SCOTT

Scott Paper Limited
1981 Annual Report

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Head Office/Vancouver, British Columbia
Plants/New Westminster,
British Columbia; Crabtree and
Lennoxville, Quebec
Sales Offices/Vancouver, Winnipeg, Toronto,
Montreal and Dartmouth

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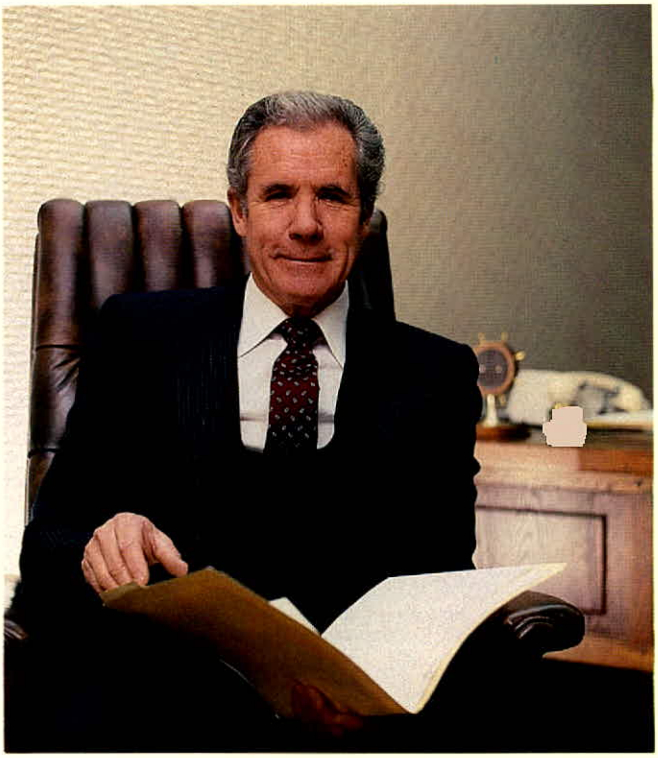
d'adviser le Secretaire.

Cover picture: Ever since Scott Paper introduced paper towels to Canadian consumers, these products have been constant leaders in their market segment. Excellent quality and appearance continue to keep Viva Towels in top demand. New packaging for Scott Family Napkins was introduced late in 1981 and CutRite wax paper also has a new look. This old favourite is gaining popularity through its use in microwave cookery.



Chairman's Message to Shareholders and Employees

We are pleased to submit the Annual Report for 1981. Financial results were favourable and on objective for the year and there were several exciting and important new developments which will have a positive impact on the future growth of the business.

Turning first to the financial highlights for 1981, net sales increased by 11% from $157,035,000 to $174,331,000 and net income after taxes amounted to $8,321,000 compared to $7,430,000, for an increase of 12%. Earnings per share were $3.28 for the year compared to $2.98 in 1980. The number of shares outstanding at year end was 2,535,750, up by 44,900 due to the conversion of options under the Stock Option Plan for senior employees. Dividend payments totalled 95¢ per share, as against 85¢ per share paid in 1980, marking the 51st consecutive year of dividend payments for the company.

Total cash flow reached $14,735,000, increasing by 15.2% over 1980. Capital expenditures for the year amounted to $13,175,000 compared to $5,010,000 in 1980. Engineering and property acquisition costs

Financial Highlights

FOR THE YEAR	1981	1980	
	(thousands of dollars except per share)		percent change
Net sales	**$174,331**	$157,035	11.0
Depreciation	**4,364**	5,399	(19.2)
Interest expense	**2,628**	2,561	2.6
Income before taxes	**13,421**	11,690	14.8
per share	**5.29**	4.69	
Income taxes	**5,100**	4,260	19.7
Income after taxes	**8,321**	7,430	12.0
per share	**3.28**	2.98	
Dividends	**2,391**	2,107	13.5
per share	**.95**	.85	
Income reinvested in the business	**5,930**	5,323	11.4
Cash flow from operations	**14,211**	12,438	14.3
per share	**5.60**	4.99	
Capital expenditures	**13,175**	5,010	163.0
Salaries, wages and benefits	**46,244**	40,731	13.5
AT YEAR END			
Ratio current assets to current liabilities	**1.5**	1.7	
Long term debt	**$ 14,494**	$ 15,296	
Shareholders' interest per share	**$ 20.63**	$ 18.47	
Number of shares outstanding at year end	**2,535,750**	2,490,850	
Number of shareholders	**1,484**	1,353	

relating to the new paper machine at New Westminster account for much of the increase in expenditures. Depreciation charged for the year amounted to $4,364,000 compared to $5,399,000 in 1980. The decline is a result of the completion in 1980 of a program of accelerated depreciation in respect of certain assets. Deferred income taxes rose by $1,500,000 primarily as a result of an increase in the amount of capital cost allowances generated by the capital expenditures during the year.

