ANNUAL REPORT 1996

ENERGY

TIMBER

KEKKILÄ

BIOTECH

VAPO OY

Contents

Vapo Oy Energy

Vapo is Finland's biggest supplier of domestic biofuel. In addition to fuel peat Vapo produces heat, electricity and wood fuels. Fuel peat is used to generate a quarter of Finland's district heat and almost a tenth of all electricity produced. Vapo Energy is also an important supplier of environmental peat. Just under 10 % of Finland's peatlands enjoys protected status, while about 1.2 % has been set aside for peat production.

Vapo 1996 in brief

Peat production in 1996 was highly successful despite the rainy start to the summer which meant that production did not fully get going until the second half of July. Sales of energy peat increased by 14 %. Sales of wood fuels – sawmill by-products and chips – tripled in the course of the year. Sales of environmental, horticultural and animal litter peat were up 15 % on the year before.

Vapo Timber Oy

Vapo Timber is Finland's fourth largest producer of sawn goods and ranks among the top ten in Europe. At the end of the year the number of sawmills rose to six, when Forssan Saha became a subsidiary of Vapo Timber. The total production capacity of Vapo Timber's sawmills exceeds 600 000 cubic metres.

The sawmill business recorded a profit, even though the average price of sawn timber was ten per cent down on the previous year and the price of raw timber remained high. Vapo Timber succeeded in expanding its market share both at home and abroad.

Kekkilä Oy

Kekkilä Oy manufactures growing media and fertilizers for the Finnish market and export. Every fourth potted plant brought into Finland has been planted in a growing medium produced by Kekkilä's Danish subsidiary. In Finland Kekkilä sells a complete range of growing media and fertilizers for hobby gardeners. Fertilizers intended for professional use are tailor-made by Kekkilä.

The impact of restructuring measures taken during the last couple of years is clearly reflected in the financial results. Kekkilä's profit after financing items was almost FIM 4 million, an improvement of FIM 10 million on 1995. The solid result can be ascribed to staff commitment, teamwork, concentration on key areas and realistic target setting.

Vapo Oy Biotech

Vapo Biotech's business consists of municipal waste handling, the manufacture of air purifiers and the treatment of sludge. Biotech has developed plants for composting and processing biowaste with Finnish conditions particularly in mind.

For Vapo Biotech 1996 was very much a year of breakthrough, a fact borne out by the strong order book. The tunnel composting plant in Kitee, eastern Finland, continued to function satisfactorily. Orders for four more plants of the same type were received. Five biofilter plants were delivered during the year under review, with a further seven on order at the start of 1997.

A YEAR OF CAUTIOUS ECONOMIC RECOVERY

Esko Muhonen

The collective agreement on economic, employment and labour market policy reached in autumn 1995 has succeeded in its objectives of promoting stability in Finnish society and creating the basis for economic development. 1996 was a year of cautious recovery, although fears were expressed that overheating might occur in certain sectors. As Finland still has massive unemployment, it is not easy to believe that overheating is possible. There is a shortage of skilled labour in certain sectors, however, as a large proportion of the long-term unemployed have left the labour markets permanently. There is no shortage of people willing to work outside the scope of the tax system in the 'black economy', and Finland now needs measures to restore respect for honest hard work and to make work a more favourable option than simply living off the benefit system.

At the end of 1994 an attempt was made to clarify Finland's energy and environmental taxation system. A new public debate on the need for amendments to the energy taxation system was started in the spring of 1995, and in December 1995 this led to an announcement by the Government that it had reached a decision in principle on medium-term energy policy measures. Work then began on the preparation of amendments to the energy taxation system, with the intention that these amendments would make allowances for the employment-creating impact of bioenergy. In summer 1996 the results of this work threw Finland's energy markets and the companies operating in them once again into a state of confusion. The new energy taxation law was passed at the end of the year; it abandoned the practice of taxing the fuels utilized to generate electricity and shifted the tax to the end-product, the electricity itself. This change was motivated by a desire to give a tax advantage to electricity generated in Finland using coal, and to make it competitive with electricity produced with

Just under 10% of Finland's peatlands enjoy protected status, while about 1.2% has been set aside for peat production.

coal elsewhere in the Nordic area. The employment-creating effects of bioenergy were recognized by a subsidy equivalent in value to the electricity tax, which was granted to small-scale generating plants, including wood and peat fired plants, for the following five years. Parliament called for Government action to make peat more competitive should the changes to the energy taxation system cause peat consumption to decrease by more than 5% from the existing level.

Condensing power plants, in particular, will reduce their use of peat following the taxation changes. It is significant, however, from the standpoint of employment and the utilization of existing invest-ments, thatduring the debate on the energy taxation law, certain condensing power plants which are major peat users announced that they were committed to maintaining their existing levels of peat utilization. This helps to reduce the fear that jobs could be lost in certain major fuel peat production areas. Under the former legislation, fuel peat consumption showed steady annual growth; it remains to be seen whether this favourable trend can be continued under the new law.

The European Union is again preparing a proposal for an energy and environmental taxation directive. Work is also being done in the EU on an energy strategy, an important element of which is the increased utilization of renewable energy sources. The status of peat in these plans is rather puzzling. Peat was previously classified as a fossil fuel. In the EU, renewable energy refers to fuels such as biomass, i.e. wood-based fuels, straw, sludges, municipal wastes and crops grown for fuel. Peat is apparently a particularly odd source of energy in the EU, and is not named in the plans or designated as a fossil fuel or biomass. In Finland the debate on the status of peat has now fallen silent and an increasing number of experts consider it is at least a slowly renewing biomass. Like wood, peat is a form of biomass, which is continually being formed from the earth's plant life. Each year, more new peat accumulates than is utilized. The use of peat for energy production is in line with the objectives of sustainable development and its designation as biomass is justified.

In order to increase the use of renewable energy sources in the European Union, it is important that in the peat-using member states, Finland, Ireland and Sweden, the utilization of peat should be encouraged in the same way as other forms of biomass and bioenergy. In all European Union plans, peat should be included in the renewable energy sources, biomass and bioenergy, and it should be part of all measures intended to increase their utilization.

In their business operations and financial results, Vapo Oy and the Kekkilä group performed according to plan in 1996. Vapo Timber Oy also achieved its targets, in spite of difficulties. Prospects for the current year are encouraging, even though it will again be the continued efforts and high standards of professionalism of Group employees and outside contractors that make it possible for us to achieve our objectives. We will again need the strong support of all our customers and business partners if we are to succeed in our task of utilizing Finland's natural resources – peat and wood – and extracting value from municipal wastes in order to create benefits for society as a whole. V

Jyväskylä, 5 February 1997

Esko Muhonen

Peat is a slowly regenerating biomass which accumulates faster than it is currently used.

A GOOD YEAR IN SPITE OF THE RAINY SUMMER

1996 proved to be a very good year for peat production, even though the unusually rainy weather during the early summer had suggested the season might turn out to be poor. Good progress was made with product development work on biofuels, and sales of wood fuels – sawmill by-products and woodchips – trebled during the year.

Peat production operations were very successful during 1996, and Vapo Oy Energy reached its target of 22.7 million cubic metres, even though production did not get into full swing until mid July. The season was exceptional in that production continued well into September.

Sales of fuel peat increased by more than 14%. Peat accounted for 25% of all district heating and 9% of all electricity produced in Finland. One significant reason for the growth in sales of fuel peat was the shortage of hydroelectric power in the Nordic countries, and Finnish power plants using peat as their main fuel continued running with good utilization rates throughout the year. Sales were also boosted by the start-up of the Kemi power plant, which is operated by Enso Oy, and the Tervasaari and Rauma plants operated by UPM-Kymmene Oy.

Vapo's sales of peat for environmental purposes were up by 15% on the previous year. The major use for this peat was on farms, where it is utilized as a conventional bedding material and is also mixed with agricultural slurry. In all, 20 000 farms utilized a total of 400 000 cubic metres of peat for bedding and land improvement purposes. Large quantities of this peat were also supplied to horticultural peat processors and to users of Vapo Oy Biotech's sludge treatment systems.

Acquisition of new peatlands and work to prepare them for production were mainly concentrated in northern Finland, where utilization of fuel peat is

Of Vapo Oy Energy's 1996 peat sales, milled peat represented 89%, sod peat 7% and horticultural peat 4%.

increasing. During the year Vapo integrated 2500 hectares of peatland previously acquired from Kemira Oy into its own production, and also took over production on peatland owned by Kemira.

Vapo Energy spent a total of FIM 37 million on environmental protection. This represents 4.4% of the unit's turnover and 8% of its investments.

During the year the quality system covering peat production and supply activities came into use on a trial basis. Fuel peat utilization represents one link in the forest industry's energy supply chain, and the quality system is ofspecial importance for the forest products industry and its customers. Paper purchasers, in particular, want to know how the forest products industry has procured the energy it uses. Alongside its quality system Vapo Energy has also developed an environmental management system, and at the end of the year this was taken into use on a trial basis in the Western Finland business unit.

Vapo Energy has increased its marketing and R&D efforts for wood and other biofuels. Vapo actively marketed sawmill by-products and woodchips to its energy customers, and sales of these fuels trebled during the year to reach 600 000 cubic metres. Wood is ideally suited for mixing with peat fuel, as wood ash binds the sulphur contained in peat. The emissions from this fuel mix are therefore more environmentally compatible.

Several projects relating to the use of wood and other biofuels have reached the stage where practical trials are being undertaken. At a pilot plant in Lieksa, eastern Finland, researchers are testing a new type of dryer and burner developed for biofuels.

A second project spanning several years seeks to develop the manufacture of "bio-oil" from indigenous wood and other biomass. In June tests were begun using a pilot plant supplied by EnsynTechnologies Inc. of Canada. This plant uses flash pyrolysis technology to produce an oil-like substance from biomass. The project involves Vapo, VTT and Wärtsilä Diesel.

Vapo has performed tests on the combustion of peat mixed with common reed harvested near Oulu, northern Finland; research to study the cultivation of reed canary grass was also continued.

Finland's new energy tax, which came into effect at the beginning of 1997, will not necessarily support the development and use of indigenous biofuels, even though that was the purpose behind the change in the taxation system. As a result of the tax, coal became by far the most competitive fuel for condensing power plants, and without special arrangements peat would have been almost completely displaced as a fuel at these plants. In co-generation power plants wood became slightly less competitive relative to peat. Time will tell how the energy tax will affect consumption of indigenous fuels.

Seppo Sänkiaho, Divisional Director

A truck-load of peat is sufficient to heat four or five single-family homes for a whole year in Finland.

Directly and indirectly, peat production creates a total of 6500 jobs throughout Finland.

"When making major power plant investments we have kept in mind that we will continue using peat, provided the price is right," says Pentti Pajunen, Vice President, UPM–Kymmene Energy.

Pentti Pajunen, Vice President, UPM-Kymmene Energy:

"Our aim is to minimize our energy costs"

The 100 MW power plant which started up at UPM-Kymmene's Tervasaari paper mill in November 1996 is fuelled by bark mixed with peat. Pentti Pajunen, Vice President, UPM-Kymmene Energy, says that it was the need for increased heat capacity that prompted the mill to construct a solid fuel boiler unit. "Our new power plant enables us to burn bark; it was a natural choice to use this with another indigenous fuel. To a certain extent we are using solid fuel to replace natural gas," he explains.

