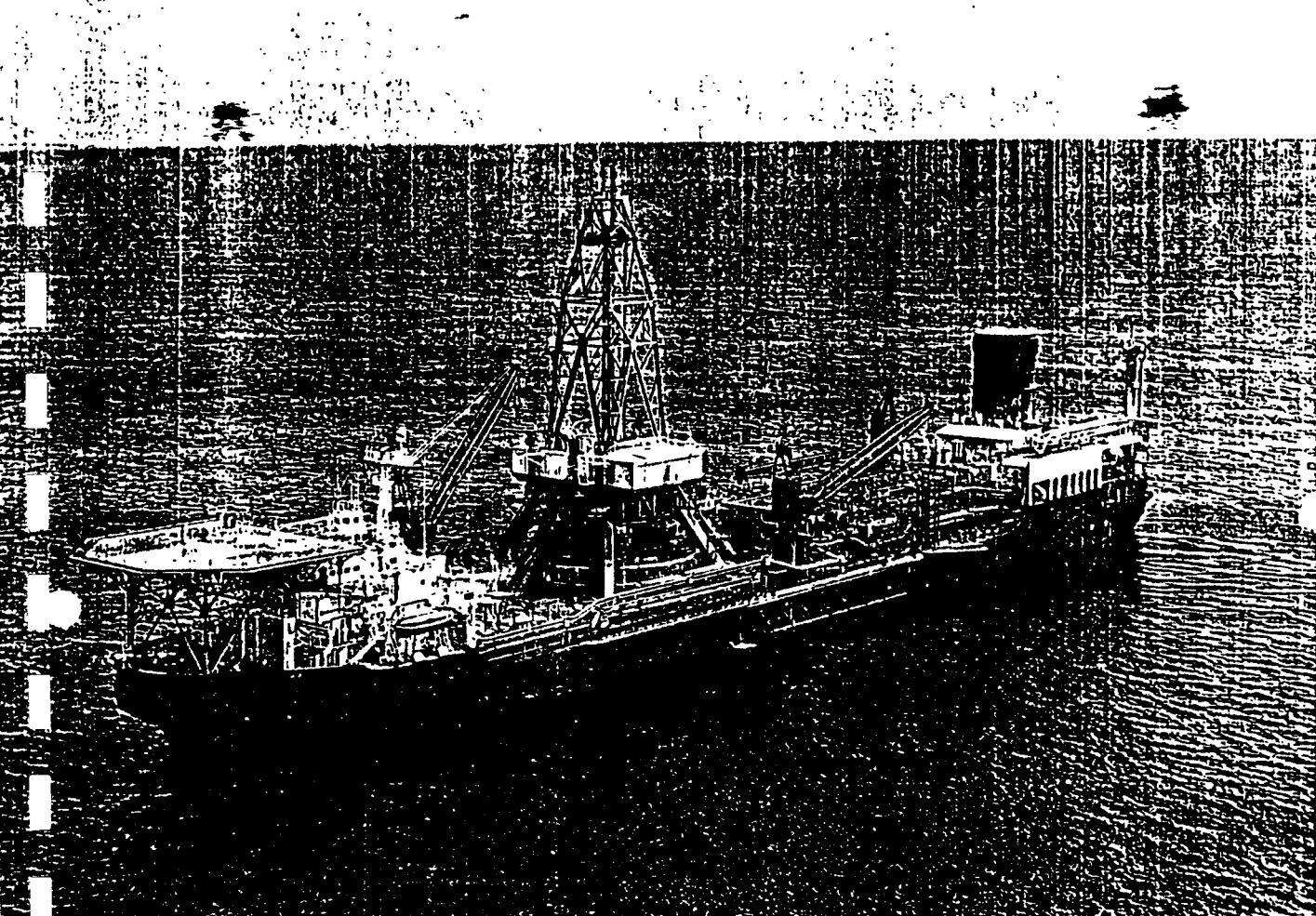
***What about non-oil energy
alternatives?***

We are developing a host of alternatives: LNG, LPG, thermal coal, nuclear fuel, and others. These may not be price-competitive now, but future markets may be different; we see our actions as wise forward investment. For instance, nuclear energy continues to be an important alternative to imported fuels for Japan.

We plan to strengthen our European connections in this field and expand nuclear-related trade with the U.S. We now import thermal coal from Australia and other sites, but hope to expand trade — and improve the U.S.-Japan trade balance — with new supplies from Alaska.

Any new energy sources nearby?

Several Pacific Basin projects offer potential to become profitable sources of supplies. China looms large in our strategy, both as an energy producer and a rapidly industrializing market for fuel. We are also participating in a joint venture consortium which is developing offshore oil fields in Vietnam. As always, we in the Energy Group must concern ourselves with developing long-term stable energy flows, as well as profiting from the current world supply/demand environment.



An on-board mini-refinery makes NKK's new Production Testing Ship a winner.

major Japanese utilities and a steel corporation. It has called on Nissho Iwai's leadership and international cooperation every step of the way, from planning, coordination, and financing to downstream marketing of the output. In 1983, we initiated a second 20-year project to develop 3.2 million more tons of Indonesian LNG per year. And for the past two years we have pioneered in promoting LNG spot sales worldwide.

This activity resulted in a total trading turnover of 12 million tons of LNG — equivalent to nearly half of Japan's annual imports — valued at \$3.2 billion.

Early 1986 has already posed

some formidable market challenges, but we're poised to meet them, by exploring and diversifying energy sources, and by developing more effective uses of natural resources.

The bulk of Nissho Iwai's LPG supplies derive from a long-term import contract with Petromin of Saudi Arabia, augmented by purchases from domestic refineries. In July 1985, we chartered the 45,000-ton LPG carrier Hourai Maru for shuttle service between Saudi Arabian ports and Japan. To accommodate the gas, we have been operating the Yokkaichi 160,000-ton LPG import terminal at full capacity since mid-1984. We handled approximately 600,000 tons of LPG during fiscal 1985.

NUCLEAR ENERGY AND THERMAL COAL

Nissho Iwai is active in nearly every sector of the nuclear industry. In fiscal 1985, our total volume of nuclear related trade surpassed \$1 billion.

We act as exclusive agent in Japan for three top French nuclear energy firms: COMURHEX, for conversion of natural and reprocessed uranium; EURODIF S.A., for enrichment services; and COGEMA, for comprehensive marketing of French nuclear fuel products and expertise, including supplying natural uranium supplies and enrichment and reprocessing services.

Nissho Iwai also prospects for uranium overseas through participation in Japanese uranium mine

Energy includes petroleum, natural gas, and nuclear energy and thermal coal.

PETROLEUM

Fiscal year 1985 marked a turning point in the international petroleum market. The worldwide decline in petroleum demand and the steady rise of non-OPEC crude oil production resulted in chaotic market conditions. In an about-face forced by its need to maintain market share, principal producer Saudi Arabia abandoned its previous role in maintaining international crude oil prices by restraining production. As Saudi Arabia took the lids off the pumps, a price war ensued. Oil prices plunged to little higher than production costs, and OPEC could no longer function effectively as a cartel.

Capitalizing on renewed worldwide demand, Nissho Iwai increased our total volume of crude oil handled

The Energy Division recorded an excellent year in fiscal 1985, with total transactions up by 12% over the previous period, to \$15.058 million. This division accounted for 28.5% of Nissho Iwai's total business.

by 87% and our turnover in petroleum products by 30%. The total dollar amount of both jumped by \$1.4 billion. Contributing to the rise were the launch of trading in Brent Crude in New York and expanded offshore transactions in petroleum products.

By targeting sales to refineries and electric power utilities, we were also able to boost domestic sales by 5% overall, or \$44 million.

Total turnover for the Petroleum Division came to \$4.7 billion for the year.

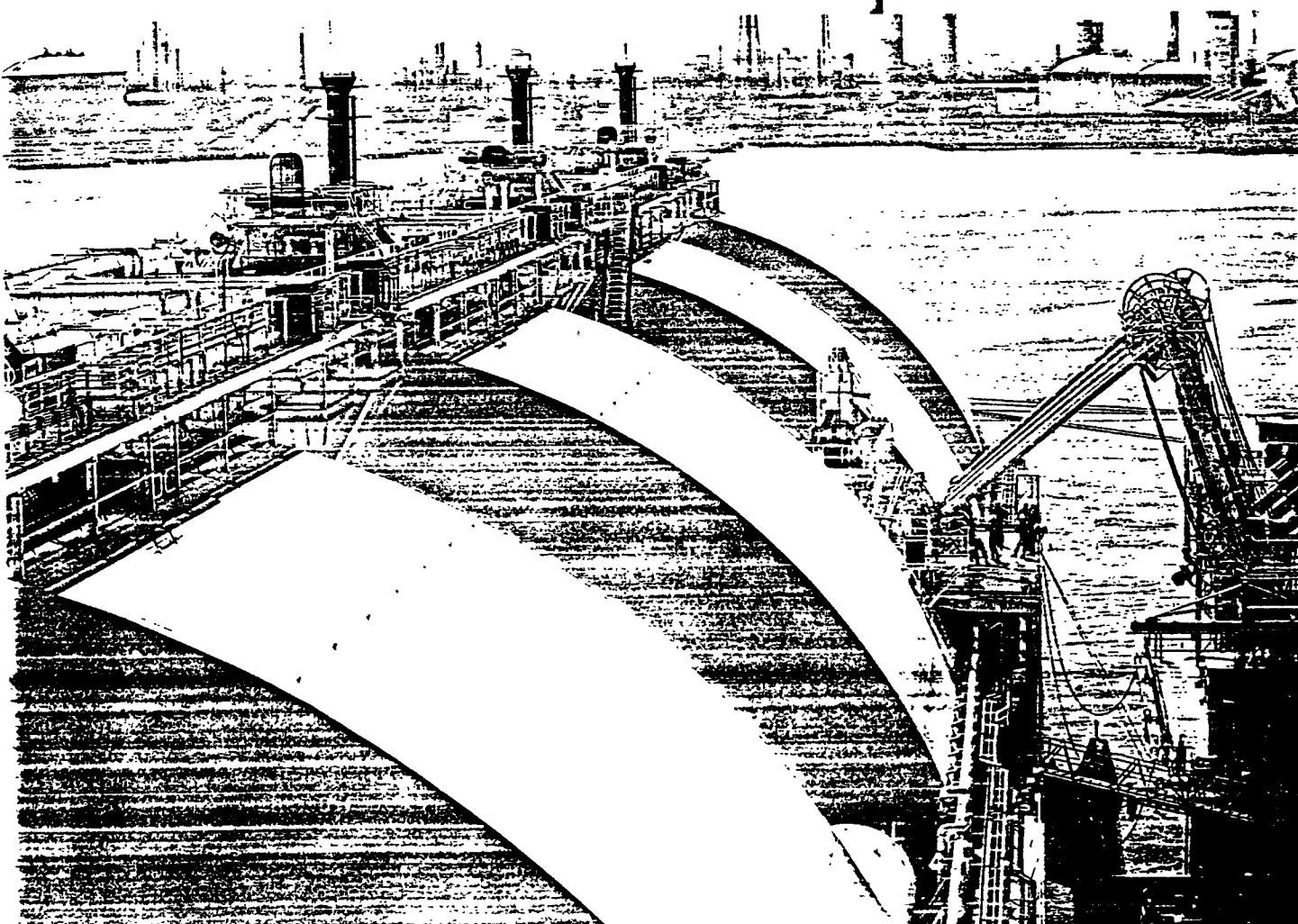
NATURAL GAS

Japan imports nearly all of its energy, and securing stable, inexpensive fuel supplies is obviously of critical importance. Popular alternative energies are the gaseous fuels, specifically LNG (liquefied natural gas) and LPG (liquefied petroleum gas), both prized as "clean" energies with a diverse range of applications.

Nissho Iwai has actively sought energy alternatives since the energy crises of the 1970s. Our role as one of Japan's top traders in LNG and our efforts in developing large-scale energy recovery projects reflect the desire to satisfy domestic needs and forge new markets worldwide.

Our first LNG project was launched in 1977 in Indonesia. That country's largest LNG undertaking is supplying 7.5 million tons of the fuel annually for 23 years to four

We import about half of all LNG used in Japan.



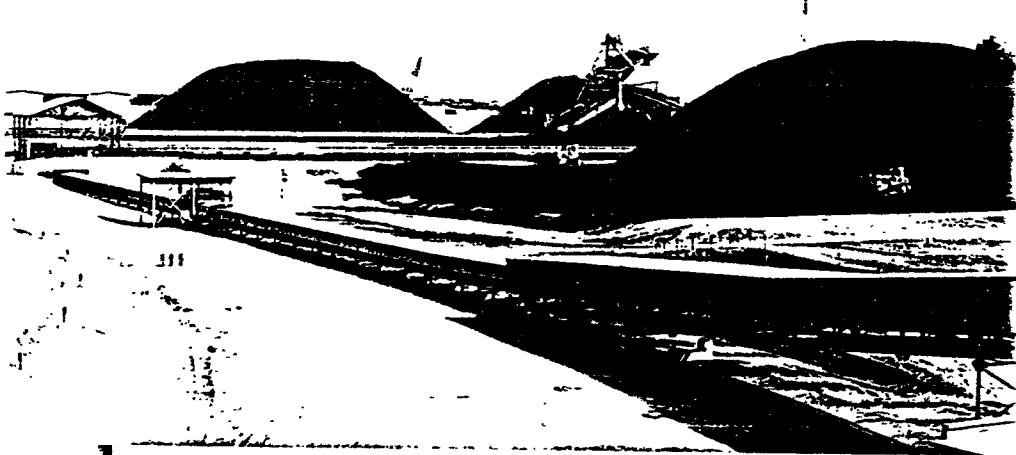
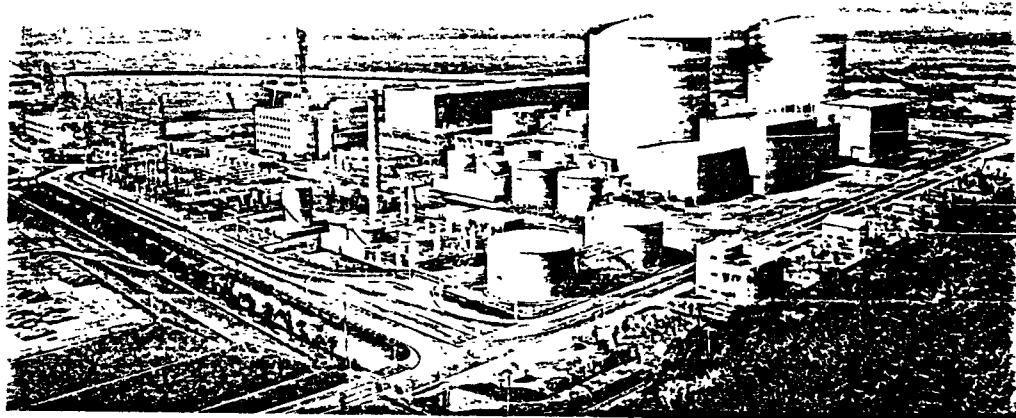
ventures like the Overseas Uranium Resources Development Co., Ltd. (OURD), which supplies Japanese electric power companies with uranium ore from Akouta, Niger.

We are involved in transportation at each stage of the nuclear fuel cycle. For instance, we are a principal shareholder in Pacific Nuclear Transport Ltd. (PNTL), a multinational joint venture based in the U.K. which transports spent fuel from Japan to Europe.

Nissho Iwai has long been a major supplier of enriched uranium and fabricated nuclear fuels for experimental reactor use to research institutions like the Power Reactor and Nuclear Fuel Development Corporation and Japan Atomic Energy Research Institute. We also supply French zirconium semi product to domestic cladding tube producers and casks designed to transport spent nuclear fuel from Kobe Steel to PNTL.

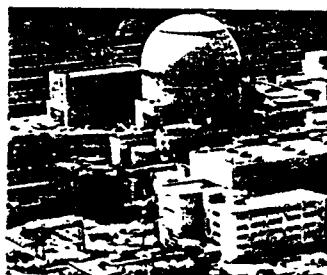
We supply nuclear power plants and R&D organizations, domestically and overseas, with both technology and equipment. Since 1972, we have represented SGN, a French nuclear engineering firm, in providing engineering services and spare parts to a spent fuel reprocessing plant in Tokaimura. We also coordinate licensing agreements between Rockwell International of the U.S. and Kawasaki Heavy Industries Ltd. under which we supply hydrogen recombiners, now standard equipment in all BWR reactors in Japan.

The year has been an active one for our Thermal Coal Department. We continued the joint exploration work with Mobil Oil in Kalimantan, Indonesia that began in 1983, and confirmed over 150 million tons in recoverable coal reserves. This volume is expected to increase as exploration continues. This year also marked the start of joint marketing activities with Mobil, which resulted in indications of interest from Japanese utilities and major clients in Hong Kong, Taiwan, and Korea.



*(top) Nuclear power is a growing force in oil-starved Japan.
(lower) Alternative energies such as coal are also gaining ground.*

The nuclear fuel cycle starts with uranium mining. The uranium in the form of yellowcake is converted, enriched, and reconverted. Then fuel is fabricated and delivered to clients. After use, another cycle begins: collection of spent fuel, reprocessing, and recycling of uranium recovered in the reactors. In Japan, one company handles the entire process: Nissho Iwai. For example, reprocessing of the uranium



remaining after power generation by Japan's 32 nuclear power plants is now entrusted to a French firm, COGEMA, and to British Nuclear Fuels plc (BNFL). The two plan to jointly market uranium that has been reprocessed and converted into fluorouranium. Nissho Iwai is helping with the arrangements as COGEMA's marketing rep in Japan.

GENERAL COMMODITIES



Koshiro Suganuma, Executive Vice President,
General Commodities Group

You have mentioned increased profitability as a primary group objective. How did you do this past year?

Our volume of transactions was slightly down last year, but gross profits were way up. Net profits did even better — 227% of the previous year's total. We were helped by lower interest payments and a greater selectivity in lumber and other divisions in order to weed out unprofitable transactions.

Another goal was to unite your diverse divisions into a cohesive team. Is that being done?

The situation is improving. For example, due to the problems plaguing upstream textile production in

Japan, many large synthetic textile manufacturers are diversifying into new areas, such as foodstuffs and other consumer products, that are covered by other General Commodities divisions. Since sectoral barriers are breaking down for our clients, they must for us, too. Close relations between our various divisions are leading to a higher degree of synergy.

Textiles is seen as a labor-intensive sector, currently weakened by global protectionism. What's your strategy?

Obviously, trade restrictions and a high yen curtailed exports from Japan and our overall trading volume. Exports of Japanese garments, mainly to the U.S., and synthetics to China were slack. But offshore trade showed robust growth in dollar value, and net profits were double those of the previous year.

Our textile-related business covers more than trade alone. Backed by close cooperation with apparel makers, we are expanding our marketing channels in Japan and emphasizing high quality goods. We're forging strong intra-industry links and are closely attending to apparel trends — to the extent of regularly sending our people to Europe to study fashion planning.

Textile production has now largely moved to the developing countries, especially those of East Asia, and we can benefit by selling them looms and other textile production equipment, and by securing foreign sources of synthetic textiles.

Food demand surely isn't growing much in Japan. Do you plan to do more than simply trade foodstuffs?

Prices for important commodities like maize, soybeans, sugar, and wheat plunged last year, so we're moving beyond simple trading to ensure future profits. The key in foodstuffs is downstream market-

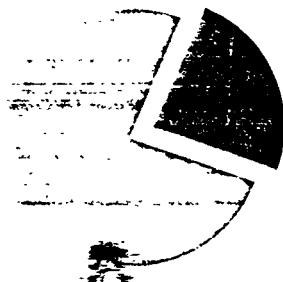
ing. One example is NI Seafoods — this venture has direct links with supermarkets and other distribution majors, and processes fish into ready-to-market forms. Our recent business agreement with gourmet food supplier Silver Palate of the U.S. and decision to launch the Season chain of restaurants are two more cases in point. But these are not isolated cases; a divisional task force is now at work deciding on an overall specialty food marketing strategy for both domestic and overseas markets.

This strategy involves both vertical and horizontal forward integration. For example, we let Japan's top broiler producer — a consumer of huge amounts of chicken feed — acquire a 30% equity share of NI Delica, a leading chicken sales company, so we could secure an attractive, regular source of broiler supplies and expand sales of compound feed and feed grain. We also linked up with a huge grain silo operator to store grain imports in deepwater ports and forged links with mid-size companies in related sectors. Now we can take care of both demand and supply of chickens and feed.

You import many categories of foreign consumer goods into Japan. Can this help right the trade imbalance?

We're trying. Many of our products are not luxuries, but household goods for daily use, so when prices fall due to the weaker dollar, demand should rise. The question is: Can demand for imports strengthen enough to right the imbalance? We don't know that yet, although we hope so.

GENERAL COMMODITIES



Total transactions for the General Commodities Group amounted to \$12.646 million for fiscal 1985, an decrease of 2.7% over the previous year. That is equivalent to 24% of Nissho Iwai's total turnover for the fiscal year.

General commodities include textiles, lumber, general commodities, chemicals, and foodstuffs.

TEXTILES

Textiles include natural and synthetic fibers, yarns, and fabrics, apparel, and interior furnishings. We also trade in products and material for industrial, agricultural, fishing, civil engineering, and construction use.

We knit together many textile sectors in a multifaceted domestic marketing approach. Nissho Iwai coordinates the production process from fiber weaving and fabrication to finished garments; we are also developing new ventures and sales routes and introducing foreign brands. We show great strength in three Japanese regions — Niigata, Fukushima, and Yamagata — which produce \$1 billion in fashionable knit garments each year. Not only does Nissho Iwai hold the top share in supplying yarn to local producers in that area, we coordinate fabric output to meet our projections of industry needs.

Foreign trade is increasingly expanding, fueled by the work of overseas offices and affiliates. Nissho Iwai continues to be the top Japanese exporter of apparel to the U.S. We also export synthetic yarns and fabric. Imports include wool, flax, silk, and other raw materials, as well as finished garments. We also operate four domestic subsidiaries to satisfy needs for specialized textiles.

Japan's total fiber demand has

been flat for the past five years, at about 2.4 million tons based on yarn weight, and it may remain so through the rest of the 1980s. We have shifted our emphasis from higher volume to upgraded product quality and added value, and from upstream to midstream marketing. We are also bolstering our relations with garment makers, the fashion industry, and retailers, to expand trade in apparel and accessories.

Textile trade with China continued to be brisk in fiscal 1985. China's huge labor force, handicraft traditions, and abundance of natural fibers such as cotton, cashmere, and angora have long made the country a popular source of fabric and fibers. In recent years, China has made

High added value comes when we supply the fabric and market the product. Here, Itokin's Lancetti brand.



GENERAL COMMODITIES

efforts to diversify into fabrication of modish apparel; a Chinese fashion show held in Japan in 1985 hinted at the country's recent style strides. Nissho Iwai coordinates textile imports from a number of Chinese production sites, and we are actively promoting higher quality goods.

Fabrics made of natural fibers continue to capture the Japanese consumer's fancy. Lightweight ramie — easily blended with cotton, acrylic, and silk to create fashionable apparel that stays crisp in Japan's humid, hot summer climate — is a top choice. Nissho Iwai is a leading importer of ramie fiber and thread, and we claim a large import share of linen, another popular summer fabric.

The appeal of natural fabrics is also enhancing domestic demand for wool bedding. In fiscal 1985, a total of 3.5 million quilts made use of 8,800 tons of wool, an increase of 10% over the previous year. These quilts accounted for 10% of all bedding produced in Japan. Nissho Iwai handled 15% of Japan's 1985 imports of such wool, most of which originates in France. Other sources are New Zealand, the U.K., and Australia.

The Stettin Bay Lumber Co. is a long-term success story in resource development.



Nissho Iwai joined with Itokin to set up popular Tokio Kumagai fashion boutiques.

LUMBER

Japan's timber imports grew at a 6% pace in 1985, and Nissho Iwai's timber business kept pace. We handled 8% of the nation's total timber imports in 1985, or 2.7 million cubic meters. A 42.4% share of this total, or 1.15 million cubic meters, came from North America, with nearly one million cubic meters from Southeast Asia and other equatorial regions, and the balance from the U.S.S.R., New Zealand, Chile, and elsewhere. Other timber transactions, including the export of 0.6 million cubic meters of U.S. logs to China and sales of 0.15 cubic

meters of logs from Papua New Guinea to Korean plywood manufacturers, earned us the top share of timber trade among the sogo shosha. Our total trade for fiscal 1985 amounted to 3.5 million cubic meters.

An intra-group organizational change occurred in April 1986 with the transfer of wood-based building materials from the General Commodities Division to the Lumber Division. This consolidation responds to a big boost in domestic demand for imported wood-based housing materials. With Japanese import tariff rates on lumber, plywood, veneer, and other goods falling, and public appreciation for the aesthetics and comfort of wooden housing on the rise, the future augurs well for lumber trading.

Reforestation in Papua New Guinea again figured into our activities last year. Since 1976, our joint venture with the Papua New Guinean government, Stettin Bay Lumber Company, has been developing that country's huge timber resources, while planting a total of 2,000 hectares. We expect to plant another 600 hectares in 1986, thanks to the increased seeding and sapling capacity provided by our newly established nursery and research center, sited near the forested areas. Eucalyptus saplings developed at the nursery have shown impressive strength and rapid growth.



GENERAL COMMODITIES

Minerals, paper and pulp, and consumer goods are all handled by this division.

Minerals

Nissho Iwai is the top supplier of raw and processed minerals like bauxite, chamotte, chromite, dolomite, fluorspar, granite, graphite, kaolin, magnesite, marble, pyrophyllite, rare earths, talc, and zircon to Japanese industry. We are also working to secure new minerals such as synthetic crystals, silicon carbide, silicon nitride, rare earths, and new ceramics for high technology applications.

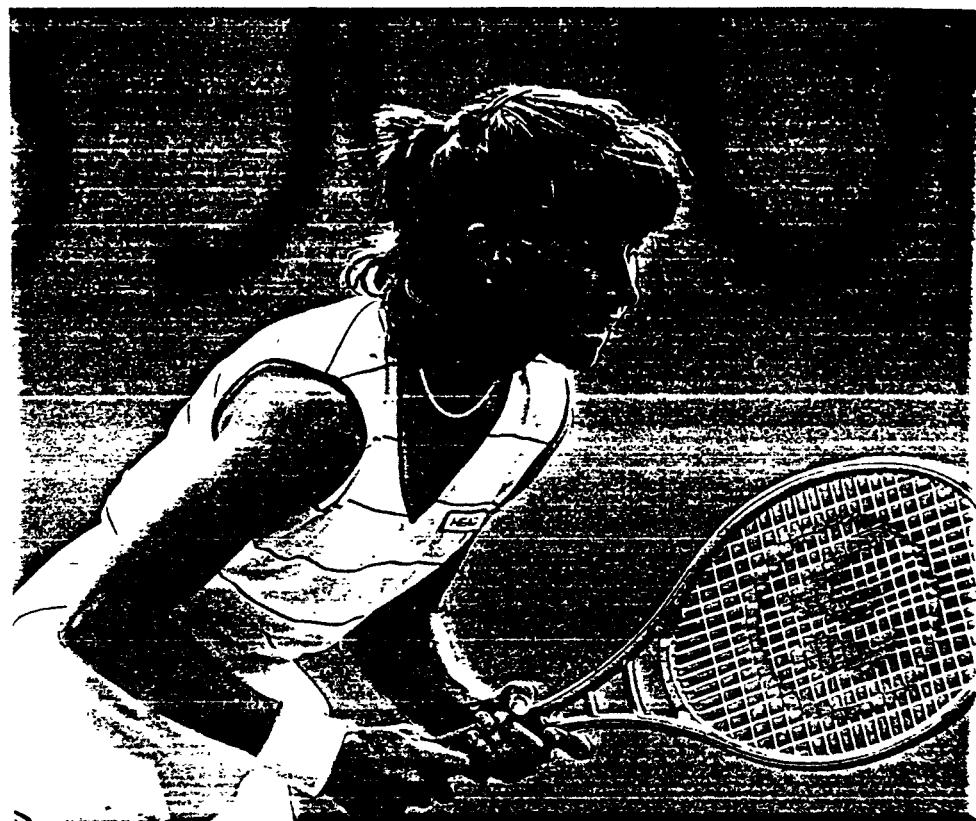
Consumer goods

The department deals in a range of items, including sportswear, tires, automotive components, electrodes, cigarettes, hides, carpets, sundries, and consumer electronic equipment.

Transforming Japan into a nation of leisure-lovers is a daunting task, but Nissho Iwai is playing a part by marketing such crowd-pleasers as Nike sports shoes and Wimbledon tennis racquets. We've formed two subsidiaries to vie for the world's second largest sporting goods market: Nike Japan Corp. and Nissho Iwai Sports Corp.

Nissho Iwai Sports has found Wimbledon tennis racquets to be top net income-earners; the new, lightweight but powerful Wimbledon Super Series racquet has proven especially popular with women.

Twenty-one percent of Japan's population will be over 65 by the year 2025, and the need for inexpensive wheelchairs and other medical aids is sure to rise. To supply this demand, Nissho Iwai is participating in a joint venture with Everest & Jennings International of the U.S. — the world's top wheelchair producer — and Japan's market leader, Nissin Medical Industries. The new company, Everest & Jennings Asia Ltd., was launched in



Branded sporting goods are all the rage in Japan — Wimbledon tennis racquets, NIKE shoes and sportswear.

April 1986 to develop, produce, and market low-cost wheelchairs for Japan and the Pacific Basin.

Nissho Iwai is one of two exclusive agents in Japan for Philip Morris Inc. Our subsidiary, NI Tobacco Co., was established in April 1984 to promote sales of imported Lark and Parliament tobacco. This April we added a new brand, Philip Morris Lights. One result of the

GENERAL COMMODITIES



Our consumer electronics business includes popular home computers, complete with game software.

ongoing liberalization of Japan's tobacco industry has been lower prices for imported cigarettes; Philip Morris Lights can offer both a price and flavor advantage which should yield handsome sales results.

A growing volume of Japanese consumer electronic equipment has found its way into Western homes with the help of Nissho Iwai. We export video and audio equipment and components, portable facsimile machines, computer games, and LCD pocket games. In 1985 we shipped about 100,000 VCRs to the U.S., with larger orders already placed for 1986. Nissho Iwai also ships bicycles produced in Taiwan to Western markets.

Paper and pulp

Japanese are among the world's most voracious readers, and sating the domestic appetite for books, magazines, and newspapers keeps paper vendors busy. To bolster our paper marketing and distribution activities we launched this division in April 1985. Nissho Iwai imports a big volume of pulp from overseas for Japanese paper manufacturers and distributes the output to both domestic and foreign customers.

chemicals. Other growth areas included yellow phosphorus, derived from our joint venture in China; calcium hypochlorite for swimming pool use — we handle over 40% of Japan's market, or 10,000 tons in all; and magnetic tape materials, which doubled in traded volume over the previous year. Exports of fertilizer also grew, with orders from Southeast Asian markets on the upswing. Domestically, we expect sales of medicinal herbs, health foods, deodorant chemicals, and chemical essences to grow by \$20 million within the next two years.

Nissho Iwai traded nearly \$240 million in fine and specialty chemicals in fiscal 1985, including pesticides and pharmaceutical intermediates, catalysts, photosensitive materials, detergent raw materials, coating resins, adhesives, and organic acids. The total volume included some \$64 million in exports. Notable were a \$20 million export order for alkylbenzene for detergent use in Southeast Asia and a \$3 million order for FCC/Reforming/Hydrogen catalysts for refineries in Indonesia. In the field of biochemicals, we began importing monoclonal antibodies from Bioscot of the U.K. for domestic medical and diagnostic applications.

In plastics, we emphasized trade in high performance resins, finished plastic products, and other high added-value items. We again handled 20% of Japan's total fiscal 1985 imports of Brazilian EDC, or 100,000 tons, and for the first time we imported Brazilian polyethylene as well. We handled one quarter of Hungary's exports of polypropylene last year, sending 6,000 tons to Southeast Asia.

Other new areas offered great promise. We doubled our exports of Japanese plastic optical fiber to the U.S. for automotive and computer use, and took our first orders to supply optical grade Japanese polycarbonate resin to compact disc producers in Europe.

Building materials

Notable among building material transactions for fiscal 1985 were increased domestic marketing and overseas exports of Portland cement and processed products. We also recorded substantial imports of asbestos, vermiculite, and insulation materials from Canada and South Africa.

CHEMICALS

American autos are increasingly powered by low-lead gasoline, fueling demand for organic octane boosters. This has enabled Nissho Iwai to expand exports of such aromatic organic chemicals as benzene, toluene, and xylene to North America. Europe and North and South America were the sources of other large-volume chemicals traded last year, namely MEG, styrene monomer, 2-ethyl hexanol, DMT, and Caprolactam for Southeast Asian markets. Our liquid chemical tankyard in Tokyo Bay, NI Chemical, was in full operation throughout the period under review.

Sales of inorganic chemicals soared in the first half of fiscal 1985, but were curtailed by the muscular yen in the latter half. Nevertheless, we recorded a great increase in the import of basic alkaline and electrically processed

FOODSTUFFS

This division handles grains, edible oils, cereals, sugar, seafood, provisions, and meats. Our transactions in fiscal 1985 totalled \$2,545 million, or 6.3% of Nissho Iwai's total trading volume. This 5.4% jump over the previous year's volume is in part thanks to our efforts to increase offshore trade and strengthen downstream marketing activities.

Grains

Nissho Iwai traded approximately \$400 million in wheat and barley in fiscal 1985. We were again the leading exporter of flour to China and Southeast Asia, and played a strong role in managing domestic sales, imports and exports, and offshore trade in rice.

Our David's Cookies ventures are now carried by 11 Japanese retail chains nationwide. The Japanese branches of the U.S. chain serve up both cookies and ice cream for the discriminating sweet tooth.

Oils and cereals

Oilseed and feedgrain supplies were ample in fiscal 1985, and depressed global demand sent prices plunging. Nissho Iwai continued our successful



strategy of diversifying markets and product lines, allowing us to fill a large order for Thai tapioca pellets for the U.S.S.R. and sell Malaysian palm oil to Saudi Arabia.

We continued as Japan's top importer of Chinese soybeans, which are used for production of Japanese foods like miso and soy sauce. Nissho Iwai also claimed a leading share of Japanese imports of corn, rapeseed, and other cereals during fiscal 1985. Other major domestic activities included marketing animal fats and oils, especially palm oil and tallow.

Sales of varietal grain from Specialty Grain, our Illinois-based

subsidiary, continued to grow. Specialty Grain is expanding its activities to encompass bioagriculture as well as conventional grain supply.

Sugar

Sugar trade was Nissho Iwai's first line of business, and it continues to sweeten profits. We import over 200,000 tons of raw sugar each year, primarily for our two sugar refining subsidiaries. We handle domestic trade of 220,000 tons of refined sugar and 90,000 tons of other nutritive sweeteners through three subsidiary wholesalers and other distributors.

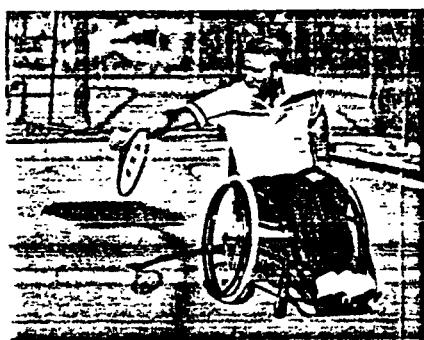
Enhanced cooperation with sugar producing countries in formulating joint marketing strategies is helping to ameliorate the adverse impact of reduced raw sugar imports due to greater domestic production of beet and cane sugar and high fructose corn syrups.

Marine products

The average Japanese eats 8.5 times as much fish as the typical American does, and Nissho Iwai helps ensure smooth deliveries of this important protein source to Japanese kitchens. We import prawn, shrimp, lobster, tuna, salmon, cuttlefish, octopus, capelin, and other fish from the

There were some surprising crowd-pleasers at a recent Tokyo import show: wheelchairs. But these were no ordinary wheelchairs; besides no-frills hospital models, there were zippy electric scooter wheelchairs, chairs for executing tight basketball pivots, even low-slung chairs for pursuing volleys across tennis courts. The low-cost chairs will be locally produced by Everest Jennings Asia, a joint venture of

Nissho Iwai, Nissin Medical, and Everest & Jennings, the world's largest wheelchair producer. Nissho Iwai will handle imports of the advanced individually owned models. As more Japanese heads turn gray and the idea of mobility for the handicapped catches on, demand for these hot wheels should accelerate.



GENERAL COMMODITIES

waters of Greenland to New Zealand, and points in between.

The Japanese fishing industry is smarting from the extension of 200-mile exclusive economic zones, but Nissho Iwai has had considerable success in securing new overseas supply sources. We're also expanding downstream marketing, chiefly through Nissho Iwai Seafood Corp., our new seafood reprocessing and distribution subsidiary.

Meat

Beef from Oceania and North America and live cattle from Australia and New Zealand were

among the meat products handled in 1985. Close ties with leading Danish pork suppliers facilitated trade of a large volume of imported Danish pork. Other products traded in the fiscal year, both domestically and abroad, included poultry, horse-meat, lamb, mutton, beef offal, compound feed, and grass seeds.

A highlight of fiscal 1985 was a business tie-up with Japan's leading poultry producer and distributor, Koyu Shokuchō Co., Ltd. The arrangement will enable us to expand our business in fresh and frozen poultry, compound feed, and feed grain. Koyu will also hold shares in our subsidiary, Nissho Iwai Delica Corp.; its participation should bolster our domestic marketing efforts.

From cookies to corn, sugar to salmon, Nissho Iwai is a major foodstuffs supplier.

Provisions

The Japanese consumer's growing awareness of foreign cuisines has led to a recent boom in "ethnic food" restaurants. To satisfy these discriminating tastes, Nissho Iwai imports food ranging from fresh fruits and vegetables to frozen and canned foods, concentrated juice, pectin, Scotch whiskey, salt, cocoa, and coffee beans. We handle increasing imports of gourmet items like foie gras, escargots, Italian pasta, and Chinese vegetables, too. Our primary domestic role, however, is dealing in milk products and distributing best-selling Nescafe for Nestle Ltd.



NISSHO IWAI SUBSIDIARIES AND AFFILIATES

Overseas subsidiaries

Nissho Iwai American Corporation

New York, Atlanta, Washington, Philadelphia, Cleveland, Chicago, Detroit, Nashville, Houston, St. Louis, Anchorage, San Francisco, Los Angeles, Portland, Bellevue, Seattle

Nissho Iwai Canada Ltd.

Vancouver, Toronto, Montreal, Calgary

Nissho Iwai Mexicana S.A. de C.V.

Mexico City

Nissho Iwai Panama International S.A.

Panama

Nissho Iwai de Venezuela C.A.

Caracas

Nissho Iwai do Brasil S.A.

Rio de Janeiro, São Paulo, Belo Horizonte

Nissho Iwai (Argentina) S.A.

Buenos Aires

Nissho Iwai (UK) Ltd.

London

Nissho Iwai Deutschland GmbH

Hamburg, Dusseldorf

N.V. Nissho Iwai (Benelux) S.A.

Brussels

Nissho Iwai France S.A.

Paris

Nissho Iwai Italia S.P.A.

Milano

Nissho Iwai España S.A.

Madrid, Las Palmas

Nissho Iwai (Nigeria) Ltd.

Lagos

Nissho Iwai Corporation (Iran) Ltd.

Tehran

Nissho Iwai Middle East E.C.

Bahrain

Nissho Iwai (Thailand) Limited, Partnership

Bangkok

Nissho Iwai Hong Kong Corporation, Ltd.

Hong Kong

Nissho Iwai Australia Ltd.

Sydney, Melbourne, Perth, Fremantle, Brisbane, Port Moresby

Nissho Iwai New Zealand Ltd.

Auckland, Wellington

Nissho Iwai International Finance plc

London

Nissho Iwai Finance (Europe) B.V.

Rotterdam

Major domestic subsidiaries and affiliates*

STEEL

Nissho Iwai Steel Leasing Co., Ltd.

Construction material leasing

Komatsu-gawa Koki Co., Ltd.

Light gauge steel rolling

Hamamatsu Kohan Kako K.K.

Steel sheet shearing and slitting

NIK Metal Corp.

Steel products sales

Oyodo Steel Co., Ltd.

Wire products manufacture

Goto Drop Forging Co., Ltd.

Steel forging

Nissho Iwai Steel Corp.

Steel products wholesale

Wataei Steel Co., Ltd.

Steel products sales

Kanon Steel Co., Ltd.

Steel products sales

Nishimura Sangyo Corporation

Steel products sales

Unicon Co., Ltd.

Palican manufacture

West Japan Stainless Steel Wire Co., Ltd.

Stainless steel wire manufacture

NEW MATERIALS & FERROALLOYS

Nissho Iwai Bentonite Co., Ltd.

Bentonite powder and Volclay panels sales

Nihon Mining & Concentrating Co., Ltd.

Antimony products manufacture

NON-FERROUS METALS

Nissho Iwai Non-Ferrous Metals Corp.

Non-ferrous metals sales and rental

Astral Gem Co., Ltd.

Precious stones, pearls and jewels wholesale

MACHINERY/CONSTRUCTION

Kokusai Kisen K.K.

Ship brokerage and agent

Kokusai Marine K.K.

Marine machinery sales

Nissho Iwai Aerospace Corporation

Aircraft and parts import and sales

World Aircraft Sales Corp.

Aircraft sales and leasing

Nissho Electronics Corp.

Computer sales, rental, and data processing

Nissho Iwai Business Automation Corp.

Electronic office equipment sales

Nissho Semiconductor Co., Ltd.

Semiconductor manufacturing, equipment sales

Nissho Medi Science Co., Ltd.

Medical machinery sales

Nissho Iwai Chemimac Corp.

Chemical machinery sales

Nissho Iwai Industrial Machinery Inc.

Industrial machinery sales

Nissho Iwai Housing Corp.

Housing

Nissho Iwai Estate Corp.

Housing

ENERGY

Nissho Iwai Sekiyu Corp.

Petroleum products and LPG sales

Nissho Propane & Oil Co., Ltd.

LPG and petroleum products sales

Nissho Iwai Gas Co., Ltd.

LPG sales

TEXTILES

Nissho Iwai Textile Co., Ltd.

Textile finished goods sales

Nissho Iwai Apparel Co., Ltd.

Garment manufacture

Nissho Iwai Seni Kako Co., Ltd.

Textile processing

Nissho Iwai (Fibre and Yarn) Ltd.

Fiber and yarn trade

The Chuo Woolen Mills, Ltd.

Wool spinning and weaving

Sunrock Textile Industry Co., Ltd.

Garment manufacture

GENERAL COMMODITIES

Nike Japan Corp.

Sportswear and sports shoe sales

The Beiser Tobacco Trading Co., Ltd.

Cigarette and tobacco leaf import

Chuo Tobacco Co., Ltd.

Cigarette and tobacco leaf import

Nippon Crown House Co., Ltd.

Housing materials manufacture

Nissho Iwai Sports Corp.

Sporting goods sales

Nissho Iwai Building Materials Corp.

Building materials sales

Torn Co., Ltd.

Log wholesale

CHEMICALS

Fuji Kako Co., Ltd.

Plastic pipe manufacture and sales

Nissho Iwai Polymers & Products Corp.

Plastic products sales

Nippla Chemical Co., Ltd.

Engineering plastics sales

Sambow Plastics Co., Ltd.

Vinyl chloride sheet manufacture

Taiyo Kagaku Kogyo Co., Ltd.

Vinyl chloride sheet manufacture

Takafuji Chemicals Co., Ltd.

Plastic sheet manufacture

FOODSTUFFS

Nissho Iwai Foods Corp.

Foodstuff sales

Marusan Co., Ltd.

Foodstuff sales

Nissho Iwai Foods Osaka Corp.

Foodstuff sales

Shin-Meito Co., Ltd.

Sugar refining

Fuji Seito Co., Ltd.

Sugar refining

Nissho Iwai Delica Corp.

Meat and cooked food wholesale

Nissho Iwai Seafoods Corp.

Seafoods sales

OTHERS

The Nikkyo Shoji Co., Ltd.

Insurance agency

Finac Co., Ltd.

Financing

Nikkyo Transportation and Warehousing Co., Ltd.

Transportation and warehousing

N.I. Service Corp.

Travel agency

Nissho Iwai Computer Systems Co., Ltd.

Computer operations, software and programming

N.I.F. Corp.

Computer communication service

N.I. Real Estate Co., Ltd.

Real estate brokerage

* This is a partial listing of companies in which Nissho Iwai has a share of 20% or more

NISSHO IWAI OVERSEAS JOINT VENTURES

AUSTRALIA

Australian Char (Holdings) Pty., Ltd.
Char manufacture
Dampier Salt Ltd.
Solar salt production
Kobe Alumina Associates (Australia) Pty., Ltd.
Alumina production
Kobe Aluminium (Australia) Pty., Ltd.
Alumina import sales
Kooyong Coal Loader Ltd.
Coal loading
Port Waratah Coal Services Pty., Ltd.
Coal loading services
Valpak Pty., Ltd.
Plastic bag manufacture

COLOMBIA

Fabrica National de Explosivos y Accesorios
Industrial explosives manufacture

COSTA RICA

Companhia NHK Cimbra Comercial Industrial
Mecanica Brasileira
Automotive suspension spring manufacture
Companhia Nipo-Brasileira de
Pelotizacao-NIBRASCO
Iron ore pellet manufacture
Companhia Siderurgica de TUBARAO
Iron manufacture
Ciquine Companhia Petroquimica
Chemicals and synthetic resin manufacture
CPC-Companhia Petroquimica Camaçari Ltda.
Synthetic resin manufacture
Daiba do Brasil Textil Ltda.
Cotton yarn manufacture
Hitachi Zosen Metalmechanica Ltda.
Industrial machinery manufacture
Kanaflex do Brasil Industria de Plasticos Ltda
Plastic hose manufacture
Minas da Serra Geral S.A.
Iron ore resources research and development
Omi-Zillo-Lorenzetti S.A. Industria Textile
Cotton yarn manufacture
Polialden Petroquimica S.A.
Polyethylene manufacture
Usinas Siderurgicas de Minas Gerais S.A.
Iron manufacture

CUBA

NIC Resources Inc.
Liquefied natural gas development
Nissho Iwai Coal Development (Canada) Ltd
Coal mine development

EGYPT

Shenzhen Aero-Fasteners Mfg. Co., Ltd
Screws and manufacture of fasteners
United Leasing Co., Ltd.
Leasing
China Prospering Building Design J.V. Co.
Architect

EL SALVADOR

Société de Galvanization de Tôles en Côte d'Ivoire
(Tôles Ivoire) S.A.
Galvanized iron sheet manufacture
Société Ivoirienne de Préfabriqués et
d'Accessoires Industriels
Steel fabrication

INDONESIA

Chiaphua-Shinko Copper Alloy Co., Ltd.
Non ferrous metal sheet and strip manufacture

INDIA

Tata-Yodogawa Ltd.
Steel ingot and roll manufacture

INDONESIA

P.T. Indonesia Steel Tube Works Ltd.
Steel tube manufacture
P.T. International Nickel Indonesia
Nickel mat manufacture
P.T. Irian Marine Product Development
Fishing
P.T. Iron Wire Works, Indonesia
Iron wire manufacture
P.T. Kaneko Nissho Iwai Sahabat Textile
Industries
Zaroring knitting, dyeing of synthetic fiber
P.T. Fabrik Araya Indonesia
Bicycle wheel rim manufacture

INDONESIA

P.T. Pardic Jaya Chemicals
Synthetic resin manufacture
P.T. Sarinotoku Hotel Corp.
Hotel management
P.T. Toyo Kanetsu Indonesia
Petroleum and LNG tank manufacture
P.T. Berau Coal
Coal mine development

IRAN

Shahou Mfg. Co., Ltd.
Synthetic fiber manufacture

KOREA

Hotel Shilla Co., Ltd.
Hotel management
The Masan Steel Tube Works Co., Ltd.
Steel pipe manufacture
Union Polymer Co., Ltd.
Synthetic resin manufacture

LEBANON

International Marine Construction Co., S.A.K.
Marine construction and maintenance

MALAYSIA

Furukawa Electric Cables (Malaysia) S.B.
Manufacture of wire for electric cables
Steel Service Centre (Malaysia) S.B.
Electrical steel processing

MEXICO

Yakult S.A. de C.V.
Manufacture of fermented milk drinks

NEW ZEALAND

Nissho Roberts (N.Z.) Ltd
Wool buying and export

PALESTINE

Nippon Marine International S.A.
Maritime operation

PAPUA NEW GUINEA

Stettin Bay Lumber Co., Pty., Ltd.
Logging and timber sawing

PHILIPPINES

Asian Transmission Corp.
Automobile transmission manufacture
Batangas Bay Terminal, Inc.
Warehousing
Bay Tank Yard Inc.
Chemical tank leasing
Canlubang Automotive Resources Corp.
Automobile import and assembly
Filipinas-Iseki Corp.
Agricultural machinery import and sales
APEX Motor Mfg. Corp.
Automobile and motorcycle shock absorber manufacture
Maranaw Hotel & Resort Corp
Hotel management
RIO-TUBA Nickel Mining Corp.
Nickel mine development

SINGAPORE

Asia Cable Engineering Co., Pte., Ltd.
Cable and wire construction
Karsai Paint (Singapore) Pte., Ltd.
Paint manufacture
The Malaysia Steel Pipe Mfg. Co., Ltd.
Steel pipe manufacture
Singapore Electrical Steel Services Pte., Ltd.
Electrical steel processing
Singapore Kobe Pte., Ltd.
Non-ferrous metal product manufacture
NHK Gasket Singapore Co., (Pte.) Ltd.
Import, export, manufacture, and sales of gaskets and gasket
materials

SPAIN

Compañía Española para la Fabricación de Acero
Inoxidable S.A.
Cold rolled stainless steel sheet manufacture
EGUZKIA-NHK S.A.
Manufacture and sales of springs

SUDAN

Kenana Sugar Co., Ltd.
Sugar refining

TANZANIA

Kamyn Industries (Tanzania) Ltd.
Garment manufacture

THAILAND

Glory Kawasaki Motors Co., Ltd.
Motorcycle import and export
NHK Spring (Thailand) Co., Ltd.
Automobile suspension spring manufacture

U.S. MEXICO

N.I.M. Co., Ltd.
Warehousing
Thai Central Chemical Co., Ltd.
Chemical fertilizer manufacture
Bangkok Steel Industry Co., Ltd.
Steel bar and galvanized steel sheet manufacture

U.K.

Metallgesellschaft Ltd
Non ferrous metals trading
Nachi (U.K.) Ltd.
Bearings sales
Pacific Nuclear Transport Ltd
Transportation of spent nuclear fuels

U.S. U.S.A.

Stiron Limited
Steel product sales

U.S. U.S.A.

Alloy Tool Steel, Inc.
Alloy steel sales

U.S. U.S.A.

Argo Plastic Co.
Plastics distribution

U.S. U.S.A.

Berwick Steel Co.
Steel processing

U.S. U.S.A.

Trilogy Ltd.
Manufacture of super minicomputers

U.S. U.S.A.

Hotel Kaimana, Inc.
Hotel management

U.S. U.S.A.

N-I Fastener Group, Inc.
Fastener sales

U.S. U.S.A.

Nissan Kizai N.I.C.E., Inc.
Sales of construction machinery

U.S. U.S.A.

Nissho Electronics (U.S.A.) Corp.
Importer and exporter of electronics machinery and technology

U.S. U.S.A.

Maruichi American Corp.
Steel pipe manufacture

U.S. U.S.A.

OAC Incorporated
Photo exposure and equipment sales

U.S. U.S.A.

Omi Georgia, Inc.
Cotton yarn manufacture

U.S. U.S.A.

Pasco Corp. of America
Bakery

U.S. U.S.A.

Roscomp Corp.
Developer of high capacity cartridge tape transport systems

U.S. U.S.A.

Sun Reality Corp.
Construction

U.S. U.S.A.

N-I Tubulars, Inc.
Tubular goods sales

U.S. U.S.A.

NISCO Steel Services, Inc.
Steel processing

U.S. U.S.A.

Nissho Iwai Aerospace (America) Corp.
Import and export of aircraft and parts

U.S. U.S.A.

Asano America, Inc.
Gear sales

U.S. U.S.A.

Comand Fabrics, Inc.
Fabrics sales

U.S. U.S.A.

Fashion Force, Inc.
Fashion merchandising

U.S. U.S.A.

Specialty Grains Inc.
Specialty grain merchandising

VENZUELA

Hilana C.A.
Wool and synthetic fiber manufacture

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FINANCIAL REVIEW

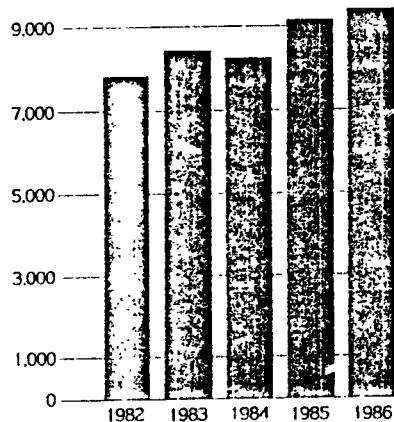
The pace of growth of the American economy — the driving force behind the world economic recovery — slackened during fiscal 1985, slowing expansion in other industrial economies which rely heavily on exports to the U.S. Developing countries were hard-hit by the drop in prices of many primary commodities, particularly crude oil.

Led by a rise in consumer demand and corporate investment in equipment and facilities, Japan's overall economic growth was steady in the fiscal year. But the yen's rapid appreciation since the autumn of 1985 has curbed economic expansion, especially in the export industries.

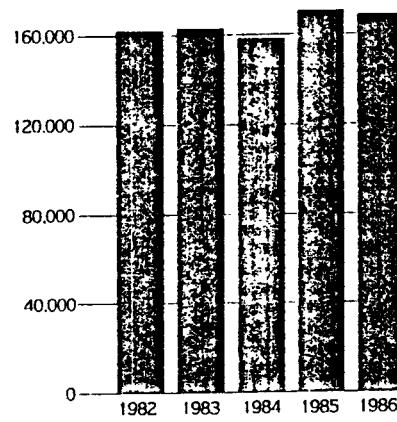
The effects of this environment on our business activities have been mixed. Our total trading transactions on a consolidated basis rose by 3.1% over fiscal 1984, to ¥9,484,528 million (\$52,809 million). Exports declined to ¥1,369,828 million (\$7,627 million), a 4% decrease from the previous year, due to the strong

yen's negative impact on machinery and steel trade. Brisk trading in non-ferrous metals and aircraft contributed to a 4.4% increase in imports, to ¥2,695,753 million (\$15,010 million). Offshore trade was also up, thanks to expanded energy business; the transactions increased by 11.3% over the previous year to ¥2,449,319 million (\$13,637 million). Domestic trade showed little movement, recording a 0.8% decrease from fiscal 1984 to ¥2,969,628 million (\$16,535 million).

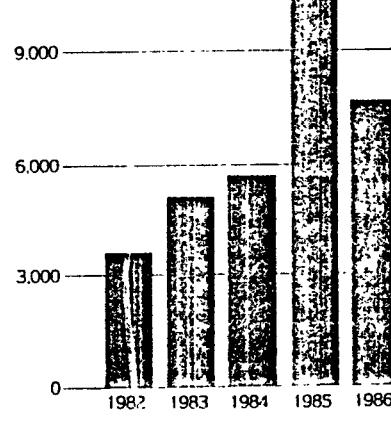
TOTAL TRADING TRANSACTIONS
(¥ billions)



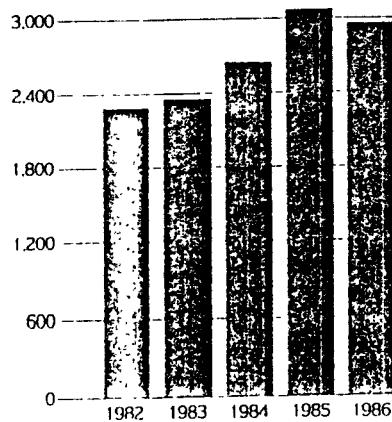
GROSS TRADING PROFIT
(¥ millions)



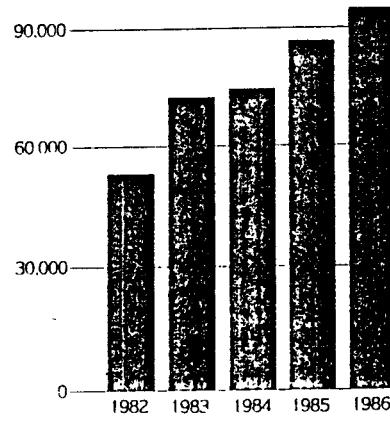
NET INCOME
(¥ millions)



TOTAL ASSETS
(¥ billions)



SHAREHOLDERS' EQUITY
(¥ millions)



Africa

Environment:

Three years of drought in Africa left economies stagnant. Although oil production increased, low prices curtailed foreign exchange earnings, forcing strict limits on imports and new investment.

