Great Lakes Forest Products Limited Annual Report 1981

Front Cover

The photograph is an enlargement showing the top of a young jackpine which has completed its summer growth and is forming a bud for next year's growing season. The oozing sap, evident in the centre, is repairing some minor damage caused by insects. During its lifetime the growing tree will continue to be attacked by insects, severe weather conditions and other natural enemies. As long as it remains healthy it will usually survive such attacks until it reaches maturity.

Overmature trees are more susceptible to insects and disease as their recuperative ability declines. As the number of overmature trees in a forest increases, so do tree-destroying insects and diseases which can spread to healthy younger trees. Under good forest management trees are cut when they reach maturity and are replaced with vigorous new growth.

Another serious enemy is forest fire which usually originates in overmature forests. In 1980, fire consumed hundreds of square miles of forests; as well as overmature stands, much young growth was destroyed.

Pictures showing some of our forest management activities appear on page 6 with further information on page 10.

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 14, 1982.

HIGHLIGHTS

'000 omitted	1981	1980
Net sales: Pulp and paper	$529,671	$503,861
Building products	38,923	35,418
Total	568,594	539,279
Operating profit	159,930	174,210
Earnings before income taxes	130,421	143,105
Income taxes	52,647	61,753
NET EARNINGS: Total amount	77,774	81,352
Per share	15.92	18.01
Cash flow	137,095	119,842
Expenditures on fixed assets	189,023	65,612
Working capital at year end	77,985	125,729

Five-year shipment and financial summaries are shown on pages 23, 26 and 27.

- ☐ Despite weak markets net earnings in 1981 were $77.8 million or $15.92 a share versus $81.4 million or $18.01 a share in 1980.
- ☐ A record $189 million was spent on additions to our fixed assets in 1981.
- ☐ The modernization and expansion at Dryden made steady progress in 1981 with completion of the kraft pulp mill and stud lumber mill scheduled for mid-1982 and the fine paper modernization for 1983.

On Inside Pages

Dollars in this report are Canadian unless otherwise identified.

All tons in this report are metric tons. A metric ton is equivalent to approximately 1.1 short tons.

OUR COMPANY

Great Lakes Forest Products Limited, incorporated under the laws of Ontario in 1936, acquired the assets of a predecessor company which went into receivership in the early 1930's. These assets, located on the company's present mill site in Thunder Bay, included two newsprint machines. During the late 1930's and 1940's, the new company improved and modernized its facilities, acquired additional licensed forest lands and established itself in the U.S. newsprint market. In the mid-1950's, extensive expansion took place with the addition of Nos. 3 and 4 newsprint machines. The expansion included enlargement of such operations as groundwood pulp production, wood handling and timber harvesting.

Over the years the company's woodlands operations evolved from the horse-drawn methods of old to modern mechanized systems. A leader in woodlands mechanization, the company continues to play an important role in the development of improved operating methods.

In 1966 the first kraft pulp mill went into operation providing diversification and permitting more complete use of tree species in the company's forest areas.

Further diversification and expansion took place during the 1970's with the construction and subsequent expansion of a stud lumber mill, construction of a waferboard plant and the addition of the second kraft pulp mill.

With the construction of the first kraft pulp mill the company commenced a comprehensive environmental control program and has gained wide recognition over the years for leadership in this field.

In 1979 the Dryden, Ontario assets of Reed Ltd. were acquired and since 1980 the company has undertaken extensive modernization and expansion of the Dryden kraft pulp mill and fine paper mill, as well as construction of a stud lumber mill.

The company manufactures the following products: *bleached kraft pulp*, a prime ingredient in a wide range of paper products from high quality printing papers to disposable paper products for home and medical use; *newsprint*, the paper on which newspapers are printed; *fine and envelope papers*, printing papers, similar to the paper in the financial section of this report, copy papers and paper that is converted to envelopes of varying sizes and styles to meet commercial and personal mailing needs; *stud lumber*, precision cut 2 × 4's for use in housing and light construction; *dimension lumber* used for general building requirements and *waferboard*, a tough, water-resistent building board for exterior sheathing, interior panelling, roofing and floor underlayment.

Pulp is sold through Lake Superior Pulp and Paper Inc., Chicago and White Plains, N.Y.; R. L. Nash is president and F. M. Jennings, vice-president. Servicing of our newsprint contracts is handled by Lake Superior Newsprint Co., Chicago; W. D. Frost is president and O. E. Babcock, vice-president. Fine papers are marketed through the company's offices in Toronto and Winnipeg; John H. Sim is director, fine paper sales. Stud and dimension lumber is marketed through St. Regis Paper Company and waferboard through MacMillan Bloedel Limited.

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

Price Range of our Common Stock

Year	High	Low
1977	$31.00	$20.50
1978	41.00	21.25
1979	53.00	40.50
1980	73.50	44.00
1981	93.50	67.00

Our Net Earnings and Dividends

Year	Net Earnings '000 omitted	Dividends Declared
1977	$13,962	$ –
1978	20,071	0.45
1979	49,876	1.50
1980	81,352	2.00
1981	77,774	2.90

TO THE SHAREHOLDERS

Despite widespread market softness and inflationary pressures in 1981 we came close to our record earnings of 1980. In a difficult year such as we have just experienced, good service, dedication and quality products can often make the difference between success and failure in the marketplace. The success we enjoyed in 1981 is due to the efforts of our employees at all levels throughout the company. On behalf of the directors, I would like to thank all employees for their contribution to our performance in 1981.

The modernization and expansion program at Dryden made excellent progress and in 1982 both the kraft pulp mill and the new stud lumber mill are scheduled to go into operation. The photographs on page 4 will give you some idea of the size and scope of this undertaking. In 1981 we proceeded with the fine paper modernization program which is scheduled for completion in 1983. These new facilities will be as up-to-date as any to be found and will be an important addition to our production capabilities.

In April 1981, M. D. Seeley, executive vice-president and director, retired after 25 years of service. Mr. Seeley is well-known throughout the industry for his leadership in the modernization of woodlands operations.

In August, we were saddened by the death of J. N. Paterson who had been a director of the company since 1975. He will be missed by his many friends in the company.

We welcome R. S. DeMone, president and chief operating officer, Maple Leaf Mills Limited, Toronto, who was appointed a director on October 23.

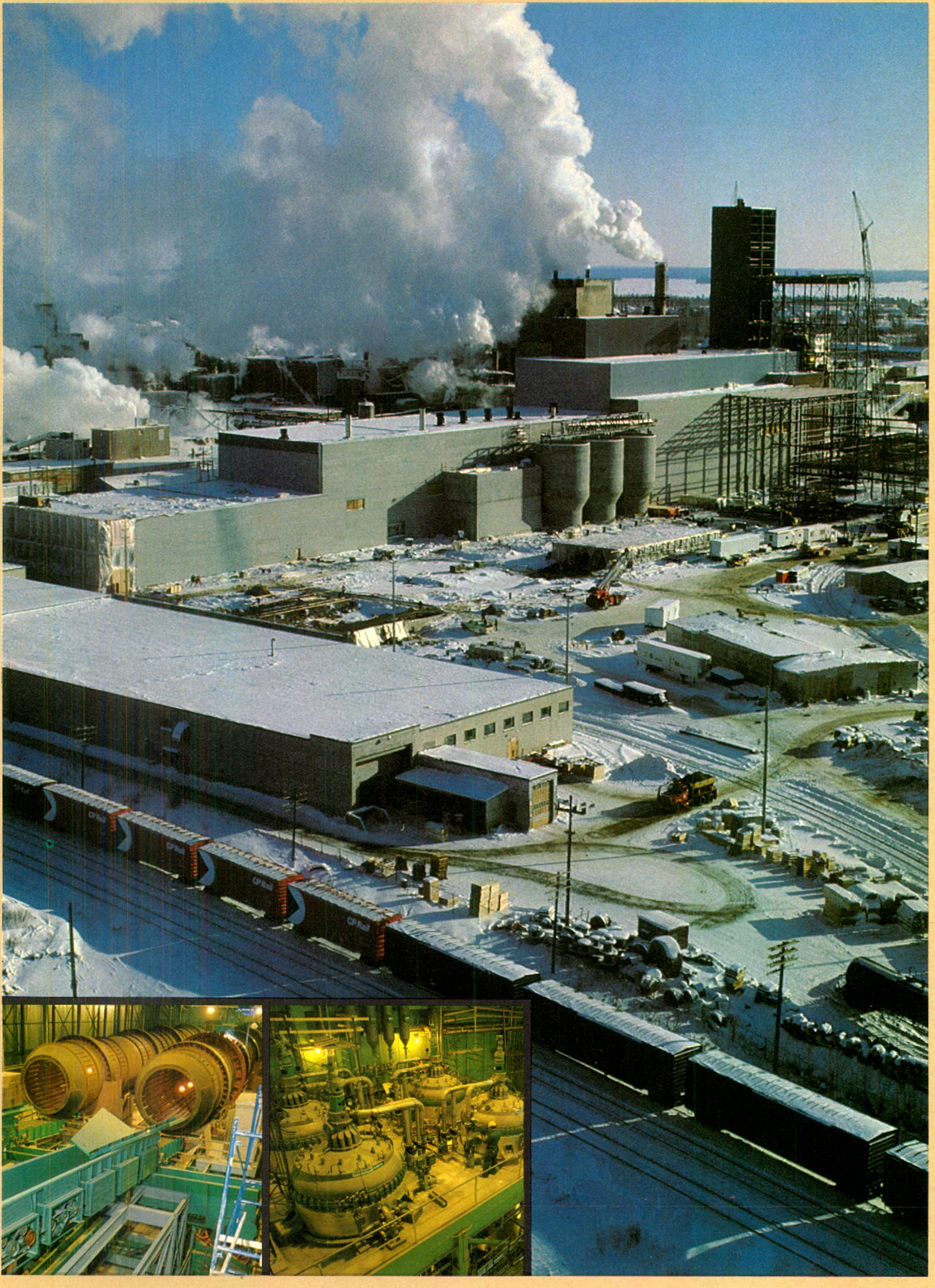
In 1981 we strengthened our executive structure with the appointment of two executive vice-presidents; C. R. Bowles, a director and previously vice-president, finance, and R. E. Chambers, previously vice-president, engineering and services. Mr. Chambers was also elected a director. We appointed K. E. Winrow, vice-president, finance and comptroller, and R. A. Lehtovaara, assistant comptroller. T. M. Brown, formerly manager of accounting at our Dryden operations, was appointed secretary of the company.

