

Australian Forest Industries
Form 10QSB
November 19, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D. C. 20549

FORM 10-QSB
QUARTERLY REPORT UNDER SECTION 13 or 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2007
Commission file number 0-25909

Australian Forest Industries
(Exact name of small business issuer as specified in its charter)

Nevada
(State or other jurisdiction of incorporation or
organization)

86-0931332
(I.R.S. Employer Identification No.)

4/95 Salmon Street, Port Melbourne, Victoria
Australia, 3207
(Address of principal executive offices) (Zip Code)

Issuer's telephone number: 011 61 3 8645 4340

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

The number of shares of the issuer's outstanding common stock, which is the only class of its common equity, on September 30, 2007, was 257,600,680.

ITEM 1 FINANCIAL STATEMENTS

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AUSTRALIAN FOREST INDUSTRIES AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

ASSETS

	September 30, 2007 (Unaudited)	December 31, 2006
CURRENT ASSETS		
Cash	\$ 8,737	\$ 4,894
Accounts receivable, net	454,590	1,493,473
Inventory	5,406	740,384
Prepaid expenses and other	122,535	33,121
Total Current Assets	591,268	2,271,872
PROPERTY, PLANT AND EQUIPMENT, net of accumulated depreciation of \$4,086,769 and \$3,189,690 at September 30, 2007 and December 31, 2006, respectively		
	19,768,012	17,929,297
OTHER ASSETS		
Long-term timber supply contract, net of amortization of \$176,531 and \$124,345 at September 30, 2007 and December 31, 2006, respectively	798,899	742,307
Total Assets	\$ 21,158,179	\$ 20,943,476
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Bank overdraft	\$ 3,256,759	\$ 1,899,238
Due to National Australia Bank	5,863,242	5,209,380
Accounts payable	7,736,845	5,311,101
Current portion of capitalized lease obligations	5,537,021	1,977,755
Due to Timberman shareholders	7,454,632	6,593,951
Related party payable	721,459	641,003
Accrued payroll, related taxes and benefits	1,006,996	1,213,106
Total Current Liabilities	31,576,954	22,845,534
OTHER LIABILITIES		
Capitalized lease obligations	817,563	3,410,322
Deferred capital gain	1,598,318	1,521,804
Total Liabilities	33,992,835	27,777,660
STOCKHOLDERS' EQUITY		
Preferred stock, par value \$0.001, 5,000,000 shares authorized, none issued and outstanding		
Common stock, par value \$0.001, 300,000,000 shares authorized, 257,600,680 issued and outstanding in 2007 and 2006, respectively	257,600	257,600
Additional paid-in capital	4,573,217	4,573,217

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Accumulated other comprehensive income	(967,462)	302,278
Accumulated deficit	(16,698,011)	(11,967,279)
Total Stockholders' Deficit	(12,834,656)	(6,834,184)
Total Liabilities and Stockholders' Deficit	\$ 21,158,179	\$ 20,943,476

See accompanying notes to financial statements.

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AUSTRALIAN FOREST INDUSTRIES

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
REVENUE – SALES	\$ 477,244	\$ 4,008,572	\$ 2,511,403	\$ 11,350,633
COSTS AND EXPENSES				
Cost of goods sold	164,358	2,414,890	775,946	6,525,037
Selling, general and administrative	585,236	2,706,697	4,792,956	6,737,478
Provision for doubtful accounts	1,372	134,154	86,251	266,649
Interest expense	190,268	254,564	1,176,953	647,648
Depreciation and amortization	169,642	149,162	493,234	436,287
Total Costs and Expenses	1,110,876	5,659,467	7,325,340	14,613,099
OPERATING LOSS	(633,632)	(1,650,895)	(4,813,937)	(3,262,466)
NON-OPERATING INCOME				
Other income	21,538	12,037	42,401	145,325
Interest income		83,555		247,586
Gain on disposal of assets	14,034	648	40,804	104,203
Total Non-Operating Income	35,572	96,240	83,205	497,114
NET LOSS	\$ (598,060)	(1,554,655)	\$ (4,730,732)	\$ (2,765,352)
NET LOSS PER SHARE				
(BASIC AND DILUTED)	\$ 0.01	\$ 0.01	\$ (0.02)	\$ (0.01)
WEIGHTED AVERAGE SHARES				
OUTSTANDING	257,600,680	257,400,680	257,600,680	257,400,680

See accompanying notes to financial statements.