Strategy:

Stress local purchases and ODA-related business; work to develop new markets such as Angola and Mozambique; expand offshore trade.

Highlight:

In Zambia, nitrogen fertilizer plant project with Kobe Steel, Ltd. is underway, with completion targeted for late 1986.

Transaction volume:

Countertrade up, while trade between Africa and Japan was down from fiscal 1984.

Branch:

South Africa: Johannesburg, Cape Town

Subsidiary offices:

Europe — Belgium: Brussels; France: Paris; Italy: Milan; Spain: Las Palmas, Madrid; U.K.: London; West Germany: Düsseldorf, Hamburg

Africa — Nigeria: Lagos

Offices:

Europe — Austria: Wien; Bulgaria: Sofia;

Czechoslovakia: Praha; East Germany:

Berlin; Finland: Helsinki; Greece: Piraeus;

Hungary: Budapest; Netherlands: Rotterdam;

Norway: Oslo; Poland: Warszawa;

Portugal: Lisbon; Rumania: Bucharest;

Sweden: Göteborg; Yugoslavia: Beograd

Africa — Algeria: Alger; Angola: Luanda;

Ethiopia: Addis Ababa; Côte d'Ivoire: Abidjan;

Kenya: Nairobi; Morocco: Casablanca; Sudan:

Khartoum; Tanzania: Dar es Salaam;

Zaire: Kinshasha; Zambia: Lusaka;

Zimbabwe: Harare

U.S.S.R.

Environment:

NIC is the leading sogo shosha in handling Japan-U.S.S.R. trade, and is active in offshore transactions as well.

Strategy:

NIC is active in technology transfer between Japan and the U.S.S.R. On basis of agency agreement with Licensintorg, have introduced more than 20 advanced Soviet

technologies to Japan since 1963. Have also supplied U.S.S.R. with latest production processes for chemical, iron and steel, machinery, and electric and electronic sectors.

Highlight:

Signed new agreement with Licensintorg in April 1986 which will ease transfer of Soviet technologies to Japan.

Transaction volume:

\$473 million in Japan-USSR trade in fiscal 1985; \$63 million in offshore trade

Office:

Moscow

Southwest Asia

Environment:

India most strategic market, with six NIC offices. NIC promotes imports from Japan of steel products, machinery, and chemicals; and exports to Japan of iron and frozen shrimp, and other raw materials.

Strategy:

Focus on countertrade, export of Indian goods to third countries, especially for offshore oil and gas development-related projects. Expand involvement in infrastructure development projects.

Subsidiary offices:

Bahrain: Manama; Iran: Teheran

Offices:

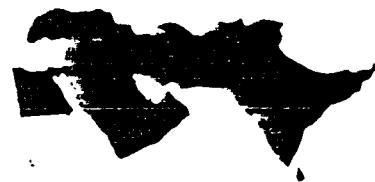
Middle East — Egypt: Alexandria, Cairo; Iraq: Baghdad; Jordan: Amman; Kuwait: Al Kuwait; Lebanon: Beirut; Oman: Muscat; Qatar: Doha; Saudi Arabia: Jeddah, Riyadh, Al Khobar; Sudan: Khartoum; Syria:

Damascus; Turkey: Ankara, Istanbul; UAE:

Abu Dhabi, Dubai; North Yemen: Sanaa

Southwest Asia — Bangladesh: Chittagong, Dhaka; India: Bombay, Calcutta, Jamshedpur, Madras, New Delhi, Pune; Pakistan:

Islamabad, Karachi; Sri Lanka: Colombo



MIDDLE EAST/ SOUTHWEST ASIA

Middle East

Environment:

Oil glut and falling oil prices resulted in extensive project cancellations and postponements in fiscal 1985.

Strategy:

Maintain good relations with oil suppliers to increase trading flexibility and promote imports of needed commodities from third countries.

Highlights:

Exports of steel, machinery, general commodities; imports of crude oil, naphtha, LPG, other petrochemical products; offshore trade of U.S. wheat to Egypt, Australian and New Zealand wool to Turkey, Korean textiles to Iran, Indonesian plywood to Saudi Arabia.

Transaction volume:

Total turnover approx. \$2 billion, same as previous year; exports represented 36%, imports 47%, offshore trade 17%; Iran: \$326 million



GLOBAL NETWORK



EAST ASIA/OCEANIA/CHINA

East Asia

Environment:

Divergent trends in the region: Boosted by low oil prices, finished goods exports from several countries are recovering from last year's troubled conditions, but Hong Kong's exports are stalled and its economy suffered adversely from China's import restrictions. Singapore is still experiencing minus growth, unemployment on the rise. Aided by an undervalued currency and low-priced oil, Taiwan managed to increase exports by 18% in the first three months of 1985 over the same period last year.

Korea:

Exports the first part of this year were up by 27% from same period last year, lower global interest rates ease servicing huge external debt. NIC handles \$600 million in total private contracts per year; 41% are exports of Nike shoes to U.S. Volume for first half of fiscal '85 119% of 1984 amount; 2nd half is 142% of 1984 amount. Total is \$5.86 million for fiscal year.

ASEAN:

Japan exported 6.4% of total to region, imported 15.6% of total volume during fiscal year. Of NIC's total exports, 10.9% went to ASEAN, 45.6% of imports came from ASEAN — mainly due to \$3 billion per year in Indonesian LNG contracts. Indonesia and Malaysia hurt by declining oil

revenues — project plans are being postponed, while exports are down. Thailand is trying to increase foreign exchange earnings from commodity sales.

Highlights:

Exports of \$22 million in Japanese steel-mill-related equipment to Posco in Korea; \$250 million in exports of Nike Shoes from Korea to Japan and U.S.; \$50 million in exports of North America/Australian wheat to Korea.

Transaction volume:

Indonesia: \$3,711 million; Hong Kong: \$1,074 million; Thailand: \$320 million

Oceania

Environment:

Although NIC is diversifying sources for base materials, Japan-Oceania trade relations remain important. Booming travel/resort industry is also forging tighter links between two regions.

Highlights:

Traded coal, wheat, coke, feroalloys. NIC was third largest exporter of Australian wool; established SBLC — largest forest resource development company in Papua New Guinea; joined cooperative Japan-Australia development project in Victoria; top importer of Japanese tractors to New Zealand.

Transaction volume:

Australia: US\$628 million; New Zealand \$28 million

China

Environment:

After earlier boom in domestic production and imports for personal consumption drained FX supplies, imports were restricted. Trade now stabilizing at slower level, with firmer export base being built. NIC was first sogo shosha in China, reinforced strong relations with government by sending high level managers to Beijing.

Strategy:

Focus on strength in handling necessary complex transaction arrangements.

Highlights:

Imports: Fuji Film production plant, Fujitsu telephone exchange equipment, Victor television assembly line, low-density polyethylene production plant, airport radar, steel, chemicals. Exports to Japan: crude oil and petroleum products, coal, soybeans, maize.



food oils, and fats. Offshore trade in polyester yarn, plywood, wool, wire, nails, nuts and bolts, cotton textiles. Technological cooperation: production technology for mid-sized bulldozers, 250cc motorcycles, steel. Joint ventures: precision screw production and marketing co., condominium development. Countertrade: food freezers for produce; frozen processed seafood exports for food freezers.

Transaction volume:

\$1 billion, same as previous year

Branches:

East Asia — Korea: Seoul; Malaysia: Kuala Lumpur; Philippines: Manila; Singapore; Taiwan: Taipei

Subsidiaries:

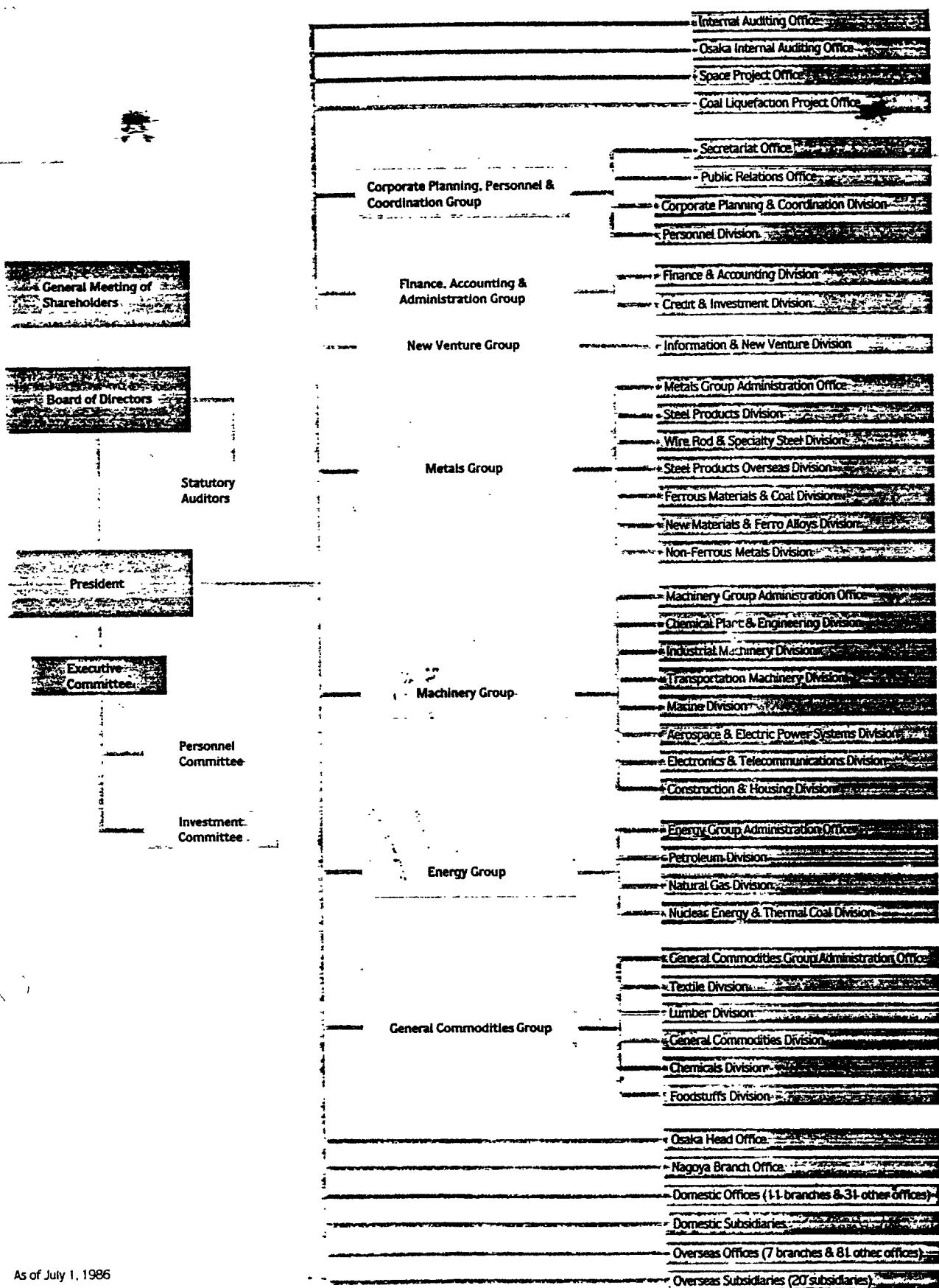
East Asia — Hong Kong; Thailand: Bangkok
Oceania — Australia: Brisbane, Fremantle, Melbourne, Perth, Sydney; New Zealand: Auckland, Wellington; Papua New Guinea: Port Moresby

Offices:

East Asia — Brunei: Bandar Sri Begawan; Burma: Rangoon; Indonesia: Jakarta; Korea: Kwangyang, Pohang, Pusan; Malaysia: Kota Kinabalu, Kuching, Sandakan, Miri; Taiwan: Kaohsiung

China — Beijing, Dalian, Guangzhou, Shanghai, Shenzhen, Tianjin

CORPORATE ORGANIZATION



BOARD OF DIRECTORS

Chairman

Mitsuo Ueda

Vice Chairman

Hatozo Kondo

President

Masaru Hayami

Executive

Vice Presidents

Koshiro Suganuma

Eiichi Koizumi

Masao Araki

Kazuo Yamanaka

Ryo Nishiura

Kunio Komatsu

Senior

Managing Directors

Shigetomi Kitamura

Masayuki Murata

Shoji Ushiki

Sokichi Ikeda

Managing Directors

Shinji Kawahara

Akira Tonegawa

Kyohei Kimura

Teruhiko Nakanishi

Tetsuro Sugiyama

Takehiko Tsuchiya

Akira Sugihara

Fujio Umetani

Directors

Wataru Sasaki

Hirotsugu Toyama

Renji Ogawa

Yasuo Ojima

Reisuke Kawai

Iwao Motoyama

Akira Nishio

Toshio Oda

Shogo Kubota

Reiichi Yoshimoto

Noboru Sakamoto

Yukichi Maeda

Toshiaki Tanimoto

Shinichi Shirai

Tsunemitsu Kitayama

Hidefumi Asuka

Susumu Yoshida

Yuzuru Fukui

Tatsuo Hirata

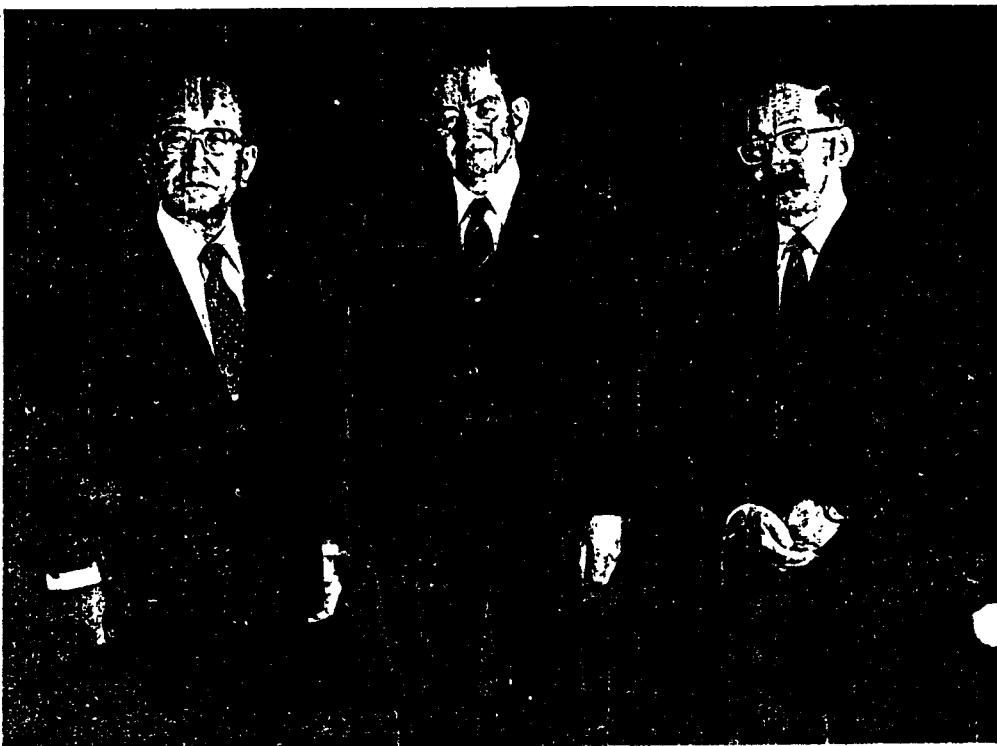
Tarnotsu Otake

Statutory Auditors

Tamotsu Kuroda

Haruo Hasegawa

Seiji Katagi



Chairman Ueda, President Hayami, Vice Chairman Kondo (left to right).

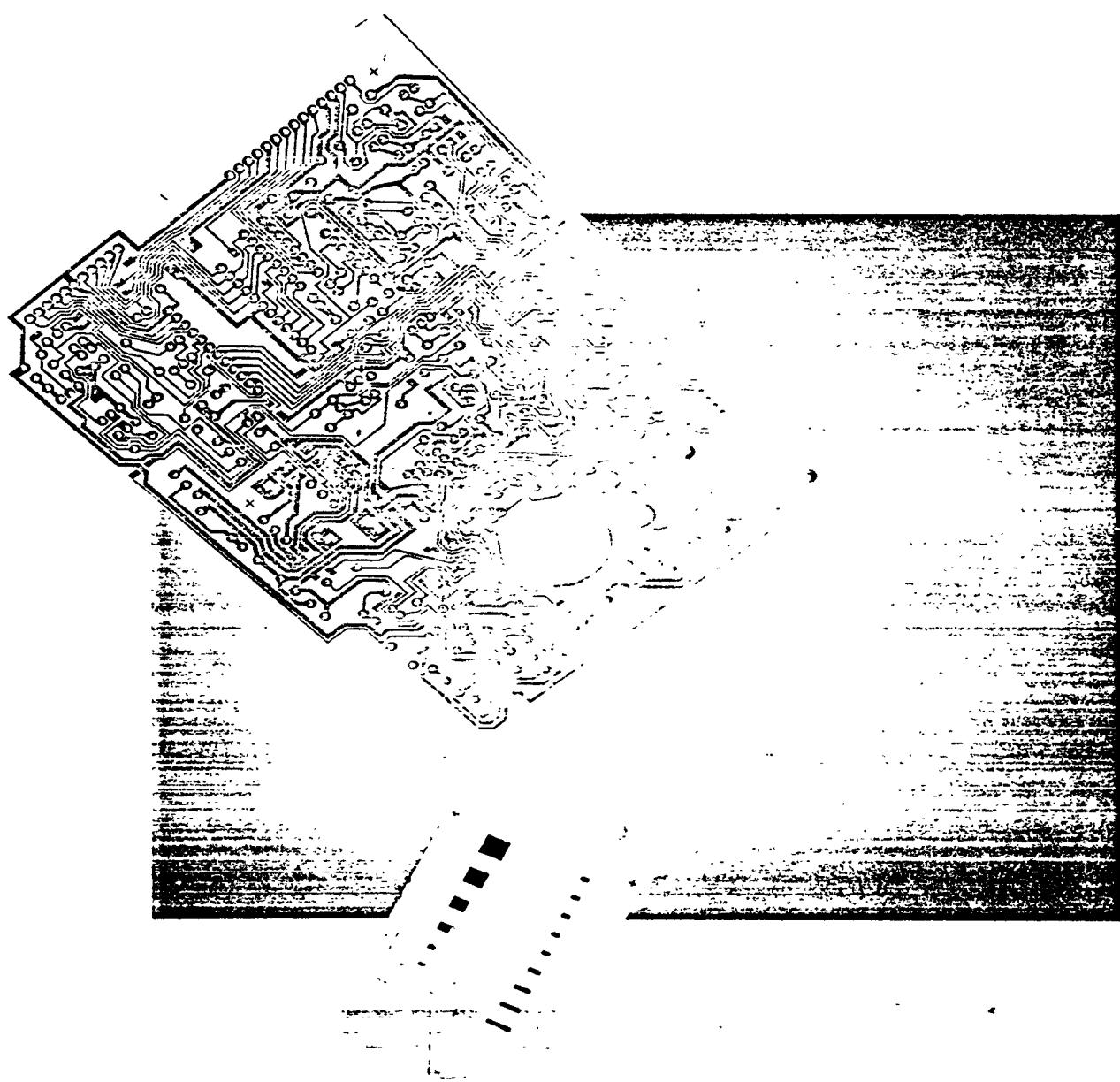


Executive Vice Presidents (seated left to right) Koizumi, Suganuma, Araki, (standing left to right) Nishiura, Yamanaka, Komatsu.

(As of June 28, 1986)

NEW CURRENTS

- Information and new ventures
- Rare metals success
- Fashionable foodstuffs
- Zaire profit center



NEW CURRENTS

The Information & New Venture Division: mining golden business opportunities

The yen's new strength is lending urgency to a fundamental shift in Japan: from heavy industry to lightweight, technologically advanced goods.

To compete, firms are complementing new geo-rationalization moves (offshore factory siting and component purchases, to name a few) with technology- and information-based production in Japan. Nissho Iwai is adopting similar measures, diversifying into new business areas which can boost our profitability now and in the future.

While the last few years have seen various divisions launch extra-organizational projects in information and high technology fields, now these projects are consolidated under the umbrella of the Information & New Venture Division. This enterprise planning structure, a first among the major *sogo shosha*, was launched in April 1986 to provide a systematic, rationalized approach to conceiving and nurturing infant ventures in new fields for Nissho Iwai.

Electronics, new materials, biotechnology... many of the projects under the new division's jurisdiction aren't new for Nissho Iwai. The difference? These projects were born in the lab; now it's time for them to bear fruit in the business arena. The Information & New Venture Division carefully screens ideas to select those that will generate

business now, rather than spin off projects as they are commercialized. Research for the sake of research is a thing of the past.

The new division comprises the New Venture Promotion Department, the Project Development Department, the Computer & Communications Project Department, the Technology & Resources Office, and the Computer & Communications Systems Department. The latter two groups provide critical support for the former three. A committee made up of the five group heads and other business division managers meets regularly to pinpoint projects with real business promise and to determine how best to support those already in motion. Seed money goes for feasibility studies and later, for market surveys to back up the market plans. An advisory group of interdisciplinary in-house specialists provides added input for new project ideas.

We maintain important links with advanced technology developers, including England's Twyford Plant Labs.



New media offer new business prospects

Why is "information," a basic *shosha* service, included in the new division? Because it represents terrific future opportunities. Nissho Iwai.

Recent deregulation and the quest for comprehensive, accurate information have opened up new business sectors that cut across industry lines.

Three business teams are at the heart of the Computer & Communications Project Department. The first seeks and develops business in the telecommunications field. Japan's Telecommunication Law was liberalized in April 1985, unleashing myriad opportunities in satellite communications, cable television, fiber optics, mobile telecommunications, videotex, high-definition television, and other industries. Nissho Iwai is mining opportunities on both the technological development and product/service marketing sides.

The second team focuses on imaging systems, including videotex, cable TV, and other visual communications businesses.

The third, the new media business team, handles all information-related business apart from telecommunications — mainly computer networks.

A group of practical visionaries

The New Venture Promotion Department is supported by the Technology & Resources Office, which researches projects with solid business prospects and fields teams to analyze the potential of electronics, biotechnology, advanced new materials, and new energy sources.

The New Venture Promotion Department's knowledge industry business team concentrates on data bases and publishing ventures. Japanese and English technology newsletters update readers on high tech developments. The biotechnology business team oversees contact with several business partners, including U.K.-based



Bioscot, Limited, the world's foremost producer of monoclonal antibodies, and Twyford Plant Laboratories, developer of plant seedlings through biotechnology.

The Department is also an umbrella for software development and advanced new materials business teams. Gallium arsenide and niobium are ushering in the next generation in semiconductor development, and Nissho Iwai is very much involved.

Success story: NIF

For manufacturing companies, high technology is an effective wedge into new markets. For the sogo shosha, information, access to technology from overseas, and marketing muscle constitute a powerful wedge. Network Information Forum (NIF) represents all three essential criteria — and a superb entree into the burgeoning computer data base market.

NIF is a joint venture between Nissho Iwai and Fujitsu Ltd., Japan's top computer maker. NIF has licensed the technology and know-how of top U.S. personal computer communications company Compu-Serve to provide Japanese individuals and corporations with access to more than 800 data bases — financial, weather, travel, encyclopedia, and more, as well as electronic mail.

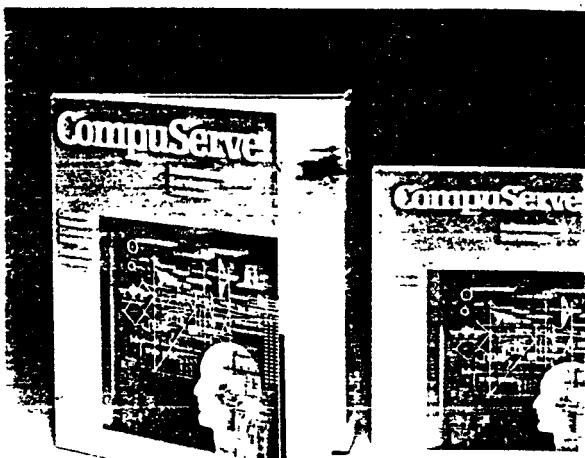
electronic bulletin boards, corporate and shopping information, and games. Communication via telex is cumbersome, so electronic mail is a particularly fertile field for growth.

At present, Japanese-language data-base services are limited; NIF plans to exploit this opportunity with services tailored exclusively to the Japanese market, including education, tax consultation, travel and leisure, interactive forums, and even arranged marriage consulting. With Japanese-language services slated for inauguration in 1987, forecasts put enrollment at 60,000 customers within four years.

Once Japanese data bases are developed, they will be marketed to customers in the U.S. and Europe, in Japanese and other languages. Our purpose is both to create new data bases and to make existing ones available worldwide. Previously, Nissho Iwai was a customer for such services — not an operator. By shifting our stance, the company acquires a completely different body of software — and source of profits. Clearly, NIF is pioneering a new industry in Japan.

Potential winners emerge

With Kobe Steel Ltd., Kanebo, and Tokio Marine, we have invested in SECOM NET to pursue opportunities in value-added networks.



Bringing the comprehensive CompuServe family of information services to Japan is one new current for Nissho Iwai.

SECOM, Japan's largest home and office security company, boasts a nationwide network of 327 offices and 220 linked access points in Japan. Future business prospects look bright for this marriage of SECOM's extensive network and IBM computer technology.

And in a major new materials venture, Nissho Iwai represented Sunwave Electronics to secure production and sales rights for state-of-the-art substrates for RCA of the U.S. Most substrates for semiconductor mounting are resin or ceramic, but Sunwave adds a high-quality metal-core base for expanded application in the automobile, communications, electric appliance, camera, and aerospace industries. Nissho Iwai is handling all domestic and export sales.

Nissho Iwai's corporate charter was modified last year to reflect the new business projects the company is undertaking. The Information & New Venture Division's charge is to plant and grow those projects. These exciting new ventures form a major part of Nissho Iwai's strategy for facing the future with confidence.

NEW CURRENTS

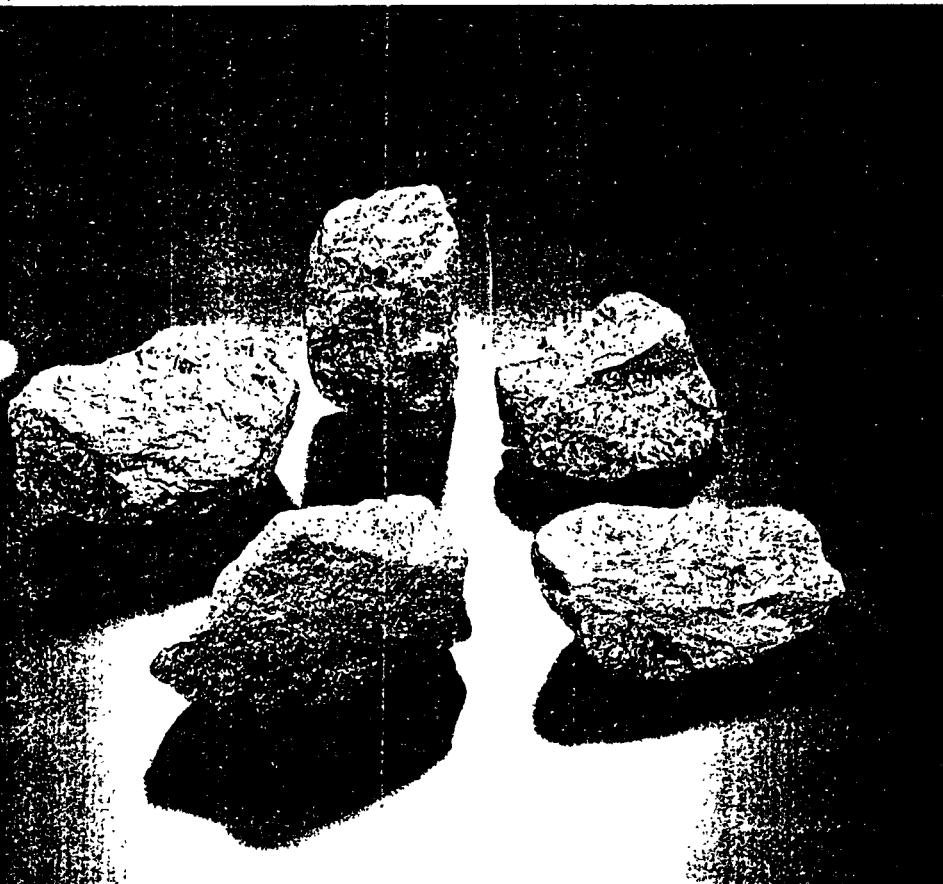
Uncommon success with rare metals and new materials

What do miniature headphones, supercomputers, and high-speed trains have in common? They're all made possible by the use of rare metals, the 79 hard-to-obtain ores found throughout modern industry. Cobalt for headphones and heat-resistant alloys, gallium arsenide for optic fiber and semiconductors, tungsten for steel rails, chromium and platinum for automobiles... the list of strategic minerals expands each year, as industries search for new metals with superior energy-saving or functional efficiency. For example, while plentiful silicon has long been the basic building block for semiconductors, scientists have found that gallium arsenide is more durable at high speeds and temperatures, and electrons can travel six to seven times faster through gallium than through silicon. Given these attractions, analysts predict that the market for rare metals will be 15 times current levels by the year 2000. Demand for gallium, in particular, should grow 100-fold.

Rare metals earn this moniker by being found in concentrations of less than 1,000 parts per million wherever they are mined. They're often difficult to extract, with just a few supply sources. Many are found in politically unstable countries, making steady supplies of rare

metals one of the 1980s' most critical issues, just as securing a steady flow of crude oil was among the top concerns of the 1970s. But unlike petroleum, most rare metals have no substitutes for industrial application. If supplies are stemmed by civil unrest or political decree in the source countries, the results for Western economies could be traumatic: It's estimated that a year-long cutoff of chrome supplies, for example, would send Japan's GNP plunging by at least 5%.

Strategic rare metals, such as this ferro niobium, play an unseen but significant role. We supply nearly 70% of Japan's ferro niobium as representatives of world-leader CBMM Brazil (right) in Asia.

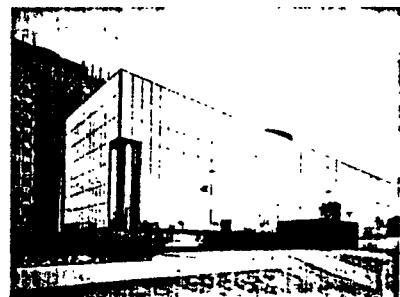


Better safe than sorry

Of course, a stockpile of strategic rare metals is a high priority for most industrialized states, but few are satisfied with current reserves. The U.S. began stockpiling metals during World War II, and currently boasts a three-year supply of up to 93 materials vital to defense and industry. Although it is the world's second largest consumer of rare metals, Japan only began amassing the ores in 1983, and is still far from its goal of a 60-day supply of seven metals: nickel, chrome, tungsten, cobalt, molybdenum, manganese, and vanadium.

Acquiring and maintaining stockpiles is one strategy to take, but it's expensive (Japan spends some \$18 million a year), and hardly a long-term solution to the problem of scarcity. Other efforts currently being made by both government and the private sector include developing new natural supply sources and new processes which can recover the metals closer to home. Extensive geological surveying in Japan has identified minor deposits of such metals as gallium and tungsten, reducing reliance on outside sources.

The sogo shosha are playing an important role as well. Nissho Iwai is among the top Japanese importers of many rare metals, such as ferro niobium and chrome, and we participate in several multinational projects to mine and process rare metals in stable countries like Brazil and Australia. We are also actively researching means of recovering metals like vanadium as byproducts from spent catalysts after industrial



use. Since rare metals like gallium, palladium, and gold can be extracted from alloyed materials and reused many times, the recycling sector is especially promising.

Gaining a grounding in rare earths

Included under the rare metals rubric are 17 elements known as rare earths: scandium, yttrium, and 15 ores in the lanthanum series. They're not much use for potted plants, but these earths are terrific when better performance in compact-sized electrical or electronic equipment is called for. You can flick your cigarette lighter, for instance, due to the use of mischmetal alloy flints, and the red colors on your television screen owe their true-to-life hues to europium and yttrium. The autofocus mechanisms in some new cameras depend on magnets made of a samarium-cobalt alloy, and other rare earths are found in catalysts, grinding machines, ceramic condensers, and other industrial products.

Rare earths can either be mined in locales ranging from Australia and India to the U.S. and the Soviet Union, or they can be recovered from uranium and phosphor ores. Nissno Iwai imports some \$44.5 million worth of rare earths annually — some 60% of Japan's total imports — from wherever they are found.

New materials make news

The list of both rare and base metals (the latter are found in higher concentrations) now used in high technology industries sounds vaguely reminiscent of an outer space adventure epic: molybdenum, tantalum, phosphor, and titanium, for instance. In fact, many of them are found in space, since titanium and other alloys help make satellites and

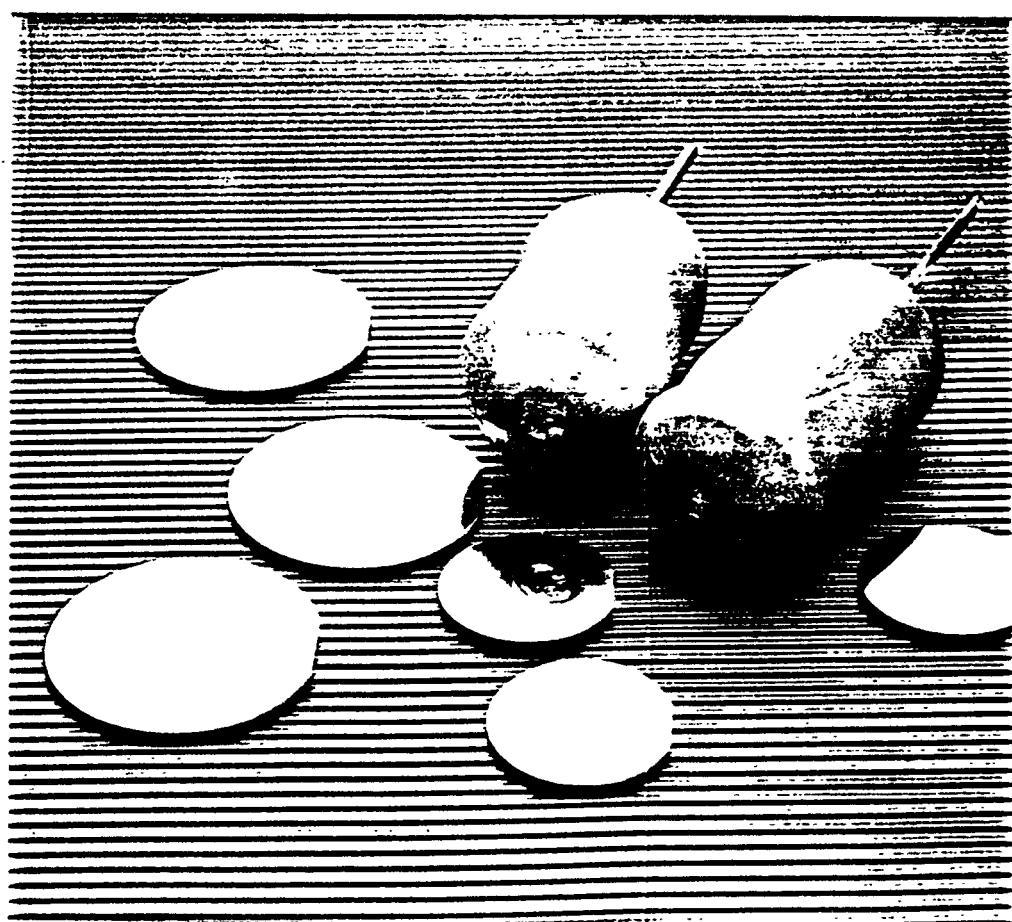
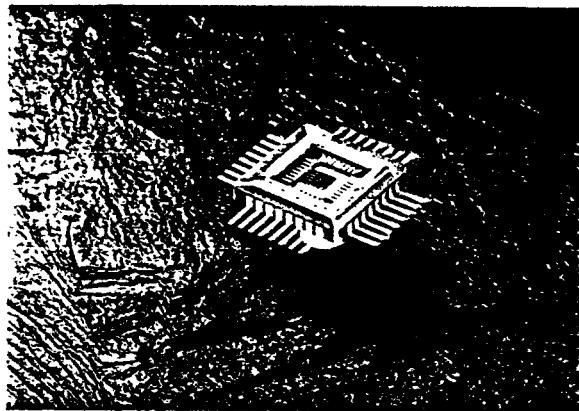
space shuttles lightweight but strong. These metals, along with novel composites such as fine ceramics, are known as new materials, and a new section of the Metals group, the New Materials Department, has been established to coordinate their trade.

Estimates have it that high tech demand for new materials by the year 2000 will be 15 times current levels. A glance at some of the most promising industrial applications makes it easy to understand the tremendous growth. One example is the new 3×6 optical switch, used for switching light paths. This switch operates by directing light through a wave guide on top of a layer of crystal niobic acid lithium. Voltage applied to electrodes changes the refractive index and allows optical switching through the wave guide. Switching of more than one gigabit of optical data can be done in less than one nanosecond.

During its first three years of operation, the New Materials Department's activities have fanned out to cover many new areas. We

market super-conducting wire and magnets for experimental super collider projects and handle many products for the demanding electronics industry: electrolytic copper foil, lead frame, copper-clad laminate, and more. As long as metals beneath the earth are being put to new uses, Nissno Iwai will be expanding our expertise to meet our customers more than halfway.

The world of semiconductors is shifting from silicon to gallium arsenide, prized for its properties at higher chip densities. We are a major supplier.



Fashionable foodstuffs: Keeping up with the Satos

Want to know more about demographic trends, changing gender roles, and work habits in Japan? Just examine the eating patterns of the average Japanese household.

Typically, if the kids are in school, most likely their mother works, at least part-time, and has little time to cook. On the way home, she's likely to drop by the local convenience shop for frozen and canned food. With dual incomes, there's more to spend on restaurant-going and former luxuries such as beef. Her children, who often stop at fast-food outlets on their return from school, prefer toast and eggs, not rice and fish, for breakfast these days. Stews, spaghetti, and other foreign foods are regular dinner entrees, often accompanied by avocado salad or kiwi fruit, and tabasco sauce, ketchup, and other foreign condiments fill the shelves. A concern about diet and health results in a preference for low-calorie meals, salads, and decreased salt intake. And more Saturdays off give the family more time for dining out. The older kids often eat out with friends, and are eager to try the latest "ethnic" foods in fashionable eateries.

Obviously, the typical family presents a broad menu of marketing opportunities for food-related businesses. The booming food and beverage market is currently estimated at over \$200 billion, and restaurants will take in some \$111 billion this year. Nissho Iwai, not one to let an opportunity go by, has launched three new food-related

ventures to pursue the evolving Japanese market through its stomach. Our approach aims at educating consumers in novel foods and cuisines and pleasing increasingly finicky tastes by supplying the highest quality foodstuffs available.

An eatery for all seasons

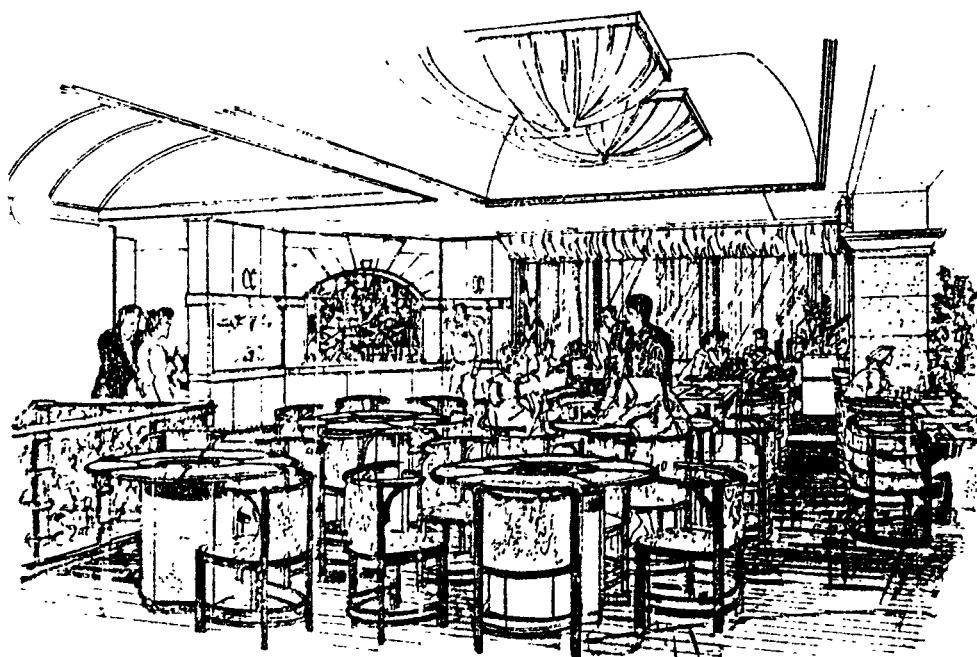
Beef has only been consumed widely in Japan for just over 100 years, and the average yearly meat intake is still just one-third that of Europe

Downstream foods marketing to upscale customers is part of our strategy with the BaliBali grilled beef chain.

or the U.S. Nevertheless, it is steadily entering the typical Japanese consumer's daily diet. All that's impeding more rapid growth are fairly painful prices, a lack of knowledge of sauces and spices to use in cooking, and scant research on ways to encourage greater meat consumption. Instead of just stacking meat in grocery freezers, for example, efforts to educate consumers through new presentation styles, samples of high quality beef, and other channels can add appeal. Control over beef processing as well as restaurant retail provides direct sales feedback on consumption trends.

Now Nissho Iwai can have just that, thanks to a new joint venture Season, Inc. This firm, jointly established and managed by Nissho Iwai, restaurant chain owner Nihon Shokutsu, Inc., and major meat processor Amai, Inc. will operate grilled beef restaurants called BaliBali. The new company, capitalized at \$111,000, brings together skills from each partner. Nihon Shokutsu, for instance, already operates 14 restaurants in Japan and has developed a smokeless, odorless tabletop gas grill for cooking sliced beef that is produced under its patent in the U.S., the U.K., and Taiwan, as well as Japan. Nissho Iwai is cooperating in Nihon Shokutsu's future plans to expand marketing overseas. Amai, Inc., a 30-year business affiliate of Nissho Iwai, processes top quality meat for supply to first-class hotels and restaurants.

BaliBali's customers will cook their own flavorful servings of thinly sliced prime beef over a charcoal grill at the table, then dip the meat in sauces and eat it with rice. The first BaliBali will open its doors in October 1986 in an upscale Tokyo neighborhood, to be followed by ten more Tokyo outlets in the next five years.



Food for the fashionable

Changing eating habits in Japan requires more than opening attractive restaurants: an introduction to new foods and ways of cooking is a must. That's the aim of S.P. Plan, a company established by Nissho Iwai in April 1986 to coordinate the launch of chic deli/restaurants modeled on the Silver Palate, a culinary mecca combining delicatessen, restaurant, and catering services on Manhattan's Upper West Side.

The first Silver Palate shop will open in Tokyo's equivalent of the Upper West Side, youthful and funky Harajuku. From September 1986, shoppers will be treated to home-style American cooking, packed picnic baskets, deli fare, gourmet foods in jars and cans, and original kitchen appliances and other interior goods in a homey but appetizing ambience. A second store, just a minute's walk from the first, will combine fine cooking with intimate concerts, rental space for parties, and events in a multi-purpose entertainment hall. A third shop is planned for a nearby department store.

These ambitious plans are just the start of an aggressive foray aimed at revamping Japanese lifestyles. Introducing Japanese to the concept of dinner parties and entertaining at home is one path to this goal; promoting novel, festive cuisines and elegant interiors is another.

Fishing for midstream profits

Eliminating the middleman and delivering fish that is fresh and custom-packaged is another way of catering to consumers' increasing demands for high food quality. It doesn't hurt our bottom line, either. Nissho Iwai's new 90%-owned seafood processing plant in suburban Tokyo has fast-freezing and low-temperature thawing equipment and facilities to prevent ozone contamination. Since most fish consumed in Japan is imported these days, the plant's location near the port of Chiba is ideal, allowing



off-loading of fish directly from refrigerated ships to storage in adjoining freezers.

The new company, Nissho Iwai Seafoods Corporation, was launched by Nissho Iwai's Marine Products Division to forestall the growing trend of seafood marketers going independent — and to stay afloat in this increasingly competitive business.

The company now processes capline, redfish, and herring for direct sales to groceries, cooperative stores, and other retail outlets. Since the processing plant is near consumer markets, distribution is rapid. It can quickly identify consumer trends in demand for value-added products like sushi, sashimi, and chilled fish. As the firm expands, it will try new ways to reach consumers, such as non-store marketing and sales to the workplace.

All three ventures will offer comprehensive feedback on consumer tastes that will also benefit Nissho Iwai's established business lines. A decade ago, many Japanese had



(top) NI Seafoods prepares and markets flavorful fish dishes to Japanese housewives. (above) New York's Silver Palate eatery-cum-delicatessen opened in Tokyo with Nissho Iwai's help.

never eaten a hamburger; today, Western dining franchises and their domestic imitators are ubiquitous. The average family's dietary habits are changing by the hour, and Season, S.P. Plan, and Nissho Iwai Seafoods Corp. will help us stay at least one meal ahead of these changes.

Using money to make money the 'zaiteku' way

Japanese corporations have a new buzzword these days: *zaiteku*. This combination of a Japanese word for finance and the "tech" of technology has come to describe the sophisticated financial engineering now practiced by many Japanese companies. These firms are eager to obtain better returns from their holdings than those available with conventional Japanese investment instruments, and the strong yen raises new foreign exchange opportunities. The *sogo shosha*, in particular, can trade on their good names to borrow funds cheaply and invest the proceeds at a higher rate, for handsome yields.

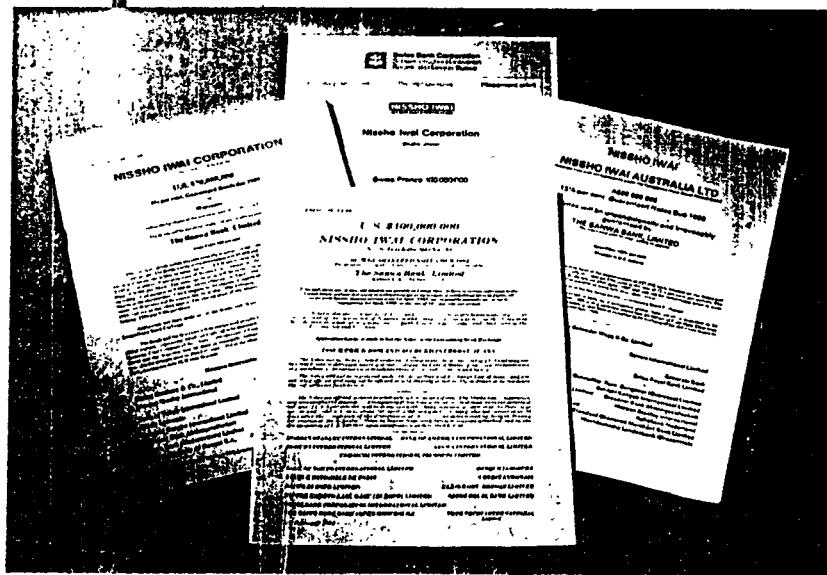
Sogo shosha have long been pros at trade finance and risk aversion, but these have been considered support services for their main business activities rather than as profit centers. Now the shosha can apply the knowledge gained over the years to raise funds and control foreign-exchange exposure, as well as manage a portfolio as diversified as that of any major fund manager, comprising fixed- and floating-rate Eurobonds, convertible debentures (CBs), commercial paper, loans, futures instruments, foreign exchange, and other products. And as their business becomes increasingly international, it's only natural that financial transactions move offshore as well; today these maneuvers are not just decided in headquarters, but depend on input from

the capital markets themselves. Since the Euromarket can offer a broader range of investment instruments than that available in Tokyo, the City of London is the top choice for many Japanese companies' offshore financial units.

The capital flows offshore

Nissho Iwai has joined the move to a greater reliance on capital markets as well as the banks as the major sources of funds. Through bond and stock issues and strategic swaps with floating rate instruments, we've lowered the cost of funds, and through zaiteku investments we can act like a bank in securing high returns. This financial muscle benefits our customers as well, since we can finance transactions at very competitive rates.

Finance means more than trade finance these days — it's full-fledged 'zaiteku.'



Overseeing these new activities since April 1986 is our new Treasury Department. The Department's three sections — Capital Market, Foreign Exchange Dealing, and Foreign Exchange Contract — are supplemented by two financial subsidiaries. One, in the U.K., opened in October 1985, focuses on capital investment. The other, in the Netherlands, launched in April 1986, handles procurement of capital. Together they provide us with great flexibility in responding to financial trends anywhere in the world.

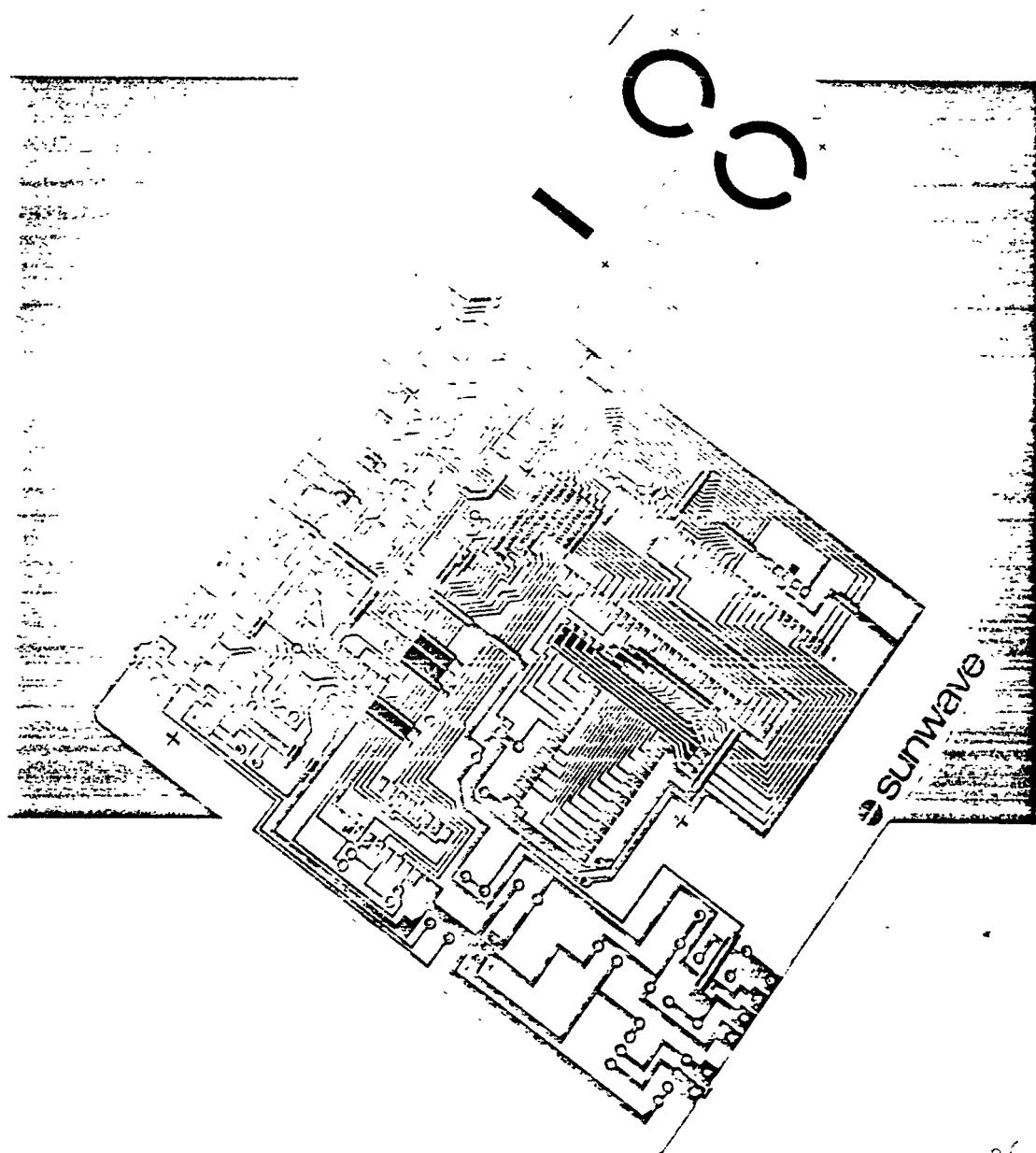
Locals receive a shot in the arm

Investment in financial instruments is not the only way to secure long-term returns. Acting on the strong yen and the prevailing low interest rates, Nissho Iwai decided to up capitalization significantly in our most active overseas subsidiaries in May 1986. We increased our capital in Nissho Iwai American Corporation by \$58 million, to a total of \$183 million, and doubled the capital in our Hong Kong venture, to HK\$150 million. Capital in the U.K. and Benelux subsidiaries received similar sizable boosts.

Why send \$86 million in capital to our overseas affiliates? Nissho Iwai's localization strategy couldn't work without the capital to back it up. Now these corporations have the wherewithal to make major financial decisions fairly independently, and they can strengthen their presence in their local economies. Becoming known as local companies rather than Japanese entities builds customer trust. Japan may not always be the world's largest capital exporter, but Nissho Iwai is demonstrating our plans to play a continuing role in bolstering economies wherever we operate.

REVIEW OF OPERATIONS

- Metals
- Machinery
- Energy
- General Commodities





Sokichi Ikeda, Senior Managing Director,
Metals Group

With steel prices still stagnant, how will you improve profitability?

Formerly, the ever-increasing volume of simple transactions in steel and other metals was enough to support our growth, but no longer. To compete today, we must offer added value by calling on our knowledge of industrial applications of various metals and by arranging complex transactions. We must have further cross-pollination of business with other Nissho Iwai divisions and carry out more direct investment. For example, with our own steel service ventures we can process steel into a form that clients, especially those in the automotive and electronics industries, can use immediately.

Where else do you see new growth?

Industries are finding increasing applications for new materials and rare metals; that's why we started a New Materials Division in the Metals Group. We see growth in molybdenum, niobium, and general alloys like ferro silicon and ferro chrome. We are the agent in Japan and Southeast Asia for CBMM, producer of 70% of the world's supply of ferro niobium for use in high tensile steel and other products, and this business should also grow. We are now looking for new uses: One is as a base metal for superconductors. With CBMM's cooperation, we're seeding research by universities and R&D centers on niobium's use as a catalyst.

Another promising rare metal is vanadium, which is used for superconductive materials. Although 60% of current supplies come from South Africa, we are exploring several alternative recovery processes — such as from spent catalysts used in petroleum refining and as a by-product from oil-burning power plants — which will allow Japanese companies to wean themselves from foreign sources — and help Nissho Iwai increase its market share.

What is the impact of lower oil prices on your business?

Both good and bad. Many steel mills changed to coking coal for fuel when oil prices rose, and may now be considering a switch back, although that trend is yet to be seen. The effects on our aluminium business will be mixed, although the overall impact should be positive.

Aluminum production is energy-intensive, so even cheap oil can't help Japanese manufacturers compete with other East Asian aluminum producers. But it will become easier for us to secure diverse supplies of the metal for domestic use, and our recycling

business in aluminum scrap will continue to grow. Lightweight aluminum is increasingly used in automobile radiators, condensers, and other components, and we are supplying a growing volume of finished aluminum and aluminum sheet to automakers in the U.S. and Japan. Our provision of aluminum sheet for engine hoods and components and semi-finished products for VCRs and computer peripherals, as well as the marketing of aluminum fishing boats, is on the rise.