These and other personnel advancements in recent years are in keeping with our policy of bringing to the forefront talented and promising young management people who have served the company well to equip us to meet the challenges of the future.

On behalf of the directors,

CHARLES J. CARTER,
chairman and president

Thunder Bay, Ontario
February 3, 1982


CP Rail

EARNINGS SLIGHTLY BELOW 1980 LEVEL; SALES UP DESPITE MARKET SOFTNESS

Net earnings were $77.8 million in 1981 compared with $81.4 million in 1980. Per share earnings, which were affected by the higher number of shares outstanding in 1981, were $15.92 a share compared with $18.01 a year ago. Improved prices for pulp and paper products, a lower effective tax rate and higher interest income from short-term investments were favorable factors affecting 1981 earnings. Detrimental factors were slightly lower shipments of our major products, pulp and newsprint, and continued escalation of operating costs, particularly energy, chemicals, transportation and wages.

Sales Increased

Net sales in 1981 were $568.6 million versus $539.3 million in 1980. Despite generally soft markets as indicated below in the brief commentaries dealing with each of our products, higher prices for some of our products and the higher rate of U.S. dollar exchange premium made an important contribution to sales revenue. Shipments of all our products for the last five years are shown in the table on page 23.

Expansion and modernization of the kraft pulp mill in Dryden is well advanced as shown in the photograph on the left. The main buildings have been closed in and the three pulp storage tanks in the centre have been completed. The tall dark building on the right houses the digester and the open steel framework to the right of the digester will house the diffuser, or pulp washing system. The open steel structure shown in front of the digester and diffuser is part of the fine paper mill which will be constructed along the length of the kraft pulp mill. The long low building in the left foreground will house the shipping and warehouse facilities.

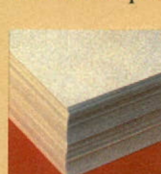
Inset at left are the discharge ends of the barking drums which are key elements in the woodroom operation. The woodroom will provide chips for the kraft pulp mill and logs for the stud lumber mill which will be closely integrated. The small photograph to the right shows the clarifils which will filter the pulping liquor for the digester where the pulping operation takes place. This filter system is the first to be installed in a North American mill.

Pulp

A moderate increase in the price of our kraft pulp, the first in 18 months, went into effect in the final quarter of 1981. The U.S. pulp market remained soft during the year and we continued to make shipments to offshore markets including the Far East. In 1981 our kraft pulp mills ran at capacity and a substantial portion of our Thunder Bay pulp production was hardwood kraft pulp. Some of this hardwood pulp was used in substitution for purchased pulp in the Dryden fine paper operation which was the main reason for the lower shipments of kraft pulp in 1981.

Newsprint

Newsprint prices increased in 1981 and demand held firm during the first half of the year. A softening trend developed in the second half and persisted into 1982. Our newsprint operation ran at capacity during 1981 except for downtime on one machine in the third quarter to carry out modernization work. This accounted for the slightly lower shipments compared with 1980.



Fine Paper

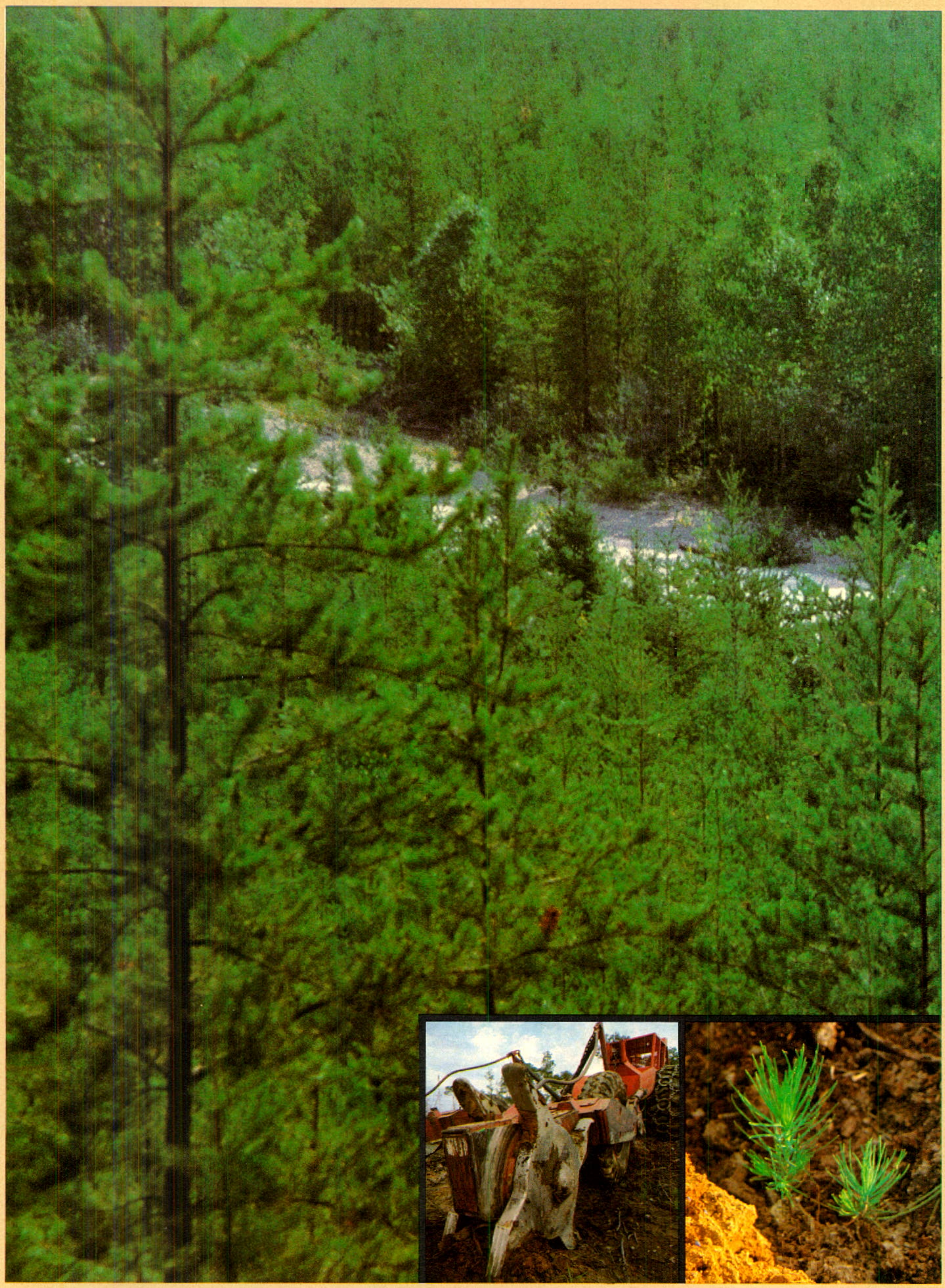
There was general softness in the demand for fine paper throughout 1981 although a lengthy strike at a major producer helped buoy up operating rates of other suppliers for the first half. We were able to maintain full production until the last weeks of December when we shut down one of our three machines. Overall, our fine paper shipments showed a modest improvement over 1980 and prices increased during the year.

Lumber

The low level of housing starts due to the high interest rates was responsible for a severe depression in the lumber market in 1981. As a result of the weak demand, our Colenso dimension lumber mill was down for three weeks during the year. The stud lumber operation in Thunder Bay was cut back from three to two shifts in late November due to extensive maintenance work in the woodroom which reduced the amount of wood available for the stud mill. Despite these curtailments in production, our total lumber shipments were up slightly over 1980. Prices, however, were depressed during the year to the extent that many producers were forced to shut down, particularly in the last quarter.

Waferboard

The waferboard market was seriously affected in 1981 by the depressed housing market. Because of weak demand, the waferboard plant has been operating on a five-day work week instead of a seven-day basis since mid-1980. The plant also shut down for one week in December 1981 and further shutdowns are scheduled for 1982. Shipments were down slightly from 1980 and prices were depressed throughout the year.