Looking over the past five years, a quick comparison of results for 1981 shows sales have increased approximately 75% and earnings have more than doubled since 1976.

Scott trademark products performed well in a weak economy and in a competitive environment characterized by high levels of price discounts. Repositioning of product lines resulted in a stronger competitive position and improved values which contributed to the growth in sales. New colours, packaging and print designs were introduced amongst improvements added to almost all consumer products during the year.

Our manufacturing operations benefited from capital expenditures made during prior years and the continued availability of low cost in-house fibers in both the eastern and western manufacturing divisions provided major benefits offsetting the costs of purchased chemical pulps. Chemical pulp prices did not increase as rapidly as anticipated which moderated the need for increases in selling prices of our products.

As indicated at the beginning of this report, several events during the year stand out in terms of their future significance. In October, the company announced a five-year capital spending program involving the three manufacturing plants at New Westminster, British Columbia, Crabtree and Lennoxville, Quebec. The first commitments under this program include a new 40,000 ton per year high technology paper machine, related converting equipment and services amounting to $63 million in New Westminster. These facilities are scheduled for start-up early in 1984 and will be located on newly acquired land adjacent to the existing plant on the north arm of the Fraser River. New Westminster plant capacity will be in excess of 100,000 tons per year when the project is completed.

The plans in Quebec include modernization of the #4 paper machine at Crabtree and the machine at Lennoxville in a program designed to enhance both the quality and efficiency capabilities of these machines. Additional converting facilities are involved at each location and expanded pulping capacity is under active consideration at Crabtree. The paper machine modifications are expected to be complete in 1983 at both locations. Capital spending on the eastern programs, including pulping facilities, will amount to $30 million.

Financing of the foregoing projects will be from internally generated cash flows, an extension of credit facilities at the Royal Bank of Canada, and very favourable terms related to the purchase of the paper machine from Sweden. It will be noted that the present level of internal cash flow, augmented by further deferred income taxes, will finance a high proportion of the $90,000,000 capital spending planned over the next several years. The balance of the $150,000,000 program announced in October will be completed when economic conditions warrant. At that time, additional long term financing will be required.

We are pleased to note that the investment in Eastern Canada is being financed in part by a capital grant under the Pulp and Paper Industry Modernization Program operated jointly by the Federal Government, Department of Regional Economic Expansion and the Quebec Government, Department of Energy and Resources. The amount of the grant is related to the total investment in qualifying facilities and will be approximately $4,000,000, based on existing plans.

We also wish to acknowledge the support and cooperation of the City of New Westminster in dealing with the complex subdivision matters associated with the new property there.

Scott Paper Limited was first to introduce the champagne group of bathroom tissues to the Canadian market. This new decorator shade has proved a strong consumer favourite in all Scott brands.

The 1980 Annual Report stated that intensive negotiations were underway with the Ministry of Forests of the Province of British Columbia to increase the amount of cottonwood acreage under our management for the supply of logs for the groundwood pulp mill in New Westminster. We are pleased to report that the Ministry has called for applications for a deciduous tree farm license made up of several parcels of good cottonwood producing areas in the southern coastal region of British Columbia. The company has applied and the hearings are scheduled for the end of March.

During the fall, we also announced two important and unique developments — the first being an agreement with the Canadian Ladies Curling Association to sponsor the 1982 Canadian Ladies Curling Championships, the second being an agreement with the Foil Division of Alcan Products Canada Limited to market Alcan's retail foil products nationally, commencing in January 1982.

The Canadian Ladies Curling Championship is to be held in Regina in late February and will be known as the Scott Tournament of Hearts. Over the years, the tournament has aroused widespread national interest and we believe it will serve as an excellent promotional vehicle for our products. We are pleased to have the opportunity to support the tournament and the Canadian Ladies Curling Association.

