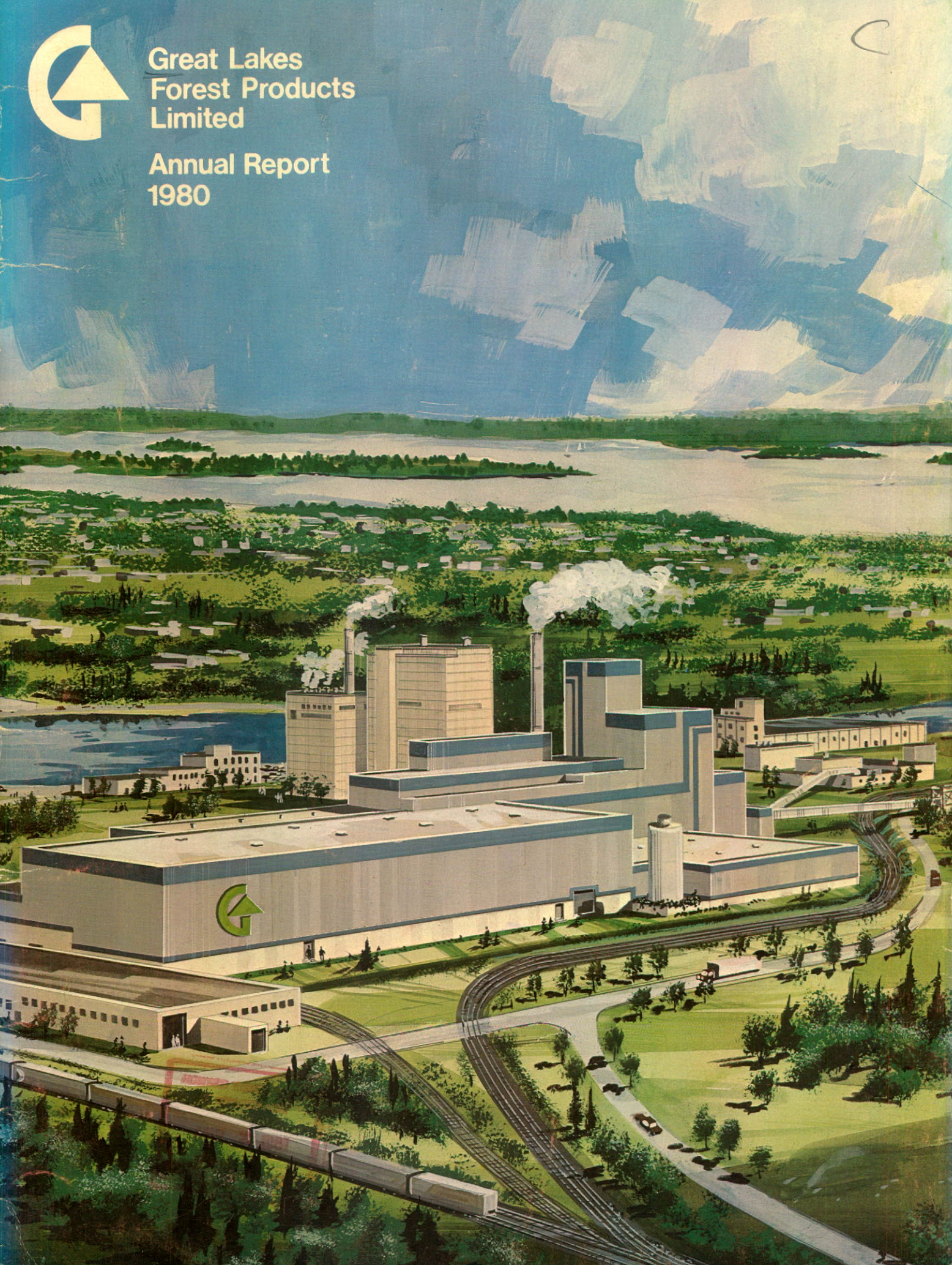
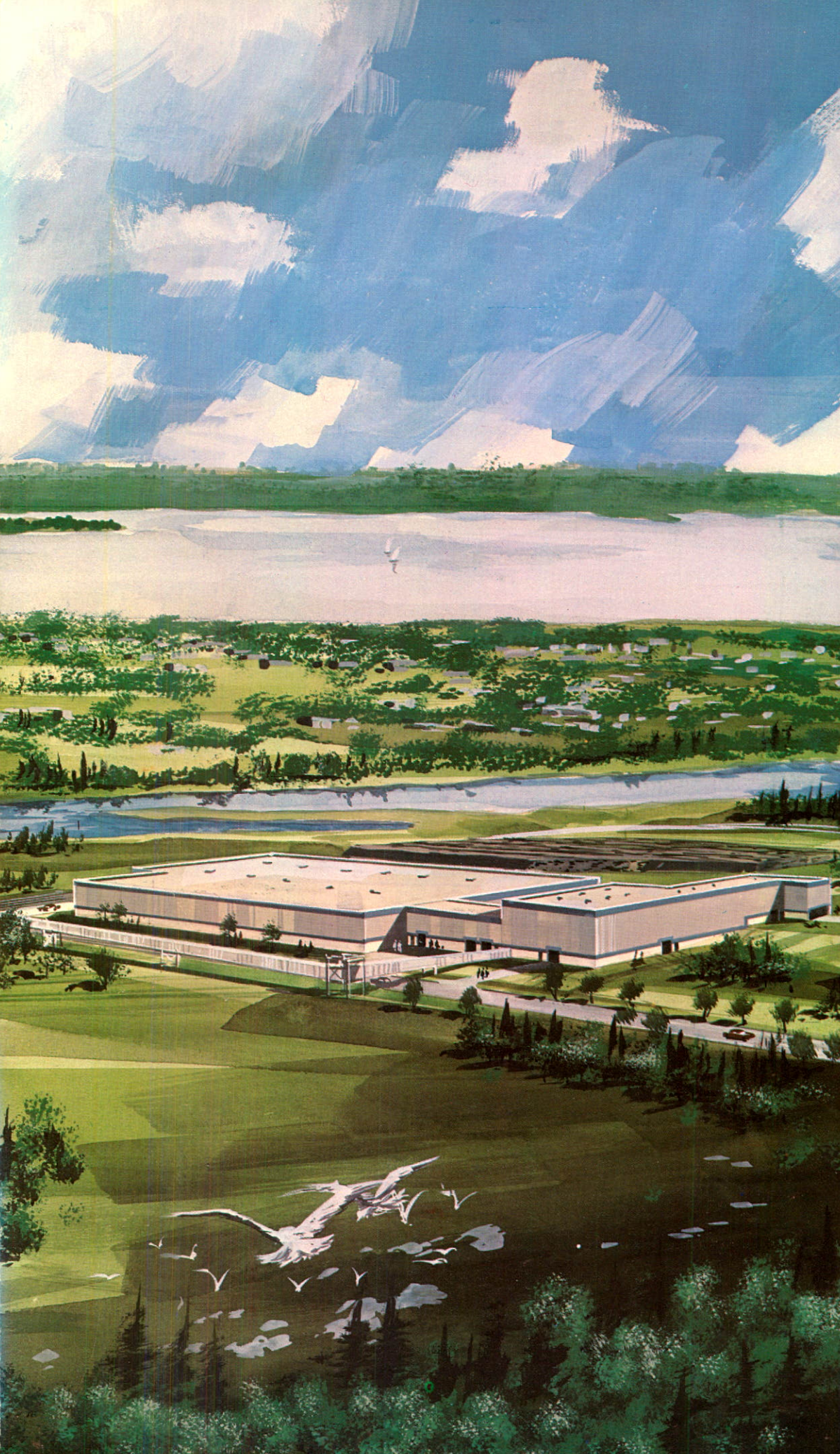




Great Lakes
Forest Products
Limited

Annual Report
1980





HIGHLIGHTS OF '80

Net earnings in 1980 were \$81.4 million or \$18.01 a share versus \$49.9 million in 1979 or \$13.32 a share.

Increased shipments, particularly the inclusion of production from our Dryden operations, and higher prices for our major products were responsible for increased net sales of \$539.3 million in 1980 versus \$338.1 million in 1979.

In 1980 construction commenced on the \$250 million modernization and expansion of our Dryden kraft pulp mill facilities as well as the \$90 million modernization and environmental program at our Thunder Bay operations and we announced a \$90 million modernization of our fine paper operation in Dryden conditional on a government incentive grant.

Our increase in working capital to \$125.7 million at the end of 1980 from \$18.1 million a year earlier and shareholders' equity of \$263.2 million compared with \$148.1 million at the end of 1979 provide a strong base for financing the company's capital expenditure program.

SCOREBOARD	1980	1979
<i>'000 omitted</i>		
Net sales: Pulp and paper	\$503,861	\$299,407
Building products	35,418	38,668
Total	539,279	338,075
Operating profit	174,210	108,410
Earnings before income taxes	143,105	81,603
Income taxes	61,753	31,727
NET EARNINGS: Total amount	81,352	49,876
Per share	18.01	13.32
Cash flow	119,842	84,891
Expenditures on fixed assets	65,612	81,931
<i>(1979 includes purchase of Dryden fixed assets)</i>		
Working capital at year end	125,729	18,128

Five-year shipment and financial summaries are shown on pages 21, 22 and 23.

On Inside Pages

2 Directors & Management	21 Shipment Summary
3 To The Shareholders	22 Financial Summary
5 1980 Results in Detail	23 Charts & Tables
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12 Management's Discussion and Analysis of 1980 Financial Statements	Inside back cover: Map of our Woodlands Areas
13 Financial Statements	<i>Dollars in this report are Canadian unless otherwise identified.</i>
19 Glossary of Terms	<i>All tons in this report are metric tons. A metric ton is equivalent to approximately 1.1 short tons.</i>
20 Industry Reference Data	

Our Company

Great Lakes Forest Products Limited was incorporated under the laws of Ontario in 1936. We manufacture bleached and unbleached kraft pulp, newsprint, lumber, waferboard and fine and kraft papers. Our mills are located at Thunder Bay and Dryden, Ontario. Head office and mailing address: Box 430, Thunder Bay, Ont., P7C 4W3.