Exchange Impact

In 1981 our average exchange premium on U.S. dollar sales was 19.4 percent compared with 17.2 percent in 1980. Since 84 percent of our 1981 sales were in U.S. dollars, the exchange rate had a major bearing on our earnings. The chart on this page shows the relative importance of exchange to our net earnings over the past ten years.

In 1981 we entered into forward exchange contracts with one of our bankers for the sale of approximately 55 percent of our forecast U.S. dollar sales revenue through 1984. These transactions were undertaken to reduce our exposure to fluctuations in exchange rates during the period when internally generated funds are expected to provide a substantial portion of the financing for our major capital expenditure program.

Income Taxes

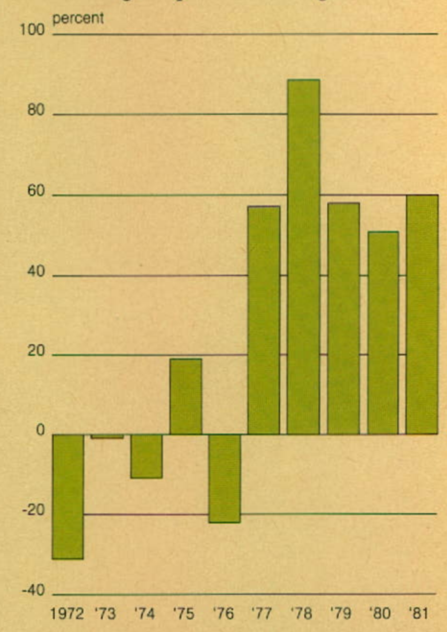
The effective tax rate on our 1981 earnings was 40.4 percent compared with 43.2 percent in 1980. The normal rate of tax would be approximately 46 percent but this was reduced in both years by claiming investment tax credits.

The healthy young jackpine growth, shown in the photograph on the left, resulted from regeneration carried out in the late 1960's. In the English River Forest, where we are responsible for forest management under a forest management agreement with the Ministry as discussed on page 9, we are using the most up-to-date regeneration techniques available. Left inset shows one method using a machine called the Bracke which turns over the soil and plants seeds in one operation. Other equipment is used to turn over the soil in preparation for aerial seeding or hand planting of nursery-grown seedlings. The small jackpines in their second year of growth, shown in the lower right, are the result of seeding.

The record level of capital spending in 1981 enabled a substantial capital cost allowance write-off at accelerated rates, thus deferring $28.7 million of taxes payable and also providing approximately $18 million of investment tax credits. $12 million of these credits were claimed in 1981 and the remainder is available to reduce income taxes payable in future years. An explanation of our treatment of tax deferrals and investment tax credits is provided in Note 1 to the financial statements on page 19.

Accelerated capital cost allowance rates were introduced many years ago as an incentive to manufacturing and processing development in Canada. The cash flow benefits which have accrued to our company through the deferral of tax as a result of the accelerated rates have represented an important element in the financing of major development projects. The Federal Government budget of November 12, 1981 proposed, among other things, that the capital cost allowance be reduced by one half in the year of acquisition of an asset. This would have affected the remainder of our expenditures on the major capital program underway and would have increased our financing requirements in 1982 by an estimated $12 to $15 million. As a result of widespread representations made to the Government, amendments to the budget were announced on December 18, 1981 introducing transitional rules which, we believe, will exempt the majority of our capital expenditure program from the new reduced allowances. The reduced rates will, however, influence future capital spending decisions.

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.

Dividends

Dividends of $2.90 per share were declared in 1981 compared with $2.00 per share in 1980. The quarterly dividends were 70 cents per share for the first three quarters of 1981 and on October 23 the directors increased the rate to 80 cents per share for the dividend payable January 4, 1982.

Cash Flow Increase

Our cash flow of $137.1 million in 1981 increased from $119.8 million in 1980 due to the deferral of a large portion of our income taxes. This deferral and its importance to the company has been discussed above in the section on income taxes. Cash flow is defined in the Glossary of Terms on page 22.

Loss-Control Program

For many years we have conducted a safety program to reduce injuries and damages to property. In 1981 we embarked upon a comprehensive program to reduce and control all forms of loss, particularly those associated with personal injury. The key ingredients in this safety and loss-control program are the involvement of every manager and supervisor and sound training for every employee. We were encouraged by the marked improvement in our safety record in 1981 and we will put forth every effort to exceed this record in 1982.

Safety in the workplace is the result of following good safety procedures. At left, Larry Durant, analytical tester, uses a gas detector to

Working Capital Down

Working capital of $78 million was down from $125.7 million in 1980. Expenditures on our major capital program, repayment of long-term debt and dividends exceeded cash flow and the funds provided by government grants and borrowings.

Details of changes in our working capital are shown in the financial statement on page 18.

Capital Expenditures

In 1981 our capital expenditures amounted to $189 million, of which $148 million was spent on the Dryden modernization programs. This involves a $250 million modernization and expansion of the kraft pulp mill at Dryden, including construction of a new stud lumber mill to replace the aging dimension lumber mill at Colenso and a $40 million environmental program to meet government standards as discussed in the next section. In addition, the $90 million fine paper modernization program commenced early in 1981 with the announcement of a $10 million joint incentive grant from the governments of Ontario and Canada.

The Dryden pulp mill expansion and modernization program, which commenced in 1980, is well advanced. All buildings have been erected and closed in with the exception of the stud lumber mill and digester to be completed early in 1982. All major mechanical equipment has been installed, piping and electrical installations were in progress by year end and, in December, we started up the expanded facilities in the chemical plant. The pulp mill is expected to be in operation by mid-1982 and the stud lumber mill by the fall of 1982.

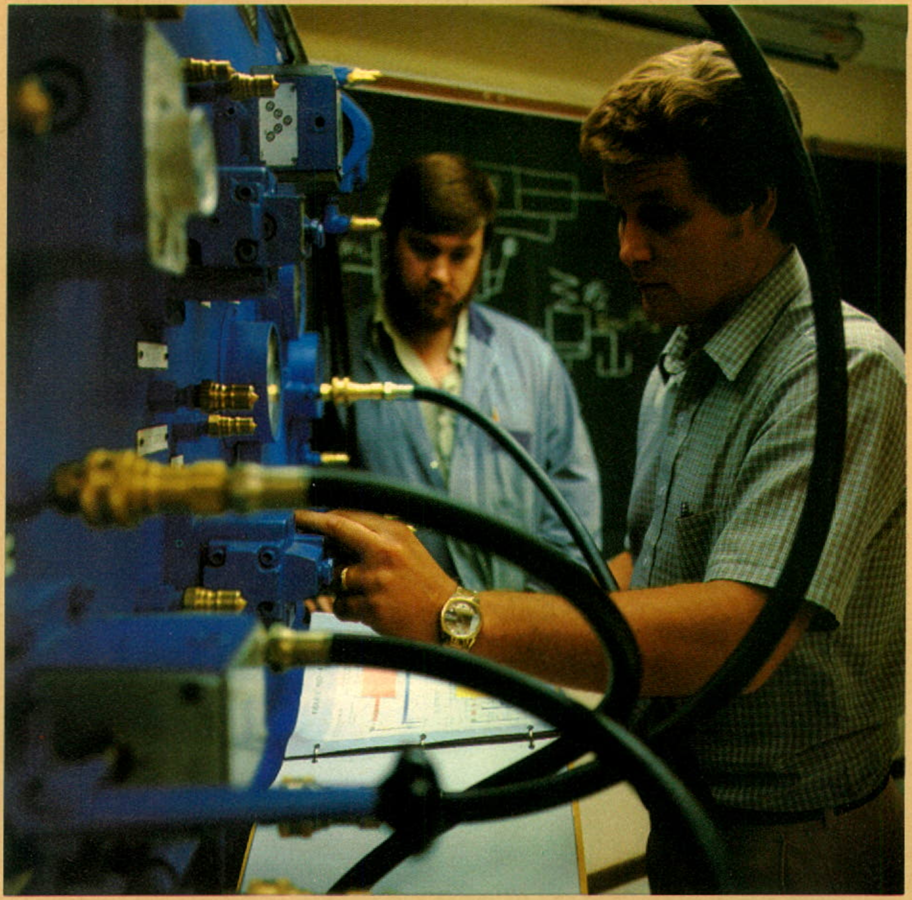
We also proceeded with the fine paper modernization project in 1981. Major equipment was ordered, building foundations were completed and structural steel erection commenced. The fine paper machine incorporates the most advanced technology and has been ordered from a Finnish supplier. This new machine will replace the three existing machines.

Upon completion of the Dryden programs, annual capacity for the kraft pulp mill 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. The new stud lumber mill will be capable of producing 60 million board feet annually and fine paper capacity will increase from 63,000 metric tons annually to 122,000 metric tons.

A total of $20 million was spent on our Thunder Bay mill facilities in 1981. We made further advancements in the program of modernization and improvements to our paper machines, resulting in some modest increases in productive capacity, and proceeded with installation of new environmental facilities. We also made progress with energy conservation projects to increase the efficiency of our bark-burning facilities.

Woodlands capital expenditures amounted to $18 million in 1981 including completion of a new camp check for any dangerous gases that might be present in a chemical tank used in our kraft operations which has been shut down for maintenance. Such testing is mandatory before any vessel of this nature can be entered for inspection or repair and is one example of safe working practices used by our personnel.