UPM-Kymmene has also started using peat in place of coal at its Rauma mill's power plant. At Rauma bark is the main fuel for the new power plant. In 1996 the company also had peat-fired power plants at its Simpele, Jämsänkoski, Kuusankoski and Kaipola mills. UPM-Kymmene also has significant holdings in Kainuun Voima, which operates the peat-fired power plant in Kajaani and, via its associated company Pohjolan Voima, in the Seinäjoki peat-fired power plant.

"Our aim is to minimize our energy costs, as energy is a significant cost factor for us," Pentti Pajunen states.

UPM-Kymmene was created in a merger last May and in terms of turnover it is Europe's leading forest products group. Each year the company consumes some 20 TWh of electricity and 26 TWh of heat energy. Indigenous fuels produce almost 70% of the total heat energy acquired. Close to 60% comes from the company's own energy sources: bark, woodchips, process liquor and heat recovery systems. Peat accounts for more than 10%.

For UPM-Kymmene the main significance of indigenous energy sources is in terms of price stability and continuity of supply independent of fluctuations on the world markets.

UPM-Kymmene takes care to ensure that its environmental image meets its customers' expectations. "Using peat as a partial replacement for natural gas at Tervasaari caused an increase in sulphur emissions. In Rauma coal was previously used as an additional fuel, and this was replaced with peat; sulphur emissions then fell to less than half the previous level," Pentti Pajunen says. At these power plants, sulphur emissions are kept within the permitted limits by feeding lime into the boiler unit.

Each year UPM-Kymmene acquires almost 2 million MWh or 2–2.5 million cubic metres of peat. Each day the company's own power plants take delivery of 55 truck-loads of peat. Vapo is UPM-Kymmene's main peat supplier.

Environmental programme and management system making good progress

During the year under review an environmental programme was prepared defining the goals of Vapo Energy's environmental protection activities. On the basis of this programme, each regional service unit will draw up a concrete and detailed environmental protection plan. Pirkko Selin, Vapo Oy's Environmental Manager, says that the programme is required not only because it will help to secure the future of the company's own operations, but also because customers are focusing ever increasing attention on environmental matters.

"The acceptability of peat production activities is very dependent on the extent to which the company meets the demands of environmentally conscious customers and members of the public," she states.

"Issues relating to biodiversity and threatened species have become a decisive factor when new peatlands are procured. These issues have to be taken seriously and resolved in advance; the question of what should be done with the peatland after it is taken out of production should also be considered in advance. Progress in water protection has to be continued, and peat production technology has to be developed to make it more environmentally compatible," Pirkko Selin explains, summarizing the main points of the environmental programme.

An environmental management system has been prepared to complement the environmental programme. Based on the ISO standard, the system was introduced in the Western Finland business unit during the year.

Quality and the environment go hand in hand

Jukka Ohrankämmen says that environmental protection has become essential nowadays: "By looking after environmental issues properly, Vapo can sell its products more easily – and that's good news for contractors, too."

"Taking proper care of the environment means a certain amount of extra work for us, but we are part of an industrial operation and so I believe we have a responsibility to clean up after ourselves," says Jukka Ohrankämmen, Vapo's main peat production contractor at the Mustakeidas site in Karvia.

Over the last couple of years the quality system has started to make its way into the contractors' everyday work, and soon the new environmental management system will make its presence felt, too. Training has been stepped up, and a yellow quality folder can now be found in every tractor cab.

"The folder gives step-by-step procedures for every stage of the production process. If you come up against something that you don't know, you can always find the answer in the book. I've been in this business a long time, and I sometimes think that the instructions are really detailed... but the folder is not meant to be learnt by heart," he says.

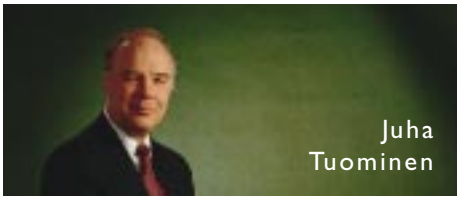
From the standpoint of peat production workers, quality and the environment go hand in hand.

"The quality system specifies the type of filtering to be used in the field ditches, the depths of the ditches, what kind of stumps can be left in the peat, how used oil and oil filters should be disposed of, and how the settling ponds should be cleaned out," he explains.

The summer of 1996 was exceptional for the rainy weather early in the season. The weather improved later, and the total peat harvest exceeded the target by 20%.

New machinery introduced during the year included dust-free pneumatic harvesters.

Positive result in spite of difficult conditions



Juha Tuominen

Vapo Timber Oy's result for 1996 was positive, with profit at FIM 12.7 million, even though average prices for sales of sawn goods were down by 10% on the previous year. Turnover during the year under review was FIM 629 million, while gross margin amounted to slightly over 5%.

The fall in the prices of sawn goods which had begun in 1995 continued during the first half of 1996. Where sawn spruce was concerned, the downward trend in price levelled out during the summer and by the end of the year a slight upturn could be witnessed. The strengthening of the Finnish mark served to dampen the rise in foreign currency-denominated prices.

The trade in raw timber was at a standstill for almost five months, from March to the end of August, due to the absence of a price agreement. Trade subsequently became quite lively when, somewhat unexpectedly, semi-comprehensive regional wood agreements lasting until the end of the year were arrived at.

Market shares grew both at home and abroad. Of Vapo Timber's main market areas the United King-dom, Germany, France and Japan performed in a particularly encouraging manner. The above-mentioned countries accounted for over 60% of total exports.

500 000 cubic metres of sawn goods were delivered, of which 390 000 cubic metres were exported. The export total was the same as in 1995, while deliveries in the domestic market showed

During 1996 Vapo Timber produced 509 000 cubic metres of sawn goods and railway sleepers. Photo: Nurmes Sawmill.

an increase of 22%. Overall growth amounted to 4%. In Finnish mark terms the value of exports fell 8% while that of domestic sales rose by more than 5%.

In the course of 1997 the wood trade will experience significant change. At the start of the year the changeover had to be made to a new, company-specific price agreement procedure for wood which has the approval of both the EU Commission and the Office of Competition; no information is yet available on how well the new system is functioning. The price paid for logs may well be the subject of unrealistic expectations thanks to the low price of pulp and the healthy demand for sawn timber. The price of logs has been serious affecting sawmill profitability for some time now, largely because prices have not followed the decline in export prices which began in 1995.

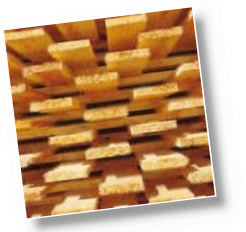
In terms of wood reserves the situation was normal at year's end. At the conclusion of the year under review Vapo had reserves of wood of approximately six months.

In the course of 1996 509 000 cubic metres of sawn goods and railway sleepers were produced. In spite of limitations on production caused by the lack of timber total sawing operations showed a 2% increase, which was largely due to the introduction of new investments.

Investments during the review period amounted to FIM 44 million. One significant investment was the new log sorting line at Kevätniemi, together with replacement of thesawmill's debarking and log feeding machinery. This investment literally lifted log handling out of the water and onto dry land. Now the sawmill is compact and modern with an annual capacity of 200 000 cubic metres. The second investment of note was the purchase of Forssa sawmill from Asko Oy on the penultimate day of 1996. The acquisition of Forssan Saha Oy boosts Vapo Timber's total annual capacity to over 600 000 cubic metres and will strongly facilitate the further refining of sawn timber, an area in which Vapo Timber is making increasing efforts.

Juha Tuominen, Managing Director

One investment of note was the purchase of Forssa sawmill at the end of 1996.



A total of 390 000 cubic metres of sawn timber was exported.

Saastamoinen knows his way around forests

Forest foreman Urpo Saastamoinen knows the forests in the Lieksa area like the back of his hand. As a young man he began working in the forest with a jibbing saw and moved wood using a horse under the guidance of his father. In the 1960s motor saws became standard and forest machinery was used increasingly for felling purposes; finally computers, too, made an appearance with the trend towards multi-function machines. Today such multi-function machines take care of more than 90% of the lumberjack's work.

Urpo Saastamoinen has been in Vapo's employ for 30 years. Nowadays he is responsible for planning felling operations and finding the best route to the nearest road, from where the timber is taken to Kevätniemi sawmill. Matching the progess of felling to the sawmill's need for timber is a key part of Saastamoinen's work.

"Working in the forest has gone in the right direction, it's all much easier now," he reveals.

Continuous training is an absolute must. "For example last summer we had a course at the forestry school in Siilinjärvi. Particular attention was paid to how key biotopes, such as the area around springs and rocky outcrops should be left untouched or dealt with in such a way that they are left in virtually their original state."

According to Saastamoinen it is the task of the landowner and the forestry centre to search out such locations and mark them on the map. Those responsible for felling, on the other hand, are responsible for ensuring that the places to be treated gently have indeed been marked.

When it is time to move on, felled areas must be left in tip-top condition. "Successful felling makes it much easier for the buyer to come back and buy again later."

Urpo Saastamoinen's plans are carried out in the depths of the forest by a multi-function machine and a tractor unit. Work is conducted by two men operating in two shifts. In a year Saastamoinen handles 100 areas of forest marked for felling. Just one day a week is spent at his desk.

In his free time Saastamoinen is also to be found in the lap of nature as a hunter. When not at work or hunting, volleyball and various organizations occupy his time.

Urpo Saastamoinen (right), a logging supervisor, and Olavi Tallus, a harvester operator, plan a new timber stand for cutting.

Sawmills invest in the environment

During 1996 Vapo Timber began the task of formulating an environmental system and confirmed the principles of such a system in January 1997. An environmental system will be created for each sawmill in the course of the current year. Environmental issues at the Hankasalmi and Kevätniemi sawmills will be included into existing quality systems while at the Nurmes, Paltamo and Peuravuono sawmills, as well as in wood procurement, the environmental system will take the form of instructions drafted in accordance with the ISO 14 000 standard.

Environmental systems at Vapo's sawmills will cover wood procurement and the production of sawn timber. Timber suppliers and subcontractors involved in felling will also be required to observe the same principles of environmental care as are being adopted by Vapo Timber.

During the year under review a clean-up was made of the soil in areas previously used for pole impregnation. Quantities of soil containing impregnating agent residues originating from the Väärälä plant, which closed in 1993, were subjected to a special stabilization method. The method was approved by Etelä-Savo environmental centre and the soil then transported to a waste site.

Ferrosulphate was first spread onto contaminated soil at the impregnation plant in order to bind arsenic, copper and chrome residues into a low-soluble form. The soil was then thoroughly mixed and taken to a waste site for disposal.

The cleaning operation at the Pitkäkangas impregnation plant in Haapajärvi involved complete replacement of the soil layer. The task was carried out in cooperation with Telecom Finland. Ekokem Oy treated the filtrate chemically, subsequent to which the purified water was released into the watercourse.

Most of the treated soil was used to build banking on the shooting range of the Haapajärvi arms depot, while some was heaped in an area specially designated for the purpose. The work was conducted throughout in close cooperation with Kokkola environmental centre and environmental officials from the town of Haapajärvi. The site in question has been on lease to Vapo from the Finnish Forest and Park Service; the impregnation plant closed down in 1975.

Laboratory serves entire Group

Vapo's laboratory provides research and analysis services for all the units within the Vapo Group. Fuel analysis related to biofuel invoicing and quality control together with analytical work related to quality control and product development for Kekkilä's growing media form central aspects of the laboratory's work. Since spring 1995 the laboratory has also undertaken a significant amount of water quality analysis work associated with Vapo Energy's water protection research.