Fine Paper Sales

All our fine paper products are marketed through our offices in Toronto, Ontario and Winnipeg, Manitoba:
JOHN H. SIM, *director, fine paper sales.*

Pulp Sales

Lake Superior Pulp & Paper Inc., Chicago and White Plains, N.Y., sale of kraft pulp:
R. L. NASH, *president;*
F. M. JENNINGS, *vice-president.*

Newsprint Services

Lake Superior Newsprint Co., Chicago, servicing of newsprint paper contracts:
W. D. FROST, *president;*
O. E. BABCOCK, *vice-president.*

Agents and Registrar

Our common share transfer agents are The Royal Trust Company, Toronto, Montreal, Calgary and Regina, and the Bank of Montreal Trust Company in New York. Our registrar is The Canada Trust Company, Toronto, Montreal, Calgary and Regina.

Shareholders' Meeting

Our shareholders' meeting will be held at 11:30 a.m. Eastern Standard Time in the Confederation Room of The Royal York Hotel, Toronto on Wednesday, April 15, 1981.

Board of Directors at December 31, 1980

C. R. BOWLES	Thunder Bay	1964
<i>vice-president, finance, Great Lakes Forest Products Limited</i>		
*C. J. CARTER	Thunder Bay	1947
<i>chairman of the board and president, Great Lakes Forest Products Limited</i>		
**PERCY M. FOX	Bermuda	1952
<i>honorary chairman, Great Lakes Forest Products Limited</i>		
*IRWIN MAIER	Milwaukee, Wisconsin	1968
<i>director, The Journal Company (publishers of The Milwaukee Journal and Milwaukee Sentinel)</i>		
†RICHARD C. MEECH, Q.C.	Toronto	1980
<i>partner, Borden & Elliot, barristers and solicitors</i>		
PAUL A. NEPVEU	Montreal	1979
<i>vice-chairman, Canadian Pacific Enterprises Limited</i>		
†JOHN N. PATERSON	Thunder Bay	1975
<i>executive vice-president and general manager, N. M. Paterson & Sons Limited</i>		
B. H. RIDDER, JR.	St. Paul, Minnesota	1957
<i>chairman of the board, Knight-Ridder Newspapers, Inc.</i>		
MURRAY D. SEELEY	Thunder Bay	1956
<i>executive vice-president, operations, Great Lakes Forest Products Limited</i>		
*IAN D. SINCLAIR	Montreal	1969
<i>chairman and chief executive officer, Canadian Pacific Limited</i>		
*W. JOHN STENASON	Montreal	1972
<i>president, Canadian Pacific Enterprises Limited</i>		
†G. GORDON STRONG	Oakland, California	1968
<i>retired publisher</i>		
J. G. TREZEVANT	Irvine, California	1975
<i>executive vice-president, Field Enterprises, Inc.</i>		
KENNETH A. WHITE	Toronto	1977
<i>chairman, president and chief executive officer, Royal Trustco Limited</i>		

** Died January 4, 1981.

* Members of the Executive Committee

† Members of the Audit Committee

Years denote beginning of connection with the company.

Honorary director, R. G. MEECH, Q.C.

Management at December 31, 1980

C. J. CARTER, <i>chairman of the board and president</i>	1947
MURRAY D. SEELEY, <i>executive vice-president, operations</i>	1956
C. R. BOWLES, <i>vice-president, finance</i>	1964
M. CEBROWSKI, <i>vice-president, mill operations</i>	1964
M. R. MCKAY, <i>vice-president, woodlands operations</i>	1944
R. E. CHAMBERS, <i>vice-president, engineering and services</i>	1959
M. G. REA, <i>secretary</i>	1969
K. E. WINROW, <i>comptroller</i>	1971
W. E. MACVITTIE, <i>assistant comptroller</i>	1968
D. D. MORROW, <i>treasurer</i>	1964
B. R. KERR, <i>assistant treasurer</i>	1964
F. H. TOLLEFSEN, <i>manager, information services</i>	1966

TO THE SHAREHOLDERS

1980 was a year of considerable achievement for our company. We set records for earnings, shipments and sales and launched our massive modernization and expansion program. We made the decision in 1980 to commit ourselves to the fine paper field and announced a new papermaking facility for Dryden conditional on an incentive grant from the Governments of Ontario and Canada. We also decided to proceed with construction of a new stud mill in Dryden.

We are happy to report that the integration of our Thunder Bay and Dryden operations has proceeded with dispatch since our purchase of the Dryden operations a little more than a year ago. The construction program is on schedule and we are looking forward to the establishment in Dryden of a highly efficient and up-to-date forest products operation.

After 44 years of service as a director of our company, R. G. Meech, Q.C., did not stand for re-election to the board at our last shareholders' meeting on April 16, 1980.

Mr. Meech was elected honorary director. We welcomed to the board Richard C. Meech, Q.C., who replaced his father.

On January 4, 1981 we were saddened by the death of our director Percy M. Fox who served as chairman from 1953 to 1978, at

which time he was appointed honorary chairman. He was widely respected throughout the industry and provided outstanding leadership in guiding this company through the major growth that occurred in his term as chairman.

On February 4, 1981 we welcomed J. R. Jones, president, Lakehead Newsprint Limited, Thunder Bay, who was appointed a director of the company.

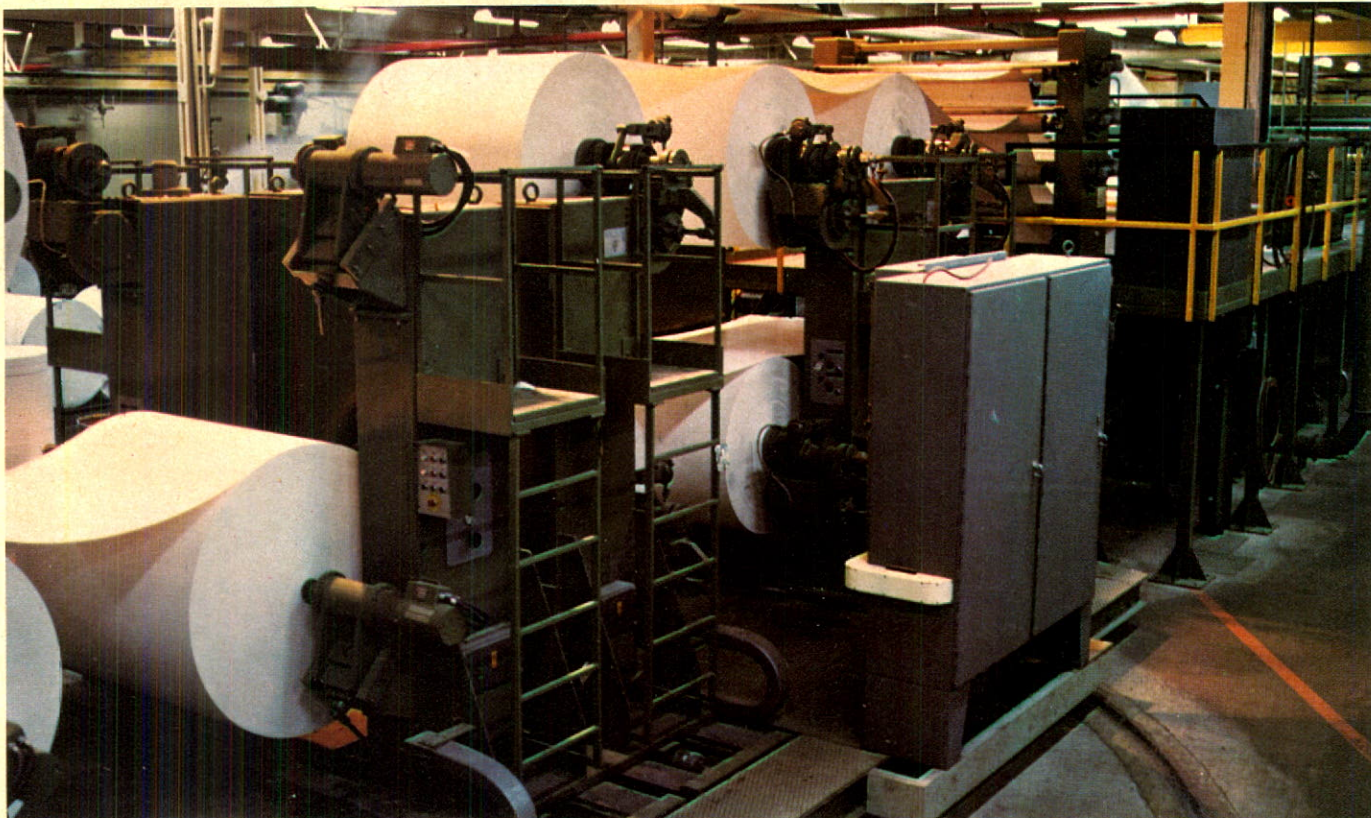
The extensive progress we made in 1980 would not have been possible without the support of Great Lakers at all levels of our operations. The directors wish to extend their appreciation to our Dryden employees who have accepted their new roles with such a positive attitude and to our Thunder Bay employees who have continued to demonstrate a dedication to their work.

In this year's annual report we have included on page 12 a discussion and analysis of our 1980 financial statements. We hope you will find this new section an interesting and worthwhile addition.

On behalf of the directors,

*CHARLES J. CARTER,
chairman and president*

Thunder Bay, Ontario,
February 4, 1981



The new precision sheeter, shown in the two photographs above, went into operation in our fine paper mill in Dryden in September 1980. Up to six rolls at a time can be fed to this high speed machine which automatically cuts the

paper into various sheet sizes for the printing trade. The sheeter is the most up-to-date facility of its kind in North America and its installation in Dryden is the first step in modernizing our fine paper operation.

Results in Detail

SUBSTANTIAL GROWTH IN 1980; DRYDEN CONTRIBUTED TO GAINS

Sharp Increase in Net Earnings

Net earnings were a record \$81.4 million or \$18.01 a share in 1980 compared with \$49.9 million or \$13.32 a share in 1979. The average number of shares outstanding in 1980 was 4,518,000 up from 3,746,000 in 1979 as a result of a rights issue discussed below. The increase reflected favorable markets for kraft pulp and newsprint as well as the contribution from our Dryden operations acquired at the end of 1979. Continued cost escalation and the depressed building products markets which persisted throughout 1980 had a detrimental effect on our earnings.

New High in Sales and Shipments

Net sales in 1980 were \$539.3 million versus \$338.1 million in 1979. The increase resulted from the addition of sales from the Dryden operations and increased shipments and prices of kraft pulp and newsprint from our Thunder Bay operations. The high rate of the U.S. dollar exchange premium, discussed below, continued to make an important contribution to sales revenue. Shipments of all products for the last five years are shown in the table on page 21.