Has your trade in precious metals benefited from growth in Japanese household savings and discretionary income?

Within the past four years our precious metals business has ballooned more than tenfold. That's in good measure due to greater use of gold, silver, and palladium in photography, electronics, and other industries, and also to gold's appeal in Japan as a tax-free investment instrument for individuals. Japan is one of the few countries where gold trading is gaining ground. With our separate dealing room we are negotiating gold futures trading. Close relations with our financial operations and overseas offices enable us to stay on top of the nearly hourly changes in gold prices.

Our performance to date has won us the trust of many large gold holders. For example, the Swiss Bank Company has asked us to trade a very large consignment of gold for them in Japan. This is an extremely promising area for us.

Metals include steel products, wire rod and specialty steel, ferrous materials and coal, non-ferrous metals, and new materials and ferroalloys.

STEEL PRODUCTS

Nissho Iwai is the fourth largest wholesaler of steel products in Japan, and we are the leading wholesaler of wire products and stainless steel. We market steel plate, steel sheet, structural steel, steel pipe, specialty steel, and fabricated steel as well.

We are promoting growth in this mature sector by diversifying product lines with new materials and high technology goods and strengthening our marketing channels. In order to bring domestic and overseas marketing of wire rod, wire products, and specialty steel under one administrative umbrella, we established a new Wire Rod and Specialty Steel Division in April 1986. The new division will bolster transaction efficiency and customer service.

Another strategy for filling clients' needs is through specialized service centers like our two American ventures: Berwick Steel Co. of Ohio, a steel service center acquired in 1985; and steel processor Nisco Steel Services, Inc. of Memphis, which we established in 1984. We operate a network of similar service centers in Southeast Asia as well, with more such enterprises planned worldwide.

Nissho Iwai supplies steel pipe and other materials to major energy projects around the world, from the North Sea to California to the Bombay High fields in India. In 1985 we received additional orders from India to fabricate, transport, and install a drilling platform and to convert a drilling rig into an early production system. We also transported three platform jackets from Japan to an offshore site in Denmark.

The fiscal year was also marked by successful completion of a countertrade deal with the Iraqi govern-

The Metals Group accounted for the largest percentage of our trade in fiscal 1985, nearly 30% in total. The fiscal 1985 turnover of \$15.596 million represents a 3.8% increase over fiscal 1984.

ment to exchange crude oil worth \$11 million for line pipe of equal value.

FERROUS MATERIALS AND COAL

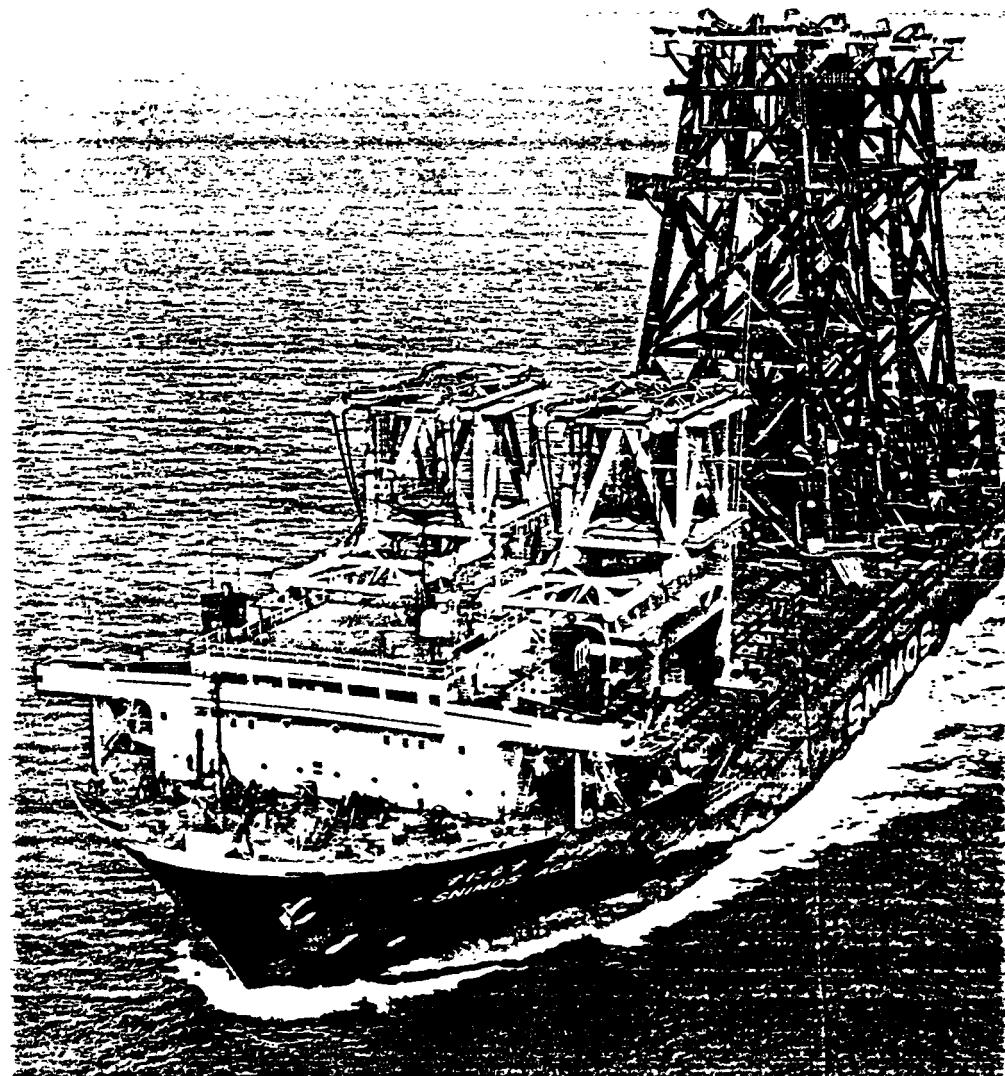
This division handles iron ore, coking coal, pig iron, steel scrap, and other raw materials for iron and steel production, as well as steam

coal for industrial use. Offshore trade figures increasingly in our transactions.

Iron ore

Nissho Iwai is Japan's third largest importer of iron ore, with a 13.5% share. Our imports come from Brazil, Australia, India, and other parts of the globe. We coordinate Japanese imports of iron ore from Companhia Vale do Rio Doce (CVRD) of Brazil, the world's largest iron ore producer. CVRD's ongoing Carajás iron Ore Project will provide Japanese steel mills with an estimated ten million tons of high quality iron ore during each of the

Among the mammoth transactions we handled was this Japanese platform jacket destined for Denmark's offshore fields.





next 15 years. The project came onstream in January 1986, when the maiden shipment of iron ore was loaded aboard the M/S Docepolo for transport to Japan.

Coking coal

Curtailed steel production cut into domestic demand for coking coal last year, but Nissho Iwai's efforts in supplying coal needed for new production technologies helped us minimize the negative impact. The Bullmoose coal project in Western Canada, with 10% Nissho Iwai equity, supplied two million tons of high quality coking coal to the Japanese steel industry during fiscal 1985, its second year of full operation.

Steam coal

Nissho Iwai was again the largest importer of steam coal to Japan in fiscal 1985, with a total volume of 2.6 million tons for general industrial use. Steam coal has gained popularity for its cost efficiency over oil. Unless plunging oil prices adversely affect future coal demand, our pursuit of new domestic markets — particularly low-volume consumers — in collaboration with operators of redistribution facilities, should stand us in good stead for continued growth.

Other raw materials

One way to redress the current global glut of shipping capacity is to dismantle retired and idle ships, and Nissho Iwai handled a 10%

(left) Brazil's Carajás iron ore mine will supply ten million tons per year to Japanese steel mills. (right) Nissho Iwai's position in steam coal is strong. Here, the Hunter Valley site in Australia.

worldwide share of this trade in fiscal 1985. That totalled 53 ships weighing some 830,000 light displacement tons.

In other transactions, we sharply increased overseas trade of steel scrap and pig iron from mid-1985, obtaining approximately 600,000 tons of scrap during the fiscal year. The bulk of the materials were shipped to Korea and India. We expect to raise our scrap trade volume to one million tons in 1986 by supplying both new and existing markets.

Nissho Iwai is the exclusive agent in Japan for direct-reduced iron from P.T. Krakatau Steel, a steel mill operated by the Indonesian government.

NEW MATERIALS & FERROALLOYS

New metals and new materials are yielding cost benefits and enhancing product quality in a wide range of industries. To ensure effective development of these diverse markets, we consolidated all trade covered by the New Materials Department, the Nickel, Zinc, and Tin Department, and the Metals and Ores Department in the New Materials and Ferroalloys Division, starting in April 1986. This division deals in tungsten, molybdenum, tantalum and other base materials for high

technology industries, niobium metal for super-conducting wire, and wire and magnets for superconducting super collider projects. In the electronics industries, we trade electrolytic copper foil for printed circuit board production, lead frame materials, gallium arsenide and other compound semiconductor crystals, silicon, and phosphor for color television use.

Nissho Iwai is Japan's top exporter of mill titanium. Titanium alloys and other composite materials have become important foreign exchange earners for us, particularly with the growth of aerospace industries. We are developing new applications for titanium — for use in eyeglass frames, for example. Our new material specialists around the globe actively seek new supply sources of high purity materials and processed goods for Japan's advanced industries.

Trade in such raw materials as nickel ore and ferro nickel for stainless steel production dominated our nickel transactions in fiscal 1985. They were augmented by growth in a new business area: provision of nickel cathode for use as "42 alloy" for semiconductor lead frames. This trade calls on the experience and expertise provided by our worldwide office network.

We claim the leading domestic share of trade in antimony. Con-

sumption of antimony, once used mainly for batteries and now valued for its flame retardant qualities, is increasing. Nissho Iwai supplies all raw materials to our affiliate, Nihon Mining and Concentrate Co., Ltd. (Nihon Seiko, K.K.), Japan's top antimony maker.

We were again a top trader in ferroalloys during the period under review, handling about 35% of Japan's total import volume of manganese and chromium ores and 20% of total ferro chrome imports. We are the sole agent in Japan and Southeast Asia for Companhia Brasileira de Metalurgia e Mineração (CBMM) of Brazil, producer of 80% of the world's ferro niobium. Our import share in Japan is nearly 70%.

As exclusive agent in Japan for American Colloid Co., the world's largest Bentonite producer, we garnered a 68% share of Japan's Bentonite imports in fiscal 1985.

NON-FERROUS METALS

Nissho Iwai's April 1986 reorganization in the Metals Group resulted in a more streamlined, efficient Non-Ferrous Metals Division. We now handle copper and aluminum raw materials, processed products, and scrap, and precious metals such as gold, silver, and platinum. We also participate in overseas mineral resource development and cable installation projects.

Our precious metals transactions in fiscal 1985 increased by approximately 50% over the previous year. This was in large part thanks to aggressive expansion of Loco Tokyo gold transactions and trade in the silver physical market and the Tokyo Commodity Exchange for Industry. Our volume of gold swap transactions, in particular, jumped fourfold over fiscal 1984's turnover, as these fixed-interest financial instruments gained in popularity. And with gold quotations at their lowest levels in six years, gold sales through banks and

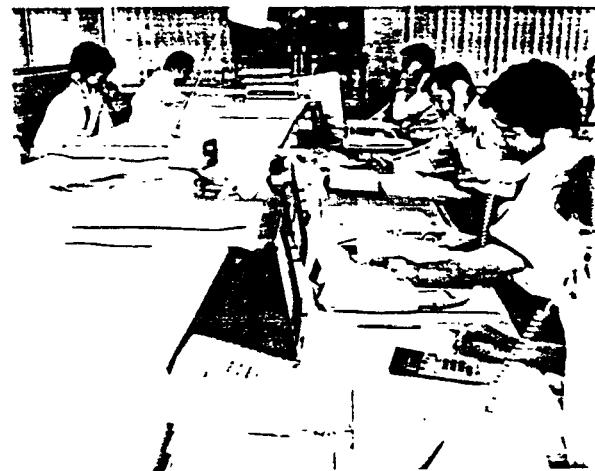
investment houses were brisk.

We launched a new overseas large-scale cable installation project during the year, securing a \$27 million order for supply and installation of 230/66KV power cable from the Public Utilities Board of Singapore. Work on the full turnkey project began in May 1985 and is slated for completion by January 1987.

We garnered a new telephone network installation order from another repeat customer, the Telecommunications Corporation of Jordan. The \$16 million network expansion project is now underway in Amman, aiming at completion by October 1987. This follows a similar project executed in the late 1970s for the Jordanian authority.

During the fiscal year we showed continued strength in conventional imports of copper concentrated ore and cathode from overseas copper mines. We also expanded our volume of complex transactions — offshore trade, copper cathode swap trading, and others — and supplied mines with Japanese and foreign-sourced equipment and materials. These activities dovetail neatly with our goal of diversifying copper business.

High energy costs and a stronger yen combined to squeeze output by the Japanese aluminum refinery sector. That resulted in a robust increase in our imports of aluminum ingots. We expect a



Gold trading is one of our newest and most successful ventures.

further boost in demand for imported ingot following a 1988 reduction in import duties: remelted ingots are expected to replace aluminum scrap as a high-volume import good. Nissho Iwai plans to expand aluminum remelting capacity in the U.S. and Southeast Asia to provide for the expected boom.

Fiscal 1985 was a satisfying year for processed aluminum: we increased export-import trade, offshore transactions, and domestic sales. Our major export customers are American beer and beverage can producers and the automobile industry. With the common aluminum alloy market on the upswing, we plan to develop import and offshore trade in this area as well.

Japan imported a record 197 tons of gold in 1985 and is poised to pass the 500-ton mark this year, thanks to demand for medals and coins commemorating the Emperor's 60-year reign. With gold prices at a multi-year low, gold jewelry sales and private hoarding are way up, too.

Japanese now regard gold as a 24-carat investment opportunity. Tax-free individual gold deposit accounts (up to ¥500,000) and spot and futures deals are increasing, with gold trading contracts now past one trillion yen. As the top sogo shosha trading in this precious metal, Nissho Iwai is helping reaffirm Marco Polo's ancient name for Japan: "the golden land."





Shigetomi Kitamura, Senior Managing Director,
Machinery Group

Machinery has traditionally been a strong area for Nissho Iwai. How does business look today?

This group contains divisions with varying prospects for growth: some are in industries like the marine sector which are structurally weak and look to remain so for awhile. But even a low-growth division can support our other business, so we must consider the overall position of the group. My role is to play coach — to field the appropriate players at the right times, and to offer the fresh perspective of an enthusiastic newcomer to this business area.

With the strong yen curtailing exports of heavy machinery, how can you stay competitive in this sector?

Japan can't compete in labor-intensive machinery, so we're trying to raise the added value of our exports, and increase the "soft" con-

tent in such areas as engineering and design. If we specialize in these strengths, mechatronics, and advanced technology components, we can stay competitive. We'll also increase imports of machinery — such as turbines and freighters — in areas where Japanese products are no longer competitive. In other words, we're undergoing a basic structural change to keep this division healthy.

Global demand for large-scale construction projects is also off. How are you coping?

Since the number of finalized plant contracts is smaller, we must make sure that the projects we enter into are viable. We stress rigorous financing criteria, partner selection, and control of risk. Finance is a Nissho Iwai strong suit; our ability to obtain financing often determines whether a project is on or not. Fortunately, our sales staff knows as much about this area as many professional financiers.

We're focusing more on medium-scale production and energy generation plants these days, as their volume is rising. Since financing and other services are less complex for these plants than for huge projects, we can create quite profitable new business flows with relative ease.

Japanese manufacturers are localizing production overseas these days. How does this affect Nissho Iwai?

Backed by our long overseas experience, we're becoming more involved in local production as well. For example, the New York-New Jersey Port Authority has been buying Kawasaki Heavy Industries' subway cars. Today we're working with Kawasaki to process and assemble these cars in suburban Yonkers, New York. That way we can also handle car repair and maintenance.

We do similar production and

processing in other sites; we've progressed far beyond knockdown assembly. Japanese automobile production is also moving to the U.S., and Japanese parts suppliers are moving with them. We can help them move: transport equipment, establish factories, arrange financing, and provide other assistance.

How can you do long-term planning for aerospace, a sector whose success depends on a few big-ticket purchases?

Our business depends on more than huge aircraft purchases. As Boeing's agent in Japan, we market their offerings in every market segment not just B747s. In addition, the Japanese market for small airplanes, equipment replacement, defense aviation, and aircraft leasing and financing looks especially promising.

What exciting opportunities exist in the electronics and telecommunications field?

We've already had impressive success in marketing our Nissho brand printers and related products, and this whole sector looks poised for explosive growth. Aided by information from experts on the technological front lines, we plan to invest heavily in production and marketing of both the products of the "information revolution" and the equipment itself. For example, we're now developing telephone switches and fiber optic and microwave transmission systems for global telecommunications. My biggest headache is making those split-second decisions. This market moves fast, and we have no plans to get left behind.

performance was better than expected, although sales were just 72% of the previous year's total.

Prominent among the year's transactions was an export contract for five 40,000-dwt newbuilding bulk carriers to be delivered to Norway within the next two years, and an order for two 450,000 cubic foot reefer ships for a Panamanian company, also slated for delivery in 1986 and 1987. We received an American order for a floating production, storage, and off-loading unit, to be built in Singapore and operated in Indonesia. In fiscal 1985, deliveries of an offshore rig and related equipment and materials amounted to \$90 million.

Commercial Division

Included in this division's activities is trade of aircraft and related items, defense and aerospace products, and electric power plant and equipment.

Our role as Boeing's commercial aircraft sales consultant in Japan ensured another noteworthy year in

this field. After competitive evaluation of Boeing and European Airbus 300-passenger aircraft, All Nippon Airways (ANA) selected Boeing's B767-300 for its fleet. In April 1986, ANA contracted to purchase 15 of the Boeing craft, with an option for ten more. In other deals, Japan Air Lines signed a purchase agreement for six B747s, ANA agreed to purchase two B747s, and Southwest Air Lines of Okinawa signed for one B737.

Several major aircraft financing activities in fiscal 1985 garnered recognition for Nissho Iwai's leasing expertise. Notable was a 27-member lease syndicate, which we organized to finance an order for two B747-300s by Varig Airlines of Brazil. We also led an international syndicate to lease two B757-200 aircraft to Eastern Airlines of the U.S.

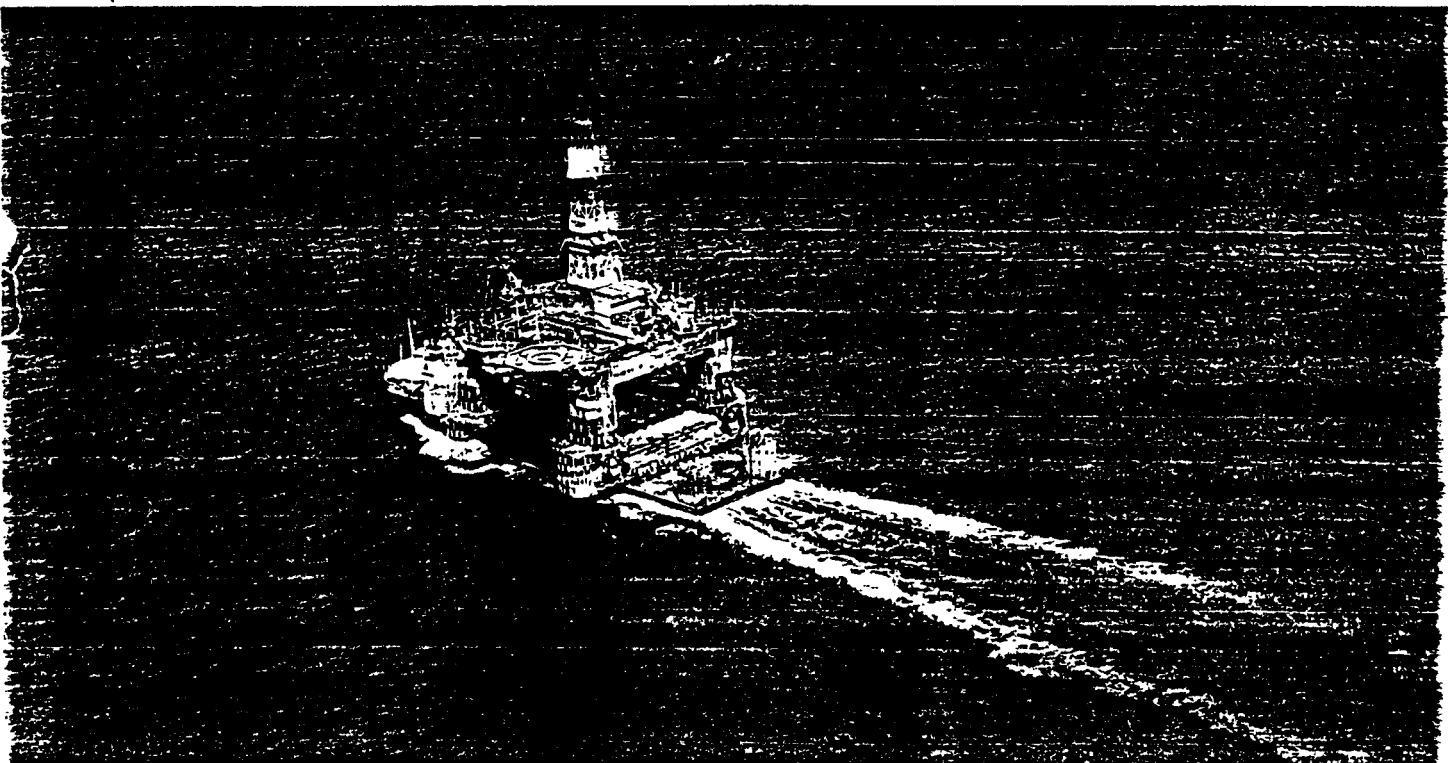
We were active in the defense field, as well, as domestic representative of McDonnell Douglas, Westinghouse, Raytheon, Litton, and other foreign aerospace giants. In 1985, the Japanese government announced a new five-year defense plan that will

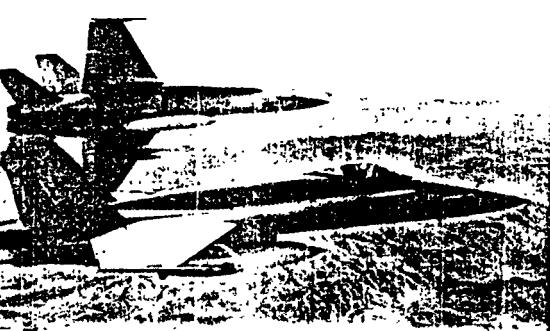
increase the size of the Self Defense Force's F-15J fighter squadron to 187 aircraft. The F-15J is now being produced by Mitsubishi Heavy Industries, Ltd. under license from McDonnell Douglas, and Nissho Iwai is coordinating all licensing arrangements. Together with our wholly owned subsidiary, Nissho Iwai Aerospace Co., Ltd., we also arranged for the sale of fire control systems, navigation equipment, and other advanced airborne avionics equipment to the Japan Defense Agency and the domestic defense industry. In fiscal 1985, we donned a new hat: We are now sales representative in Japan for McDonnell's F/A-18 multi-role fighter, AV-8B VSTOL fighter, and AH-64 anti-tank helicopter.

The year was marked by our mediation of an OEM production contract between McDonnell Douglas of



(top) The world's first American-flag pure car carrier will carry Japanese cars to market. (bottom) We supplied this all-weather-type semi-submersible drilling rig to a North Sea site.





(top) The Boeing 767-300: Another best-selling commercial jetliner for Japan.

(bottom) McDonnell Douglas's F/A-18 multi-role fighter is a strong contender for defense sales in Japan.

the U.S. and the Sansui Electric Co. of Japan. The \$20 million undertaking will have Sansui producing LASER-FILM™ videodisc players for export from June 1986.

On the global front, a lagging economic recovery, unstable political conditions, and currency exchange flux dampened growth prospects for exports of heavy electric power systems. Nissho Iwai is thus concentrating on trade in promising markets and working to expand business in large-scale thermal/hydroelectric

power, substation, and transmission projects.

Among significant business for fiscal 1985 was a contract to provide a massive, \$26 million hydraulic power station, consisting of four 150MW turbines and generators from Fuji Electric Co., for the Indian State of Orissa. This contract was the largest single transaction of its kind recorded in this field in 1985. India is also the site for a new 4.8MW combined cogeneration power plant which will burn low-sulpher heavy stock (LHS) fuel. This efficient facility will be built by Mitsui Engineering & Shipbuilding of Japan and operated by Chemicals and Plastics India Ltd.

An \$11 million order was secured in April 1986 to provide Indonesia's electric power authority with load dispatch centers for its 200MW Gresik power station. The equipment will be produced by Fuji Electric Co. In nearby Singapore, a drum-lifting ceremony in February 1986 marked the start of work on the third unit of the Pulau Seraya thermal power station. Nissho Iwai is the main contractor, and Mitsui Engineering & Shipbuilding is supplying three 250MW boilers.

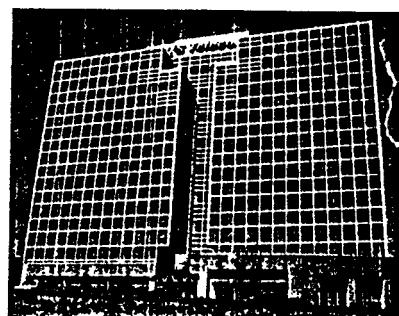
ELECTRONICS & TELECOMMUNICATIONS

This division spans many of today's most exciting high-growth fields: computers, consumer electronics, telecommunications, cable television (CATV), local area networks (LAN), value-added networks (VAN), satellite systems, and many more.

One of our major projects in 1985 was in China, where demand is mounting for consumer electronics and technical transfer from abroad. In association with Japan Victor Company (JVC), we signed our first contract to supply production equipment and technology for assembly of television sets in China back in 1979. The client was the Tianjin Communication and Broadcasting Company. Since then, we have established 17 JVC-affiliated television production facilities and nine plants producing color TV monitors, video cameras, radio/cassette players, compact disc players, and keyboards in the People's Republic. Nissho Iwai's JVC-related China trade to date surpassed \$100 million in fiscal 1985.

In tandem with resistor industry leader Koa Corp., we market advanced resistor manufacturing plants overseas. In 1985, we supplied two plants and technical assistance worth \$3.9 million to Shanghai and Wuhan, China. We are now negotiating to provide a similar facility, on a larger scale, to the Soviet Union.

Fiscal 1985 marked a \$40 mil-



We are doing more and more in telecommunications with partners such as U.S. Telecom.

MACHINERY

Machinery includes chemical plant and engineering, industrial machinery, transportation machinery, marine, aerospace and electric power systems, electronics and telecommunications, and construction and housing.

The Machinery Group showed a total transaction volume of \$9.509 million for fiscal 1985, down by 2.7% from fiscal 1984. That figure represents 18% of Nissho Iwai's volume for the year, a slightly smaller share than in the previous year.

This division, together with our related overseas subsidiaries, trades in plant and machinery for energy projects and production of chemicals, fertilizers, textiles, processed foods, and other goods.

Offshore demand for Japanese plant exports was dealt a double blow in fiscal 1985, as oil producers and foreign exchange-strapped developing countries curtailed purchases and a strengthening yen damaged our competitiveness. Sales were slightly off for the fiscal year, but an upturn may be in sight: our contract volume in March 1986 was 42% higher than for the same month in 1985.

We secured several sizable orders during the period under review. One was a \$280 million contract to supply an ammonia/urea plant for the Iraqi government. The Hitachi Zosen Corp. of Japan and M.W. Kellogg Co. of the U.S. are participants in the project, which will provide Iraq with 1,000 tons of ammonia and 1,750 tons of urea per day. This is the biggest project of its kind for which we have served as prime contractor. Another undertaking in the Middle East was a \$45 million order to provide the Egypt General Petroleum Corporation with an LPG recovery plant from Hitachi Zosen. Nissho Iwai is providing full project financing, based on EXIM Bank suppliers' credits. This is our second full turn-key plant order from the Egyptian authority.

Nissho Iwai is an increasing presence in the Caribbean, as shown

by two financing agreements finalized in fiscal 1985. As part of a consortium, we secured a \$28 million yen loan for construction of an LPG terminal in the Dominican Republic. The project is scheduled for completion in early 1988.

We made our first major inroads into the Trinidad and Tobago market in fiscal 1985 by participating in the third phase of the Trinidad Nitrogen Co., Ltd.'s ammonia plant project. The project called on our financing expertise to secure a \$50 million loan with very attractive rates to cover Japanese supplies and services.

Nissho Iwai is involved in many projects calling for U.S.-Japanese cooperation. One was launched last year in Carbo Negro, Chile, the site

of a new methanol plant slated to open in 1989. We provided a \$50 million loan to Signal Methanol Inc. of the U.S. to construct the plant, which should prove to be a major source of export revenues for the Chilean government.

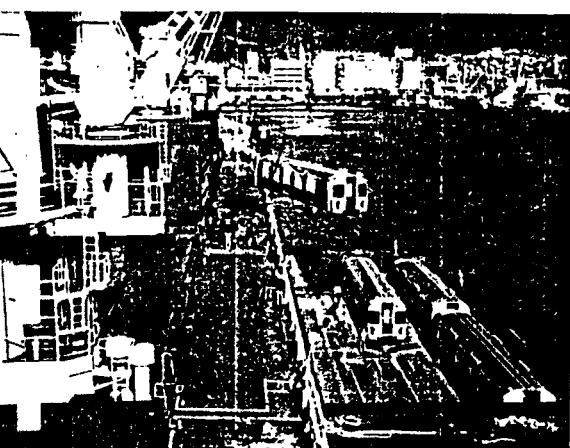
Although steel production plant and equipment investment remains depressed worldwide, Nissho Iwai achieved an encouraging turnover of \$1,000 million in fiscal 1985 steel mill-related transactions. In addition, we obtained some \$557 million in new orders in this field.

A major new order was for a full range of equipment to renovate and expand a hot strip mill owned by Usiminas (Usinas Siderurgicas de Minas Gerais S.A.) of Brazil. The \$67 million project involves a consortium including manufacturers Hitachi, Ltd. of Japan, Davy McKee (Sheffield) Ltd. of the U.K., and Equipamentos Villares S.A. of Brazil.

Domestically, Nissho Iwai contracted with Kawasaki Steel Corp.

This New Zealand plant is converting natural gas to gasoline; Nissho Iwai helped put the project together.





The state of Pennsylvania bought 366 Japanese subway cars; these are bound for Philadelphia.

for an energy-saving \$18 million No. 2 coal dry quenching machine from Ishikawajima-Harima Heavy Industries Co., Ltd. for its Mizushima steel works.

Equipment sales to Kobe Steel, Ltd. were again brisk in fiscal 1985. We helped the company procure equipment worth \$26 million for a direct reduction plant.

The year also marked the signing of a \$180 million contract to export a color film production plant and relevant technology to Shantou, China, in conjunction with Fuji Film Co., Ltd. Mounting popular interest in photography is accompanying the growing affluence of the Chinese people; demand for the new plant's output is sure to rise.

Many of our most important projects occur far from factories or drilling sites. In Honduras, Nissho Iwai is assisting an integrated rural development project in constructing irrigation and drainage canals and farm roads and providing agricultural equipment and educational aids. In the Dominican Republic, we're helping transform 7,500 rural hectares into arable land by constructing irrigation and drainage works and installing a pumping station.

In many developing nations, merely obtaining water for household use can take the better part of

the day. Nissho Iwai's Underground Water Resources Development Project is making this task less arduous by supplying technicians and materials needed to dig wells, install pumps, and train local residents in maintenance. Since this work began in 1975, more than 2,000 wells have been dug in Africa and the Middle East, benefiting some five million people. We signed new contracts in 1985 to dig wells in Benin and Somalia.

We're working with Japan's leading machine tool producers to fill contracts signed with nationalized electric, automobile, construction equipment, and capital goods authorities in India and Eastern Europe for quality machine tools. Japanese machine tools are valued as high precision productivity aids, and we expect overseas demand to grow.

Our Mechatronics Department has some impressive transactions to its credit after the first year of operation. A highlight was mediating for Sunwave Industrial Corporation, a leader in enameling for home interiors, in acquiring production and marketing rights for advanced printed circuit board technology from RCA Corp. This process enables Sunwave to produce a metal core ceramic substrate with superior magnetic shielding and mechanical strength. Nissho Iwai has authority to market the new circuit board domestically and overseas, and we have already begun shipping samples to major automotive, communication, and electronics producers in Japan, Europe, and North America.

MACHINERY MANUFACTURING

Several big-ticket orders for rolling stock and construction equipment helped make fiscal 1985 a successful year for this division. The total contract volume reached \$900 million.

Our major orders originated in the far reaches of the globe. For example, in cooperation with Toshiba

Corporation, we inked a ten-year contract with the Turkish State Railway for local assembly of electric locomotives. Our first shipment will be components for 45 locomotives, with a total value of \$30 million.

With Iseki & Co., Ltd., we assumed joint control of Australia's Maber Iseki Pty. Ltd. last year. The venture, reorganized as Iseki Australia Pty. Ltd., will promote expanded sales of agricultural tractors.

In a complex countertrade transaction, Nissho Iwai will supply Ecuador with 310 Mitsubishi Montero jeep-type vehicles in exchange for Ecuadorian bananas and frozen tuna.

Exports of Toyota passenger cars to Poland continued to show steady growth. We received orders for 1,500 cars, worth \$7.5 million, in fiscal 1985.

Despite a still-depressed construction equipment market worldwide, Nissho Iwai's total contract volume for fiscal 1985 rose by 50% to \$300 million, with Eastern Europe and the U.S.S.R. continuing to be our major markets. A highlight for the year was a contract to supply the national construction authority of Cuba with 150 bulldozers and 1,000 forklifts from Komatsu to assist in agricultural development efforts.

MARINE

The Marine Division handles new and secondhand vessels, ship equipment and containers, offshore oil drilling rigs and vessels, marine equipment, welding materials and robots, and welding machinery.

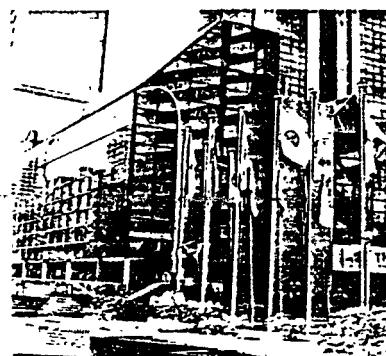
The worldwide recession which has beset the shipping and shipbuilding industries prompted drastic restructuring in 1985. By dint of scrapping, shipbuilding cutbacks, and stringent rationalization measures, companies are attempting to put themselves on an even keel for the eventual market recovery. Given these troubled waters, the division's

lion lease contract agreement for the supply of multiplex equipment and digital microwave radio systems to a major U.S. telecommunications carrier, which leases telephone lines and facilities to telecommunications companies. Our leveraged leasing arrangements were key in securing the contract; we offered special financing tailored to the needs of the company's five-year expansion plan.

On August 19, 1985, Nissho Iwai inked a full turn-key contract with the Telecommunications Corporation of Jordan to expand the installed network base of Amman and one rural district. The \$16 million contract is handled by several Nissho Iwai divisions. We will supply and install Fujitsu digital telephone exchanges and Furukawa Denko cable over the next few years, and will provide maintenance training for local staff. Much of the project will be funded by a Japanese government yen loan, which Nissho Iwai will secure. This is our third yen loan-financed communications project in Jordan since 1977.

Nissho Iwai is the top sogo shosha in the construction industry. Our overseas expertise encompasses real estate, civil engineering, and construction. We have participated in projects to construct public works, commercial buildings, schools, factories, and all types of housing. Our role has been that of project organizer, financier, and material provider, among others. Domestically, we are involved in housing developments, condominium construction and sales, civil engineering, urban redevelopment, and provision of construction information. Despite stagnant construction demand, we were able to increase our fiscal 1985 transaction volume by 1.5% over the previous year's total, to \$360 million.

With competition fierce for



Singapore's 18-story multi-use complex on Orchard St. was developed by Forum with Nissho Iwai.

domestic projects, Japanese contractors are increasingly emphasizing overseas business to generate new demand. This is an advantage for Nissho Iwai, since we can draw on overseas experience to create a positive investment climate for overseas projects and act as project developer, builder, supplier, or lead manager. Since overseas projects currently amount to only 2% of the total business volume of Japanese construction firms, there's room for expansion.

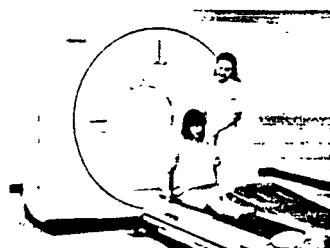
Fiscal 1985 was punctuated by several important overseas developments. One was in Singapore, where construction of an elegant 18-floor multi-use complex was completed in March 1986. The new pride of bus-

tling Orchard Street, the building took 2.5 years and \$28 million to complete. Takenaka Komuten Co. Ltd. of Japan was the builder, with Nissho Iwai providing funding for the owner, Forum Development Pte., Ltd. Several retail tenants have already set up shop, including American chain Toys 'R' Us.

Another significant contract was for the construction of a new suburban campus for the National Technical University in Guayaquil, Ecuador. Nissho Iwai is participating in a consortium led by Tokura Construction Co. of Japan that will undertake the relocation project with financing provided by the InterAmerican Development Bank. The project is valued at \$8.22 million.

Domestic business was equally active during the year. We garnered land-use consulting contracts with several Tokyo office and residential buildings and the NI Seafoods processing factory. We completed sales of five new condominiums, or some 429 units, through two fully owned subsidiaries, Nissho Iwai Housing and Nissho Iwai Realty and Construction. These ventures are also active in a growing volume of cooperative marketing and mediation transactions. Other domestic growth areas in 1985 were housing construction and sales, and land sales for retail and resort home development.

Viewing the brain and other soft tissue called for a scalpel until the advent of computed axial tomography (CAT) scanners. These non-invasive diagnostic tools have long been must-haves in hospitals throughout the industrialized world. Now they are available in the developing world as well. In the last six months of fiscal 1985, Nissho Iwai exported a total of 11 CAT scanners to countries as varied as Turkey, India, Argentina, and Mongolia, and negotiations are underway for another 25 units. Japanese CAT scanners, produced by Toshiba and Hitachi, have earned kudos for their quality; they will be joined by scanners from General Electric, which has set up a production plant here that will export to the U.S.





Masao Araki Executive Vice President,
Energy Group

***Oil prices are often in flux.
How can you undertake strategic
planning?***

Obviously, oil is a crucial component of our business. Oil prices affect demand for other fuels, so we can't rely on a portfolio of energies for steady income. And since the price of oil tends to be quite volatile — often determined more by psychological and speculative factors than pure market factors — planning can be difficult.

Our policy is to create trade flows in oil, not just react ad hoc to prevailing conditions. We rely on both in-house and outside professionals to inform us of domestic and foreign conditions. We also maintain direct contacts with oil producers, oil majors, refineries, and other major oil traders. We're enhancing our capabilities in overall international oil trading, and offshore oil trade, in particular, looks to become an increasingly important focus.

Because Japan is almost completely dependent on outside energy sources, we hope to continue to maintain a diversified energy portfolio, no matter how low the price of oil goes. And amassing oil reserves now, for resale when prices go up, is obviously part of our strategy.

***With LNG prices relatively high,
is it still a viable energy form?***

LNG may not be currently competitive with petroleum for industrial or electric power generation use, but this is a stable, clean energy, easily transportable by available ships, and we'd like to develop new applications to enable us to maintain a steady flow. Although cost factors terminated the Canadian LNG project, we would still like to diversify our supply sources.

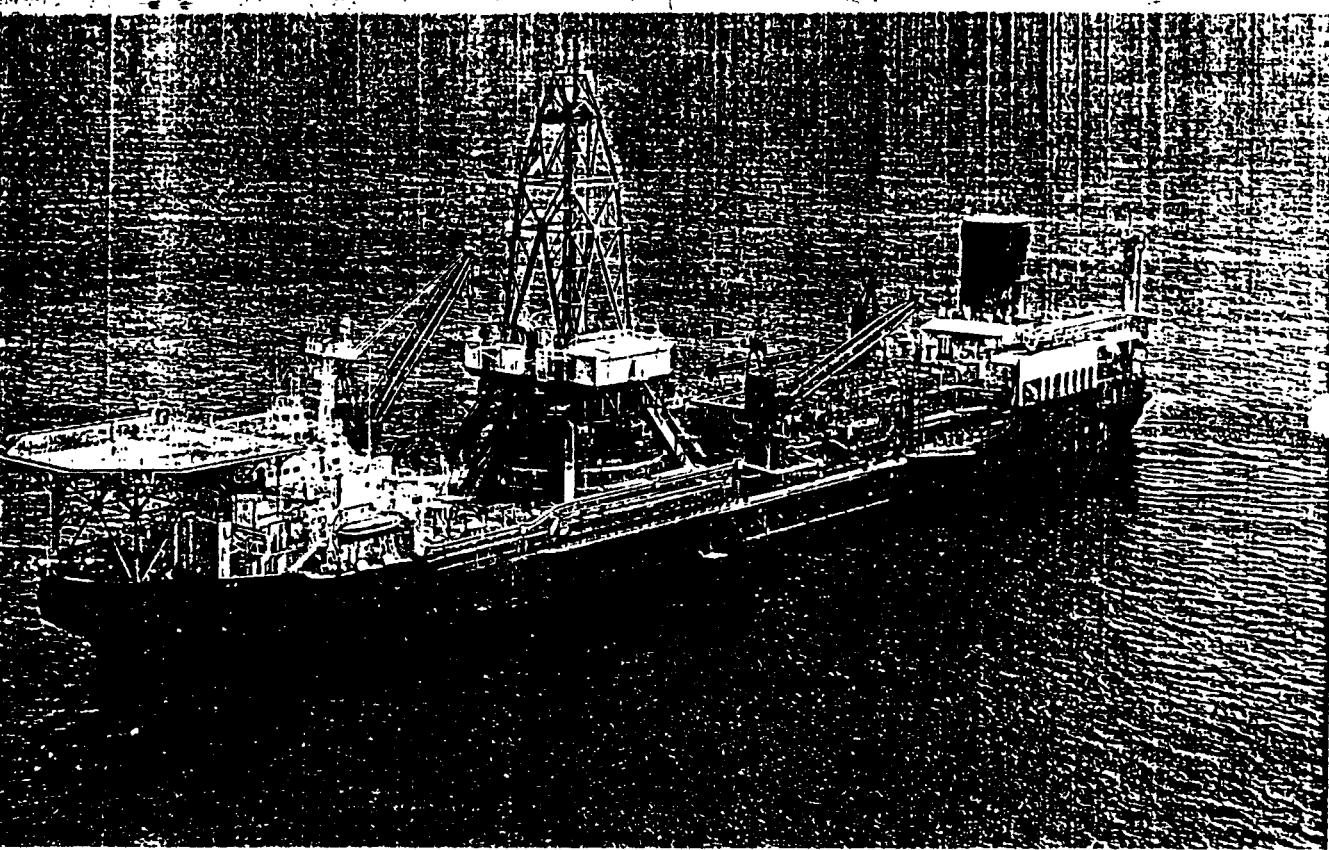
***What about non-oil energy
alternatives?***

We are developing a host of alternatives: LNG, LPG, thermal coal, nuclear fuel, and others. These may not be price-competitive now, but future markets may be different; we see our actions as wise forward investment. For instance, nuclear energy continues to be an important alternative to imported fuels for Japan.

We plan to strengthen our European connections in this field and expand nuclear-related trade with the U.S. We now import thermal coal from Australia and other sites, but hope to expand trade — and improve the U.S.-Japan trade balance — with new supplies from Alaska.

Any new energy sources nearby?

Several Pacific Basin projects offer potential to become profitable sources of supplies. China looms large in our strategy, both as an energy producer and a rapidly industrializing market for fuel. We are also participating in a joint venture consortium which is developing offshore oil fields in Vietnam. As always, we in the Energy Group must concern ourselves with developing long-term stable energy flows, as well as profiting from the current world supply/demand environment.



An on-board mini-refinery makes NKK's new Production Testing Ship a winner.

major Japanese utilities and a steel corporation. It has called on Nissho Iwai's leadership and international cooperation every step of the way, from planning, coordination, and financing to downstream marketing of the output. In 1983, we initiated a second 20-year project to develop 3.2 million more tons of Indonesian LNG per year. And for the past two years we have pioneered in promoting LNG spot sales worldwide.

This activity resulted in a total trading turnover of 12 million tons of LNG — equivalent to nearly half of Japan's annual imports — valued at \$3.2 billion.

Early 1986 has already posed

some formidable market challenges, but we're poised to meet them, by exploring and diversifying energy sources, and by developing more effective uses of natural resources.

The bulk of Nissho Iwai's LPG supplies derive from a long-term import contract with Petromin of Saudi Arabia, augmented by purchases from domestic refineries. In July 1985, we chartered the 45,000-ton LPG carrier Hourai Maru for shuttle service between Saudi Arabian ports and Japan. To accommodate the gas, we have been operating the Yokkaichi 160,000-ton LPG import terminal at full capacity since mid-1984. We handled approximately 600,000 tons of LPG during fiscal 1985.

NUCLEAR ENERGY AND THERMAL COAL

Nissho Iwai is active in nearly every sector of the nuclear industry. In fiscal 1985, our total volume of nuclear related trade surpassed \$1 billion.

We act as exclusive agent in Japan for three top French nuclear energy firms: COMURHEX, for conversion of natural and reprocessed uranium; EURODIF S.A., for enrichment services; and COGEMA, for comprehensive marketing of French nuclear fuel products and expertise, including supplying natural uranium supplies and enrichment and reprocessing services.

Nissho Iwai also prospects for uranium overseas through participation in Japanese uranium mine

Energy includes petroleum, natural gas, and nuclear energy and thermal coal.

PETROLEUM

Fiscal year 1985 marked a turning point in the international petroleum market. The worldwide decline in petroleum demand and the steady rise of non-OPEC crude oil production resulted in chaotic market conditions. In an about-face forced by its need to maintain market share, principal producer Saudi Arabia abandoned its previous role in maintaining international crude oil prices by restraining production. As Saudi Arabia took the lids off the pumps, a price war ensued. Oil prices plunged to little higher than production costs, and OPEC could no longer function effectively as a cartel.

Capitalizing on renewed worldwide demand, Nissho Iwai increased our total volume of crude oil handled

The Energy Division recorded an excellent year in fiscal 1985, with total transactions up by 12% over the previous period, to \$15.058 million. This division accounted for 28.5% of Nissho Iwai's total business.

by 87% and our turnover in petroleum products by 30%. The total dollar amount of both jumped by \$1.4 billion. Contributing to the rise were the launch of trading in Brent Crude in New York and expanded offshore transactions in petroleum products.

By targeting sales to refineries and electric power utilities, we were also able to boost domestic sales by 5% overall, or \$44 million.

Total turnover for the Petroleum Division came to \$4.7 billion for the year.

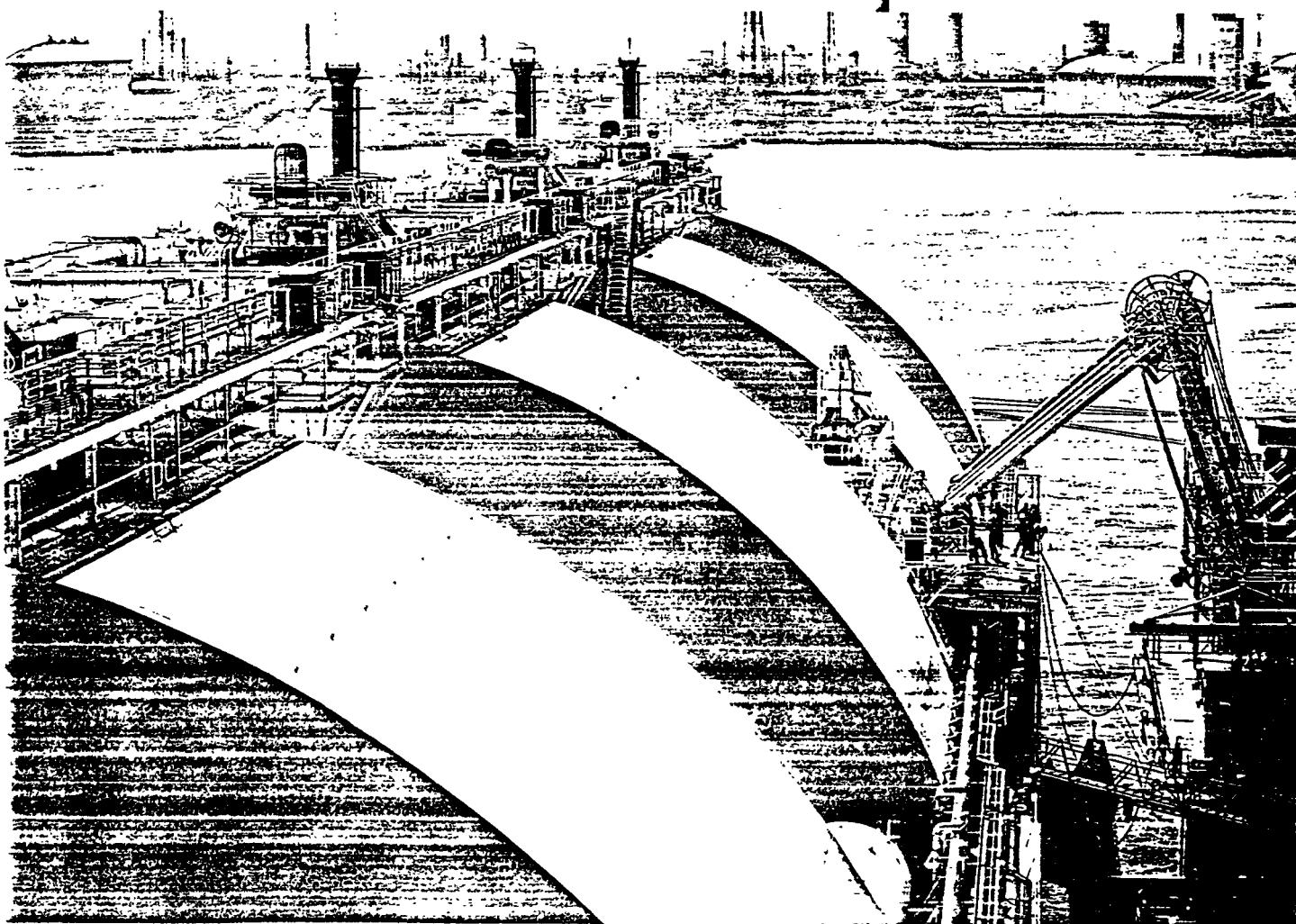
NATURAL GAS

Japan imports nearly all of its energy, and securing stable, inexpensive fuel supplies is obviously of critical importance. Popular alternative energies are the gaseous fuels, specifically LNG (liquefied natural gas) and LPG (liquefied petroleum gas), both prized as "clean" energies with a diverse range of applications.

Nissho Iwai has actively sought energy alternatives since the energy crises of the 1970s. Our role as one of Japan's top traders in LNG and our efforts in developing large-scale energy recovery projects reflect the desire to satisfy domestic needs and forge new markets worldwide.

Our first LNG project was launched in 1977 in Indonesia. That country's largest LNG undertaking is supplying 7.5 million tons of the fuel annually for 23 years to four

We import about half of all LNG used in Japan.



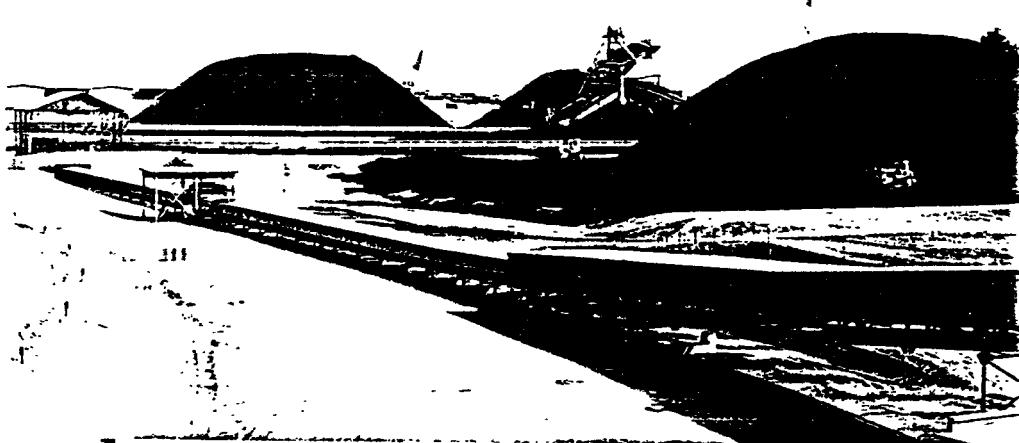
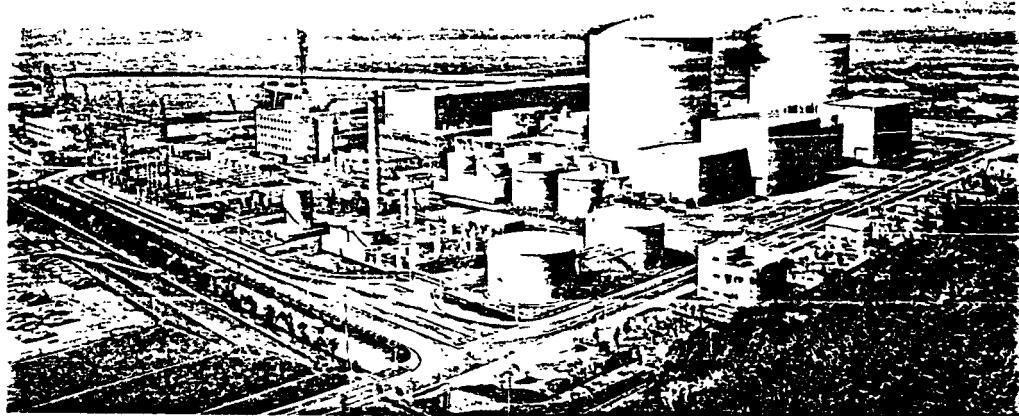
ventures like the Overseas Uranium Resources Development Co., Ltd. (OURD), which supplies Japanese electric power companies with uranium ore from Akouta, Niger.

We are involved in transportation at each stage of the nuclear fuel cycle. For instance, we are a principal shareholder in Pacific Nuclear Transport Ltd. (PNTL), a multinational joint venture based in the U.K. which transports spent fuel from Japan to Europe.

Nissho Iwai has long been a major supplier of enriched uranium and fabricated nuclear fuels for experimental reactor use to research institutions like the Power Reactor and Nuclear Fuel Development Corporation and Japan Atomic Energy Research Institute. We also supply French zirconium semi product to domestic cladding tube producers and casks designed to transport spent nuclear fuel from Kobe Steel to PNTL.

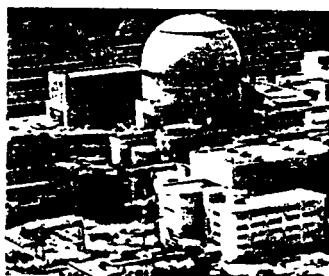
We supply nuclear power plants and R&D organizations, domestically and overseas, with both technology and equipment. Since 1972, we have represented SGN, a French nuclear engineering firm, in providing engineering services and spare parts to a spent fuel reprocessing plant in Tokaimura. We also coordinate licensing agreements between Rockwell International of the U.S. and Kawasaki Heavy Industries Ltd. under which we supply hydrogen recombiners, now standard equipment in all BWR reactors in Japan.

The year has been an active one for our Thermal Coal Department. We continued the joint exploration work with Mobil Oil in Kalimantan, Indonesia that began in 1983, and confirmed over 150 million tons in recoverable coal reserves. This volume is expected to increase as exploration continues. This year also marked the start of joint marketing activities with Mobil, which resulted in indications of interest from Japanese utilities and major clients in Hong Kong, Taiwan, and Korea.