The arrangement with Alcan is based on an Agency Agreement whereby Scott will assume the sales and marketing responsibility for the Alcan foil line within our consumer products division. The Alcan foil line has a strong franchise across Canada, it fits in well with our own sales and sales promotional program, and is complimentary to our own support of CutRite wax paper. We are looking forward to a long and beneficial association with Alcan.

Sancella, our joint venture company with Molnlycke A.B. of Sweden, increased its sales volumes and expanded its capacity to support the introduction of new products in the Canadian health care market. New manufacturing facilities

Under a newly established agreement with the Foil Division of Alcan Products Limited, the Alcan Foil line joins Scott's consumer products division. We look forward to the responsibility for national sales and marketing of these quality products.

Scott's fine line of commercial division products provides an extra touch of quality for a steadily growing list of industrial, institutional and business concerns who wish to supply the best in paper products for staff and customers.

have been established at the Scott Paper Limited plant at Crabtree, Quebec.

The enthusiasm and diligence of our people throughout the company was again much in evidence during 1981. As business becomes more complex and competitive, the attitude and determination of our employees is more important than ever. Formal communications programs with Scott people throughout the company were undertaken during the year under a program entitled "Focus Meetings". These meetings include a formal report on the company, its progress and prospects, open and informal discussions and an exchange of views on subjects of interest and concern. The Focus meetings have become a most important part of the company's internal communications program.

Interest in the annual Stock Purchase Plan was at an all-time high, as approximately 25% of all employees participated in the 1981 Plan.

Early in 1981, Mr. William S. Wesson of Scott Paper Company of Philadelphia was appointed President of Scott Paper International Inc. and a director of Scott Paper Limited, succeeding Mr. James D. Stocker, Jr., who was elected Senior Executive Vice President of Scott Paper Company. The strong and enthusiastic support we have had from Scott Paper Company, its officers and management has been a very major factor in the development of this company.

Mr. Bernard A. Goulet, Group Vice President, has elected to retire after a very distinguished career. Mr. Goulet, who had been responsible for manufacturing, ventures and quality control, will remain as a director. His management responsibilities will be assumed by Mr. Robert T. Stewart, who has been appointed Executive Vice President. Mr. Stewart is a director of the company and will continue to be responsible for all marketing operations.

Your directors and management are enthusiastic and confident about the future. However, progress could be slowed by the weak economic environment, certainly during 1982 and possibly beyond. Most economic forecasts for the 1980's predict a healthy and growing economy in Canada and our own forecasts parallel this outlook. Nevertheless, at the present time, our economy is in a deep recession with little evidence of a change in sight.