There were two increases in the price of our kraft pulp early in 1980. The U.S. kraft pulp market softened in the latter part of the year after a strong first half and, for the first time, we made shipments to the Far East and Europe. A price increase for newsprint went into effect in 1980 with another announced for January 1, 1981. The prices for dimension and stud lumber and waferboard were depressed during 1980 due to general economic conditions and

high interest rates which seriously reduced housing starts. There were increases in prices for fine and kraft paper in 1980 and further increases were announced for early 1981.

The weak demand for building products resulted in reduced operation at our waferboard plant for seven months during 1980 with shutdowns totalling four weeks. At Colenso, some 65 kilometres west of Dryden, our dimension lumber operation ran at a reduced rate for six months of the year and were shutdown for three weeks in late summer. The stud lumber mill at Thunder Bay, on the other hand, operated throughout the year reflecting a strong demand for our product in the market area which we serve, although at depressed prices.

Exchange Impact

In 1980 our average exchange premium on U.S. dollar sales was 17.2 percent compared with 16.7 percent in 1979. Since 87 percent of our 1980 sales were priced in U.S. dollars, the exchange rate had a major bearing on our earnings. The chart on page 8 shows the relative importance of exchange to our net earnings over the past ten years. It is of interest to note that while the average exchange rate increased in 1980, exchange premium represented slightly more than 50 percent of our 1980 net earnings versus about 60 percent in 1979.

Operating Profit Increased

Operating profit of \$174.2 million in 1980 was up from \$108.4 million in 1979. Operating profit is defined in the glossary of terms on page 19 and reference is made to the analysis and discussion on page 12 for the various factors affecting operating profit and

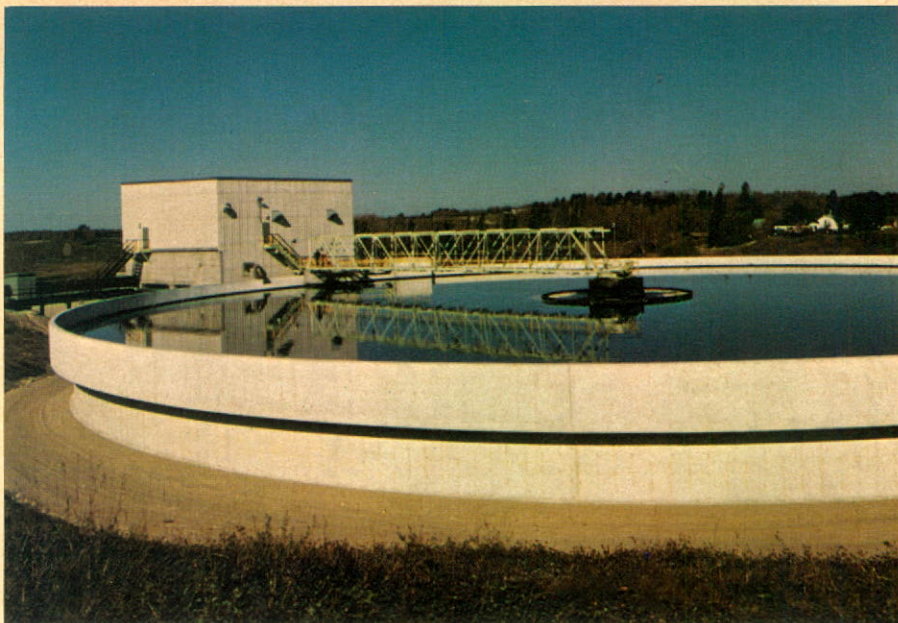


The Koehring feller forwarder, shown at top, is the key unit in the mechanized full-tree system which we introduced in our woodlands operation in 1980. The cutting head can hold two or three trees at a time which it deposits in the carrying section. When the load has reached about 125 trees the machine moves to roadside where it dumps the trees ready for the delimiting operation.

The Roger delimeter, centre photograph, delimits and tops the full trees in preparation for the mobile slasher operation. This machine can handle more than one tree at a time and, with its relatively simple operation, it is capable of a high rate of productivity.

The Nesco mobile slasher cuts tree lengths into eight-foot logs for use in our manufacturing operations and, when the timber is suitable, 16-foot sawlogs for sale to other wood-using industries. This is one of the ways we derive maximum value from our wood resources. The slasher is a new model with larger wheels and improved drive for greater mobility. The machine also has improved controls which enhances operating efficiency.

Completion of the primary effluent clarifier or settling tank in September 1980 was the first major step in our Dryden environmental improvement program. Shortly after start up the new facility met government requirements for removal of suspended solids. The liquid discharge or effluent from the mill enters the clarifier at the centre and moves outward towards the periphery where it flows over a weir to the discharge flume. The clarifier, which measures 73 metres in diameter, can hold up to 16 million litres of effluent. As the effluent moves from the centre, solid particles sink to the bottom and are removed by automatic scrapers. The resulting sludge is dewatered and used as landfill.



earnings. It is noted that price increases for our major products, kraft pulp and newsprint, over the past two years have been adequate to cover inflation of operating costs whereas, due to market conditions, the average selling prices for stud lumber and waferboard in 1980 were below the levels of two years earlier.

Rights Issue

Through the exercise of rights issued to shareholders of record May 1, 1980, 98.6 percent of the 976,871 common shares offered were taken up by May 22, 1980, the expiry date. In accordance with its undertaking, dated March 19, 1980, Canadian Pacific Enterprises Limited, our majority shareholder, subscribed for the 527,616 shares for which it was issued rights and took up the 13,334 common shares not subscribed for under rights issued to other shareholders. Our company now has 4,884,355 common shares outstanding. This increase affects the comparison of 1980 earnings per share with previous years as well as other per share financial comparisons.

Dividends

Dividends of \$2.00 per share were declared in 1980 compared with \$1.50 a share in 1979.

Increase in Cash Flow

Our cash flow of \$119.8 million increased from \$84.9 million in 1979 due largely to higher earnings. Cash flow in 1980, as defined in the glossary of terms on page 19, comprised the following amounts: \$81.4 million in net earnings, \$28.4 million in depreciation and \$10.1 million in deferred income taxes.

Working Capital at High Level

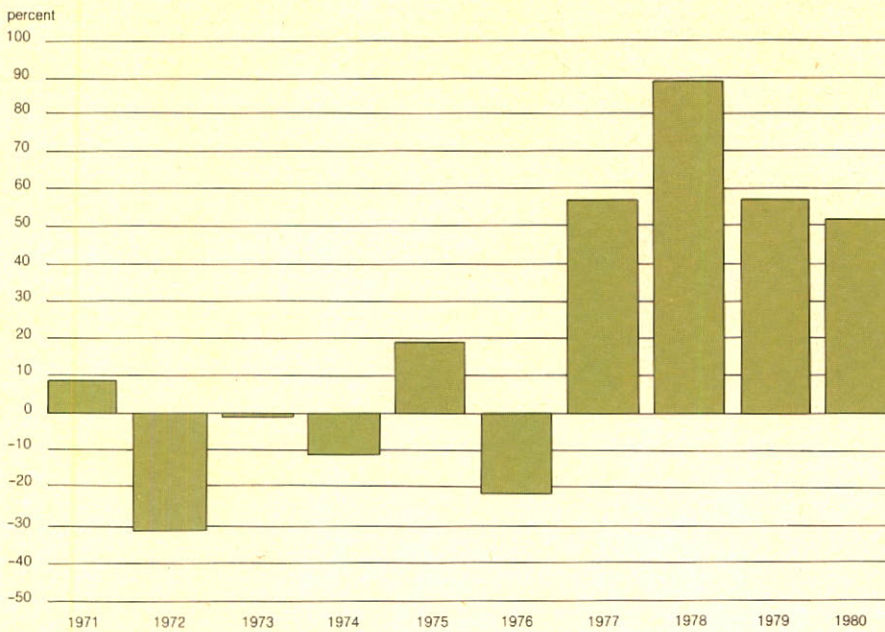
Working capital was \$125.7 million at the end of 1980 compared to \$18.1 million at December 31, 1979. In the second quarter of 1980 we realized \$43 million from the rights issue of common shares, discussed above, and we received \$25.3 million of a \$38 million incentive grant from the Governments of Ontario and Canada to assist in the modernization and environmental undertakings in Dryden and Thunder Bay. The initial payment was made by Ontario and the balance of \$12.7 million will be contributed by the federal government as construction progresses.

Details of changes in our working capital are shown in the financial statement on page 16.

Our Modernization and Expansion Programs

In 1980 we proceeded with the \$250 million modernization and expansion program at Dryden. This program will involve the replacement of about 80 percent of the existing pulp mill which is too old and inefficient to be restored. On completion of this project in 1982, annual capacity will increase from about 165,000 metric tons of bleached and 25,000 metric tons of unbleached kraft pulp to 225,000 metric tons of fully-bleached kraft pulp. This program includes construction of a new sawmill and, in December 1980, we announced plans to construct a stud lumber mill in Dryden designed to produce 60 million board feet annually. The stud mill will replace the aging dimension lumber operation at Colenso. Included in this capital program is \$40 million for environmental improvement facilities to meet government requirements. During the construction period as many as possible of the existing facilities will continue to operate.

Exchange Impact on Earnings



The chart illustrates the percentage of our net earnings that is attributable to the premium of the U.S. dollar over the Canadian dollar. Negative values indicate the percentage by which net earnings were reduced when the value of the U.S. dollar was less than the Canadian dollar.

On September 25, 1980 we announced plans to proceed with an additional \$90 million project to modernize the fine paper operation conditional on receipt of a government incentive grant. This project would provide for a new 210-inch fine paper machine, capable of producing 122,000 metric tons annually, and ancillary equipment including stock blending and proportioning facilities for a computerized operation. The new machine would replace the three existing machines which have a total capacity of 63,000 metric tons by mid-1983. The new fine paper machine will have the flexibility of producing fine, envelope and specialty papers over a range of basis weights. With this modern facility and our geographical location, we believe we would be in a good position to service the markets of eastern and western Canada, as well as the markets immediately to the south.

We also announced plans in 1980 to spend \$90 million at our mill in Thunder Bay to upgrade our newsprint operation, install new environmental improvement facilities and extend our energy conservation program.

Consideration is being given to the possibility of installing a 175,000 metric-ton-per-year modern high-speed newsprint machine integrated with the Dryden kraft pulp mill. Additional timber rights would be required to make this possible.

