





#### FRONT COVER

The photograph shows a tree-planting crew at work in a cutover area that had been treated the previous year by heavy mobile equipment using powered cone-shaped heads to prepare the soil. Tree planting permits the proper spacing of trees for optimum growth. In future, genetically improved trees now in the development stage will be used. In 1985 we planted some 7.4 million trees on cutover areas in our Thunder Bay and Dryden woodlands. Attempts to mechanize the tree-planting operations to permit expansion of this method of regeneration over much larger areas than is presently feasible have been tried but have not proven successful to date due to technical problems and rugged terrain in Northwestern Ontario. We are continually on the lookout for new technology that could improve such regeneration techniques. The mainstay of our forest renewal program continues to be seeding either from aircraft or by mechanical means on the ground, both methods being successful in meeting forest management objectives.



## HIGHLIGHTS

	1985	1984
<i>(thousands of dollars)</i>		
Net sales: Pulp and paper	\$540,928	\$554,609
Building products	51,182	47,367
Total	592,110	601,976
Operating profit	78,535	96,144
Earnings before income taxes	6,369	26,870
Income taxes	2,819	9,091
NET EARNINGS before extraordinary item:		
Total amount	3,550	17,779
Per share (restated for 1984)	0.18	0.91
Extraordinary Item	(3,334)	—
NET EARNINGS: Total amount	216	17,779
Per share (restated for 1984)	0.01	0.91
Cash flow	43,086	71,448
Expenditures on fixed assets	45,108	47,223
Working capital at year end	65,709	74,859

*Financial and five-year shipment summaries are shown on pages 18, 19 and 20.*

- Net earnings for 1985 were \$216,000 or one cent per share after an extraordinary item compared with \$17.8 million or a restated 91 cents per share in 1984.
- Net sales were \$592.1 million in 1985, slightly lower than net sales of \$602 million in 1984.
- Over 50 percent of our forest area is now held under forest management agreements.
- Accord has been reached in the mercury litigation with two Indian bands.
- Construction of the Ponderay newsprint mill in the State of Washington was postponed.

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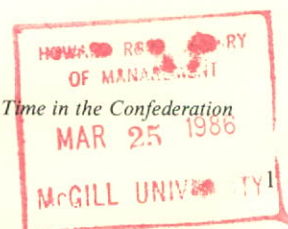
Inside back cover:  
Directors and Management

*Dollars in this report are Canadian unless otherwise identified.*

*A metric ton, the standard used in this report, is equivalent to approximately 1.1 short tons.*

### 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 Tuesday, April 15, 1986.*



## TO THE SHAREHOLDERS

1985 has been a disappointing year with difficult market conditions having an adverse effect on our earnings. Many of our employees experienced the impact directly through downtime of our kraft pulp mills, stud lumber mills and woodlands operations and through layoffs as we were forced to trim our operations to meet the competitive challenge. Although we will continue to face intense competition in our markets, we expect to see some improvement in 1986 and we believe the steps we have taken will strengthen the viability of our company. We look forward with confidence to growth in the future and the continued support of our employees.

As managing partner of Ponderay Newsprint Company, we announced

in November the decision to postpone the newsprint mill venture in the State of Washington. Although poor market conditions necessitated the delay, we believe that this project, which offers a promising opportunity, will proceed when markets improve.

We are pleased that an accord was reached late in 1985 with the Indian bands regarding claims for mercury pollution from the Dryden assets we purchased from Reed in 1979. We believe the agreement is fair and equitable to all parties and expect the governments will act expeditiously to see it to conclusion. The co-operation of all parties and the efforts of The Honourable Emmett Hall were instrumental in reaching this accord.

In 1985 we appointed G. K. Seed vice-president, woodlands operations following the retirement of M. R. McKay who had served the company for 41 years. R. A. Lehtovaara, formerly assistant comptroller, was appointed comptroller. On February 5, 1986, C. R. Bowles was appointed president and chief operating officer having previously been executive vice-president.

On behalf of the directors,

CHARLES J. CARTER,  
*chairman and chief executive officer*

Thunder Bay, Ontario  
February 5, 1986



## EARNINGS DOWN, PRICES DEPRESSED, IMPROVEMENT PROJECTED

Net earnings for 1985 were \$216,000 or one cent per share compared with \$17.8 million or 91 cents per share on a restated basis in 1984. Restatement of the 1984 per share amount is for comparative purposes to give retroactive effect to the four-for-one stock split which occurred in May 1985. Net earnings are after a change in the method of accounting for investment tax credits which decreased earnings by \$2.1 million or 11 cents per share and an extraordinary charge of \$3.3 million or 17 cents per share for the Indian claims settlement described on page 6. The principal reasons for depressed earnings, which without the above items would have been \$5.6 million or 29 cents per share, were lower selling prices for kraft pulp and fine papers and reduced shipment volumes for kraft pulp, newsprint and stud lumber. Largely offsetting these was a significantly higher exchange premium on U.S. dollar sales in 1985.

### Net Sales Down Slightly

Net sales were \$592.1 million in 1985, slightly lower than net sales of \$602 million in 1984. A higher U.S. dollar exchange premium made an important contribution to sales revenue almost offsetting the effect of lower shipment volumes for kraft pulp and newsprint and lower selling prices for kraft pulp and fine papers.

Intense competition prevailed in the kraft pulp market throughout 1985 due to an oversupply condition aggravated by the strength of the U.S. dollar which enabled offshore suppliers to compete in North American markets. North American prices

deteriorated to mid-1979 levels by the fourth quarter and substantial quantities of kraft pulp traded in world markets at even lower prices.

Due to these difficult market conditions, the Thunder Bay and Dryden operations were shut down for approximately four weeks during 1985. Although the United States is our principal market, we were able to increase shipments of kraft pulp to China and other overseas markets in 1985.

The newsprint market was influenced by conditions similar to those affecting the kraft pulp market. As a result, lower volumes of newsprint were shipped in 1985 and several attempts to implement a modest price increase were unsuccessful. Instead, pricing was seriously undermined in 1985 by extensive discounting. Only minor shutdowns were experienced by our newsprint operations, primarily for installation of major capital improvements.

Higher shipments of fine papers in 1985 reflect increased capacity following the start-up of the new fine paper machine in Dryden in April 1984. Although the fine paper market did not strengthen significantly in 1985, the additional tonnage enabled us to increase our presence in the U.S. marketplace.

Oversupply and weak prices continued in the building products market in 1985. Some price improvement was experienced for stud lumber and waferboard early in the year due to seasonal demand but these gains were eroded by year end. Virtually full operation was maintained at our waferboard plant during 1985 but,



due to the integrated nature of our operations, some downtime was required in the stud lumber mills when the kraft pulp mills were down.

#### Exchange Impact

In 1985 our average exchange premium on U.S. dollar sales proceeds was 36.5 percent, up significantly from 21.7 percent in the previous year when our exchange premium was largely determined by forward exchange contracts. Since 86 percent of our sales was exported and priced in U.S. dollars, exchange made a major contribution to our earnings in 1985.

#### Income Taxes

Income taxes were \$2.8 million in 1985 compared with \$9.1 million in 1984. The effective rate of tax on earnings in 1985, before the charge for the extraordinary item, was 44.3 percent and in 1984 was 33.8 percent. The principal difference in rate between the two years is due to the new method of accounting for investment tax credits under which no portion of the tax credits claimed in 1985 was applied against the income tax expense.

An income tax reduction of approximately \$2.7 million has been applied against the extraordinary item of \$6 million relating to the Indian claims settlement as discussed on page 6.

#### Share Split and Dividends

On April 22, 1985 the shareholders passed a special resolution authorizing a four-for-one split of the company's common shares, effective May 6, thereby increasing the number of shares outstanding to 19,537,420.

Dividends of 45 cents per share based on the increased number of shares were declared in 1985 versus 32½ cents per share restated to the comparable basis for 1984. Coincident with the share split, the directors increased the quarterly dividend rate from 10 cents per share on the restated basis for the first quarter to 15 cents per share for the second and third quarters. In October, due to depressed market conditions and earnings, the quarterly dividend payable January 2, 1986 was reduced to five cents per share.

#### Capital Expenditures

Capital expenditures in 1985 totalled \$45.1 million. At Thunder Bay, a variety of installations went on stream in the mill operations, primarily to modernize equipment and achieve quality improvements. This included a \$3 million cleaning system which started up in July in the original kraft mill to remove impurities from the pulp and a \$5.4 million installation of a top-wire former and related equipment on No. 4 newsprint machine in October to enhance the printing quality of the newsprint sheet. Expenditures totaling \$10 million were made for other quality improvements to Nos. 1 and 4 paper machines with the work scheduled for completion in 1986. Other expenditures were incurred to improve energy efficiency.