Workers improve their skills and keep abreast of new technology at our Thunder Bay training centre. The photograph on the right shows a hydraulic simulator used at the centre to simulate hydraulic circuits used in our harvesting machines. Training staff members John Schermack and Bob Allan are setting up the equipment for a training session with woodlands mechanical workers.



northeast of Savant Lake and the start of construction of a new equipment maintenance garage at Dryden. Equipment purchases comprised feller-forwarder and delimber units to expand our use of the full-tree harvesting system discussed on page 10, as well as replacement units for all types of our mobile equipment to keep these facilities modern and efficient.

Our Environmental Programs

A new environmental control order for our Thunder Bay operations was issued on May 12, 1981 by the Ontario Ministry of the Environment. This order requires in-plant measures in our original kraft pulp mill to remove oxygen-consuming wastes from the liquid discharge, or effluent, and improvements to our air pollution control facilities. Certain recycling techniques developed through the closed-cycle system in our newer mill will also be utilized. These undertakings commenced in 1981 and will be completed over the next two years.

The control order also requires the installation of a collection system for spent sulphite pulping liquor and the burning of this waste material in the kraft mill chemical recovery furnace.

We commenced this project in 1980, well ahead of receiving the control order, and it is scheduled for completion by mid-1982. The new system will result in a significant reduction in the discharge of oxygen-consuming wastes in the effluent from the sulphite pulp mill operation.

We continue to update and add improvements to our environmental facilities in Thunder Bay including refinements to the closed-cycle system in our newer kraft pulp mill. This innovative approach to environmental control involves the recycling of processing wastes within the mill operation with the objective of discharging only essentially clean water. Further progress was made in 1981 towards achieving this objective and we are proceeding with specific improvements required by the control order.

In Dryden we made progress in meeting the Ministry's control order issued in June 1980. We proceeded with the installation of odor abatement facilities and construction of the effluent control system. Primary treatment facilities have been in operation since the fall of 1980 and extensive work on the secondary treatment system was undertaken in 1981. The system calls for two 58-acre basins to stabilize and aerate the treated effluent before it is discharged to the river. Start-up of this facility is scheduled for late in 1982, well in advance of the control order requirement.

Our Forest Resources

In 1981 we assumed full responsibility for forest management of a designated portion of our woodlands under a forest management agreement signed with the Ontario Ministry of Natural Resources in 1980. This agreement requires the Government to reimburse the company for the basic cost of regeneration. We are responsible for planning and implementing all aspects of forest management including harvesting, road construction and reforestation. The new agreement changes the arrangement, which has been in effect since 1962, whereby the Provincial Government was fully responsible for regeneration of cutover areas on Crown land in Ontario.

We believe this new arrangement will result in more intensive forest management which will lead to improved yield per acre and provide greater security for our future wood supply. The area covered by the forest management agreement is known as the English River Forest covering some 2,420 square miles near Ignace. This is one of ten similar areas, known as working circles, which comprise our total woodlands limits. Each of these areas has an allowable annual harvest and, therefore, to meet our total requirements harvesting operations are spread throughout our forest area. It is our desire to have agreements that will cover all these working circles as soon as possible and we are actively pursuing this matter with the Ministry. Two more agreements are under negotiation, but it may be several years before agreements can be concluded for all areas.

In the English River Forest we cut approximately 12,000 acres in 1981 and carried out silvicultural treatment to assist regeneration and foster younger growth on some 9,500 acres. Much of the treatment was undertaken with specially designed machines, one of which is shown in the photograph on page 6. In 1982 we expect to treat substantially more acreage in the management area than the 12,600 acres we plan to harvest. In addition, regeneration was carried out by the Ministry on other areas of our woodlands not covered by the agreement.

In October 1981 we opened our newest camp northeast of Savant Lake. All harvesting operations in this area use the full-tree system which was introduced to our company in 1980. Under this system trees are cut and forwarded to roadside with branches intact, in some cases by chain saw and skidder, but in the main by Koehring feller-forwarders which collect and carry about 125 such trees in each load to roadside where they are unloaded for the delimber operation. Delimbing is followed by the slasher operation which cuts the tree-lengths into pulpwood or, if required, sawlogs for sale to other wood-using industries.

Our operations are being extended into the northeastern portion of our woodlands area to provide the wood required for our mill expansion of the mid-1970's. Plans for developing new harvesting operations in the Armstrong area east of the new camp have now been delayed for two years due to a proposal by the Ministry to create a 2,100-square-mile wilderness park, 1,500 square miles of which are in our woodlands area. We have held most of the 1,500 square miles under licence since 1957 to support our various mill expansions and there is no practical alternative to replace this needed fibre. Direct appeals have been made to the Government but no action has yet been taken by the Ministry to resolve the matter. We continue our efforts to bring the critical nature of this matter to the attention of the public and the various levels of government. For many years we have supported multiple use of the forest where, we believe, recreation and enjoyment are compatible with woodlands operations. Despite all our efforts, environmental groups maintain constant pressure on the Government to carry out its proposal.

Forest fire losses returned to more normal levels compared with the serious fire situation in 1980. Under new co-operative arrangements with the Ministry, we increased our fire-fighting capabilities in 1981 and assumed a greater role in the fire protection program.

Employee Relations

In 1981 we enjoyed stable working conditions which were reflected in good operating results. On September 30, 1981 the contract with the sawmill workers in our Dryden operations expired and is still under negotiation. All other contracts with the unions representing our Thunder Bay and Dryden employees expire between April 30 and September 30, 1982. Although recent statements by one of the major unions representing the employees in our industry indicate that demands in 1982 will be substantial, we are hopeful that reasonable attitudes will prevail.

Market Outlook

As we head into 1982, the near-term market outlook for our various products is clouded by economic uncertainty. Recession conditions coupled with high inflation and interest rates have contributed to soft markets in 1981 and we do not look for improvement in the early part of

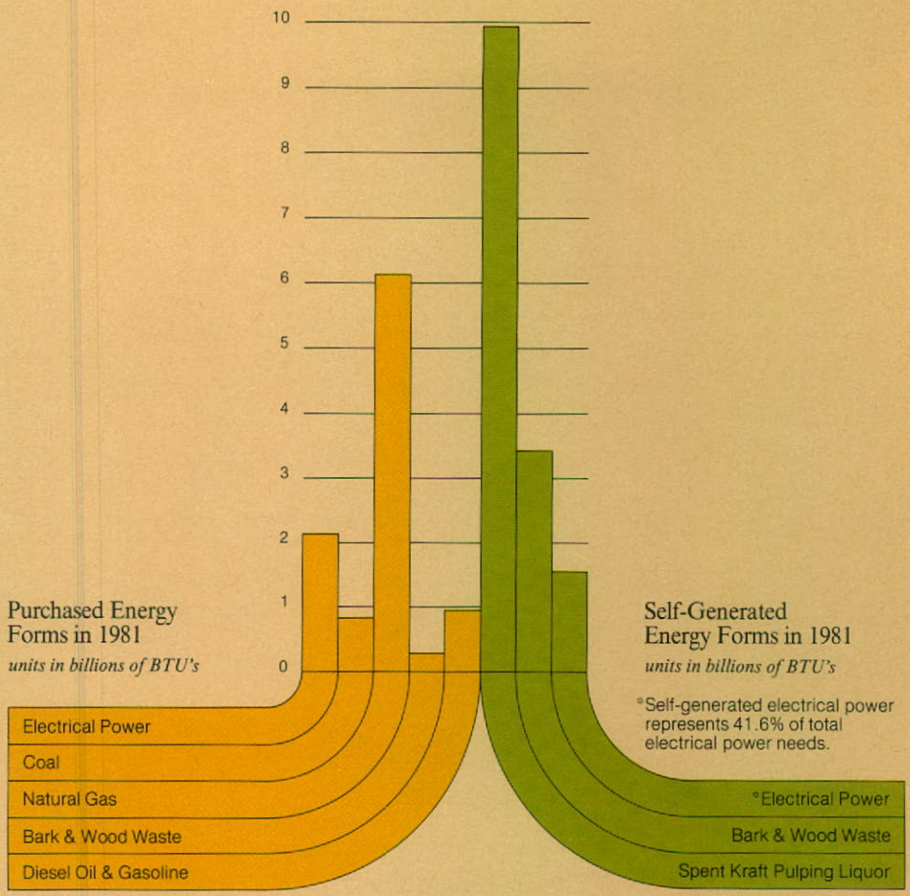
Consumption of Various Energy Forms

The graph on the right compares the relative quantities of purchased and self-generated energy forms used at our mill in Thunder Bay. On completion of our construction program at Dryden similar conservation measures discussed here will be incorporated in that operation.

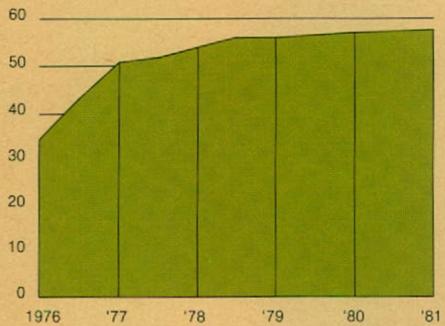
This graph shows the importance of spent kraft pulping liquor as an energy source. It represents a thermal energy source much greater than natural gas usage. Bark and wood waste, some of which was purchased, also represents a significant portion of self-generated energy. Use of these materials is expected to increase substantially in 1982 when a new bark drying system goes into operation.