Government Incentive Grants

The \$250 million Dryden modernization and expansion program and the \$90 million program at our Thunder Bay mill qualified for a \$38 million government incentive grant under the program to encourage investment by the pulp and paper industry in pollution abatement facilities and modernization. In 1980 \$25.3 million was received from Ontario and the remainder will come from the federal government over the course of the programs. This incentive grant was an important factor in our decision to proceed with these undertakings. Application has been made for a government incentive grant for the Dryden fine paper project.

Capital Expenditures

In 1980 our capital expenditures totalled \$65.6 million. The majority of our capital spending during the

year was concentrated on our Dryden and Thunder Bay modernization and environmental improvement programs, discussed above, on which a total of \$42 million has been spent to date. Other significant capital projects included the primary effluent treatment facility described in the caption on page 7 and a new precision sheeter discussed on page 4. Both these projects were started prior to our purchase of the Dryden facilities in December 1979.

We proceeded with the kraft pulp mill modernization and expansion program in 1980 and by the end of the year pouring of concrete foundations was well underway and structural steel construction was progressing on schedule. We had also commenced siding and roofing in several areas.

In our Thunder Bay operations we proceeded with the program of modernization and improvements to our mill facilities as described under our modernization programs. The projects completed in 1980 were a new 30-ton-per-day chlorine dioxide generator for the kraft mill bleaching process and an unloading station for purchased wood chips incorporating

a truck dumper to increase the efficiency of this operation. The purchase and installation of equipment for the modernization of our newsprint machines and improvement of energy consumption commenced in 1980 and will be completed in 1981. Engineering work and equipment purchases for the sulphite liquor recovery system, discussed below, were well underway by year end.

Our Environmental Programs

A new environmental control order for our Dryden operations was issued June 5, 1980 superseding all previous orders affecting that mill. The new order specifies completion of a primary treatment plant by December 31, 1980, completion of odor abatement facilities and a secondary treatment system by December 31, 1983. We have complied with the primary treatment requirement with completion of the primary effluent clarifier or settling tank mentioned above under capital expenditures and we expect to meet the other requirements in the order within the Ontario Ministry of the Environment's time frame.

During 1980 we had discussions with the Ministry concerning a proposed new control order for our Thunder Bay operations. As provided under the Environmental Protection Act, the Ministry issued a notice of intent with respect to the proposed new control order and the contents have undergone the public hearing process. A principal requirement of the notice of intent was for a reduction in the discharge of oxygen-demanding effluent from our sulphite and kraft pulping operations.

Although a new control order has not been issued, we have received a cer-

tificate of approval from the Ministry to cover the installation of a sulphite recovery system and we commenced this project in 1980. We have discussed with the Ministry methods of achieving the objective of reducing the oxygen-demanding effluent from our kraft pulping operation and we must await issuance of a control order before determining the course to follow. One method would be to install a conventional secondary treatment lagoon. The alternative would involve in-plant measures in our original kraft pulp mill to recycle processing wastes along the lines of the closed-cycle concept, an innovative approach employed in our newer Thunder Bay kraft pulp mill. The closed-cycle concept involves the recycling of processing wastes with the objective of discharging only essentially clean water. We await issuance of the control order.

Woodlands Mechanization

In 1980 we completed a further step in our woodlands mechanization program with the introduction of a mechanized full-tree system, photographs and a description of which can be found on page 6. Developed through the close co-operation of our woodlands technical staff and suppliers, the full-tree system will reduce manual operations.

Our Forest Resources

Due to severe drought conditions in 1980 we experienced a serious forest fire situation which is discussed in an item on page 24.

In 1980 we signed a forest management agreement with the Government of Ontario covering an area of 2,420 square miles near Ignace known as the English River Forest.

In 1962 the provincial government assumed full responsibility for regeneration of all cutover areas on Crown lands in Ontario. But, because of a growing concern that our forests require more intensive management to meet future fibre needs of our industry, the Government of Ontario has embarked on this new program which transfers responsibility for forest management to the forest products companies. It is expected that the new agreements will eventually extend to all licensed areas in the province.

Under the new forest management agreement the government will reimburse the company for the basic costs of regeneration. We will be responsible for planning and implementing all aspects of forest management including harvesting, road construction and reforestation. The agreement affords the incentive for companies to engage in some aspects of forest management at their own expense by providing the opportunity to harvest any resulting increased yield at reduced Crown dues. We are encouraged by recent government announcements that more money may be made available for forest management. The forest management agreement is for an initial term of 20 years but is subject to review and extension by the Ontario Ministry of Natural Resources every five years. We welcome this opportunity to become directly responsible for forest management and we believe that this program will make a worthwhile contribution to the improvement of Ontario's forests.

Preparations to extend our harvesting activities into the northeastern



Our data centre, shown above, gathers, processes and prints information for a wide range of company operations including payroll, accounts payable, accounts receivable, invoicing, mill and woods inventories, wood measurement and newsprint roll handling and shipping. There are about 50 locations

throughout our company from which information on our computer can be accessed concerning data for both Thunder Bay and Dryden operations. The data centre touches nearly all aspects of the company's activities and is essential in today's fast-moving computerized world.

section of our forest areas will continue in 1981 with construction of Camp 702, some 50 kilometres northeast of Camp 700 at Savant Lake. A map of our licensed areas appears on the inside back cover. The road to the new campsite was completed in 1980 and further road construction will be undertaken in 1981. Harvesting operations are expected to commence in this area late in 1981.

Plans for developing new harvesting operations in the Armstrong area have been delayed by an Ontario Ministry of Natural Resources proposal to establish a wilderness park in the vicinity of Whitewater Lake. The proposed park includes a 1,500-square-mile tract of forest land within the northeastern portion of our forest area near Armstrong, most of which we have held under licence from the Ontario Government since 1957. Several groups are pressing the government to carry out this proposal. Such a move would ban harvesting in the area and permit only single-purpose activities such

as canoeing or backpack camping. Because there is no practical alternative to provide this needed fibre, which represents an important portion of the wood requirement for our Thunder Bay mill, we have made strong representations to the Ministry to reject this proposal. We have also conducted an extensive public relations campaign to bring the matter to the attention of the public, as well as the various levels of government. We have long supported the need for recreation and enjoyment of our forest areas which we believe can be accommodated within the concept of multiple use.

Labor Relations

Two-year agreements were negotiated with all unions representing our employees providing for substantial increases in wages and benefits in line with general settlements throughout the industry in Canada. These agreements will expire during 1982, except for the agreement with our sawmill workers at Colenso which expires in the fall of 1981.

Market Outlook

U.S. newsprint consumption was 10.1 million metric tons in 1980, down slightly from 10.2 million in 1979. However, restriction of supply caused by strikes and inventory building by publishers contributed to a tight market in 1980. The recession in the U.S. which had an effect on 1980 newsprint consumption is expected to continue in 1981 and consumption will therefore likely remain at about the same level as 1980. Off-shore shipments are expected to increase in 1981 which will add some strength to newsprint demand. This will be more than offset, however, by the introduction of new newsprint manufacturing capacity with the result that slightly lower operating rates can be expected for North American producers in 1981. Looking further ahead, we anticipate that the U.S. economy will strengthen and demand for newsprint will resume an upward trend. Market opportunities are also expected to increase in other areas of the world. This growth will absorb the planned increases in new produc-

tion capacity and we believe that, over the longer term, market prospects for newsprint are promising.

The weakness that developed in the kraft pulp market in the U.S. in 1980 can be expected to continue in 1981. New developments in recent years, however, are helping to broaden and add stability to the kraft pulp markets. Markets for kraft pulp are opening in Europe, the Far East and elsewhere for North American producers. The Scandinavians, major suppliers of market kraft pulp, are reaching the limits of their economic fibre supplies and are turning their attention to the secondary stages of manufacture of finished paper products. There are also a number of new paper machines that will go into operation over the next few years without a corresponding increase in pulp manufacturing capacity. As a result of these favorable factors, world wide demand for market pulp can be expected to strengthen over the longer term.

Soaring interest rates in Canada and the U.S. are expected to hold 1981 housing starts to the lower levels experienced in 1980, especially during the first half of the year. This will have a detrimental effect on the building markets served by our lumber and waferboard production. It remains to be seen how the new administration in the U.S. will deal with the problems of inflation and whether interest rates will return to more moderate levels. Pressure for new housing is gaining momentum and eventually this pent up demand will have to be satisfied. When this occurs we can expect a resurgence in

the demand for building products. An important development in recent years has been the wider acceptance of waferboard in relation to its chief competitor, plywood. This has led to an increase in waferboard manufacturing capacity in Canada and the U.S. Despite current depressed conditions in the housing market and the introduction of new waferboard capacity, we believe that building product commodities such as lumber and waferboard are at a low point in their cycle and that their long-term prospects are promising.

The market for our fine paper products is largely domestic and we expect this market to experience only modest growth in 1981. A shortage of supply in the latter part of 1980, caused by a strike at a major producer, continues into 1981 and the operating mills in Canada can therefore be expected to run near full capacity for part of the year despite generally soft demand. It is anticipated, however, that demand will strengthen in the last quarter and prospects for the next few years are encouraging.

Company Outlook

Inflation will continue to be a major economic problem in 1981. We must also face the recession in the U.S., projected weakness in our major markets and the continued depression in the building products market. On the positive side, there is a new administration in the U.S. committed to improving the business climate. We can expect to benefit from the U.S. dollar exchange premium in 1981 and we will continue to take advantage of new kraft pulp market

opportunities in other parts of the world, as well as supplying our traditional U.S. markets. The efficiency of our operations at our Thunder Bay facilities will continue to be a major source of strength in meeting the unrelenting challenge of cost inflation. Market conditions in 1981 may not permit price increases to match cost escalations but overall we expect to see close to full operating rates during the year.

On completion of the modernization and expansion program our Dryden facilities will be as efficient as any in the industry. The increase in our manufacturing capacity for bleached kraft pulp, stud lumber and fine paper will enhance our position in the markets where we are well established as well as the newer markets opening to us in pulp and fine paper. We believe that this increased market potential will enable us to gain our full share from future upswings in demand and successfully weather the inevitable downturns that occur in the cyclical fortunes of our industry. The addition of the Dryden production facilities increases the diversification of our operations and, in the years ahead, will make an important contribution to the stability and strength of our company.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF 1980 FINANCIAL STATEMENTS

Operating Results

Net sales increased by about \$201 million or 60 percent in 1980, of which \$129 million is represented by net sales from the company's Dryden operations which were acquired at the end of 1979. The remainder is attributable to the company's Thunder Bay operations with increased net selling prices and volumes contributing \$57 million and \$15 million, respectively. As discussed below, a substantial portion of the company's sales is billed in U.S. dollars and the average U.S. dollar exchange premium in 1980 was similar to that in 1979.