Capital expenditures in the Dryden mill operations of \$4.4 million were primarily to enhance productivity and improve product quality. In addition, \$4.2 million was spent on the final phase of the Dryden modernization program for demolition of the old mill and modifications to the fine paper mill for improved efficiency.

Woodlands capital expenditures totalled \$11.4 million, mainly for the replacement of harvesting equipment.

#### Our Forest Resources

In 1985 two new forest management agreements were signed with the Ontario Ministry of Natural Resources increasing the portion of our forest areas covered by such agreements to over 50 percent. These new agreements cover some 5,000 square miles in the Brightsand and Dog River-Mattawin Forest areas shown on the woodlands map on page 21. These 20-year agreements, known as FMA's, give the company responsibility for planning and implementing a complete forest management program including harvesting, road construction and regeneration of cutover areas.

A five-year performance assessment of our first FMA covering the English River Forest was conducted by a Ministry review committee in 1985. The committee report shows that in the five-year period 54,610 acres were harvested and 58,480 acres were regenerated by means of site preparation, planting, seeding and natural regeneration. The com-





These jackpine seedlings in containers are received from the Ontario Ministry of Natural Resources nursery in Thunder Bay and stored in a sheltered area where they are shaded and watered until required for planting. Yvan Audet, skidder operator, is loading the trees on a specially designed carrying rack which is transported by a skidder to a planting operation such as the one shown on the front cover.

mittee commended the company for meeting all of its responsibilities under the agreement and consequently the term of the FMA for the English River Forest was extended for an additional five years to 2005 as called for in the agreement.

In the Trout Lake Forest area north of Dryden, our second FMA which was signed in late 1984, we carried out a program of forest management activities similar to the English River Forest maintaining a balance between harvesting and regeneration work.

Budworm infestations continued to cause grave concern in 1985. In Northwestern Ontario, 24 million acres of forest were damaged by the spruce budworm with balsam fir and spruce trees suffering moderate to severe defoliation, and the predictions are that the situation will continue to be serious in 1986. As a consequence of this damage, we have

redirected some of our woodlands operations in an attempt to salvage as much as possible of the budworm infested forest.

The threat of devastation of jackpine trees, a major fibre component for our mill operations, by the jackpine budworm is increasing. To date our woodlands have been minimally affected by the jackpine budworm but the infestation immediately west of our forest area increased tenfold in 1985 over the previous year and appears to be moving eastward.

During 1985 the Ministry improved its forest protection policy by providing for aerial spraying of immature stands in addition to mature forest areas that will be harvested within the next 10 years. This was reflected in the Ministry's 1986 initial spray proposal which was moderately improved over the previous year's

limited program and included the use of both chemical and biological sprays. However, the Minister of Natural Resources subsequently announced to the legislature that he was cancelling the use of chemical sprays in 1986 and would only permit biological spray to be used, a spray which had limited success in our area in 1985. It is essential that the spray program be extended and chemicals, which have been approved by the federal government as environmentally safe, must be used where required if the expanding budworm devastation is to be curbed. We are dismayed by the Ontario Government's vacillation on this matter which can only result in further serious losses of timber in our forest area and throughout Northern Ontario. We will continue pressing the Ministry to devote adequate funding to live up to its responsibility of providing effective protection for our vital forest resource.



In 1985 we were well prepared to assist the Ministry in carrying out extensive forest fire detection and suppression activities. However, the cold, wet weather throughout the spring and summer months reduced the forest fire hazard to minimal levels resulting in only a few small fires which were easily controlled.

### Employee Relations

Three-year agreements signed in 1984 with all unions representing our employees extend to various dates between April 30 and September 30, 1987.

Temporary shutdowns of our operations due to market conditions affected many of our employees during the year and some permanent reductions of workforce were necessary as part of the continuing program to pare operations for cost efficiency in these difficult times.

Our efforts in the prevention of occupational injury and illness for all employees continued in 1985. A major achievement was the province-wide safety record set by our Thunder Bay kraft mill employees who worked one million man-hours without a lost-time injury as discussed in the caption with the photograph on page 7.

A well-equipped fitness centre was opened in our Thunder Bay operations in 1985 as discussed in the caption with the photograph on page 8. Designed with the concept that healthy, productive employees are valuable team members to the company and to fellow workers, this facility assists employees in maximizing their level of health and fitness. If it proves successful, this program may be extended to other areas of our operations.

### Accord Reached in Mercury Litigation

Effective October 15, 1985, a memorandum of agreement providing for settlement of claims for mercury pollution in the Wabigoon-English River system was signed by all parties involved: our company; Reed Inc.; the federal and provincial governments and the Grassy Narrows and Islington Indian Bands.

The discharge of mercury from the Dryden mill and the related claims for damages occurred prior to our 1979 acquisition of the Dryden assets from Reed. The purchase arrangements provided that our company and Reed would share the liability for environmental damages with participation by the Ontario Government under certain circumstances.

The memorandum of agreement calls for payments totalling \$16.67 million to the two Indian bands. We will contribute \$6 million, Reed Inc. \$5.75 million, the federal government \$2.75 million and the Ontario Government \$2.17 million. \$2 million of the settlement funds will be used to establish a mercury disability fund which the provincial government has agreed to "top up" if necessary. Court approvals and legislation by the federal and provincial governments are required before the settlement is finalized but we are confident these will be obtained in the near future. The agreement will absolve us of all present and future pollution claims associated with the Dryden assets purchased from Reed. Our contribution to this settlement has been charged against 1985 earnings as an extraordinary item of \$3.3 million after income taxes. Full details

of the claims and proposed settlement are included in Notes 10 and 11 to the Financial Statements on pages 16 and 17.

### Washington State Venture

In November 1985 our company, as managing partner of Ponderay Newsprint Company, announced the decision to delay commencement of construction of a 154,000 metric-ton-per-year newsprint mill at Usk in northeastern Washington State. Poor market conditions caused the delay in the project but we have confidence that construction will proceed when market conditions improve.

The four U.S. newspaper publisher partners in this project concur with us in the quality of the project and the desire to proceed when economic conditions permit. Since one of the original five publishers withdrew from the partnership in August, we shall be seeking a new partner when the time is appropriate.

The partners have invested \$3.5 million (U.S. funds) to date and are committed to additional investments which may be required to maintain the integrity of the project during the postponement. We have invested \$1.4 million (U.S. funds) in this venture representing our 40 percent participation.

### Market Outlook

The U.S. economy is projected to show continued growth at a moderate pace in 1986. This will bring a positive element to our markets which have been seriously depressed over the past year. Another favorable development for North American producers is the decline in North





On August 13, 1985, chairman and president Charles Carter paid tribute to the company's 120 Thunder Bay kraft pulp mill employees for working one million man-hours without a lost-time injury over a period of 784 days. Jeff Lougheed, assistant bleach plant operator, shown above with Mr. Carter, was one of the seven representatives who accepted awards on behalf of the employees. In November 1984 the Thunder Bay mechanical department achieved a similar record which was recognized as a "first" for a trades group in Ontario. Personnel at all levels in the company are continually reminded that the prevention of occupational injury and illness and the control of all losses are critical to the success of our company and to the personal security of all employees and their families.

American currency values which began in 1985 and is expected to continue in 1986.

High inventory levels which have been overhanging the kraft pulp market in recent years show signs of easing as we enter 1986. Also, very little new manufacturing capacity is scheduled to enter the market over the next few years. In January 1986 several major producers, including our company, announced increased prices for the second quarter to begin reversing the impact that serious price erosion has had on kraft pulp producers. Despite the oversupply problem in the kraft pulp market, which we expect will continue for some time, these encouraging signs point to some improvement in market conditions in 1986. However, lower cost suppliers from the newer producing countries in Europe and South America will continue to pose a threat in U.S. markets. It may be

some time before there is a return to the profit margins achieved in the early 1980's, but we expect some improvement over the next few years. Looking further ahead, we believe that markets for this product will continue to grow as demand for a wide variety of paper products increases.