Although on-site generation of electrical power has been included as a form of self-generated energy, it should be pointed out that the generators are driven by thermal energy largely produced from the above wastes. Our electrical power generation represents 41.6 percent of the mill's total power demand.

The energy conservation program extends to our woodlands operations. Some of the measures introduced over the past few years have reduced our dependency on purchased fuels. For example, two of our major garages are entirely heated with hot water from the engine cooling systems of the main electrical generating plants.



Percentage of Energy Self-Sufficiency



Energy self-sufficiency at our Thunder Bay mill is plotted in the above graph. The increase in our energy self-sufficiency commenced in 1976 when the new kraft pulp mill went into operation along with the No. 6 power boiler discussed in the caption below.

Wood residue from the stud mill, woodroom and waferboard plant is shown here on the main conveyor belts which feed No. 6 power boiler. This boiler consumes some 1,400 tons per day of wood residues and contributes a significant portion to the new mill's energy needs.

1982. We are optimistic that economic conditions will show some improvement later in 1982 and recent predictions indicate promise of a return to real growth in the latter part of the year and a lowering of inflationary pressures. It is, however, expected that interest rates will remain at relatively high levels and this factor will dampen the prospect for economic recovery generally and will continue to depress housing construction.

Weakness in the kraft pulp market continues into 1982 and recovery can be expected only when there is a return to real economic growth. There has been only minor expansion of market kraft pulp production capacity in recent years and little has been announced. There has, however, been considerable increase in production capacity for printing and writing papers, the largest users of market pulp, and as these end products resume market growth, demand for market pulp can be expected to show considerable strength. With the growing use of this product as a major ingredient in a wide range of paper products, we believe there is a promising future for kraft pulp.

U.S. consumption of newsprint was 10.1 million metric tons in 1981, unchanged from a year ago. The weakness in business activity which is reducing advertising lineage is expected to result in some reduction in consumption in 1982. The anticipated move in 1982 on the part of publishers to reduce newsprint inventories built up as a hedge against possible strikes in Canadian suppliers' mills can be expected to cause a further reduction in demand. Also, little improvement in Canadian and offshore markets is expected. In its January 1982 forecast the Canadian Pulp and Paper Association predicted a reduction of about seven percent in total newsprint shipments by Canadian producers for 1982. Over the next few years, we believe that demand will resume an upward trend and by the mid-1980's we look for a healthier balance in newsprint supply and demand.

Our fine paper is sold mainly in the domestic market which is expected to remain soft during most of 1982, with the possibility of some improvement in the latter half. Fine paper, like other segments of the forest products industry, faces a cyclical pattern of supply and demand and at present we are on the down cycle. Over the next few years we believe the situation will change and we look forward to improved markets for our fine paper products as we move on into the 1980's.

High interest rates in North America will continue to depress housing construction activity in 1982 although there are forecasts that there may be some improvement later in the year. The pent-up demand for new housing will have to be satisfied at some point and when conditions improve we believe that a reasonably vigorous market for our building products will develop.

Company Outlook

The efficiency of our large scale operations at Thunder Bay continues to be the major source of our strength. This will be enhanced as our modernized Dryden facilities come into production. We also continue to increase the productivity of our woodlands operations through the introduction of modern equipment and improved systems. In this way we have kept abreast of the industry in maintaining up-to-date, efficient plant and equipment. However, such facilities are only as good as the employees who operate them. We have a stable work force, many of whom are long-term employees, and through extensive training programs and on-going efforts to strengthen our relationships, we believe that our employees are fully capable of meeting the challenges ahead of us.

In 1982, it appears unlikely that continuing escalation of operating costs will be recovered through higher selling prices in view of anticipated market weakness. We can, however, expect to benefit from the continuing U.S. dollar exchange premium. The modernized and expanded kraft pulp mill in Dryden is scheduled to go into production in 1982 although we can expect production losses during the tie in and start up of the new facility. On balance, all indications are that 1982 is going to be a difficult year for our industry. However, barring any unforeseen setbacks and assuming the orderly completion of negotiations with our unions, we expect that our performance will compare favorably with others in the industry as it has in the past.

Looking beyond 1982, with the number of positive factors in our favor and our well established position in the marketplace, we believe that we have the stability and strength to weather the difficult times and make the most of the opportunities that will occur when the fortunes of our industry are on the upswing.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF 1981 FINANCIAL STATEMENTS

Operating Results

Net sales of $568.6 million in 1981 increased $29.3 million or 5 percent over 1980. Higher prices for all of the company's pulp and paper products increased net sales by approximately $35 million and a 2.2 percent higher average rate of exchange premium on U.S. dollar sales added a further $10 million. Offsetting these, by approximately $11 million, were slightly lower shipment volumes of newsprint, as a result of downtime for modernization of one of our machines, and kraft pulp, due largely to the use of Thunder Bay hardwood pulp production in substitution for purchased pulp in the Dryden fine paper operations. Also, continued increase in freight costs reduced net sales by a further $6 million. Our lumber and waferboard operations experienced little change during the difficult markets of 1980 and 1981, representing approximately 7 percent of our net sales.

Cost of sales of $397.3 million increased $41.4 million, or 11.6 percent in 1981. This increase resulted from the general escalation of all costs, particularly energy, chemicals, transportation and wages and was partially offset by the slightly lower shipment volumes. Selling and administrative expenses of $11.4 million increased by $2.2 million over 1980 due to higher net sales, cost escalation and the higher costs associated with increased offshore sales. Although totally consumed by year end, average cash balances were higher in 1981 and their investment at higher interest rates resulted in an increase of $3.1 million in interest and other income. Depreciation increased by $2.2 million in 1981 as a result of additional assets put into service, particularly woodlands facilities and equipment. Income taxes at an effective rate of 40.4 percent compare with 43.2 percent a year ago and reflect the claiming of additional investment tax credits.

The record level of capital expenditures provided almost $18 million of investment tax credits of which $12 million were claimed in 1981 and the balance is available to reduce taxes payable in future years.

Financial Condition

Working capital decreased from $125.7 million to $78 million during 1981. Cash and term deposits, which at the end of 1980 amounted to $91.7 million, have been totally utilized during 1981 as the company approaches the mid-point of expenditures on its $430 million modernization and expansion program. These expenditures account for the majority of the large increase of $174.1 million in the cost of fixed assets during 1981. The reduction in income and other taxes payable from $42.7 million in 1980 to $6.4 million in 1981 reflects the requirement to make monthly installments on 1981 income taxes during 1981 whereas 1980 income taxes were not required to be remitted until early 1981. Deferred income taxes increased by $28.7 million in 1981 to $118.3 million due to the availability of a substantial amount of capital cost allowance at accelerated rates resulting from the expenditures on our modernization and expansion program. The notes payable of $9.95 million issued in 1981 represent financing of equipment for our Dryden fine paper machine. As at December 31, 1981, the estimated cost to complete the major modernization program is $225 million. Financing of this amount and of the company's normal working capital requirements is expected to be provided by internally generated funds and the company's line of credit arrangements.

Effects of Economic Conditions

In 1981, 84 percent of the company's sales revenue was in U.S. dollars and consequently foreign exchange premium represents a significant element of net earnings. In order to reduce the exposure of our cash flow to fluctuations in the foreign exchange rate during our major capital expenditure program, the company has entered into forward contracts for the sale of approximately 55 percent of its expected U.S. dollar sales proceeds to the end of 1984 at rates which average $1 U.S. = $1.18 Cdn.

Inflation and the rapidly rising cost of energy resources are having a significant impact on our operations through the continual escalation of our basic operating costs. In the market conditions faced by the forest products industry in 1981, these cost escalations generally exceeded the increases in the selling prices of our products. The resulting compression of margins was a major factor in the reduction of net earnings in 1981. In 1982, it appears unlikely that continuing

The paper in this section is Opaque Litho manufactured in our Dryden fine paper mill.

escalation of operating costs will be recovered through higher selling prices in view of anticipated market weakness.

No attempt has been made to measure the effects of inflation on these financial statements. Several methods are in use in other countries but the Canadian Institute of Chartered Accountants has only recently issued a re-exposure draft on the subject. The position proposed will be discussed by the profession during the first quarter of 1982 prior to a recommendation being made later in the year. We do not consider it appropriate to experiment with any of the various methods until such time as some well-established guidelines make it possible for the readers of financial statements to understand the implications of the exercise.