Cost of sales increased by almost \$133 million or 60 percent in 1980, reflecting a volume increase of \$97 million, largely due to the newly reported Dryden production, and cost escalation of \$36 million, particularly in the labor and energy components.

The 1980 increase in selling and administrative expenses of \$2.6 million or 40 percent reflects costs with respect to the company's Dryden operations as well as some additional selling expenses associated with new shipments to Asia and Europe. The \$1.8 million increase in interest income and the \$2.1 million reduction in interest expense reflect the improvement in the company's financial position which enabled the repayment of almost \$60 million of long-term debt during 1979 and increased short-term investment of surplus funds. The depreciation increase of \$8.2 million represents the additional charge for the newly acquired Dryden assets. The effective income tax rate of 43.2 percent in 1980 versus 38.9 percent in 1979 was due in part to a newly introduced surtax which increased the effective rate by 1.5 percent. Although the 1980 rate benefited from claiming investment tax credits earned in 1980, the 1979 rate was substantially lower than normal due to claiming a large backlog of investment tax credits built up over several years.

Financial Condition

Working capital improved to \$125.7 million at the end of 1980 from \$18.1 million a year earlier with cash and term deposits amounting to \$91.7 million at the end of 1980. Shareholders' equity of \$263.2 million compared with \$148.1 million at the end of 1979. These items reflect the strong operating results of 1980 as well as the \$43 million rights issue of common shares and provide a strong base for financing the company's capital expenditure programs which is outlined below.

Capital Expenditure Programs

The company has announced major capital programs aggregating \$430 million for its Dryden and Thunder Bay mills.

The modernization and expansion of the Dryden kraft pulp mill, scheduled for completion in 1982, is estimated to cost \$250 million and a further \$90 million is being spent for modernization and environmental improvements at Thunder Bay. These projects were the subject of a \$38 million grant from the Ontario and federal governments of which the Province's portion of \$25 million was received in 1980. These programs were commenced in 1980 with \$42 million having been expended by the end of the year. The company announced a \$90 million modernization of its Dryden fine paper facilities for completion in mid-1983 which is conditional on a grant from the Governments of Ontario and Canada. These programs will expand the company's production and provide more efficient facilities for the future.

Financing of the capital expenditure programs outlined above has been carried out to date from internally-generated funds supplemented by the \$43 million rights issue of common shares and \$25.3 million of government grants. At December 31, 1980 cash and short-term investments amounted to \$91.7 million and the company's line-of-credit arrangements with its bankers and others totalled \$105 million. These cash resources, together with internally-generated funds over the course of the capital expenditure programs and additional grant money, are expected to provide the financing for the balance of the capital expenditure programs as well as for the company's normal requirements. Should additional financing be required, the company's increased equity base will enhance its ability to obtain such financing.

Effects of Economic Conditions

Approximately 87 percent of the company's sales are to the United States or to other countries in U.S. dollars. The rate of exchange premium which we have earned on these sales, 16.7 percent in 1979 and 17.2 percent in 1980, has contributed substantially to our total revenue. The chart on page 8 shows the percentage that exchange represents within our net earnings.

Inflation, particularly the cost of energy, is having a significant impact on our operations through the continual escalation of our basic operating costs. In the soft market conditions which we have experienced for our building products in 1979 and 1980, we have not been able to recover these increased costs through price increases, whereas the stronger demand for our pulp and paper products has enabled price increases adequate to meet rising costs in the last two years.

The concern for high rates of inflation in recent years has led to the development of a number of systems designed to measure and reflect the impact of inflation on financial statements. Accounting and financial bodies in several countries have mandated systems for use in their particular jurisdiction but in Canada no decision has yet been made by the Canadian Institute of Chartered Accountants. A proposal currently under study in Canada differs significantly from the system now required by the Securities and Exchange Commission in the United States.

Proponents of inflation accounting point out that historical cost accounting does not reflect the economic or replacement value of a company's major operating assets, inventories and fixed assets and, consequently, as these assets are used the charge against earnings is understated and profits are overstated. Various systems deal also with the counter-effect of long-term debt but few address deferred taxes which, for this company, have become a major contributor of financing.

The object of the various systems is to measure the impact of inflation by turning statements of financial results and financial condition into statements of economic results and economic condition. However, to do so requires many subjective decisions which reflect only some of the conditions which affect a company and the result is, in our view, arbitrary and incomplete. For these reasons, we do not intend to attempt to quantify the impact of inflation on our financial statements until such time as a system which we would hope has the general acceptance and understanding of the public has been prescribed for use in this country.

EARNINGS

consolidated statement for years ended December 31 (thousands of dollars)

	1980	1979
Net sales:		
Pulp and paper	\$503,861	\$299,407
Building products	35,418	38,668
	539,279	338,075
Cost of sales	355,957	223,122
Selling and administrative expense	9,112	6,543
OPERATING PROFIT	174,210	108,410
Interest and other income	6,163	4,340
	180,373	112,750
Interest (Note 7)	8,893	10,944
Depreciation	28,375	20,203
EARNINGS before income taxes	143,105	81,603
Income taxes	61,753	31,727
NET EARNINGS	\$ 81,352	\$ 49,876
Net earnings per share	\$ 18.01	\$ 13.32

RETAINED EARNINGS

consolidated statement for years ended December 31 (thousands of dollars)

Retained earnings at beginning of year	\$136,447	\$ 92,302
Net earnings	81,352	49,876
	217,799	142,178
Dividends declared	9,280	5,731
RETAINED EARNINGS at end of year	\$208,519	\$136,447

	1980	1979
Liabilities		
CURRENT LIABILITIES		
Accounts payable and accrued charges	\$ 46,115	\$ 36,041
Due to Reed Ltd.	—	16,063
Note payable	—	10,000
Income and other taxes payable	42,660	22,231
Dividend payable	2,442	1,954
Current portion of long-term debt	5,509	5,107
	96,726	91,396
LONG-TERM DEBT (Note 4)		
First Mortgage Bonds:		
8% sinking fund bonds, Series B, maturing 1989	12,680	13,502
11¼% sinking fund bonds, Series C, maturing 1995	32,026	32,260
8¾% debentures maturing 1984 (U.S. \$18.3 million)	19,163	19,603
Lease obligations	12,504	16,509
	76,373	81,874
Current portion	5,425	5,107
	70,948	76,767
DEFERRED INCOME TAXES	89,613	79,498
Shareholders' Equity		
Common shares without par value (Note 5):		
Authorized 10,000,000 shares		
Issued 4,884,355 shares (1979—3,907,484)	54,649	11,666
Retained earnings	208,519	136,447
	263,168	148,113
	\$520,455	\$395,774

Approved by the Board: C. J. CARTER, *Director* RICHARD C. MEECH, *Director*

CHANGES IN FINANCIAL POSITION

consolidated statement for years ended December 31 (thousands of dollars)

	1980	1979
WORKING CAPITAL PROVIDED		
Net earnings	\$ 81,352	\$ 49,876
Charges not affecting working capital:		
Depreciation	28,375	20,203
Increase in deferred income taxes	10,115	14,812
GENERATED FROM OPERATIONS	119,842	84,891
Issue of Common Shares (Note 5)	42,983	8,916
Government grants (Note 2)	25,334	—
Lease financing	—	8,033
Sale of fixed assets	153	292
	188,312	102,132
WORKING CAPITAL USED		
Acquisition of Dryden fixed assets	—	68,697
Expenditures on fixed assets	65,612	13,234
Reduction of long-term debt	5,819	28,873
Dividends declared	9,280	5,731
	80,711	116,535
INCREASE (DECREASE) IN WORKING CAPITAL	107,601	(14,403)
Working capital at beginning of year	18,128	32,531
WORKING CAPITAL at end of year	\$125,729	\$ 18,128

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Year ended December 31, 1980

1. Summary of Significant Accounting Policies

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the financial position and results of operations of Great Lakes Forest Products Limited and all its subsidiary companies.

FOREIGN EXCHANGE

Current assets and current liabilities in foreign currencies are translated into Canadian dollars at current rates of exchange at the date of the balance sheet. Other assets and liabilities and items affecting earnings are converted at rates of exchange in effect at the dates of the transactions.

INVENTORIES

Inventories of finished goods and materials and supplies are valued at average cost which is less than net realizable value. Inventories of pulpwood and sawlogs are valued at average cost.

FIXED ASSETS AND DEPRECIATION

Fixed assets are recorded at cost. The cost and related accumulated depreciation of items disposed of are removed from the accounts and any gain or loss is included in earnings. Depreciation is based on the estimated economic lives

of the assets, using the following methods and composite rates of depreciation:

Buildings and machinery	
Pulp and paper	4½% straight line
Building products	10% straight line
Woodlands improvements and equipment	30% diminishing balance

No depreciation is charged on major improvements or expansions until construction has been completed.

CAPITAL LEASES

Assets under capital lease are capitalized at their fair value at the inception of the lease. The related obligation is recorded as long-term debt and represents the present value of minimum lease payments. The assets are depreciated in accordance with the depreciation policy stated above and the implicit interest content of the lease payments is charged to earnings as interest on long-term debt.

INCOME TAXES

Income taxes are charged against earnings based on the items included within the determination of those earnings irrespective of any timing differences for the recognition of certain items under current tax legislation. The excess of the income taxes charged to earnings over the amount actually payable in any year is set aside as deferred income taxes to be drawn upon in those years when tax payments exceed the amount charged to earnings.

Investment tax credits are recognized in the year in which they are claimed as a reduction of income taxes payable. These tax credits affect taxable income of future years since the value of depreciable assets for taxation purposes is reduced by the amount thereof. A portion of the tax credits, determined at the current tax rate, is therefore set aside as deferred income taxes and the balance is applied to reduce income taxes charged against earnings.

INTEREST

Interest on debt incurred to finance major expansion programs, less any interest earned on the temporary investment of the proceeds, is capitalized during the construction period.

NET EARNINGS PER SHARE

Net earnings per share are calculated based on the average number of shares outstanding during the year.