*(top) Nuclear power is a growing force in oil-starved Japan.
(lower) Alternative energies such as coal are also gaining ground.*

The nuclear fuel cycle starts with uranium mining. The uranium in the form of yellowcake is converted, enriched, and reconverted. Then fuel is fabricated and delivered to clients. After use, another cycle begins: collection of spent fuel, reprocessing, and recycling of uranium recovered in the reactors. In Japan, one company handles the entire process: Nissho Iwai. For example, reprocessing of the uranium



remaining after power generation by Japan's 32 nuclear power plants is now entrusted to a French firm, COGEMA, and to British Nuclear Fuels plc (BNFL). The two plan to jointly market uranium that has been reprocessed and converted into plutonium. Nissho Iwai is helping with the arrangements as COGEMA's marketing rep in Japan.

GENERAL COMMODITIES



Koshiro Suganuma, Executive Vice President,
General Commodities Group

You have mentioned increased profitability as a primary group objective. How did you do this past year?

Our volume of transactions was slightly down last year, but gross profits were way up. Net profits did even better — 227% of the previous year's total. We were helped by lower interest payments and a greater selectivity in lumber and other divisions in order to weed out unprofitable transactions.

Another goal was to unite your diverse divisions into a cohesive team. Is that being done?

The situation is improving. For example, due to the problems plaguing upstream textile production in

Japan, many large synthetic textile manufacturers are diversifying into new areas, such as foodstuffs and other consumer products, that are covered by other General Commodities divisions. Since sectoral barriers are breaking down for our clients, they must for us, too. Close relations between our various divisions are leading to a higher degree of synergy.

Textiles is seen as a labor-intensive sector, currently weakened by global protectionism. What's your strategy?

Obviously, trade restrictions and a high yen curtailed exports from Japan and our overall trading volume. Exports of Japanese garments, mainly to the U.S., and synthetics to China were slack. But offshore trade showed robust growth in dollar value, and net profits were double those of the previous year.

Our textile-related business covers more than trade alone. Backed by close cooperation with apparel makers, we are expanding our marketing channels in Japan and emphasizing high quality goods. We're forging strong intra-industry links and are closely attending to apparel trends — to the extent of regularly sending our people to Europe to study fashion planning.

Textile production has now largely moved to the developing countries, especially those of East Asia, and we can benefit by selling them looms and other textile production equipment, and by securing foreign sources of synthetic textiles.

Food demand surely isn't growing much in Japan. Do you plan to do more than simply trade foodstuffs?

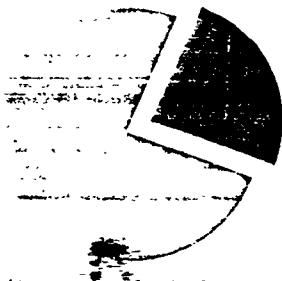
Prices for important commodities like maize, soybeans, sugar, and wheat plunged last year, so we're moving beyond simple trading to ensure future profits. The key in foodstuffs is downstream market-

ing. One example is NI Seafoods — this venture has direct links with supermarkets and other distribution majors, and processes fish into ready-to-market forms. Our recent business agreement with gourmet food supplier Silver Palate of the U.S. and decision to launch the Season chain of restaurants are two more cases in point. But these are not isolated cases: a divisional task force is now at work deciding on an overall specialty food marketing strategy for both domestic and overseas markets.

This strategy involves both vertical and horizontal forward integration. For example, we let Japan's top broiler producer — a consumer of huge amounts of chicken feed — acquire a 30% equity share of NI Delica, a leading chicken sales company, so we could secure an attractive, regular source of broiler supplies and expand sales of compound feed and feed grain. We also linked up with a huge grain silo operator to store grain imports in deepwater ports and forged links with mid-size companies in related sectors. Now we can take care of both demand and supply of chickens and feed.

You import many categories of foreign consumer goods into Japan. Can this help right the trade imbalance?

We're trying. Many of our products are not luxuries, but household goods for daily use, so when prices fall due to the weaker dollar, demand should rise. The question is: Can demand for imports strengthen enough to right the imbalance? We don't know that yet, although we hope so.



Total transactions for the General Commodities Group amounted to \$12,646 million for fiscal 1985, an decrease of 2.7% over the previous year. That is equivalent to 24% of Nissho Iwai's total turnover for the fiscal year.

General commodities include textiles, lumber, general commodities, chemicals, and foodstuffs.

TEXTILES

Textiles include natural and synthetic fibers, yarns, and fabrics, apparel, and interior furnishings. We also trade in products and material for industrial, agricultural, fishing, civil engineering, and construction use.

We knit together many textile sectors in a multifaceted domestic marketing approach. Nissho Iwai coordinates the production process from fiber weaving and fabrication to finished garments; we are also developing new ventures and sales routes and introducing foreign brands. We show great strength in three Japanese regions — Niigata, Fukushima, and Yamagata — which produce \$1 billion in fashionable knit garments each year. Not only does Nissho Iwai hold the top share in supplying yarn to local producers in that area, we coordinate fabric output to meet our projections of industry needs.

Foreign trade is increasingly expanding, fueled by the work of overseas offices and affiliates. Nissho Iwai continues to be the top Japanese exporter of apparel to the U.S. We also export synthetic yarns and fabric. Imports include wool, flax, silk, and other raw materials, as well as finished garments. We also operate four domestic subsidiaries to satisfy needs for specialized textiles.

Japan's total fiber demand has

been flat for the past five years, at about 2.4 million tons based on yarn weight, and it may remain so through the rest of the 1980s. We have shifted our emphasis from higher volume to upgraded product quality and added value, and from upstream to midstream marketing. We are also bolstering our relations with garment makers, the fashion industry, and retailers, to expand trade in apparel and accessories.

GENERAL COMMODITIES

Textile trade with China continued to be brisk in fiscal 1985. China's huge labor force, handicraft traditions, and abundance of natural fibers such as cotton, cashmere, and angora have long made the country a popular source of fabric and fibers. In recent years, China has made

High added value comes when we supply the fabric and market the product. Here, Itokin's Lancetti brand.



GENERAL COMMODITIES

efforts to diversify into fabrication of modish apparel; a Chinese fashion show held in Japan in 1985 hinted at the country's recent style strides. Nissho Iwai coordinates textile imports from a number of Chinese production sites, and we are actively promoting higher quality goods.

Fabrics made of natural fibers continue to capture the Japanese consumer's fancy. Lightweight ramie — easily blended with cotton, acrylic, and silk to create fashionable apparel that stays crisp in Japan's humid, hot summer climate — is a top choice. Nissho Iwai is a leading importer of ramie fiber and thread, and we claim a large import share of linen, another popular summer fabric.

The appeal of natural fabrics is also enhancing domestic demand for wool bedding. In fiscal 1985, a total of 3.5 million quilts made use of 8,800 tons of wool, an increase of 10% over the previous year. These quilts accounted for 10% of all bedding produced in Japan. Nissho Iwai handled 15% of Japan's 1985 imports of such wool, most of which originates in France. Other sources are New Zealand, the U.K., and Australia.

The Stettin Bay Lumber Co. is a long-term success story in resource development.



Nissho Iwai joined with Itokin to set up popular Tokio Kumagai fashion boutiques.

LUMBER

Japan's timber imports grew at a 6% pace in 1985, and Nissho Iwai's timber business kept pace. We handled 8% of the nation's total timber imports in 1985, or 2.7 million cubic meters. A 42.4% share of this total, or 1.15 million cubic meters, came from North America, with nearly one million cubic meters from Southeast Asia and other equatorial regions, and the balance from the U.S.S.R., New Zealand, Chile, and elsewhere. Other timber transactions, including the export of 0.6 million cubic meters of U.S. logs to China and sales of 0.15 cubic

meters of logs from Papua New Guinea to Korean plywood manufacturers, earned us the top share of timber trade among the sogo shosha. Our total trade for fiscal 1985 amounted to 3.5 million cubic meters.

An intra-group organizational change occurred in April 1986 with the transfer of wood-based building materials from the General Commodities Division to the Lumber Division. This consolidation responds to a big boost in domestic demand for imported wood-based housing materials. With Japanese import tariff rates on lumber, plywood, veneer, and other goods falling, and public appreciation for the aesthetics and comfort of wooden housing on the rise, the future augurs well for lumber trading.

Reforestation in Papua New Guinea again figured into our activities last year. Since 1976, our joint venture with the Papua New Guinean government, Stettin Bay Lumber Company, has been developing that country's huge timber resources, while planting a total of 2,000 hectares. We expect to plant another 600 hectares in 1986, thanks to the increased seeding and sapling capacity provided by our newly established nursery and research center, sited near the forested areas. Eucalyptus saplings developed at the nursery have shown impressive strength and rapid growth.



GENERAL COMMODITIES

Minerals, paper and pulp, and consumer goods are all handled by this division.

Minerals

Nissho Iwai is the top supplier of raw and processed minerals like bauxite, chamotte, chromite, dolomite, fluorspar, granite, graphite, kaolin, magnesite, marble, pyrophyllite, rare earths, talc, and zircon to Japanese industry. We are also working to secure new minerals such as synthetic crystals, silicon carbide, silicon nitride, rare earths, and new ceramics for high technology applications.

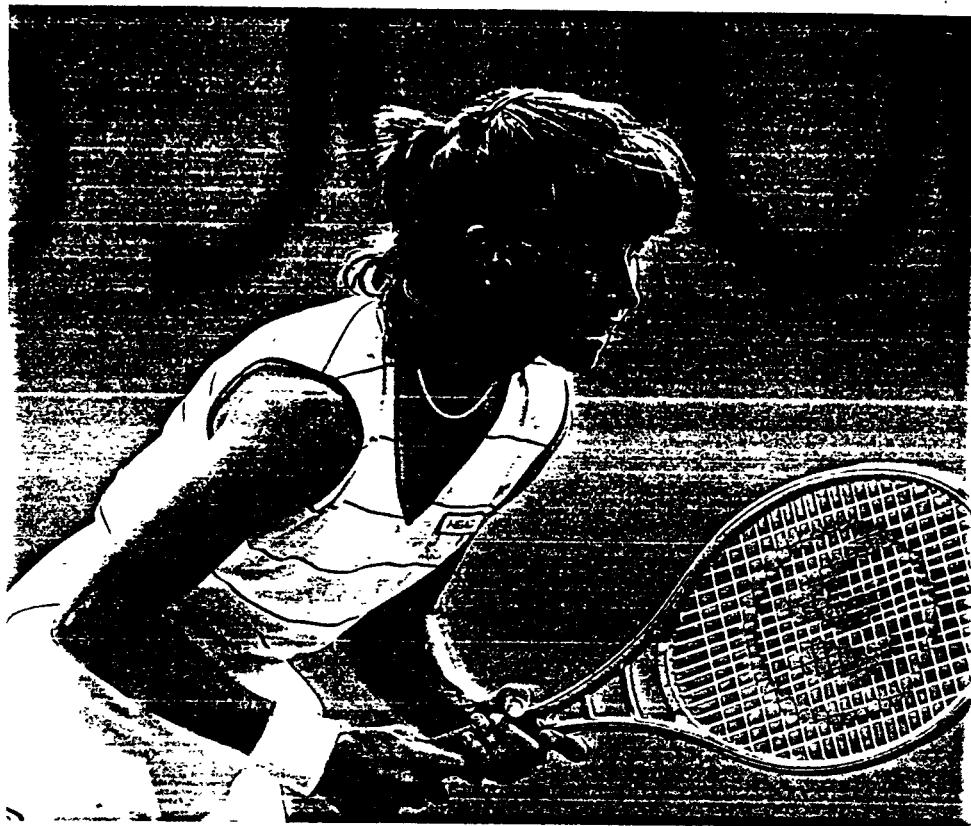
Consumer goods

The department deals in a range of items, including sportswear, tires, automotive components, electrodes, cigarettes, hides, carpets, sundries, and consumer electronic equipment.

Transforming Japan into a nation of leisure-lovers is a daunting task, but Nissho Iwai is playing a part by marketing such crowd-pleasers as Nike sports shoes and Wimbledon tennis racquets. We've formed two subsidiaries to vie for the world's second largest sporting goods market: Nike Japan Corp. and Nissho Iwai Sports Corp.

Nissho Iwai Sports has found Wimbledon tennis racquets to be top net income-earners; the new, lightweight but powerful Wimbledon Super Series racquet has proven especially popular with women.

Twenty-one percent of Japan's population will be over 65 by the year 2025, and the need for inexpensive wheelchairs and other medical aids is sure to rise. To supply this demand, Nissho Iwai is participating in a joint venture with Everest & Jennings International of the U.S. — the world's top wheelchair producer — and Japan's market leader, Nissin Medical Industries. The new company, Everest & Jennings Asia Ltd., was launched in

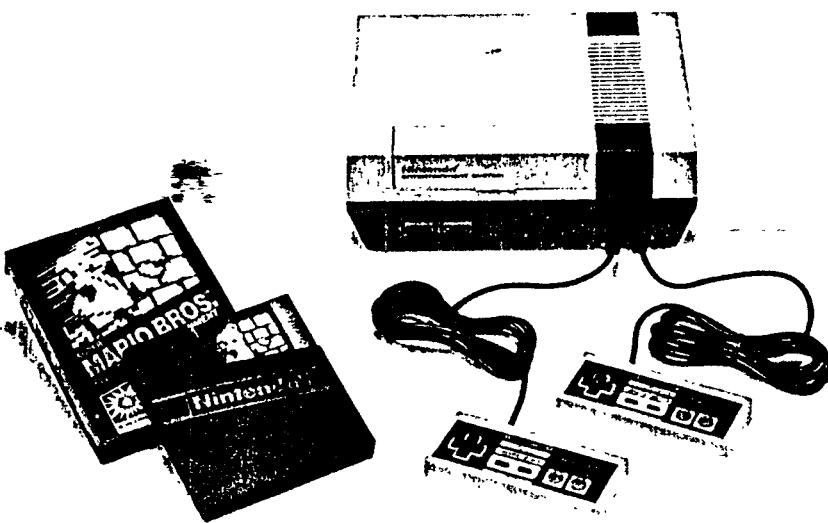


Branded sporting goods are all the rage in Japan — Wimbledon tennis racquets, NIKE shoes and sportswear.

April 1986 to develop, produce, and market low-cost wheelchairs for Japan and the Pacific Basin.

Nissho Iwai is one of two exclusive agents in Japan for Philip Morris Inc. Our subsidiary, NI Tobacco Co., was established in April 1984 to promote sales of imported Lark and Parliament tobacco. This April we added a new brand, Philip Morris Lights. One result of the

GENERAL COMMODITIES



Our consumer electronics business includes popular home computers, complete with game software.

ongoing liberalization of Japan's tobacco industry has been lower prices for imported cigarettes; Philip Morris Lights can offer both a price and flavor advantage which should yield handsome sales results.

A growing volume of Japanese consumer electronic equipment has found its way into Western homes with the help of Nissho Iwai. We export video and audio equipment and components, portable facsimile machines, computer games, and LCD pocket games. In 1985 we shipped about 100,000 VCRs to the U.S., with larger orders already placed for 1986. Nissho Iwai also ships bicycles produced in Taiwan to Western markets.

Paper and pulp

Japanese are among the world's most voracious readers, and sating the domestic appetite for books, magazines, and newspapers keeps paper vendors busy. To bolster our paper marketing and distribution activities we launched this division in April 1985. Nissho Iwai imports a big volume of pulp from overseas for Japanese paper manufacturers and distributes the output to both domestic and foreign customers.

Building materials

Notable among building material transactions for fiscal 1985 were increased domestic marketing and overseas exports of Portland cement and processed products. We also recorded substantial imports of asbestos, vermiculite, and insulation materials from Canada and South Africa.

CHEMICALS

American autos are increasingly powered by low-lead gasoline, fueling demand for organic octane boosters. This has enabled Nissho Iwai to expand exports of such aromatic organic chemicals as benzene, toluene, and xylene to North America. Europe and North and South America were the sources of other large-volume chemicals traded last year, namely MEG, styrene monomer, 2-ethyl hexanol, DMT, and Caprolactam for Southeast Asian markets. Our liquid chemical tankyard in Tokyo Bay, NI Chemical, was in full operation throughout the period under review.

Sales of inorganic chemicals soared in the first half of fiscal 1985, but were curtailed by the muscular yen in the latter half. Nevertheless, we recorded a great increase in the import of basic alkaline and electrically processed

chemicals. Other growth areas included yellow phosphorus, derived from our joint venture in China; calcium hypochlorite for swimming pool use — we handle over 40% of Japan's market, or 10,000 tons in all; and magnetic tape materials, which doubled in traded volume over the previous year. Exports of fertilizer also grew, with orders from Southeast Asian markets on the upswing. Domestically, we expect sales of medicinal herbs, health foods, deodorant chemicals, and chemical essences to grow by \$20 million within the next two years.

Nissho Iwai traded nearly \$240 million in fine and specialty chemicals in fiscal 1985, including pesticides and pharmaceutical intermediates, catalysts, photosensitive materials, detergent raw materials, coating resins, adhesives, and organic acids. The total volume included some \$64 million in exports. Notable were a \$20 million export order for alkylbenzene for detergent use in Southeast Asia and a \$3 million order for FCC/Reforming/Hydrogen catalysts for refineries in Indonesia. In the field of biochemicals, we began importing monoclonal antibodies from Bioscot of the U.K. for domestic medical and diagnostic applications.

In plastics, we emphasized trade in high performance resins, finished plastic products, and other high added-value items. We again handled 20% of Japan's total fiscal 1985 imports of Brazilian EDC, or 100,000 tons, and for the first time we imported Brazilian polyethylene as well. We handled one quarter of Hungary's exports of polypropylene last year, sending 6,000 tons to Southeast Asia.

Other new areas offered great promise. We doubled our exports of Japanese plastic optical fiber to the U.S. for automotive and computer use, and took our first orders to supply optical grade Japanese polycarbonate resin to compact disc producers in Europe.

FOODSTUFFS

This division handles grains, edible oils, cereals, sugar, seafood, provisions, and meats. Our transactions in fiscal 1985 totalled \$2,545 million, or 6.3% of Nissho Iwai's total trading volume. This 5.4% jump over the previous year's volume is in part thanks to our efforts to increase offshore trade and strengthen downstream marketing activities.

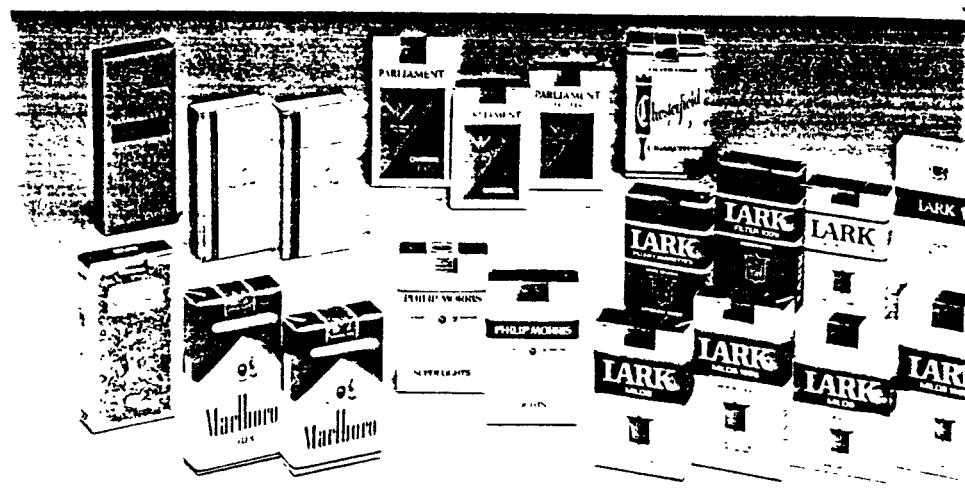
Grains

Nissho Iwai traded approximately \$400 million in wheat and barley in fiscal 1985. We were again the leading exporter of flour to China and Southeast Asia, and played a strong role in managing domestic sales, imports and exports, and offshore trade in rice.

Our David's Cookies ventures are now carried by 11 Japanese retail chains nationwide. The Japanese branches of the U.S. chain serve up both cookies and ice cream for the discriminating sweet tooth.

Oils and cereals

Oilseed and feedgrain supplies were ample in fiscal 1985, and depressed global demand sent prices plunging. Nissho Iwai continued our successful



Philip Morris Lights joined our product line in fiscal 1985.

strategy of diversifying markets and product lines, allowing us to fill a large order for Thai tapioca pellets for the U.S.S.R. and sell Malaysian palm oil to Saudi Arabia.

We continued as Japan's top importer of Chinese soybeans, which are used for production of Japanese foods like miso and soy sauce. Nissho Iwai also claimed a leading share of Japanese imports of corn, rapeseed, and other cereals during fiscal 1985. Other major domestic activities included marketing animal fats and oils, especially palm oil and tallow.

Sales of varietal grain from Specialty Grain, our Illinois-based

subsidiary, continued to grow. Specialty Grain is expanding its activities to encompass bioagriculture as well as conventional grain supply.

Sugar

Sugar trade was Nissho Iwai's first line of business, and it continues to sweeten profits. We import over 200,000 tons of raw sugar each year, primarily for our two sugar refining subsidiaries. We handle domestic trade of 220,000 tons of refined sugar and 90,000 tons of other nutritive sweeteners through three subsidiary wholesalers and other distributors.

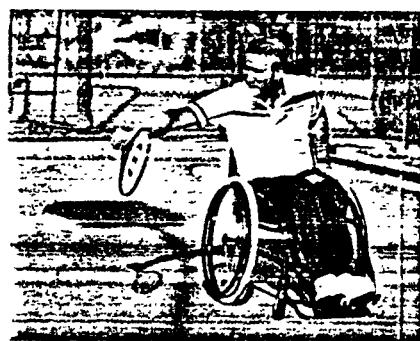
Enhanced cooperation with sugar producing countries in formulating joint marketing strategies is helping to ameliorate the adverse impact of reduced raw sugar imports due to greater domestic production of beet and cane sugar and high fructose corn syrups.

Marine products

The average Japanese eats 8.5 times as much fish as the typical American does, and Nissho Iwai helps ensure smooth deliveries of this important protein source to Japanese kitchens. We import prawn, shrimp, lobster, tuna, salmon, cuttlefish, octopus, capelin, and other fish from the

There were some surprising crowd-pleasers at a recent Tokyo import show: wheelchairs. But these were no ordinary wheelchairs: besides no-frills hospital models, there were zippy electric scooter wheelchairs, chairs for executing tight basketball pivots, even low-slung chairs for pursuing volleys across tennis courts. The low-cost chairs will be locally produced by Everest Jennings Asia, a joint venture of

Nissho Iwai, Nissin Medical, and Everest & Jennings, the world's largest wheelchair producer. Nissho Iwai will handle imports of the advanced individually owned models. As more Japanese heads turn gray and the idea of mobility for the handicapped catches on, demand for these hot wheels should accelerate.



GENERAL COMMODITIES

waters of Greenland to New Zealand, and points in between.

The Japanese fishing industry is smarting from the extension of 200-mile exclusive economic zones, but Nissho Iwai has had considerable success in securing new overseas supply sources. We're also expanding downstream marketing, chiefly through Nissho Iwai Seafood Corp., our new seafood reprocessing and distribution subsidiary.

Meat

Beef from Oceania and North America and live cattle from Australia and New Zealand were

among the meat products handled in 1985. Close ties with leading Danish pork suppliers facilitated trade of a large volume of imported Danish pork. Other products traded in the fiscal year, both domestically and abroad, included poultry, horsemeat, lamb, mutton, beef offal, compound feed, and grass seeds.

A highlight of fiscal 1985 was a business tie-up with Japan's leading poultry producer and distributor, Koyu Shokuchō Co., Ltd. The arrangement will enable us to expand our business in fresh and frozen poultry, compound feed, and feed grain. Koyu will also hold shares in our subsidiary, Nissho Iwai Delica Corp.; its participation should bolster our domestic marketing efforts.

Provisions

The Japanese consumer's growing awareness of foreign cuisines has led to a recent boom in "ethnic food" restaurants. To satisfy these discriminating tastes, Nissho Iwai imports food ranging from fresh fruits and vegetables to frozen and canned foods, concentrated juice, pectin, Scotch whiskey, salt, cocoa, and coffee beans. We handle increasing imports of gourmet items like foie gras, escargots, Italian pasta, and Chinese vegetables, too. Our primary domestic role, however, is dealing in milk products and distributing best-selling Nescafe for Nestle Ltd.

From cookies to corn, sugar to salmon, Nissho Iwai is a major foodstuffs supplier.



NISSHO IWAI SUBSIDIARIES AND AFFILIATES

Overseas subsidiaries

Nissho Iwai American Corporation

New York, Atlanta, Washington, Philadelphia, Cleveland, Chicago, Detroit, Nashville, Houston, St. Louis, Anchorage, San Francisco, Los Angeles, Portland, Bellevue, Seattle

Nissho Iwai Canada Ltd.

Vancouver, Toronto, Montreal, Calgary

Nissho Iwai Mexicana S.A. de C.V.

Mexico City

Nissho Iwai Panama International S.A.

Panama

Nissho Iwai de Venezuela C.A.

Caracas

Nissho Iwai do Brasil S/A.

Rio de Janeiro, São Paulo, Belo Horizonte

Nissho Iwai (Argentina) S.A.

Suenos wires

Nissho Iwai (UK) Ltd.

London

Nissho Iwai Deutschland GmbH

Hamburg, Dusseldorf

N.V. Nissho Iwai (Benelux) S.A.

Brussels

Nissho Iwai France S.A.

Paris

Nissho Iwai Italia S.P.A.

Milano

Nissho Iwai Espana S.A.

Madrid, Las Palmas

Nissho Iwai (Nigeria) Ltd.

Lagos

Nissho Iwai Corporation, (Iran) Ltd.

Tehran

Nissho Iwai Middle East E.C.

Bahrain

Nissho Iwai (Thailand) Limited, Partnership

Bangkok

Nissho Iwai Hong Kong Corporation, Ltd.

Hong Kong

Nissho Iwai Australia Ltd.

Sydney, Melbourne, Perth, Fremantle, Brisbane, Port Moresby

Nissho Iwai New Zealand Ltd.

Auckland, Wellington

Nissho Iwai International Finance plc

London

Nissho Iwai Finance (Europe) B.V.

Rotterdam

Major domestic subsidiaries and affiliates*

STEEL

Nissho Iwai Steel Leasing Co., Ltd.

Construction material leasing

Komatsugawa Koki Co., Ltd.

Light gauge steel rolling

Hamamatsu Kohan Kako K.K.

Steel sheet shearing and slitting

NIK Metal Corp.

Steel products sales

Oyodo Steel Co., Ltd.

Wire products manufacture

Goto Drop Forging Co., Ltd.

Steel forging

Nissho Iwai Steel Corp.

Steel products wholesale

Wataei Steel Co., Ltd.

Steel products sales

Kanon Steel Co., Ltd.

Steel products sales

Nishimoto Sangyo Corporation

Steel products sales

Unicon Co., Ltd.

Paican manufacture

West Japan Stainless Steel Wire Co., Ltd.

Stainless steel wire manufacture

NEW MATERIALS & FERROALLOYS

Nissho Iwai Bentonite Co., Ltd.

Bentonite powder and Volcany paners sales

Nihon Mining & Concentrating Co., Ltd.

Antimony products manufacture

NON-FERROUS METALS

Nissho Iwai Non-Ferrous Metals Corp.

Non-ferrous metals sales and rental

Astral Gem Co., Ltd.

Precious stones, pearls and jewels wholesale

MACHINERY/CONSTRUCTION

Kokusai Kisen K.K.

Ship brokerage and agent

Kokusai Marine K.K.

Marine machinery sales

Nissho Iwai Aerospace Corporation

Aircraft and parts import and sales

World Aircraft Sales Corp.

Aircraft sales and leasing

Nissho Electronics Corp.

Computer sales, rental, and data processing

Nissho Iwai Business Automation Corp.

Electronic office equipment sales

Nissho Semiconductor Co., Ltd.

Semiconductor manufacturing, equipment sales

Nissho Medi Science Co., Ltd.

Medical machinery sales

Nissho Iwai Chemimac Corp.

Chemical machinery sales

Nissho Iwai Industrial Machinery Inc.

Industrial machinery sales

Nissho Iwai Housing Corp.

Housing

Nissho Iwai Estate Corp.

Housing

ENERGY

Nissho Iwai Sekyu Corp.

Petroleum products and LPG sales

Nissho Propane & Oil Co., Ltd.

LPG and petroleum products sales

Nissho Iwai Gas Co., Ltd.

LPG sales

TEXTILES

Nissho Iwai Textile Co., Ltd.

Textile finished goods sales

Nissho Iwai Apparel Co., Ltd.

Garment manufacture

Nissho Iwai Seni Kako Co., Ltd.

Textile processing

Nissho Iwai (Fibre and Yarn) Ltd.

Fiber and yarn trade

The Chuo Woolen Mills, Ltd.

Wool spinning and weaving

Sunrock Textile Industry Co., Ltd.

Garment manufacture

GENERAL COMMODITIES

Nike Japan Corp.

Sportswear and sports shoe sales

The Bensei Tobacco Trading Co., Ltd.

Cigarette and tobacco leaf import

Chuo Tobacco Co., Ltd.

Cigarette and tobacco leaf import

Nippon Crown House Co., Ltd.

Housing materials manufacture

Nissho Iwai Sports Corp.

Sporting goods sales

Nissho Iwai Building Materials Corp.

Building materials sales

Tarin Co., Ltd.

Log wholesale

CHEMICALS

Fuji Kako Co., Ltd.

Plastic pipe manufacture and sales

Nissho Iwai Polymers & Products Corp.

Plastic products sales

Nippla Chemical Co., Ltd.

Engineering plastics sales

Sambow Plastics Co., Ltd.

Vinyl chloride sheet manufacture

Taiyo Kagaku Kogyo Co., Ltd.

Vinyl chloride sheet manufacture

Takafuji Chemicals Co., Ltd.

Plastic sheet manufacture

FOODSTUFFS

Nissho Iwai Foods Corp.

Foodstuff sales

Marusan Co., Ltd.

Foodstuff sales

Nissho Iwai Foods Osaka Corp.

Foodstuff sales

Shin-Metro Co., Ltd.

Sugar refining

Fuji Sento Co., Ltd.

Sugar refining

Nissho Iwai Delica Corp.

Meat and cooked food wholesale

Nissho Iwai Seafoods Corp.

Seafoods sales

OTHERS

The Nikkyo Shoji Co., Ltd.

Insurance agency

Finac Co., Ltd.

Financing

Nikkyo Transportation and

Warehousing Co., Ltd.

Transportation and warehousing

N I Service Corp.

Travel agency

Nissho Iwai Computer Systems Co., Ltd.

Computer operations, software and programming

N.I.F. Corp.

Computer communication service

N I. Real Estate Co., Ltd.

Real estate brokerage

* This is a partial listing of companies in which Nissho Iwai has a share of 20% or more

NISSHO IWAI OVERSEAS JOINT VENTURES

AUSTRALIA

Australian Char (Holdings) Pty., Ltd.
Char manufacture
Dampier Salt Ltd.
Solar salt production
Kobe Alumina Associates (Australia) Pty., Ltd.
Alumina production
Kobe Aluminium (Australia) Pty., Ltd.
Aluminium import sales
Kooyong Coal Loader Ltd.
Coal loading
Port Waratah Coal Services Pty., Ltd.
Coal loading services
Valpak Pty., Ltd.
Plastic bag manufacture

BRAZIL

Fabrica National de Explosivos y Accesorios
Industrial explosives manufacture
Companhia NHK Cimbra Comercial Industrial e
Mecanica Brasileira
Automotive suspension spring manufacture
Companhia Nipo-Brasileira de
Pelotizacao-NIRASCO
Iron ore pellet manufacture
Companhia Siderurgica de TUBARAO
Iron manufacture
Cigune Companhia Petroquimica
Chemicals and synthetic resin manufacture
CPC-Companhia Petroquimica Camaçari Ltda.
Synthetic resin manufacture
Daiwa do Brasil Textil Ltda.
Cotton yarn manufacture
Hitachi Zosen Metalmechanica Ltda
Industrial machinery manufacture
Kanaflex do Brasil Industria de Plasticos Ltda
Plastic lime manufacture
Minas da Serra Geral S.A.
Iron ore resources research and development
Omi-Zillo-Lorenzetti S.A. Industria Textile
Cotton yarn manufacture
Polialden Petroquimica S.A.
Polyethylene manufacture
Usinas Siderurgicas de Minas Gerais S.A.
Iron manufacture

CANADA

NIC Resources Inc.
Liquefied natural gas development
Nissho Iwai Coal Development (Canada) Ltd.
Coal mine development

CHINA

Shenzhen Aero-Fasteners Mfg. Co., Ltd
Sales and manufacture of fasteners
United Leasing Co., Ltd.
Leasing
China Prospering Building Design J V Co
Architect

COLOMBIA

Société de Galvanization de Tôles en Côte d'Ivoire
(Tôles Ivoire) S.A.
Galvanized iron sheet manufacture

Société Ivoirienne de Préfabriqués et
d'Accessoires Industriels
Steel fabrication

COLOMBIA

Chiaphua-Shinko Copper Alloy Co., Ltd
Non ferrous metal sheet and strip manufacture

COLOMBIA

Tata-Yodogawa Ltd
Steel iron rod and roll manufacture

COLOMBIA

PT. Indonesia Steel Tube Works Ltd.
Steel tube manufacture

PT. International Nickel Indonesia
Nickel mat manufacture

PT. Irian Marine Product Development
Fishing

PT. Iron Wire Works, Indonesia
Iron wire manufacture

PT. Kanebo Nissho Iwai Sahabat Textile
Industries
Weaving, knitting, dyeing of synthetic fiber

PT. Pabrik Araya Indonesia
Bicycle wheel rim manufacture

INDONESIA

P.T. Pardic Jaya Chemicals
Synthetic resin manufacture
P.T. Sarinotoky Hotel Corp.
Hotel management
P.T. Toyo Kanetsu Indonesia
Petroleum and LNG tank manufacture
P.T. Berau Coal
Coal mine development

IRAN

Shahou Mfg. Co., Ltd.
Synthetic fiber manufacture

KOREA

Hotel Shilla Co., Ltd.
Hotel management
The Masan Steel Tube Works Co., Ltd.
Steel pipe manufacture
Union Polymer Co., Ltd.
Synthetic resin manufacture

KUWAIT

International Marine Construction Co., S.A.K.
Marine construction and maintenance

MALAYSIA

Furukawa Electric Cables (Malaysia) S.B.
Manufacture of wire for electric cables
Steel Service Centre (Malaysia) S.B.
Electrical steel processing

MEXICO

Yakult S.A. de C.V.
Manufacture of fermented milk drinks

NEW ZEALAND

Nissho Roberts (N.Z.) Ltd
Wool buying and export

PALESTINE

Nippon Marine International S.A.
Maritime operation

PAPUA NEW GUINEA

Stettin Bay Lumber Co., Pty., Ltd.
Logging and timber sawing

PHILIPPINES

Asian Transmission Corp.
Automobile transmission manufacture
Batangas Bay Terminal, Inc.
Warehousing
Bay Tank Yard Inc.
Chemical tank leasing
Canlubang Automotive Resources Corp.
Automobile import and assembly
Filipinas-Iseki Corp.
Agricultural machinery import and sales
APEX Motor Mfg. Corp.
Automobile and motorcycle shock absorber manufacture
Maranaw Hotel & Resort Corp.
Hotel management
RIO-TUBA Nickel Mining Corp.
Nickel mine development

SINGAPORE

Asia Cable Engineering Co., Pte., Ltd.
Cable and wire construction
Kansai Paint (Singapore) Pte., Ltd.
Paint manufacture
The Malaysia Steel Pipe Mfg. Co., Ltd.
Steel pipe manufacture
Singapore Electrical Steel Services Pte., Ltd.
Electrical steel processing
Singapore Kobe Pte., Ltd.
Non-ferrous metal product manufacture
NHK Gasket Singapore Co., (Pte.) Ltd.
Import, export, manufacture and sales of gaskets and gasket materials

SPAIN

Compañía Española para la Fabricación de Acero
Inoxidable S.A.
Cold rolled stainless steel sheet manufacture
EGUZKIA-NHK S.A.
Manufacture and sales of springs

SUDAN

Kenana Sugar Co., Ltd.
Sugar refining

TANZANIA

Kamyn Industries (Tanzania) Ltd
Garment manufacture

THAILAND

Glory Kawasaki Motors Co., Ltd.
Motorcycle import and export
NHK Spring (Thailand) Co., Ltd
Automobile suspension spring manufacture
N.I.M. Co., Ltd.
Warehousing

Thai Central Chemical Co., Ltd
Chemical fertilizer manufacture

Bangkok Steel Industry Co., Ltd.
Steel bar and galvanized steel sheet manufacture

U.K.

Metallgesellschaft Ltd
Non ferrous metals trading
Nachi (U.K.) Ltd.
Bearings sales

Pacific Nuclear Transport Ltd.
Transportation of spent nuclear fuels

Stiron Limited
Steel product sales

U.S.A.

Alloy Tool Steel, Inc.
Alloy steel sales

Argo Plastic Co
Plastics distribution

Berwick Steel Co.
Steel processing

Trilogy Ltd.
Manufacture of super minicomputers

Hotel Kaimana, Inc.
Hotel management

N-I Fastener Group, Inc.
Fastener sales

Nissan Kizai NICE, Inc.
Sales of construction machinery

Nissho Electronics (U.S.A.) Corp.
Importer and exporter of electronics machinery and technology

Maruchi American Corp.
Steel pipe manufacture

OAC Incorporated
Photo exposure and equipment sales

Omi Georgia, Inc.
Cotton yarn manufacture

Pasco Corp. of America
Bakery

Rosscomp Corp.

Developer of high capacity cartridge tape transport systems

Sun Reality Corp.

Construction

N-I Tubulars, Inc.
Tubular goods sales

NISCO Steel Services, Inc
Steel processing

Nissho Iwai Aerospace (America) Corp.
Import and export of aircraft and parts

Asano America, Inc
Gear sales

Command Fabrics, Inc.
Fabrics sales

Fashion Force, Inc.

Fashion merchandising

Specialty Grains Inc.
Specialty grain merchandising

VENUE

Hilana C.A.
Wool and synthetic fiber manufacture

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FINANCIAL REVIEW

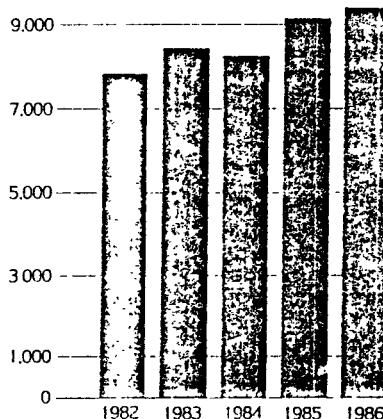
The pace of growth of the American economy — the driving force behind the world economic recovery — slackened during fiscal 1985, slowing expansion in other industrial economies which rely heavily on exports to the U.S. Developing countries were hard-hit by the drop in prices of many primary commodities, particularly crude oil.

Led by a rise in consumer demand and corporate investment in equipment and facilities, Japan's overall economic growth was steady in the fiscal year. But the yen's rapid appreciation since the autumn of 1985 has curbed economic expansion, especially in the export industries.

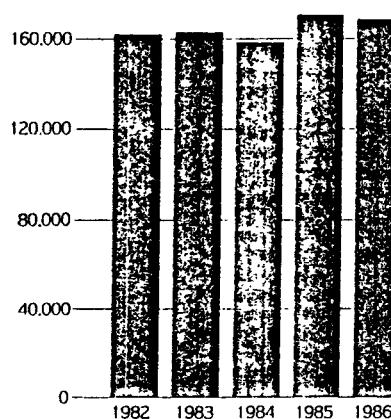
The effects of this environment on our business activities have been mixed. Our total trading transactions on a consolidated basis rose by 3.1% over fiscal 1984, to ¥9,484,528 million (\$52,809 million). Exports declined to ¥1,369,828 million (\$7,627 million), a 4% decrease from the previous year, due to the strong

yen's negative impact on machinery and steel trade. Brisk trading in non ferrous metals and aircraft contributed to a 4.4% increase in imports, to ¥2,695,753 million (\$15,010 million). Offshore trade was also up, thanks to expanded energy business; the transactions increased by 11.3% over the previous year to ¥2,449,319 million (\$13,637 million). Domestic trade showed little movement, recording a 0.8% decrease from fiscal 1984 to ¥2,969,628 million (\$16,535 million).

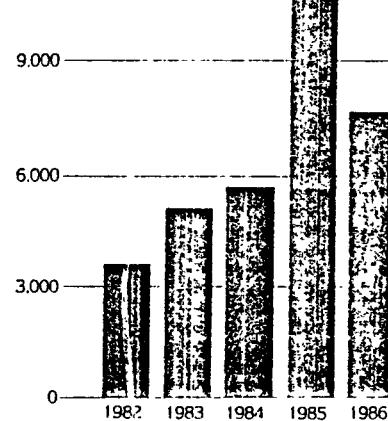
TOTAL TRADING TRANSACTIONS
(¥ billions)



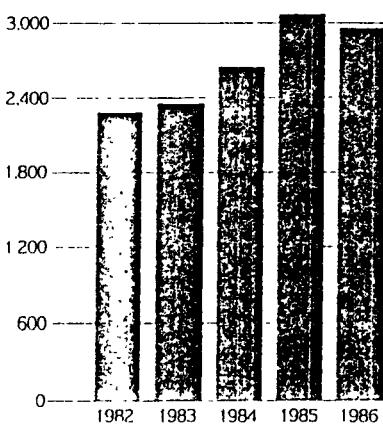
GROSS TRADING PROFIT
(¥ millions)



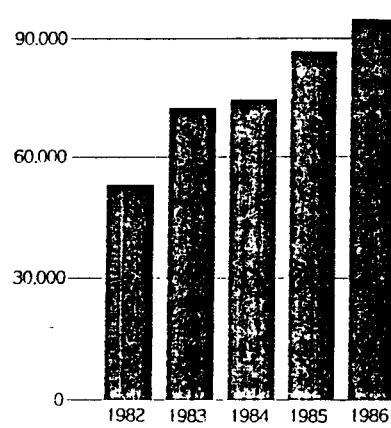
NET INCOME
(¥ millions)



TOTAL ASSETS
(¥ billions)



SHAREHOLDERS' EQUITY
(¥ millions)



FINANCIAL REVIEW

Transactions by commodities

METALS

28.9% 29.3% 29.5%

ENERGY

24.5% 26.2% 28.5%

1984
1985
1986

- Led by mounting precious metals transactions, sales of *metals* rose by 3.8% to ¥2,801,107 million (\$15.596 million).

MACHINERY/ CONSTRUCTION

19.6% 19.1% 18.0%

GENERAL COMMODITIES

27.0% 25.4% 24.0%

- *Machinery* transactions declined by 2.7% to ¥1,707,896 million (\$9.509 million), impaired by the strengthened yen.

- Declines in exports and offshore trade of *textiles* contributed to a 12.8% drop in sales, to ¥437,430 million (\$2,436 million).

- *Lumber, chemicals, and general commodities* increased by 5.3% to ¥1,150,514 million (\$6,406 million).

- Trade in *foodstuffs* declined by 7.6% to ¥683,260 million (\$3,804 million).

Financial results

Gross trading profits remained steady, declining by a slight 0.6% from the previous year to ¥169,564 million (\$944 million). Selling, general and administrative expenses decreased by 0.5% to ¥133,794 million (\$745 million), resulting in operating income of ¥35,770 million (\$199 million), down by 1.1% over fiscal 1984. From this total we subtracted ¥16,887 million (\$94 million) in other income and expenses, ¥10,527 million (\$59 million) in income taxes, and ¥645 million (\$3 million) in equity in losses of unconsolidated subsidiaries and affiliates to obtain a net income of ¥7,711 million (\$43 million), a 28.8% decline from the previous year.

Transactions by type of trade

IMPORT

27.2% 28.1% 28.4%

EXPORT

16.0% 15.5% 14.5%

OFFSHORE

22.2% 23.9% 25.8%

DOMESTIC

34.6% 32.5% 31.3%

1984 1985 1986

CONSOLIDATED FINANCIAL STATEMENTS

Nissho Iwai Corporation and consolidated subsidiaries

CONSOLIDATED BALANCE SHEET

March 31, 1986 and 1985

ASSETS

	Millions of yen	Thousands of U.S. dollars (Note 1)	
	1986	1985	1986
Current assets:			
Cash and time deposits (Note 4)	¥ 375,815	¥ 326,616	\$ 2,092,511
Marketable securities (Notes 3 and 4)	316,987	217,991	1,764,961
Receivables			
Trade notes (Note 4)	461,795	583,884	2,571,242
Trade accounts (Note 4)	831,422	942,993	4,629,298
Loans	57,360	64,016	319,376
Unconsolidated subsidiaries and affiliates	130,958	122,406	729,165
Allowance for doubtful receivables	(13,622)	(20,502)	(75,846)
Inventories	192,309	248,745	1,070,763
Advance payments to suppliers	63,949	85,051	356,063
Other current assets	87,083	76,378	484,872
Total current assets	2,504,056	2,647,578	13,942,405
 Investments and non-current receivables:			
Investment securities (Note 4)	93,536	80,011	520,802
Investments in and advances to unconsolidated subsidiaries and affiliates	76,018	72,392	423,263
Long-term loans and receivables	277,348	201,472	1,544,254
Allowance for doubtful receivables	(74,014)	(8,932)	(412,105)
	372,888	344,943	2,076,214
 Property and equipment, at cost (Note 4):			
Land	39,860	36,180	221,938
Buildings and structures	36,358	39,588	202,439
Equipment and fixtures	26,139	25,099	145,540
Construction in progress	375	182	2,088
Accumulated depreciation	(30,396)	(31,063)	(169,243)
	72,336	69,986	402,762
 Other assets:			
Foreign currency translation adjustments	4,947	5,400	27,544
Others	1,056	1,045	5,880
	¥2,955,283	¥3,068,952	\$16,454,805

See accompanying notes

LIABILITIES AND SHAREHOLDERS' EQUITY

	Millions of yen	Thousands of U.S. dollars (Note 1)
	1986	1985
Current liabilities:		
Short-term loans, principally unsecured (Notes 4 and 5)	¥1,179,704	\$ 6,568,508
Current portion of long-term debt (Notes 4 and 5)	102,619	571,375
Payables		
Trade notes	486,328	2,707,840
Trade accounts	349,880	1,948,107
Unconsolidated subsidiaries and affiliates	21,192	117,995
Accrued liabilities	22,554	125,579
Income taxes payable	3,532	19,666
Advances received from customers	38,325	213,391
Other current liabilities	47,381	263,814
Total current liabilities	2,251,515	12,536,275
Non-current liabilities:		
Long-term debt less current portion shown above (Notes 4 and 5)	596,819	3,323,046
Employees' retirement benefits	11,397	63,458
	608,216	3,386,504
Minority interest in consolidated subsidiaries	828	563
Contingent liabilities (Note 8)		4,610
Shareholders' equity:		
Common stock, par value ¥50 per share	34,260	32,040
Additional paid-in capital (Note 6)	27,592	25,370
Retained earnings		
Legal reserve (Note 6)	5,150	4,801
Unappropriated	27,753	24,397
Treasury stock	(31)	(2)
Total shareholders' equity	<u>94,724</u>	<u>86,606</u>
	<u>¥2,955,283</u>	<u>¥3,068,952</u>
		<u>\$16,454,805</u>

Nissho Iwai Corporation and consolidated subsidiaries
CONSOLIDATED STATEMENT OF INCOME
For the years ended March 31, 1986 and 1985

	1986	1985	Thousands of U.S. dollars (Note 1) 1986
Net sales (Total trading transactions)	¥9,484,528	¥9,202,963	\$52,809,176
(Note 7)	9,314,964	9,032,367	51,865,056
Cost of sales (Note 7)	169,564	170,596	944,120
Gross trading profit			
Selling, general and administrative expenses	133,794	134,426	744,955
Operating income	35,770	36,170	199,165
 Other income (expenses):			
Interest and dividend income	137,110	131,438	763,419
Interest expense	(156,582)	(156,494)	(871,837)
Gain on sale of securities	52,222	6,143	290,768
Gain on disposal of properties	8,618	4,616	47,984
Losses on foreign shipping operations	(58,096)	—	(323,474)
Foreign currency translation adjustments	(821)	236	(4,571)
Other, net	662	2,398	3,685
Income before income taxes	18,883	24,507	105,139
 Income taxes	10,527	11,797	58,614
Equity in losses of unconsolidated subsidiaries and affiliates	(645)	(1,881)	(3,591)
Net income	¥ 7,711	¥ 10,829	\$ 42,934
 Net income per share	 ¥13.17	 ¥19.56	 7.3¢

See accompanying notes

Nissho Iwai Corporation and consolidated subsidiaries

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

For the years ended March 31, 1986 and 1985

	Millions of yen	Thousands of U.S. dollars (Note 1)
	1986	1985
Common stock:		
Balance at beginning of year	¥32,040	¥28,463
Conversion of convertible debentures	2,220	3,297
Exercise of warrants	—	280
Balance at end of year	<u>¥34,260</u>	<u>¥32,040</u>
Additional paid-in capital (Note 6):		
Balance at beginning of year	¥25,370	¥21,844
Conversion of convertible debentures	2,222	3,246
Exercise of warrants	—	280
Balance at end of year	<u>¥27,592</u>	<u>¥25,370</u>
Legal reserve (Note 6):		
Balance at beginning of year	¥ 4,801	¥ 4,484
Transfer from unappropriated retained earnings	349	317
Balance at end of year	<u>¥ 5,150</u>	<u>¥ 4,801</u>
Unappropriated retained earnings:		
Balance at beginning of year	¥24,397	¥19,615
Net income	7,711	10,829
Appropriation		
Cash dividends paid	3,490	3,158
Bonuses to directors and statutory auditors	24	118
Transfer to legal reserve	349	317
Effect on opening retained earnings of increase in consolidated subsidiaries and affiliates	(414)	(2,621)
Foreign currency translation adjustments	(78)	167
Balance at end of year	<u>¥27,753</u>	<u>¥24,397</u>
Number of shares of common stock authorized (thousands)	<u>1,600,000</u>	<u>1,600,000</u>
Number of shares of common stock issued (thousands):		
Balance at beginning of year	575,146	497,618
Conversion of convertible debentures	17,305	25,764
Exercise of warrants	—	2,002
Free distribution of shares (Note 6)	—	49,762
Balance at end of year	<u>592,451</u>	<u>575,146</u>

See accompanying notes.

Nissho Iwai Corporation and consolidated subsidiaries

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the years ended March 31, 1986 and 1985

	Millions of yen	Thousands of U.S. dollars (Note 1)	1986
			1985
Source:			
Net income	¥ 7,711	¥ 10,829	\$ 42,934
Items not affecting working capital in the current periods			
Depreciation	4,427	4,234	24,649
Employees' retirement benefits	1,151	1,177	6,409
Equity in losses of unconsolidated subsidiaries and affiliates	645	1,881	3,591
Working capital provided from operations	13,934	18,121	77,583
Proceeds from long-term debt borrowed	207,660	141,922	1,156,236
Disposal of property and equipment	7,884	2,064	43,898
Convertible debentures issued (Note 5)	—	9,598	—
Guaranteed notes issued (Note 5)	28,767	—	160,173
Common stock issued upon conversion of convertible debentures	4,442	6,543	24,733
Common stock issued upon exercise of warrants	—	560	—
Total	262,687	178,808	1,462,623
Application:			
Additions to property and equipment	14,661	9,370	81,631
Payment of cash dividends	3,490	3,158	19,432
Reduction of long-term debt	130,496	128,290	726,593
Increase in investments and non-current receivables	28,590	106,879	159,187
Convertible debentures converted into common stock	4,442	6,543	24,733
Other, net	895	4,905	4,983
Total	182,574	259,145	1,016,559
Increase (decrease) in working capital	¥ 80,113	¥ (80,337)	\$ 446,064
Changes in components of working capital:			
Increase (decrease) in current assets			
Cash and time deposits	¥ 49,199	¥ 28,808	\$ 273,936
Marketable securities	98,996	52,480	551,203
Receivables, net of allowance for doubtful receivables	(224,884)	247,288	(1,252,138)
Inventories	(56,436)	2,868	(314,23)
Advance payments to suppliers	(21,102)	(18,383)	(117,494)
Other current assets	10,705	133	59,605
Total	(143,522)	313,194	(799,120)
Increase (decrease) in current liabilities			
Short-term loans and current portion of long-term debt	115,584	231,462	643,564
Payables	(297,482)	152,918	(1,656,359)
Income taxes payable	(5,835)	6,349	(32,489)
Advances received from customers	(30,329)	(10,553)	(168,870)
Other current liabilities	(5,573)	13,355	(31,030)
Total	(223,635)	393,531	(1,245,184)
Increase (decrease) in working capital	¥ 80,113	¥ (80,337)	\$ 446,064

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 1986 and 1985

1. Basis of presenting consolidated financial statements

The accompanying consolidated financial statements of Nissho Iwai Corporation (the "Company") and its consolidated subsidiaries are stated in Japanese yen, the currency of the country in which the Company is incorporated and principally operates. The translation of Japanese yen amounts into United States dollar amounts for the year ended March 31, 1986 is included solely for the convenience of readers outside Japan and has been made at the rate of ¥179.60 = US\$1. The approximate rate prevailing on March 31, 1986. It should be noted, however, that this translation should not be construed to imply that the Japanese yen amounts could be or could have been converted into United States dollars at the above or any other rate.

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Japan, and from the consolidated financial statements filed with the Minister of Finance and stock exchanges in Japan as required by the Securities and Exchange Law of Japan.

For the purpose of this report, consolidated statements of shareholders' equity and changes in financial position, which are not required in Japan, are prepared and certain reclassifications have been made and additional information is provided in order to present the accompanying consolidated financial statements in a format which is familiar to readers outside Japan.

2. Summary of significant accounting policies

Consolidation

The consolidated financial statements include the accounts of the Company and its significant majority-owned domestic and foreign subsidiaries. Intercompany transactions and accounts have been eliminated. The excess of costs of the Company's investments in the subsidiaries and affiliates (companies in which ownership is 20% to 50%) over their equity in the net assets at dates of acquisition is, with minor exceptions, being amortized on a straight-line basis over the period of five years.

Allowance for doubtful receivables

Allowance for doubtful receivables is provided in amounts at least sufficient to cover expected losses on collection, that is, the higher of management's estimate or a maximum amount permitted for tax purposes.

Inventories

Inventories, consisting mainly of commodities and materials held for resale, are stated at cost, principally on the first-in, first-out basis, except for items whose net realizable values are substantially less than their original costs.

Marketable securities and investments

Investments in unconsolidated subsidiaries and affiliates are, with minor exceptions, stated at cost adjusted for equity in undistributed net income or loss since acquisition or formation. Marketable securities and other investments in

both listed and unlisted securities are stated at cost by the moving average method.

Property and equipment

Property and equipment are stated at cost. Depreciation is computed primarily by the declining-balance method except for buildings and structures in the Company's Osaka head office and those located outside Japan, which are depreciated by the straight-line method. Repair and maintenance expenditures are charged to income when incurred.

Translation of foreign currency

Receivables and payables denominated in foreign currencies
Current receivables and payables in foreign currencies are principally translated at historical rates, except for those hedged by foreign exchange forward contracts, which are translated at the exchange rate contracted therein, while those of the overseas branches of the Company and foreign consolidated subsidiaries are translated at the year-end rate. Non-current receivables and payables in foreign currencies are principally translated at historical rates.

In the case that fluctuation of foreign exchange rates is significant, the current exchange rate is applied to translation of both current and non-current receivables and payables denominated in foreign currencies.

Foreign currency financial statements

Financial statements of foreign consolidated subsidiaries are translated into Japanese yen at the year-end rate for monetary current assets and liabilities, retained earnings, and net income, at historical rates for other balance sheet accounts, and at the annual average rate for revenue and expense accounts except for depreciation. Resulting translation adjustments are reflected in the consolidated financial statements as "Foreign currency translation adjustments."

Net sales (total trading transactions) and related costs

As general trading companies, the Company and certain of its consolidated subsidiaries act as principal or agent in trading transactions. Where the consolidated companies act as agent, the companies charge a commission to their principal but the total sales value of the relative contracts is included in the companies' net sales (total trading transactions), and cost of sales represents the total sales value less the commission.