Newsprint consumption in the United States was 11.6 million metric tons in 1985 versus 11.4 million metric tons in 1984 and we expect slow growth to continue in 1986. Although North American manufacturing capacity will not increase significantly in the next year or so, oversupply will continue to have a detrimental effect on prices. North American producers also face continued competition from off-shore producers. However, we expect that the supply-demand balance will show some improvement by the end of 1986 and, looking further, we believe the excess capacity will be taken up

by increasing demand for newsprint offering more encouraging prospects for the longer term.

For white, uncoated fine papers, our particular field, we expect strong price competition to continue in 1986 in the Canadian and U.S. markets as a result of oversupply. However, consumption is projected to increase in 1986 and it is anticipated that prices will stabilize and then show some improvement in the latter part of the year. Competitive pressures are expected to remain over the next few years as increases in manufacturing capacity enter the market. Over the longer term, we believe supply and demand will return to a healthier balance and markets for fine papers will again provide opportunities for solid growth.

Little change is expected in the building products market in 1986 with the prediction that North American



In 1985 we opened a fitness centre in our Thunder Bay mill designed to provide a variety of services to meet the needs of employees with special emphasis on back-care fitness, probably the most common physical ailment in our industry. This is a unique facility in the forest industry which was patterned after the "wellness centres" established in the work places in Scandinavia. Fitness specialist Francis Puchalski, shown left, tests Ray Chisholm, millwright, on the exercycle while Ken McMillan, stores co-ordinator, exercises on a weight-lifting machine. Employees' use of the centre is voluntary and confidential. This program helps to encourage a healthier workforce.



housing starts will maintain the relatively strong 1985 levels. Over-supply of panel and lumber products will continue to be a detrimental factor in 1986. Pricing for building products is expected to be more stable in 1986, but little overall improvement is anticipated. Also, the increased protectionist sentiment in the United States against imports of lumber could lead to tariff barriers. Looking to the future, we believe that waferboard will continue to increase its share of the panel market. It is also anticipated that there will be steady demand for housing and only those with the most cost-efficient operations will be in the position to serve the continued demand for building products.

#### Company Outlook

Economic prospects indicate some improvement in our markets in 1986. Despite continued price competition,

we expect stability to return to our markets and some improvement in pricing, particularly for kraft pulp. The downward pressure on the Canadian dollar in the early weeks of 1986 indicates continuation of a high exchange premium on our U.S. dollar sales. We will face rising costs in 1986 but our continuing efforts to pare operations and improve efficiency wherever possible will help to offset these costs. On balance, we look for a modest improvement in our earnings in 1986 in contrast to the disappointing results in 1985.

The course of the economy over the next few years is unclear but there are some encouraging signs. The current oversupply situation for all our products will gradually be absorbed since little new manufacturing capacity is being added in North America. It is anticipated that the lower value of North American currencies will

reduce the ability of offshore suppliers to compete in these markets and we believe the demand for our products will experience an upward trend. With the high quality of our manufacturing facilities in Thunder Bay and Dryden, the efficiency of our woodlands operations and our skilled workforce, we believe we are in an excellent position to make the most of market opportunities.

We have seen some trying times in recent years, but this is a cyclical industry and prosperity will return. As we look to the future, there will be recurrences of down cycles from time to time just as there will be periods of solid growth. Our company is strong and we have proven our ability to withstand adversity. We are also well prepared to move ahead as our fortunes improve and ensure that all those associated with us will share fully in the benefits of a healthy, growing company.



### MANAGEMENT'S DISCUSSION AND ANALYSIS OF 1985 FINANCIAL STATEMENTS

#### Operating Results

Net sales of \$592.1 million in 1985 were \$9.9 million or 1.7 percent lower than net sales of \$602 million in 1984. Lower shipment volumes for newsprint, kraft pulp and stud lumber, partially offset by increased shipments of fine papers and waferboard, accounted for a reduction of \$25.2 million in net sales. Lower selling prices, principally for kraft pulp and fine papers, represented a further reduction of \$40.1 million. However, a significantly higher exchange premium on U.S. dollar sales proceeds in 1985 offset the above by \$55.4 million. Difficult market conditions for newsprint and kraft pulp, caused by oversupply and intense competition, resulted in lower overall shipment volumes in 1985. Kraft pulp shipments to Europe and Asia increased in 1985, however, as efforts to expand into these markets were successful.

Significant erosion of kraft pulp prices occurred in 1985 as additional North American capacity came on stream and offshore competition, notably from hardwood pulp producers, intensified. As a result, kraft pulp prices fell to mid-1979 levels by the end of the year and substantial quantities were trading in world markets at even lower prices. Competitive newsprint markets prevailed throughout 1985 resulting in several unsuccessful attempts to implement a modest price increase. Fine paper markets failed to strengthen sufficiently in 1985 to allow prices to improve. However, the additional fine paper tonnage available in 1985 from the company's new fine paper machine that started up in Dryden in April 1984 enabled the company to increase its presence in U.S. fine paper markets. Stud lumber and waferboard prices improved due to seasonal conditions during the first half of the year but these gains were eroded by year end. The exchange premium on U.S. dollar sales proceeds averaged 36.5 percent in 1985 compared to 21.7 percent in 1984 when it was largely determined by forward exchange contracts.

Cost of sales of \$498 million in 1985 increased \$4.1 million over the prior year. Due to market conditions, shutdowns of kraft pulp, stud lumber and woodlands operations were necessary for varying periods during the year. While newsprint, fine papers and waferboard facilities operated without major shutdowns in 1985, newsprint operations experienced some downtime for major capital improvements. Operating performance of our Dryden facilities continued to improve in 1985 and several new production records were established. Higher volumes from the new fine paper machine partially offset continued escalation of manufacturing costs as a result of rising labor rates and material costs. Selling and administrative expenses of \$15.5 million in 1985 were \$3.6 million higher than in the prior year due largely to higher selling costs and to corporate expenses associated with development of the proposed newsprint mill in the State of Washington in partnership with several publishers.

Interest payments decreased by \$2 million in 1985 to \$25.2 million due largely to lower interest rates. All interest was

charged to earnings in 1985 whereas interest of \$2.4 million was capitalized in 1984 in connection with construction of the Dryden fine paper machine. Depreciation expense of \$46.1 million increased by \$2.2 million due to additional depreciation associated with the fine paper machine and higher depreciation on woodlands equipment as a result of equipment purchases in 1985. Income taxes of \$2.8 million or 44.3 percent on pretax earnings before the extraordinary item in 1985 compare with income taxes of \$9.1 million or 33.8 percent on pretax earnings of \$26.9 million in 1984. The principal reason for the higher effective tax rate in 1985 was due largely to the change in the method of accounting for investment tax credits as explained below.

The company has adopted new recommendations of the Canadian Institute of Chartered Accountants on accounting for investment tax credits which have been applied effective January 1, 1985. Investment tax credits applicable to 1985 capital expenditures have been deducted from the cost of the related assets with depreciation calculated on the net amount. Previously these tax credits, net of deferred income taxes, were applied to reduce income taxes charged to earnings. The effect of this change has been to reduce net earnings for 1985 by \$2.1 million or 11 cents per share.

An extraordinary charge of \$6 million, net of income taxes of \$2.7 million, relating to the settlement with two Indian bands of outstanding mercury pollution claims associated with the acquisition of the Dryden assets in 1979 further reduced net earnings by \$3.3 million or 17 cents per share in 1985.

The company has also adopted recent recommendations of the Canadian Institute of Chartered Accountants on the presentation of the Statement of Changes in Financial Position. These new recommendations call for the reporting of the sources and uses of cash and cash equivalents net of short-term borrowings in a format that identifies operating, financing and investing activities. Previously, this statement reported the sources and uses of working capital. Under this new format, certain 1984 amounts have been reclassified for comparative purposes.

#### Financial Condition

Working capital of \$65.7 million in 1985 decreased by \$9.2 million from \$74.9 million at the end of 1984. The principal changes within working capital were: a decrease of \$7.4 million in accounts receivable due to lower shipments and selling prices in December 1985, an increase of \$6.8 million in inventories due largely to higher quantities of finished product and materials and supplies on hand at the end of the year, a drawdown of an additional \$6.1 million under a loan agreement with Canadian Pacific Securities Limited and the recording of the \$6.1 million liability and interest for the settlement of outstanding litigation. Cash flow from operations in 1985 was



\$43.1 million compared to \$71.4 million in 1984. This decrease was largely due to the lower level of earnings in 1985 and the drawdown of deferred income taxes provided in prior years.