2. Fixed Assets (thousands of dollars)

	December 31, 1980		December 31, 1979
	Cost	Net Value	Net Value
Land	\$ 843	\$ 843	\$ 1,116
Buildings and machinery			
Pulp and paper	396,716	246,254	247,781
Building products	26,078	11,399	14,087
Woodlands improvements and equipment	43,849	16,091	11,789
Timber licences	3,945	—	—
Assets under capital lease	21,566	7,855	11,477
Construction in progress	15,558	15,558	—
	<u>\$508,555</u>	<u>\$298,000</u>	<u>\$286,250</u>

By agreement made as of March 31, 1980, the company has been granted \$38 million under the joint Ontario and federal governments' Pulp and Paper Industry Facilities Improvement Programme for environmental, modernization and energy conservation projects to be undertaken at its facilities in Dryden and Thunder Bay. \$25.3 million was received on April 17, 1980 and the remainder will be received over the following three years. Amounts as received are being applied to reduce the cost of the projects. The agreement provides for a pro rata refund of a portion of the grant should the company fail to complete any component project.

3. Capital Expenditure Program

The company has commenced major capital expenditure programs aggregating \$340 million for the modernization, expansion and environmental improvement of its facilities at Dryden and Thunder Bay and has announced a \$90 million program, which is conditional upon the receipt of government assistance, for the construction of a new fine paper machine at Dryden. As at December 31, 1980, outstanding commitments for the purchase of major items of equipment amounted to \$43.5 million.

4. Long-Term Debt

Required payments to reduce long-term debt over the next five years amount to \$5.5 million in 1981, \$6.1 million in 1982, \$10.1 million in 1983, \$15.9 million in 1984 and \$2.9 million in 1985.

Obligations under capital leases comprise many individual leases with implicit interest rates ranging from 6 percent to 12 percent with expiry dates extending to 1989.

5. Common Shares

By articles of amendment dated April 18, 1980, the authorized capital of the company was increased from 4.5 million common shares without par value to ten million common shares without par value.

Pursuant to its offer to shareholders dated April 21, 1980 to subscribe for common shares (on the basis of one share for each four shares held) and a related undertaking from Canadian Pacific Enterprises Limited, dated March 19, 1980, the company issued 976,871 common shares without par value at the subscription price of \$44.00 per share. In accordance with its undertaking, Canadian Pacific Enterprises Limited subscribed and paid for all of the common shares in respect to which it was issued rights pursuant to the offer and also took up and paid for, at the offering price of \$44.00 per common share, 13,334 common shares not subscribed for under rights issued to other shareholders.

6. Dividend Restriction

Certain of the indentures relating to the company's long-term debt contain covenants limiting dividends. The most restrictive of these requires that, after any dividend is declared, working capital (which for these purposes is before the deduction of the current portion of long-term debt) must be over \$10 million and shareholders' equity must be over \$50 million.

7. Interest

Interest on long-term debt amounted to \$7.9 million (\$10.6 million in 1979).

8. Executive Remuneration

In 1980, directors' fees amounted to \$58,000. The total remuneration, including directors' fees, received by the directors and senior officers amounted to \$649,000.

9. Past Service Pension Costs

Past service pension costs, resulting from retroactive increases in benefits in 1980 and prior years, are being funded and charged to earnings over 15-year periods from the dates such costs were established. Based on recent actuarial reports, the unfunded amount was \$13.4 million at December 31, 1980.

10. Litigation

The agreement under which the company purchased the assets of the Dryden operations of Reed Ltd. in 1979 provides that the company and Reed Ltd. shall share equally any liability up to \$15 million plus related costs arising from

claims, actions or proceedings based on actions, circumstances or events up to the date of purchase and related to the discharge, escape or presence of any pollutant from or in the assets purchased by the company. Amounts payable by Reed Ltd. pursuant to the foregoing have been unconditionally guaranteed by Reed International Limited (the United Kingdom-based senior company in the Reed group of companies). In the event that any liability in excess of \$15 million plus related costs were to arise, the company would be responsible.

Legal proceedings based on alleged pollution are as follows:

- a) Two actions instituted by writs dated in 1970 by Barney's Ball Lake Lodge Limited and by Ontario Central Airways Limited against Dryden Chemicals Limited and Dryden Paper Company Limited (predecessor companies to Reed Ltd.) claiming damages said to be caused by alleged pollution of the Wabigoon-English River system. No proceedings have been taken in the Airways action and the last proceedings in the Lodge action were examination for discovery of the President of the plaintiff in 1971. The examination for discovery was adjourned pending production by the plaintiff of further information, which information has not been produced. The amount of damages claimed in the Lodge action total \$3.8 million and no amount has been specified in the Airways action. It is not possible to make any firm estimate of the damages sustained or the ultimate liability, if any, should these actions proceed.
- b) An action instituted by writ dated in 1977 on behalf of numerous plaintiffs, members of two Indian bands, against Reed Ltd. and its predecessor companies, claiming damages said to be caused by alleged pollution of the Wabigoon-English River system and requesting a mandatory order requiring removal of the alleged pollutants. A statement of claim has not been filed nor have any proceedings on this action been taken and it is not possible to make any firm estimate of the damages sustained or the ultimate liability, if any, should this action proceed.

The Treasurer of Ontario has written to the company stating in paragraph 2, "I further understand that the Reed group of companies and Great Lakes are willing to assume, on an equal basis, responsibility, up to a maximum of \$15 million, for any environmental damages attributable to the operations of Reed Ltd. or any of its predecessor companies in the Dryden area prior to this acquisition by Great Lakes". The letter further states, "... in the event that Great

Lakes is required to pay any monies as a result of any final decision of a court against Great Lakes, Reed Ltd. or any other person prior to the year 2010 in respect of pollution caused by Reed Ltd. or any of its predecessor companies in the Dryden area prior to the date upon which Great Lakes acquires the assets and undertaking of the Dryden complex of Reed Ltd. or in the event that any settlement with any claimant is made the amount of which settlement has been approved by the Attorney General of Ontario, I have been authorized by the Executive Council of Ontario to advise you that I will make a Recommendation to the Executive Council of Ontario that the Government of Ontario take effective steps to ensure that Great Lakes Forest Products Limited will not be required to pay any monies in excess of the maximum amount of \$15 million referred to in paragraph 2 of this letter, provided that over the next three to four years Great Lakes expends in the order of \$200 million for the modernization and expansion of the Dryden facilities”.

11. Related Party Transactions

Canadian Pacific Enterprises Limited owns approximately 54 percent of the common shares of the company and consequently many of the companies within the Canadian Pacific organization are related parties.

GLOSSARY OF TERMS

NET SALES: The Canadian dollar proceeds from the sale of products after deducting costs of delivery to customers.

OPERATING PROFIT: Profit realized from manufacture and sale of products after deducting all costs except interest, foreign exchange on long-term debt, depreciation and income taxes. Applies to operations only; does not include investment or other income.

DEPRECIATION: The distribution on a yearly basis of the original cost of a fixed asset (defined below) over its estimated useful life, which is written off as a deduction from earnings.

NET EARNINGS: Total income less all costs; the net amount available from the year's operations to pay dividends or retain for use in the business.

CASH FLOW: Total funds generated by operations in a year. In our case, cash flow includes net earnings and charges not affecting working capital; principally depreciation and deferred income taxes.

RETAINED EARNINGS: Accumulated total of annual net earnings since the start of the company (1936) less dividends to shareholders during the same period.

CURRENT ASSETS: Assets which, in the normal course, will be converted into cash or consumed in operations within the following year.

FIXED ASSETS: Assets, such as land, buildings and machinery, held for long-term use rather than for sale or consumption in operations. Also includes equipment under capital lease (defined below).

The company has a revolving line of credit with Canadian Pacific Securities Limited in the amount of \$25 million which provides for loans of up to one year at interest rates based on the lender's cost of borrowing. Interest paid on borrowings under this line of credit amounted to \$297,000 during 1980.

The company makes extensive use of both major Canadian railroads, including C.P. Rail, for the transportation of its inbound pulpwood and outbound finished products. Freight rates are at published tariff rates.

In addition, as part of normal business transactions, the company makes use of other services, facilities and products of the Canadian Pacific organization. These transactions are, to the knowledge of management, at terms and rates no more nor less favorable than with unrelated parties.

Note 5 also discusses a related party transaction.

12. Industry Segment and Export Sales

The company's entire operations consist of the manufacture and sale of products of the forest industry. In 1980, 87 percent (1979-95 percent) of the company's net sales were exported, largely to United States destinations.

CAPITAL LEASE: A long-term lease obligation which conveys on the lessee substantially all the benefits of ownership of the asset leased. Such leases typically contain an option under which the lessee may purchase the asset from the lessor.

CURRENT LIABILITIES: Amounts owed (including a portion of long-term debt) due for payment within one year.

LONG-TERM DEBT: Amounts borrowed for a term of longer than one year.

SINKING FUND: Amounts paid to independent trustees of our bond issues, as stipulated in the trust deeds of these issues, to provide annual instalments for their redemption.

WORKING CAPITAL: Amount by which current assets exceed current liabilities, both as defined above. This is a measure of working or operating resources.

BALANCE SHEET: Statement of financial position at a year end showing what is owned (assets of all kinds) versus what is owed (liabilities of all kinds) and shareholders' equity; set forth in accordance with The Business Corporations Act (Ontario). The word "Consolidated" means that all subsidiaries are included to show position of the enterprise as a whole.

SHAREHOLDERS' EQUITY: Value of the shareholders' ownership or interest in the company on an historic basis. Consists of share capital plus retained earnings and is the amount by which assets exceed liabilities.

Industry Reference Data

NEWSPRINT PAPER

The United States is Canada's principal customer for newsprint and accounts for approximately 45 percent of the free-world's consumption. The following table, based on reports issued by Canadian Pulp and Paper Association (CPPA), indicates the size and growth of newsprint markets over the period 1976 through 1980. World totals for newsprint omit communist countries for which reliable information is lacking.

	1976	1977	1978	1979	1980
	(millions of metric tons)				
Free-world production capacity	22.1	22.6	23.1	23.8	25.0
Free-world production	19.6	20.0	21.1	22.2	23.4
Canadian production capacity	9.0	9.0	9.0	9.1	9.2
Canadian production	8.1	8.2	8.8	8.7	8.6
Canadian exports	7.1	7.3	8.0	7.8	7.6
Canadian exports to U.S.	5.7	5.8	6.4	6.4	6.1
Total U.S. consumption	8.7	9.3	9.9	10.2	10.1

Source: CPPA (1980 estimated).