AUSTRALIAN FOREST INDUSTRIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	For the Nine Months Ended September 30,	
	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (4,730,732)	\$ (2,765,352)
Adjustments to reconcile net loss to cash flows from operating activities:		
Depreciation and amortization	493,234	407,419
Stock based compensation		70,000
Amortization of leaseback gain	(40,804)	(252,150)
Changes in operating assets and liabilities:		
(Increase) decrease in prepaid expenses	(89,414)	53,046
(Increase) decrease in inventories	734,978	(562,603)
(Increase) decrease in receivables	1,038,883	(1,044,880)
(Increase) decrease in Timber contract	52,187	66,662
Increase (decrease) in accounts payable and other liabilities	2,425,744	1,990,795
Increase (decrease) in bank overdraft	1,357,521	1,989,217
Increase (decrease) in related party payable		13,643
Increase (decrease) in accrued payroll	(206,109)	299,350
Increase (decrease) in taxes payable		69,437
Net Cash Provided by (Used in) Operating Activities	1,035,488	334,584
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital additions	(85,016)	(3,833,830)
Net Cash Used in Investing Activities	(85,016)	(3,833,830)
CASH FLOWS FROM FINANCING ACTIVITIES		
Loans from shareholders	33,032	2,777,287
Capital leases	202,559	554,609
National Australian Bank loan		110,880
Sale leaseback deferred credit	76,514	37,083
Net Cash Provided By (Used In) Financing Activities	312,105	3,479,859
EFFECT OF EXCHANGE RATES ON CASH	(1,258,734)	(107,627)
INCREASE (DECREASE) IN CASH	3,843	(127,014)
CASH AT BEGINNING OF PERIOD	4,894	127,014
CASH AT END OF PERIOD	\$ 8,737	\$

See accompanying notes to financial statements.

AUSTRALIAN FOREST INDUSTRIES AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2007

NOTE A - BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary in order to make the financial statements not misleading have been included. Results for the nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the financial statements and footnotes thereto included in the Australian Forest Industries annual report on Form 10-KSB for the year ended December 31, 2006.

NOTE B - GOING CONCERN

As indicated in the accompanying financial statements, the Company incurred a net loss of \$4,730,732 for the nine months ended September 30, 2007, and has a Stockholders' Deficit of \$12,834,656 at September 30, 2007. Management's plans include the raising of capital through the equity markets to fund future operations, seeking additional acquisitions, and generating of revenue through its business. Additionally, even if the Company does raise sufficient capital to support its operating expenses and generate adequate revenues, there can be no assurances that the revenue will be sufficient to enable it to develop business to a level where it will generate profits and cash flows from operations. Additionally, during the fourth quarter of 2006, the Company experienced a severe liquidity problem and was having difficulty obtaining logs to operate its businesses. Currently, management has entered into a processing contract with Weyerhaeuser to process their logs for which the Company is receiving a processing fee. The Company's wholly owned subsidiary in Australia, Integrated Forest Products, is currently under administration in Australia (in the U.S. this is tantamount to a Chapter 11 Bankruptcy). There is no assurance that the company will emerge from the administrative proceedings and be self-sufficient and profitable. (See Note D to the Financial Statement.) These matters raise substantial doubt about the Company's ability to continue as a going concern. However, the accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. These consolidated financial statements do not include any adjustments relating to the recovery of the recorded assets or the classification of the liabilities that might be necessary should the Company be unable to continue as a going concern.

NOTE C - LITIGATION

Oz Investmentcorp Pty Ltd. initiated a letter of demand for the \$1,578,600 due from the Timberrmans Group for full payment of funds lent to the Timberrmans Group. The Company is currently negotiating with Oz and had agreed to provide additional collateral.