Gross trading profit represents the difference between net sales and cost of sales with respect to purchase and sale transactions in which the companies act as principal, and represents compensation in the form of commission with respect to agency transactions.

A substantial part of net sales and cost of sales represents transactions in which title to and payment for the goods pass through the companies' inventories.

Most of such transactions are against counterpart orders.

Employees' retirement benefits

The Company has a lump-sum retirement benefit plan in effect generally covering all employees other than directors and statutory auditors. Under the terms of the lump-sum retirement benefit plan, eligible employees are entitled under

most circumstances, upon mandatory retirement or earlier voluntary termination of employment, to lump-sum payments based on compensation at the time of retirement, years of service, and other factors. Liability for employees' retirement benefits under the lump-sum benefit plan is provided to the maximum amount permitted by the Corporation Tax Law of Japan, based on the sum that would be required if all employees voluntarily retired at the balance sheet date. The Company also has a funded pension plan which covers substantially all of its employees and provides for life-time annuity payments commencing at age 60. Certain of the consolidated subsidiaries also have retirement benefits and/or pension plans similar to those of the Company. Past service costs are being funded over approximately 20 years. Retirement benefits to directors and statutory auditors are charged to current income when approved by the General Meeting of Shareholders.

3. Marketable securities

At March 31, 1986 and 1985, the marketable securities in current assets consisted of the following:

	Millions of yen	Thousands of U.S. dollars
	1986	1985
Marketable equity securities	¥ 79,616	\$ 443,296
Other marketable securities	237,371	1,321,665
	<u>¥316,987</u>	<u>\$1,764,961</u>
Market value of marketable equity securities	¥266,885	\$1,485,996
Gross unrealized gains (net)	¥187,269	\$1,042,700

4. Pledged assets

The following assets are pledged as collateral at March 31, 1986:

	Millions of yen	Thousands of U.S. dollars
Time deposits	¥ 9,502	\$ 52,906
Trade notes and accounts receivable	193,316	1,076,370
Securities, principally marketable equity securities	31,029	172,767
Property and equipment, less accumulated depreciation	3,920	21,826
	<u>¥237,767</u>	<u>\$1,323,869</u>
Obligations with collateral pledged were:	Millions of yen	Thousands of U.S. dollars
Short-term loans	¥ 31,020	\$ 172,717
Long-term debts	187,037	1,041,409
	<u>¥218,057</u>	<u>\$1,214,126</u>

Income taxes

The Company and its consolidated domestic subsidiaries are subject to a number of different taxes based on income, which in in the aggregate indicate an effective statutory rate of 58% for the years ended March 31, 1986 and 1985. The corporate enterprise tax, based on income and accounted for on an accrual basis, is included in selling, general and administrative expenses in the accompanying consolidated statement of income. Interperiod tax allocation is applied for the timing differences principally resulting from the elimination of unrealized intercompany profit on consolidated financial statements.

Net income per share

The computation of net income per share is based on the weighted average number of shares of common stock outstanding during the relevant period.

5. Short-term loans and long-term debt

Short-term loans at March 31, 1986 and 1985 were represented by short-term notes, generally for 90 days, bearing interest principally at 4.5% per annum. The Company and its consolidated subsidiaries have had no difficulty in renewing such notes when they considered such renewals advisable.

As is customary in Japan, long-term and short-term bank borrowings are made under general agreements which provide that additional security and guarantees for present

and future indebtedness will be given upon the request of the bank, and that any collateral so provided will be applicable to all indebtedness due to such bank. In addition, the agreements provide that the bank has the right to offset cash deposited against long-term borrowings that become due and, in case of default and certain other specified events, against all other debts payable to the bank. No such requests have been made to date.

A summary of long-term debt is as follows:

	Millions of yen		Thousands of U.S. dollars
	1986	1985	1986
8.0% convertible bonds due 1996 payable in United States dollars	¥ 3,943	¥ 3,980	\$ 21,954
5.25% convertible notes due 1988 payable in Swiss Francs	398	719	2,216
8.9% mortgage debentures due 1986	—	1,700	—
6.5% guaranteed bonds with warrants due 1989 payable in United States dollars	16,285	16,285	90,674
2.875% convertible notes due 1990 payable in Swiss Francs	1,046	5,130	5,824
10.75% guaranteed notes due 1992 payable in United States dollars	24,925	—	138,781
13.25% guaranteed notes due 1990 payable in United States dollars issued by Nissho Iwai Australia Ltd., a wholly owned subsidiary	3,842	—	21,392
Long-term loans, principally from commercial and trust banks and insurance companies, maturing serially through 2010 principally at rates of 6.0% to 13.25%	466,691	395,258	2,598,502
Long-term loans from governmental financial institutions, principally The Export-Import Bank of Japan. maturing serially through 2010 at rates of 4.5% to 10.1%	168,684	169,890	939,220
Other long-term indebtedness, maturing serially through 1990 at rates of 5.45% to 7.6%	13,624	5,511	75,858
Total	699,438	598,473	3,894,421
Less current portion	102,619	103,143	571,375
	<u>¥596,819</u>	<u>¥495,330</u>	<u>\$3,323,046</u>

The conversion price and subscription price per share at March 31, 1986 are as follows.

8.0% convertible bonds due 1996	¥ 361.10
5.25% convertible notes due 1988	¥ 250.40
6.5% guaranteed bonds with detachable stock purchase warrants due 1989	¥ 280.00
2.875% convertible notes due 1990	¥ 264.00

The aggregate annual amounts of long-term debt maturing in the years ending March 31, 1987 to 1991 and thereafter are as follows:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
1987	¥ 102,619	\$ 571,375
1988	91,617	510,117
1989	126,885	706,487
1990	91,258	508,118
1991 and thereafter....	287,059	1,598,324
	<u>¥699,438</u>	<u>\$3,894,421</u>

6. Shareholders' equity

The Commercial Code of Japan provides that:

(a) the entire issue price of shares must be credited to common stock, with the provision that, by resolution of the Board of Directors, up to one half of such issue price may be credited to additional paid-in capital so long as the former amount, the "value of the shares," is equal to at least the aggregate par value of the shares issued.

(b) an amount at least equal to 10% of cash dividends paid shall be appropriated as legal reserve until such reserve equals 25% of common stock. The legal reserve may not be distributed to shareholders, but may be appropriated to eliminate or reduce a deficit, if any, by resolution of the shareholders or it may be capitalized by resolution of the Board of Directors.

(c) Japanese companies, upon approval by the Board of Directors, may distribute additional paid-in capital or the portion of the stated capital in excess of the aggregate amount of the par value in the form of a free distribution of shares.

In Japan, a free distribution as described above is clearly distinguished from "stock dividends" paid out of unappropriated retained earnings, which must be approved by the General Meeting of Shareholders.

On December 28, 1983, the Board of Directors of the Company resolved to make a free distribution of shares on May 15, 1984, to the shareholders of record on March 31, 1984, at the ratio of 1 to 10. Such free share distribution was made from such portion of the price of new shares accounted for as stated capital in excess of the par value of such new shares.

7. Sales to and purchases from unconsolidated subsidiaries and affiliates

Sales to and purchases from unconsolidated subsidiaries and affiliates are as follows:

	Millions of yen	Thousands of U.S. dollars
	1986	1985
Sales	¥240,609	¥255,193
Purchases	¥142,240	¥211,444

8. Contingent liabilities

Contingent liabilities at March 31, 1986, are as follows:

	Millions of yen	Thousands of U.S. dollars
	1986	1985
For repurchase of notes discounted and endorsed	¥145,484	\$810,045
For guarantees of loans from banks to:		
Unconsolidated subsidiaries and affiliates	¥ 39,363	\$219,170
Others	65,934	367,116
	¥105,297	\$586,286

REPORT OF INDEPENDENT AUDITORS

ASAHI SHINWA & Co.
CERTIFIED PUBLIC ACCOUNTANTS (JAPAN)

HANKYU TERMINAL BLDG.
1-1-4, SHIBATA, KITA-KU,
OSAKA, 530 JAPAN

To Mr. Masaru Hayami
President
Nissho Iwai Corporation

We have examined the accompanying consolidated balance sheets of Nissho Iwai Corporation and consolidated subsidiaries as of March 31, 1986 and 1985, and the related consolidated statements of income, shareholders' equity and changes in financial position for the years then ended, all expressed in Japanese yen. Our examinations were made in accordance with auditing standards generally accepted in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements of certain foreign consolidated subsidiaries and certain unconsolidated subsidiaries and affiliates have been examined by other independent auditors; insofar as our opinion on the consolidated financial statements relates to data included for those subsidiaries and affiliates, it is based solely on their reports. The statements of such foreign consolidated subsidiaries show total assets and net sales constituting 17% and 14%, respectively, of the consolidated totals for 1986 and 15% and 11%, respectively, of such totals for 1985. In the consolidated financial statements, the Company's equity in net income of such unconsolidated subsidiaries and affiliates is 5% for 1986 and 12% for 1985 of the respective consolidated net income.

In our opinion, based on our examinations and the reports of other independent auditors, the statements mentioned above, expressed in Japanese yen, present fairly the consolidated financial position of Nissho Iwai Corporation and consolidated subsidiaries as of March 31, 1986 and 1985, and the consolidated results of operations and changes in financial position for the years then ended, in conformity with accounting principles and practices generally accepted in Japan applied on a consistent basis during the period.

We have also reviewed the translation of the statements mentioned above into United States dollars on the basis described in Note 1. In our opinion, such statements have been properly translated on such basis.

July 15, 1986

Asahi Shinwa & Co.

BANK REFERENCES

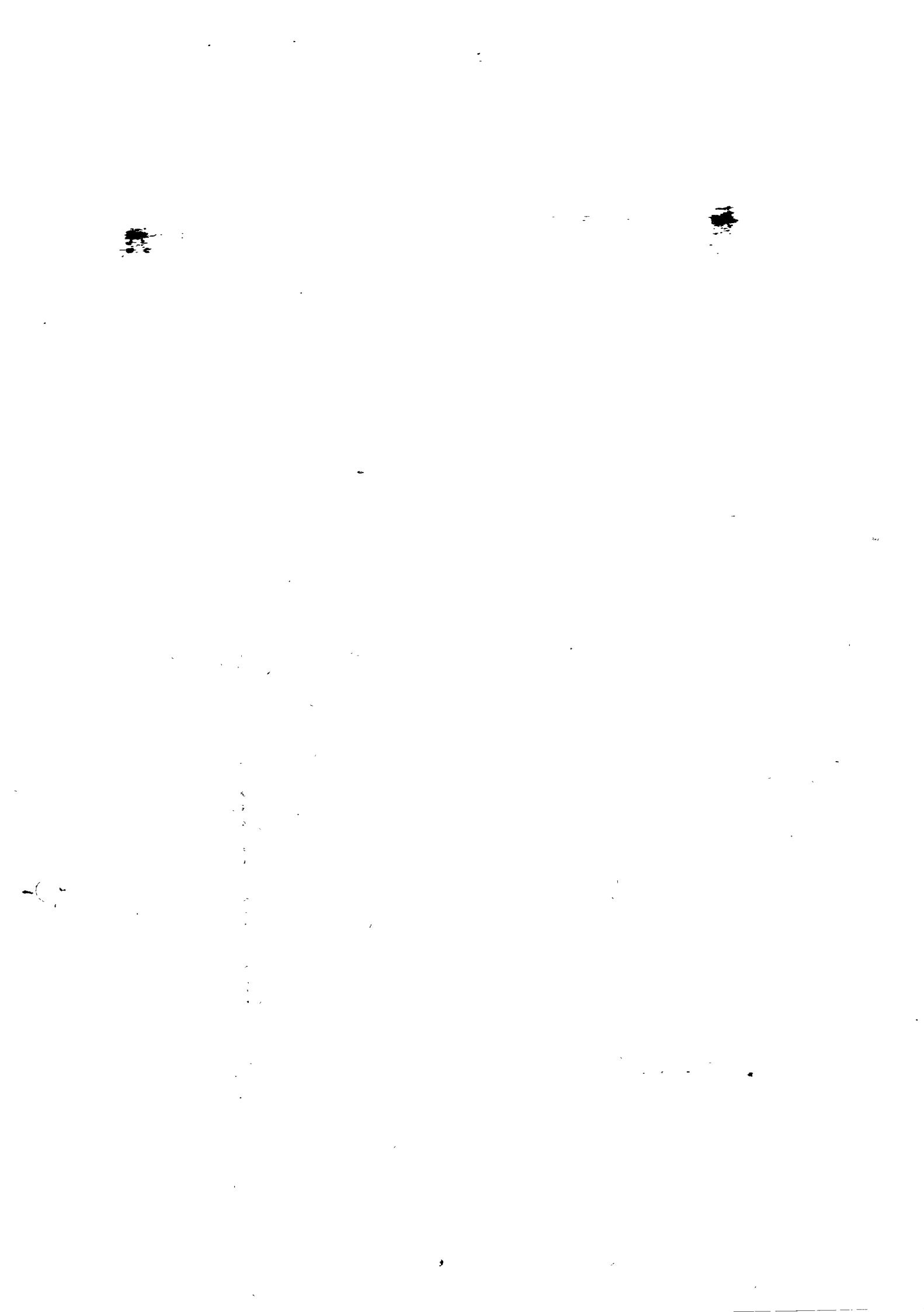
Algemeene Bank Nederland N.V.
American Express International Banking Corporation
Australia and New Zealand Banking Group Limited
Banca Commerciale Italiana S.P.A.
Banco de Bilbao
Banco de Vizcaya
Banco do Brasil S.A.
Banco do Estado de São Paulo S.A.
Banco Español de Credito
Banco Hispano Americano S.A.
Bangkok Bank Limited
Bank Bumiputra Malaysia Berhad
Bank Negara Indonesia 1946
Bank of America N.T. & S.A.
Bank of British Columbia
Bank of California, N.A.
Bank of London & South America Limited (BOLSA)
Bank of Montreal
Bank of New Zealand
Bank of Nova Scotia
Bank of Tokyo, Ltd.
Bank of Yokohama, Ltd.
Bankers Trust Company
Banque Indosuez
Banque Paribas
Banque Nationale de Paris
Barclays Bank plc
Baring Brothers & Co., Limited
Chase Manhattan Bank, N.A. (The)
Chemical Bank
Chuo Trust & Banking Company Limited
Citibank N.A.
Commerzbank A.G.
Commonwealth Bank of Australia
Continental Illinois National Bank & Trust Company of Chicago
Credit Lyonnais S.A.
Credito Italiano S.P.A
Crocker National Bank
Dai-Ichi Kangyo Bank Limited
Daiwa Bank Limited
Deutsche Bank A.G.
Development Bank of Singapore Limited
Export-Import Bank of Japan (The)
Fidelity Bank (The)
First Interstate Bank of California
First Interstate Bank of Oregon N.A.
First Interstate Bank of Washington N.A.
First National Bank of Boston
First National Bank of Chicago (The)
Fuji Bank Limited
Grindlays Bank plc
Hang Seng Bank Ltd.
Hill Samuel & Co., Limited
Hokkaido Takushoku Bank Limited
Hongkong and Shanghai Banking Corporation (The)
Industrial Bank of Japan Limited
InterFirst Bank Dallas, N.A.
Irving Trust Company
Kleinwort, Benson Limited
Kyowa Bank Limited
Lloyds Bank plc
Long-Term Credit Bank of Japan, Ltd.
Malayan Banking Berhad
Manufacturers Hanover Trust Company
Mellon Bank, N.A.
Mercantile Bank Limited
Mitsubishi Bank Limited
Mitsubishi Trust and Banking Corporation
Mitsui Bank Limited
Mitsui Trust & Banking Company Limited
Morgan Guaranty Trust Company of New York
National Australia Bank Ltd.
National Bank of Detroit
National Westminster Bank plc
Nippon Credit Bank Limited
Nippon Trust and Banking Co., Ltd.
Norinchukin Bank (The)
Papua New Guinea Banking Corporation
Republic Bank Dallas N.A.
Royal Bank of Canada (The)
Saitama Bank, Ltd
Sanwa Bank Limited
Security Pacific National Bank
Schroder Wagg (J. Henry) & Co., Limited
Société Générale
Société Générale de Banque S.A.
Standard Chartered Bank
Sumitomo Bank Limited
Sumitomo Trust & Banking Company Limited
Swiss Bank Corporation
Taiyo Kobe Bank, Ltd.
Texas Commerce Bank N.A.
Thai Farmers Bank Ltd
Tokai Bank Limited
Toronto-Dominion Bank
Toyo Trust and Banking Co., Ltd.
Union Bank of Switzerland
Union de Banques Arabes et Françaises
U.B.A.F.
United Overseas Bank Limited
United States National Bank of Oregon
Wells Fargo Bank
Westdeutsche Landesbank Girozentrale
Westpac Banking Corporation
Yasuda Trust and Banking Company Limited

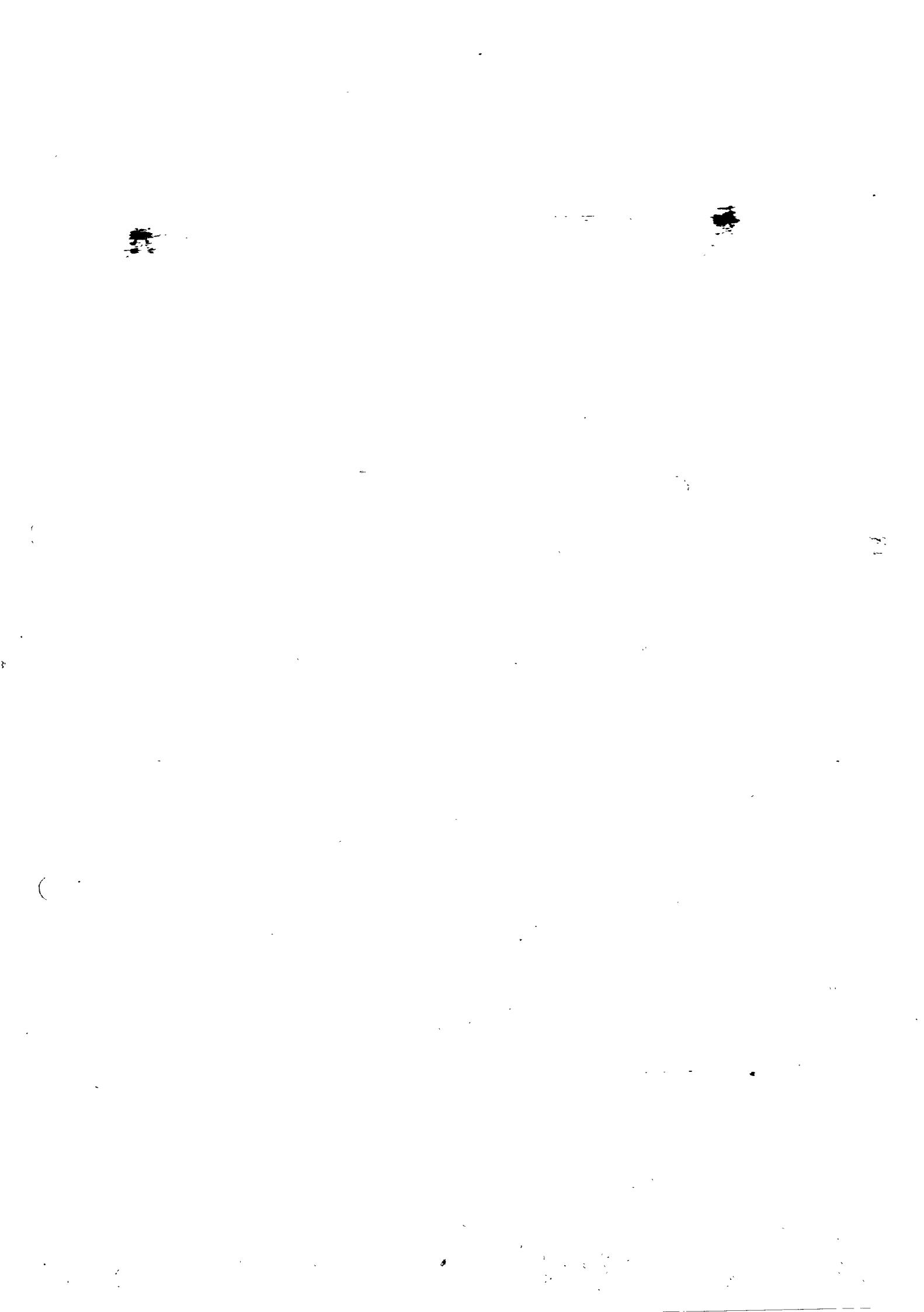
Classification of Shareholders		No. of Shares	Percentage
Banking organizations	343,873,976	58.04	
Securities dealers	9,518,954	1.61	
Corporations, private	141,178,992	23.83	
Individuals	78,957,317	13.33	
Foreign corporations and individuals	18,922,046	3.19	
Total number of shares	592,451,285	100.00	
Total number of shareholders	24,722		

(As of March 31, 1986)

Business term ends	March 31, every year
General meeting of shareholders held	June, every year
Newspaper in which public notice is made	The Nihon Keizai Shimbun published in Osaka
Share transfer agents	The Toyo Trust & Banking Co. Ltd. Osaka Branch, 24, Fushimi-cho 4-chome, Higashisumiyoshi-ku, Osaka 546, Japan
Agents' offices	Head offices and branch offices of The Toyo Trust & Banking Co. Ltd., and The Nomura Securities Co. Ltd.

NISSHO IWAI
NISSHO IWAI CORPORATION





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SCHEDULE 3B CONFIDENTIAL



PAPUA NEW GUINEA GOVERNMENT

NATIONAL EXECUTIVE COUNCIL

Decision No: 61/85-

Meeting No: 14/85

Subject..... PROJECT AGREEMENT - STETTIN BAY LUMBER COMPANY PTY. LTD.....

On 8th May, 1985, Council:-

(a) approved the appointment of the State Negotiating Team with the following Membership:-

- (i) Secretary, Department of Forests or his nominee;
- (ii) Secretary, Department of Finance or his nominee;
- (iii) State Solicitor, Department of Justice or his nominee;
- (iv) Secretary, Department of East New Britain or his nominee;
- (v) Secretary, Department of West New Britain or his nominee;
- (vi) Secretary, Department of Lands or his nominee.

(b) approved the Secretary, Department of Forests to lead the Negotiating Team;

(c) authorised the Secretary for Forests to use his discretion to co-opt other members, if considered necessary;

(d) approved the following terms of Reference for the State Negotiating Team:-

- (i) to negotiate an agreement with Stettin Bay Lumber Company Pty. Ltd. for forest development consistent with the State Negotiating Guidelines, as approved by National Executive Council;

CONFIDENTIAL



PAPUA NEW GUINEA GOVERNMENT

NATIONAL EXECUTIVE COUNCIL

2

Decision No: 61/85

Meeting No: 14/85

Subject: PROJECT AGREEMENT - STETTIN BAY LUMBER COMPANY PTY. LTD

(ii) When negotiating such an agreement, to give careful consideration to:-

- project viability;
- forest resource estimates; and
- availability of land for reforestation, housing and industrial facilities.

(iii) To provide regular reports on the status of negotiations to the Minister for Forests;

(iv) To provide a formal report, with recommendations, to the Minister for Forests, if the team determines that an Agreement, consistent with the State Negotiating Guidelines cannot be negotiated; and

(v) Alternatively, to provide a formal report with recommendations and draft agreement to the Minister for Forests on completion of negotiations.

(e) approved the issue of following Negotiating Guidelines to the State Negotiating Team that the Project, as detailed in the negotiated Agreement must:-

(i) Be consistent with the 1979 White Paper 'Revised National Forest Policy'.

(ii) Make realistic provision for a sustained forest industry in West and East New Britain in the area of SBLC's operations. This will include provision for an extensive reforestation programme and processing activities based on use of both natural and plantation forest resources.

.../3

CONFIDENTIAL



PAPUA NEW GUINEA GOVERNMENT

- - - 3 -

NATIONAL EXECUTIVE COUNCIL

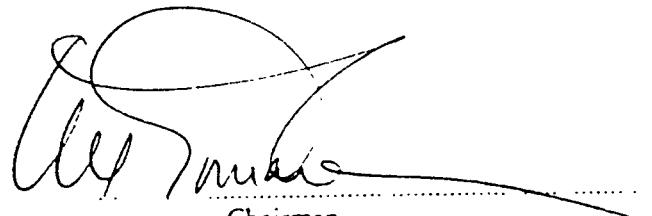
Decision No: 61/85

Meeting No: 14/85

Subject: PROJECT AGREEMENT - STETTIN BAY LUMBER COMPANY PTY., LTD.....

(iii) Ensure, as far as reasonably possible, that Stettin Bay Lumber Company Pty. Ltd., commitments to reforest, process, and construct roads are implemented. This may include provision in the Agreement for:-

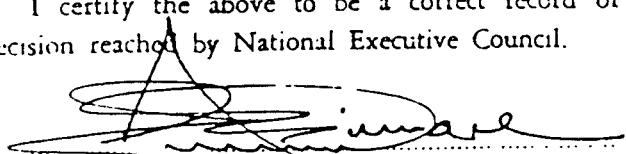
- performance guarantees;
- penalty restrictions;
- incentive measures; and
- interim reappraisal.



M.T. SOMARE

Chairman

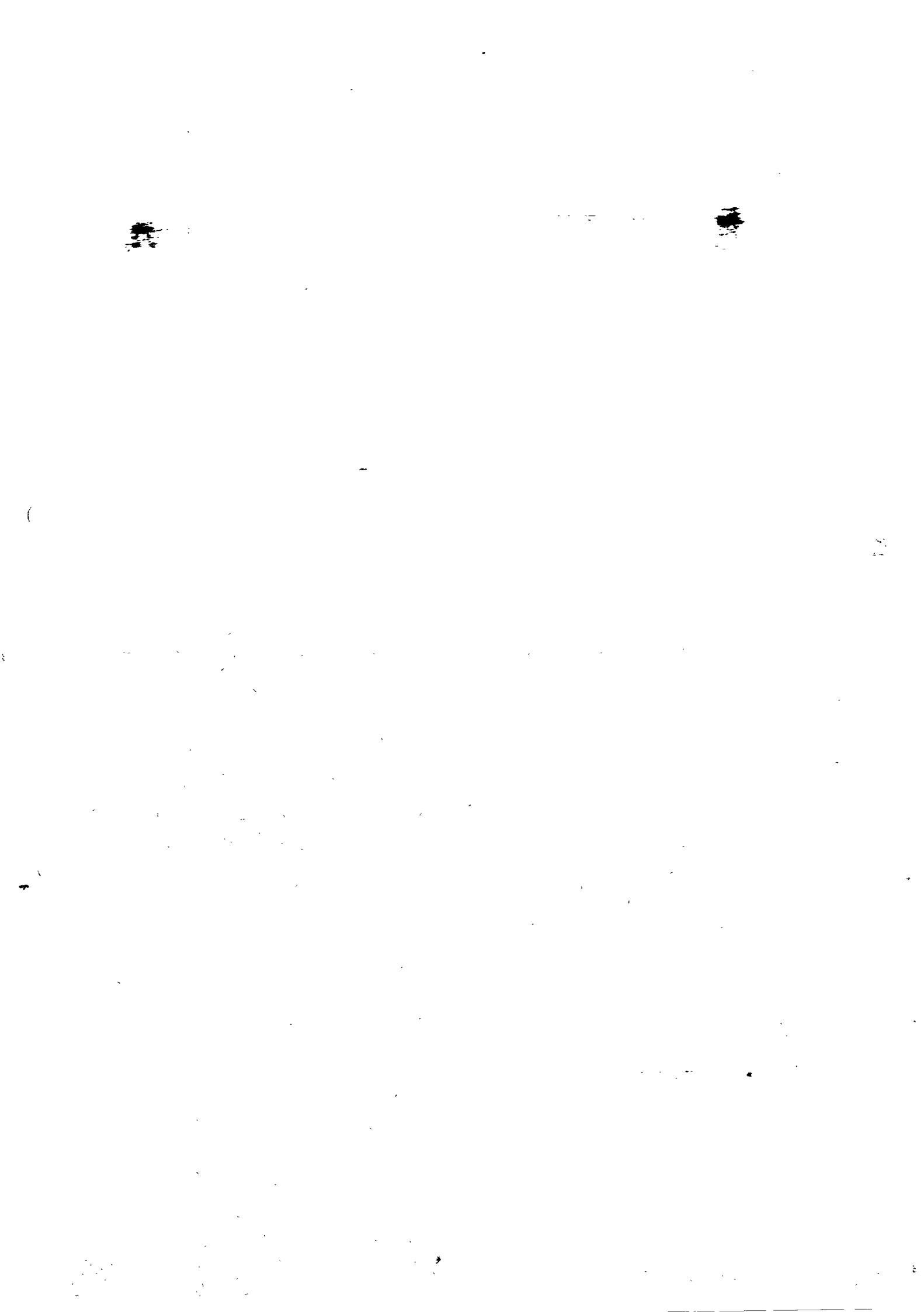
I certify the above to be a correct record of the
Decision reached by National Executive Council.


J. WINARE Secretary, N.E.C.

Date: 13th May 1985

Distribution: FOREST/FINANCE/LANDS/JUSTICE/STATE SOLICITOR/ PRIME MINISTER/

CONFIDENTIAL



SCHEDULE 4

STETTIN BAY LUMBER CO. PTY. LTD.

SAWMILLERS AND TIMBER EXPORTERS



CABLES. "DEWAI" KIMBE
PHONE: 935266, 935267, 935258
TELEX: 93103

P.O. BOX 162
KIMBE - WNB

13th April, 1988

The Hon. T. Horick, M.P.,
Minister for Forests,
Ministry of Forests,
P.O. Box 5055,
BOROKO, N.C.D.

Dear Minister,

ANIA T.R.P.- FULLEBORNE EXTENSION TIMBER AREAS

In 1984 our company was invited to submit a proposal for the development of the above forest resource and the proposal was duly submitted in June that year.

Since then there have been many delays and the original proposal has been rewritten a number of times to update the financial information. Negotiations have been unduly protracted (see Annexures A1 & A2). However, there have been four meetings this year with agreement on the terms and conditions for the project being reached on all aspects except the following matters:

- * Ownership of the plantation trees
- * Log harvest volumes

Despite efforts to reach an understanding on the issue of ownership of plantation trees, an impasse has been reached.

The company has at all times during the negotiations maintained a position that the plantation trees would belong to the company and the proposals submitted were based on this contention. Our belief in this view is substantiated by the letter from Mr. A. Yauieb, then Director of Forests in 1982 (see Annexure B) in which he recommended that the ownership of forests replanted by our company should belong to the company.

During negotiations in Rabaul the State Negotiating Team agreed that the company should retain ownership of the plantation trees on condition that:

- * the company acknowledge that a timber permit was required to harvest the trees, and
- * the company pay royalties on the plantation trees, and
- * the company undertake not to mortgage or sell the standing plantations.

The company agreed that:

- * it would be necessary for it to obtain a timber permit to harvest the plantation trees, and
- * it would pay royalties on all plantation trees harvested.

The State also agreed to a log harvest level that during the early stages of the project was based on volumes to be harvested from the natural forest. Later in the project term, when the plantation forests are expected to reach maturity, the log harvest was to be based on the area of forest replanted by the company some 20 years earlier. This is true implementation of the principle of sustained yield.

At later negotiations the State withdrew its agreement on these issues and the matters remain deadlocked.

We enclose herewith the copies of the latest correspondence between the State Negotiating Team and the Company (see Annexure C1 & C2), which clearly indicate the difference of the opinion between two parties on the issue of the ownership of the plantation trees, and we now ask that we be allowed to put our case to you and that you mediate in these areas of dispute.

To support our case we wish to express our views as the undermentioned in contending the views of the State Negotiating Team as expressed in their letter dated 31st March, 1988.

(1) Forest Act

The State considers that they will have no control over the plantation unless they own it, because of the ambiguity in the Forestry Act. However, we cannot agree with the State due to the following grounds.

The Forestry Act quotes:

"10. Permit and Licence

(1) Subject to this Act, the Minister may grant permits and licences to take and contract for the sale of forest produce on-

12. Permits

(1) A permit-

(b) subject to this Act, and the covenants, terms and conditions expressed in the permit, confers on the holders the exclusive right or the right, in common with other permit holders, to take and remove any timber, other vegetable growth or roadmaking materials over which the State has right specified in the permit on and from the land defined in the permit.

(5) Every permit is subject to a condition that the holder of the permit shall pay the royalties fixed under Section 16 for all forest produce taken under the permit.

16. Royalties on Permits and Licences

(1) The royalty payable on timber and forest produce taken under a permit or licence is as fixed by the Minister in the permit or licence.

17. Transfer of Permit or Licence

A permit or licence shall not be transferred except with the written consent of the Minister."

It is our firm belief that the import of the words as appeared in the above mentioned Section of the Forestry Act, i.e. "forest produce", "any timber", "all forest produce", "timber and forest produce", includes the plantation trees, and the State has full control over the plantation trees, as well as the State's control of the log export of the plantation trees under the Export Control and Valuation Act.

We also consider that while the State is well protected of its rights under the existing legislation, should the State require clarification or enforcement of the State's control over plantation trees including the payment of royalty, these conditions should be written into the project agreement, the same as the other many conditions contained in the draft of the project agreement over which we have conducted the negotiation over the years.

Furthermore, if the State is still in any doubt with regard to the question of royalty payment or the need to obtain a timber permit to harvest the plantation trees, may we suggest that the project agreement may be enacted by the parliament to make the agreement enforceable as a law.

(2) Payment of Royalty

The State Negotiating Team mentioned in its letter that in the Company's August 1986 Part II Financial Projection we did not provide for royalty to be paid on logs harvested from the plantation. However, in the Content and Format Specification Part II, the Company provided the following royalty payment.

For natural forest	6,798,000M ³	@ K4.00/M ³	= K27,293,000
For plantation forest	4,056,000M ³	@ K0.50/M ³	= 2,028,000
TOTAL			K29,220,000

The detail of the calculation of the royalty payment is shown in Annexure D.

(3) Profitability of the Project

The State Negotiating Team mentioned in its letter "If it were to transpire that the State did not own plantation, and log harvest did not reflect this, the company would have an extremely large windfall gain from plantation."

In this regard, we wish to offer our comments as follows:

The attached calculation of the Internal Rate of Return (Annexure E) shows the internal rate of return of 22.21% (before tax) or 21.15% (after tax) after the project period of 30 years, based on the financial structure of that the plantation trees are owned by the company.

As we believe that the internal rate of return of the excellent projects of the country such as Bougainville Copper or Ok Tedi Mining is in the vicinity of 20%, the internal rate of return as above of our project illustrates if nothing else, the soundness of the project, from which we will be able to render the payment of the Government Revenue in addition to the infrastructure committed.

Royalties	K23,840,000
Export Levy	65,592,000
Income Tax	78,296,000
Dividends	5,400,000
Withholding tax on dividends	7,740,000
Estimated Import Levy	3,456,000
Indirect benefits can be assessed as:	
Forest Industry Council Levy	2,462,000
Provincial Retail Sales Tax on Sawn timber	900,000
TOTAL	K187,686,000

(4) Land Lease - Legal Ground

The Company has already established the reforestation plantations covering 3,000 hectares as at the end of 1987, of which the details of land leases and licences are shown in Annexure F.

As you will see from the annexure, either the land leases or licences have been granted to the Company.

If you will see the draft of the project agreement prepared by the State Negotiating Team, Section 12.2, quote:

"Land Applications

The Company shall lodge applications under the Land Act, Chapter 185 of the Revised Laws in respect of all land to fulfill its obligation under this agreement including project land,."

Based on the above two facts, the Company believes that

- (a) Any improvements including plantations should be the property of the lessee in accordance with the Land Act.
- (b) If the State wishes to appropriate the plantation trees then just compensation should be paid as per Section 48 of the Land Act.

We are appalled to see the letter from the State Negotiating Team, saying "Company access would be given to the plantation areas otherwise than by way of a lease or licence," and we oppose this newly mentioned idea as the idea is contrary to the hitherto practice with the Company.

(5) Commercial Grounds

The State Negotiating Team mentioned in its letter that the cost of K77,253,000 referred to by the Company as the total cost of reforestation shall have been paid for from income from natural forest log harvests allowed by the Department to the Company.

However, the source of the total income of K227,500,000 out of the whole project period of 30 years are analysed as follows:

Log export ex the existing timber area	K20,522,000
Log export ex Ania/Fulleborne	77,582,000
Buluma Sawmill ex natural forest	3,472,000
Amio Sawmill ex natural forest	<u>1,926,000</u>
Sub-total ex natural forest	K103,502,000
Log export ex plantation forest	115,957,000
Buluma Sawmill ex plantation forest	4,217,000
Amio Sawmill ex plantation forest	<u>3,829,000</u>
Sub-total ex plantation forest	K124,003,000
GRAND TOTAL	K227,505,000

The statement made by the State Negotiating Team that the total cost of reforestation shall have been paid for from income from natural forest log harvest is correct. However, the balance of the profit ex natural forest after deduction of the plantation establishment cost (K103,502,000-K77,253,000) will be K26,249,000 which is merely 3.7% of the turnover, (K26,249,000+K707,535,000), over 30 years of the project period.

(6) Finance

We cannot agree with the thought of the State Negotiating Team that borrowings are secured by the future earnings from timber harvested as if it were in the mining industry, and that ownership of the plantation is not essential to ensure borrowings.

For financiers, the essential security for their lending is the total assets of the company, in the form of the floating charges, and not only the earnings. In other words, the security for the financiers is the company itself or its total assets who have the ability of creating such earnings. It is impossible to raise the finance by way of offering the future possible earnings only, ignoring the financial status of the company which is the basis of the future earnings.

(7) Encouragement of Foreign Investment

We are at a loss how the Government of Papua New Guinea can attract the foreign investment for reforestation projects when the Government advises the investors that investors are not allowed to own the plantation trees after investing millions and millions of Kina to create the new timber resources of the country, unless the State commits the irrevocable assurance that the investors are assured of the exclusive right of access to the plantation for its maintenance and the harvest and disposal of the plantation trees.

Your agreement to mediate in the area of dispute between the State Negotiating Team and the Company would be much appreciated so that the project agreement can be finalised at an earliest possible date.

For your further information, we are enclosing herewith the summary of our Company's operation as Annexure G, and the extract of our proposal of the project as Annexure H.

Yours faithfully,
STETTIN BAY LUMBER CO. PTY. LTD.


 S. HIRATA
 Managing Director

STETTIN BAY LUMBER CO. PTY. LTD.

SAWMILLERS AND TIMBER EXPORTERS

PHONE 93 5266 93 5267 93 5258
TELEX. 93 103
FAX: 93 5225

P O BOX 162
KIMBE- WNB.

SBLC

9th November, 1987.

Letter No. S - 164

The Secretary,
Department of Forests,
P.O. Box 5055,
BOROKO.
National Capital District.

Dear Sir,

RE: ANIA-FULLEBORNE TIMBER PROJECT AGREEMENT
A CONSOLIDATED PROJECT AGREEMENT.

We wish to refer to your speech addressed at the recent Forest Industries Association meeting, wherein you mentioned:

"If unnecessary delays in obtaining operating authority are encountered by the company, the secretary's office welcomes you to lodge your complaints, I will personally follow up the progress of the authority being sought by your company".

Taking this opportunity, may we advise the following hitherto progress of this negotiation between the state and the company.

June, 1984 ... The Company submitted "The Proposal of Development Project of Ania Timber Right Purchase and Fulleborne Extension.

February, 1985 ... The company received LETTER OF INTENT - REVISED CONSOLIDATED TIMBER PERMIT AREA - STETTIN BAY LUMBER CO. PTY. LTD (SBLC) - WNB, advising that the Ania/Fulleborne Extension TRP area will be committed to the company.
(Reference Office of the Ministry of Forests letter 151-14-0/1-1-7 dated 26 February 1985)

May, 1985 ... National Executive Council appointed a State Negotiating Team to represent the State during any negotiation with the Company (Reference Department of Forests letter 151-14-31 dated 28th May, 1985).

July, 1985 ... The Company received the letter from the Secretary for Forests, asking the Company to submit a Development Plan as per Development Plan Guideline prepared by the State Negotiating Team.
(Reference Department of Forests letter 151-14-31 dated 19 July, 1985)

December, 1985 ... The Company submitted "PROJECT OF FOREST DEVELOPMENT OVER CONSOLIDATED TIMBER PERMIT AREA INCLUDING ANIA AND FULLEBORNE EXTENSION AREA".

June, 1986 ... The company received the state requirement, which was the result of the evaluation by the State Negotiating Team, and the company was asked to re-submit detailed revised proposal.
(Reference: Department of Forests letter 151-14-31 dated 4th June, 1986)

August, 1986 ... The company submitted accordingly Development Proposal - SBLC's Proposed Consolidated Timber Project Area - East and West New Britain.

November, 1986 ... The company received a Draft Project Agreement
(Reference: Department of Forests letter 151-14-20 dated 11 November, 1986)

December, 1986 ... The company submitted the comment on the said draft project agreement (Reference: SBLC's letter 40-3-0 dated 19th December, 1986)

March, 1987 ... On 25th March, 1987, a discussion was held between the State Negotiating Team and the company for the clarification and the detailed explanation on SBLC's proposal submitted in August, 1986.

April, 1987 ... The company submitted the letter of the clarification and the full explanation on the points raised at March discussion.
(Reference SBLC's letter S - 88 dated 21st April, 1987)

June, 1987 ... The negotiations were held in Kimbe and Port Moresby between the State Negotiating Team and company, wherein the agreements were reached on a certain clauses of the draft project agreement, leaving the rest yet to be discussed.

September, 1987 ... On 23rd September, the company received the revised draft project agreement based on the June negotiation and the draft shareholders agreement.
(Reference SBLC's letter S - 158 dated 29th September, 1987)

October, 1987 ... On 30th October, the company submitted Department of Forests the comment on both revised draft project agreement and shareholders' agreement, when we were advised that the next negotiation would take place in Port Moresby in the week starting on 9th November, 1987, but we have not heard any notice of the meeting, up to today's date.
(Reference SBLC's letter S - 162 dated 21st October, 1987, and Nissho Iwai's letter dated 28th October, 1987).

As you have seen from the above, the negotiation between the State and the company has been over three years since June, 1984, and we believe that this project has been long awaited not only by our company but also by the people of West New Britain.

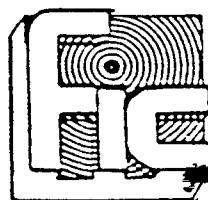
It would be highly appreciated if you could take up this matter personally and follow up in a hope that the negotiations can resume at the earliest possible date.

Should there be any assistance we could render towards the early finalisation of the Project agreement and Shareholders' Agreement, please do not hesitate to advise us.

Yours faithfully,
STETTIN BAY LUMBER CO. PTY. LTD.,

..... 

S. HIRATA,
Managing Director.



**FOREST INDUSTRIES COUNCIL
OF PAPUA NEW GUINEA**

Annexure A 2

P.O. BOX 1829 PORT MORESBY
LOT 4 SECTION 406
WAIGANI DRIVE

Phone 25 6399
256302
Telex NE 22226 FORINCO

Ref: ~~PK~~/egm

24/09/87

COPY

The Secretary,
Department of Forests
P O Box 5055
HOHOLA
National Capital District

Dear Sir,

SUBJECT: ANIA - FULLEBORNE TIMBER PROJECT AGREEMENT

The Forest Industries Council is concerned about the long delay in finalising some of the major projects, amongst which is the above Project Agreement between the State and Stettin Bay Lumber Company. A major project of this magnitude requires ample time for planning, feasibility studies and long term financing arrangements.

Presently the Company is left in great anticipation with no light in the tunnel. FIC as you will realise does not wish to see delays caused by the Government which will deny the industry of continued allocation of resource or deny landowners of employment and revenue (royalties).

In view of the size of some of the projects and the level of capital investment involved, I hope to constantly check with your office for projects that have been in the pipeline for a long time in order that foreign investment is not prevented or discouraged for the timber industry.

As for Ania-Fulleborne, we would appreciate it if a firm commitment is made to finalise the Agreement by November or December 1987. Since most of the activities leading up to the round-table negotiations have been completed, we hope that you will arrange for negotiations soon.

Yours faithfully,

DIKE KARI
ACTING EXECUTIVE DIRECTOR.

cc: Mr Simon Hirata - SBLC

~~Department of Primary Industry~~
DEPARTMENT OF PRIMARY INDUSTRY
OFFICE OF FORESTS

TELEGRAMS: FORESTS
TELEPHONE: 254022

OFFICE OF FORESTS
P.O. BOX 5055
BOROKO,
PAPUA NEW GUINEA

The Secretary
Department of Lands, Surveys
and Environment
P O Box 5665
BOROKO

Date: 1 September 1982

Our Reference: 355-2-6

Action Officer: P Kelly/ln

Designation:

Your Reference: 82/962

Date: 11 August 1982

Attention: MR A WHITE

Dear Sir,

APPEAL BY STETTIN BAY LUMBER COMPANY WEST NEW BRITAIN - REFORESTATION
LEASE

We believe that there is a case for the Minister to refer the lease granted to SBLC back to the Land Board. The following comments are relevant to reasons stated by SBLC for their appeal and to your queries regarding ownership of the trees and funding of the project.

In relation to the length of the lease we believe 15 years is too short. As we wish to encourage reforestation for sawlog production the length of the lease on any particular area should be sufficient to cover at least one rotation i.e. approximately 40 years for sawlogs. We see no reason to guarantee renewal of the lease after this time. However, as it is likely to be in our interests that harvested plantations are replanted it may be wise to provide scope for renegotiation of the lease at the end of its term if possible, but this should not mean unconditional or automatic renewal.

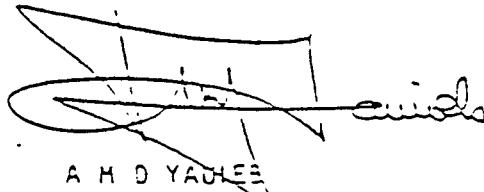
Finance for the SBLC project will be made available through the Japan International Co-operation Agency (JICA). The loans which SBLC will receive from JICA will be at soft interest rates but they must still be paid back by the Company. We have encouraged companies to seek soft loans for reforestation and given the long time lag on returns associated with such projects, we think it would be unduly penalising the company if they do not receive some return on their funds invested. It is also unlikely that JICA would be willing to make future funds available if the approach outlined by the Land Board decision is adopted.

In addressing the question of ownership of the trees we are mostly concerned that the arrangements arrived at will be able to be accommodated within our proposed Reforestation Policy of which your Department has received a copy.

State ownership of the plantations is no longer regarded as necessary. Therefore, given that S8LC will be paying for the establishment and maintenance of the plantations we feel that the company should be considered the owners of the trees. However, as it is desirable that this Office record the volume of logs harvested throughout the country, we would like it to be made explicit in the Lease Agreement with the company that harvest of the plantations will require written approval of the Director of Forests. This is in fact necessary as the plantations will be on state land however we feel it should also be made explicit in the Lease Agreement.

The Director's approval will be given as per the Forestry Act i.e. by issue of a Timber Permit. Embodied in the issue of a Timber Permit is the setting of a royalty to be charged for timber removed. At the time of harvest of the S8LC plantation this royalty will be set to take into account the fact that the company has met the cost of establishing and maintaining the plantations. This should perhaps also be made explicit in the Lease Agreement.

S8LC is one of few logging companies in PNG that are currently seriously concerned with reforestation. We feel they should receive as much encouragement as possible. We therefore feel that the appeal by the company is justified. We suggest the above conditions as providing a satisfactory arrangement.



A M D YAOLES
Director

STETTIN BAY LUMBER CO. PTY. LTD.
SAWMILLERS AND TIMBER EXPORTERS

CABLES. "DEWAI" KIMBE
PHONE. 93 5266, 93 5267, 93 5258
TELEX. 9310

P.O. BOX 162
KIMBE - W.N.B.



17th March, 1988

The Secretary,
Department of Forests,
P.O. Box 5055,
BOROKO, N.C.D.

Dear Sir,

CONSOLIDATED PROJECT AGREEMENT

Following discussions between the State Negotiating Team and the Company today, we wish to advise you our concern over the dispute and the matter which has created the impasse.

As you are aware, our Company has been involved in a series of meetings with the State Negotiating Team, and during the course of negotiations, considerable progress has been achieved due to the fair and reasonable approach to the issues by both parties, however, it now appears that an unreconcilable deadlock has been reached.

The issue is the ownership of plantation trees. Throughout the negotiations, the Company has proceeded in the firm belief and on the basis that any plantations created by the Company would belong to the Company and form part of its assets. We believe that the Company should be recognised as the undisputed owner of the plantation trees on both legal and commercial grounds.

1. LEGAL GROUNDS.

- (a) The Company will be meeting all costs involved in the establishment and maintenance of the plantations which are deemed to be an improvement and as such in accordance with the Land Act are the property of the lessee.
- (b) The States demand to the Company to surrender the ownership of the plantation trees free of charge is against the import of Section 48 of the Land Act.
- (c) It is understood that the Forestry Act requires that a Timber Permit be issued prior to the harvest of the plantation trees and that royalties are payable on the forest produce from the plantation, and because of these provisions we can see no reason why the plantation should be owned by the State in this project.

2. COMMERCIAL GROUNDS.

- (a) The total cost of reforestation during the 30 year project period is K77,253,000, the Company having spent so much must own the asset.

2.

- (b) At the end of the Project Year 30, when the proposed agreement terminates, the residual value (at cost) of the plantation is estimated to be K45,450,000 which we cannot abandon.
- (c) The Company's past policy of capitalisation of reforestation expenses, which in 1987 was K1.5 million (and budgeted K1.75 million in 1988), permits the Company to record sufficient accounting profit and to place the Company in a position to meet dividend payments. Capitalisation of these costs is not available unless there is a corresponding asset of the Company.
- (d) The reforestation scheme stands as a major asset item in our Balance Sheet and without which, we would be unable to attract the interest of financiers to implement the project as proposed.
- (e) We feel it is most important for the country overall to encourage reforestation by way of attracting foreign investment and the denial of ownership of the plantation trees certainly discourages the overseas investor.

The Company acknowledges that the ownership of the plantations does not allow it to avoid or evade the obligations of the Forestry Act in regard to the harvest of the plantation trees.

Accordingly,

- (1) We acknowledge that the harvest of plantation trees shall be subject to the Timber Permit as approved by the Minister for Forests, and furthermore subject to the Forest Working Plan as approved by the State.
- (2) We acknowledge that the silviculture techniques employed for plantation trees shall be in accordance with the Forest Working Plan as approved by the State.
- (3) We acknowledge that we shall pay the prescribed royalty for the harvest of plantation trees.
- (4) Any log exports from the plantation forest shall be subject to the provisions of the Export Control and Valuation Act.

In the meantime we hereby confirm that the proposed ownership of the trees means the ownership by Stettin Bay Lumber Co. Pty. Ltd., a Company incorporated in Papua New Guinea and not by Nissho Iwai Corporation of Japan.

The Company trusts that it has a long term future in the Papua New Guinea timber industry and is willing to make firm commitments, but cannot see its future secure unless it has control of its assets.

We shall be grateful if you will give this matter your full and prompt consideration as it is our wish to finalise the negotiations and complete the Agreement at an early date.

Yours faithfully,
STETTIN BAY LUMBER CO. PTY. LTD.


S. HIRATA
Managing Director



DEPARTMENT OF FORESTS

TELEGRAMS FORESTS

TELEX NE22360

TELEPHONE 277800

FAX: 254433

FRANGIPANI STREET
P.O. BOX 5055
BOROKO
PAPUA NEW GUINEA

Date: 31 March 1988

Our Reference:

The Managing Director,
Stettin Bay Lumber Co. Pty. Ltd
P.O. Box 162,
KIMBE, West New Britain

Action Officer:
Designation:

Your Reference:

Date:

Dear Sir,

re: STETTIN BAY LUMBER CO. PTY. LTD. - OWNERSHIP OF
REFORESTATION PLANTATION

I refer to your letter of 17 March 1988. The Department's concern in relation to plantation ownership is twofold -

(a) as to forest management generally in Papua New Guinea - it bears on the future control by the State of the forestry resource in Papua New Guinea;

(b) as to the Stettin Bay project negotiations - it bears on the log harvest volume to be negotiated. Log harvests are negotiated to take account of who owns plantation.

More specifically, and with reference to your letter of the 17th March 1988, I comment as follows -

(a) Resource replacement and control of plantation: The Department is committed to the principle of resource replacement with the rate of reforestation related to the rate of cutting. The only reliable way of ensuring a continuous supply of timber for the future is by creating plantations. The Department is of the view that control of the replaced resource is an essential part of forest management in Papua New Guinea. Plantation should be a national asset. Without ownership the State may not under the current Forestry Act have control of plantation resources with the effect that, as the natural forest is progressively harvested, there is a diminishing resource over which the Department of Forests has control. Under the

current Forestry Act, without ownership being in the State a company may be able to harvest plantation without a timber permit and without payment of royalty. Stettin Bay Lumber Co. Pty. Ltd. was itself of this view and in its August 1986 Part II financial projections did not provide for royalty to be paid on logs harvested from plantation, and no doubt it has taken advice on these matters. It is acknowledged that the company has recently said "it is understood" a timber permit is required and royalty will be paid on plantation harvests, but there is clearly some ambiguity in the Forestry Act as to whether a permit is required and hence whether royalty is payable.

If the plantation is not owned by the State it is possible that the plantation could be "locked up" by the company if a permit is not required or if a permit is required but the State and the company are unable to agree on the basis on which a further permit would be issued.

(b) Ownership of plantation and relationship to log harvest entitlement:

The Department to date has negotiated on the basis that plantation shall be owned by the State with the cost of establishing plantation met from the revenue from the log harvest allowed. If it were to transpire that the State did not own plantation and log harvests did not reflect this, the company would have an extremely large windfall gain from plantation. The estimated value of a plantation of 15,000 hectares where all timber has had 20 years growth would be in excess of K500,000,000 in 1988 kina. Related to the plantation ownership question is the question of an appropriate figure for residual values to be shown in the company's projected cash flow, as this will then bear on the log harvest to be negotiated.

(c) Legal grounds:

The argument that the company has a legal claim to plantation ownership (or at any rate to remove plantation) may be able to be raised if the company is to be given a lease or licence over plantation areas and if it makes a payment for the plantation. If the State is to own plantation then effect shall need to be given to this intention so that the contrary cannot be contended at a later date. Company access would be given to the plantation areas otherwise than by way of a lease or licence. The State would itself secure possession of the land so that the company may fulfill its reforestation obligations. The State could determine to have the necessary area reserved for reforestation purposes by notice in the National Gazette pursuant to s25 of the Land Act.

(d) Commercial grounds:

Payment for reforestation; Residual values; Reforestation treated as an asset by the company etc: As mentioned above, the negotiated log harvest entitlement takes into account

76
(152)

Office of the Ministry of Forests

TELEPHONE: 253066

TELEGRAMS: FORESTS BOROKO

TELEX: NE 22360

P.O. BOX 5055

BOROKO

PAPUA NEW GUINEA

OUR NO 151-14-31

Date: 8th September, 1982

Mr S. Mori

Managing Director

Stettin Bay Lumber Company Pty Ltd

P O Box 162

KIMBE

West New Britain Province

Dear Sir

LETTER OF INTENT TO ISSUE CONSOLIDATED PERMIT (TP 14-31) FOR STETTIN BAY LUMBER COMPANY PTY LTD.

In December 1981 the Director of the Office of Forests verbally advised you that the State despite its rejection of Stettin Bay Lumber Company Pty Ltd's Proposal over the Ania-Kapiura forest resource area was prepared to consider allocating the Kapiura portion of that resource if the Company accept the terms and conditions put to it in a Letter of Intent.

Such consideration was based on three (3) main factors:-

1. the remaining forest resources available to Stettin Bay Lumber Company Pty Ltd has a very limited life given the current rate of cut;
2. the West New Britain Provincial Government wants the Ubac-Calai II road, the alignment for which runs through the Kapiura forest resource, constructed. Construction will include the Kapiura, Aum and Fisi River Bridges; and
3. there is a need to make sure that the timber industry complex which your Company has established, is sustained. The State can not guarantee any additional resources for Stettin Bay Lumber Company Pty Ltd in the West New Britain Province other than those resources covered by this Letter of Intent.