AUDITORS' REPORT TO THE SHAREHOLDERS

To the Shareholders of Great Lakes Forest Products Limited

We have examined the consolidated balance sheet of Great Lakes Forest Products Limited as at December 31, 1981 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1981 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Thorne Riddell

THORNE RIDDELL & CO.
Chartered Accountants

Toronto, Canada, January 22, 1982

EARNINGS

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

	1981	1980
Net sales:		
Pulp and paper	$529,671	$503,861
Building products	38,923	35,418
	568,594	539,279
Cost of sales	397,312	355,957
Selling and administrative expense	11,352	9,112
OPERATING PROFIT	159,930	174,210
Interest and other income	9,248	6,163
	169,178	180,373
Interest (Note 5)	8,154	8,893
Depreciation	30,603	28,375
EARNINGS before income taxes	130,421	143,105
Income taxes	52,647	61,753
NET EARNINGS	$ 77,774	$ 81,352
Net earnings per share	$ 15.92	$ 18.01

RETAINED EARNINGS

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

Retained earnings at beginning of year	$208,519	$136,447
Net earnings	77,774	81,352
	286,293	217,799
Dividends declared	14,164	9,280
RETAINED EARNINGS at end of year	$272,129	$208,519

BALANCE SHEET

consolidated statement at December 31 (thousands of dollars)

	1981	1980
Assets		
CURRENT ASSETS		
Cash and term deposits	$ –	$ 91,700
Accounts receivable	68,703	65,627
Inventories:		
Finished goods	9,098	10,847
Pulpwood and sawlogs	38,230	30,936
Materials and supplies	25,612	22,247
Prepaid expenses	1,652	1,098
	143,295	222,455
FIXED ASSETS (Note 2)	682,667	508,555
Accumulated depreciation and depletion	239,946	210,555
	442,721	298,000
	$586,016	$520,455

	1981	1980
Liabilities		
CURRENT LIABILITIES		
Accounts payable and accrued charges	$ 50,897	$ 46,115
Income and other taxes payable	6,428	42,660
Dividend payable	3,907	2,442
Current portion of long-term debt	4,078	5,509
	65,310	96,726
LONG-TERM DEBT (Note 3)		
First Mortgage Bonds:		
8% sinking fund bonds, Series B, maturing 1989	11,715	12,680
11¼% sinking fund bonds, Series C, maturing 1995	31,370	32,026
8¾% debentures maturing 1984 (U.S. $16.7 million)	17,506	19,163
Notes payable	9,953	–
Bank loans	568	–
Lease obligations	8,563	12,504
	79,675	76,373
Current portion	4,078	5,425
	75,597	70,948
DEFERRED INCOME TAXES	118,331	89,613
Shareholders' Equity		
Common shares without par value		
Authorized 10,000,000 shares		
Issued 4,884,355 shares	54,649	54,649
Retained earnings	272,129	208,519
	326,778	263,168
	$586,016	$520,455

Approved by the Board:

C. J. Carter

C. J. CARTER, *Director*

R. C. Meech

RICHARD C. MEECH, *Director*

CHANGES IN FINANCIAL POSITION

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

	1981	1980
WORKING CAPITAL PROVIDED		
Net earnings	$ 77,774	$ 81,352
Charges not affecting working capital:		
Depreciation	30,603	28,375
Increase in deferred income taxes	28,718	10,115
GENERATED FROM OPERATIONS	137,095	119,842
Issue of common shares	–	42,983
Government grants (Note 2)	13,117	25,334
Notes payable	9,953	–
Bank loans	568	–
Sale of fixed assets	582	153
	161,315	188,312
WORKING CAPITAL USED		
Expenditures on fixed assets	189,023	65,612
Reduction of long-term debt	5,872	5,819
Dividends declared	14,164	9,280
	209,059	80,711
INCREASE (DECREASE) IN WORKING CAPITAL	(47,744)	107,601
Working capital at beginning of year	125,729	18,128
WORKING CAPITAL at end of year	$ 77,985	$125,729

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Year ended December 31, 1981

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, 1981 Cost	December 31, 1981 Net Value	December 31, 1980 Net Value
Land	$ 1,325	$ 1,325	$ 843
Buildings and machinery			
Pulp and paper	416,677	248,333	246,254
Building products	26,174	8,877	11,399
Woodlands improvements and equipment	60,214	24,958	16,091
Timber licences	3,945	—	—
Assets under capital lease	20,308	5,204	7,855
Construction in progress	154,024	154,024	15,558
	$682,667	$442,721	$298,000

The company has been granted $48 million through agreements under the joint Ontario and Federal Governments' Pulp and Paper Industry Facilities Improvement Programme for environmental, modernization and energy conservation projects currently being undertaken at its facilities in Dryden and Thunder Bay. $25.3 million was received in 1980, $13.1 million in 1981 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 agreements provide for a pro rata refund of a portion of the grant should the company fail to complete any component project.

The cost to complete these projects is estimated to be $225 million of which $47.5 million is committed at December 31, 1981.

3. Long-Term Debt

Bank loans are subject to the terms of an agreement with the company's bankers covering the period to June 1, 1985. The agreement provides for loans of up to $80 million in Canadian or U.S. funds or a combination of the two currencies secured by assignment of accounts receivable and charges on inventory. Bank loans at December 31, 1981 are in Canadian funds and bear interest at floating prime rate.

Required payments to reduce long-term debt over the next five years amount to $4.1 million in 1982, $9.4 million in 1983, $15.9 million in 1984, $2.9 million in 1985 and $3.1 million in 1986.

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.

4. 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.

5. Interest

Interest on long-term debt amounted to $8.2 million ($7.9 million in 1980).

6. Executive Remuneration

In 1981, directors' fees amounted to $58,000. The total remuneration, including directors' fees, received by the directors and senior officers amounted to $873,000.

7. Past Service Pension Costs

Past service pension costs, resulting from retroactive increases in benefits in 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 million at December 31, 1981.

8. Investment Tax Credits

At December 31, 1981 investment tax credits are available to reduce income taxes payable in future years by $5.9 million.

9. Forward Exchange Contracts

The company has entered into forward exchange contracts for the delivery of $990 million U.S. funds to the end of 1984 at exchange rates which average $1 U.S. = $1.18 Cdn.

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 wrote to the company in 1979 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.

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. There were no borrowings under this line of credit during 1981.

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.

A small portion of the company's production is sold to a subsidiary of CIP Inc., a subsidiary of Canadian Pacific Enterprises Limited. Such sales are made in accordance with the company's normal terms of sale.

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.

12. Industry Segment and Export Sales

The company's entire operations consist of the manufacture and sale of products of the forest industry. In 1981, 84 percent (1980—87 percent) of the company's net sales were exported, largely to United States destinations, and priced in U.S. dollars.

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, 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.

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.

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

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

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

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).

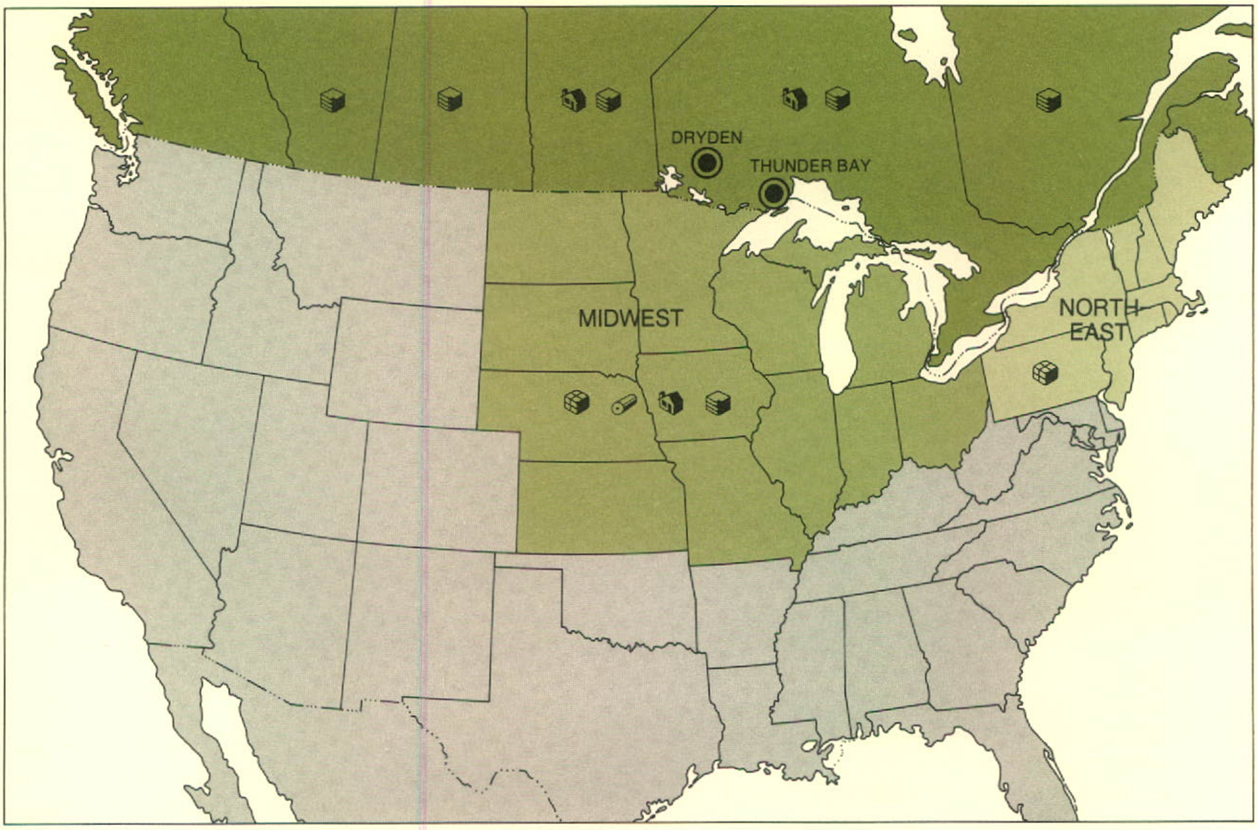
LONG-TERM DEBT: Amounts borrowed for a term of longer than one year.