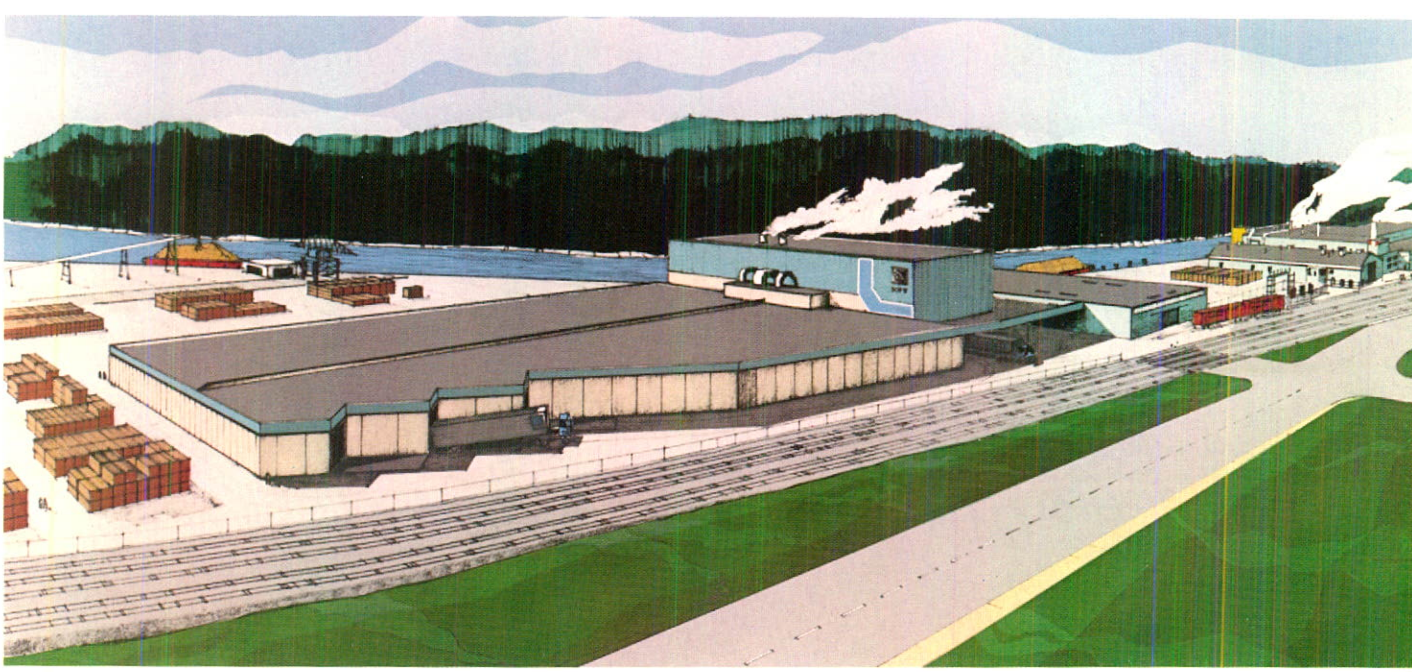
We see a concerted effort in the U.S. to lower taxes and the cost of government. We also see a discipline of lower salary and wage increases and a decline in the rate of inflation. This should result in an improved investment climate and the creation of jobs.

Unless government in Canada can set an example of restraint and unless expectations by the total work force are reduced, Canada's competitive position will continue to erode. An improvement in the investment climate and employment opportunities will only develop with a change in direction and leadership.

We wish to thank our customers, suppliers and employees for their strong support and we look forward to another year of progress at Scott Paper Limited.

FOR THE BOARD OF DIRECTORS

George L. O'Leary
Chairman



Artist's rendition shows site for new high-technology #4 paper machine and related facilities to be installed at the Western Manufacturing Division, New Westminster. Expansion is first phase of a $150 million program involving all three manufacturing operations.

Consolidated Statements of Income and Retained Income

	Year ended December 31 1981	1980
	(in thousands)	
Income:		
Sales, less allowances and excise taxes	$174,331	$157,035
Investment and other	915	1,082
	175,246	158,117
Expenses (Note 6):		
Cost of products sold	118,126	107,433
Selling and distribution expenses	30,703	28,789
Research and development expenses	2,089	1,330
Administrative and general expenses	8,279	6,314
Debenture interest and amortization of issue costs	1,683	1,781
Bank interest	945	780
	161,825	146,427
Income before income taxes	13,421	11,690
Income Taxes:		
Current	3,600	4,740
Deferred	1,500	(480)
	5,100	4,260
Income for the year	$ 8,321	$ 7,430
Income per share	$3.28	$2.98
Retained Income:		
Retained income at beginning of year	$ 38,672	$ 33,349
Income for the year	8,321	7,430
	46,993	40,779
Dividends (Note 8)	2,391	2,107
Retained income at end of year	$ 44,602	$ 38,672

Consolidated Statement of Financial Position

	Year ended December 31	
	1981	1980
	(in thousands)	
Current assets:		
Cash	$ 37	$ 33
Short-term investments	—	7,000
Trade and other accounts receivable	12,991	11,039
Inventories (Note 2)	41,143	34,096
Prepaid expenses	280	362
	54,451	52,530
Current liabilities:		
Bank indebtedness	14,784	11,230
Accounts payable and accrued liabilities	19,635	16,478
Income taxes payable	—	3,157
Current portion of long-term debt (Note 4)	770	770
	35,189	31,635
Working capital	19,262	20,895
Add: **Non-current assets —**		
Fixed assets (Note 3)	60,387	51,648
Unamortized debenture discount and issue expenses	213	252
Miscellaneous assets	100	166
	60,700	52,066
Deduct: **Non-current liabilities —**		
Sinking fund debentures (Note 4)	14,494	15,296
Deferred income taxes	13,153	11,653
	27,647	26,949
Net assets	$52,315	$46,012
Shareholders' interest:		
Share capital (Note 5)	$ 7,713	$ 7,340
Retained income (Note 4)	44,602	38,672
	$52,315	$46,012