Capital expenditures were \$45.1 million in 1985. The major items of expenditure in the Thunder Bay mill operations were \$16 million spent on our newsprint machines to improve productivity and product quality, \$3.4 million to improve kraft mill processes and \$1.6 million to upgrade our data processing equipment. Capital expenditures for the Dryden mill operations were \$8.6 million, the majority of which was spent to upgrade handling facilities for waste fuel, demolish additional segments of the old kraft mill, install a computerized order-entry system for the new fine paper machine and improve its winder capabilities. Expenditures on woodlands capital items were \$11.4 million, largely for replacement of harvesting equipment. During the year the company drew down an additional \$11.5 million under long-term line of credit agreements with various banks. As at December 31, 1985 the relationship of debt to debt-plus-equity was 44.9 percent versus 42.8 percent in 1984 and floating rate borrowings represented 71.4 percent of total debt compared to 67.2 percent at the end of 1984.

### Effects of Economic Conditions

Net earnings for 1985, after a change in accounting for investment tax credits which reduced earnings by \$2.1 million and an extraordinary charge of \$3.3, million, were \$216,000 compared to net earnings of \$17.8 million in 1984. The decrease in net earnings was largely the result of difficult market conditions facing our principal products in 1985 offset to a large extent by higher exchange premiums on the U.S. dollar. Markets for our products

will remain influenced by oversupply which will result in continued price competition. However, signs in early 1986 indicate a return of some stability to our markets with a modest improvement in pricing, particularly for kraft pulp. Also, downward pressure on the Canadian dollar should provide continuation of a high exchange premium on U.S. dollar sales.

The company has taken a number of steps in 1985 to control costs and improve productivity and product quality that will benefit results in 1986. Rationalization of employment levels in 1985 has resulted in a reduction of approximately seven percent in our total labor force and further manpower reductions are contemplated in 1986. Capital expenditures in 1986 will be held to minimum levels necessary to maintain productivity and product quality. Late in 1985 the company, as managing partner of the project, announced the decision to delay commencement of construction of a newsprint mill in the State of Washington until market conditions improve.

### Inflation Accounting

Guidelines of the Canadian Institute of Chartered Accountants on the reporting of certain supplementary information on the effects of changing prices have not been widely adopted in Canadian financial reporting. The company has expressed reservations in previous annual reports and continues to be concerned about the subjective nature of this information, the difficulty in interpreting its significance and its lack of general usefulness to the readers of our financial statements in assessing the performance or future prospects of this company. For these reasons, the supplementary information has not been reported.

## 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, 1985 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, 1985 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, except for the change in the method of accounting for investment tax credits as explained in Note 4 to the financial statements, on a basis consistent with that of the preceding year.



Toronto, Canada, January 26, 1986

THORNE RIDDELL  
Chartered Accountants



## EARNINGS

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

	1985	1984
Net sales:		(Note 14)
Pulp and paper	\$540,928	\$554,609
Building products	51,182	47,367
	592,110	601,976
Cost of sales	498,027	493,927
Selling and administrative expense	15,548	11,905
OPERATING PROFIT	78,535	96,144
Other income (expense)	(879)	(633)
	77,656	95,511
Interest (Note 7)	25,192	24,789
Depreciation	46,095	43,852
EARNINGS before income taxes and extraordinary item	6,369	26,870
Income taxes (Note 8)	2,819	9,091
NET EARNINGS before extraordinary item	3,550	17,779
Extraordinary item (Note 11)	(3,334)	—
NET EARNINGS	\$ 216	\$ 17,779
Net earnings per share before extraordinary item	\$ 0.18	\$ 0.91
Net earnings per share	\$ 0.01	\$ 0.91

## RETAINED EARNINGS

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

Retained earnings at beginning of year	\$273,929	\$262,500
Net earnings	216	17,779
	274,145	280,279
Dividends declared	8,792	6,350
RETAINED EARNINGS at end of year	\$265,353	\$273,929



## BALANCE SHEET

*consolidated statement at December 31 (thousands of dollars)*

	1985	1984
<b>Assets</b>		
<b>CURRENT ASSETS</b>		
Cash	\$ 1,403	\$ 2,229
Accounts receivable	72,173	79,607
Inventories:		
Finished goods	16,033	13,371
Pulpwood and sawlogs	45,431	44,699
Materials and supplies	38,866	35,483
Prepaid expenses	3,063	2,502
	176,969	177,891
<b>FIXED ASSETS (Note 2)</b>	978,313	937,689
Accumulated depreciation	393,887	351,443
	584,426	586,246
<b>DEFERRED FOREIGN EXCHANGE</b>	6,570	4,092
	\$767,965	\$768,229

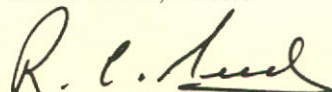


	1985	1984
<b>Liabilities</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued charges	\$ 48,162	\$ 52,635
Loan payable (Note 12)	43,780	37,705
Income and other taxes payable	11,692	9,566
Accrued claims settlement (Note 11)	6,108	—
Dividend payable	977	1,954
Current portion of long-term debt	541	1,172
	111,260	103,032
<b>LONG-TERM DEBT (Note 3)</b>		
<b>First Mortgage Bonds:</b>		
8% sinking fund bonds, Series B, maturing 1989	7,512	9,830
11¼% sinking fund bonds, Series C, maturing 1995	25,608	28,002
Term loan (U.S. \$25 million)	34,957	33,042
Notes payable	5,677	8,554
Lease obligations	925	1,277
Bank loans	142,613	127,308
	217,292	208,013
Current portion	541	1,172
	216,751	206,841
<b>DEFERRED INCOME TAXES</b>	119,952	129,778
<b>Shareholders' Equity</b>		
Common shares (19,537,420 shares issued) (Note 5)	54,649	54,649
Retained earnings	265,353	273,929
	320,002	328,578
	\$767,965	\$768,229

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)*

Funds provided (used)	1985	1984
OPERATING ACTIVITIES		(Note 14)
Net earnings before extraordinary item	\$ 3,550	\$ 17,779
Items not involving cash:		
Depreciation	46,095	43,852
Deferred income taxes	(9,826)	8,836
Amortization of deferred exchange	3,267	981
Cash flow from operations	43,086	71,448
Change in working capital, other than current operating funds	2,249	(45,761)
	45,335	25,687
FINANCING ACTIVITIES		
Issue of long-term debt	11,475	35,256
Reduction of long-term debt	(7,310)	(5,350)
	4,165	29,906
INVESTING ACTIVITIES		
Expenditures on fixed assets	(45,108)	(47,223)
Sale of fixed assets	833	383
	(44,275)	(46,840)
OTHER ACTIVITIES		
Dividends on common shares	(8,792)	(6,350)
Extraordinary item (Note 11)	(3,334)	—
	(12,126)	(6,350)
INCREASE (DECREASE) IN CURRENT OPERATING FUNDS	\$ (6,901)	\$ 2,403

### ANALYSIS OF CHANGE IN CURRENT OPERATING FUNDS

Increase (decrease) in cash	\$ (826)	\$ 2,108
(Increase) decrease in loan payable	(6,075)	295
	\$ (6,901)	\$ 2,403



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Year ended December 31, 1985

### 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

Monetary assets and liabilities in foreign currencies are translated into Canadian dollars at rates of exchange at the date of the balance sheet with any unrealized exchange gain or loss on long-term debt deferred and amortized over the remaining life of the debt. Other assets and liabilities and items affecting earnings are converted at rates of exchange in effect at the dates of the transactions. In all cases, however, items covered by forward exchange contracts are converted at the contract rates.

#### INVENTORIES

Inventories of finished goods are valued at the lower of average cost and net realizable value. Inventories of pulpwood and sawlogs and materials and supplies are valued at average cost.

#### FIXED ASSETS AND DEPRECIATION

Fixed assets are recorded at cost which is net of investment tax credits and the proceeds of government grants. 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. The following methods and composite rates of depreciation are used for the principal assets of the business:

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

The company follows the tax allocation method in accounting for income taxes. Under this method, deferred income

taxes are recorded to reflect the tax effect of timing differences between reported and taxable income. The principal timing difference results from the claiming of capital cost allowance for tax purposes either greater or less than the depreciation charged to earnings and consequently deferred income taxes may be either a charge or a credit to 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 with stock splits given retroactive effect.