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.

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.

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

OUR MARKETS



Kraft Pulp Newsprint Building Products Fine Paper

The bulk of our production is shipped to customers in the shaded portions of the United States shown above which extends in a radius of approximately 1,500 kilometers from our mills at Thunder Bay and Dryden. Virtually our entire newsprint and the majority of our kraft pulp markets at present lie within this area with newsprint concentrated in the midwest and kraft pulp extending from the midwest into the northeastern section. We also ship kraft pulp to offshore markets, including the Far East. Some of our fine paper production is shipped to the midwestern United States but the majority is shipped to markets in Canada as shown on the map. Our building products are sold to customers in the United States in the shaded portion, as well as to customers in Canada.

OUR SHIPMENT SUMMARY: LAST FIVE YEARS

	1977	1978	1979	1980	1981
Newsprint (000 metric tons)	338	362	378	391	386
Kraft pulp (000 metric tons)	304	327	356	521	504
Fine papers (000 metric tons)	. . .	. . .	. . .	62	64
Total (000 metric tons)	642	689	734	974	954
Lumber (millions of board feet)	86	103	107	132	137
Waferboard (millions of sq. ft.—⅜-inch basis)	75	97	111	87	86

While waferboard is manufactured in varying thicknesses, for comparative purposes with the industry statistics on page 25, our shipment volume is shown here on a ⅜-inch equivalent basis.

NEWSPRINT PAPER

The United States is Canada's principal customer for newsprint and accounts for approximately 44 percent of the free-world's consumption. The following table, based on reports issued by the Canadian Pulp and Paper Association (CPPA), indicates the size and growth of newsprint markets over the period 1977 through 1981. World totals for newsprint omit communist countries for which reliable information is lacking.

	1977	1978	1979	1980	1981
		(millions of metric tons)			
Free-world production capacity	22.5	23.0	23.7	24.7	25.9
Free-world production	20.0	21.1	22.3	23.2	24.3
Canadian production capacity	9.0	9.0	9.1	9.1	9.5
Canadian production	8.2	8.8	8.7	8.6	8.9
Canadian exports	7.3	8.0	7.8	7.6	7.8
Canadian exports to U.S.	5.8	6.4	6.4	6.1	6.0
Total U.S. consumption	9.3	9.9	10.2	10.1	10.1

Source: CPPA (1981 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 1981 of approximately 64.6 million metric tons or 65.7 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 1981 the production capacity in North America and Scandinavia for market bleached kraft pulp was approximately 14.7 million metric tons of which Canadian production capacity amounted to approximately 41.5 percent, or 6.1 million metric tons. Our company is a major supplier of this market pulp.

	1977	1978	1979	1980	1981
Paper Grade Chemical Pulp		(millions of metric tons)			
North American and Scandinavian production	53.2	55.2	58.7	59.4	60.2
Bleached Kraft Pulp					
North American and Scandinavian production	25.8	27.6	29.6	31.0	31.7
Bleached Kraft Market Pulp					
Total demand for North American and Scandinavian production	10.2	12.2	12.6	13.3	12.7
Canadian shipments	4.6	5.3	5.4	5.9	5.4
Canadian exports to U.S.	1.8	1.9	2.0	2.0	1.9
Total U.S. supply (including imports)	3.3	3.7	4.0	4.0	3.8

Source: CPPA (1981 estimated).

FINE PAPER

The term "fine paper" 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 42 percent of all fine papers produced in Canada; business papers, representing 34 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.

	1977	1978	1979	1980	1981
		(thousands of metric tons)			
Canadian production capacity	807.3	834.5	943.0	982.0	1,025.0
Domestic shipments	517.5	628.8	704.4	697.2	661.1
Export shipments	168.8	156.7	204.1	200.8	127.2
Canadian imports	154.6	141.1	130.0	150.9	217.7
Canadian demand	672.1	769.9	834.4	848.1	878.8

Sources: Statistics Canada, CPPA (1981 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.

	1977	1978	1979	1980	1981
			(millions)		
North American housing starts	2.2	2.3	1.9	1.5	1.3
Seasonally adjusted year-end rate of North American housing starts	2.5	2.3	1.7	1.7	1.2
Softwood lumber production			(billions of board feet)		
U.S.	31.7	30.7	29.7	31.6	30.0
British Columbia	12.0	12.5	12.5	12.0	10.4
Rest of Canada	5.2	5.8	6.0	6.2	6.1
Total	48.9	49.0	48.2	49.8	46.5

Sources: Statistics Canada, U.S. Bureau of Census, National Forest Products Assn. (1981 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.

	1977	1978	1979	1980	1981
			(billions of square feet)		
Softwood plywood (⅜-inch basis)					
U.S. production	19.7	19.9	19.7	16.7	71.1
Canadian production	2.7	2.9	2.8	2.6	2.4
Waferboard (⅜-inch basis)					
Canadian production	.4	.5	.6	.6	.8
U.S. production	.1	.1	.1	.2	.4

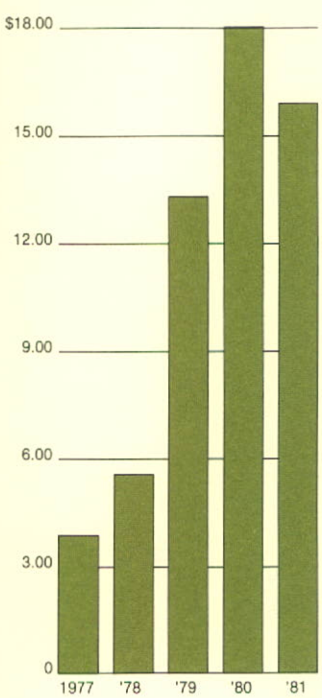
Sources: Dept. of Industry, Trade and Commerce, American Plywood Assn., FORSIM of Data Resources Inc. (1981 estimated).

FINANCIAL SUMMARY: LAST FIVE YEARS

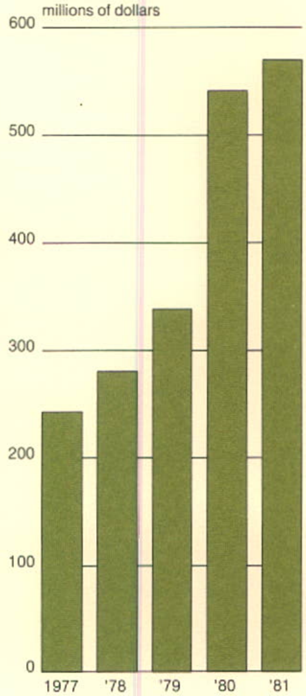
Except for per share amounts as indicated, all dollar figures are in thousands	1977	1978	1979	1980	1981
SALES & EARNINGS					
Net sales: pulp and paper	216,534	239,990	299,407	503,861	529,671
building products	24,914	37,372	38,668	35,418	38,923
total	241,448	277,362	338,075	539,279	568,594
Operating profit	60,528	75,133	108,410	174,210	159,930
Interest expense	14,792	13,435	10,944	8,893	8,154
Depreciation	19,952	19,654	20,203	28,375	30,603
Earnings before income taxes	25,250	39,740	81,603	143,105	130,421
Income taxes	11,288	19,669	31,727	61,753	52,647
Net earnings	13,962	20,071	49,876	81,352	77,774
Net earnings per share	3.87	5.56	13.32	18.01	15.92
Dividends declared, total	–	1,625	5,731	9,280	14,164
Dividends per share	–	.45	1.50	2.00	2.90
ASSETS & LIABILITIES					
Current assets	59,272	109,418	109,524	222,455	143,295
Current liabilities	36,372	76,887	91,396	96,726	65,310
Ratio of above assets to liabilities	1.6	1.4	1.2	2.3	2.2
Working capital	22,900	32,531	18,128	125,729	77,985
Inventories, described in balance sheet	25,706	27,628	49,915	64,030	72,940
Fixed assets, see notes to financial statements	378,782	387,699	468,927	508,555	682,667
Accumulated depreciation and depletion	144,808	162,885	182,677	210,555	239,946
Long-term debt	134,391	97,607	76,767	70,948	75,597
Ratio of above debt to shareholders' equity	1.8	1.0	.5	.3	.2
Deferred income taxes	45,877	64,686	79,498	89,613	118,331
Retained earnings, at year end	73,856	92,302	136,447	208,519	272,129
EQUITY & OTHER DATA					
Common shares outstanding, at year end	3,610,029	3,610,039	3,907,484	4,884,355	4,884,355
Number of shareholders	2,912	2,727	2,557	2,726	2,518
Percentage of shares held in Canada	97.8	97.9	98.0	98.4	98.4
Shareholders' equity, total	76,606	95,052	148,113	263,168	326,778
Shareholders' equity per share	21.22	26.33	37.90	53.88	66.90
Cash flow from operations	44,962	58,534	84,891	119,842	137,095
Cash flow per share	12.45	16.21	22.66	26.53	28.07
Net earnings percentage on net sales	5.8	7.2	14.8	15.1	13.7
Annual expenditures on fixed assets	8,196	10,776	81,931	65,612	189,023
Number of employees on payroll	3,863	3,831	5,598	5,709	5,745

Net earnings per share and cash flow 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.