BLEACHED KRAFT PULP

Bleached kraft pulp is included in the general commodity classification of paper grade chemical pulp. North America and Scandinavia are the major suppliers of paper grade chemical pulp, having a production capacity in 1980 of approximately 62.6 million metric tons or 67 percent of the world's total production capacity. The bulk of the pulp produced by these countries is captive production for use by the producers or affiliated companies. The balance, known as market pulp, is available for sale on the open market. Most of this market pulp consists of bleached kraft pulp. In 1980 the production capacity in North America and Scandinavia for market bleached kraft pulp was approximately 14.0 million metric tons of which Canadian production capacity amounted to approximately 43 percent, or 6.0 million metric tons. Our company is a major supplier to this market.

	1976	1977	1978	1979	1980
	(millions of metric tons)				
Paper Grade Chemical Pulp					
North American and Scandinavian production	52.7	53.2	55.2	58.2	59.5
Bleached Kraft Pulp					
North American and Scandinavian production	25.0	25.8	27.6	29.6	30.9
Bleached Kraft Market Pulp					
Total demand for North American and Scandinavian production	9.9	10.2	12.2	12.6	13.3
Canadian shipments	4.5	4.6	5.3	5.4	5.9
Canadian exports to U.S.	1.7	1.8	1.9	2.0	2.0
Total U.S. supply (including imports)	3.2	3.3	3.7	4.0	4.1

Source: CPPA (1980 estimated).

FINE PAPER

The term "fine papers" covers a broad range of papers manufactured to suit a variety of specialty end uses. The major categories are: printing grades, which include coated and uncoated papers designed specifically for the printing of text books, annual reports, magazines, advertising pieces, etc., representing approximately 43 percent of all fine papers produced in Canada; business papers, representing 33 percent, include papers for office copiers, letterheads, documents, office forms etc. and converting papers, representing 24 percent, include papers which are made into envelopes, scribblers and continuous and single, multiple-part forms.

At our Dryden mill we manufacture only a few fine paper products in this broad range of categories, primarily those classified as uncoated printing papers, copy papers, and envelope papers.

	1976	1977	1978	1979	1980
	(thousands of metric tons)				
Canadian Production Capacity	792.8	807.3	834.5	943.0	982.0
Domestic Shipments	432.1	517.5	628.8	704.4	697.2
Export Shipments	104.4	168.8	156.7	204.1	200.8
Canadian Imports	215.9	154.6	141.1	130.0	149.7
Canadian Demand	648.0	672.1	769.9	834.4	846.9

Sources: Statistics Canada, CPPA (1980 estimated).

LUMBER

Residential construction provides the principal use for softwood lumber produced in Canada and the U.S., a substantial portion of which is stud lumber. The following table indicates the level of housing construction and the sources of softwood lumber production in North America over the past five years.

	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
			(millions)		
North American housing starts	1.8	2.2	2.3	1.9	1.5
Seasonally adjusted year-end rate of North American housing starts	2.2	2.5	2.3	1.7	1.7
Softwood lumber production			(billions FBM)		
U.S.	29.7	31.7	30.7	29.7	24.7
British Columbia	10.5	12.0	12.5	12.5	11.9
Rest of Canada	<u>4.3</u>	<u>5.2</u>	<u>5.8</u>	<u>6.0</u>	<u>5.7</u>
Total	44.5	48.9	49.0	48.2	42.3

Sources: Statistics Canada, U.S. Bureau of Census, National Assn. of Home Builders (U.S.), Western Wood Products Assn. and Southern Forest Assn., National Forest Products Assn. (1980 estimated).

BOARD

Waferboard competes in its uses with the exterior grades of softwood plywood sheathing which represent approximately 60 percent of all softwood plywood production in North America.

	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
			(billions of square feet)		
Softwood plywood (3/8-inch basis)					
U.S. production	18.4	19.7	19.9	19.7	16.7
Canadian production	2.4	2.7	2.9	2.8	2.6
Waferboard (3/8-inch basis)					
Canadian production4	.4	.5	.6	.7

Sources: Dept. of Industry, Trade and Commerce, American Plywood Assn. (1980 estimated).

OUR SHIPMENT SUMMARY: LAST FIVE YEARS

	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
Newsprint (000 metric tons)	298	338	362	378	391
Kraft pulp (000 metric tons)	118	304	327	356	521
Fine papers (000 metric tons)					62
Total (000 metric tons)	416	642	689	734	974
Lumber (millions of board feet)	45	86	103	107	132
Waferboard (millions of sq. ft.—3/8-inch basis)	48	75	97	111	87

While waferboard is manufactured in varying thicknesses, for comparative purposes with the industry statistics above our shipment volume is shown here on a 3/8-inch equivalent basis.

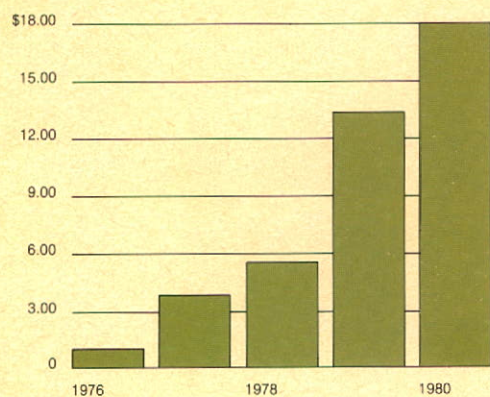
FINANCIAL SUMMARY: LAST FIVE YEARS

Except for per share amounts as indicated,
all dollar figures are in thousands

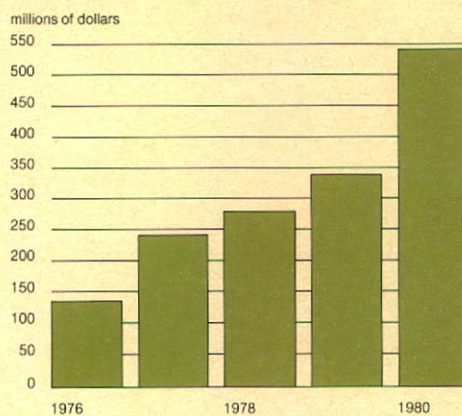
	1976	1977	1978	1979	1980
SALES & EARNINGS					
Net sales: pulp and paper	124,371	216,534	239,990	299,407	503,861
building products	11,943	24,914	37,372	38,668	35,418
total	136,314	241,448	277,362	338,075	539,279
Operating profit	25,144	60,528	75,133	108,410	174,210
Interest expense	5,139	14,792	13,435	10,944	8,893
Depreciation	13,104	19,952	19,654	20,203	28,375
Earnings before income taxes	7,123	25,250	39,740	81,603	143,105
Income taxes	3,183	11,288	19,669	31,727	61,753
Net earnings	3,940	13,962	20,071	49,876	81,352
Net earnings per share	1.09	3.87	5.56	13.32	18.01
Dividends declared, total amount	—	—	1,625	5,731	9,280
Dividends per share	—	—	.45	1.50	2.00
ASSETS & LIABILITIES					
Current assets	55,048	59,272	109,418	109,524	222,455
Current liabilities	107,019	36,372	76,887	91,396	96,726
Ratio of above assets to liabilities	.5	1.6	1.4	1.2	2.3
Working capital (deficiency)	(51,971)	22,900	32,531	18,128	125,729
Inventories, described in balance sheet	28,293	25,706	27,628	49,915	64,030
Fixed assets, see notes to financial statements	371,922	378,782	387,699	468,927	508,555
Accumulated depreciation and depletion	125,893	144,808	162,885	182,677	210,555
Long-term debt	95,891	134,391	97,607	76,767	70,948
Ratio of above debt to shareholders' equity	1.5	1.8	1.0	.5	.3
Deferred income taxes	35,523	45,877	64,686	79,498	89,613
Retained earnings, at year end	59,894	73,856	92,302	136,447	208,519
EQUITY & OTHER DATA					
Common shares outstanding, at year end	3,610,029	3,610,029	3,610,039	3,907,484	4,884,355
Number of shareholders	3,116	2,912	2,727	2,557	2,726
Percentage of shares held in Canada	97.6	97.8	97.9	98.0	98.4
Shareholders' equity, total	62,644	76,606	95,052	148,113	263,168
Shareholders' equity per share	17.35	21.22	26.33	39.54	58.25
Cash flow from operations	19,625	44,962	58,534	84,891	119,842
Cash flow per share	5.44	12.26	16.21	22.66	26.53
Net earnings percentage on net sales	2.9	5.8	7.2	14.8	15.1
Annual expenditures on fixed assets	81,402	8,196	10,776	81,931	65,612
Number of employees on payroll	3,471	3,863	3,831	5,598	5,709

All per share figures, except for dividends per share, are based on the average number of shares outstanding during the year. Dividends per share are based on the number of shares outstanding at the record dates of the dividends.