### 2. Fixed Assets (thousands of dollars)

	December 31, 1985		December 31, 1984
	Cost	Net Value	Net Value
Land	\$ 1,494	\$ 1,494	\$ 1,485
Buildings, machinery and equipment			
Pulp and paper	817,835	534,492	530,002
Building products	46,544	15,916	18,049
Woodlands improvements and equipment	95,841	22,790	20,726
Timber licences	3,945	—	—
Assets under capital lease	3,065	145	208
Construction in progress	9,589	9,589	15,776
	<u>\$978,313</u>	<u>\$584,426</u>	<u>\$586,246</u>

### 3. Long-Term Debt

The company has an unsecured term loan from a foreign bank in the amount of \$25 million in U.S. funds repayable on April 6, 1990 with interest thereon at the fixed rate of 11.94 percent per annum payable annually.

The notes payable are to two non-resident suppliers of equipment and contain terms and conditions which are similar and maturity dates which are two months apart. The terms and conditions of the larger of the two notes provide for interest at the rate of 10 percent with the principal to be repaid in ten semi-annual installments to August 1987. Repayment of these notes has been arranged through a foreign bank which extends the terms of repayment to 1989 with the right of prepayment.

Obligations under capital leases comprise many individual leases with implicit interest rates ranging from 9 percent to 11 percent with expiry dates extending to 1989.



Loan agreements with two Canadian banks provide for unsecured operating lines of credit of \$50 million each in either Canadian or U.S. funds at floating rates. These agreements continue to January 1, 1987 and June 1, 1987, respectively, with extensions thereafter at the discretion of the company subject to the right of the banks to refuse further extensions upon the giving of specified notice. As at December 31, 1985, \$71 million in Canadian funds was owing under these agreements.

In addition, the company has loan agreements with two other banks for unsecured operating lines of credit of \$50 million each in U.S. funds, or the Canadian equivalent, at floating or fixed interest rates. The revolving credit periods under these agreements expire on June 30, 1986 and December 30, 1990 respectively. Amounts then outstanding convert to term loans extending to June 30, 1990 and December 30, 1993. As at December 31, 1985, \$51.2 million in U.S. funds was owing under these agreements.

Required amounts to reduce long-term debt over the next five years, based on the exchange rate at December 31, 1985 and assuming no extensions to existing bank loan agreements, are as follows (thousands of dollars):

	Bonds	Bank Loans	Other	Total
1986	\$ —	\$ —	\$ 541	\$ 541
1987	1,430	78,162	2,975	82,567
1988	3,150	16,686	1,561	21,397
1989	6,860	19,049	1,647	27,556
1990	2,070	54,006	—	56,076

#### 4. Change in Accounting Policy

The company has adopted new recommendations of the Canadian Institute of Chartered Accountants on the method of accounting for investment tax credits. Effective January 1, 1985 investment tax credits applicable to capital expenditures during the year have been deducted from the cost of the related assets. Previously these tax credits, net of deferred income taxes, were applied to reduce income taxes charged to earnings. The effect of this change has been to reduce net earnings for 1985 by \$2.1 million or 11 cents per share.

#### 5. Common Shares

A four-for-one split of the company's common shares was authorized by the shareholders on April 22, 1985. The number of common shares issued and outstanding following the stock split on May 6, 1985 increased from 4,884,355 to 19,537,420.

#### 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 for the year amounted to \$20.8 million (\$22.4 million in 1984) on long-term debt and \$4.4 million (\$4.8 million in 1984) on short-term indebtedness. No interest was capitalized in 1985 (\$2.4 million in 1984).

#### 8. Income Taxes

The company has provided for income taxes resulting in the following effective rates:

	1985	1984
	thousands of dollars	
Earnings before income taxes and extraordinary item	\$ 6,369	\$26,870
	percent	
Combined basic federal and provincial rate	51.0 %	51.0 %
Manufacturing and processing allowance	(5.9)	(5.9)
	45.1	45.1
Increase (decrease) in the income tax rate resulting from:		
Unrealized exchange losses	23.1	1.8
Deferred tax drawdown at average rate	(12.1)	—
3% inventory allowance	(12.3)	(2.2)
Federal investment tax credits	—	(8.6)
Other	0.5	(2.3)
Effective rate of income tax	44.3 %	33.8 %

#### 9. 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 actuarial valuation of the employees' pension plans as at January 1, 1985, the unfunded amount as at December 31, 1985 is estimated to be \$42.9 million.

#### 10. Litigation (See also Note 11)

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 was 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.



- 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.

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". These expenditure requirements have been met by the company. The position of the Government of Ontario was confirmed in a letter to the company from the Provincial Secretary for Resources Development dated January 28, 1982.

### 11. Extraordinary Item

With respect to the litigation discussed in Note 10, a Memorandum of Agreement was signed effective October 15, 1985 between the company, Reed Inc. (successor to Reed Ltd.), the Government of Ontario, the Government of Canada, the Islington Indian Band and the Grassy Narrows Indian Band. The Memorandum of Agreement was subsequently ratified by vote of the members of the two Indian bands.

Under the terms of the Memorandum of Agreement, an amount of \$16.67 million, plus interest at an agreed rate from October 15, 1985, will be paid to the two Indian bands upon the fulfillment of certain conditions. The payment will be borne \$6 million by the company, \$5.75 million by Reed Inc., and \$4.92 million by the two levels of government. The conditions include:

- a) the enactment of federal and Ontario legislation establishing a mercury disability fund and board for the Indians and abolishing existing and future rights of action of the Indian bands and their past, present and future members relating to the alleged pollution of the Wabigoon-English River system;
- b) the disposition of all existing legal proceedings and claims by way of dismissals and consent judgments; and

- c) the complete indemnification of the company and Reed Inc. by the Government of Ontario with respect to any claim, action or proceeding, existing or which may arise, relating to the discharge, escape or presence of any pollutant from or in any of the Dryden assets acquired by the company from Reed Ltd.

Upon settlement in accordance with this Memorandum of Agreement, the company will release Reed Inc. and the Government of Ontario from their undertakings described in Note 10 and will provide an indemnification to Reed Inc. with respect to future pollution claims similar to that provided by the Government of Ontario.

The company believes that the accord reached in this Memorandum of Agreement will resolve the issues of the alleged pollution of the Wabigoon-English River system. Reed Inc. has deposited its portion of the proposed settlement with an escrow agent. As at December 31, 1985, the company has recorded a liability of \$6 million for the proposed settlement and has charged this amount to earnings, net of income taxes of \$2.7 million, as an extraordinary item. Interest at the agreed rate of 8.52 percent has been accrued from October 15, 1985.

### 12. Related Party Transactions

Canadian Pacific Enterprises Limited owns approximately 54 percent of the common shares of the company and consequently the many 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 \$50 million Canadian funds, or the U.S. equivalent, which provides for loans of up to one year at interest rates based on the lender's cost of borrowing. At December 31, 1985, \$27 million in Canadian funds and \$12 million in U.S. funds were owing under this line of credit and interest for the year amounted to \$4.3 million.

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

In addition, in the normal course of business, 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.

### 13. Industry Segment and Export Sales

The company's entire operations consist of the manufacture and sale of products of the forest industry. In 1985, 86 percent (87 percent in 1984) of the company's net sales was exported, largely to United States destinations, and priced in U.S. dollars.

### 14. Comparative Figures

The company has adopted recent recommendations of the Canadian Institute of Chartered Accountants on the presentation of the Statement of Changes in Financial Position and certain 1984 amounts have been reclassified to conform to this new format. In addition, for comparative purposes, there have been certain minor reclassifications of 1984 amounts in the Statement of Earnings and the 1984 earnings per share have been restated to give effect to the four-for-one stock split which occurred on May 6, 1985.