1996 was characterized, however, by the development and significant increase in analysis linked to the environmental business activities. Thus the laboratory also made its own contribution to the testing and optimization of tunnel composting plants.

Also related to the environmental business activities are odour measurements, which are used in the testing and development of biofilters. This work became considerably easier at the beginning of 1996, when the laboratory took into use a gas chromatograph which can perform measurements on malodorous sulphur compounds. The same equipment can also be used to analyze volatile organic compounds (VOCs).

"The objective in all our analysis work is to produce reliable and accurate results. No compromises are accepted in this respect. This approach has also formed the basis of the laboratory's own ISO 9001 quality system," says Laboratory Manager Jaakko Lehtovaara.

On many occasions, domestic and international ring tests have confirmed that Vapo's laboratory has a good level of know-how and performs highly accurate work. Jaakko Lehtovaara says that the laboratory staff continuously work to maintain their high standards.

"By meeting fellow researchers at Finnish and international events we ensure that we have the latest research information on analytical methods."

Leena Välimäki checks the effectiveness of chemical treatment in separating humus from water.

Profitability restored, result even better than expected

Matti Hilli

The Kekkilä group reported a profit of FIM 3.9 million for 1996, which is an improvement of almost FIM 10 million over 1995.
The group's turnover was FIM 141 million.

Kekkilä Oy produced a better-than-expected profit performance, but this should not really come as a surprise: the result is now beginning to reflect the merger of Kekkilä and Vapo's Horticultural Peat Division in July 1994, as well as other measures to rationalize the business sector that have been taken over the last couple of years. Kekkilä's healthy development is underlined by the fact that the profitable result can be traced back to a number of items in the income statement: in addition to an increase in overall sales, the sales margin was improved, fixed costs were reduced and capital costs also decreased.

Four factors lie behind this successful outcome. Kekkilä's own people represent the most important factor: they are to be commended for the way they have taken personal responsibility for their work. Their commitment shows that in 1996 Kekkilä took a major step towards the creation of its own corporate culture. The second factor was that the group's employees worked together as 'the Kekkilä team'.

The third important factor was that the right things were done: a good example of this is the creation of the Kekkilä brand for hobby gardeners. The fourth factor behind Kekkilä's success was the setting of realistic targets for the group as a whole,

Virpi Hepo-Oja and Saima Järvelä tend the flowers at Välivainio Nursery, Oulu, northern Finland.

for the various units, and for individual employees. This helped to avoid the situation where employees find they have to meet unreasonable expectations.

In 1996 sales of products intended for the Finnish hobby gardening sector increased by more than one quarter, even though there was no growth in the overall market. The main factors contributing to this increase were the product relaunch implemented in 1995, carefully planned marketing efforts, and active selling work.

In the professional markets Kekkilä has concentrated on tailor-made fertilizers and closed growing systems for vegetable cultivation. From the customer's point of view, comprehensive technical sales support and advice on product utilization are of central importance.

Thanks to its reliability, consistent quality and customer-oriented products, Kekkilä has successfully retained its market leading position in the production of landscaping materials in the greater Helsinki area.

Exports from Finland grew by 2% – a good achievement in markets suffering from oversupply. Even more important than the increase in export sales, however, was the improvement in their profitability. This was achieved by concentrating on profitable areas and products. In addition, costs were reduced by action to upgrade logistics.

The main focus of exports shifted towards products with greater added-value. This was essential from the standpoint of profitability, as strong price competition from Russia and the Baltic states has caused a substantial reduction in prices of bulk products.

Kekkilä's Danish subsidiary, Stenrøgel Mosebrug A/S, increased its sales by around 8%, which was mainly achieved through increased exports. Harsh local winter weather conditions, increased raw material costs and deficiencies in production planning nevertheless caused the company to report its first ever loss in the year. The situation was corrected in the second half and the company is again positioned for profitable operation.

In the UK the operations of Kekkilä's subsidiary, VapoGro Ltd, were rationalized following the losses incurred in 1995. In order to improve profitability, the amount of products offered was reduced by one third and activities were concentrated in the southern and central parts of England. This led to a 16% reduction in sales, but a clear improvement in profitability during the second half shows that we are on the right track.

In the long term, increased cooperation with our long-standing raw material supplier, Haifa Chemicals, will be of great significance for Kekkilä's exports. The first visible result of this cooperation was the joint development of the Starex family of standard products for the professional market.

In 1996 Kekkilä exceeded its profit target by FIM 2 million. It is our understanding that we can further improve our profitability by concentrating on doing the right things and maintaining our cost-efficiency. In the current year our aim is to achieve "better growth" both in our customers' business operations and in the development of our ultimate "customers" – the plants that benefit from our products. We can achieve this objective by developing even better products and serving our customers to ensure they are always in an optimal position to achieve this "better growth". V

Matti Hilli, Managing Director

Recyclable materials are utilized in all Kekkilä packaging.

Pertti Ilmelä tells Sanna Damski about caring for bonsai trees: "It's important to keep the moisture level consistent – the tree shouldn't be allowed to dry out," he says.

Expertise and service are the decisive factors

The cold, wet weather during the spring and early summer of 1996 was especially unfavourable for the garden centre trade. Pertti Ilmelä, Managing Director of the Ilmelä Garden Centre in Helsinki, says that business did not suffer a major setback, however, which is an indication that the sector has recovered from the recession.

"As far as our garden centre is concerned, the upturn started in the autumn of 1995. Sales of plants for offices and public buildings picked up first, followed slightly later by retail sales. Last year sales were stable in spite of the weather, and there were clear signs that ordinary people had more money to spend. So we feel we can look forward to the coming spring and summer with confidence," he explains.

Another factor affecting the gardening sector last year – besides the increase in purchasing power – was Finland's membership of the European Union. For the Ilmelä Garden Centre, which imports seedlings direct from Belgium and Holland, the EU meant simpler import procedures.

"EU membership has been a positive development for us because it has helped to make international business and trade formalities somewhat easier. On a more general level, it has become easier to do business in Belgium and Holland because we're now seen as part of the same Europe. But I'm sure that Finnish growers don't share my views on EU membership: opening the country's borders to foreign competition has eroded their profitability," Pertti Ilmelä states.

In the Helsinki area competition between garden centres is tough and there are plenty of firms vying for market share. He says that for a company to be successful it must have a clear strategy, which at Ilmelä means an emphasis on professionalism and service.

"Our employees are well-trained, service-minded professionals who can answer most of the questions put by our customers. If they can't provide an immediate answer, they can turn to our own collection of reference books. This ability to sort out our customers' problems and our wide range of products are our particular strengths."

Ilmelä appreciates similar qualities in his suppliers:

"Reliability, good products and good salespeople – these are the things we expect of our suppliers. It's also important that everything gets done properly and that the supplier has the required level of flexibility."

Kekkilä is one of Ilmelä's longest-standing suppliers. The two companies have been doing business since the 1950s, when the garden centre was owned by Pertti Ilmelä's father.

"We've been buying fertilizers, compost and peat products from Kekkilä for over 40 years. Our long-term business relationship is definitely based on the fact that Kekkilä satisfies all our criteria."

Kekkilä brand successfully relaunched

Last year Kekkilä implemented a high-profile relaunch of the Kekkilä brand: completely new packaging was introduced and advertising helped to create a new brand image. Sales of Kekkilä's products for the hobby gardening sector grew rapidly and the intended change in the brand image perception was achieved. The new image is the result of two years' carefully planned work.

"We initiated the project to relaunch our brand in 1995 with an extensive qualitative consumer survey; this provided the basis for our efforts to reposition the Kekkilä brand and pre-test our advertising message," says Mikael Johansson, Kekkilä's Marketing Manager.

"Later, when the new packaging was being developed, we utilized the results of consumer packaging tests. Advertising cannot be left to chance."

The right products at the right time

For Osmo Sahimäki, a supervisor at Kekkilä's Parkano plant, the approach of spring means an increasing workload and long days on the phone. It is his responsibility to ensure that customers get the right products at the right time.

"The job of organizing transportation is rather like doing a big jigsaw puzzle where all the pieces are constantly changing. We plan everything as precisely as we can in advance, of course, but sometimes things turn out very differently from what we expected. In spring everything depends on the weather, and so we have to arrange our transportation according to what the weather does," he explains.

Sometimes it is necessary for decisions to be taken quickly so the goods can be got to where they are needed. Osmo Sahimäki says that even 'rush jobs' are done properly.

"Over the years we've built up a flexible and efficient transportation system, and this enables us to handle the rush jobs. Our system is based on five local hauliers, who look after our transportation needs on an on-going basis. They give us a considerable amount of flexibility; also, their vehicles are fitted with lifting gear, so unloading is easy even in places where fences or other obstructions make access difficult."

"We also use hauliers whose routes pass our plant. That helps us to keep our transportation costs at a reasonable level, and avoids the need for us to use the most expensive transportation options."

Osmo Sahimäki has been working at the Parkano plant for more than 20 years. "There's a very good working atmosphere here in Parkano: in fact, you really feel as though you're working for your own business. You don't hear complaints, even on busy days. When things get tough, everybody just gets down to work and gets the job done."

For Osmo Sahimäki (right), a supervisor at the Parkano plant, spring is a particularly busy time. "The job of organizing transportation is rather like doing a big jigsaw puzzle where all the pieces are constantly changing," he says.

Last year Kekkilä's exports went to 28 different countries.

Since 1924 Kekkilä has been supplying plant-specific fertilizers to professional growers.

A BREAKTHROUGH YEAR, VOLUME OF ORDERS RISING RAPIDLY


Kari Mutka

1996 was a breakthrough year for Vapo Oy Biotech. This is most clearly visible in the volume of orders received, which totalled more than FIM 40 million in February 1997.

The factor behind this increase in environmental business activity is the new waste tax, which came into effect in Finland on September 1, 1996. Tax at the rate of FIM 90 per tonne has to be paid on waste taken to municipal landfill sites. In future the costs associated with landfill disposal of waste will be further increased by the introduction of more stringent standards applying to landfills. In fact, it will become cheaper to re-utilize and recycle waste rather than dump it at a landfill site.

All these developments make good sense from an environmental point of view, and they do not result in excessive costs for the individual or for society as a whole. Waste handling costs will of course rise, but it must be remembered that processing represents only a small part of the total cost of managing waste. In future, too, transportation costs will continue to represent the biggest part of the total cost of managing waste.

It is a certain fact that several composting and other waste handling plants will be built during the next 5–10 years. It may even be possible to talk about a boom, the start of which can be seen in Biotech's rapidly growing order book. It is equally certain that the environmental business sector will continue to develop even after the plants have been built. Completely new, permanent markets for waste processing will be created, and these are markets in which Biotech – as part

In principle, the computer used to monitor and control the processes at a tunnel composting plant can be located anywhere. This photo shows the processes at the Kitee plant being controlled from a portable computer set up in the plant's equipment room.

of the Vapo Group – has a great deal to offer.

1996 saw very significant developments in tunnel composting plants. The composting plant in Kitee, eastern Finland, went into use in spring 1996 and has been operating according to plan since then. During the second half of the year orders for four more plants were received: this shows that the markets are convinced that Vapo's concept is effective.

Biotech supplied five biofilters last year and already has orders for seven units, which will be supplied during 1997. The increase in large-scale composting is also reflected in the biofilter business: ammonia emissions and odours mean that to be fully effective a composting plant must be linked to an efficient odour removal system. For this reason, all tunnel compostingplants supplied by Vapo are fitted with biofilters.