It is therefore necessary and timely that appropriate steps are taken now to rationalise the harvesting of the resources available to the Company. This indeed is one of my prime responsibilities as Minister for Forests. The schedule for log production, log export and log processing, presented in this letter of Intent is a reflection of the reasons outlined above.

The Kapiura resource is to be developed as part and parcel of one single Consolidated Permit (TP 14-31) which will be an amalgamation of all permits (TP 14-2, and 14-21) previously allocated to Stettin Bay Lumber Company Pty Ltd. As from the date you endorse this offer in this Letter of Intent the operational conditions stipulated in it will apply and supersede those of Permits PT 14-2, 14-20 and 14-21.

As it will take some time for the formal documentation of the Consolidated Permit, and to avoid unnecessary interruptions/delays to your roading, logging and related operations while awaiting the finalisation of the document, I am prepared to grant permission to Stettin Bay Lumber Company Pty Ltd to proceed/continue its normal activities if you accept by signing the appropriate space at the base of this letter and return the signed copy to this Office, the principal terms and conditions outlined hereunder:-

1. FOREST RESOURCE TO BE COVERED BY CONSOLIDATED PERMIT

<u>NAME</u>	<u>Area</u>	<u>Estimated Remaining Resource (as at 31/12/81)</u>
(i) Kulu-Dagi (Bola, Ilonde, Laulimi, Kising, Keveloho)	34,800 ha	630,200
(ii) Hoskins (Bango, Witori, Mumi, Gila, Malalimi, Nopili, Mosa, Wangore) (Kapi?)	69,000 ha	190,000
(iii) Bilomi-Kapiura (within WNBP)		1,553,400 2,373,600 M ³

2. PERMIT PERIOD: 10 Years as from 1/10/82.
3. MINIMUM ANNUAL CUT REQUIREMENT: 75,000 cubic metres
4. MAXIMUM ANNUAL ALLOWABLE CUT: 250,000 cubic metres until 31st December, 1985 and thereafter drop to 200,000 cubic metres for the rest of the Permit duration. This volume includes all logs harvested irrespective of diameter class and irrespective of whether it is for log export or local processing.

The conditions in this clause also apply to the remaining (84,847 M³ as at 5/5/82) log export allowance for Bilomi.

ROYALTY RATE:

- (a) on the outstanding volume from Bilomi Road Permit i.e. some 84,847 m³ - royalty free.
- (b) all other timber; K3.86/m³ with respective allowances for premium species to be added. This royalty will remain static till 1st January 1986, at which time it shall be reviewed in accordance with Section 16 of the Forestry Act.

BANK GUARANTEE: K100,000 to be lodged within 60 days from the date the Company endorse this letter of intent.

MAXIMUM ANNUAL LOG EXPORT ALLOWANCE: 200,000 cubic metres until 31st December, 1985 and thereafter drop to 75,000, except that

- (a) an allowance of 5,000 cubic metres of logs would be permitted for export for every 100 hectares of land reforested by the Company in the previous year.
- (b) a negotiated allowance for any additional infrastructure requirements of the State.

Only one Log Export Licence will apply to all the Company's log export from the province as from the 1st July 1982.

8. MINIMUM ANNUAL PROCESSING REQUIREMENT: 50,000 cubic metres until 31st December 1985 when it may be reviewed upward depending on market demands for processed timber.
9. A five year detailed Forest Working Plan together with an outline plan of operation for the remaining life of the Permit is to be submitted within 90 days as from the date the Company endorse this Letter of Intent.
10. LOG PRODUCTION/EXPORT/PROCESSING SCHEDULE

YEAR	MAXIMUM		
	LOG PRODUCTION	LOG EXPORT	LOG PROCESSING
1982 (July 1)	125,000	100,000 (45,000)	25,000
1983	250,000	200,000 (45,000)	50,000
1984	250,000	200,000	50,000
1985	250,000	200,000	50,000
1986-1991	200,000	75,000 -150,000	50,000

The above schedule includes a log export allowance for the construction of the Ubac-Galai II. Road, the Kapiura Arm and Flisi bridges especially over the three and a half year period until 1985.

The figures in brackets show the approximate remaining allowance for Bilomi as at 5 May 1982.

At the end of 1986 a major review of the Permit in particular of the above production, export and log processing schedule, may be undertaken. A Revised schedule may be established after considering such factors as market conditions for processed products, the remaining resources, resource replacement efforts by the Company, further infrastructure requirements and the State of the Papua New Guinea timber industry.

11. INFRASTRUCTURE CONSTRUCTION/MAINTENANCE

1982

Construct 6 Kilometres of Ubae-Balai Road. (4 Kilometres from Galai II to Kaptura River and 2 Kilometre from Ubae towards Galai).

1983

- (i) Construct Aum Bridge.
- (ii) Part construction (Basement only) of Kapiura Bridge.
- (iii) 6 Kilometres of road works from Ubae towards Galai.

1984

- (i) Completion of Kaptura Bridge.
- (ii) 8 Kilometres of road works from Ubae towards Galai.

1985

- (i) Construct Fisi Bridge.
- (ii) 8 Kilometres of road from Ubae towards Galai.

12. RESOURCE REPLACEMENT

The Company will use its best endeavours to secure sufficient land in the first two years of the tenure of this permit and thereafter to embark on a reforestation programme at an annual planting rate of at least 200 hectares.

✓ 13. Unused log export allowance may be carried over from the first semester to the next throughout the permit period but not from one project year to the next except for 1982, 1983, 1984, 1985 and 1986.

14. Stettin Bay Timber Company Pty Ltd will be responsible to meet the cost of regular (once a quarter) inspection/supervision by the Department of Works and Supply of the road and bridge construction.



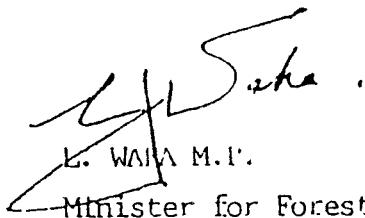
15. The Company shall offer to the State or its nominee on the 1st day of January, April, July and October each year an option to purchase of 25% of its budgeted log export volume for the quarter on a first refusal basis. Species composition of each offer should be proportionate to that of the forest area being logged.

16. Log Export Tax Rebate may be claimed should appropriate processing within PNG exceed 30% of total annual harvest.

17. Log export activities may be suspended if the Company fails to meet any or all of the terms and conditions of this Letter of Intent.

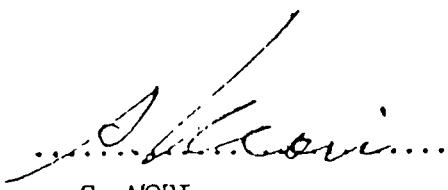
18. The eventual issue of a formal Consolidated Permit will supersede the authority of this letter of intent.

Yours faithfully



L. Wala M.P.
Minister for Forests.

I, S. Mori, Manager of Stettin Bay Lumber Company Pty Ltd acknowledge and accept the above conditions and will observe them until the formal issue of a consolidated Timber Permit by the Minister for Forests.



S. MORI

...18th Oct. 1988

DATE.

SCHEDULE 3A

REPUBLIC OF PAPUA NEW GUINEA

FILE COPY

CONFIDENTIAL

FILE: 151-14-31

MINISTER FOR FORESTS

DATE: 15 APRIL 1985

POLICY SUBMISSION NO: 73/85

FOR MEMBERS OF NATIONAL EXECUTIVE COUNCIL

PROJECT AGREEMENT - STETTIN BAY LUMBER COMPANY PTY. LTD.

A. PURPOSE

To seek the approval of the National Executive Council for negotiation of a Project Agreement between the State and Stettin Bay Lumber Company Pty. Ltd., by appointing a State Negotiating Team, and issuing Negotiating Guidelines to the Team.

B. FACTS AND CONSIDERATIONS

Stettin Bay Lumber Company Pty. Ltd. (SBLC) operates one of the largest timber operations in Papua New Guinea; in fact, on the basis of annual log harvest, SBLC is the largest producer of logs in PNG, with a total harvest of almost 300,000 M3 in 1984.

SBLC is a joint venture company, with 75% of issued shares being held by Nissho Iwai Corporation of Japan, and the remaining 25% of shares being held by the State.

SBLC initially operated under a variety of Timber Permits and Licences, though currently these have been replaced by a Letter of Intent to issue a Consolidated Permit.

Though it was planned that the current concession would contain sufficient timber resources to maintain SBLC's operations until 1992, SBLC in 1984 began seeking a Timber Permit over the Ania-Fulleborne TRP areas, outside SBLC's current concession.

Given that the SBLC operation is the largest in PNG, and given that in 1984 the State successfully concluded Project Agreements for two other concessions, Vanimo and Open Bay, I believe that a Project Agreement should be negotiated for the SBLC operation too. Such an Agreement would offer advantages to both the State and to SBLC:-

- (i) SBLC has tended to expand on a 'piece-meal' basis. A Project Agreement would enable the whole SBLC operation, including Ania-Fulleborne, to be considered as an integral operation. The Project Agreement would provide a strategy and direction for longer term development, and would give the Project both stability and security.
- (ii) A substantial portion of the Ania TRP is within East New Britain Province. Negotiation of a detailed Project Agreement will allow all interested bodies, including both the East and West Provincial Governments, to be fully involved in the design of the ongoing SBLC project. On completion of the Agreement, monitoring will be assisted by having each party's duties and obligations clearly specified in the Agreement.
- (iii) Negotiation of a Project Agreement will allow the State to influence the direction of long term development in and around SBLC's timber concession. In Ania-Fulleborne, for instance, SBLC proposes to undertake only limited reforestation and processing activities, concentrating instead on a 'Roads for Logs' project. Negotiations will allow the State to evaluate the importance of these roads, and whether it may be preferable to promote reforestation and processing activities as well.

For these reasons I have already advised SBLC that Ania-Fulleborne will be committed to their company, provided that SBLC agree to enter into a Project Agreement with the State. SBLC have not yet accepted my Letter of Intent on this matter, but have indicated verbally that the concept of a Project Agreement is acceptable in principle.

As a first stage in preparing and negotiating a Project Agreement, it is necessary for National Executive Council to appoint a State Negotiating Team, and to provide that Team with Negotiating Guidelines.

I propose that membership of the Team should be as listed in Appendix A, with Terms of Reference as also detailed in Appendix A. I recommend that the size of the Team be restricted to a minimum, with only essential Departments being represented. Other Departments would of course be fully consulted when appropriate.

Proposed Negotiating Guidelines are attached as Appendix B. I recommend that these Guidelines be framed in sufficiently broad terms to allow the Team flexibility to negotiate without having to refer back to NEC during negotiations. National Executive Council would, of course, have to consider any negotiated Agreement prior to execution by the Head of State.

C. VIEWS OF OTHER MINISTERS AFFECTED

To be sought in Council.

D. FINANCIAL IMPLICATIONS

Nil

E. STAFFING IMPLICATIONS

Nil

F. LEGISLATIVE IMPLICATIONS

Nil

G. CONSTITUTIONAL IMPLICATIONS

Nil

H. DECENTRALISATION IMPLICATIONS

The Secretary, Department of Forests has consulted the Provincial Secretaries of the Department of East and West New Britain. No objections to the concept of negotiating a Project Agreement were raised.

I. POLITICAL IMPLICATIONS

Nil

J. PLANNING IMPLICATIONS

Longer term planning in the area of SBLC's operations should be simplified once an Agreement has been executed.

K. PREVIOUS POLICY REFERENCES

Nil

L. RECOMMENDATIONS

It is recommended that Council:-

- appoints a State Negotiating Team with membership and Terms of Reference as detailed in Appendix A; and
- approves the issue of Negotiating Guidelines to the State Negotiating Team, as detailed in Appendix B.

[Signature]
L.J. WAKA MP

MINISTER FOR FORESTS.

APPENDIX A

STATE NEGOTIATING TEAM

MEMBERSHIP

Secretary, Department of Forests (plus his nominee)
Secretary, Department of Finance (or his nominee)
State Solicitor, Department of Justice (or his nominee)
Secretary, Department of East New Britain (or his nominee)
Secretary, Department of West New Britain (or his nominee)

The Secretary, Department of Forests, will lead the Negotiating Team. The Secretary will have discretion to co-opt other members, if considered necessary.

TERMS OF REFERENCE

- (1) To negotiate an agreement with Stettin Bay Lumber Company Pty. Ltd. for forest development consistent with the State Negotiating Guidelines, as approved by National Executive Council.
- (2) When negotiating such an agreement, to give careful consideration to:-
 - project viability;
 - forest resource estimates; and
 - availability of land for reforestation, housing and industrial facilities.
- (3) To provide regular reports on the status of negotiations to the Minister for Forests.
- (4) To provide a formal report, with recommendations, to the Minister for Forests, if the team determines that an Agreement, consistent with the State Negotiating Guidelines cannot be negotiated.
- (5) Alternatively, to provide a formal report, with recommendations and a draft agreement to the Minister for Forests on completion of negotiations.

APPENDIX B

STATE NEGOTIATING GUIDELINES

The Project, as detailed in the negotiated Agreement, must:-

- (1) Be consistent with the 1979 White Paper 'Revised National Forest Policy'.
- (2) Make realistic provision for a sustained forest industry in West and East New Britain in the area of SBLC's operations. This will include provision for an extensive reforestation programme and processing activities based on use of both natural and plantation forest resources.
- (3) Ensure, as far as reasonably possible, that Stettin Bay Lumber Company Pty. Ltd.'s commitments to reforest, process, and construct roads are implemented. This may include provision in the Agreement for:-
 - performance guarantees;
 - penalty restrictions;
 - incentive measures; and
 - interim reappraisal.

the cost of establishing plantation to be owned by the State. Where the plantation is owned by the State the harvest is higher than if it were not owned by the State. Hence the cost of K77,253,000 referred to by the company as the total cost of reforestation shall have been paid for from income from natural forest log harvests allowed by the Department to the company. It is not paid for by the company from its own resources. Similarly the reference to residual values, capitalisation of reforestation expenses and reference to reforestation as a balance sheet item is not relevant if the log harvest negotiated has taken into account the reforestation obligations of the company.

Finance: The Department is of the view that a mortgage over the plantation should not be necessary to secure borrowings by the company. A parallel is drawn to mining projects where borrowings are secured by the future earnings of the mining company - with a timber project the borrowings are secured by future earnings from timber harvested. It is not agreed that ownership of the plantation is essential to ensure borrowings.

Encouragement of foreign investment: It is not considered that ownership of plantation is necessary to ensure foreign investment. As referred to above, the reforestation obligations are taken into account in determining the log harvest. Access to agreed plantation areas shall be assured during the project life pursuant to the project agreement.

I have gone into some detail in responding to your letter in order to make clear the wider ramifications of the question at issue. Current legislation may not adequately cover the plantation issues now being negotiated. Notwithstanding this, it appears a resolution of the plantation ownership issue should be sought and then consideration given to the manner in which effect can be given to the resolution, bearing in mind the terms of the legislation. I am sure that with the good intentions which have been displayed by both sides in negotiations to date, when this issue is resolved all remaining matters should be able to be resolved without delay to the mutual satisfaction of the State and the company.

I note your advice that you propose to make representations to the Minister for Forests in relation to the plantation ownership question.

Yours faithfully,

erjmsf

✓ M. KOMTAGAREA
Secretary

ANNEXURE D

YR	Royalty Payment (Schedule 21)	Log Production Schedule		
		Selective Logging	Plantation Logging	Total
1	K1,400,000	350,000M ³	0	350,000M ³
2	1,400,000	350,000	0	350,000
3	1,400,000	350,000	0	350,000
4	1,400,000	350,000	0	350,000
5	1,400,000	350,000	0	350,000
6	1,400,000	350,000	0	350,000
7	1,400,000	350,000	0	350,000
8	1,400,000	350,000	0	350,000
9	1,400,000	350,000	0	350,000
10	1,400,000	350,000	0	350,000
11	1,400,000	350,000	0	350,000
12	1,400,000	350,000	0	350,000
13	1,400,000	350,000	0	350,000
14	1,400,000	350,000	0	350,000
15	1,400,000	350,000	0	350,000
16	573,000	106,000	297,000	403,000
17	573,000	106,000	297,000	403,000
18	573,000	106,000	297,000	403,000
19	573,000	106,000	297,000	403,000
20	573,000	106,000	297,000	403,000
21	573,000	106,000	297,000	403,000
22	573,000	106,000	297,000	403,000
23	573,000	106,000	297,000	403,000
24	520,000	100,000	240,000	340,000
25	520,000	100,000	240,000	340,000
26	520,000	100,000	240,000	340,000
27	520,000	100,000	240,000	340,000
28	520,000	100,000	240,000	340,000
29	520,000	100,000	240,000	340,000
30	520,000	100,000	240,000	340,000
TOTAL	K29,224,000	6,798,000M ³	4,056,000	10,854,000M ³
		@ K4.00	@ K0.50	
	K29,220,000	K27,192,000	K2,028,000	

ANNEXURE E

INTERNAL RATE OF RETURN

YEAR	CASH FLOW	loans	profit	Net
1	(4,550)	5649	9778	-7014
2	1,099	942	1044	2687
3	942	4,105	4983	-1386
4	4,105	7,441	2299	1292
5	7,441	8512	1582	2780
6	8,512	14686	10631	-6119
7	14,686	13510	1358	3239
8	13,510	13120	1200	3400
9	13,120	17087	1250	3755
10	17,087	18826	350	4832
11	18,826	22470	9350	-4571
12	22,470	20357	350	4789
13	20,357	18870	350	4825
14	18,870	23109	350	5322
15	23,109	25722	350	5408
16	25,722	24443	350	6122
17	24,443	26527	350	6481
18	26,527	26724	350	6710
19	26,724	33092	350	6540
20	33,092	40097	350	5599
21	40,097	44301	0	6000
22	44,301	48595	0	6041
23	48,595	53421	0	6095
24	53,421	60515	0	6109
25	60,515	66049	0	6141
26	66,049	68078	0	6173
27	68,078	73384	0	6173
28	73,384	77179	0	6173
29	77,179	84268	0	6173
30	84,268	91193	0	6173
GUESS		0.14		0.5
IRR		-185.90%		22.21%

YEAR	CASH FLOW		loans	profit	Net
1	(4,550)	1,099	5649	9778	2764
2	1,099	942	-157	1844	3731
3	942	4,105	3163	4983	3597
4	4,105	7,441	3336	2299	3591
5	7,441	8512	1071	1582	4362
6	8512	14686	6174	10631	4512
7	14,686	13510	-1176	1358	4597
8	13,510	13120	-390	1280	4680
9	13,120	17202	4082	1250	4890
10	17,202	19068	1866	350	5016
11	19,068	22905	3837	9350	4530
12	22,905	20704	-2201	350	5139
13	20,704	19217	-1487	350	5175
14	19,217	23536	4319	350	5672
15	23,536	26548	3012	350	5285
16	26,548	26106	-442	350	5670
17	26,106	28773	2667	350	6101
18	28,773	29550	777	350	6357
19	29,550	36711	7161	350	6255
20	36,711	43267	6556	350	6481
21	43,267	48396	5129	0	8676
22	48,396	56099	7703	0	8716
23	56,099	64333	8234	0	8770
24	64,333	74842	10509	0	8819
25	74,842	83789	8947	0	8851
26	83,789	86388	2599	0	8895
27	86,388	94319	7931	0	8895
28	94,319	101539	7220	0	8895
29	101,539	112053	10514	0	8895
30	112,053	122403	10350	0	8895
GUESS		0.14			0.3
IRR		-188.55%			21.15%

LAND LEASES/LICENCES - SMIC

Portion Number	Date Issued	Purpose	Area Ha.	Term Years	Documents	Ownership	Valid
① MUNISSI 2072	85/3/18	Reforestation	55.930	40	Held	SDIC	From 83/5/26
② MUNISSI 2084	81/1/29	Reforestation	78.436	20	Held	Not mentioned	
③ MALLIM 1034	81/5/5	Reforestation	120.000	15	Held	STATE	
④ LAKTEMATA 722	81/10/27	Reforestation	800.000	ANNUAL	Held	Not mentioned	
⑤ MUNISSI 10	81/10/27	Reforestation	1,436.000	ANNUAL	Held	Not mentioned	
⑥ MOPILLI 78	81/8/23	Reforestation	8,262.000	40	Held	Not mentioned	
⑦ POTA GAIAT L.A.8	87/2/81	Reforestation	95.000	ANNUAL	Held	Not mentioned	
⑧ L. A. 8	88/1/22	Reforestation	90.000	ANNUAL	Held	Not mentioned	

ANNEXURE G

THE OUTLINE OF STETTIN BAY LUMBER CO. PTY. LTD.

Stettin Bay Lumber Company is one of the largest employers of Papua New Guineans in the country, and the largest timber operation of the country.

Its ratio of expatriate staff to Papua New Guineans is 24 expatriates: 1,000 Papua New Guineans i.e. for one expatriate staff there are about 42 Papua New Guineans gainfully employed.

Stettin Bay Lumber Company's sale in 1987 was K18,235,506 most of which was extremely valuable foreign exchange earned by the Company for Papua New Guinea.

Stettin Bay Lumber Company had until 31st December, 1986 invested into Papua New Guinea K44,045,000 which included Fixed Assets, Road and Bridge Construction and Reafforestation. Stettin Bay Lumber Co. is in the process of finalising negotiations with the State for the development of consolidated timber area and the total investment in this new project is estimated to be K243,911,000 which consists of K43,898,000 for Road and Bridge Construction, K77,252,000 for Reafforestation, K25,949,000 for Sawmill and K96,812,000 for other Infrastructure and Miscellaneous Capital Expenditure. The estimated employment opportunities under this new project will boost the employment of Papua New Guineans by the Company to 1,500.

Stettin Bay Lumber Company has contributed very significantly in projects of national importance and value.

Apart from logging operations the Company is also responsible for building 60 kilometres of National Highway and 700 kilometres of provincial roads with five (5) permanent steel bridges along the Bialla/Kimbe Highway. The outstanding achievement was the building of the Kapiura Bridge which was built in Japan and shipped over in parts to be assembled in Papua New Guinea having a single span of 114 metres.

This section of the road provides the communication link between Kimbe and Bialla, the two largest towns in West New Britain. The 700 kilometres of provincial roads provide essential access to aid the development of the area especially to oil palm. In the area a new oil palm project has commenced with over 4,000 hectares of oil palm now planted and another 3,000 hectares due for planting. The project is now employing 400 people and this figure will rise to 1,200 when the oil mill is completed. This is a good example of the development that has taken place following our construction of roads, as the project development depended on the road access to Kimbe.

The company has replanted 3,000 hectares to various species of timber under their reafforestation program. Negotiations are underway to replant 15,000 hectares of tree plantation to regenerate the timber resources. The new plantations will harvest about 600 cu. metres per hectare as compared to 30-40 cu. metres per hectare in natural forests presently in P.N.G. This will be a great asset to the future generations of Papua New Guinea.

In the reafforestation department the company employs 260 workers on their own and 12 local groups of contractors who consist of 150 workers, who comprise of unemployed youths from the oil palm blocks.

Stettin Bay Lumber Company has always been receptive and accommodating in assisting the West New Britain Provincial Government in providing assistance in improving the law and order situation and the social development of the region, providing in the company's compound a rural police station to maintain law and order in the surrounding area. The company also provides one pre-school and one community school.

The company is continuously endeavouring to promote local participation in the economic development of the region, such as logging contractors (Wagore Logging Pty. Ltd.) and Forest Sawmills-(Kulu Lumber Pty. Ltd. and Otto Sawmilling).

Stettin Bay Lumber Company produced and exported 227,887 cu. metres of logs in 1987, making it the largest exporter of logs in Papua New Guinea. In sawn timber, of the total exports of 4,500 cu. metres by Papua New Guinea, Stettin Bay Lumber Company produced and exported 2,834 cu. metres (63%).

STETTIN BAY LUMBER CO. PTY. LTD.ANIA PROJECT

(Project Agreement Relating to Talasea, Hoskins, Kapiura and Ania-Fulleborne Timber Areas)

1. Project Period: 30 years

2. Timber Resources of Natural Forests (Operable area)

Existing Timber Area	119,000 ha	2,106,000M ³
Ania-Fulleborne Timber Area	91,300 ha	4,702,000M ³
TOTAL	210,300 ha	6,808,000M³

3. Logging (30 years)

Plantation Forests	6,272,000M ³	(54.8%)
<u>Natural Forests</u>	<u>5,178,000M³</u>	<u>(45.2%)</u>
TOTAL	11,450,000M³	(100.0%)

4. Sawmill (30 years)

	<u>Log volume to be processed</u>	<u>Sawn Timber to be produced</u>
Buluma Sawmill (Existing sawmill)	1,450,000M ³	505,600M ³
Amia Sawmill (New sawmill)	840,000M ³	327,700M ³
TOTAL	2,290,000M³	893,300M³

5. Reforestation

Total areas to be planted	22,500 hectares
Total Investment	K75,000,000

6. Infrastructure

(1) South Coast Road (to be constructed within 13 years)

Amio/Gasmata	55km
<u>Amia/Uvol</u>	<u>65km</u>
	120km

K3,300,000

(2) Bridge Construction (to be constructed within 13 years)

15 Bridges	K8,473,000
------------	------------

(3) Village Access Road (to be constructed within 10 years)

40.5 km	K290,000
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(4) Wharf/Jetty

Amio 1	K2,000,000
Uvol 1	K200,000

(5) Other Infrastructure (to be constructed within 5 years)

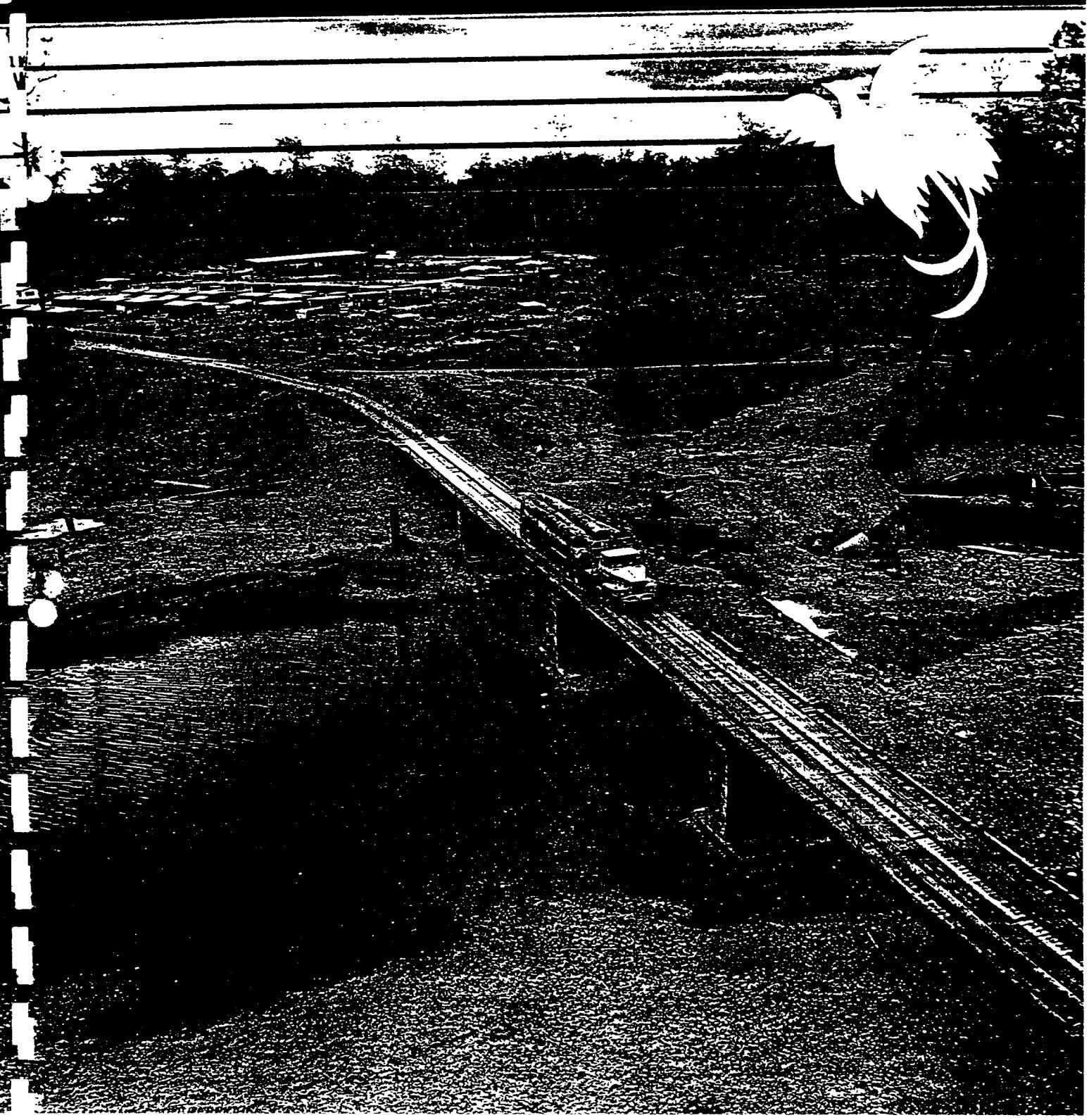
School (9), Police Station (1), Clinic (5), Government Houses (47) Government offices (2) Sports ground (1), Community Centre (1) Others (1)	K1,673,000
TOTAL	K15,936,000

7. Papua New Guinea Government Revenue

Royalties	K23,840,000
Export Levy	65,592,000
Income Tax	78,296,000
Dividends	5,400,000
Withholding tax on dividends	7,740,000
Estimated Import Levy	3,456,000
Indirect benefits can be assessed as:	
Forest Industry Council Levy	2,462,000
Provincial Retail Sales Tax on Sawn Timber	900,000
<hr/>	
TOTAL	K187,686,000

SCHEDULE 5

SBLC



INFORMATION

ESTABLISHED January, 1970

CAPITAL Authorized Capital K5,000,000

Issued Capital K2,800,000

SHAREHOLDERS Nissho-Iwai Corporation K100,000 (75%)
Independent State of K-700,000 (25%)
Papua New Guinea

WORKING STAFF Nationals 100
Expatriate 33

SALES AMOUNT 1981.1-12 K 9,138,979

1982.1-12 K11,962,926

1983.1-12 K 9,808,085

1984.1-12 K14,575,000

PRODUCTION Logs Sawn Timber
1981 253,908m³ 14,653m³
1982 278,658m³ 13,111m³
1983 243,513m³ 13,213m³
1984 295,200m³ 14,100m³

MARKETING

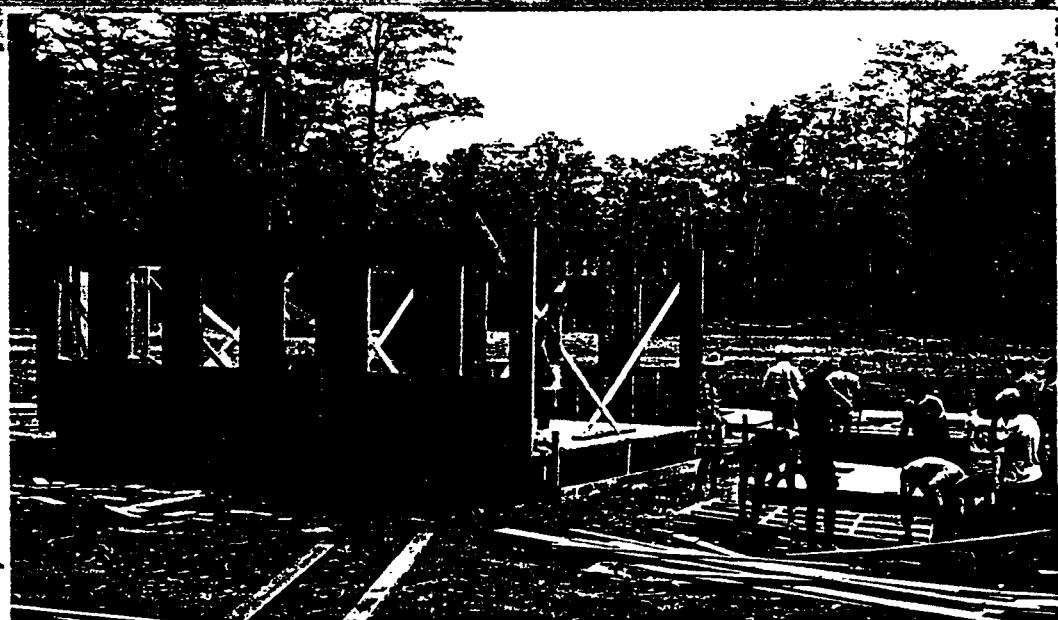
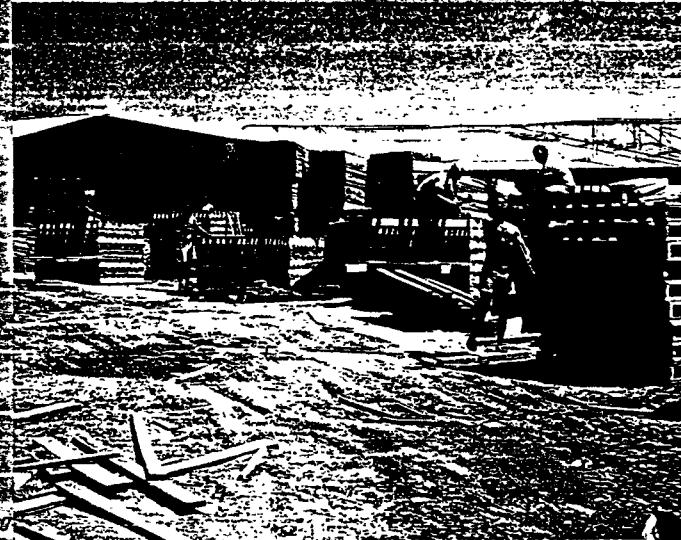
Logs Japan, China, Korea, Taiwan etc

Sawn Timber Australia, New Zealand, Europe

Japan, PNG etc

Furniture, Pallet

Pre-Fabricated Houses, PNG



Prefabricated House

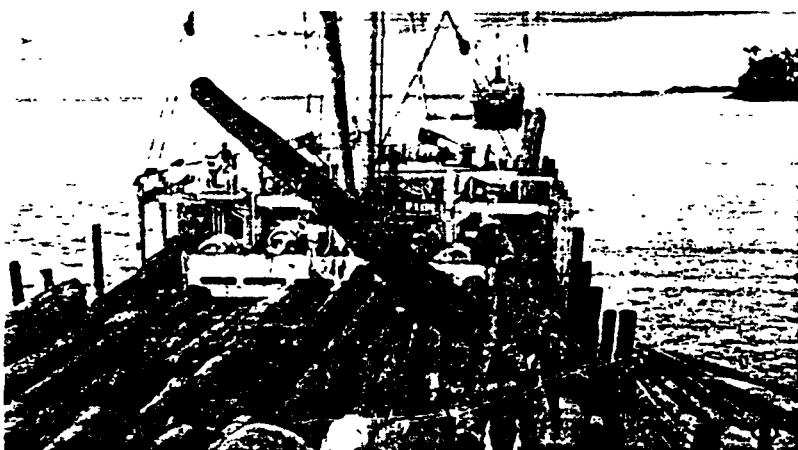


LOGGING

TIMBER PERMIT	a) Forest Resource to be covered by CONSOLIDATED PERMIT		LOGGING EQUIPMENTS	a) Bulldozer, Skidder, Log Loader, Road Grader, Excavator, abt. 51 units	
	Name	Area	Remaining Resource	b) Dump Truck, Hauling Trailer, Truck, abt. 62 units	c) Associated Support Vehicles, abt. 40 units
	KULLU-DAGI	34,800ha	630,200m ³		
	HOSKINS	69,080ha	190,000m ³		
	BICOMB KAPURA	83,000ha	1,553,400m ³		d) Tug Boat, Pontoon, abt. 13 units
	b) Annual Allowable Cut		250,000m ³		
	c) Annual Logs Export Allowance		200,000m ³	LOGGING BASES	Buluma, Lasibu and Bofa
MAIN SPECIES	Malas, Taur, Celtis, Kamarere, Labulla, Basswood, Pencil Cedar, Amoora and abt. 150 Mixed Tropical Hardwoods.			SHIPPING PORTS	Buluma, Lasibu and Bofa



Loading of Logs



Shipping of Logs

SAWMILL

SAWMILL

Re-Established: February 1976

FACTORY

Site: 100ha of 37ha of Buluma Complex

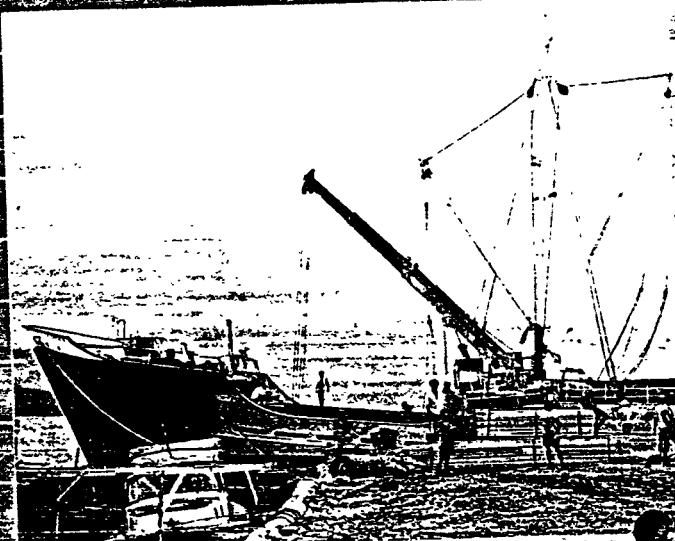
Buluma Sawmill

Main Machines

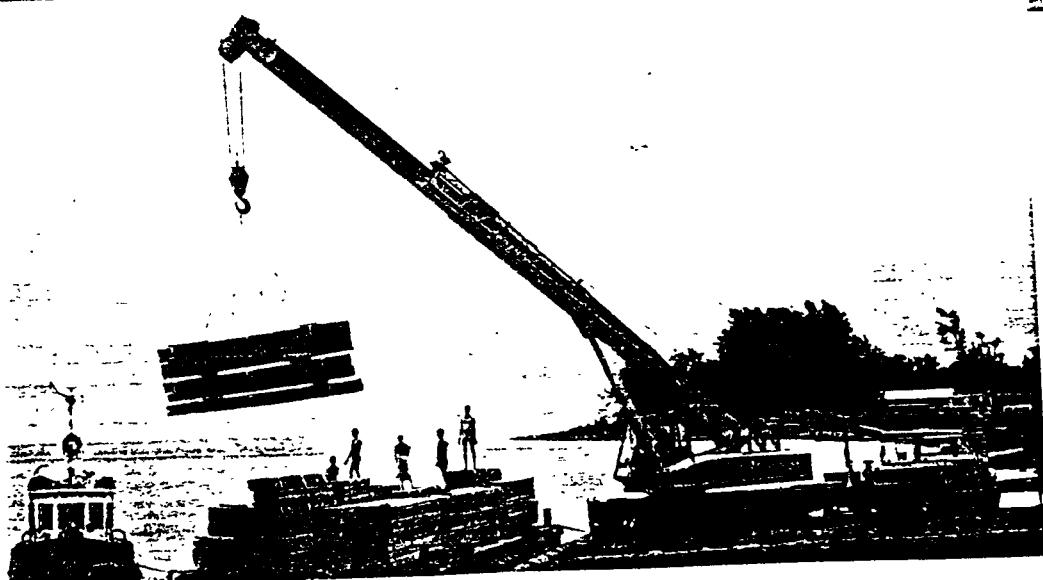
- 2 Conveyor Lines with
- 2000mm Bandsaw with 1500mm Carriage, 1 set
- 1500mm Bandsaw with 1500mm Carriage, 1 set
- 1200mm Bandsaw with 1900mm Carriage, 2 sets
- 1300mm Horizontal Bandsaw, 1 set

Associated Support Machines and Equipments

- Table Bandsaw (F200mm) 3 sets
- Planer 4 sets
- Pressure Treatment Tank 1 set
- Power Plant abt. 2.000KVA



Shipping of Sawn Timber





REFORESTATION

PLANTED AREA 1976 — 55ha 1977 — 80ha 1978 — 120ha
1982 — 220ha 1983 — 500ha 1984 — 466ha

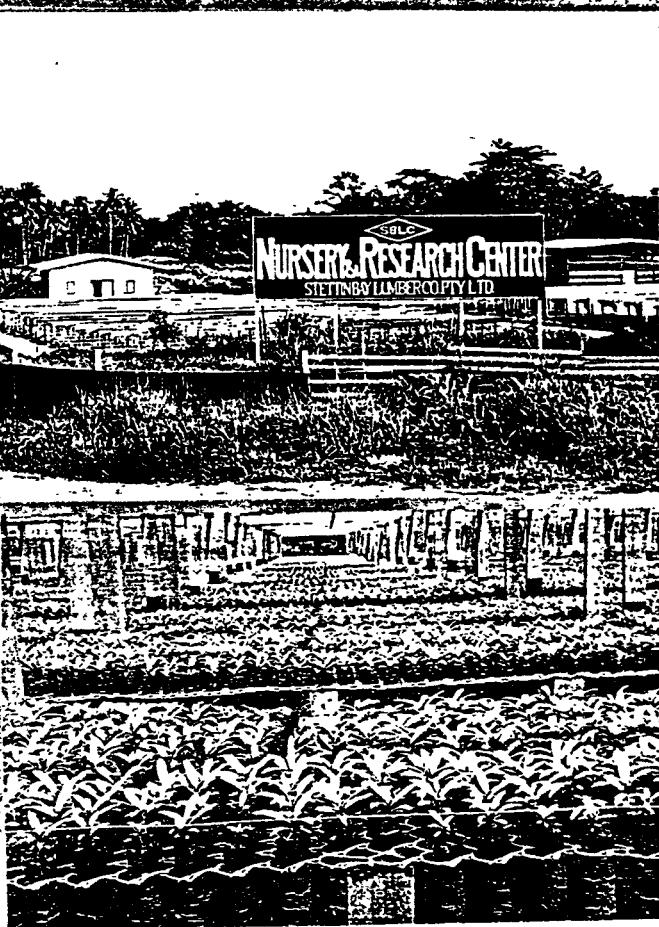
SPECIES
Kamarere (*Eucalyptus Deglupta*)
Giant Ipil-Ipil (*Leucaena Leucocephala*)
Terminalia sp.
Erima (*Octomeria*)
Teak (*Tectona Grandis*)

NURSERY (KWALAKESSI)
Established: March 1982
Site: 10ha at KWALAKESSI
Seedling Capacity: 250,000 pieces

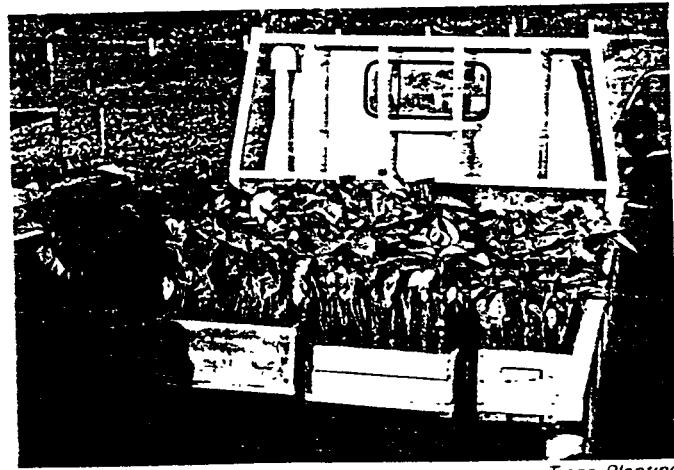
(MOPILI)
Established: 1985
Site: 3ha at MOPILI
Seedling Capacity: 400,000 pieces



Kamarere Plantation



Seedling



Trans-Planting



(PAPUA NEW GUINEA)

BRIDGE AND ROAD CONSTRUCTION

Built (1980—1984)

National Road	80Km
Provincial Road	600Km
Permanent Steel. Bridge	120m (1) 100m (1)
	60m (1) 50m (2)

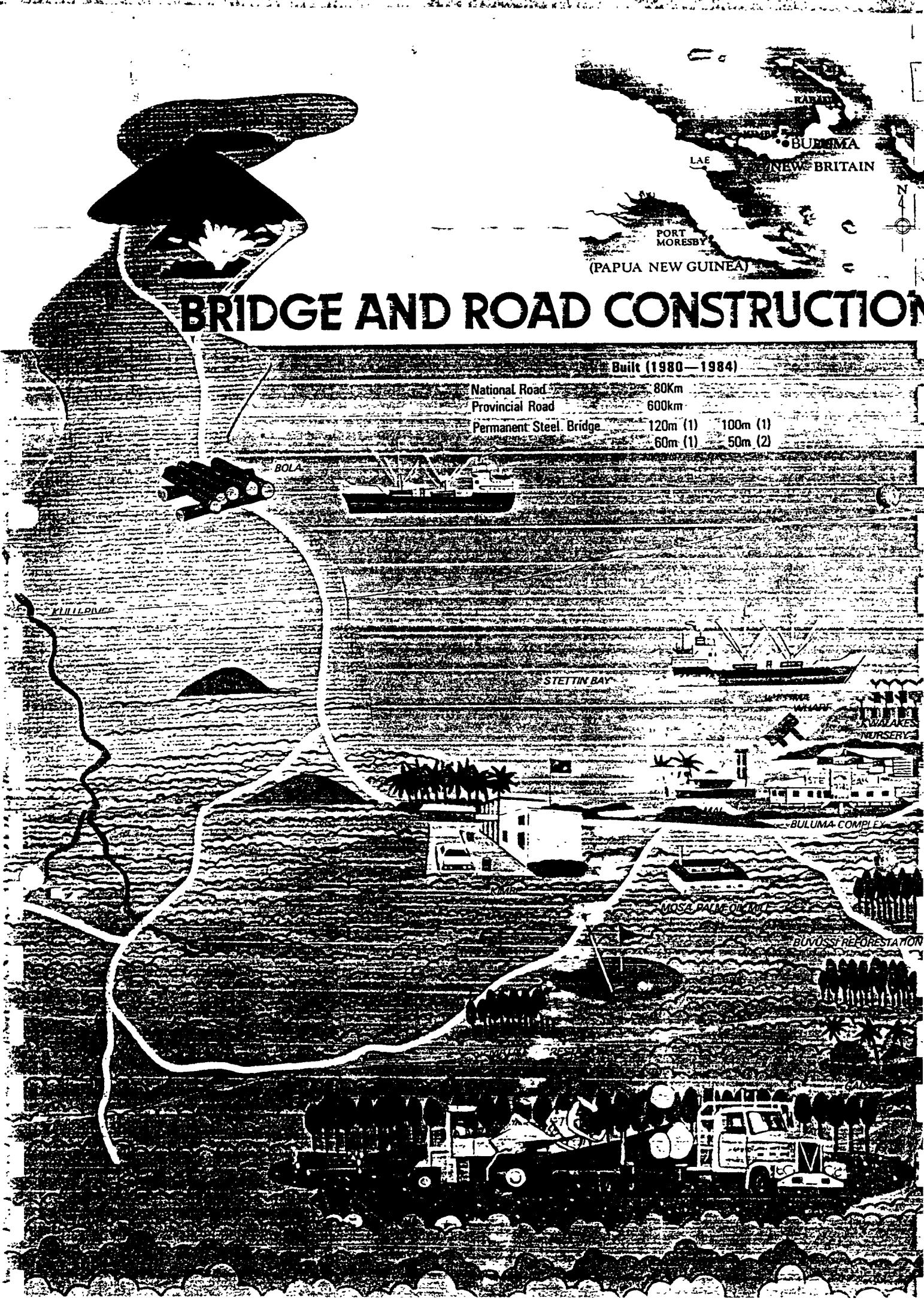
BOLA

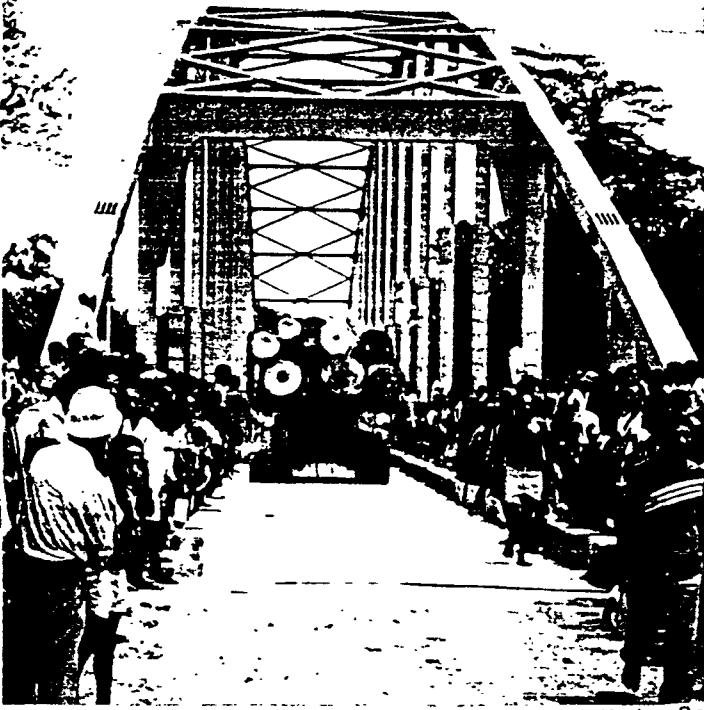
STETTIN BAY

BULUMA COMPLEX

MOA PALM OIL MILL

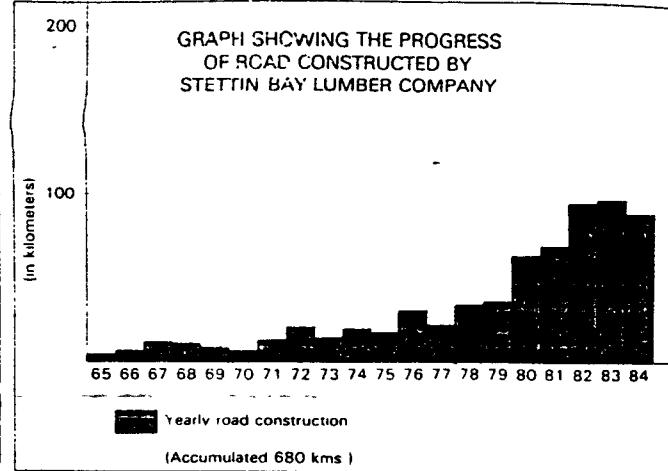
BUNUSSI REFORESTATION





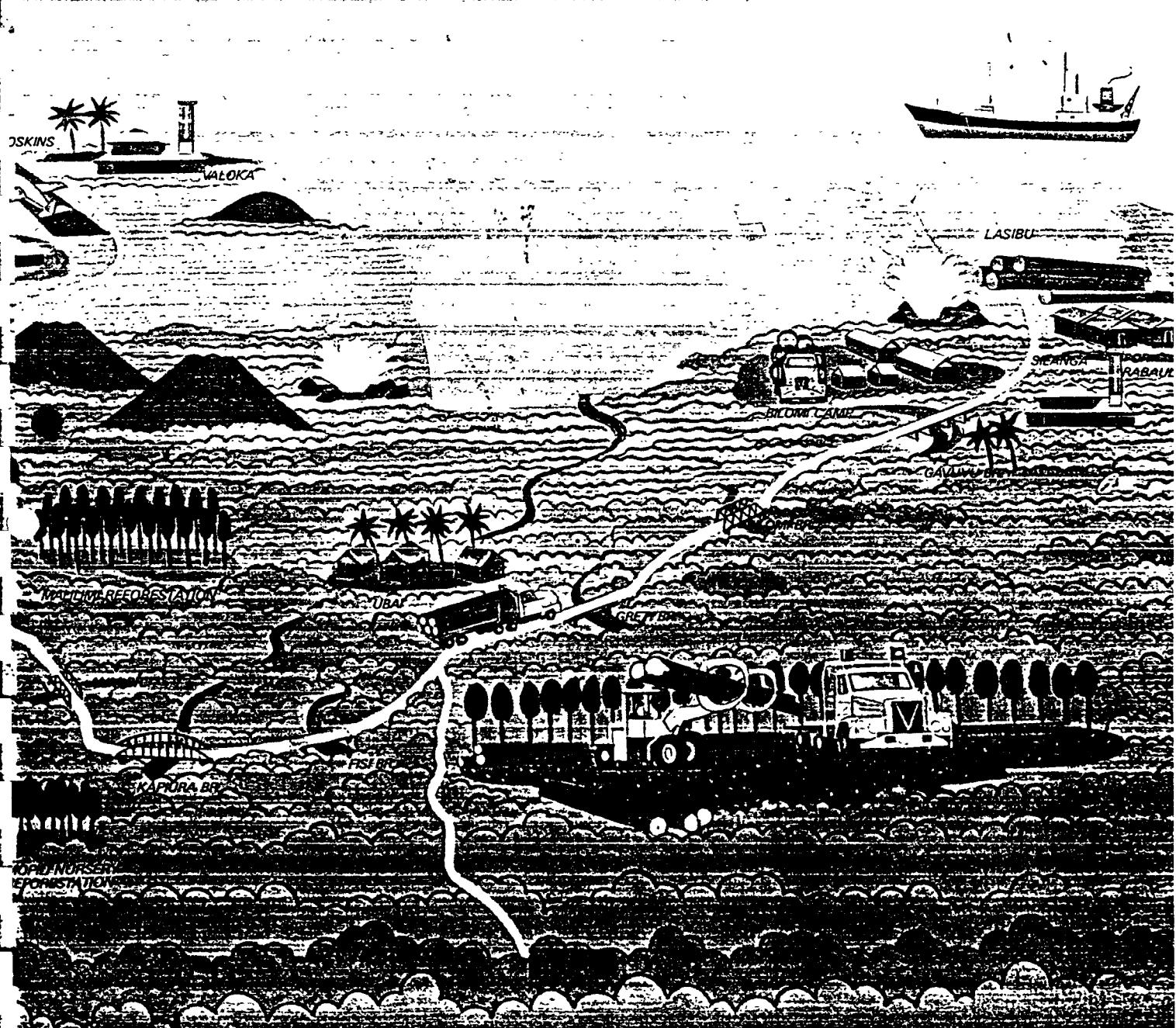
Kapiura Bridge

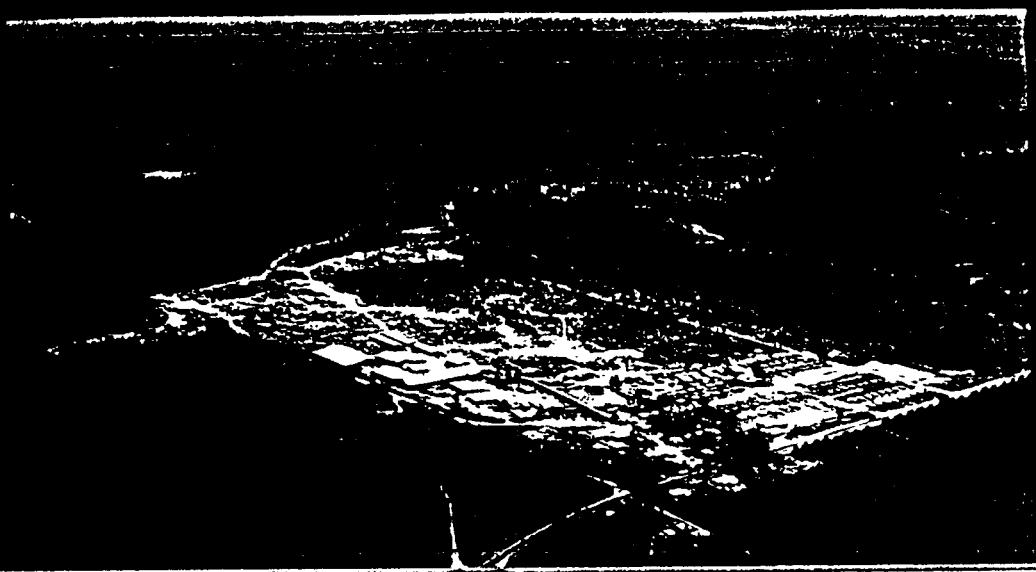
GRAPH SHOWING THE PROGRESS
OF ROAD CONSTRUCTED BY
STETTIN BAY LUMBER COMPANY



Yearly road construction

(Accumulated 680 kms)





BULUMA COMPLEX



STETTIN BAY LUMBER CO., PTY., LTD.