APPROVED BY THE BOARD OF DIRECTORS:

George O'Leary

G. L. O'Leary
Director

W. D. H. Gardiner
Director

Consolidated Statement of Changes in Financial Position

	Year ended December 31	
	1981	1980
	(in thousands)	
Financial resources were provided by:		
Operations —		
Income for the year	$ 8,321	$ 7,430
Items which did not involve an (inflow) outflow of working capital —		
Depreciation	4,364	5,399
Deferred income taxes	1,500	(480)
Amortization of debenture issue costs	39	44
(Gain) loss on disposal or retirement of fixed assets	(13)	45
	14,211	12,438
Decrease in miscellaneous assets	66	51
Issue of common shares	373	293
Proceeds on disposal of fixed assets	85	6
	14,735	12,788
Financial resources were used for:		
Additions to fixed assets	13,175	5,010
Dividends	2,391	2,107
Reduction of long-term debt	802	1,040
	16,368	8,157
(Decrease) increase in working capital during the year	(1,633)	4,631
Working capital at beginning of year	20,895	16,264
Working capital at end of year	$19,262	$20,895

Auditors' Report

To the Shareholders of
Scott Paper Limited:

We have examined the consolidated statement of financial position of Scott Paper Limited as at December 31, 1981 and the consolidated statements of income and retained income 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.

Price Waterhouse

February 16, 1982
Vancouver, B.C.

Price Waterhouse
Chartered Accountants

Notes to Consolidated Financial Statements, December 31, 1981

1. Summary of significant accounting policies:

(a) Principles of consolidation—

The consolidated financial statements include the accounts of Scott Paper Limited and its wholly-owned subsidiaries, Omega Products Limited, Westminster Paper Company Limited and West Tree Farms Limited.

(b) Inventories—

Inventories of finished products and work-in-process are valued at the lower of average cost and market value determined on the basis of net realizable value. Raw materials and supplies are valued at average cost which is not in excess of replacement cost.

(c) Depreciation and amortization—

Fixed assets—

Depreciation is provided on buildings, machinery and equipment on a straight-line basis over their estimated useful economic lives at rates ranging from 2½% to 20% of original cost per annum.

Debenture discount and issue expenses—

The amortization of debenture discount and issue expenses is provided on a basis related to the principal amount outstanding.

(d) Capitalization of interest—

The Company capitalizes interest costs related to major capital expenditures during the period of construction.

2. Inventories:

Inventories consist of—

	December 31	
	1981	1980
	(in thousands)	
Finished products and work-in-process	$26,675	$21,903
Raw materials and supplies	14,468	12,193
	$41,143	$34,096

3. Fixed assets:

Fixed assets consist of—

	December 31	
	1981	1980
	(in thousands)	
Land, at cost	$ 3,091	$ 757
Buildings, machinery and equipment, at cost	105,925	95,423
Less: Accumulated depreciation	48,629	44,532
Net book value of depreciable assets	57,296	50,891
	$60,387	$51,648

The Company has announced major capital expenditure programs with total costs estimated at $93 million through 1986. As at December 31, 1981, approximately $8 million has been spent on these programs.

4. Sinking fund debentures:

	December 31			
	1981			1980
	8¾% Series A	11⅝% Series B	Total	Total
	(in thousands)			
Principal amount issued	$12,000	$11,000	$23,000	$23,000
Principal amount outstanding	$ 7,344	$ 7,920	$15,264	$16,066
Less: Payments due within one year	—	770	770	770
	$ 7,344	$ 7,150	$14,494	$15,296

Sinking fund debentures, *continued*

8¾% sinking fund debentures, Series A—

The Series A debentures were issued on July 2, 1971 with a maturity date of July 2, 1991 and require that mandatory sinking fund payments be made in each of the years 1974 to 1990 to retire $360,000 of the debentures per annum with an option to retire a further $180,000 per annum. At December 31, 1981 the Company had $1,416,000 of debentures available to meet future sinking fund requirements.