## FINANCIAL SUMMARY: LAST FIVE YEARS

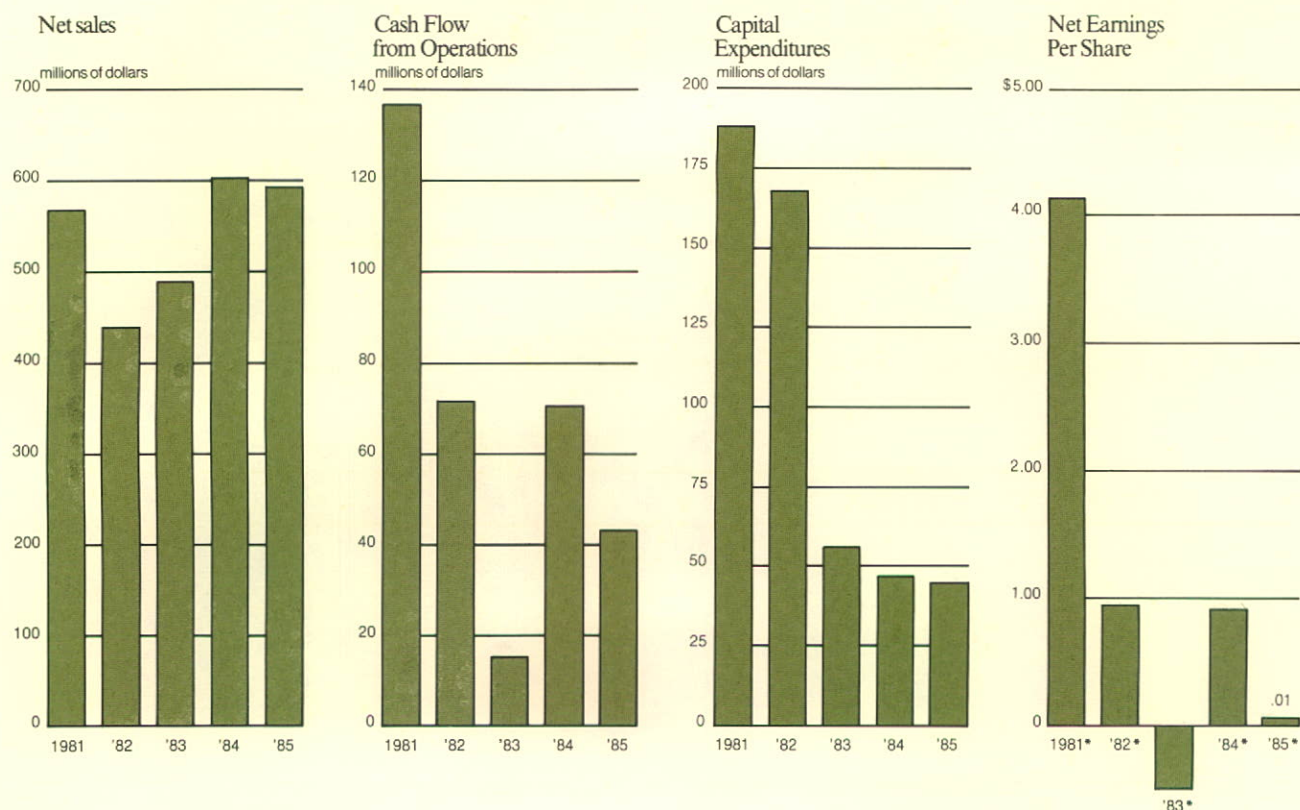
Except for per share amounts as indicated,  
all dollar figures are in thousands

	1981	1982	1983	1984	1985
<b>SALES &amp; EARNINGS</b>					
Net sales: pulp and paper	529,671	416,246	453,185	554,609	540,928
building products	38,923	21,608	41,796	47,367	51,182
total	568,594	437,854	494,981	601,976	592,110
Operating profit	159,930	57,203	35,429	96,144	78,535
Interest expense	8,154	6,630	17,679	24,789	25,192
Depreciation	30,603	33,701	39,863	43,852	46,095
Earnings (loss) before income taxes and extraordinary item	130,421	17,350	(22,901)	26,870	6,369
Income taxes	49,400	(1,202)	(12,965)	9,091	2,819
Extraordinary item net of income taxes	—	—	—	—	(3,334)
Net earnings (loss)	81,021	18,552	(9,936)	17,779	216
Net earnings (loss) per share	4.15*	0.95*	(0.51)*	0.91*	0.01
Dividends declared, total	14,164	15,630	5,862	6,350	8,792
Dividends per share	0.73*	0.80*	0.30*	0.33*	0.45
<b>ASSETS &amp; LIABILITIES</b>					
Current assets	143,295	151,762	141,796	177,891	176,969
Current liabilities	65,310	102,771	115,101	103,032	111,260
Ratio of above assets to liabilities	2.2	1.5	1.2	1.7	1.6
Working capital	77,985	48,991	26,695	74,859	65,709
Inventories, described in balance sheet	72,940	75,564	72,990	93,553	100,330
Fixed assets, see notes to financial statements	682,667	844,613	892,490	937,689	978,313
Accumulated depreciation	239,946	272,183	309,232	351,443	393,887
Long-term debt	75,597	154,021	171,862	206,841	216,751
Ratio of above debt to shareholders' equity	.23	.46	.54	.63	.68
Deferred income taxes	115,084	134,453	120,942	129,778	119,952
Retained earnings at year end	275,376	278,298	262,500	273,929	265,353
<b>EQUITY &amp; OTHER DATA</b>					
Common shares outstanding at year end	4,884,355	4,884,355	4,884,355	4,884,355	19,537,420
Number of shareholders	2,518	2,397	2,080	1,825	1,763
Percentage of shares held in Canada	98.4	98.4	98.5	98.0	97.9
Shareholders' equity, total	330,025	332,947	317,149	328,578	320,002
Shareholders' equity per share	16.89*	17.04*	16.23*	16.82*	16.38
Cash flow from operations	137,095	71,622	16,416	71,448	43,086
Cash flow per share	7.02*	3.67*	0.84*	3.66*	2.21
Net earnings (loss) percentage on net sales	14.2	4.2	(2.0)	3.0	0.04
Annual expenditures on fixed assets	189,023	168,765	56,023	47,223	45,108
Number of employees on payroll	5,745	5,246	5,598	5,630	5,233

Certain figures for 1981 on pages 18 and 19 have been restated from those originally reported to reflect retroactive application of the 1982 change in accounting for investment tax credits.

\*A four-for-one stock split on May 6, 1985 has been given retroactive effect for all periods prior to that date for purposes of calculating per share amounts on a comparative basis.





## Results by Quarters

### 1985 Sales and Earnings (thousands of dollars)

Quarter	Net Sales	Oper. Profit	Net Earnings (Loss)
First	\$148,162	\$26,991	\$ 4,838
Second	146,819	14,843	(1,657)
Third	158,022	16,730	(1,343)
Fourth	139,107	19,971	(1,622)
	\$592,110	\$78,535	\$ 216

### Net Earnings (Loss) Per Share

Quarter	1981*	1982*	1983*	1984*	1985*
First	\$ 1.06	\$ 0.74	\$(0.39)	\$0.01	\$0.25
Second	1.11	0.39	(0.01)	0.23	(0.09)
Third	1.02	0.05	(0.02)	0.28	(0.07)
Fourth	.96	(0.23)	(0.09)	0.39	(0.08)
	\$ 4.15	\$ 0.95	\$(0.51)	\$0.91	\$0.01

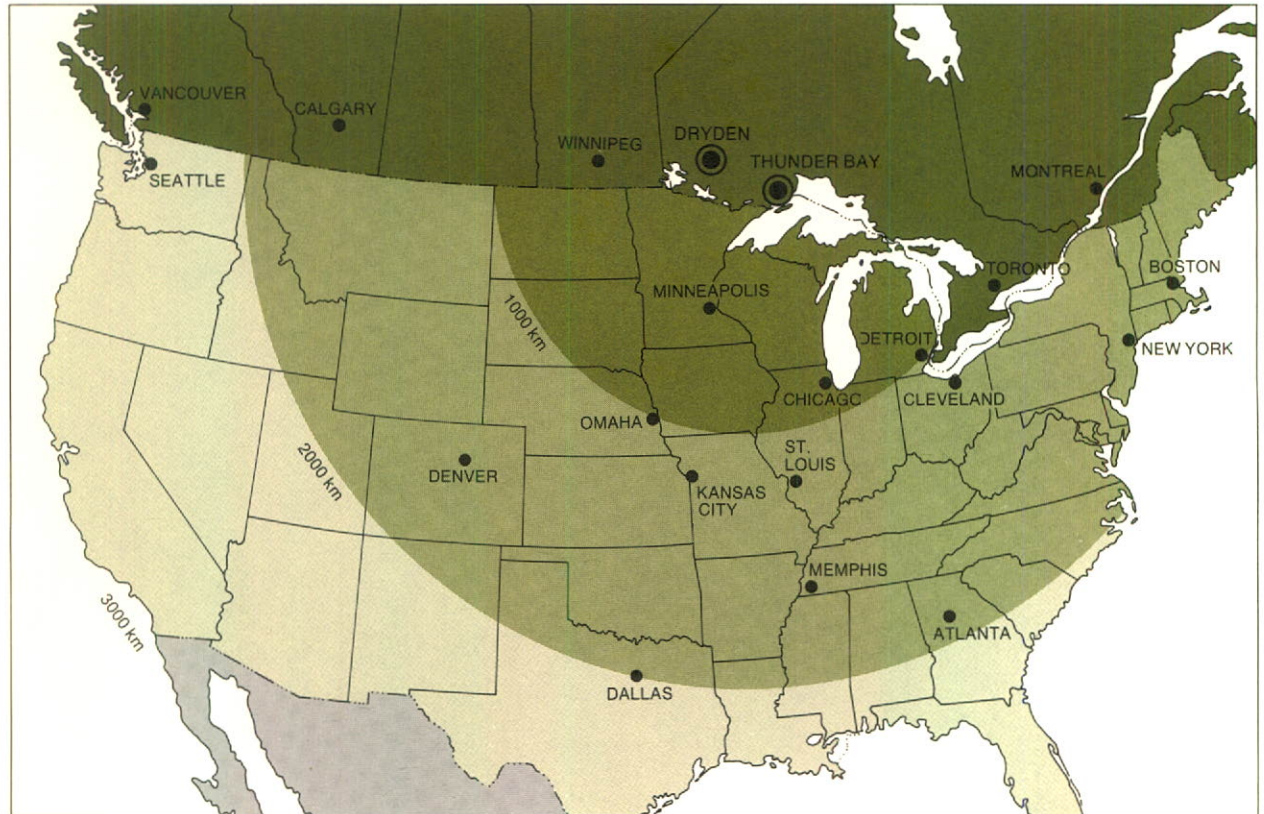
## Price Range and Dividends Per Share of our Common Stock