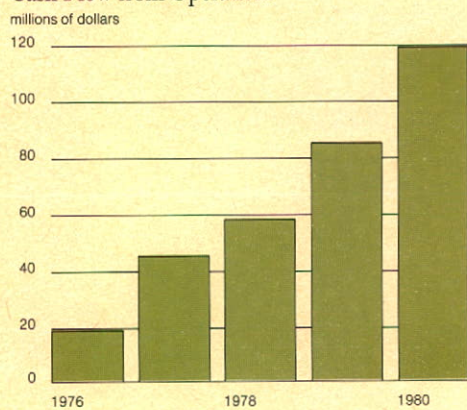
Net Earnings Per Share



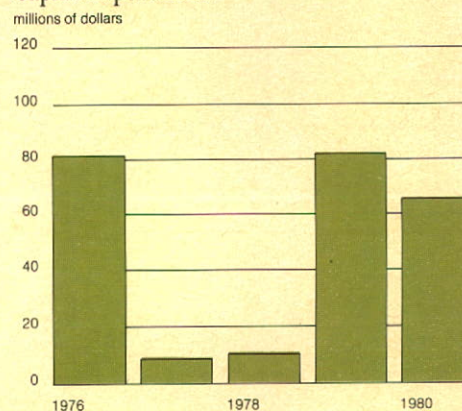
Net Sales



Cash Flow from Operations



Capital Expenditures



1980 Results by Quarters

Sales and Earnings '000 omitted
1980 Quarterly

Quarter	Net Sales	Oper. Profit	Net Earnings
First	\$134,615	\$ 45,030	\$ 20,544
Second	135,240	44,192	19,353
Third	137,879	45,408	21,646
Fourth	<u>131,545</u>	<u>39,580</u>	<u>19,809</u>
	\$539,279	\$174,210	\$ 81,352

Net Earnings Per Share

Quarter	1976	1977	1978	1979	1980
First	\$(0.93)	\$0.43	\$0.71	\$ 2.31	\$ 5.26
Second	0.64	1.12	1.28	2.99	4.35
Third	0.52	0.98	1.23	3.81	4.39
Fourth	<u>0.86</u>	<u>1.34</u>	<u>2.34</u>	<u>4.21</u>	<u>4.01</u>
	\$ 1.09	\$3.87	\$5.56	\$13.32	\$18.01

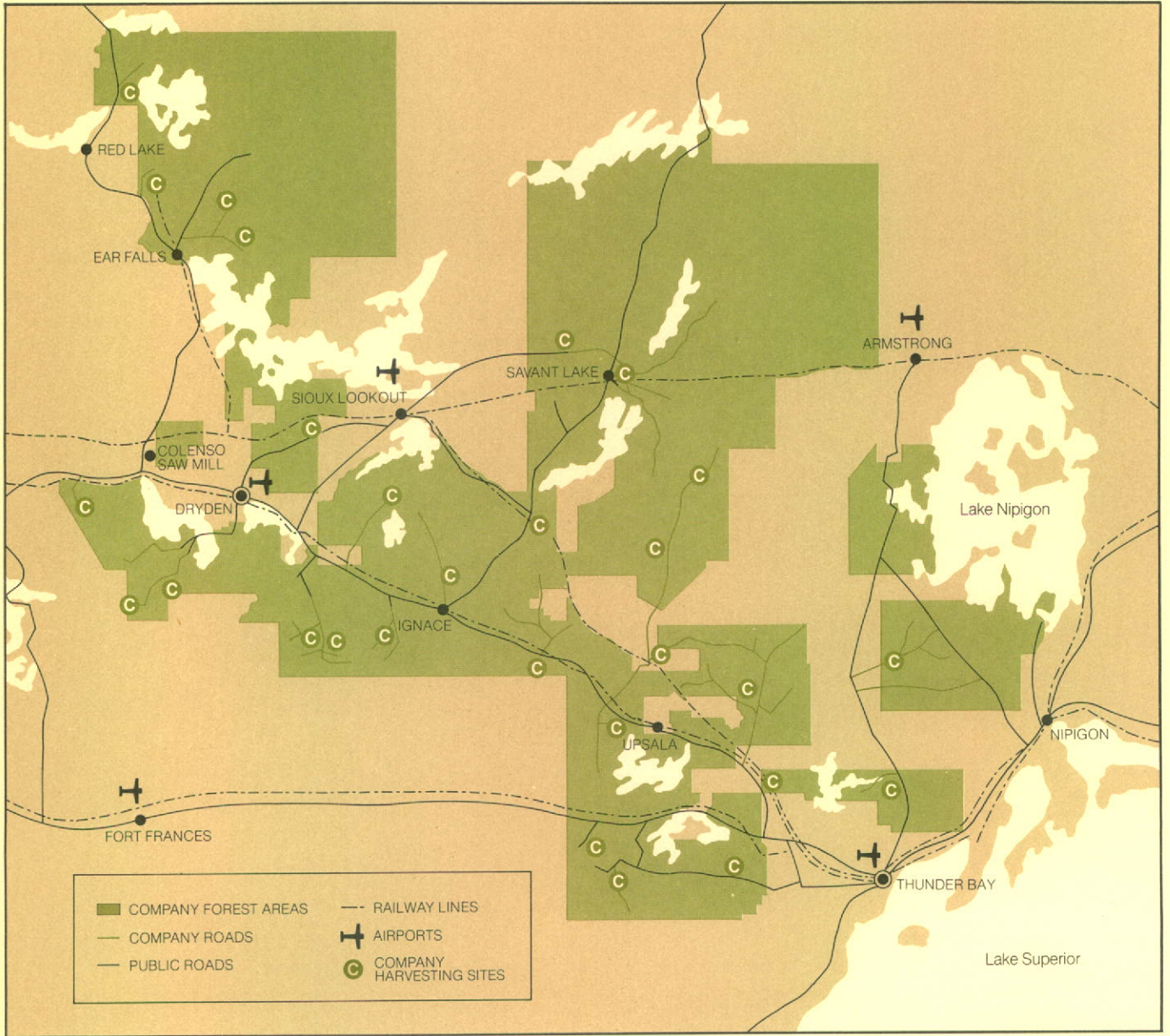


COMBATting THE MENACE OF FOREST FIRES

During the early summer of 1980 forest fires swept through Northwestern Ontario causing the most serious losses in history. Above normal temperatures and drought in the spring contributed to extensive outbreaks of fire in May and June. Substantial losses were experienced by our company with the largest fire covering some 250 square miles near Ignace, shown in the photographs. While the situation interrupted our harvesting program, we were able to meet our fibre needs in 1980 and the long-term availability of fibre from our forest areas will not be appreciably affected.

Much analysis of the fire situation has taken place since the summer by the forest products industry and the Ontario Ministry of Natural Resources. As a result, our company and others will be increasing the number of trained fire fighting crews and the provincial capabilities for fire prevention, detection and suppression will be upgraded for the coming season and future years.

MAP OF OUR WOODLANDS AREAS

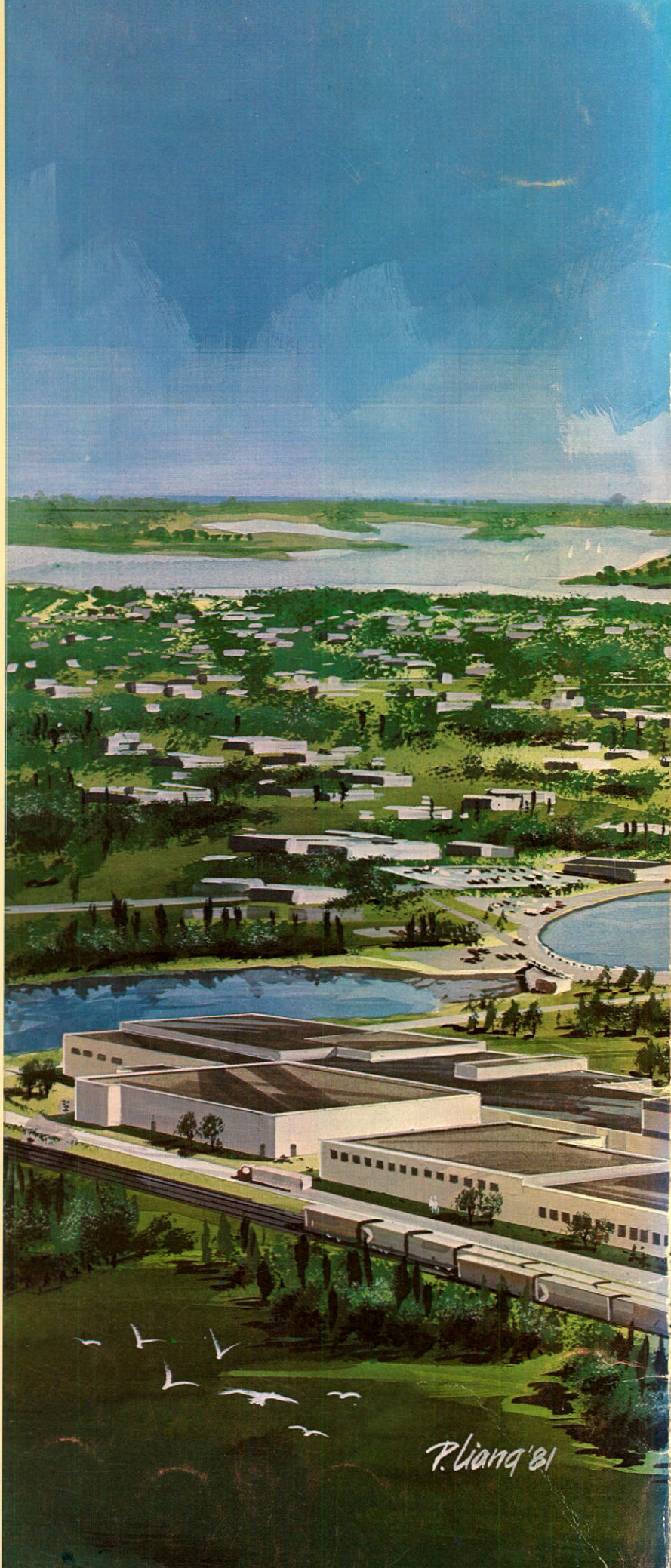


The map shows our woodlands areas for both Thunder Bay and Dryden operations. These forest areas encompass some 21,000 square miles which are held under licence from the Province of Ontario. To open and harvest these resources some 4,000 kilometres of company roads have been built as well as the camps and work sites shown on the map. The

Dryden woodlands work force commutes by bus daily to their work sites from Dryden and Ear Falls, whereas our Thunder Bay operations require camps to accommodate most of the work force because of the distance of most operating areas from the main centres. Wood is brought to the mills by rail and truck on a scheduled daily delivery system.

COVER

The illustration is an artist's concept of the Dryden mill complex as it will appear when our current modernization and expansion plans are completed. The building in the foreground bearing the company logo is the fine paper mill with an annual capacity of 122,000 metric tons which is intended to replace the existing smaller facility. This mill is conditional on a government incentive grant. The larger building immediately behind the fine paper mill will house the new 225,000 metric-tons-per-year bleached kraft pulp mill. In the background are the older buildings housing the existing facilities such as the power boiler, chemical recovery boiler, lime kiln, evaporators and chemical plant that will remain as part of the new kraft mill operation. To the left of these older buildings is the existing three-storey office building which will continue to be used. We will also continue to use the buildings on the left for warehousing, shipping and fine paper handling. The green area bounded by the office building, the kraft mill and the buildings on the left is now occupied by components and buildings of the existing kraft mill that will not be required by the new kraft operation. As indicated by the illustration they will all be removed. On the cover flap is the 60 million board-feet-per-year stud lumber mill and the new woodroom to the right. While these structures appear to be in close proximity to the pulp and fine paper complex, they will actually be located some distance to the right.



P. Liang '81