HEAD OFFICE:

P.O. BOX 162, KIMBE, WEST NEW BRITAIN, PAPUA NEW GUINEA
Telephone: 935266 935267 935258 Telex: NE93103 Cable: DEWAI KIMBE

MANAGEMENT (DIRECTORS):

N. Komatsu (Chairman)

S. Mori (Managing Director)

Y. Yamanishi

T. Yoshimura

S. Noda

H. Ragi

D. Kari

SOLE AGENCIES

LOGS : NISSHO IWAI CORPORATION
Lumber 2nd Dept.
4-5 Akasaka 2-chome, Minato-ku, Tokyo 107, JAPAN

SAWN TIMBER: NISSHO IWAI AUSTRALIA LTD.

Lumber Dept.
182 George st., Sydney, NSW 2000, AUSTRALIA

SCHEDULE 6

STETTIN BAY LUMBER CO. PTY. LTD.

SAWMILLERS AND TIMBER EXPORTERS

PHONE: 93 5266, 93 5267, 93 5258
 TELEX: 93 103
 FAX: 93 5225

P.O. BOX 162
 KIMBE. W.N.B.

SBLC

SH/cp

15th June, 1988.

Letter No. S-241

Mr. John Reeve,
 Counsil Assisting the Commission,
 Commission of Inquiry into Aspects
 of the Forest Industry,
 P.O. Box 2554,
 BOROKO.
 N. C. D.

Dear Sir,

Further to our letter (Our Reference S-227) dated 19th May, 1988, we submit
 the undermentioned information in reply to item (i) of your letter dated
 5 May, 1988.

(Unit M³)

	1984	1985	1986	1987
(A) Log input to Sawmill (Gross volume)				
SBLC	37,733	41,046	37,914	42,009
Kulu Lumber(Flitch Cont- ractor)			1,992	7,160
Otto Sawmilling(")				50
<u>Total</u>	<u>37,733</u>	<u>41,046</u>	<u>39,906</u>	<u>49,219</u>
(B) Log input to Sawmill (Net volume)				
SBLC	34,374	37,333	31,701	39,013
Kulu Lumber			1,210	5,163
Otto Sawmilling				49
<u>Total</u>	<u>34,374</u>	<u>37,333</u>	<u>32,911</u>	<u>44,225</u>
(C) Sawmill output				
SBLC	16,271	16,426	13,683	16,233
Kulu Lumber			344	1,661
Otto Sawmilling				17
<u>Total</u>	<u>16,271</u>	<u>16,426</u>	<u>14,027</u>	<u>17,911</u>
(D) Sawmill net production after deducting dress missing, defects and wastage.				
SBLC	14,054	14,533	12,906	13,916
Kulu Lumber			344	1,661
Otto Sawmilling				17
<u>Total</u>	<u>14,054</u>	<u>14,533</u>	<u>13,250</u>	<u>15,594</u>

	1984	1985	1986	1987
(E) Recovery (c)/(b) (Against net volume)				
SBLC	47%	44%	43%	42%
Kulu Lumber			28%	32%
<u>Otto Sawmilling</u>				35%
<u>AVERAGE</u>	<u>47%</u>	<u>44%</u>	<u>43%</u>	<u>40%</u>
(F) Recovery (c)/(a) (Against gross volume)				
SBLC	43%	40%	36%	39%
Kulu Lumber			17%	23%
<u>Otto Sawmilling</u>				34%
<u>Average</u>	<u>43%</u>	<u>40%</u>	<u>35%</u>	<u>36%</u>
(G) Net Recovery (d)/(b)				
SBLC	41%	39%	41%	36%
Kulu Lumber			28%	32%
<u>Otto Sawmilling</u>				35%
	<u>41%</u>	<u>39%</u>	<u>40%</u>	<u>35%</u>
(n) Net Recovery (d)/(a)				
SBLC	37%	35%	34%	33%
Kulu Lumber			17%	23%
<u>Otto Sawmilling</u>				34%
	<u>37%</u>	<u>35%</u>	<u>33%</u>	<u>32%</u>

Yours faithfully,
STETTIN BAY LUMBER CO., PTY., LTD.,

.....
S. HIRATA,
MANAGING DIRECTOR.

SCHEDULE 7

SAWMILL MANAGER'S REPORT.

We refer to the attached the comparison between the actual performance and the budget for our sawmilling operation.

Amongst other things, you would notice the sizeable differences as follows:-

	1-12 Actual	1-12 Business Plan	Difference
Log input (M3)	49,219	50,000	-78
Production Cost	(15,594) 2,834,295 (Recovery) (35.26%)	(16,800) 2,811,810 (40%)	(-1206) 22,485 (-4.74%)
<u>Sales</u>			
Export	(2,834) 643,460	(4,797) 971,269	(-1963) -327,805
Local	(7,219) 1,714,202	(7,925) 1,972,385	(-706) -258,183
Total	(10,053) 2,357,662	(12,722) 2,943,654	(-2669) -585,992

We should like to offer the explanation as follows;

(1) Low Recovery.

Through the year of 1987, all efforts were concentrated into the achievement of 50,000 M3 of processing, which is a requirement of our timber permit condition, for which we engaged two local contractor, Kulu Lumber Pty., Ltd., and Otto Sawmilling who both operate forest mills to supplement the production of our Buluma main sawmill. Consequently, our sawmill achieved the record production of 49,219 M3 of log processing.

The breakdown of the production was as follows:-

	Gross log input	Net log input	Net Output	Recovery
SELC	42,031 M3	38,935 M3	13,916 M3	35.74%
Kulu Lumber	7,138	5,240	1,661	31.70
Otto Sawmilling	50	49	.17	34.70
Total	49,219 M3	44,224 M3	15,594 M3	35.26%

The low recovery, as you have seen from the above, attributable to:

- (A) Mainly low recovery was due to the Forest mill employed by the contractor for its inherent design shortcomings.
- (B) For SELC proper, the low quality of the logs in general, as the sawmill had to saw considerable volumes of logs rejected from the log export.

(2) Sales..

There was a sizeable shortfall of the export sales of our sawn timber as against the original business plan, due to the short supply of export species such as Eriwa, Pencil Cedar, Walnut, Taun and White species..

Whilst 7,219 M3 of the local sales was the record for domestic sales by the company, due to the completion of stage 1 of Mosa Kapiura Project in March, 1987, whereby we had been able to sell our CCA-DAR sawn timber at K340/M3, and increase of the sales of the pallet timber, the average sales price for local market remained as @ K237.46/M3 as compared the budget of @ K248.88/M3.

(3) Outlook of January - March, 1988 Operation.

It is the intention of the company to commence the sawn timber export to Cairns, Northern Queensland to exploit new market and dispose of the stock of red mix rough sawn timber.

SAWN TIMBER

		1-12 PERFORMANCE		1-12 BSNS PLAN		DIFFERENCE			
(LOG INPUT M ³)		49,219		50,000		-781			
INPUT AMOUNT		1282,496		1213,650		68,846	-		
DEFECT ALLOWANCE		(6,494)	81.83	(3600)	72.02	(2,894)	9.81		
WAGE R/MAINTENANCE		266,373 104,211	17.08 6.58	252,000 96,000	15.00 5.71	14,373 8,211	2.08 0.97		
ELECTRICITY		87,414	5.61	90,000	5.36	-2,586	0.25		
FUEL/OIL		48,635	3.11	60,000	3.57	-11,365	-0.46		
BUNDLING		26,009	1.67	36,000	2.14	-9,991	0.47		
CHEMICAL		51,665	3.31	101,160	6.02	-49,495	-2.71		
OTHERS		198,021	12.70	120,000	7.14	78,021	5.55		
(S.TOTAL)		782,328	50.16	755,160	44.95	27,168	5.21		
SALARIES		138,555	8.89	168,000	10.00	-29,445	-1.11		
TECH.ASST FEE		120,358	7.72	96,000	5.71	24,358	2.01		
INTEREST		181,291	11.63	204,000	12.14	-22,705	0.51		
INSURANCE		28,327	1.82	18,600	1.11	9,727	0.71		
DEPRECIATIONS		327,434	21.00	360,000	21.43	-32,566	-0.43		
(S. TOTAL)		793,965	50.91	846,600	50.39	-52,635	0.52		
ADMINISTRATION									
PRODUCTION COST		(15,594) 2834,295 (2,647)	181.76	2811,810 (2,647)	167.36	(-1206) 22,485	14.40		
OPENING		504,254	190.50	501,395	189.42	2,859	1.08		
HOME USE		(3,238) 51,555 (477)	164.16	(13,600) 594,000 (1,200)	165.00	(-362) -62,445			
DRESS MISSING		77,971 (4,453)	163.46	198,000 (1,925)	165.00	-120,029 (2528)	-1.54		
CLOSING		819,886 (10,053)	184.12	327,962 (12,722)	170.37	491,924 (-2669)	13.75		
TO SALES		1929,137	191.90	2193,243	172.40	-264,106	19.50		
SHIPPING CHG/FRT		411,181	40.90	468,000	36.79	-56,819	4.11		
SALES COST		2340,318 (2,834)	232.80	2661,243 (4,797)	209.18	-320,925	23.62		
EXPORT		643,460 (7,219)	227.05	971,269 (2735)	202.60	-327,805 (-706)	24.45		
LOCAL		1714,202	237.46	1972,385	248.38	-258,183	11.42		
TOTAL		(10,053) 2357,662	234.52	(12722) 2943,654	231.38	(-2669) -585,992	3.14		
P/L ON SALES		17,344	1.72	282,411	22.20	-265,067	20.48		
ADMINISTRATION		308,440	30.68	288,000	22.63	20,440	8.05		
NET PROFIT		(291,096)	(28.96	(5,589)	(0.44)	-285,507	28.52		

SCHEDULE 8

REFORESTATION DEPARTMENT(1) PLAN AND PERFORMANCE FOR 1987

(A) PLANTING:

<u>AREA</u>	<u>PLAN</u>	<u>PERFORMANCE</u>
Mopili	410 ha	413,538 750 ha
LA-8	90	99,5430
Total	500	513,0817 ha

(B) PLANTATION MAINTENANCE (TENDING):

<u>AREA</u>	<u>PLAN</u>	<u>PERFORMANCE</u>
Test Plantation	50 ha	29 ha
Buvussii	1,300	1,291
Lakiemata	400	491
LA- 8	150	203
Mopili	2,000	2,529
Total	3,900 ha	4,546 ha

(C) EXPENSES:

See the attached sheet of "DETAILS OF COST" remarks.

(1) LOAN INTEREST : Allocation method changed.

(2) PLAN FOR 1988 OPERATION

(A) PLANTING:

<u>AREA</u>
Mopili
L.A. 8
750 ha

(B) OPERATION MAINTENANCE:

<u>AREA</u>	<u>TENDING</u>	<u>THINNINGS</u>	<u>TOTAL</u>
Test Plantation	30 ha	30 ha	60 ha
Buvussii	1,100	200	1,300
Lakiemata	400	200	600
L.A. 8	800	-	800
Mopili	3,400	200	3,600
Total	5,730 ha	630 ha	6,360 ha

(3) ACTIVITIES DURING JAN/MAR 1988

(A) LAND PREPARATION:

BUSH CUTTING	Mopili	228 ha
	LA - 8	90
		<u>318 ha</u>

The local contractors have carried out bush cutting of 188 ha to date.

(B) PLANTING:

Mopili	54 ha
--------	-------

(C) SEEDLING STOCK:

	TOTAL STOCK	PLANTABLE SIZE
Kamarere	118,640 p'cs	37,590 p'cs
Erima	18,700	10,420
T. Bressii	17,150	17,150
Teak	6,700	4,930
Total	161,190 p'cs	70,090 p'cs

(D) TENDING:

AREA	DIRECT	CONTRACTOR	TOTAL
Test	0	0	0
Buvussii	109	148	257 ha
Lakiemata	63	0	63
LA-8	109	0	109
Mopili	809	0	809
TOTAL	1,090	148	1,238 ha

(E) Every job in the field is following our annual plan now.

SCHEDULE 9A

STETTIN BAY LUMBER CO. PTY. LTD.

SAWMILLERS AND TIMBER EXPORTERS



CABLES: "DEWAI" KIMBE
 PHONE: 93 5266, 93 5267, 93 5258
 TELEX: 93103

P.O. BOX 162
 KIMBE - W.N.B.

26th April, 1988

The Commissioner,
 Commission of Inquiry into Aspects
 of the Forest Industry,
 P.O. Box 2554,
BOROKO, N.C.D.

Dear Sir,

ATTENTION MR J. REEVE: COUNSEL ASSISTING THE COMMISSION

We refer to your letter of March 25, 1988 addressed to Nissho Iwai Australia Ltd., Port Moresby and their reply of March 28, 1988 and are pleased to submit to you the following information concerning our export sales of sawn timber to Nissho Iwai Australia Ltd., Sydney.

1. Marketing tables for sawn timber exports to Australia.
2. Marketing tables for sawn timber exports to New Zealand.
3. Contract notes between Stettin Bay Lumber Company Pty. Ltd. and Nissho Iwai Australia Ltd., Sydney.
4. Contract notes between Nissho Iwai Australia Ltd. and their respective customers.
5. S.B.L.C. invoices to Nissho Iwai Australia Ltd., Sydney.
6. Nissho Iwai Australia Ltd., Sydney invoices to customers.
7. Vouchers covering freight payments.

While examining these documents you will note that the F.O.B. price per 100 S.ft. by S.B.L.C. at Kimbe is higher than the C.I.F. price per 100 Sft. charged by Nissho Iwai Australia Ltd.

This apparent anomaly is caused by different trading customs. S.B.L.C. sells its sawn timber based on actual measurement of timber, whereas, in Australia timber is marketed on its nominal size.

To illustrate this we use an example from Contract Note SVP-0221 dated June 17, 1985 between S.B.L.C., Nissho Iwai Australia Ltd. and between Nissho Iwai Australia Ltd. and Maritme Timbers Pty. Ltd. This contract called for the supply of 3/4" x 3 3/4" DAR timber from S.B.L.C.

The quantity invoiced was 17184 S.ft. @ AS86.50. In Australia this timber was sold as its nominal size 1" x 4" but in fact was 3/4" x 3 3/4" (actual size).

Calculate:
$$\frac{3/4" \times 3 3/4"}{1" \times 4"} = \frac{2.8125}{4} = 0.703125.$$

Bulk price A\$86.50 x 0.703125
 = \$60.82
 plus freight 13.83 (insurance not included)
 \$74.65 = cost to Nissho Iwai Australia Ltd.
 compared to selling price of \$78.33.

Freight calculation:

USS36,603.31 ÷ 620.3951 M³ = USS59/M³ converted @ .7077 = A\$83.37/M³
 + .2373 = A\$19.67/100 S.ft x 0.703125 = A\$13.83 per nominal 100 S.ft.

We regret that to date we have been unable to locate the relative documents to invoices on the following partial shipments.

Vessel	Buyer	Contract Number	Species
Sinwa Maru	Maritime Timbers	262	Red Cedar
"	"	279	Amoora
"	"	249	Basswood
Parkarti Tiga	Maritime Timbers	262	Red Cedar
"	"	281	Amoora
"	"	301	Erima
"	"	310	Erima
"	"	212	Amoora
"	"	302	Malas
Lupe V3	Maritime Timbers	310	Erima
Seini	Maritime Timbers	324	Amoora
"	"	346	Kamarere
Seini	Australian Furniture Timbers	323	Amoora
Nimos	Maritime Timbers	383	Y. Kamarere
"	"	382	Y. Kamarere
Captaine Cook	Aickin & Co.	367	Malas

The documents relating to the above shipments will be forwarded to you as soon as they can be located.

Should you have any further queries, please do not hesitate to contact us.

Yours faithfully,
STETTIN BAY LUMBER CO. PTY. LTD.



 S. HIRATA
 Managing Director

SCHEDULE 9B

SBLIC SAWN TIMBER TO NEW ZEALAND 1986 - 87

NO	VESSEL	MONTH	VOLUME (M ³)	SBLIC TOTAL FOB (AUD)	NIA TOTAL FOB (AUD)	NIA MARKUP	SBLIC PRICE AUD PER M ³	NIA PRICE AUD PER M ³	NIA MARKUP
1986									
1	CAPT COOK	JAN	381.0325	\$119,744.06	\$120,010.71	\$266.83	\$314.014	\$314.714	\$0.70
2	CAPT COOK	MAR	307.4364	102,311.04	102,608.95	297.31	\$332.737	333.756	0.97
3	CAPT COOK	MAY	238.9353	81,742.90	82,516.65	773.75	\$342.113	345.051	3.24
4	CAPT KERMADIC	JUNE	50.3458	12,031.32	11,946.48	85.34 - LOSS	244.67	237.28	1.69
5	CAPT COOK	JULY	429.8775	133,822.91	135,950.33	2127.42	311.30	316.15	4.95
6	CAPT COOK	SEPT	*359.1348	118,376.46	119,466.60	1090.14	329.62	332.65	3.03
7	CAPT KEMADIL	OCT	56.3873	13,380.08	14,733.35	1353.27	237.99	261.29	24.00
8	CAPT COOK	NOV	634.0384	205,420.47	207,489.01	2068.54	323.99	327.25	3.26
1986 SUMMARY									
		////	2457.488	786,829.76	794,722.08	AV/TOTAL 7892.32	AV/TOTAL 320.176	AV/TOTAL 323.388	3.21
1987									
9	CAPT COOK	JAN	408.706	K 108,784.60	K 110,025.03	K 1240.43	K 266.17	K 269.20	3.025
10	CAPT COOK	MAR	309.7185	79,177.80	80,026.46	848.66	255.64	258.38	2.74
11	CAPT COOK	JUNE	79.5363	17,259.08	17,355.85	96.77	216.99	218.21	1.22
12	CAPT LAPEROUSE	JULY	48.5214	12,070.99	12,122.47	51.48	248.78	249.84	1.06
13	CAPT LAPEROUSE	AUG	132.1077	29,816.56	30,188.04	371.48	225.70	228.51	2.81
14	CAPT LAPEROUSE	OCT	38.1399	11,041.50	11,106.23	64.73	289.50	291.20	1.70
15	CAPT LAPEROUSE	OCT	203.5913	57,157.55	57,584.22	426.67	280.746	282.641	2.095
1987 SUMMARY									
		////	1220.3217	315,308.08	318,408.30	3100.22	AV/TOTAL 258.38	AV/TOTAL 260.324	2.54

NOTES

1. Infact a further parcel of 28.4682 m² was shipped at a price to SBLIC of \$11,281.59. The parcel is excluded as there is no end invoice from NIA to the customer
2. The NOTIFY PARTIES are always:- J.SCOTT & CO of AUCKLAND or C.AICKENS & SONS LTD of AUCKLAND (the latter through TEMARU PTY LTD of SYDNEY). The one exception is one invoice for 23.5m² for BRIGHT BUILDING SUPPLIES of Paramata NZ
3. The 6% commission to NIA would have amounted to K47,109.78 in 1986 and K18,918.48 in 1987

SCHEDULE 3C

SBLC SAWN TIMBER TO AUSTRALIA 1986 - 37

(ALL MONEY FIGURES ARE AUD UNLESS SHOWN)

SCHEDULE 10A

STETTIN BAY LUMBER COMPANY PTY LTD.

Marketing Table 1984

Shipment Number	Vessel	Month	Number of logs	Volume in 3	F.O.B. Sales Price: US \$	Freight Rate	Name & country of purchaser	Notify Party	W.E.P. price U.S. \$	M.E.P. comparison	% to be	Royalties (estimate)
1	Bogo	Jan	1520	4697.736	240424.24		Nissho Iwai Corp'n Japan	240424.24	0.00	0.00	19591.18	
2	Basilieu	Jan	2771	679.776	23719.87		Nissho Iwai Corp'n Japan	23719.87	0.00	0.00	21747.12	
3	Morera	Jan	2700	642.776	23524.63		Nissho Iwai Corp'n Japan	23524.63	0.00	0.00	21773.10	
4	PNG Trader	Jan	1714	77.5.117	26420.92		Nissho Iwai Corp'n Japan	26420.92	0.00	0.00	21791.17	
5	Pacific Nyatoh	Feb	1604	3,913.546	29657.97		Nissho Iwai Corp'n Japan	29657.97	14121.77	5.00	21773.08	
6	San Miguel	Feb	1332	4416.820	235024.25		Nissho Iwai Corp'n Japan	235024.25	11191.63	5.00	17663.29	
7	Lae	Mar	1603	596.752	264239.83		Nissho Iwai Corp'n Japan	264239.83	7066.21	3.00	23587.01	
8	T.P. Trader	Mar	2462	8999.701	43270.06		Nissho Iwai Corp'n Japan	43270.06	29673.53	5.00	33338.00	
9	Tropical Moon	Mar	1520	4795.651	255222.29		Nissho Iwai Corp'n Japan	255222.29	0.00	0.00	19142.60	
10	Sankou Maru	Mar	1456	5199.226	254550.29		Nissho Iwai Corp'n Japan	254550.29	12121.44	5.00	20796.91	
11	Ever Venture	Mar	1711	7454.980	296657.73		Nissho Iwai Corp'n Japan	296657.73	0.00	0.00	23419.92	
12	Lae	Apr	1367	5879.211	305901.84		Nissho Iwai Corp'n Japan	305901.84	0.00	0.00	23596.84	
13	Pacific Nyatoh	Apr	1442	5719.779	297844.90		Nissho Iwai Corp'n Japan	297844.90	0.00	0.00	23399.20	
14	San Miguel	Apr	1337	4416.105	259969.24		Nissho Iwai Corp'n Japan	259969.24	226060.21	33909.93	15.00	17664.42
15	Macarena	May	1847	6432.001	363189.16		Nissho Iwai Corp'n Japan	363189.16	315816.66	47372.50	15.00	25808.00
16	Lae	May	1744	5896.677	320624.35		Nissho Iwai Corp'n Japan	320624.35	0.00	0.00	23586.71	
17	Pacific Nyatoh	May	1828	5999.000	367909.53		Nissho Iwai Corp'n Japan	367909.53	341773.65	26133.58	7.65	23996.00
18	Varde	Jun	1474	4915.005	282434.93		Nissho Iwai Corp'n Japan	282434.93	245197.12	17237.41	6.50	19656.02
19	Bogo	Jun	2166	7540.948	456011.06		Nissho Iwai Corp'n Japan	456011.06	419899.69	36111.37	4.00	30163.70
20	Salona	Jun	139	1028.134	63116.40		Nissho Iwai Corp'n Japan	63116.40	7664.77	5051.43	6.75	4112.54
21	Yasmat	Jun	2026	6317.960	398129.59		Nissho Iwai Corp'n Japan	398129.59	360380.31	27749.29	7.70	25271.84
22	Lae	Jun	1560	5699.416	350996.82		Nissho Iwai Corp'n Japan	350996.82	322607.37	28389.45	8.80	23597.66
23	Great Honor	Jly	1893	6500.000	404904.17		Nissho Iwai Corp'n Japan	404904.17	376655.04	28249.13	7.50	26000.00
24	Pacific Nyatoh	Jly	1846	5999.994	367739.57		Nissho Iwai Corp'n Japan	367739.57	359165.50	28374.07	7.00	23999.98
25	Tenwa	Jly	751	2789.454	184238.00		Nissho Iwai Corp'n Japan	184238.00	167489.09	16748.91	10.00	11157.82
26	Port Moresby	Aug	1306	6000.000	335074.45		Nissho Iwai Corp'n Japan	335074.45	332745.23	2329.22	0.70	24000.00
27	Yasmat	Aug	1452	6491.957	364429.15		Nissho Iwai Corp'n Japan	364429.15	362255.62	2173.53	0.60	25967.83
28	PNG Trader	Aug	1657	5548.346	305907.15		Nissho Iwai Corp'n Japan	305907.15	304082.65	1824.50	0.60	22033.38
29	Eastern Freedom	Aug	1479	7847.873	328428.10		Nissho Iwai Corp'n Japan	328428.10	326469.28	1558.82	0.60	23391.49
30	Pacific Nyatoh	Sep	1603	5997.901	344203.28		Nissho Iwai Corp'n Japan	344203.28	342150.98	2052.90	0.60	23991.20
31	Lae	Sep	1459	5897.873	330955.12		Nissho Iwai Corp'n Japan	330955.12	328981.23	1973.89	0.60	23591.49
32	Negros	Oct	1646	6993.335	396862.06		Nissho Iwai Corp'n Japan	396862.06	394495.07	2366.97	0.60	27973.34
33	Port Moresby	Oct	1640	5998.313	334658.51		Nissho Iwai Corp'n Japan	334658.51	332662.53	1995.98	0.60	23993.25
34	Pacific Nyatoh	Nov	2048	5849.254	324310.36		Nissho Iwai Corp'n Japan	324310.36	322696.88	1613.48	0.50	23397.02
35	T.P. Trader	Nov	2662	9041.619	525549.44		Nissho Iwai Corp'n Japan	525549.44	525549.44	0.00	0.00	36166.48
36	S. Breeze	Nov	2272	10402.544	586834.05		Nissho Iwai Corp'n Japan	586834.05	586834.05	0.00	0.00	41930.18
37	Lae	Dec	1949	5999.860	334939.52		Nissho Iwai Corp'n Japan	334939.52	334939.52	0.00	0.00	23999.44
38	Clydebank	Dec	4	37.194	5313.42		Nissho Iwai Corp'n Japan	5313.42	2831.56	2481.86	87.65	148.78
39	Tenwa Maru	Dec	2142	5976.160	351130.43		Nissho Iwai Corp'n Japan	351130.43	351130.43	0.00	0.00	23904.64
40	Pakarti Tiga	Dec	2146	8199.704	465630.87		Nissho Iwai Corp'n Japan	465630.87	465630.87	0.00	0.00	32798.82
41	Pacific Nyatoh	Dec	893	5985.773	345191.95		Nissho Iwai Corp'n Japan	345191.95	345191.95	0.00	0.00	23943.39

TOTALS:

68127

243729

13391276

13009364

381912

29 974917.83

Royalty Payments	Bilbao	Bilbao	Sundry	Total	Cumulative Total
January	61159.47	48037.20		109196.67	109196.67
February	49334.47	34088.22		83422.69	192618.36
March	55046.53	42864.61		97911.14	290529.5
April	59023.24	29566.19		88592.43	379118.93
May	74873.60	35341.36		90214.36	469333.89
June	47709.30	41281.01		88990.31	556265.66
July	71131.32			73113.32	632417.98
August	74426.25	10621.64		84747.89	717165.24
September	70137.32	40760.87		110898.19	784043.42
October	70137.32	29167.44		99304.76	902548.18
November	101194.77			103194.77	1007735.25
December	75401.31	9720.96		85121.67	1103756.25

Note: Clydebank shipment was sold in Aust. \$ 7494.89 converted at US\$1 = AUS\$1.4

- * The figures do not cross check due to errors in Nissho Invoice SV 4363. In this case Nissho Iwai Australia added clearance and delivery charges into its prices ranging from \$7.30 to \$8.06 per 100 superfeet.
- ** Nissho Iwai Invoices on four parts of the shipment aggregating 87.3976 cu do not break up the CIF price. Calculations are based on the volume for which full details are available. Clearance and delivery charges are again applied in the same range.
- *** Nissho Iwai invoices do not split the CIF price. Freight is known and for calculations insurance is assumed at \$2,000.00.
- **** Calculations are only possible on part of the shipment for one buyer where the prices are in Lina and the CIF price is split.

SCHEDULE 10B

1984

MEP % AND UNIT PRICE

SHIP NO	EX PNG CP NEP	UNIT (PNG)	SHIP NO	EX PNG CP NEP	UNIT (PNG)
1	0	49.09	21	7.7%+	61.43
2	0	44.99	22	8.8%+	59.50
3	0	46.53	23	7.5%+	62.29
4	0	47.23	24	7.9%+	64.59
5	5%+	49.48	25	10.0%+	66.05
6	5%+	52.62	26	0.7%+	55.85
7	3%+	44.81	27	0.6%+	56.14
8	5%+	48.25	28	0.6%+	55.54
9	0	53.22	29	0.6%+	56.16
10	5%+	48.36	30	0.6%+	57.39
11	0	50.70	31	0.6%+	56.11
12	0	51.84	32	0.6%+	56.75
13	0	49.64	33	0.6%+	55.79
14	15%+	58.37	34	0.5%+	53.44
15	15%+	56.29	35	0	58.13
16	0	54.37	36	0	55.98
17	7.65%+	61.33	37	0	55.82
18	6.5%+	57.48	38	87.65%+	142.86
19	8.6%+	60.47	39	0	58.76
20	8.7%+	61.38	40	0	56.79
			41	0	57.67

* Shipment was of only four logs

Over the year the margin above MEP prices averaged 2.94%

The unit price averaged USD 54.94 per m³

Periods 1-13 44.98 to 53.22 14-25 54.37-66.05 26-41 55.44-58.76

STETTIN BAY LUMBER COMPANY PTY LTD.

Marketing Table 1985

Shipment Number	Vessel	Month	Number of logs	Volume in m ³	F.O.B. sales Price in US \$	Freight Rate	Name & Country of purchaser	Maturity Party	M.E.P. in U.S. \$	M.E.P. comparison	Sign	Royalties
1	Negros	Jan	2070	7047.614	407158.05		Nissho Iwai Corp Japan	407158.05	0.00	0.00	-616.46	
2	Tenwa Maru	Jan	1650	3544.003	330724.72		Nissho Iwai Corp Japan	330724.72	0.00	0.00	23970.95	
3	Vanguard - A	Feb	2530	8369.806	389325.15		Nissho Iwai Corp Japan	389325.15	0.00	0.00	13479.12	
4	Lae	Mar	1680	5955.613	345777.82		Nissho Iwai Corp Japan	345777.82	0.00	0.00	23822.46	
5	Big Shine	Feb	1930	6414.235	369929.42		Nissho Iwai Corp Japan	369929.42	0.00	0.00	23856.94	
6	Negros	Mar	2451	7038.757	402510.31		Nissho Iwai Corp Japan	402510.31	0.00	0.00	28155.03	
7	Pacific Nyatoh	Mar	1610	5946.078	334924.57		Nissho Iwai Corp Japan	334924.57	-16517.79	-4.70	23784.31	
8	Big Shine	Apr	2011	6780.916	366359.26		Nissho Iwai Corp Japan	366359.26	0.00	0.00	27123.66	
9	Lae	Apr	1856	5999.404	325779.41		Nissho Iwai Corp Japan	394149.74	-27590.48	-7.00	27123.66	
10	Varde	May	1209	3406.035	180980.33		Nissho Iwai Corp Japan	346800.22	-23020.81	-6.00	23997.62	
11	Pacific Nyatoh	May	2011	5835.726	284944.75		Nissho Iwai Corp Japan	180980.33	0.00	0.00	13624.14	
12	Lae	Jun	1650	5949.477	306397.40		Nissho Iwai Corp Japan	284944.75	0.00	0.00	23342.90	
13	Pacific Nyatoh	Jun	1562	5580.201	272990.47		Nissho Iwai Corp Japan	306397.40	0.00	0.00	13998.71	
14	Vortex Breeze	Jul	2733	10015.003	508368.33		Nissho Iwai Corp Japan	272990.47	0.00	0.00	22320.80	
15	Great Honor	Jul	1409	2481.675	100306.26		Nissho Iwai Corp Japan	557482.07	-49113.74	-8.01	40060.23	
16	Tenwa Maru	Jul	1720	5994.255	255015.55		Nissho Iwai Corp Japan	111441.98	-11135.72	-9.00	19261.70	
17	Inna	Jul	1296	4632.745	213950.67		Nissho Iwai Corp Japan	283335.74	-28320.19	-10.00	13977.02	
18	Vortex Breeze	Aug	1623	5039.761	179212.41		Nissho Iwai Corp Japan	239312.63	-23620.76	-9.06	18770.58	
19	Lae	Aug	1469	5894.117	258817.68		Nissho Iwai Corp Japan	179212.41	0.00	0.00	20239.04	
20	PNG Trader	Sep	1533	3297.478	246620.86		Nissho Iwai Corp Japan	258817.68	0.00	0.00	23576.47	
21	Tenwa Maru	Sep	1598	5999.939	259107.02		Nissho Iwai Corp Japan	246620.86	0.00	0.00	21189.91	
22	Vortex Breeze	Oct	3980	9915.928	443348.70		Nissho Iwai Corp Japan	259107.02	0.00	0.00	23999.76	
23	Pacific Nyatoh	Oct	1963	5437.300	209859.91		Nissho Iwai Corp Japan	443348.70	0.00	0.00	39663.71	
24	Lae	Oct	1611	5996.816	253892.64		Nissho Iwai Corp Japan	209859.91	0.00	0.00	21749.20	
25	Yoyo Maru	Oct	1862	5755.996	221864.75		Nissho Iwai Corp Japan	253892.64	0.00	0.00	23987.26	
26	Vortex Mariner	Nov	3034	9999.771	438134.87		Nissho Iwai Corp Japan	221864.75	0.00	0.00	23023.98	
27	Varde	Nov	1534	5309.531	250905.20		Nissho Iwai Corp Japan	438134.87	0.00	0.00	39999.08	
28	Tenwa Maru	Dec	1556	5999.993	254271.38		Nissho Iwai Corp Japan	250905.20	0.00	0.00	21238.20	
29	PNG Trader	Dec	2184	5652.106	250355.79		Nissho Iwai Corp Japan	254271.38	0.00	0.00	23999.97	
30	Sun Coral	Dec	1570	4696.242	203424.75		Nissho Iwai Corp Japan	250355.79	0.00	0.00	22608.42	
TOTALS:			56962	184366.762	8986804.43				9166129.92	-179325.49	-1.96	738267.05

Royalty Payments	Buluma	Bilomi	Sundry	Total	Cumulative Total
January	49133.73	23203.24	6238.40	78575.37	78575.37
February	41938.36	26375.61		68513.97	147089.34
March	52938.61	21554.06		74492.67	221582.01
April	41491.68	22014.06	5144.39	69450.93	291032.94
May	47670.28	34250.80		81929.00	372962.02
June	44199.04	25017.57		69216.61	442178.63
July	39968.18	26619.16		66507.34	508765.97
August	58388.35	24300.72	5314.82	88693.89	597459.86
September	31735.51	23303.79	1355.35	76394.65	673854.51
October	37432.71	42349.02	9415.42	109217.15	783071.66
November	63770.70	36107.44		29878.14	882949.80
December	55604.43	25064.09	5639.46	106308.07	969257.80

SCHEDULE 11B

STETTIN BAY LUMBER CO PTY LTD

MARKETING TABLE 1985

PH'L W.	VESSEL	MONTH	NUMBER OF LOGS	VOLUME M3	MEP PRICE US \$	FOB SALES PRICE US \$	CAF SALES PRICE US \$	FREIGHT US \$	INTEREST US \$	SURPLUS OVER FOB PRICE US \$	SURPLUS % OVER FOB	SURPLUS % OVER MEP	BUYERS
2	NEGROS	JAN	2076	7046.614	409158.65	409158.65	589083.24	151502.20	28422.39	-			Nissho Iwai Tokyo
1	TENWA MARU	JAN	1690	5994.963	339924.92	339924.92	494584.45	112705.30		41954.23	12.3	12.3	Hyosung (HK) Ltd Hong Kong
4	VANGUARD B	FEB	2533	8369.806	489325.15	489325.15	697917.98	175760.19	32832.64	-			Nissho Iwai Tokyo
4	LAE	MAR	1680	5955.614	345777.82	345777.82	491338.16	114943.35		30616.99	8.8	8.8	Chungoo Lumber Co Ltd Seoul
6	BIG SHINE	FEB	1933	6414.235	369929.42	369929.42	522760.15	123153.31		29677.42	8.0	8.0	Oriental Chemical Industry Seoul
7	NEGROS	MAR	2451	7038.757	402510.31	402510.31	572905.04	151333.28	19611.45	-			Nissho Iwai Tokyo
3	PACIFIC NYATOH	MAR	1619	5946.078	351442.36	334924.57	484605.36	116543.13		33137.66	9.9	6.7	Hyosung (HK) Ltd Hong Kong
9	BIG SHINE	APL	2011	6780.916	394149.74	366559.26	528911.45	133584.05		28768.14	7.8	0.3	Hyosung (HK) Ltd Hong Kong
0	LAE	APL	1856	5999.404	348800.22	325779.41	449955.30	119988.08		4167.81	1.2		Bando Lumber Co Ltd Pusan
11	VARDE	MAY	1209	3406.035	180980.33	180980.33	289820.94	97753.20	11087.41	-			Nissho Iwai Tokyo
12	PACIFIC NYATOH	MAY	2011	5835.726	284944.75	284944.75	420172.27	118465.24		16762.28	5.8	5.8	Hour Chun Cheng Wood Industry Taiwan
13	LAE	JUN	1650	5999.677	306397.40	306397.40	425977.07	125993.22		- 6413.55			Oriental Chemical
13	PACIFIC NYATOH	JUN	1562	5580.201	272990.47	272990.47	401774.47	122764.42		6019.58	2.2	2.2	Hyosung Corp Seoul
14	VUTEX BREEZE	JUL	2733	10015.063	557482.07	508368.33	779601.79	221332.89	7573.39	42317.18			Hanyang Maruni Mokko & Nissho Iwai
15	GREAT HONOR	JUL	1409	2481.675	111411.98	100306.26	166337.28	59063.86	6967.16	-			Nissho Iwai
16	TENWA MARU	JUL	1726	5994.255	283335.74	255015.55	419597.85	130075.33		34506.97	13.5	2.2	Taesung Lumber Inchon
17	INNA	JUL	1296	4692.745	239522.63	215895.87	350075.15	117318.63	16860.65	-			Nissho Iwai Tokyo
18	VUTEX BREEZE	AUG	1623	5059.761	179212.41	179212.41	315846.81	123964.14	12670.25	-			Nissho Iwai Tokyo
19	LAE	AUG	1469	5894.117	256617.68	256617.68	400799.96	127902.34		16279.94	6.3	6.3	Oriental Chemical
20	PNG TRADER	SEP	1533	5297.478	246820.86	246820.86	391769.97	128722.49	16226.61	-			Nissho Iwai
21	TENWA MARU	SEP	1598	5999.939	259107.02	259107.02	392996.00	130198.68		3690.30	1.4	1.4	Oriental Chemical
22	VUTEX BREEZE	OCT	3980	9915.928	443348.70	443348.70	676709.55	231041.12	13233.22	- 10913.49			Nissho Iwai & Hanyang
23	PACIFIC NYATOH	OCT	1963	5437.300	209859.91	209859.91	358861.80	119620.60		29381.29	14.0	14.0	Hour Chuan Chen Taiwan
24	LAE	OCT	1611	5996.816	253892.64	253892.64	371802.59	122934.73		- 5042.78			Oreitani Chemical
25	YUYU MARU	OCT	1862	5755.996	221864.75	221864.75	379895.74	123753.91		34277.08	15.4	15.4	Taesung Lumber Inchon
26	VUTEX MARINER	NOV	3036	9999.771	438134.87	438134.87	599019.35	204995.31		- 44110.83			Oriental Chemical
27	VARDE	NOV	1534	5309.551	250905.20	250905.20	418522.24	116810.12	10781.83	40055.09			Nissho Iwai, Maruni Mokko
28	TENWA MARU	DEC	1556	5999.993	254271.38	254271.38	365999.57	113999.87		- 2271.68			Oriental Chemical
29	PNG TRADER	DEC	2184	5652.106	258355.79	258355.79	394466.18	116998.59	19111.80	-			Nissho Iwai Tokyo
30	SUN CORAL	DEC	1570	4696.242	203424.75	203424.75	320790.03	76313.93	13618.09	27346.26			Nissho Iwai Tokyo
			56962	184566.762	9166129.92	8986804.43	13472900.74	3930335.51	202369.89	350205.89			

SCHEDULE 11C
1985 PURCHASES BY NIHK FROM SBLC
RESALES BY NIHK

SHIP NO	EX PNG CF MEP	END FOB CF MEP	EX PNG UNIT PRICE	END UNIT PRICE	FREIGHT
1	0	0	58.06	58.06	21.50+
2	0	12.3	56.70	63.70	18.80
3	0	0	58.46	58.46	21.00+
4	0	8.8	58.06	63.20	19.30
5	0	8.0	57.67	62.30	19.20
6	0	)	57.18	57.18	21.50+
7	*4.70	4.7	56.33	61.90	19.50
8	*7.0	0.3	54.06	58.30	19.70
9	*6.5	*5.4	54.30	55.00	20.00
10	0	0	53.14	53.14	<u>23.70+</u>
11	0	5.3	48.83	51.70	20.30
12	0	*2.1	51.07	50.00	21.00
13	0	2.2	48.92	50.00	22.00
14	*8.81	) 7.6)	50.76	53.22	22.10++
		)		50.40	HANYANG
		)		72.90	NM
15	*9.99	*9.99	40.42	40.42	23.80+
16	*10.0	2.2	42.54	48.30	21.70
17	*9.86	*9.86	46.01	46.01	25.00+
18	0	0	35.42	35.42	24.50+
19	0	6.3	43.91	46.30	21.70
20	0	0	46.59	46.59	24.30+
21	0	1.4	43.18	43.80	21.70
22	0)	* 2.5)	44.71	43.57	23.30++
	)	)		43.70	HANYANG
23	0	14.0	38.59	44.00	22.00
24	0	* 1.9	42.34	41.50	20.50
25	0	15.4	38.54	44.50	21.50
26	0	*10.1	43.81	39.40	20.50
27	0)	15.9)	47.26	44.09	22.00++
	)	)		73.00	NM
28	0	* 0.9	42.38	42.00	19.00
29	0	0	45.71	45.71	20.70
30	0	13.4	43.32	49.14	16.25+

NOTES: -

- * The margin shown is a percentage below MEP prices
- + This shipment was made to NIC Japan and it seems the MEP margins and buyer prices are falsely low.
- ++ This shipment was made in part to another buyer and in part to NIC. The MEP margins and buyer prices are, it seems, falsely low.

SCHEDULE 11 0

1985

NIHK JAPAN SHIPMENT SALES

A. TO MISSHO IWAI

SHIP NO	VOL	PRICE DIFF	UNIT PRICE DIFF
1	7046.614	NIL	NIL
3	8369.306	NIL	NIL
6	7038.757	NIL	NIL
10	3406.035	NIL	NIL
14	2265.989	5569.07 PROFIT	2.46 PROFIT
15	2481.675	NIL	NIL
17	4692.745	NIL	NIL
18	5059.761	NIL	NIL
20	5297.478	NIL	NIL
22	6455.785	7418.75 LOSS	1.14 LOSS
27	3342.247	10583.32 LOSS	3.17 LOSS
29	5652.106	NIL	NIL
30	4636.242	27,346.26 PROFIT	5.82 PROFIT
	<u>65805.240</u>	<u>14,913.26</u>	<u>AV 0.23 PROFIT</u>

B. TO MARUMI NOKKO

SHIP NO	VOL	PRICE INC	UNIT PRICE INC
14	1757.400	38,308.34	22.14
27	1967.304	50,638.40	25.74
	<u>3724.704</u>	<u>89,547.24</u>	<u>AV 24.04</u>

(UNIT: KINA 1,000)

DETAILS OF COST

CD-3

STETTEN BAY LUMBER CO. PTY. LTD.

A/C TITLE	1987	1987	DIFFERENCES	1968	
	BUDGET	ACTIVITIES		BUDGET	
Royalties					
F.I.C. Levy					
Vages	305	301		437	
Repair & Maintenance	200	197		200	
Electricity					
Fuel & Oil	35	22		30	
Bundling					
Chemicals					
Rations	15	15		20	
Road Cost	133	97		100	
General Expenses	80	60		60	
Contract Logging					
Canteen					
Joinery Shop					
Buy-in- S/TBR					
N.P.F.	6	6		6	
Bridge Materials					
Other Expenses					
SUB TOTAL (A)	774	698		853	
Salaries	111	96		100	
Deferred Pay	5	5		5	
T/Assist. Fee (NIC/TX)					
T/Assist. Fee (NISSAN)					
Techn. Assist Fee (ITOH)					
Interest (Loan)	71	198	(+127)	200	changed allocation
Interest (O/O)	30	27		27	
Insurance	6	10		10	
Depreciation	100	89		110	
LEASE FEE	22	22		22	
SUB TOTAL (B)	345	448		474	
ADMIN (C)	400	487		480	
TOTAL (A) & (B)+(C)	1,519				

SCHEDULE 12A

MILLION U.S. DOLLARS (1,000,000 U.S. DOLLARS)

January-June 1986

Report Number Number	Master Number	Month	Report Date	Billings (\$)	Billings (\$)	Billings (\$)	Billings (\$)	Number of countries in which billings were made	Entity Name	Net Royalties (\$)	R.E.P. (\$)	Net Royalties (\$)	Royalties (\$)
1	Kenzo Maru	Mar	1986-01-01	14745.74	14745.74	14745.74	14745.74	1	Nissho Iwai Corp'n Japan	117701.44	0.00	0.000	30641.75
2	FNG Trader	Mar	1986-01-01	16121.74	16121.74	16121.74	16121.74	1	Nissho Iwai Corp'n Japan	133461.45	0.00	0.000	22792.32
3	Pacific System	Mar	1986-01-01	14113.700	261111.40	261111.40	261111.40	1	Nissho Iwai Corp'n Japan	261111.40	0.00	0.000	23990.80
4	Lee	Mar	1986-01-01	20991.681	277320.60	277320.60	277320.60	1	Nissho Iwai Corp'n Japan	277320.60	0.00	0.000	23984.32
5	Transocean	Mar	1986-01-01	12571.120	209479.20	209479.20	209479.20	1	Nissho Iwai Corp'n Japan	209479.20	0.00	0.000	20984.48
6	Del Remedios	Mar	1986-01-01	15000.000	11731.434	11731.434	11731.434	1	Nissho Iwai Corp'n Japan	11731.434	0.00	0.000	20697.74
7	Sanku Maru	Mar	1986-01-01	1762.000	299502.85	299502.85	299502.85	1	Nissho Iwai Corp'n Japan	299502.85	0.00	0.000	23999.91
8	FNG Trader	Mar	1986-01-01	3620.503	323160.43	323160.43	323160.43	1	Nissho Iwai Corp'n Japan	323160.43	0.00	0.000	22602.26
9	Pacific System	Mar	1986-01-01	1725.000	30991.408	304454.52	304454.52	1	Nissho Iwai Corp'n Japan	304454.52	0.00	0.000	23997.99
10	Lee	Mar	1986-01-01	5999.420	310807.10	310807.10	310807.10	1	Nissho Iwai Corp'n Japan	310807.10	0.00	0.000	23997.72
11	Vortex Mariner	Apr	1986-01-01	10461.077	462178.00	462178.00	462178.00	1	Nissho Iwai Corp'n Japan	462178.00	0.00	0.000	39947.30
12	Lee	Apr	1986-01-01	1310.000	219791.00	219791.00	219791.00	1	Nissho Iwai Corp'n Japan	219791.00	0.00	0.000	21214.76
13	Pacific System	May	1986-01-01	19917.243	242657.01	242657.01	242657.01	1	Nissho Iwai Corp'n Japan	242657.01	0.00	0.000	33998.97
14	Marky Ten	May	1986-01-01	5874.413	209455.04	209455.04	209455.04	1	Nissho Iwai Corp'n Japan	209455.04	0.00	0.000	23411.65
15	Ocean Rainbow	May	1986-01-01	1747.000	26001671	271214.34	271214.34	1	Nissho Iwai Corp'n Japan	271214.34	0.00	0.000	23562.40
16	Sea Bagoes	May	1986-01-01	6201.042	301401.51	301401.51	301401.51	1	Nissho Iwai Corp'n Japan	301401.51	0.00	0.000	23597.53
17	Lee	May	1986-01-01	1724.000	10991629	10991629	10991629	1	Nissho Iwai Corp'n Japan	10991629	0.00	0.000	23904.52
18	Transocean	May	1986-01-01	1239.000	247710.09	247710.09	247710.09	1	Nissho Iwai Corp'n Japan	247710.09	0.00	0.000	19904.20
19	Sally	May	1986-01-01	1994.000	501447.01	501447.01	501447.01	1	Nissho Iwai Corp'n Japan	499394.10	1053.00	0.411	33797.00
20	Marky Ten	May	1986-01-01	6226.144	320630.21	318740.70	318740.70	1	Nissho Iwai Corp'n Japan	318740.70	1889.42	0.593	25144.58
21	Ocean Rainbow	May	1986-01-01	1340.000	25894.537	111430.64	111430.64	1	Nissho Iwai Corp'n Japan	111430.64	0.00	0.000	10354.15
22	Lee	May	1986-01-01	127.000	3464.756	179437.64	179437.64	1	Nissho Iwai Corp'n Japan	178401.52	1056.12	0.532	13939.02
23	Siti Helmi	Aug	1986-01-01	9216.813	107378.19	107378.19	107378.19	1	Nissho Iwai Corp'n Japan	306005.29	1572.99	0.514	34864.05
24	Yaman	Aug	1986-01-01	4584.000	14498.074	692912.55	692912.55	1	Nissho Iwai Corp'n Japan	689151.59	3760.96	0.540	57995.90
25	Santos	Aug	1986-01-01	311.000	1496.320	64401.23	64401.23	1	Nissho Iwai Corp'n Japan	63957.31	443.02	0.673	5985.28
26	Ferry	Aug	1986-01-01	1261.000	3500.408	237572.84	237572.84	1	Nissho Iwai Corp'n Japan	236210.91	1361.93	0.577	18001.63
27	Eastern Grace	Sep	1986-01-01	4306.000	14480.283	646706.95	646706.95	1	Nissho Iwai Corp'n Japan	643110.44	3596.51	0.359	33921.13
28	Marky Ten	Sep	1986-01-01	2394.000	6082.417	334405.19	334405.19	1	Nissho Iwai Corp'n Japan	324685.34	9719.85	2.994	24329.67
29	Siti Madai	Sep	1986-01-01	646.000	2595.097	133599.51	133599.51	1	FIC Port Moresby	153599.51	1.00	0.000	10380.39
30	Superior Island	Oct	1986-01-01	4481.000	13430.218	673012.50	673012.50	1	Nissho Iwai Corp'n Japan	671297.93	1714.47	0.553	53720.87
31	Maritime Maritime	Nov	1986-01-01	1657.000	30020.71	363089.45	363089.45	1	F.I.C. Port Moresby	294273.95	68613.50	23.384	23202.68
32	Yaman	Nov	1986-01-01	4640.000	14542.391	720306.94	720306.94	1	Nissho Iwai Corp'n Japan	728306.94	0.00	0.000	58169.56
33	Marky Ten	Nov	1986-01-01	1733.000	3545.638	269468.34	269468.34	1	Nissho Iwai Corp'n Japan	272849.16	16619.18	6.091	22182.55
34	Tenwa Maru	Nov	1986-01-01	2840.000	5682.250	297628.60	297628.60	1	Nissho Iwai Corp'n Japan	279979.91	17648.89	6.304	23520.92
35	Kenzan Maru	Dec	1986-01-01	2115.000	8212.660	474533.55	474533.55	1	Nissho Iwai Corp'n Japan	42669.72	47663.83	11.166	32850.64

TOTALS:

76464 241522.381 12000095.17

11820180.11 179915.00 1.522 966089.52

Royalty Payments

	Volume	Billions	Sundry	Total	Cumulative Total
January	55121.58	30086.00		85207.58	85207.58
February	60187.78	32054.10		92241.68	177449.46
March	64253.31	31681.42		95934.73	273384.19
April	10550.02	25990.17		15410.19	358794.38
May	70141.68	25753.76		95895.44	454689.82
June	61874.80	30084.72		91959.52	546649.34
July	64226.19	40270.44		104496.63	651145.97
August	74021.56	43046.28		117968.84	769114.81
September	63853.35	35758.83		99618.18	866732.99
October	64278.66	41657.10		105933.85	974668.84
November	68318.77	36602.98		105121.75	107070.59
December	64199.66	25559.86		90159.72	1169950.31

Equipment No.	Vessel	Month	Number of Logs	Volume	MPZ Price US\$	FOB Sales Price US\$	C & F Sales Price US\$	Freight US\$	Interest US\$	Surplus Over FOB Price	Surplus % Over FOB	Surplus % Over MPZ	Buyers
1	Pacific Swan	Jan	4167	14710.438	621770.44	621770.44	929460.14	223895.96		83801.74	13.4	13.4	Oriental Chemical Industry Seoul
2	PGC Trader	Jan	1630	5698.204	253426.45	253426.45	387477.87	102567.67		31483.75	12.4	12.4	" " "
3	Pacific Nyatch	Jan	1810	5997.700	261113.40	261113.40	449827.49	104959.75		83754.34	32.0	32.0	Hanyang Plywood Inchon
4	Lae	Jan	1952	5996.081	275329.63	275329.63	440711.95	104931.42		60450.90	21.9	21.9	Oriental Chemical
5	Industrious	Feb	2201	5247.120	289478.23	289478.23	429668.36	99695.28	19789.19	20705.66			Nissho Iwai Corp Tokyo
6	Del Remedios	Feb	1508	5174.434	242798.73	242798.73	393526.98	91846.20		58612.05	24.1	24.1	Taesung Lumber Co Inchon
7	Sasko Maro	Feb	1762	5999.978	299505.85	299505.85	458998.32	103499.62		55992.85	18.6	18.6	Oriental Chemical
8	PNG Trader	Mar	1825	5650.565	323160.45	323160.45	487593.29	108773.38	15330.87	40328.59			Maruni Makko Co Ltd & Nissho Iwai
9	Pacific Nyatch	Mar	1725	5999.498	304454.52	304454.52	443962.85	103491.34		36016.99	11.8	11.8	Oriental Chemical
10	Lae	Mar	1990	5999.429	310807.10	310807.10	440958.03	103490.15		26660.78	8.5	8.5	Hanyang Plywood
11	Vortex Mariner	Apr	3443	9986.976	462178.09	462178.09	646675.78	182262.31		2235.38	0.4	0.4	Taesung Lumber, Hanyang Plywood & Oriental Chemical
12	Lae	Apr	1596	5303.690	239793.06	239793.06	371258.30	100770.11		30695.13	12.8	12.8	Taesung Lumber
13	Pacific Nyatch	May	1710	5999.743	302657.91	302657.91	425901.75	107995.37		15000.54	4.9	4.9	Oriental Chemical
14	Marky Ten	May	2472	5854.913	308885.84	308885.84	446516.90	120025.72	18171.38	- 566.04			Nissho Iwai Tokyo
15	Ocean Rainbow	May	1747	5890.871	279224.34	279224.34	412360.97	110748.37		22338.26	8.0	8.0	Taesung Lumber
16	Sea Highway	May	1746	6399.382	309461.51	309461.51	479953.65	116788.72		53783.42	17.3	17.3	Oriental Chemical
17	Lae	Jun	1724	5999.629	290915.32	290915.32	443972.55	115192.88		37864.35	13.0	13.0	Taesung Lumber
18	Pacific Nyatch	Jly	1386	4976.073	245503.69	245503.69	380669.58	102755.91		32409.98	13.2	13.2	Oriental Chemical
19	Salix	Jly	3316	9994.900	499394.10	501477.69	673213.78	181907.18		-10171.09			Maruni Makko Co Ltd & Nissho Iwai
20	Marky Ten	Jly	1709	6281.144	318740.79	320830.21	475098.76	135152.10	14367.19	4949.26			Hanyang Plywood
21	Ocean Rainbow	Jly	1340	2588.537	111430.64	111430.64	142369.54	57724.38		-26785.48			Nissho Iwai Tokyo
22	Lae	Aug	927	3484.756	178401.52	179457.64	252644.81	67562.74		5624.43	3.1	3.1	Eagon Industrial Co. Inchon
23	Siti Halen	Aug	1764	6216.013	306005.29	307578.18	430782.01	114996.24		5624.43	2.6	2.6	Taesung Lumber
24	Yannan	Aug	4584	14448.174	689151.51	692912.55	1042481.29	210235.12		139,333.53	20.2	20.2	Oriental Chemical
25	Santas	Aug	311	1496.320	65957.31	66401.23	68828.13(FOB)			2426.10			Sunkyong Ltd Seoul, Hanyang & Hour Chu
26	Field	Aug	1261	4500.408	236210.91	237572.84	338504.24	84382.65	5759.51	10,789.24			Cheng Wooden Industry Showa Shoji Co.
27	Eastern Grace	Sep	4366	13480.283	643119.44	646786.95	949678.08	217032.56		85938.57	13.2	13.3	Nissho Iwai Tokyo & Oriental Chemical
28	Marky Ten	Oct	2394	6082.417	324685.34	334405.19	466109.06	115565.92	16149.79	- 11.84			Oriental Chemical & Taesung Lumber
29	Sitih Midah	Oct	646	2595.097	153598.51	153598.51	FIC						Nissho Iwai Tokyo
30	Jupiter Island	Oct	4481	13430.218	671297.93	675012.40	985148.92	198767.28		111369.29	16.4	16.5	FIC
31	Maritime Gardiner	Nov	1657	5808.671	294275.95	363889.45	FIC						Hanyang & Oriental Chemical
32	Yannan	Nov	4640	14542.391	728306.94	728306.94	1046081.89	206501.95		111723.00	15.3	15.3	FIC
33	Marky Ten	Nov	1739	5545.638	272849.16	289468.84	419416.60	102594.30		27353.46	9.4	10.0	Taesung Lumber & Oriental Chemical
34	Tenmaru	Nov	2840	5882.230	279979.91	279628.80	428725.75	116468.15	14611.34	17.46			Oriental Chemical
35	Kenzan Maru	Dec	2115	8212.660	426869.72	474533.55	663933.02	165895.73	23505.47	- 1.73			Nissho Iwai Tokyo
			76,464	24,522.381	11820180.11	12000993.17	16852598.64	4078475.95	123684.74	1,293,357.30			Nissho Iwai Tokyo

SCHEDULE 12C
1986 PURCHASES BY NINK FROM SBLC
RESALES BY NIHK

SHIP NO	EX PNG CF NEP	END FOB CF NEP	EX PNG UNIT PRICE	END UNIT PRICE	FREIGHT
1	0	13.4	42.27	47.96	15.90
2	0	12.4	44.47	50.00	18.00
3	0	32.0	43.54	57.50	17.50
4	0	21.9	45.92	56.00	17.50
5	0	7.15	55.17	59.11	19.00+
6	0	24.1	46.32	58.30	17.75
7	0	18.6	49.92	59.25	17.25
8	0	12.48 }	57.19	58.82	19.25++
		}		85.75	NN
9	0	11.8	50.75	56.75	17.25
10	0	8.5	51.81	56.25	17.25
11	0	0.4	46.28	46.50	18.25
12	0	12.8	45.21	51.00	19.00
13	0	4.9	50.44	53.00	18.00
14	0	1.8 *	52.66	52.66	20.50+
15	0	8.0	47.40	51.20	18.00
16	0	17.3	48.36	49.16	18.25
17	0	13.0	48.49	54.80	19.20
18	0	13.2	49.34	53.85	20.65
19	0.41	2.04+	50.17	49.16	18.20
20	0.59	2.15	51.01	51.83	21.50+
21	0	24.04+	43.05	32.70	22.30
22	0.59	3.1	51.50	53.11	19.50
23	0.51	2.6	49.48	50.80	18.50
24	0.55	20.2	47.79	57.40	14.50
25	0.67	4.35	44.38	46.00	FOB
26	0.57	3.14 }	52.79	56.15	18.75++
		}		54.25	ORIENTAL
27	0.56	13.3	47.97	54.35	16.10
28	2.99	2.99	54.98	54.98	19.00+
*29	0		59.19		
30	0.55	16.5	50.26	58.55	14.80
*31	23.38		62.59		
32	0	15.3	50.08	57.73	14.20
33	6.09	10.0	52.20	57.13	18.50
34	6.30	6.30	50.60	50.60	19.30
35	11.17	11.17	57.78	57.78	20.20

- * Indicates the margin shown was below MEP
- ** This shipment was made through Forest Industries Council.
- + This shipment was made to NIC Japan alone and the veracity of the MEP margins and buyer prices shown depends on whether the price from NIHK to NIC was a market price or a falsely low price.
- ++ This shipment was made in part to another buyer and in part to NIC. Again the veracity of MEP margins and buyer prices depends on whether the price from NIHK to NIC was a market price or a falsely low price.