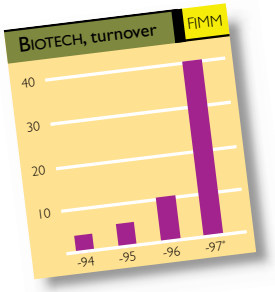
In addition to sales in the Finnish market, biofilters have also been exported to Sweden, Norway, and the UK. Special export sales efforts will next be directed to the Netherlands, where Biotech has concluded a marketing cooperation agreement with KTM Biotech Bv.

Biotech's sludge treatment service was expanded during the year. In northern Finland the material to be treated is mainly sludge from septic tanks located outside urban areas. A transportable unit – which utilizes centrifugal force to dewater sludge – has been in use in southern Finland, and this has proved to be a viable method of treating industrial sludges, too. Companies using the sludge treatment service represent such sectors as potato processing, oil refining, and leather production. In order to satisfy increased demand, Biotech took a second spin-dewatering unit into use in June. This unit is also built on an articulated trailer for easy transportation.

For handling dry waste, Vapo Oy Biotech offers a facility in which incoming waste is mechanically sorted into three types: combustible materials (paper, plastic, wood, textiles), metals, and landfill waste. The combustible material is taken to an existing power plant where it is added to the main fuel, which could be peat. Vapo already supplies peat to power plants in almost every inland town in Finland, and so has existing business contacts with whom it can begin negotiations concerning the supply of this fuel material.

From the outset our activities have been based on team work, and our own personnel has been relatively small. The unit retains control over project management and core process know-how, but the majority of the work is sub-contracted to outside suppliers. We will continue to keep our organization lean, flexible and competitive, and we will concentrate our resources on the core issues: product development, marketing and project expertise. V

Kari Mutka, Senior Vice President



Vapo Oy Biotech's turnover 1994–1996. 1997 figure is total of completed sales plus orders outstanding. *Situation at beginning of February 1997.

The second-generation biofilter, Biohelmi, was tested for almost the entire year in Hanko, southern Finland.

BIOHELMI DEVELOPMENT WORK CONTINUES

Biohelmi ('Biopearl'), the second-generation biofilter developed to eliminate odour problems caused by carbon disulphide, was tested in a pilot-scale version for almost the whole of 1996. The tests were performed at a plant located in Hanko, southern Finland, which is operated by OyVisko Ab and manufactures synthetic sausage skins. In the tests the Biohelmi unit was used to filter out carbon disulphide and hydrogen sulphide, compounds which are to some extent harmful to the health and are extremely malodorous.

Measurements on the pilot plant showed that it fulfilled expectations; the unit provided data and valuable experience which can be used in the construction of a full-size filter. The Biohelmi filter has worldwide potential, as the technology used represents one of the few reasonably-priced methods of eliminating the odour and health problems caused by carbon disulphide.

The tests are being continued and work is being done to assess the wide range of possible applications. At the moment there is special interest in VOCs (volatile organic compounds) which cause problems when solvents are used, for instance in paint shops, food processing, plastics manufacture, and printing. The EU is planning to tighten the limits on emissions of these compounds, and Biohelmi probably represents a solution which will enable users to comply with the more stringent limits.

Biotech has continued work to further develop its conventional biofilter. The objective is to reduce the surface area of the filter by increasing its loading capacity.

Last year also saw a large number of composting trials. In the spring a 20 cubic-metre automated pilot composting plant with its own instrumentation was completed, and since then has been in constant use by Vapo Biotech, together with six 200 litre capacity pilot compostors. Researchers have also taken measurements at the tunnel composting plant in Kitee.

The pilot composting plant is utilized to identify the optimum mixing ratio and process parameters for each composting plant on the basis of material samples supplied by customers. This is an important task, as the composition and dry matter content of sludges and waste vary between locations. V

Tunnel composting plant completes Kitee's waste handling system

The town of Kitee in eastern Finland has a comprehensive network of ecopoints where recyclable and hazardous waste can be disposed of, and waste sorting at source is operating efficiently. Since last spring, separately collected biowastes and sludges have been processed in a tunnel composting plant supplied by Vapo.

Pentti Karhu, the municipal engineer in Kitee, says that the opening of the composting plant was the culmination of an extensive project to organize waste handling in the town. The objectives and schedule for the project were established in 1991.

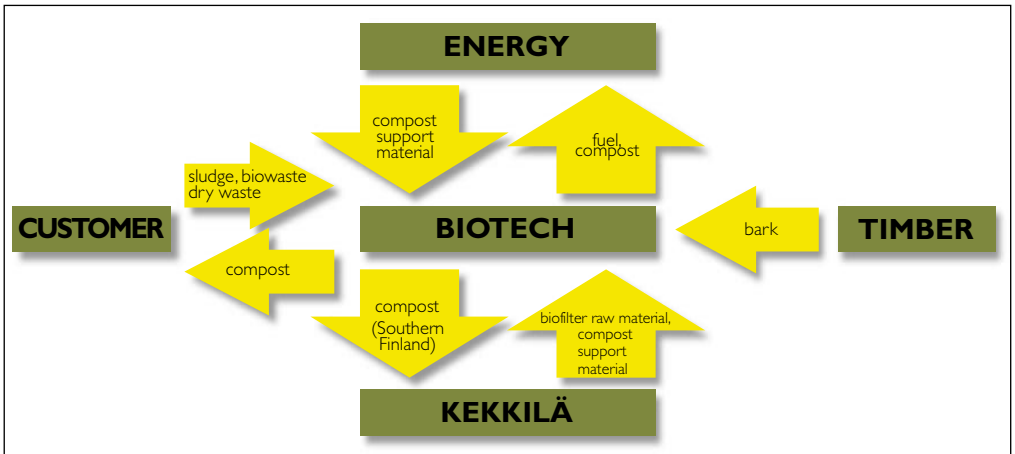
"We had a number of years to complete the project, but the timetable was still tight. Even so, we believe it would have been difficult to create an effective system any faster. A lot of different pieces had to fall into place, and we had to encourage the development of a favourable attitude towards waste sorting and large-scale composting among the town's residents. That all takes time," Pentti Karhu states.

As it was, there was sufficient time for a public debate on waste sorting, recycling and composting, and to prepare people for the changes before they occurred. Most of the feedback from members of the public has been positive. Pentti Karhu says that Kitee's experience of tunnel composting – with the first plant of its kind in Finland – has been favourable.

"I can honestly say that our experience with the plant has been very positive – the process is working just as we planned. Furthermore, the town's residents take a favourable view of the plant, which is clean and free from odour problems."

Pentti Karhu.

The Kitee tunnel composting plant processes some 1500 tonnes of sludges and 600 tonnes of separately collected biowaste each year. Initially, the final product is being used to landscape part of a landfill facility which is being closed, and it has proven excellent for this purpose.



Synergy with the Parent Company

Practical experience has shown that the tunnel composting plants supplied by Vapo Oy Biotech are practical and effective units. However, as part of the Vapo Group, Biotech is able to offer its customers many additional benefits.

Biotech's environmental business activities are linked with the Parent Company in many ways. For the customer, the support and resources of a major company mean security and reliability, as well as confidence that an effective use can be found for the final product. The significance of this will increase in future, when compost supplies increase and marketing becomes more difficult.

Kekkilä Oy is Finland's largest marketer of universal compost and Vapo Oy Energy has a nationwide peat retail network which also markets humus for various purposes. The product from composting plants can also be used as a fuel in heating and power plants. Vapo Oy Energy already has existing sales channels for biofuels, and so it is well placed to market the final product from Biotech composting plants.

The material to be composted is in the tunnel for a period of one to two weeks, after which it is allowed to mature.

Reino Niemi is responsible for the operation of Vapo Oy Biotech's pilot composting plant.

Report of the Board of Directors

Esko Muhonen, Chairman

Aarno Heinonen

Mauri Jaakonaho

Raimo Rantala

Juha Tuominen

Kari Poikolainen, Secterary

Market conditions

Continued economic growth ensured that demand for energy remained stable during 1996. Electricity consumption increased by 2% over the previous year. The output of electricity generated using fuel peat increased by 8.9% and represented 9% of all electricity produced in Finland. Biofuels produced 25% of the nation's district heating.

In the sawn goods industry, export prices bottomed out during the spring and a period of slow recovery began from May onwards. In spite of the increase in prices, the average price for 1996 was 10% lower than in the year before. In volume terms, sawn goods exports from Finland decreased by 5% to a total of 7 million cubic metres. Consumption of sawn goods in the domestic market grew by over 10% and prices firmed to some extent.

Demand for growing media and fertilizers in Finland has picked up, although the overall markets in this sector are still only showing slow growth. Professional growers are going through a transition period brought about by the EU; as a result they are reducing the area under cultivation and some are re-orienting their businesses. It has been estimated that the area under cultivation is decreasing at the rate of 3% per year.

In the environmental business sector the markets opened up in 1996. New legislation on the taxation of waste came into force at the beginning of September, and this accelerated the development of the markets.

Turnover

Group turnover was up by 7% on the previous year and totalled FIM 1645 million (1995: FIM 1535 million). Vapo Oy's turnover was FIM 886 million (FIM 798 million).

Deliveries of biofuels increased by 14% to a total of 19.3 TWh. Vapo Timber Oy reported turnover of FIM 629 million (1995: FIM 622 million) and deliveries of sawn goods were up by 21 000 cubic metres on the 1995 figure.

The Kekkilä group's turnover was FIM 141 million (FIM 129 million). Sales of growing media and fertilizers were up by 16% in the domestic market. Exports increased by 2%.

Operating profit

Group operating profit was FIM 186 million, compared to FIM 182 million for the year before. The Parent Company, Vapo Oy, reported operating profit of FIM 167 million (FIM 146 million), Vapo Timber Oy FIM 15 million (FIM 36 million), and the Kekkilä group FIM 7 million (FIM -2 million).

The Parent Company's consistent profit performance is a reflection of the development of its main business activity. Vapo Timber's operating result was depressed by low export prices and rising raw material prices caused by shortages. As anticipated, the Kekkilä group succeeded in improving its financial performance: increased sales efforts and the practical implementation of measures taken in 1994 to rationalize the entire growing media sector both contributed to the improvement in profitability.

Investments

The Group's net investments for the period totalled FIM 158 million. Of this, FIM 80 million was spent on increasing peat production capacity and developing environmental protection.

Vapo Timber's largest investments were the replacement of the log sorting and debarking line and the infeed unit at Kevätniemi mill, as well as the acquisition of the business operations of Forssa sawmill at the end of the year. The remaining investments were targeted at increasing kilning and storage capacity at the sawmills and developing information systems. There were also smaller maintenance investments at all units. This subsidiary's investments totalled FIM 44 million.

The remainder of the investments represented spending to develop new business operations, as well as general administrative investments.

Financing

New long-term borrowing totalling FIM 60 million was taken up during the year. The net decrease in long-term borrowing during the year was FIM 52 million. Interest-bearing net debt totalled FIM 351 million at December 31, 1996. The majority of the investments were financed from income and from cash assets remaining from the previous year. The Group's financial position continued to improve during the year, and the solvency ratio at the year end was 59% (55%).

Group net financial expenses were FIM 18 million or 6% of the operating margin. The liquidity position was good throughout the year and the current ratio (the ratio of current assets to current liabilities) was 2.0.