On November 14, 2007, the Company was named as a co-defendant in a lawsuit brought in the High Court of Justice Chancery Division, England by Courical Holding B.V. ("Plaintiff") whereby it is alleged that the Plaintiff invested \$650,000 in Zebra Mining Services Limited ("Co-Defendant") in exchange for 325,000 shares of Company common stock and 325,000 warrants to purchase Company common stock pursuant to an agreement between the three parties. The Plaintiff alleges that it never received any consideration for its investment from either the Co-Defendant or the Company. Although the Company anticipates submitting an answer to such Complaint, it has not currently done so as it is considering its course of action thereto.

NOTE D - ADMINISTRATION

The Company's wholly owned subsidiary in Australia, Integrated Forest Products, is currently in Administration and is being operated by Court appointed administrators. Administration in Australia is similar to Chapter 11 Bankruptcy or receivership in the U.S. There is no assurance that the Company's subsidiary will emerge from the administrative proceedings.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS

It should be noted that this Management's Discussion and Analysis of Financial Condition and Results of Operations may contain "forward-looking statements." The terms "believe," "anticipate," "intend," "goal," "expect," and similar expressions may identify forward-looking statements. These forward-looking statements represent the Company's current expectations or beliefs concerning future events. The matters covered by these statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those set forth in the forward-looking statements, including the Company's dependence on weather-related factors, introduction and customer acceptance of new products, the impact of competition and price erosion, as well as supply and manufacturing restraints and other risks and uncertainties. The foregoing list should not be construed as exhaustive, and the Company disclaims any obligation subsequently to revise any forward-looking statements to reflect events or circumstances after the date of such statements, or to reflect the occurrence of anticipated or unanticipated events. In light of the significant uncertainties inherent in the forward-looking information included herein, the inclusion of such information should not be regarded as a representation that the strategy, objectives or other plans of the Company will be achieved. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made.

As indicated in the accompanying financial statements, the Company incurred a net loss of \$4,730,732 for the nine months ended September 30, 2007, and has a Stockholders' Deficit of \$12,834,656 at September 30, 2007. Management's plans include the raising of capital through the equity markets to fund future operations, seeking additional acquisitions, and generating of revenue through its business. Additionally, even if the Company does raise sufficient capital to support its operating expenses and generate adequate revenues, there can be no assurances that the revenue will be sufficient to enable it to develop business to a level where it will generate profits and cash flows from operations. Additionally, during the fourth quarter of 2006, the Company experienced a severe liquidity problem and was having difficulty obtaining logs to operate its businesses. Currently, management has entered into a processing contract with Weyerhaeuser to process their logs for which the Company is receiving a processing fee. The Company's wholly owned subsidiary in Australia, Integrated Forest Products, is currently under administration in Australia (in the U.S. this is tantamount to a Chapter 11 Bankruptcy). There is no assurance that the company will emerge from the administrative proceedings and be self-sufficient and profitable. (See Note D to the Financial Statement.) These matters raise substantial doubt about the Company's ability to continue as a going concern. However, the accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. These consolidated financial statements do not include any adjustments relating to the recovery of the recorded assets or the classification of the liabilities that might be necessary should the Company be unable to continue as a going concern.

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The Company's wholly owned subsidiary in Australia, Integrated Forest Products, is currently in Administration and is being operated by Court appointed administrators. Administration in Australia is similar to Chapter 11 Bankruptcy or receivership in the U.S. There is no assurance that the Company's subsidiary will emerge from the administrative proceedings.

We are currently seeking alternative business operations and any transaction that would involve the sale of most or all of our assets. If and when such sale has been completed, we will seek to use the proceeds from such sale, after satisfying our current liabilities, to develop or acquire a business or businesses which we believe will best serve the long term interests of our shareholders. Such businesses may or may not be related to the timber industry.

RESULTS OF OPERATIONS

Operating costs for the three-months ended September 30, 2007 aggregated \$1,110,876. This includes costs incurred in general and administrative selling of \$585,236. We incurred an operating loss of \$(633,632) and a total net loss of \$(598,060) or \$(0.01) per share.