Year	Stock Prices		Dividends	
	High	Low	As Declared	Restated*
1981	\$93.50	\$67.00	\$2.90	\$0.73
1982	81.50	46.00	3.20	0.80
1983	91.50	58.50	1.20	0.30
1984	91.00	76.00	1.30	0.33
1985	24.00	15.50	0.45	0.45

\*All earnings per share amounts have been restated for periods prior to May 6, 1985 to give retroactive effect to the four-for-one stock split which occurred on that date. Stock prices per share have been left to reflect actual trading values and consequently dividends per share have been provided on both the actual and restated basis.



## OUR MARKETS



The Thunder Bay and Dryden mills are well situated to serve North American markets. Most of our production reaches customers within a radius of 2,000 kilometres of our mills. Virtually our entire newsprint market

at present lies within this area. Our kraft pulp production reaches across the whole of the United States and to offshore markets including the Far East. Some of our fine paper production is shipped to the Mid-

western United States but the majority is shipped to markets in Canada. Most of our lumber and waferboard is sold to customers in the United States within the 2,000 kilometre range and to customers in Canada.

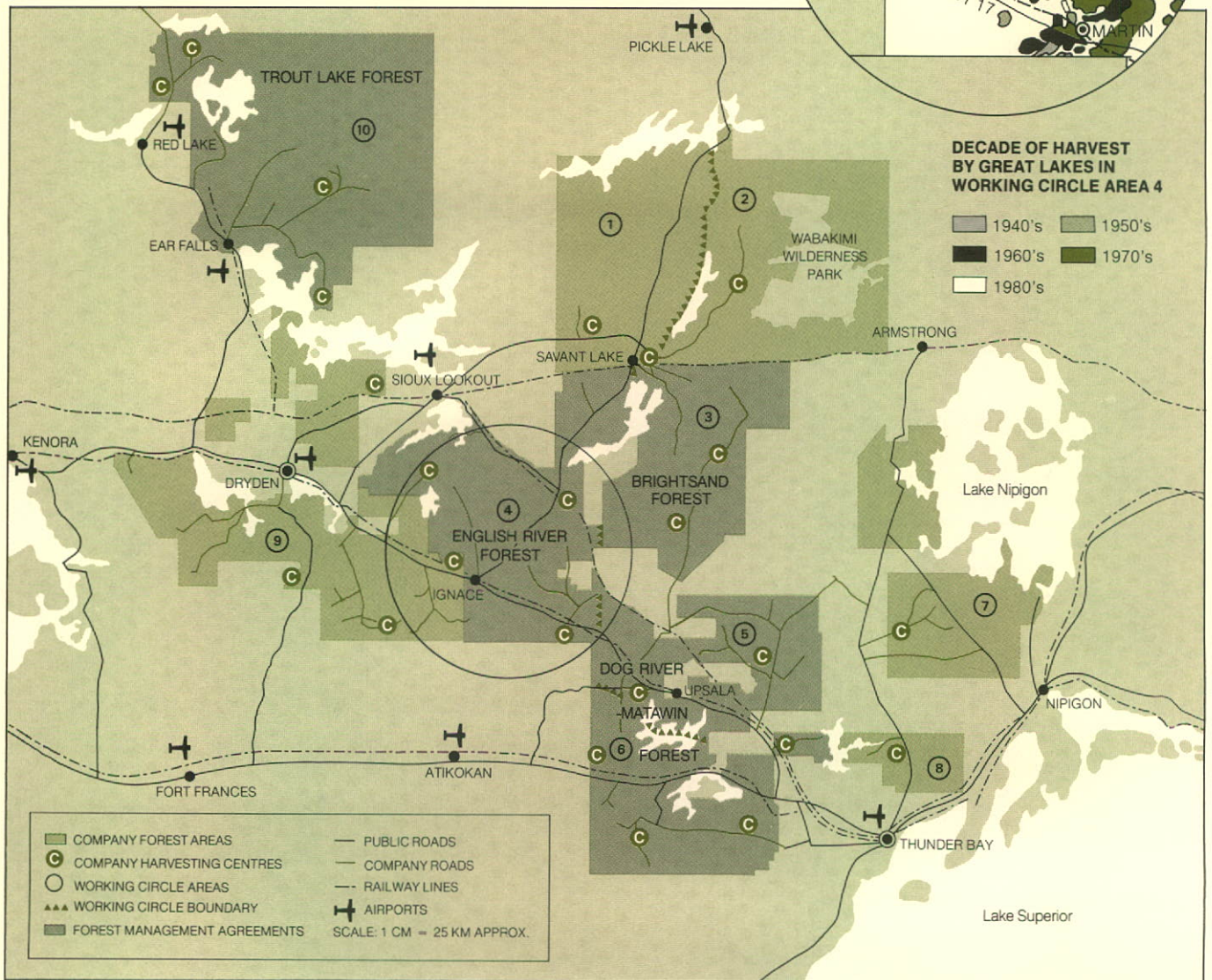
## OUR SHIPMENT SUMMARY: LAST FIVE YEARS

	1981	1982	1983	1984	1985
Newsprint (thousands of metric tons)	386	360	393	398	379
Kraft pulp (thousands of metric tons)	504	380	531	559	491
Fine papers (thousands of metric tons)	64	44	46	59	82
Total (thousands of metric tons)	954	784	970	1,016	952
Stud lumber (millions of board feet)	137	114	137	162	152
Waferboard (millions of sq. ft.— $\frac{3}{8}$ -inch basis)	86	15	73	107	107

While waferboard is manufactured in varying thicknesses, for comparative purposes with the industry statistics on page 23, our shipment volume is shown here on a  $\frac{3}{8}$ -inch equivalent basis.



## MAP OF OUR WOODLANDS AREAS



The map shows our woodlands areas for both Thunder Bay and Dryden operations. These areas include some 40,000 square kilometres of productive forest land to which we hold timber harvesting rights granted by the Province of Ontario. Also shown are the subdivisions into which the total forest area is divided for management purposes. Each numbered area is a separate forest management unit or working circle which has specific 20-year objectives for annual harvest, regeneration and road building. About 4,400 kilometres of company roads provide access to all our woodlands oper-

ations. Some working circles have an extensive road system as a result of development started in the 1930's, while others, such as areas 1, 2 and 10, have undergone later development as wood requirements increased due to recent mill expansions.

Grey areas shown on the map are under forest management agreements with the Province as discussed on pages 4 and 5. As well as roads and rail lines, the map shows harvesting centres. Wood is brought from the forest to the mill by rail and truck on a scheduled delivery system.

### Long-Term Harvesting Pattern

The upper right circle which is taken from the English River Forest shows a typical harvesting pattern that has taken place over the past four and a half decades. This activity will continue for another three and a half decades in the white areas shown in the working circle at which time forests that were cut in the 1940's will be ready for a second harvest. For example, in the past few years, we commenced cutting second-growth timber for our Dryden mill which started operations in the second decade of this century.