Personnel and salaries

The Vapo Group employed an average of 1046 people in 1996 (1083). The energy business had an average directly-employed staff of 425, the growing media and fertilizer business 135, the sawn goods business 409, and a total of 77 employees were involved in the environmental business activities, foreign operations and central administration. The

personnel of the Parent Company remained unchanged from the previous year at 502.

In Vapo Oy, the Parent Company, a total of FIM 2.2 million was paid in salaries to the Board of Directors and Managing Director. Incentive payments represented FIM 0.1 million of this total. Salaries paid to other personnel totalled FIM 71 million.

In the Vapo Group, a total of FIM 5.1 million was paid in salaries to the Boards of Directors and Managing Directors. Incentive payments represented FIM 0.1 million of this total. Salaries paid to other Group personnel totalled FIM 146.8 million. During the year an incentive pay scheme was implemented in the Group on an experimental basis; under this scheme a total of FIM 3.4 million will be paid to employees.

Research and development

1996 Vapo's research activities mainly involved pilot-scale trials of processes and equipment. A pilot plant to produce an oil-like liquid from biomass by means of flash pyrolysis was installed at the premises of VTT Energy, and tests were started in June. The trials were used to establish the process parameters necessary for the design of a larger-scale plant.

A trial version of the second-generation air treatment plant, Biohelmi, was tested during the year. The unit was linked to degassing equipment operated by a Finnish company, Oy Visko Ab; its purpose was to filter out carbon disulphide and hydrogen sulphide compounds produced in the company's process. Trials to test the removal of malodorous gases were also performed at pulp mills.

A third pilot-scale unit was used to study the tunnel composting process using industrial and municipal sludges blended with various materials. This work has also been advanced by joint research with Jyväskylä University and the Lappeenranta Technical University.

As part of a project to study alternative uses for peat, research was conducted to determine how much cotton grass fibre is present in the peatlands of Western Finland. Research was also done into methods for cleaning the fibres. Work to study peat production in winter conditions was undertaken in conjunction with the Thule Institute.

A pilot plant was constructed to demonstrate the CFB (circulating fluidized bed) dryer and a new combustion method for high-moisture biomass. The objective is to commercialize technology to replace oil at oil-fired heating plants using wood fuel dried from high-moisture biomass. The new generation CFB dryer was also demonstrated as a method of drying raw material for the manufacture of chipboard.

Environmental review

Vapo's environmental management activities during the year included the preparation of a new Group environmental policy; on the basis of this new policy, environmental programmes and objectives were drawn up for both Vapo Energy and Vapo Timber.

The ISO quality system was supplemented with an ISO environmental management system, which was first introduced in the Western Finland business unit at the end of the year. A computer-based environmental database was developed for information management purposes. This system will be used to store updated information related to water treatment, land use, and environmental requirements. The Aqua Peat project involved work to study the environmental impacts of peat production, the carbon dioxide balance, after-use of sites released from production, biodiversity at peat extraction sites, and the life cycle of peat production activities. Work was also done to develop water treatment and monitoring methods and to study the impact of peat production activities on the environment in terms of dust problems and the impact on fish and crayfish stocks.

Changes in Group structure

Under the terms of the shareholders' agreement, VAM Vapo Wastech Ltd Oy (Jyväskylä) has been a Vapo Group company since the beginning of 1996. Vapo's holding in the company remains at 50%.

Vapo's holding in Karel-Vapo Oy (Petroskoi, Russia) increased to 52% at the end of the year, and therefore this company became a Vapo subsidiary.

During the last days of the year, Vapo acquired the fixed assets of Forssa sawmill. The sawmill will be operated by Forssan Saha Oy, a new company which will be a wholly-owned subsidiary of Vapo Timber Oy. The company's registered office is in the town of Forssa.

The outlook

Finland's 1996 budget legislation included a change to the energy taxation system, and this will reduce fuel peat consumption for electricity production at condensing power plants. As far as co-generation plants are concerned, peat still occupies a stable position, and possible new sites where it could be used are being studied. Vapo is focussing special efforts on the production, delivery and utilization of wood as a fuel, and a project has been launched to develop these activities.

In the sawn goods sector it is expected that market prices will again increase during the year, although some observers have also forecast negative price trends during the second half of the year. The high price of sawlogs represents a procurement problem for the sawmills. In addition to the issue of wood availability, another factor creating uncertainty is the new company-specific raw timber price agreement system which was introduced at the beginning of 1997. This procedure has not been tried in practice and its effectiveness is therefore unknown.

The environmental business activities can expect a period of rapid growth as communities and industrial companies increase their focus on environmental

matters. A clear indication of this is the significant increase in the volume of orders on hand for 1997. In Finland the boom in construction of waste handling plants will last several years, and the overall market for waste handling services will grow to a new level over the next few years.

The Kekkilä group's profitability will be further improved by continued emphasis in those areas and products where Kekkilä has a good level of competitiveness, and by action to improve cost efficiency. It is expected that growth in the gardening and construction sectors will make for improved sales growth potential during the current year.

Proposal for the distribution of profits

According to the Consolidated Balance Sheet, the Group's non-restricted shareholders' equity is FIM 864,433,761.20, of which FIM 522,792,678.61 represents distributable funds. The Parent Company's non-restricted shareholders' equity is FIM 429,049,247.16, of which profit for the financial period is FIM 108,718,317.34.

The Board of Directors proposes that the profit for the period as shown in the financial statements be utilized as follows:

- a dividend of FIM 36,000,000 or 12% of the registered share capital be paid;
- a total of FIM 72,718,317.34 be transferred to the retained earnings account.

Jyväskylä, 18 March 1997

Esko Muhonen
Chairman, Managing Director

Juha Tuominen
Mauri Jaakonaho
Aarno Heinonen
Raimo Rantala

ADMINISTRATION 31.12.1996

Supervisory Board

Chairman
Markku Koski, MP

Vice Chairman
Aarne Heikkilä, Executive Director

Members
Rune Holmström, Economic Counsellor
Armas Komi, MP
Leila Lehtinen, Consultant
Reijo Lindroos, MP
Paavo Niiles, Company Director
Erkki Pulliainen, MP
Taisto Turunen, Chief Director
Jan Vapaavuori, Master of Laws

Staff representatives on Supervisory Board
(1.7.1996 – 30.6.1998)

Kauko Korhonen
(peat industry workers)
Juhani Nevalainen
(sawmill workers)
Kaisa Runtti
(salaried office personnel)

Deputy staff representatives on Supervisory Board
(1.7.1996 – 30.6.1998)

Teuvo Penttinen
(peat industry workers)
Erkki Flink
(sawmill workers)
Marja Meriläinen
(salaried office personnel)

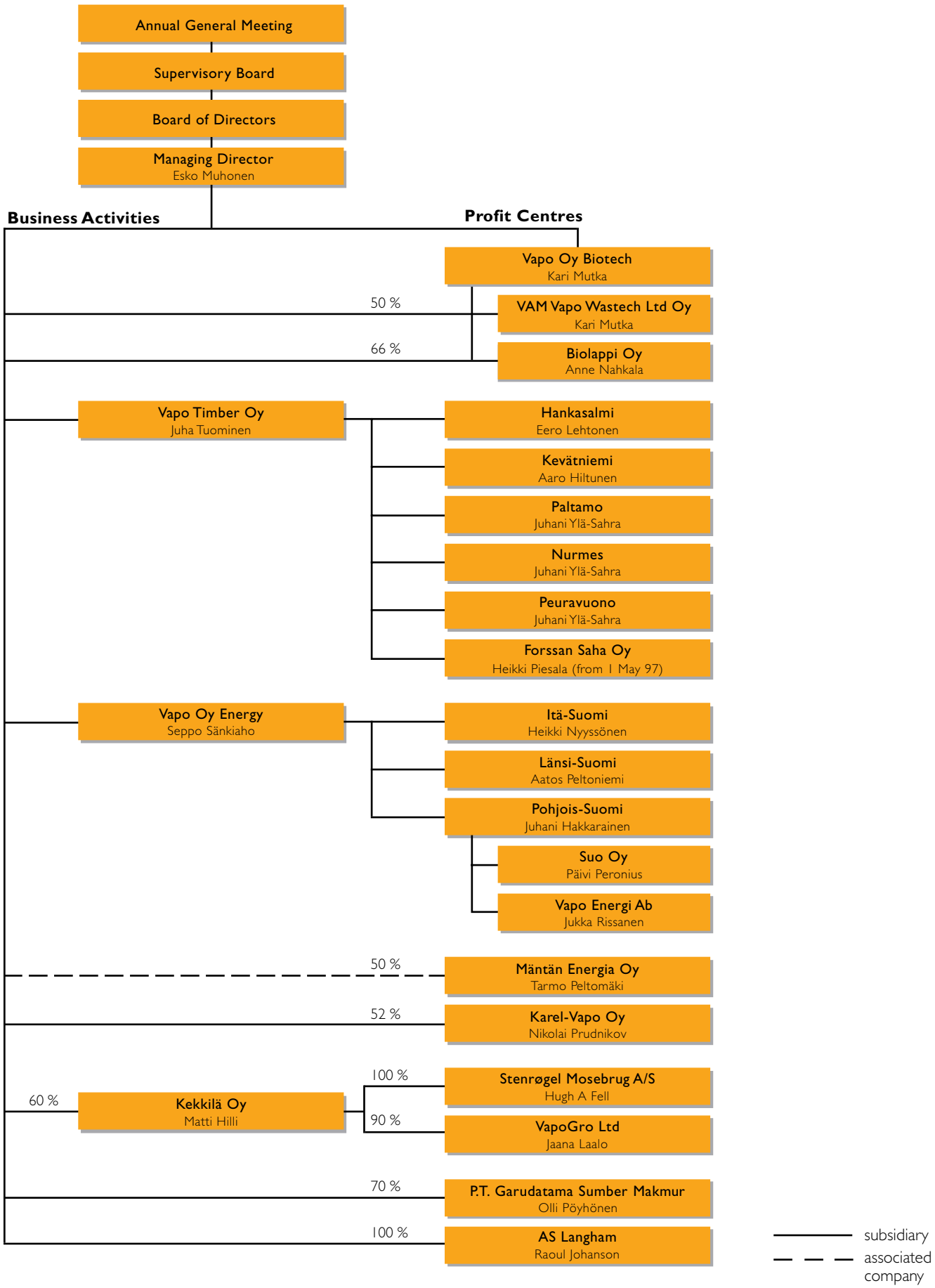
Board of Directors

Esko Muhonen, Chairman,
Managing Director, Vapo Oy
Juha Tuominen, Vice Chairman,
Managing Director, Vapo Timber Oy
Raimo Rantala,
Controller, Vapo Oy
Mauri Jaakonaho,
Deputy Managing Director, Valmet Oy
Aarno Heinonen, Controller,
Werner Söderström Oy

Auditors

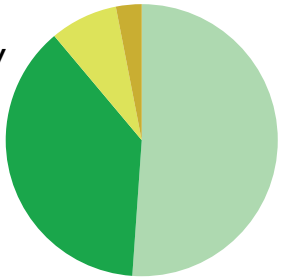
Arthur Andersen Kihlman Oy
(Certified Public Accountants)
Erkki Mitro, CPA