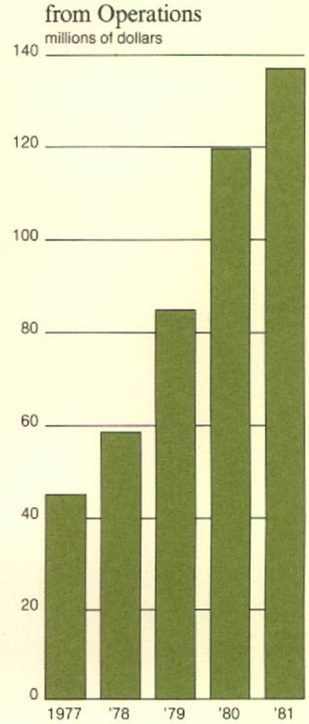
Net Earnings Per Share



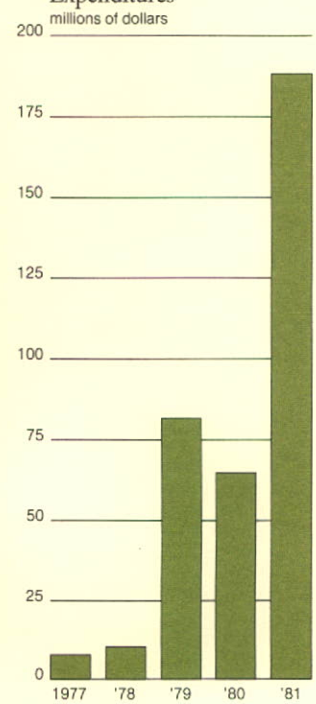
Net Sales



Cash Flow from Operations



Capital Expenditures



1981 Results by Quarters

Sales and Earnings '000 omitted
1981 Quarterly

Quarter	Net Sales	Oper. Profit	Net Earnings
First	$138,871	$ 42,461	$ 20,998
Second	149,283	42,517	21,022
Third	141,141	39,192	19,534
Fourth	139,299	35,760	16,220
	$568,594	$159,930	$ 77,774

Net Earnings Per Share

Quarter	1977	1978	1979	1980	1981
First	$0.43	$0.71	$ 2.31	$ 5.26	$ 4.30
Second	1.12	1.28	2.99	4.35	4.30
Third	0.98	1.23	3.81	4.39	4.00
Fourth	1.34	2.34	4.21	4.01	3.32
	$3.87	$5.56	$13.32	$18.01	$15.92

Board of Directors at December 31, 1981

C. R. BOWLES *executive vice-president, Great Lakes Forest Products Limited*	Thunder Bay	1964
*C. J. CARTER *chairman of the board and president, Great Lakes Forest Products Limited*	Thunder Bay	1947
R. E. CHAMBERS *executive vice-president, Great Lakes Forest Products Limited*	Thunder Bay	1959
R. S. DEMONE *president and chief operating officer, Maple Leaf Mills Limited*	Toronto	1981
†J. R. JONES *president, Lakehead Newsprint Limited*	Thunder Bay	1981
*IRWIN MAIER *director, The Journal Company (publishers of The Milwaukee Journal and Milwaukee Sentinel)*	Milwaukee, Wisconsin	1968
†*RICHARD C. MEECH, Q.C. *partner, Borden & Elliot, barristers and solicitors*	Toronto	1980
PAUL A. NEPVEU *chairman of the board, CIP Inc.*	Montreal	1979
B. H. RIDDER, JR. *chairman of the board, Knight-Ridder Newspapers, Inc.*	St. Paul, Minnesota	1957
*IAN D. SINCLAIR *chairman and chief executive officer, Canadian Pacific Enterprises Limited*	Montreal	1969
*W. JOHN STENASON *president, Canadian Pacific Enterprises Limited*	Montreal	1972
†G. GORDON STRONG *retired publisher*	Oakland, California	1968
J. G. TREZEVANT *senior vice-president, Field Newspaper Syndicate*	Irvine, California	1975
KENNETH A. WHITE *chairman and chief executive officer, Royal Trustco Limited*	Toronto	1977

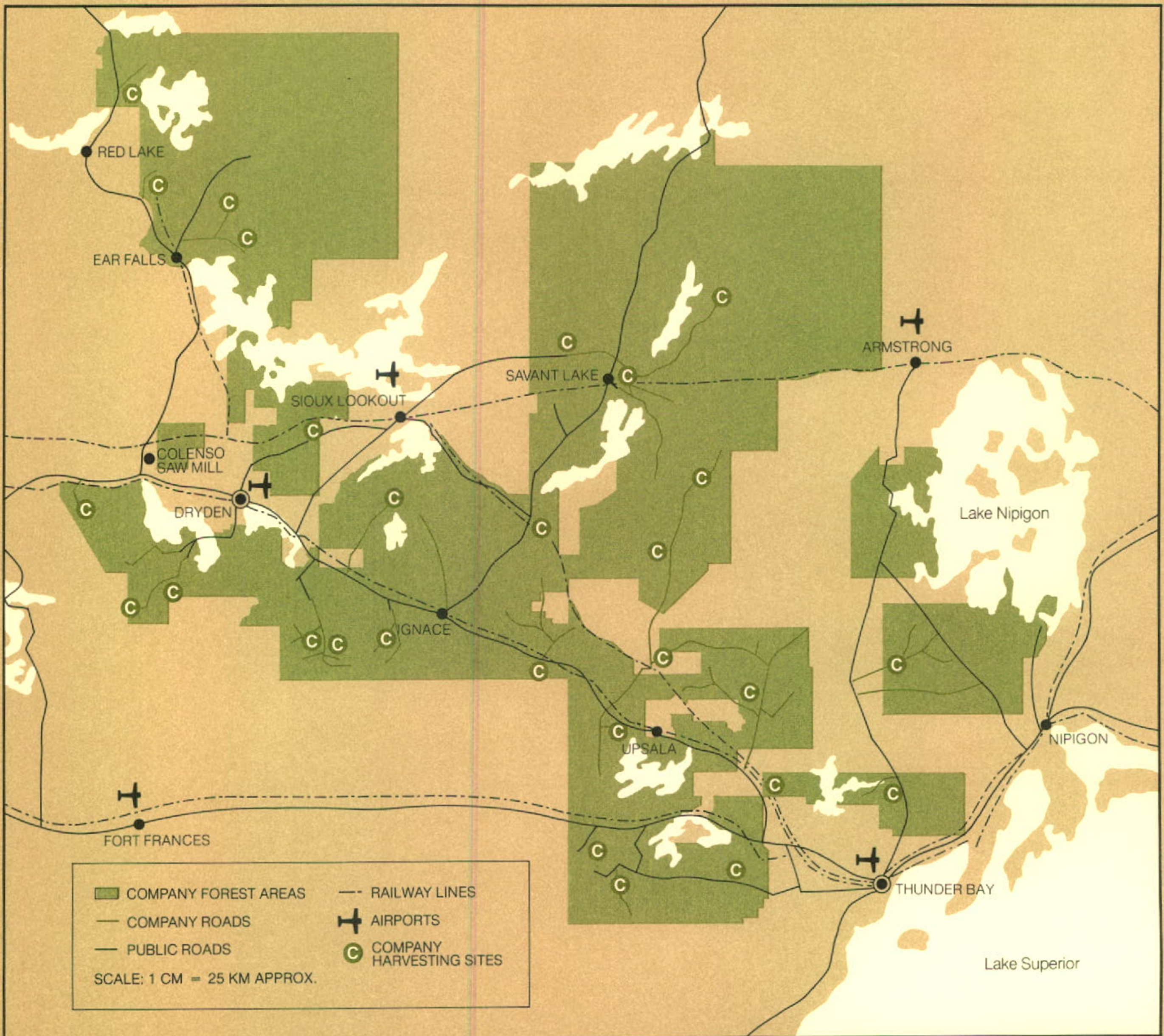
* *Members of the Executive Committee*
† *Members of the Audit Committee*
Years denote beginning of connection with the company or acquired operations.

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

Management at December 31, 1981

C. J. CARTER, *chairman of the board and president*	1947
C. R. BOWLES, *executive vice-president*	1964
R. E. CHAMBERS, *executive vice-president*	1959
M. CEBROWSKI, *vice-president, mill operations*	1964
M. R. MCKAY, *vice-president, woodlands operations*	1944
K. E. WINROW, *vice-president finance and comptroller*	1971
T. M. BROWN, *secretary*	1956
D. D. MORROW, *treasurer*	1964
W. E. MACVITTIE, *assistant comptroller*	1968
R. A. LEHTOVAARA, *assistant comptroller*	1975
B. R. KERR, *assistant treasurer*	1964
F. H. TOLLEFSEN, *manager, public relations*	1966

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 or forest management agreement with the Province of Ontario. To open and harvest these resources about 4,000 kilometres of company roads have been built as well as the camps and work sites shown on the map. The newest camp was completed late in 1981 and is located northeast of Savant Lake. 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.