## 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 the Canadian Pulp and Paper Association (CPPA), indicates the size and growth of newsprint markets over the period 1981 through 1985. World totals for newsprint omit communist countries for which reliable information is lacking.

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
	(millions of metric tons)				
Free-world production capacity . . . . .	26.0	27.3	28.0	28.2	28.6
Free-world production . . . . .	24.1	22.4	23.1	25.1	25.4
Canadian production capacity . . . . .	9.5	9.9	10.0	9.8	9.8
Canadian production . . . . .	8.9	8.1	8.5	9.0	9.0
Canadian exports . . . . .	7.9	7.1	7.5	8.0	8.0
Canadian exports to United States . . . . .	6.1	5.6	6.0	6.6	6.7
Total U.S. consumption . . . . .	10.2	10.1	10.6	11.4	11.6

Source: CPPA (1985 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 1985 of approximately 66.7 million metric tons or 64.8 percent of the world's total production capacity. Most 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 1985 the production capacity in North America and Scandinavia for market bleached kraft pulp was approximately 15.9 million metric tons of which Canadian production capacity amounted to approximately 40.5 percent, or 6.4 million metric tons. Our company is a major supplier of this market pulp.

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
	(millions of metric tons)				
<b>Paper Grade Chemical Pulp</b>					
North American and Scandinavian production . . . . .	59.9	55.2	60.3	63.4	62.6
<b>Bleached Kraft Pulp</b>					
North American and Scandinavian production . . . . .	31.7	30.4	33.4	35.3	36.2
<b>Market Bleached Kraft Pulp</b>					
Total demand for North American and Scandinavian production . . . . .	13.0	11.8	14.1	14.1	14.4
Canadian shipments . . . . .	5.5	4.7	5.8	5.5	5.7
Canadian exports to United States . . . . .	1.9	1.6	2.0	2.0	1.9
Total U.S. supply (including imports) . . . . .	3.9	3.6	4.4	4.8	4.8

Source: CPPA (1985 estimated).



## FINE PAPERS

The term "fine papers" covers a broad range of papers manufactured to suit a variety of specialty end uses. The major categories are: converting papers, which include papers used for envelopes, scribblers and continuous and single multiple-part forms, representing approximately 37 percent of all fine papers produced in Canada; printing grades, representing 43 percent, which include coated and uncoated papers designed specifically for the printing of text books, annual reports, magazines, advertising pieces, etc.; and business papers, representing 20 percent, which include papers for office copiers, letterheads, documents, office forms, etc.

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

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
	(thousands of metric tons)				
Canadian production capacity . . . . .	1,019.0	1,008.0	1,026.0	1,126.0	1,190.0
Domestic shipments . . . . .	661.6	648.8	718.8	769.1	801.4
Export shipments . . . . .	127.2	174.1	238.4	252.2	278.9
Canadian imports . . . . .	217.7	153.3	195.9	268.7	255.0
Canadian demand . . . . .	879.3	802.1	914.7	1,037.8	1,056.4

Sources: Statistics Canada, CPPA (1985 estimated).

## LUMBER

Residential construction provides the principal use for softwood lumber produced in Canada and the United States, 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>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
	(millions)				
North American housing starts . . . . .	1.3	1.2	1.9	1.9	1.9
Seasonally adjusted year-end rate of North American housing starts . . . . .	1.1	1.4	1.8	1.8	2.0
Softwood lumber production	(billions of board feet)				
United States . . . . .	22.8	21.0	29.7	31.2	31.1
British Columbia . . . . .	10.4	10.1	13.0	13.0	14.0
Rest of Canada . . . . .	<u>6.0</u>	<u>5.9</u>	<u>7.6</u>	<u>7.5</u>	<u>7.9</u>
Total . . . . .	39.2	37.0	50.3	51.7	53.0

Sources: Statistics Canada, U.S. Bureau of Census, National Forest Products Assn. (1985 estimated).

## BOARD

Waferboard competes in its uses with the exterior grades of softwood plywood sheathing which represent approximately 80 percent of all softwood plywood production in North America.

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
	(billions of square feet)				
Softwood plywood (3/8-inch basis)					
U.S. production . . . . .	17.1	17.0	21.0	22.4	23.2
Canadian production . . . . .	2.4	1.9	2.3	2.1	2.2
Waferboard (3/8-inch basis)					
Canadian production . . . . .	.8	.6	1.0	1.4	1.5
U.S. production . . . . .	.3	.6	1.3	2.1	2.8

Sources: Dept. of Industry, Trade and Commerce, American Plywood Assn., FORSIM of Data Resources Inc. (1985 estimated).



## 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 widespread recognition over the years for leadership in this field.

In 1979 the Dryden, Ontario assets of Reed Ltd. were acquired and in 1980 the company undertook an extensive modernization and expansion of the Dryden kraft pulp mill and fine paper mill, as well as construction of a stud lumber mill. The kraft pulp and stud lumber mills commenced operation in 1983 and the fine paper machine in 1984.

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 papers*, printing papers, similar to the paper used for 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 and *waferboard*, a tough, water-resistant building board for exterior sheathing, interior panelling, roofing and floor underlayment.

Pulp is sold through Lake Superior Pulp and Paper Inc., White Plains, N.Y.; R. L. Nash is chairman and chief executive officer, K. E. Roth, 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 lumber and waferboard are marketed by Champion International Corporation; James D. Kingston is director, building products sales.

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

The head office of Great Lakes Forest Products Limited is in Thunder Bay and the mailing address is P.O. Box 430, Thunder Bay, Ontario, P7C 4W3.



## Board of Directors at December 31, 1985

C. R. BOWLES . . . . .	Thunder Bay	1964
<i>executive vice-president, Great Lakes Forest Products Limited</i>		
* R. W. CAMPBELL . . . . .	Calgary	1983
<i>vice-chairman, Canadian Pacific Limited</i>		
* C. J. CARTER . . . . .	Thunder Bay	1947
<i>chairman of the board and president, Great Lakes Forest Products Limited</i>		
R. E. CHAMBERS . . . . .	Thunder Bay	1959
<i>executive vice-president, Great Lakes Forest Products Limited</i>		
R. S. DEMONE . . . . .	Toronto	1981
<i>chairman, president and chief executive officer, Maple Leaf Mills Limited</i>		
† J. R. JONES . . . . .	Thunder Bay	1981
<i>president, Lakehead Newsprint Limited</i>		
* W. NORMAN KISSICK . . . . .	Toronto	1982
<i>chairman and chief executive officer, Union Carbide Canada Limited</i>		
† J. ROSS LEMESURIER . . . . .	Toronto	1984
<i>retired investment dealer</i>		
†* RICHARD C. MEECH, Q.C. . . . .	Toronto	1980
<i>partner, Borden &amp; Elliot, barristers and solicitors</i>		
* B. H. RIDDER, JR. . . . .	St. Paul, Minnesota	1957
<i>director, Knight-Ridder Newspapers, Inc.</i>		
BARTLETT B. ROMBOUGH . . . . .	Calgary	1984
<i>president and chief executive officer, PanCanadian Petroleum Limited</i>		
STANLEY H. STAUFFER . . . . .	Topeka, Kansas	1984
<i>president, Stauffer Communications Inc.</i>		
WILLIAM W. STINSON . . . . .	Montreal	1982
<i>president and chief executive officer, Canadian Pacific Limited</i>		
J. G. TREZEVANT . . . . .	Irvine, California	1975
<i>consultant, News America Syndicate</i>		

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

\* *Members of the Executive Committee*

† *Members of the Audit Committee*

Years denote beginning of connection with the company or acquired operations.

## Management at December 31, 1985

C. J. CARTER, <i>chairman of the board and president</i> . . . . .	1947
C. R. BOWLES, <i>executive vice-president</i> . . . . .	1964
R. E. CHAMBERS, <i>executive vice-president</i> . . . . .	1959
K. E. WINROW, <i>vice-president, finance</i> . . . . .	1971
G. K. SEED, <i>vice-president, woodlands operations</i> . . . . .	1965
M. CEBROWSKI, <i>vice-president</i> . . . . .	1964
T. M. BROWN, <i>secretary</i> . . . . .	1956
D. D. MORROW, <i>treasurer</i> . . . . .	1964
R. A. LEHTOVAARA, <i>comptroller</i> . . . . .	1975
B. R. KERR, <i>assistant treasurer</i> . . . . .	1964
W. E. MACVITTIE, <i>assistant comptroller</i> . . . . .	1968
F. H. TOLLEFSEN, <i>manager, public relations</i> . . . . .	1966