GROUP ORGANIZATION 1.1.1997



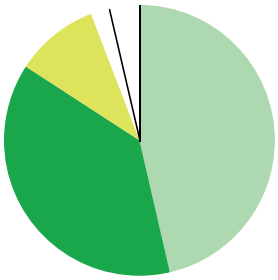
FIVE YEARS IN FIGURES

Turnover by business activity 1996, %

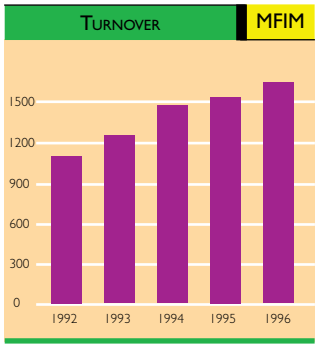


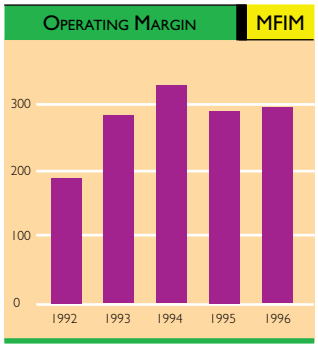
Vapo Oy Energy 51%
Vapo Timber Oy 38%
Kekkilä Oy 8%
Biotech and others 3%

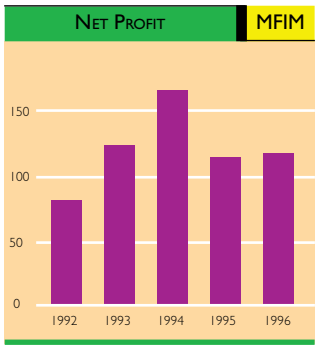
Turnover by main products 1996, %

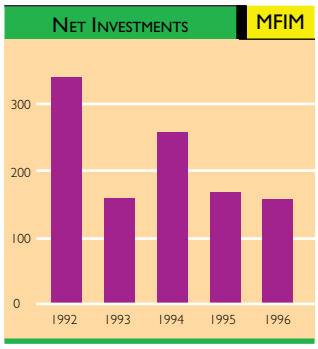


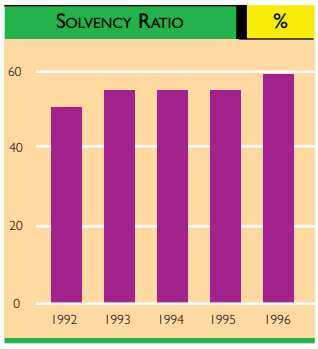
Fuel peat and other biofuels 46.5%
Timber products 37.6%
Growing media, fertilizers and environ. peat 10.2%
Thermal and electric power 2.0%
Environmental products and services, others 3.7%

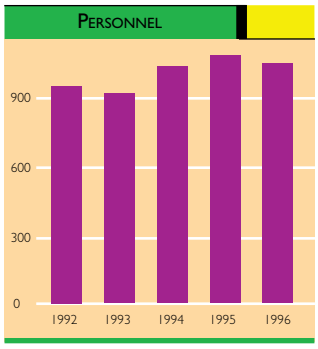












FIM million	1992	1993	1994	1995	1996
Turnover	1103	1257	1497	1535	1645
Growth %	5.3	14.0	19.1	2.5	7.2
Operating margin	189	283	327	289	293
Operating margin as % of turnover	17.1	22.5	21.8	18.8	17.8
Planned depreciation	73	89	97	108	108
Net financial items	0	-29	-14	-9	-18
Taxes	35	41	48	59	48
Dividends distributed	30	36	45	36	36
Net profit	81	124	168	114	120
Net investments	336	158	258	164	158
Liabilities	863	766	1203	849	909
Balance sheet total	1685	1682	2246	2090	2107
Current ratio	2.10	2.37	1.69	2.19	2.02
Solvency ratio %	50.3	55.9	55.7	55.3	59.6
Return on capital invested %	12.9	16.4	16.9	13.2	11.9
Personnel	948	917	1040	1083	1046

The turnover figures for 1992–95 have been restated to make them comparable with 1996 turnover.
The key ratios presented here include the deferred tax liability.

INCOME STATEMENT

		Group		Parent Company	
		1996	1995	1996	1995
FIM 1000					
TURNOVER	1	1 645 433	1 534 940	886 388	798 036
Increase in finished goods inventories		+976	+72 128	+10 687	+74 631
Production for own use		37 201	37 900	37 089	37 319
Share of associated company profit		784	561		
Other operating income		7 196	5 697	5 675	4 195
Expenses:					
Materials and supplies:					
Purchases during the period		433 669	494 107	78 772	89 712
Increase/decrease in inventories		+25 681	-33 935	+706	-525
External charges		616 664	580 057	478 516	466 426
Salaries, wages and social expenses	2	202 675	203 380	99 250	95 342
Rents		7 292	7 791	6 123	6 804
Other expenses		138 017	148 852	51 273	63 579
Preparation of peat reserves		-25 974	-38 530	-25 974	-38 530
		-1 398 024	-1 361 722	-688 666	-682 808
OPERATING MARGIN		293 566	289 504	251 173	231 373
	3				
Depreciation of fixed assets and other capitalized expenditure		107 272	107 205	-84 130	85 704
Amortization of goodwill		663	663		
		-107 935	-107 868	-84 130	-85 704
OPERATING PROFIT		185 631	181 636	167 043	145 669
Financial income and expenses:	5				
Dividend income		374	10	5 734	14 579
Interest income from long–term investments			14	3 618	4 559
Other interest income		10 501	17 547	8 541	13 635
Other financial income		212		1 872	4 860
Exchange rate differences		-556	9 636	1 265	2 837
Interest expenses		-27 566	-34 327	-25 642	-27 897
Other financial expenses		-617	-1 679	-283	-940
		-17 652	-8 799	-4 895	11 633
PROFIT BEFORE EXTRAORDINARY ITEMS, APPROPRIATIONS TO RESERVES AND TAXES		167 979	172 837	162 148	157 302
Extraordinary income and expenses	6				
Extraordinary expenses		-2 068			
PROFIT BEFORE APPROPRIATIONS TO RESERVES AND TAXES		165 911	172 837	162 148	157 302
Increase in depreciation difference	4		-76 876	-25 835	-57 949
Decrease in voluntary reserves			+44 661	+14 980	+40 181
Direct taxes					
For the accounting period		-42 072	-37 473	-42 575	-34 974
Change in deferred tax liability		-6 235			
		-48 307	-37 473	-42 575	-34 974
NET PROFIT BEFORE MINORITY INTEREST		117 604	103 149	108 718	104 560
Minority interest		+931	+2 805		
NET PROFIT		118 535	105 954	108 718	104 560

BALANCE SHEET

FIM 1000	Notes	Group		Parent Company	
ASSETS		1996	1995	1996	1995
FIXED ASSETS AND OTHER					
LONG–TERM INVESTMENTS	7				
Intangible assets					
Intangible rights		6 883	7 203	6 118	11 272
Goodwill		2 390	3 053		
Other capitalized expenditure		9 946	7 779	4 842	418
Advances paid		207	14	207	14
		19 426	18 049	11 167	11 704
Tangible assets					
Land and water areas		91 507	84 835	75 596	71 658
Buildings and structures		144 615	143 466	59 170	63 568
Machinery and equipment		493 405	472 452	356 958	365 521
Preparation of peat reserves and other tangible assets		462 921	447 248	437 504	426 902
Advances paid and construction in progress		15 091	13 141	10 892	7 994
		1 207 539	1 161 142	940 120	935 643
Shares and other long-term investments	8				
Investments in associated companies		2 737	2 935		
Shares and holdings		22 027	21 821	145 345	141 223
Loans receivable				56 244	56 653
Capital loan				3 140	0
		24 764	24 756	204 729	197 876
CURRENT ASSETS					
Inventories					
Materials and supplies		58 828	84 381	5 165	5 871
Work in progress		314	158	134	158
Finished goods		383 496	388 187	324 666	313 955
Advances paid		7 403	5 988	373	543
		450 041	478 714	330 338	320 527
Receivables	9				
Accounts receivable		224 647	221 231	160 010	135 601
Loans receivable		1 026	21	14 210	8 706
Prepaid expenses and accrued income		34 191	46 903	15 286	27 818
Other receivables		8 808	14 276	410	183
		268 672	282 431	189 916	172 308
Investments					
Other investments		89 265	40 543	62 183	33 347
Cash on hand and bank balances		47 100	84 260	16 779	60 834
BALANCE SHEET TOTAL		2 106 807	2 089 895	1 755 232	1 732 239

BALANCE SHEET

FIM 1000

	Notes	Group		Parent Company	
SHAREHOLDERS' EQUITY AND LIABILITIES		1996	1995	1996	1995
SHAREHOLDERS' EQUITY	10				
Restricted equity					
Share capital		300 000	300 000	300 000	300 000
Non-restricted equity					
Contingency reserve		179 030	179 030	178 945	178 945
Retained earnings		566 869	172 015	141 386	72 826
Profit for the period		118 535	105 954	108 718	104 560
		1 164 434	756 999	729 049	656 331
MINORITY INTEREST		32 977	25 976		
RESERVES					
Accumulated depreciation difference			433 938	404 560	378 725
Voluntary reserves					
Transition reserve			5 535		14 980
Other reserves			18 863		
			24 398		14 980
LIABILITIES					
Long-term	11				
Interest-bearing					
Debenture loans		21 000	21 000	21 000	21 000
Loans from financial institutions		257 599	291 122	208 499	243 252
Pension fund loans		65 302	70 605	58 834	63 293
Other long-term liabilities		2 529	56 145	1 107	54 315
		346 430	438 872	289 440	381 860
Non-interest bearing					
Deferred tax liability		134 569			
Other long-term liabilities		6 129	5 848	5 271	5 848
		140 698	5 848	5 271	5 848
Current	9				
Interest-bearing					
Loans from financial institutions		98 456	42 561	93 552	28 943
Pension fund loans		4 975	5 354	4 428	4 764
Other current liabilities		37 380	23 107	59 256	80 508
		140 811	71 022	157 236	114 215
Non-interest bearing					
Advances received		96 357	78 612	75 954	57 460
Accounts payable		109 428	153 842	41 565	58 435
Accrued liabilities		75 198	92 880	51 580	63 777
Other current liabilities		474	7 508	577	608
		281 457	332 842	169 676	180 280
BALANCE SHEET TOTAL		2 106 807	2 089 895	1 755 232	1 732 239

STATEMENT OF SOURCE AND APPLICATION OF FUNDS

FIM 1000	Group 1996	Group 1995	Parent Company 1996	Parent Company 1995
SOURCES OF FUNDS				
Finance from operations				
Operating margin	293 566	286 947	251 173	231 223
Interest and other financial income	11 087	29 765	21 030	40 619
Disposal of fixed assets	3 567	6 283	2 605	5 823
	308 220	322 995	274 808	277 665
Finance from other sources				
Increase in shareholders' equity		194		
Increase in minority interest	3 296	475		
Increase in long–term liabilities		11 252		
	3 296	11 921		
	311 516	334 916	274 808	277 665
APPLICATION OF FUNDS				
Profit distribution				
Interest on liabilities	28 739	36 005	25 925	28 836
Taxes	48 307	37 473	42 575	34 938
Dividends	36 000	45 000	36 000	45 000
	113 046	118 478	104 500	108 774
Investments				
Fixed assets	161 344	170 188	90 738	134 430
Other long–term investments	8	721	6 792	713
Change in valuation items		-91		
	161 352	170 818	97 530	135 143
Repayment of capital				
Decrease in shareholders' equity	466			
Decrease in long–term liabilities	15 325		56 828	7 364
	15 791		56 828	7 364
	290 189	289 296	258 858	251 281
BREAKDOWN OF CHANGE IN WORKING CAPITAL				
Decrease (-) /increase (+) in liquid assets	-2 197	-316 309	+2 387	-282 902
Decrease (-) /increase (+) in inventories	-28 673	+103 121	+9 811	+73 962
Decrease (+) in current liabilities	+52 197	+258 808	+3 752	+235 324
	+21 327	+45 620	+15 950	+26 384

ACCOUNTING PRINCIPLES

Extent of consolidation

The consolidated financial statements include the Parent Company, Vapo Oy, and all active companies in which the Parent Company either owns more than 50% of the voting rights or otherwise exercises control. Associated Companies are those in which the Parent Company owns a 20-50% holding.