SCHEDULE 13A

STETTIN BAY LUMBER COMPANY PTY LTD.
Marketing Table 1987

Shipment Number	Vessel	Month	Number of logs	Volume in J	F.O.B. Sales Price: US \$	Freight Rate	Name & country of purchaser	Notify Party	M.E.P. price U.S. \$	M.E.P. reparation	U.S. \$	Stage	Royalties (estimated)
1	Jupiter Island	Jan	3123	10484.211	639536.99		Nissho Iwai Corp., Japan		560801.21	59474.57	12,221	41237.44	
2	PNG Trader	Jan	1812	5509.130	360752.18		Nissho Iwai Corp., Japan		31774.91	73722.47	14,411	22337.72	
3	Conwa Maru	Jan	1981	1094.245	419977.15		Nissho Iwai Corp., Japan		323049.21	93617.14	29,173	23992.08	
4	Bogo	Feb	2162	7246.073	413393.44		Nissho Iwai Corp., Japan		382334.84	31059.60	8,123	28984.29	
5	Speco Ace	Feb	1842	5997.416	363601.65		Nissho Iwai Corp., Japan		322199.44	41402.21	12,450	23989.66	
6	Dnyang Guide	Feb	1803	5726.009	412481.45		F.I.C. Port Moresby P.N.G		312619.96	99747.40	31,912	22915.64	
7	Hakushina Maru	Mar	2641	6235.534	398275.97		Nissho Iwai Corp., Japan		363947.55	24329.43	6,145	24742.14	
8	PNG Trader	Mar	1754	5699.312	359056.65		Nissho Iwai Corp., Japan		317969.95	41086.70	12,922	22797.25	
9	Speco Ace	Apr	1726	5990.290	359417.40		Nissho Iwai Corp., Japan		340593.50	19823.90	5,527	23961.16	
10	Eastern Glory	Apr	1859	5997.492	371844.50		Nissho Iwai Corp., Japan		340222.11	31622.39	9,295	23999.97	
11	Agathis	Apr	1845	5938.538	410666.92		Nissho Iwai Corp., Japan		371816.25	46450.67	12,600	23774.15	
12	Tenwa Maru	May	1678	5554.010	309869.14		Nissho Iwai Corp., Japan		288433.07	21436.07	7,432	22216.04	
13	Kreya Maru	May	5570	16954.049	999705.75		Nissho Iwai Corp., Japan		908824.12	90881.03	10,000	67816.19	
14	Ocean Loyal	Jun	720	2365.013	148995.82		Nissho Iwai Corp., Japan		131997.96	16997.86	12,877	2460.95	
15	Dona Ingela	Jun	1014	9998.186	606472.56		Nissho Iwai Corp., Japan		542829.18	63644.28	11,724	39993.54	
16	Speco Baron	Jun	2189	6036.324	459591.71		Nissho Iwai Corp., Japan		392649.96	66741.75	16,989	24145.30	
17	Pakarti Tiga	Jul	2042	8167.980	613711.16		Nissho Iwai Corp., Japan		458169.57	155541.59	13,988	32671.92	
18	Dona Paula	Jul	2072	6113.328	469066.24		Nissho Iwai Corp., Japan		375034.97	114027.27	30,404	24453.31	
19	Pacific Swan	Jul	6456	14922.615	1164993.06		Nissho Iwai Corp., Japan		825890.19	309113.77	41,061	50691.26	
20	PNG Trader	Aug	1581	5885.407	559113.68		Nissho Iwai Corp., Japan		525892.11	33221.57	6,317	23541.63	
21	Speco Baron	Aug	1716	5999.829	512985.38		Nissho Iwai Corp., Japan		454978.25	58007.13	12,749	23999.32	
22	Pakarti Tiga	Sep	2074	6988.164	503422.32		Nissho Iwai Corp., Japan		503422.32	0.00	0,000	27052.66	
23	Mount Healthy	Sep	1961	6403.722	591551.71		Nissho Iwai Corp., Japan		547017.74	44911.97	8,176	25614.69	
24	Holy	Sep	2920	10031.862	902669.30		Nissho Iwai Corp., Japan		826727.58	76141.80	9,210	40127.53	
25	PNG Trader	Oct	1703	5699.442	507250.34		Nissho Iwai Corp., Japan		452003.93	55166.41	12,203	22797.77	
26	Sebil Franca	Oct	1272	4200.732	441076.88		Nissho Iwai Corp., Japan		409118.78	31958.10	7,811	16402.93	
27	Holy	Nov	3361	11139.697	1058271.24		Nissho Iwai Corp., Japan		956361.46	101909.78	10,656	44558.79	
28	Octogen Builder	Nov	2502	8196.784	696726.66		Nissho Iwai Corp., Japan		660709.33	36018.33	5,451	32787.14	
29	PNG Trader	Dec	1687	5699.186	507138.55		Nissho Iwai Corp., Japan		463820.14	43318.41	9,339	22792.74	
30	Sun Goddess	Dec	1472	5507.464	505666.68		Nissho Iwai Corp., Japan		432545.12	74141.56	17,141	22029.86	
31	Agathis	Dec	2349	5973.906	520690.60		Nissho Iwai Corp., Japan		499138.22	29552.46	5,921	23895.62	
32	Holy	Dec	3041	11007.134	946986.66		Nissho Iwai Corp., Japan		776741.32	168245.34	21,660	44028.54	
33	Siti Akiko	Dec/Jan	3163	9945.682	944839.82		Nissho Iwai Corp., Japan		817856.20	126983.62	15,526	39782.73	

TOTALS: 75828 243705.385 18514030.81 16192922.57 2321108.24 14,334 974821.54

Royalty Payments	Buluma	Bilomi	Sundry	Total	Cumulative Total
January	59910.53	24345.35		84255.88	84255.88
February	47340.97	22269.37		69610.34	151866.22
March	56710.10	26000.94		63819.04	237385.26
April	54736.73	22414.83		77151.56	314536.82
May	61534.79	47401.33		106936.12	423472.94
June	65035.27	33391.51	1844.40	102711.18	523744.12
July	58686.16	10930.25	7802.59	77427.00	601171.12
August	70544.82	32305.69	8423.21	111273.72	712444.84
September	67115.00	35327.00	535.54	102977.54	813422.38
October	66069.54	38352.17	602.39	106421.71	921844.09
November	79699.27	30639.10	602.39	116940.76	1040784.85
December	51396.03	29165.51		79581.54	1120386.39

SCHEDULE 138

SIETTIN BAY LUMBER CO LTD

MARKETING TABLE 1987

SHIP# #	VESSEL	NUMBER MONTH	VOLUME OF LUGS M3	MEP PRICE US \$	FOB PRICE US \$	CAF PRICE US \$	FREIGHT US \$	INTEREST US \$	SURPLUS FOB PRICE % OVER FOB	SURPLUS FOB % OVER CAF	SURPLUS MEP % OVER MEP	BUYERS	
1	JUPITER ISLAND	JAN	3123	10,494.211	569,891.31	639,556.88	894,656.36	1,166.32		59,953.16	15.6	29.7	Tae Sung Lumber & Oriental Chemical
2	PNG TRADER	JAN	1819	5,599.430	295,769.91	369,562.38	691,685.95	390.60		29,732.97	8.0	35.0	Oriental Chemical
3	TENWA MARU	JAN	1981	5,599.245	325,069.23	419,877.15	512,368.31	373.68		2,717.00	0.6	30.0	Hanyang Plywood
4	BUGU	FEB	2162	7,246.073	382,336.86	413,393.44	595,611.21	360.20		62,567.57	15.1	24.0	Tae Sung Lumber & Hanyang Plywood
5	SPECU ACE	FEB	1842	3,997.416	322,199.64	383,801.85	507,198.44	450.01		46,130.78	12.7	27.1	Tae Sung Lumber & Hanyang Plywood
6	DOUYANG GUIDE	FEB	1803	5,728.909	312,693.96	412,481.45	601,494.86						FIC
7	NAKUSHIMA MARU	MAR	2481	6,235.334	363,947.95	388,275.97	690,276.24	1,216.26		19,193.98			Nissho Iwai Japan
8	PNG TRADER	MAR	1754	5,699.312	317,969.95	359,056.65	695,099.23	1,463.48		40,579.10	11.3	25.6	Oriental Chemical
9	SPECU ACE	APL	1796	5,990.290	340,593.50	359,417.40	514,820.63	1,015.51		41,507.72	11.5	17.7	Hanyang & Ok San Industrial
10	EASTERN GLORY	APL	1859	5,997.492	340,222.11	371,844.50	515,821.66	12,749.07		21,820.07	5.8	15.7	Ok San Industrial & Hanyang
11	AGATHIS	APL	1845	5,938.538	371,016.25	418,666.92	600,661.61	12,491.52	12,826.70	39,676.47			Nissho Iwai Japan & Maruni Mokko
12	TENWA MARU	MAY	1678	5,554.010	288,433.07	309,869.14	444,121.50	10,303.20		23,969.16	8.3	16.4	Tae Sung Lumber & Oriental Chemical
13	KEIYU MARU	MAY	5570	16,954.040	908,828.12	999,705.75	1370,472.40	25,310.72		161,466.96	11.6	22.8	Ok San, Oriental, Hanyang & Tae Sung
14	UEAM LOYAL	JUN	720	2,365.013	131,997.96	148,995.82	212,851.17	4,935.25		18,920.10	12.6	27.2	Hanyang Plywood
15	DUNA ANGELA	JUN	3034	9,998.386	542,829.18	606,472.66	904,654.45	24,965.30		83,216.49	13.7	27.0	Oriental Chemical
16	SPECU BARUN	JUN	2189	6,036.324	392,849.96	459,591.71	650,262.55	14,853.61	20,948.61	27,868.62			Nissho Iwai Japan
17	PAKARTI TICA	JUL	2342	8,167.980	458,169.57	613,711.16	921,563.82	16,554.35		125,270.31	20.0	61.2	Tae Sung Lumber, Dongah Environmental
18	DUNA PAULA	JUL	2072	6,113.328	375,038.97	489,066.24	682,803.01	14,663.21	15,342.27	34,531.29			Nissho Iwai, Japan & Maruni Mokko
19	PACIFIC SWAN	JUL	4856	14,992.815	825,880.19	11164,993.96	1663,257.76	31,189.82		161,153.98	13.8	60.5	Oriental Chemical, Dongah & Tae Sung
20	PNG TRADER	AUG	1681	5,885.607	525,892.11	559,113.68	731,259.81	18,135.18	25,011.02	0.00			Nissho Iwai Japan
21	SPECU BARUN	AUG	1716	5,999.029	454,078.25	512,985.38	723,130.94	19,199.69		58,947.87	11.4	25.7	Hanyang Plywood
22	PAKARTI TICA	SEP	2074	6,988.164	503,422.32	503,422.32	832,704.75	32,696.67		2,585.76	0.5	0.5	Sudershen Plywood & Indian Cos. Edical
23	MOUNT HEATWY	SEP	1961	6,403.722	547,017.74	591,851.71	785,600.90	16,496.77	27,352.66	15.74		Nissho Iwai	
24		SEP	2920	10,031.882	826,727.58	902,869.38	1290,871.90	29,920.58	23,365.69	33,712.25	6.3	16.1	Hanyang Plywood & Nissho Iwai
25	PNG TRADER	SEP	1703	5,699.442	452,083.93	507,250.34	721,036.41	15,584.38		54,209.69	10.6	24.1	Oriental Chemical
26	SECOL FRANCE	OCT	1272	4,200.732	409,118.78	441,076.88	598,175.20	19,101.61	12,251.00	19,662.71	7.2	15.6	Maruni, Nissho Iwai
27	HOLY	NOV	3361	11,139.697	956,361.46	1,058,271.24	1400,804.16	29,381.97	25,221.00	30,149.33	5.2	16.4	Hanyang & Nissho Iwai
28	OCTAGON BUILDER	NOV	2502	8,196.784	660,700.33	696,726.64	1003,000.00	21,375.42		90,697.92	13.0	19.1	Tae Sung, Dongah
29	PNG TRADER	DEC	1687	5,698.106	463,820.14	507,130.55	691,930.73	16,728.29		38,063.89	7.5	17.5	Oriental Chemical
30	SUN CEDARSS	DEC	1472	5,507.464	432,545.12	506,686.68	682,717.98	16,040.33		35,590.97	7.0	25.3	Hanyang
31	AGATHIS	DEC	2349	5,973.906	499,130.22	528,690.68	726,920.09	156,300.91	16,461.93	23,058.93			Nissho Iwai & Maruni Mokko
32	HOLY	DEC	3041	11,007.134	776,741.32	904,986.66	1206,829.09	16,000.00					Oriental Chemical/Hanyang
33	SITI AKIKO	DEC/JAN	3163	9,945.682	817,856.20	904,839.82	1004,930.05	16,000.00					Maruni Mokko & Nissho Iwai

75026 243705.385 16192922.57 18514030.81 26,812,681.37 8,019,349.73 172,734.68 173,828.28

PURCHASE BY NIHK FROM SDLC
RESALES BY NIHK

SCHEDULE 13C

1987

SHIP NO	EX PNG CF MEP	END FOB CF MEP	EX PNG UNIT PRICE	END UNIT PRICE	FREIGHT
1	12.22	29.7	61.00	70.53	14.80
2	24.95	35.0	66.00	71.31	16.50
3	29.17	30.0	70.00	70.45	15.00
4	3.12	24.0	57.05	65.70	16.50
5	12.85	27.1	60.63	68.32	16.24
6	31.91	31.91	72.00	72.00	-
7	6.685	2.59	62.27	56.81	18.75+
8	12.92	25.6	63.00	70.12	16.75
9	5.53	17.7	60.00	66.94	19.00
10	9.295	15.7	62.00	65.64	20.30
11	12.6	23.27	70.50	65.00	21.80++
	)	)		113.20	NM
12	7.43	16.4	55.79	60.46	19.50
13	10.00	22.8	58.97	65.83	15.00
14	12.88	27.2	63.00	71.00	19.00
15	11.72	27.0	60.66	68.98	21.50
16	16.99	24.1	76.14	80.75	23.50+
17	33.95	61.2	75.14	90.47	22.35
18	30.40	39.6	80.00	71.80	23.50++
	)	)		129.50	NM
19	41.06	60.5	78.07	88.45	21.25
20	6.32	6.32	95.00	95.00	25.00+
21	12.75	25.7	85.50	95.32	25.20+
22	0	0.5	72.04	72.41	46.75++
23	8.2	8.2	92.42	92.42	26.00+
24	9.2	16.1	90.00	90.00	29.00++
	)	)		96.75	HANYANG
25	12.2	24.1	89.00	98.51	28.00
26	7.8	15.6	105.00	96.00	29.80++
				140.20	NM
27	10.66	16.4	95.00	95.00	26.50++
	)	)		100.49	HANYANG
28	5.45	19.1	85.00	96.07	26.30
29	9.34	17.5	89.00	95.68	25.75
30	17.14	25.3	92.00	98.46	25.50
31	5.92	)	88.50	81.29	26.50++
	)	)		133.50	NM
32	21.66	UNKNOWN	85.85	UNKNOWN	UNKNOWN
33	15.53	UNKNOWN	95.00	91.55	UNKNOWN++

- * This shipment was made through Forest Industries Council
- ** This shipment was to India.
- + This shipment was made to NIC Japan alone and indications are that the MEP margins and buyer prices shown are falsely low because prices from NIHK to NIC were falsely low.
- ++ This shipment was made in part to another buyer and in part to NIC. The MEP margins and buyer prices shown appear to be falsely low because the component of the shipment to NIC appears to be at falsely low levels.

SCHEDULE 13D

1987

NIHK JAPAN SHIPMENTS SALES

A. TO NISSHO IWAI

SHIP NO	VOL	PRICE DIFFERENCE	UNIT PRICE DIFFERENCE
7.	6235.534	34 019.97 LOSS	5.46 LOSS
11	4439.683	24 324.64 LOSS	5.48 LOSS
16	6036.324	27 868.62 PROFIT	4.61 PROFIT
18	4601.010	30 428.30 LOSS	8.20 LOSS
20	5885.407	NIL	NIL
23	6403.722	15.74 LOSS	NIL
*24	5034.624	NIL	NIL
26	2900.521	26 104.72 LOSS	9.00 LOSS
*27	5652.074	NIL	NIL
31	4707.525	33 928.20 LOSS	7.21 LOSS
33	<u>8415.325</u>	29 034.94 LOSS	3.45 LOSS
	60512.352	149 987.89 LOSS	AV2.48 LOSS

* Shipments 24 and 27 were joint shipments to NIC and a Korean buyer but no adjustments are necessary as NIHK sold to NIC at the same price at which it bought from SBLC.

B. TO MARUNI NOKKO

SHIP NO	VOL	PRICE ADDITION	UNIT PRICE ADDITION
11	1498.955	64 001.11	42.70
18	1312.315	64 959.59	49.50
26	1300.211	45 767.43	35.20
31	1266.381	56 987.14	45.00
33	<u>1529.757</u>	47 422.47	31.00
	6907.519	279 137.74	AV40.41

* This figure is calculated. The CNF price is known to be USD153.00 per cu m and the freight figure used is that applicable on the previous like shipment of USD 27.00 per cu m

SUBMISSION TO THE COMMISSION OF INQUIRY
INTO ASPECTS OF THE FOREST INDUSTRY
BY
STETTIN BAY LUMBER COMPANY PTY LIMITED

Dated the 22nd of July 1988

STETTIN BAY LUMBER COMPANY PTY LTD. (hereinafter referred to as "SBLC") has appeared before the Commission of Inquiry into aspects of Forestry at the request of the Commission and it is submitted has been completely frank in its evidence and disclosures to the Commission and has cooperated fully both in the Commission hearings and a later visit by Commissioner, Mr. Justice Barnett to the Company's logging concession at Buluma in the West New Britain Province. The Company stresses its desire to co-operate with the Commission and with the authorities of Papua New Guinea in all matters pertinent to the Company's operations. It is notable that SBLC is owned as to 83% by Nissho Iwai Corporation of Japan which latter Company is the seventh largest Company in the World outside the United States of America (Source Forbs Magazine 1986) and the sixth largest Trading Company in Japan. That the parent Company operates internationally both of itself and through subsidiaries is less a matter of concern than it is a benefit to Papua New Guinea having regard to the international influence, research and marketing available to the Papua New Guinean subsidiary through its parent Company.

Nissho Iwai Corporation has made a major commitment to the timber industry in Papua New Guinea with the SBLC operation in the West New Britain Province. It is already in evidence that

in excess of K44 Million has been invested at SBLC it being significant that the Papua New Guinean Government declined to take up a recent equity issue whereby its interest in the corporation was diluted from 25% to 17%. It is additionally in our submission an indication of the confidence that the Papua New Guinea Government has in the operation controlled by the foreign corporation that it has allowed dilution.

SBLC must be seen in our submission as being an abiding resident in the Country with a commitment to Papua New Guinea's future and economic prosperity. The investment abovementioned is intended to be increased to an estimated K244 Million including substantial contributions to general benefit infrastructure i.e., road and bridge construction as well as reforestation and capital expenditure for value added timber production. The Company is estimated to employ with its new development 1,500 people; the present operation (let alone the planned development) is the largest timber operation in Papua New Guinea.

The Company contributes substantially to Papua New Guinean society by earned foreign exchange - in excess of K16 Million out of total turn over of K18 Million in 1987 - by road and bridge construction in the West New Britain Province and the clearing of specified areas for oil palm development. The Company has in the area of its concession built a pre-school, a community school and a rural police station with associated housing. The Company promotes Papua New Guinean participation in its logging operation with logging contractors and sawmill operators. In addition to foreign exchange earned through the export of Papua New Guinean logs the Company in 1987 exported 2,834 cubic metres of sawn timber - effectively 63% of total Papua New Guinean sawn timber exported.

The above significant contributions by SBLC to the Papua New Guinean economy and society and other evidence received by the

Commission must leave this Commission, in our submission with no doubt that SBLC is a firmly committed conscientious corporate citizen.

RELATIONS WITH GOVERNMENT - PERMIT CONDITIONS

Evidence has been received by the Commission of the practice of the Forestry Department and diverse Forest Ministers in the granting of Letters of Intent for the operation of timber concessions. The evidence by SBLC is that it still operates on a letter of intent that being partially because of the continuing but protracted negotiations between the Company and the Government for a consolidated timber permit over current and planned timber areas. The Ania-Fullebourne negotiation has not been completed nor a consolidated permit issued. That is not in the submission of the Company, a matter within its control. The Company has co-operated at all times with the Government in the negotiating process and has contributed substantial time and resources to achieve the grant of a consolidated permit.

So far as the Company has had obligations under its Letter of Intent for construction of roads and infrastructure all of those requirements have been completed. The evidence received by the Commission is that the Company has built 60 kilometres of national highway and over 700 kilometres of Provincial roads with five permanent steel bridges on the national highway including the Kapiura bridge with a single span of 114 metres. This roading development has had a significant impact upon the development of oil palm projects in the West New Britain Province with over 4000 hectares of oil palm planted and provision for a further 3000 hectares. This integration of cash crop development with extraction of logs and construction of road ways is an example of proper Forest Policy. Similar although different infrastructure and capital expenditure is planned by the Company on the south coast of New Britain in the Ania-Fullebourne timber area.

SIGNIFICANT FACTORS OF THE LOGGING OPERATION

In addition to the substantial road construction referred to above and other contributions to West New Britain Society including the construction of a major wharf at the Buluma complex, the Company has been involved in a major reforestation programme of 3,000 hectares with plans underway to replant a total of 15,000 hectares. It is in evidence before the Commission that the additional replantings became the subject of a disagreement with the Government negotiators as to who should own the plantations. The Government negotiators are insisting that the Plantations should belong to the Government notwithstanding the contribution to their creation and maintenance of in excess of K77 Million by the Company. It has already been suggested to the Commission in evidence that this has created an impasse and a delay in the granting of the Ania-Fullebourne timber area to the Company. It is regrettable that some four years have been taken up in the negotiation of the grant of the new timber resource to the Company.

Mr. Bob Brown, the Australian Environmentalist said in a recent interview, "both in the production and disposal of that consumption (the World's natural resource of rainforest) the World's environment is undergoing an assault it can't withstand. Growth of use of resources is exponential."

Undoubtedly by the end of this Century tropical rainforest will be depleted to an extent that should see an increase in World prices for South Seas Logs. However Papua New Guinea as small as it is in World terms cannot afford to restrict the sale of its current resources. Rather the lead demonstrated by SBLC in its reforestation programme must be continued and expanded in order that in the next Century Papua New Guinea can reap the benefit of sustained yield of tropical hardwood in a World where demand for the same is high.

To achieve the investment required for a desirable reforestation programme there must be a promotion of such companies as SBLC in the forest industry and clear assurances to a producer that his commitment to such a plantation of tree crops will assure to them ownership of the trees planted.

THE MARKETING FUNCTION

Evidence was led before the Commission both by Mr. Ota and Mr. Hirata as to the method of marketing the SBLC products. The Commission must see as significant that the majority of sales from SBLC have been made to Nissho Iwai Corporation. It is submitted however that the Commission should not assume that the prices for the sale of logs transacted between SBLC and NIC will never be arms length prices. Rather an open mind should be maintained and the Commission must give full weight to the nature of the business transacted and the functions necessary to carry on each facet of the marketing operation including the development of future markets.

The Commission is invited to find from the evidence that the motive of SBLC Japanese staff is to obtain the best market price for SBLC. It is appreciated that the Commissioner made particular note of the relationship of the Japanese staff to the parent Company and the difficulty for a staff member to refuse a sale to NIC in the negotiating process. The evidence which the Commission is urged to accept is Mr. Hirata's evidence that he and his staffs' motivation in the running of SBLC is to ameliorate and perpetuate a profitable Company and upon so doing their epitaph with the parent Company will be written.

Furthermore there has been evidence from SBLC and from many other Companies before the Commission that the negotiating process involves an understanding that each party involved in

the sale of logs must make a profit in order that the orderly marketing of logs continues and markets are protected. It is significant in our submission that SBLC does not of itself engage any agent. SBLC is involved solely and admittedly almost exclusively in the sale of its logs to Nissho Iwai Corporation in a relationship of buyer and seller. Nissho Iwai Corporation sells mostly to end users but there is only one party between the Producer and the end Purchaser of the SBLC logs (with some small exceptions of sales to Timber Merchants). This contrasts favourably in our submission to evidence of other producers in Papua New Guinea. Of course more will be said on the issue of transfer pricing below.

SHIPPING COSTS

This issue is mentioned for the purpose of dismissing it as there is no evidence adverse to the Company which requires comment. It is the case that SBLC logs have not been shipped on any vessels owned or controlled by Nissho Iwai Corporation. Freight rates for logs from SBLC were always competitive market prices; the Company was not interested in those freight rates in any manner whatever.

THE QUALITY OF SBLC LOGS

The evidence before the Commission is that the SBLC logs are generally of a lesser quality than other Papua New Guinea log producers. It is submitted that there is a substantial difference. The Commission is in possession of the Forest Industries Council computer print outs for log exports for the month of December 1987 (inclusive of year to date figures).

The Commission is in possession of figures for Stettin Bay Lumber Company and for Gaulim Logging Pty Limited and Central Pomio Logging Pty Limited (CPLC). A comparison of those figures for the year 1987 shows the following:-

GROUP	SBLC	CPLC	GAULIM
Group 1	4.4%	11.7%	10.1%
Group 2A	28.6%	42.3%	45.1%
Group 2B	11.1%	9.3%	12.5%
Group 2C	43.6%	15.5%	16.7%
Group 3	12.3%	21.2%	15.5%

It is submitted that utilizing these figures there must be great care in comparing apples with apples. Effectively in making comparisons with MEP there is a danger in accepting certain statistics because the export of product by each of the producers in each grade may have been different having regard to the timing of the alterations in the MEP price. Accordingly it is our submission that it is inappropriate to compare from the year to date figures price performance of one producer as against another for a given grade or species as that could give rise to incorrect analysis. Similarly it is dangerous to take the year end figures as a comparison against MEP those figures indicating in fact that SBLC obtained an FOB average price as against the MEP average price of 113% where Gaulim obtained 120% and CPLC 123%. Those higher figures by the smaller producers are explainable in our submission in the same way as the average FOB price is explainable. By comparison of the group species above it is obvious that the parcels of logs offered by Stettin Bay Lumber were of a lesser quality than the other two producers. Accordingly it is understandable that SBLC obtained an FOB average for 1987 of \$74.24 whilst CPLC had an average of \$83.26 and Gaulim an average of \$85.48. It is for the same reason, that is the lower quality of logs produced, that SBLC obtained a slightly lower performance against MEP for the year. It is in our submission however significant that the performance of SBLC as against MEP over the 1987 year showed an average over MEP of 13% This must be considered in the context of the 1987 overseas log market being buoyant in comparison to previous years.

It is further notable that the SBLC FOB figure is a net figure whereas the Gaulim and CPLC figures may have commissions to be deducted. Such details are we believe already in evidence to the Commission from domestic log traders. Both Gaulim and CPLC sell domestically and the log traders commission or trading profit (of perhaps \$5,00 per m³) must be deducted from those FIC figures before comparison is made with SBLC results. Look also we submit at the 53 variety of species exported by SBLC in comparison to CPLC - 28 species, and Gaulim being fortunate in having basically one species in its Group 2A and basically two species in Group 2C

In 1986 fourteen of the thirty five SBLC shipments were above MEP although some of them only marginally. Much was made in the Commission of the effect of the FIC on the marketing of SBLC and other producers' logs. The submission by SBLC is that it was not the FIC corporation's marketing activities which increased Papua New Guinea FOB prices for logs but rather that it was the general up turn of the market overseas commencing from October 1986. Additionally care must be taken in comparing two shipments in the one month where there is a variation in the price obtained. It is the case that some price negotiations are completed two months prior to a shipment and some one month or even sooner. Therefore in a moving market different results can arise for shipments in the same month.

It is submitted that it is inappropriate to compare the performance of a producer on an individual shipment. The mutability of the South Seas log market is such that a broader view must be taken of the marketing functions. It is not surprising in a market with the volatility of the South Seas log trade that a given shipment will show a very high profit in comparison to another shipment which will show a substantial loss. There are many marketing tables before the Commission which do show losses being sustained by marketers and there are

additionally losses sustained overseas in our submission which are not disclosed. This is a natural result. Some of the losses are from errors of judgment undoubtedly but others may be of the "loss leader" type to be followed by increased volume sold and profits improved. Therefore, it is more appropriate to consider individual company's marketing effort by reference to percentage results over a period of say one to three years.

Questions were led to Mr. Ota during the Inquiry as to what was the criteria for judging a fair market price. Examples were suggested to Mr. Ota as to whether profit of a certain percentage or a certain number of Dollars per cubic metre would be sought by Nissho Iwai Corporation in its marketing effort with customers. Whilst obviously log trading is governed by profit motive, neither Nissho Iwai Corporation nor Stettin Bay Lumber Company are involved in the South Seas log market (and particularly the Papua New Guinean log market) for "quick gain". SBLC and its parent Company have demonstrated by their commitment to Papua New Guinea a long term view of trading and profits. It is submitted that Mr. Ota and Mr. Hirata gave evidence touching upon the myriad factors in the mind of a log trader including the need for future sales, development of markets, need to ensure that the customer is making a profit, fair profits to be obtained by the Company and many other factors which were difficult for the Japanese witnesses to convey in the English Language. The inability of the witnesses therefore to explain precisely what they meant by the best market price is regrettable but witnesses should not be criticized for their inability to sufficiently convey what is in their mind at a time of negotiating an individual parcel of logs. In summary it is submitted that it is more relevant for the Commission to consider results obtained by SBLC and indeed by Nissho Iwai Corporation over a greater period of time than one single shipment.

PNG MARKET PRICE

Much has been said in the Commission and in the Press about the so-called, "Middleman" and the undesirability of having a number of persons taking a profit between the producer and the end user. It is however clearly the fact arising from the evidence of SBLC and most or all other producers that there is a Papua New Guinea market price and there is an end user price. Those prices are never in our submission the same and properly so. It cannot be because of the nature of the trade that they will be the same. This Commission must be concerned to make recommendations to Government where possible to reduce the number of middlemen in the market. There cannot be however criticism of Nissho Iwai Corporation where generally between SBLC and the end user there is only one party. The need for international marketing expertise and the cost associated with developing new markets and maintaining good relationships with customers is a necessity which must be accepted. It is in evidence that many end users are unable because of their financial resources to open a Letter of Credit. They cannot take a shipment of 6,000 cubic metres of logs, they cannot charter such a vessel or consume the product if it were obtained. There is a need for a trading company to stand in the market as a buyer of logs and to on sell logs giving credit as required to the end user. It is appropriate therefore to promote a PNG market price and MEP should be maintained to ensure that a fair price is obtained by PNG producers, MEP must however be flexible and to immediately follow market movements with a range of prices which are to be the MEP price (e.g. MEP for Calophyllum between US\$80.00 to US\$85.00 per m³). Other countries use different names for MEP particularly the word "reference prices" is used to indicate in other countries in the South East Asia Region an acceptable price for the sale of logs in that market.

THE HONG KONG CONNECTION

SBLC has not attempted to disguise the fact that its log sales have been made to Nissho Iwai Hong Kong Corporation Limited.

Undoubtedly Hong Kong is a low tax country . The evidence of SBLC is however that the use of Hong Kong arises from historical reasons rather than from any intention to create profits in a low tax country or a Tax Haven, and in fact no unreasonable profit is taken in Hong Kong.

It is our submission that sales from SBLC through Hong Kong create a gross return for the Hong Kong Company of only one percent of the C&F invoice value of the "on sale" made by the Hong Kong Company. It is in evidence, and a copy of this agreement will be provided to the Commission, that an agreement exists between Nissho Iwai Corporation Japan and Nissho Iwai Hong Kong for the balance of proceeds after the deduction of the one percent commission to be remitted to Japan. It is also in evidence or alternatively the Commission is able to take judicial notice of the fact that Japan is not a tax haven or low tax country and that accordingly it is persuasive evidence that SBLC is not involved in transfer pricing if it is not intending to retain any profits made from the sale of logs in a tax haven or low tax country. More will be said of course in this matter below addressing specifically the issue of transfer pricing.

It is further submitted that the Government of Papua New Guinea has always been aware of the sales of SBLC produced logs to the parent Company, Nissho Iwai Corporation utilizing the vehicle of the Hong Kong subsidiary Corporation. Not only has that been well known to the Government but the Government has impliedly approved of the continuation of that course of action in the negotiation of the Ania-Fullebourne agreement.

SBLC argues that there is substantial benefit to it by selling to Nissho Iwai Hong Kong. That includes:-

- (a) A guaranteed telegraphic transfer of funds ~~immediately~~ upon the shipment of the logs.
- (b) No banking charges involved in the negotiation of a letter of credit.
- (c) No risk associated with the buyer being insolvent or the Letter of Credit having unreasonable or onerous terms.
- (d) That a ship will always be dispatched to take SBLC production.
- (e) Korean buyers could not open Letters of Credit at sight. Accordingly by the use of the Hong Kong Banking System and the backing of Nissho Iwai Corporation no risk ensures to SBLC in sales to a Korean market.
- (f) Any delays by a Korean buyer in opening a Letter of Credit are overcome by the Hong Kong Corporation.
- (g) Prior existence of approval systems in the Japanese market for foreign currency were overcome by using the Hong Kong Corporation. Additionally qualifications for foreign currency loans in Japan were restrictive in comparison to the Hong Kong Banking system. For the above reasons Hong Kong historically became the site for trading of south sea logs as it provides flexibility and the removal of foreign exchange restrictions.

It was clearly evident from both of the SBLC directors that there is a commitment by Nissho Iwai Corporation to its subsidiary and not surprisingly a commitment by SBLC to Nissho Iwai Corporation. That is not an unhealthy arrangement having regard to the assurance of sales and the lack of risk in the sales process. The cash flow of SBLC is assured and a resultant continuity arising therefrom for the reforestation programme, infrastructure construction and the employment of Papua New Guineans.

Nissho Iwai Hong Kong Corporation Limited is a substantial multifaceted Trading Company inter reacting within the Nissho Iwai Group as a financier and clearing house but with its own trading operation. It is not a post office box Company. The annual financial returns provided with this submission demonstrates that conclusively.

BENEFITS TO SBLC OF SALES TO NISSHO IWAI CORPORATION

In addition to the above substantial benefits to SBLC there is additionally the benefit that Nissho Iwai Corporation maintains a large number of experience staff for marketing including the creation of new markets for south sea logs. There is no cost to SBLC of that marketing effort and all the risk associated with marketing is absorbed by the Hardwood Department in Nissho Iwai Corporation. However benefits are passed on to SBLC. It was suggested in the Commission of Inquiry perhaps indirectly that now that markets and consumers have become established that SBLC should sell direct to them rather than through Nissho Iwai Corporation. However that does not sufficiently recognize the effort of Nissho Iwai Corporation in establishing those customers and the markets and it is the fact that the customers are the customers of Nissho Iwai Corporation. Those customers are serviced from the point of view of public relations and further by the settlement of any claims that arise by Nissho Iwai Corporation staff.

Additional risk that has not been passed on to the Stettin Bay Lumber Corporation is claims by end users of SBLC logs. Claims to producers and traders of logs in the Papua New Guinea market frequently are made for quality and volume but in our submission it is significant that any such claims are settled by Nissho Iwai Corporation and are not a risk to SBLC.

Trading companies in Japan have a long history and provide a unique service to the economy of the Country in a different way than their counter parts outside Japan. The loyalty of a Japanese worker to his employer and visa versa is well known and understood but there is a similar two way loyalty involving trading companies.

The recognized arrangements in trading of buying and selling is the tip of the involvement, encouragement and assistance provided by the Japanese Trading Company. It is common for the trading company to give its buying customer six months credit and additionally to buy the product produced by the small manufacturer from the raw material supplied by the trading Company.

Nissho Iwai Corporation has by its efforts effected substantial market penetration in Japan and in the other countries in which it has established and developed markets for Papua New Guinea logs. Through this market penetration Nissho Iwai has been able to create markets for lesser known species, e.g. Malas, by assisting manufacturers with technical information. Korean and Chinese plywood manufactures have been invited to Japan by Nissho Iwai Corporation and technical know-how imparted in discussion and visualization of Japanese manufacture using Papua New Guinea logs including Malas. Nissho Iwai Corporation in its role as a major trading Company thus promotes log species sales by diversifying the market.

Having offices in all parts of the World, both in consuming and producing countries, where experienced timber staff are actively engaged, market information is constantly fed to SBLC, at no cost to it. SBLC thus have the benefit of up to date market information and promotion of its production.

TRANSFER PRICING

Mr. Reeve in a letter to SBLC and dated the 5th of May 1988 has requested certain further materials and comment from SBLC arising from the potential for transfer pricing between SBLC and Nissho Iwai Corporation. SBLC assures the Commission of its continuing co-operation and will forward so far as it is able all of the material requested by Mr. Reeve. SBLC has been adopting the suggestion made by Mr. Reeve that documents be forwarded as they become available and the summary of sawmill input and output figures and the documents referred to in paragraphs K & L of Mr. Reeve's letter have already been provided along with the shipping documentation. The other material requested and presently available will be forwarded with this submission and so far as the Company is presently aware the only outstanding documents to be obtained are the Invoices and Freight Debit Notes for SBLC logs from Nissho Iwai Hong Kong Corporation to its buyer for the year 1984. These documents have been put into storage because of their age and the lack of current need for the documents. Searches have been made in the storage for the documents but regrettably to date they have not been located. However any missing documents will be provided as soon as they come to hand.

Mr. Reeve in his letter dated the 5th of May 1988 has referred to the potential for transfer pricing and impliedly seeks comments from SBLC in addition to the material requested. It is regretted that SBLC is not completely aware as to the evidence or submissions to be placed before the Inquiry and particularly the written material by Academic Economists referred to by Mr. Reeve on the first page of his letter of the 5th of May 1988.

In this submission SBLC will make reference to the internal revenue code of the United States of America on Transfer Pricing and to the Booklet published by Touche Ross International and titled, "Transfer Pricing Rules Between Major Trading Nations". A copy of the latter is provided with this submission.

It is generally accepted in our submission that transfer pricing is judged by reference to an "arms length price". That is defined in the USA Regulation and in the Touche Ross text in similar terms as being the price that an uncontrolled party would have paid for the particular product under the same circumstances as a sale to a controlled party. It is accepted by all major trading nations we submit that such a price involves a profit to both parties and that accordingly the fact that Nissho Iwai Corporation makes a gross profit in its "on trade" of SBLC logs is not of itself an indication of transfer pricing.

Our researches have disclosed three major methods of explaining an, "arms length price". They are:-

- (a) the comparable uncontrolled price method.
- (b) The resale price method.
- (c) The cost plus method.

The facts and circumstances of a particular trade may dictate that one of the above methods is more appropriate than the others.

COMPARABLE UNCONTROLLED PRICE METHOD

It is our submission that in the circumstances of the notable difference between the quality and species of logs produced by SBLC to that produced elsewhere in Papua New Guinea that the comparable uncontrolled price method is inappropriate. It should be accepted that the physical property and circumstances involved in a controlled sale must be identical to the physical property and circumstances in uncontrolled sales for the

comparable uncontrolled price method to be reasonably applicable. If such properties and circumstances are so nearly identical that any difference either has no effect on price or such difference can be reflected by a reasonable adjustment to the price of controlled sales then the method may be appropriate. We submit that such adjustment in the circumstances is inappropriate particularly because of the high volume of the lesser desired species, Malas and the generally lower value of parcels of logs sold by SBLC. Additional differences which affects the price of logs include terms of sale and in this regard the Commission is requested to consider that SBLC receives a telegraphic transfer of its sale almost immediately upon export with no reference back to it of claims for volume or species deficiencies. Nissho Iwai Corporation by itself and its Hong Kong subsidiary take the risk of the "on sale" both financially and in respect of claims.

Accordingly those terms of sale are not comparable to other producers in Papua New Guinea. Notwithstanding therefore the desirability of utilizing the comparable uncontrolled price method to achieve an accurate estimate of "arms length price" we submit that the circumstances of the SBLC sales to Nissho Iwai are such that this method cannot be reasonably utilized.

COST PLUS METHOD

The cost plus method is equally inappropriate in our submission because of lack of published information on gross profits in the Papua New Guinea timber industry and the difficulties associated with making gross profit comparison with other industries (i.e. commodity producers in Papua New Guinea) or with other log producing countries such as Canada or the USA or any South East Asian country. It is the case that Canada, USA and other South East Asian countries sell extensively into the Japanese market but SBLC does not have access to the gross profit figures achieved by producers in those countries.

SBLC's gross profit on sale between 1984 and 1987 varied between 13.5% and 36% moving with the swings of the market. The Company obviously has fixed costs but a dynamic market; fortunate perhaps that the Papua New Guinea Market does not move as much as Malaysia but gross profits must suffer in the years of depressed log prices.

The use of the cost plus method is impossible therefore because of the volatility in the international price of the commodity produced.

RESALE PRICE METHOD

Pursuant to this method the "arms length price" of a controlled sale is equal to the applicable re-sale price reduced by an appropriate mark up. The applicable resale price is available to the Commission by the material voluntarily supplied by Nissho Iwai Corporation. As submitted elsewhere however it is inappropriate to consider individual sales or ship by ship transactions. It is more efficacious to consider the results annually which should disclose a gross return to Nissho Iwai Corporation averaging US\$4.00 per m³ over a period of years.

SBLC submits that assuming a markup on SBLC FOB prices of an average of \$4.00 per cubic metre is reasonable having regard to the necessity for that amount to represent the costs of the re-seller and a reasonable profit for the task undertaken. This can be examined in at least two ways. The first that it is as between SBLC and Nissho Iwai Corporation a sales arrangement but secondly some transactions of this type between multi-national enterprises may appear to be more akin to the provision of services. The functions of some distributors may be so minimal and the risk and responsibilities which they undertake so small that their profit appears to be an agency fee or commission rather than a profit on sale.

Rather than the Commission comparison, we submit that the risk and function of Nissho Iwai Corporation make the transaction in fact and in form a buyer/seller arrangement. It has already been stated that the risk undertaken by Nissho Iwai Corporation and its subsidiary in Hong Kong are the total risk of a vendor whilst having an absolute responsibility to pay SBLC.

Whilst the Hong Kong subsidiary is essentially a finance and clearing house for the transactions it provides a substantial contribution for the benefit of SBLC and additionally for the benefit of the letter of credit applicant.

We reiterate the consequence of the commission agreement between Nissho Iwai Corporation and Nissho Iwai Hong Kong Limited which allows 1% to the Hong Kong Corporation and remits the remainder to Japan where they are subject to Japanese tax at a rate we submit in excess of 50%. In the circumstances we submit that the Commissioner must find that the remuneration retained in Hong Kong is reasonable having regard to the functions performed by the Hong Kong Corporation of a clearing house and financier.

Nissho Iwai Corporation Japan we submit has established the markets and customers into which the SBLC logs are sold. Nissho Iwai Corporation maintains proper commercial relationships with those clients including the necessity for frequent visits to maintain the client base, to establish new clients and to develop new markets. It is in evidence that Nissho Iwai Corporation developed the Japanese, Korean, Taiwanese and Thailand markets for Papua New Guinea logs and was involved in the establishment of the Indian market and it should be noted that Nissho Iwai Corporation is the only Company to market PNG Logs (i.e. from SBLC) to Mainland China and the Thailand Market. Whilst we do not presently have evidence before the Commission of the cost to Nissho Iwai Corporation of the whole marketing exercise nor of what is a reasonable profit in the circumstances we submit the gross

return achieved by Nissho Iwai Corporation is not unreasonable nor other than proper remuneration for the marketing effort and client and market development undertaken.

CONCLUSION

The Commissioner is invited to consider in writing his report, the co-operation and open disclosure made by SBLC and Nissho Iwai Corporation after request made by Counsel Assisting the Inquiry. The Commissioner is invited to consider the importance to Papua New Guinea of the foreign exchange earned by SBLC, the contribution to renewing the resource that is presently being exploited and the current plans for further reforestation. In our submission the sales to Nissho Iwai Corporation cannot be shown to amount to transfer pricing having regard to the level of profits achieved by Nissho Iwai Corporation as compared to the cost which has been proved or may be judicially implied and by the factor of the substantial majority of that profit being taken in a non tax haven country. His Honour we are sure appreciates the importance to this multi-national corporation of maintaining a good working relationship with the Government of Papua New Guinea and the Commissioner should therefore in the absence of clear and cogent evidence condemning SBLC, make findings and recommendations of and concerning the Company supportive of the good working relationship which already exists.

6/6/66
J. J. Boddy

SCHEDULE 15

FOREST MANAGER'S REPORT.1. ACHIEVEMENT FOR THE YEAR OF 1987 AGAINST BUDGETS OF FOREST DIVISION.

		<u>Budget</u>	<u>Actual</u>	<u>Rate of Performance</u>
A.	Total Log Production :	278,000 M3	274,762 M3	98.8%
B.	Total Log Export :	226,420	225,314	99.5
C.	Input Sawmill :	50,004	49,220	98.4
D.	Total Log Sales :	K13,296,253	K15,458,380	116.3
E.	Net Profit :	K 759,569	K 2,752,458	362.4%

The total log production and log export were very close to the target, even though we did not achieve the target due to bad weather especially during the month of January, 1987, and also continuous heavy rain in December, 1987, the above figure is a good result.

Due to the good log market which was supported by a high demand of P.N.G. logs in Japan, Korea and Taiwan, we achieved a quite good net profit. The actual net profit was quite better than the target by 362.4%. But we cannot disregard the cost increase in some items against our budget. The following is the comparison showing the difference between the budget and the actual result.

A. Variable Costs:

		<u>Budget</u>	<u>Actual</u>	<u>Difference</u>
Royalties	:	K1,112,016	K1,147,681	(+)K35,665
F.I.C. Levy	:	58,386	60,055	(+) 1,669
Wages		750,500	730,163	(-) 20,337
Repair & Maintenance	:	1,656.080	1,892,149	(+)236,065
Fuel & Oil	:	1,178,000	1,199,344	(+) 21,344
Contract Logging	:	466,250	405,229	(-) 61,021
Others	:	188,951	120,982	(-) 67,969
Sub Total	:	5,410,183	5,555,599	(+)145,416 (102%)

B. Fixed Costs:

		<u>Budget</u>	<u>Actual</u>	<u>Difference</u>
Salaries	:	K 400,950	K 361,639	(-)K39,311
Tech. Ass't. Fee	:	56,400	65,879	(+) 9,479
Interest	:	702,000	634,524	(-) 67,476
Insurance	:	64,140	97,911	(+) 33,771
Depreciation	:	2,488,800	2,113,442	(-)375,358
Lease	:	483,840	504,348	(+) 20,508
Sub Total	:	K4,196,130	K3,777,743	(-)418,387 (90.0%)

Total Production Cost: K9,606,313 K9,333,342 (-)K272,971
(97.2%)

X	Shipping Cost	:	K2,130,908	K2,608,820	(+)K	477,912
X	Administration Cost	:	2,103,912	2,313,301	(+)	209,389
	Grand Total	:	K13,841,133	K14,255,463	(+)K	414,330

Though we saved on items of variable cost such as wages, contract logging, others and fixed cost such as salaries, interest and depreciation, due to a huge increase of repair and maintenance and shipping cost, as a whole, 3% of cost up was inevitable. The reason for such a huge increase of cost up which was not able to avoid are as follows:

AA: Repair and Maintenance.

Due to the delay of replacement of machines, repair and maintenance cost especially for jinkers, Dump trucks and 980C remarkably increased.

BB: Shipping Cost.

A. Disposal of missing Logs	K118,600
B. Unexpected Demurrage	56,000
C. Additional Export Levy	273,313
Total	K447,913

A volume of 3,509 M3 of logs was written off as missing, due to cargo short on shipment carried out during the month of January, February and December, 1987, excessive demurrages were incurred. A 10 percent export tax have been imposed on FOB amount instead of MEP amount, besides as sales price has risen reflecting good market, export tax automatically increased.

In view of cost increased during year 1987 operation, we must endeavour to save our cost especially on repair and maintenance and shipping cost for 1988 operation.

2. LOG PRODUCTION.

The total log production for January, February and March (estimation), 1988 is about 46,950 M3 or 23% less than the same period of last year. The details are as follows:

	1987	1988	Difference
January	21,364 M3	16,464 M3	(-) 4,900 M3
February	18,144	12,464	(-) 5,661
March	21,473	18,000 (est)	(-) 3,473
Total :	60,981 M3	46,947 M3	(-) 14,034 M3

The reasons for the low production compared with last year are as follows:

- A. Very bad weather in January and February, with record rainfall.
- B. There are no logging areas suitable for the wet season operation as we failed to obtain Uletevasa area.

3. LOG MARKET.

As previously reported in November, 1987, the log price dropped by US\$10-15/M3 compared to October, then this downward trend continued until mid of February, 1988. While this trend hit bottom in mid February, FOB price has now risen by US\$ 3-5/M3 compared to February, 1988 and from April onward it is expected that upward trend will continue.

At present the prevailing FOB price is MEP plus US\$ 3-5/M3 depending on the assortment.

TO NIC/POM
ATTN: HIRATA-MD/SBLG

(宛名 01)

FROM NISSHO IWAI CORPORATION TOKYO Tel. (03) 588-3119

Ref No. M-63

Page

Hardwood Lumber Dept. Sect-2

Date JUN/23/88

1/1

NIC/HKG & NIC/Tk.n との
T-COMM ASRMT



SCHEDULE 16

南洋材売買 TRADE COMMISSIONに関する覚書

日商岩井株式会社木材第二部（以下甲といふ）と NISSHO IWAI HONG KONG CORPORATION LTD.（以下乙といふ）は、南洋材の取引に関する TRADE COMMISSION に關し、次の通り覚書を取交す。

1. 本覚書にいう南洋材とは原木、半製品並びに製品をいう。
2. 甲は乙に對し日本國に輸入する南洋材に關し乙發行の INVOICE AMOUNT の 1.0%を TRADE COMMISSION として支払う。
3. 本覚書の有効期間は 1983年10月1日より1984年3月31日迄とし、期間満了1カ月前までに甲又は乙より別段の通知が無い限り更に同一内容にて6カ月間延長するものとし、以後も同様とする。
4. 甲、乙は本覚書承認の証としてそれぞれ署名の上、各一通を保有する。
5. 尚、本覚書發行を以て1983年4月1日付覚書は失効するものとする。

1983年10月1日

東京都港区赤坂2丁目4番5号

日商岩井株式会社
木材第二部 山西陽一郎

乙

NISSHO IWAI HONG KONG CORPORATION LTD
ROOM NO. 1401 SWIRE HOUSE, NO.11 CHATER
ROAD, HONG KONG

Managing Director

N. HIMOTO

Translation

Memorandum of Agreement in Relation to the
Trade Commission on South-sea Lumber.

The memorandum of agreement has been entered into between Lumber 2nd Department of Nissho Iwai Corporation (hereinafter abbreviated as the first party) and Nissho Iwai Hong Kong Corporation Ltd (hereinafter abbreviated as the 2nd party) on the following terms and conditions.

1. In this memorandum of agreement, the south-sea lumber means log, semi-products and finished products.
2. The first party pays 2nd party the trade commission of 1% of the invoice amount of 2nd party's invoices of south-seas lumber to be imported to Japan.
3. This memorandum of agreement shall be effective from October 1, 1983 to March 31, 1984, and will be extended six-monthly thereafter automatically unless either party notify the other party.
4. Two originals of this memorandum of agreement have been signed by both parties, and each party retain one original each.
5. This memorandum of agreement supercedes the memorandum of the agreement dated April 1, 1983, which now becomes null and void.

Dated October 1, 1983.

Signed by: (1st party) Y. Yamanishi,
General Manager,
Lumber 2nd Department,
Nissho Iwai Corporation.

(2nd party) Nissho Iwai Hong Kong Corporation Ltd,
Managing Director, N. Himoto.