Operating costs for the nine-month period ended September 30, 2007 aggregated \$(4,813,937). This includes general and administrative selling of \$4,792,956 and interest expenses of \$1,176,953. As a result of the above we realized a net loss of \$(4,730,732) for the nine-month period ended September 30, 2007 or \$(0.01) per share.

LIQUIDITY AND CAPITAL RESOURCES

On September 30, 2007 we had current assets of \$21,158,179 and on December 31, 2006 we had current assets of \$20,943,476.

Net cash provided by operating activities for the nine-month period ended September 30, 2007 was \$1,035,488. Net cash used in investing activities for the six-month period ended September 30, 2007 was \$(85,016). Net cash provided by financing activities was \$312,105 for this period.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's discussion and analysis of its financial condition and results of operations are based upon its financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to bad debts, income taxes and contingencies and litigation. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Recent Accounting Pronouncements Affecting The Company:

In June 2006, the Financial Accounting Standards Board (“FASB”) issued Interpretation 48, “Accounting for Income Tax Uncertainties” (“FIN 48”). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as “more-likely-than-not” to be sustained by the taxing authority. Recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company expects to adopt the provisions of FIN 48 beginning in the first quarter of 2007. The Company is currently in the process of determining the impact, if any, of adopting the provisions of FIN 48 on its financial position, results of operations and liquidity.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements,” which defines fair value, establishes a framework for measuring fair value under other accounting pronouncements that permit or require fair value measurements, changes the methods used to measure fair value and expands disclosures about fair value measurements. In particular, disclosures are required to provide information on the extent to which fair value is used to measure assets and liabilities; the inputs used to develop measurements; and the effect of certain of the measurements on earnings (or changes in net assets). SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Early adoption, as of the beginning of an entity’s fiscal year, is also permitted, provided interim financial statements have not yet been issued. The Company expects to adopt the provisions of FIN 48 beginning in the first quarter of 2008. The Company is currently evaluating the potential impact, if any, that the adoption of SFAS No. 157 will have on its consolidated financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB No. 108”). SAB No. 108 provides guidance on how prior year misstatements should be considered when quantifying misstatements in the current year financial statements. SAB No. 108 requires registrants to quantify misstatements using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB No. 108 does not change the guidance in SAB No. 99, “Materiality,” when evaluating the materiality of misstatements.

SAB No. 108 is effective for fiscal years ending after November 15, 2006. Upon initial application, SAB No. 108 permits a one-time cumulative effect adjustment to beginning retained earnings. The Company adopted SAB No. 108 for the fiscal year ended December 31, 2006. Adoption of SAB No. 108 did not have a material impact on the consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (“SFAS 159”). SFAS 159 allows entities to measure at fair value many financial instruments and certain other assets and liabilities that are not otherwise required to be measured at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We have not determined what impact, if any, that adoption will have on our results of operations, cash flows or financial position.

ITEM 3. CONTROLS AND PROCEDURES

(a) Our principal executive officer and principal financial officer have each evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) as of a date within 90 days prior to the filing date of this quarterly report and have each concluded that our disclosure controls and procedures are adequate.

(b) There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

(c) Not applicable

PART II

Item 1. Legal Proceedings

Oz Investmentcorp Pty Ltd. initiated a letter of demand for the \$1,578,600 due from the Timbermans Group for full payment of funds lent to the Timbermans Group. The Company is currently negotiating with Oz and had agreed to provide additional collateral.

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Item 2. Changes in Securities

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

a. Exhibit Index

Exhibit 31.1 Certification of Chief Executive Officer

Exhibit 31.2 Certification of Chief Financial Officer

Exhibit 32.1 Certification of Chief Executive Officer

Exhibit 32.1 Certification of Chief Financial Officer

b. Reports on Form 8-K

None.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AUSTRALIAN FOREST INDUSTRIES

/s/ Michael Timms

Name: Michael Timms

Title: CEO, President and Chairman of the Board

Date: November 16, 2007

/s/ Colin Baird

Name: Colin Baird

Title: Chief Financial Officer

Date: November 16, 2007