Principles of consolidation

The acquisition method of consolidation has been adopted. Inter-company transactions, receivables and liabilities, internal margins and distribution of profit within the Group have been eliminated. Minority interest has been disclosed separately from the Group's net profit and shareholders' equity in the consolidated accounts. Corporation tax credits received by subsidiary companies have been set off against the tax charge for the period in the consolidated accounts.

The results of associated companies are accounted for in the consolidated financial statements using the equity method.

In the 1996 consolidated financial statements the depreciation difference and voluntary reserves have been separated into non-restricted equity and deferred tax liabilities.

Foreign currency items and hedging arrangements

In translating the accounts of overseas subsidiaries into Finnish Marks, income statements have been translated at the average rate of exchange for the accounting period and balance sheets at the Bank of Finland's average rate of exchange at the balance sheet date. Exchange differences arising on the translation of these accounts are shown as non-restricted shareholders' equity.

Foreign currency denominated receivables and liabilities have been translated to Finnish Marks at the Bank of Finland's average rate at the balance sheet date, or at contracted rates, and have been credited or charged to income for the period.

Since the beginning of 1996 exchange rate gains and losses arising on the translation of receivables and liabilities have been entered as exchange rate differences in the income statement. The figures for 1995 have been restated to maintain comparability.

Forward contracts and options used as hedges against exchange rate risks are stated at the appropriate rate on the balance sheet date. The interest component is apportioned over the term of the contract, and exchange rate differences arising on contracts to hedge liabilities or receivables are entered as exchange rate differences in the income statement.

Inventories

Inventories are valued at the lower of direct cost and net realizable value.

Fixed assets and depreciation

Fixed assets are stated at original cost less depreciation. Planned depreciation is charged on a straight-line basis against the original cost of the asset. In each case the straight-line depreciation rate is based on the useful life of the asset:

- intangible rights 5–10 years
- buildings and structures 20–40 years
- machinery and equipment 5–15 years
- peat reserves according to utilization
- other capitalized expenditure 4–10 years
- goodwill 5–10 years

Turnover

The basis on which turnover is reported has been changed during the accounting period. Turnover represents sales revenues less indirect taxes and trade discounts. 1995 turnover has been restated on the same basis as 1996 turnover.

Pension arrangements

Pension cover for Group employees is provided by insurance schemes.

NOTES TO THE ACCOUNTS

Note number	FIM 1000	Group 1996	Group 1995	Parent Company 1996	Parent Company 1995
1	TURNOVER BY BUSINESS ACTIVITY				
	- fuel peat activities	835 831	748 925	841 385	760 992
	- horticultural peat activities	139 534	128 584		
	- sawmills	626 944	619 897		
	- other business activities	43 124	37 534	45 003	37 044
		1 645 433	1 534 940	886 388	798 036
	BUSINESS OPERATIONS BY MARKET AREA				
	- Finland	1 182 923	1 052 746	870 528	788 183
	- Other Scandinavian countries	71 096	78 468	7 008	5 433
	- Other European countries	310 988	311 768	776	1 409
	- Other markets	80 426	91 958	8 076	3 011
		1 645 433	1 534 940	886 388	798 036
2	SALARIES, WAGES AND SOCIAL EXPENSES				
	Salaries and wages	154 536	152 839	75 141	70 779
	Pension expenses	25 932	26 102	12 992	12 976
	Social expenses	22 207	24 439	11 117	11 587
		202 675	203 380	99 250	95 342
	Taxation value of fringe benefits	2 277	2 044	956	919
	Total	204 952	205 424	100 206	96 261
3	PLANNED DEPRECIATION				
	Intangible rights	2 930	4 369	2 537	3 860
	Goodwill	663	663		
	Other capitalized expenditure	1 853	925	607	205
	Buildings and structures	9 588	10 333	4 452	4 264
	Machinery and equipment	62 173	63 440	47 587	50 747
	Preparation of peat reserves and other tangible assets	30 728	28 138	28 947	26 628
	Total	107 935	107 868	84 130	85 704
4	Change in depreciation difference:				
	Buildings and structures		3 078	-1 854	-1 365
	Machinery and equipment		42 535	20 349	28 050
	Preparation of peat reserves		31 263	7 340	31 264
	Total		76 876	25 835	57 949
5	FINANCIAL INCOME RECEIVED FROM GROUP COMPANIES				
	Dividend income			5 133	14 579
	Interest income from long–term investments			3 616	4 557
	Interest income from short–term investments			1	952
	FINANCIAL EXPENSES PAID TO GROUP COMPANIES				
	Interest expenses			1 559	610
6	EXTRAORDINARY EXPENSES				
	Reduction in value of decommissioned production plant	2 068	0		

Note number		Group 1996	Group 1995	Parent Company 1996	Parent Company 1995
	FIM 1000				
7	FIXED ASSETS AND OTHER CAPITALIZED EXPENDITURE				
	Intangible rights				
	Initial cost 1 Jan	38 023	40 510	35 486	38 707
	- additions 1 Jan – 31 Dec	2 474	4 408	2 450	3 674
	- disposals 1 Jan – 31 Dec	-20 494	-6 895	-20 494	-6 895
	Initial cost 31 Dec	20 003	38 023	17 442	35 486
	- accumulated planned depreciation 31 Dec	-13 120	-25 618	-11 324	-24 214
	Book value 31 Dec	6 883	12 405	6 118	11 272
	Goodwill				
	Initial cost 1 Jan	7 626	7 626		
	- additions 1 Jan – 31 Dec				
	Initial cost 31 Dec	7 626	7 626		
	- accumulated depreciation 31 Dec	-5 236	-4 573		
	Book value 31 Dec	2 390	3 053		
	Other capitalized expenditure				
	Initial cost 1 Jan	6 203	5 713	1 320	1 919
	- additions 1 Jan – 31 Dec	24 575	1 089	20 241	
	- disposals 1 Jan – 31 Dec	-145	-599		-599
	Initial cost 31 Dec	30 633	6 203	21 561	1 320
	- accumulated depreciation 31 Dec	-20 687	-3 626	-16 719	-902
	Book value 31 Dec	9 946	2 577	4 842	418
	Land and water areas				
	Initial cost 1 Jan	84 835	82 485	71 658	69 224
	- additions 1 Jan – 31 Dec	7 075	2 638	4 075	2 639
	- disposals 1 Jan – 31 Dec	-403	-288	-137	-205
	Book value 31 Dec	91 507	84 835	75 596	71 658
	Buildings and structures				
	Initial cost 1 Jan	201 034	192 865	101 793	98 041
	- additions 1 Jan – 31 Dec	13 627	8 602	335	3 949
	- disposals 1 Jan – 31 Dec	-4 146	-433	-751	-197
	Initial cost 31 Dec	210 515	201 034	101 377	101 793
	- accumulated depreciation 31 Dec	-65 900	-57 568	-42 207	-38 225
	Book value 31 Dec	144 615	143 466	59 170	63 568
	Accumulated difference between total and planned depreciation 1 Jan		33 197	30 704	32 069
	- increase in depreciation difference 1 Jan – 31 Dec		4 457		
	- decrease in depreciation difference 1 Jan – 31 Dec		-1 377	-1 855	-1 365
	Accumulated difference between total and planned depreciation 31 Dec		36 277	28 849	30 704

Note number		Group 1996	Group 1995	Parent Company 1996	Parent Company 1995
	FIM 1000				
	Machinery and equipment				
	Initial cost 1 Jan	770 218	683 442	614 883	557 446
	- additions 1 Jan – 31 Dec	86 092	108 319	40 564	75 438
	- disposals 1 Jan – 31 Dec	-15 791	-21 543	-13 499	-18 001
	Initial cost 31 Dec	840 519	770 218	641 948	614 883
	- accumulated depreciation 31 Dec	-347 114	-297 766	-284 990	-249 362
	Book value 31 Dec	493 405	472 452	356 958	365 521
	Accumulated difference between total and planned depreciation 1 Jan		189 188	182 409	154 032
	- increase in depreciation difference 1 Jan – 31 Dec		42 860	20 349	28 377
	Accumulated difference between total and planned depreciation 31 Dec		232 048	202 758	182 409
	Machinery and equipment, share of book value 31 Dec	254 543	236 544	145 233	137 852
	Preparation of peat reserves and other tangible assets				
	Initial cost 1 Jan	615 746	567 877	591 527	546 465
	- additions 1 Jan – 31 Dec	46 858	51 452	39 935	48 645
	- disposals 1 Jan – 31 Dec.	-386	-3 583	-386	-3 583
	Initial cost 31 Dec	662 218	615 746	631 076	591 527
	- accumulated depreciation 31 Dec	-199 297	-168 498	-193 572	-164 625
	Book value 31 Dec	462 921	447 248	437 504	426 902
	Accumulated difference between total and planned depreciation 1 Jan		134 494	165 613	134 494
	- increase in depreciation difference 1 Jan – 31 Dec		31 119	7 340	31 119
	Accumulated difference between total and planned depreciation 31 Dec		165 613	172 953	165 613
	Shares and holdings				
	Initial cost 1 Jan	24 756	24 035	141 223	139 406
	- additions 1 Jan – 31 Dec	921	721	4 263	1 817
	- disposals 1 Jan – 31 Dec	-913	0	-141	0
	Book value 31 Dec	24 764	24 756	145 345	141 223
	TAXATION VALUES				
	Land and water areas	56 895	55 169	50 178	48 177
	Buildings and structures	157 310	152 069	74 772	79 785
	Shares and holdings	131 708	184 445	113 667	141 185
		345 913	391 683	238 617	269 147
	Book value has been used in cases where taxation value is not available.				
8	LONG-TERM INVESTMENTS IN GROUP COMPANIES				
	Group companies				
	Shares and holdings			125 689	120 937
	Loans receivable			56 244	56 653
	Capital loan			3 140	0
	Total			185 073	177 590
	Associated companies				
	Shares and holdings	2 737	2 935	1 000	1 723

Note number		Group 1996	Group 1995	Parent Company 1996	Parent Company 1995
	FIM 1000				
9	GROUP RECEIVABLES AND LIABILITIES				
	Accounts receivable/group companies			14 091	5 284
	Accounts receivable/associated companies			1 004	5 369
	Loans receivable/group companies			13 184	8 687
	Prepaid expenses and accrued income/group companies			1 605	190
	Prepaid expenses and accrued income/associated companies			1 750	6 510
	Accounts payable/group companies			1 045	1 665
	Accrued liabilities/group companies			181	286
	Other current liabilities/group companies			22 551	58 671
	PENSION COMMITMENTS FOR BOARD OF DIRECTORS AND MANAGING DIRECTOR				
	Those members of the Board of Directors who are Vapo employees have the option of retiring at the age of 60–62 years.				
10	SHAREHOLDERS' EQUITY				
	Restricted equity				
	Share capital	300 000	300 000	300 000	300 000
	Non–restricted equity				
	Contingency reserve	179 030	179 030	178 945	178 945
	Retained earnings 1 Jan	277 969	216 821	177 386	117 826
	Distribution of dividends	-36 000	-45 000	-36 000	-45 000
	Change in exchange rate difference	-466	194		
	Equity from previous periods included in reserves	325 366			
	Net profit for the period	118 535	105 954	108 718	104 560
	Retained earnings 31 Dec	685 404	277 969	250 104	177 386
	Distributable part of non–restricted equity	522 793			
	Voluntary reserves				
	Accumulated depreciation difference	473 584	433 938		
	Transition reserve	1 346	18 863		
	Investment reserve	4 535	4 535		
	Other voluntary reserves	1 138	1 000		
		480 603	458 336		
	Deferred tax liability relating to voluntary reserves	134 569			

Note number		Group 1996	Group 1995	Parent Company 1996	Parent Company 1995
	FIM 1000				
11	LONG-TERM LIABILITIES DUE AFTER FIVE YEARS OR MORE				
	Loans from financial institutions	18 828	23 011	1 233	2 657
	Pension fund loans	48 808	52 748	44 011	47 346
	Other long-term liabilities	8 495	14 880	2 295	2 580
		76 131	90 639	47 539	52 583
	DEBENTURE LOANS				
	Debenture loan 1994/1999	21 000	21 000	21 000	21 000
	- repayable in a single instalment				
	CHARGES ON ASSETS, MORTGAGES PLEDGED, GUARANTEES, AND OTHER CONTINGENT LIABILITIES				
	Charges on assets				
	- for corporate debts		8 455		
	Mortgages pledged				
	- for corporate debts	94 989	137 017	5 000	5 000
	Guarantees				
	- for corporate debts	92 750	77 221		
	- for Group company debts			74 515	60 221
		92 750	77 221	74 515	60 221
	Other contingent liabilities				
	- other liabilities	346	1 622		1 336
	- open forward contracts	80 383	47 145	67 203	
		80 729	48 767	67 203	1 336
	Charges on assets, mortgages pledged, guarantees and other contingent liabilities total	268 468	271 460	146 718	66 557

PARENT COMPANY SHARES AND HOLDINGS

	Parent Company shareholding %	Group share of shareholders' equity		Parent Company shareholding Nominal value	Parent Company shareholding Book value	Profit/loss per most recent financial statements
Group companies		FIM 1000		FIM/share	FIM 1000	FIM 1000
Vapo Timber Oy, Jyväskylä	100	177 226	5000	5 000	71 000	1 541
Biolappi Oy, Rovaniemi	67	213	60	10 000	1 100	-679
Suo Oy, Jyväskylä	100	629	150000	1	9	105
Biofilter Oy, Helsinki	100	878	60	10 000	760	1
Vapo (U.K.) Ltd, London	99		99		1	
Kekkilä Oy group, Eurajoki	60	40 273	1514383	10	47 087	2 620
A/S Langham, Haapsalu	100	46	10	42	248	-173
Vapo Energi Ab, Överkalix	100	1 404	10000	60	600	561
P.T. Garudatama Sumber Makmur, Jakarta	70	-1 150	5000	136	1 593	-2 524
VAM Vapo Wastech Ltd Oy, Jyväskylä	50	1 284	5	100 000	3 000	-3 498
Karel-Vapo Oy, Petroskoi	52	257	171		291	235
Total					125 689	
Associated companies						
Mäntän Energia Oy, Mänttä	50	2 737	2000	500	1 000	1568
Other Parent Company owned shares and holdings					18 655	

AUDITORS' REPORT

To the shareholders of Vapo Oy

We have audited the accounting, the financial statements and the corporate governance of Vapo Oy for the period 1 January to 31 December 1996. The financial statements, which include the report of the Board of Directors, consolidated and Parent Company income statements, balance sheets and notes to the financial statements, have been prepared by the Board of Directors and the Managing Director. Based on our audit we express an opinion on these financial statements and on corporate governance.

We have conducted the audit in accordance with the Finnish Standards on Auditing. Those standards require that we perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the management as well as evaluating the overall financial statement presentation. The purpose of our audit of corporate governance is to examine that the members of the Supervisory Board, the Board of Directors and the Managing Director have legally complied with the rules of the Companies Act.

In our opinion the financial statements have been prepared in accordance with the Accounting Act and other rules and regulations governing the preparation of financial statements. The financial statements, which show a profit for the accounting period of FIM 108,718,317.34 give a true and fair view, as defined in the Accounting Act, of both the consolidated and Parent Company's result of operations as well as of the financial position. The financial statements, with the consolidated financial statements, can be adopted and the members of the Supervisory Board, the Board of Directors and the Managing Director of the Parent Company can be discharged from liability for the period audited by us. The proposal by the Board of Directors regarding the distribution of retained earnings is in compliance with the Companies Act.

Jyväskylä, 18 March 1997

ARTHUR ANDERSEN KIHLMAN OY
Certified Public Accountants

Erkki Mitro
CPA

STATEMENT OF THE SUPERVISORY BOARD

The Supervisory Board has examined Vapo Oy's Consolidated Financial Statements, Parent Company Financial Statements and Auditors' Report for 1996, and has found that these require no comment on the part of the Supervisory Board.

The Supervisory Board recommends the adoption of the Consolidated Income Statement and Balance Sheet and of the Parent Company Income Statement and Balance Sheet and supports the proposal of the Board of Directors as regards the distribution of profits.

The Company's present articles of association stipulate that all the members of the Supervisory Board are elected each year at the Annual General Meeting.

Helsinki, 2 April 1997

Markku Koski

Aarne Heikkilä	Rune Holmström
Armas Komi	Leila Lehtinen
Reijo Lindroos	Paavo Niiles
Erkki Pulliainen	Taisto Turunen

Jan Vapaavuori

EMPLOYEE PARTICIPATION (EP) COMMITTEE MEMBERS
1.7.1995–30.6.1997

- Salaried peat industry personnel
  Jaakko Argillander
  (Lauri Korkeala)
- Peat industry workers
  Teuvo Penttinen
  (Kauko Korhonen)
  Risto Saarikoski
  (Ilpo Viinamäki)
- Sawmill workers
  Juhani Nevalainen
  (Juha Palokas)
  Erkki Flink
  (Eetu Karjalainen)
- Forestry workers
  Hannu Turpeinen
  (Reijo Hampinen)
- Salaried forestry personnel
  Heikki Miettinen
  (Paavo Kivimäki)
- Sawmill supervisors
  Juha Castrén
  (Veikko Manninen)
- Salaried office personnel
  Maija Kirvesoja
  (Kirsi Pennanen)
  Merja Katajasalo
  (Rauni Levola)
- Senior salaried personnel
  Ilkka Ilmavirta
  (Maila Salmelin)

EMPLOYEE REPRESENTATIVES ON IN–HOUSE MAGAZINE EDITORIAL BOARD 1996–1997

Erkki Flink, sawmill workers
Pentti Haataja, senior salaried employees
Hannu Laukkanen, supervisors
Anneli Ovaska, salaried office personnel
Pauli Turunen, peat industry workers

EMPLOYEE REPRESENTATIVES IN BUSINESS UNIT MANAGEMENT GROUPS
1.1.1996–31.12.1997.


- Western Finland
  Tapani Koivistoinen
  (Kosti Kaukajoki)
  Sirpa Mäki-Pirilä
  (Heimo Pihlajamäki)


- Eastern Finland
  Teuvo Penttinen
  (Aarno Kuivalainen)
  Merja Koponen
  (Hannu Laukkanen)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  Jouko Niva
  (Eino Ämmänpää)
  Anneli Ovaska
  (Jaakko Argillander)


- **Hankasalmi**
  Pertti Janhunen
  Veikko Manninen


- **Kevätniemi**
  Juha Palokas
  (Armas Ruokolainen)
  Birgitta Kettunen
  (Merja Katajasalo)


- **Nurmes**
  Reino Määttä

- **Paltamo**
  Tuomo Rautiainen

- Peuravuono
  Kalevi Siivikko
  (Mauri Bogdanoff)

Development programme generates common culture

A programme of training conducted throughout the Vapo group has succeeded in generating a common corporate language and culture. The scope of the programme included profit-oriented thinking, management and cooperation feedback, project management, negotiation skills and self-knowledge training. Quality systems have brought with them process thinking and process teams. A second phase of team training has been started.

In the course of the year the number of training days came to over 6 000, of which vocational training accounted for two thirds. Vocational training focused on the production of peat and sawn goods as well as the use of computers.

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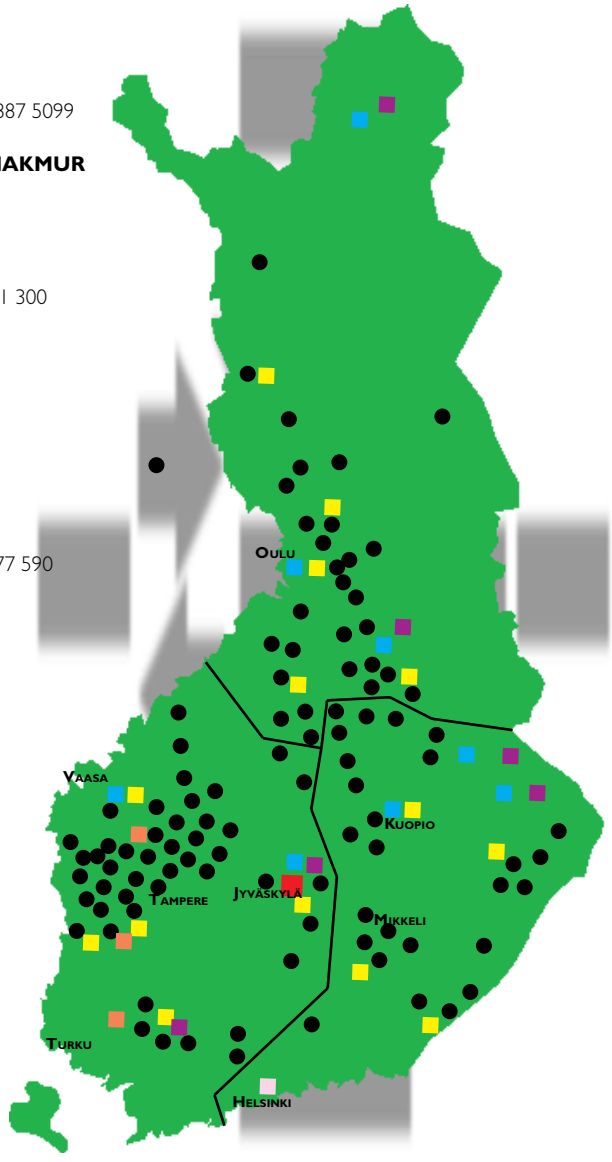
This year Vapo Oy Energy and Vapo's Central Administration will get an e-mail system. Use the recipient's name as the first part of the address (but leave out Scandinavian accents: for ä use a, for ö use o): firstname. lastname @vapo.fi. E.g. Erkki Mäntymaa's address is erkki.mantymaa@vapo.fi



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