11⅝% sinking fund debentures, Series B—

The Series B debentures were issued on December 9, 1975 with a maturity date of October 31, 1990 and require that mandatory sinking fund payments be made in each of the years 1978 to 1989 to retire $770,000 of the debentures per annum.

The trust agreement contains a distribution test formula which limits the availability of retained income for payment of dividends. As at December 31, 1981 approximately $29,000,000 is available for distribution under the most restrictive tests.

Minimum sinking fund payments required for Series A and B debentures in each of the five years following December 31, 1981 is as follows—

1982	$ 770,000*
1983	$ 770,000*
1984	$ 770,000*
1985	$ 794,000*
1986	$1,130,000

*Net of amounts acquired and lodged for future sinking fund requirements.

5. Share capital:

The authorized share capital of the Company consists of 6,000,000 common shares without par value of which 2,535,750 (1980 — 2,490,850) are issued and outstanding. Of the 3,464,250 unissued shares, 14,250 are reserved for options under the "Key Employee Stock Option Plan". The following options are outstanding (but not yet exercised)—

Number of shares	Option price per share	Expiry date
7,500	$11.25	April 24, 1984
4,300	$13.75	September 11, 1984

During 1981 the following options were exercised—

41,550	shares purchased at $ 8.00
2,250	shares purchased at $11.25
1,100	shares purchased at $13.75
44,900	

6. Expenses include:

	December 31 1981	1980
	(in thousands)	
Depreciation	$4,364	$5,399
Remuneration of 20 directors and senior officers	$1,274	$1,137
Research and development costs paid to parent company	$1,240	$ 850

7. Pension plans:

The Company's hourly employees at the Western Manufacturing Division are members of an industry pension plan to which the Company contributes. In addition, the Company has a number of contributory pension plans, participation being available to substantially all of its other employees. Length of service and individual earnings determine the pensions and retirement benefits for all members of the Company plans. It is the Company's practice to provide for its portion of the cost of pensions and retirement benefits accrued, through charges to earnings determined by periodic actuarial computations. The most recent actuarial reports revealed that the plans were, in aggregate, fully funded.

8. Dividends paid:

The Company paid four quarterly dividends during the year amounting in total to $2,391,000. Dividends were paid at a rate of 22.5 cents per share for the first and second quarters and were increased to a rate of 25 cents per share for the third and fourth quarters.

Ten Year Review

	1981	1980	1979	1978	1977	1976	1975	1974	1973	1972
Sales and Earnings	(thousands of dollars except per share)									
Net sales	**$174,331**	157,035	140,522	116,539	103,884	99,431	84,629	73,571	56,295	48,118
Depreciation	**4,364**	5,399	4,732	4,661	3,831	3,869	3,286	3,008	2,394	2,031
Interest expense	**2,628**	2,561	2,660	2,705	2,471	2,306	2,115	1,220	1,099	1,103
Income before taxes	**13,421**	11,690	9,806	6,555	5,674	6,143	5,404	5,523	3,538	3,244
Income taxes	**5,100**	4,260	3,542	2,316	2,015	2,578	2,445	2,586	1,544	1,557
Income after taxes	**8,321**	7,430	6,264	4,239	3,659	3,565	2,959	2,937	1,994	1,687
Per Share*										
Income before taxes	**$ 5.29**	4.69	3.99	2.70	2.36	2.56	2.25	2.30	1.47	1.35
Income after taxes	**3.28**	2.98	2.55	1.75	1.52	1.49	1.23	1.22	.83	.70
Cash flow-operations	**5.60**	4.99	4.86	4.54	3.90	3.74	3.21	3.10	2.34	1.78
Dividends paid	**.95**	.85	.65	.49	.43	.40	.40	.33	.33	.32
Shareholders' equity	**20.63**	18.47	16.45	14.63	13.42	12.33	11.25	10.41	9.52	9.03
Number of shares outstanding (thousands)	**2,536**	2,491	2,456	2,426	2,402	2,400	2,400	2,400	2,400	2,400
Condensed Funds Statement										
Source of funds										
—operations	**$ 14,211**	12,438	11,938	11,026	9,373	8,983	7,705	7,447	5,619	4,266
—long-term financing and other	**524**	350	866	296	37	38	10,892	58	429	55
	14,735	12,788	12,804	11,322	9,410	9,021	18,597	7,505	6,048	4,321
Expenditures for										
—fixed assets	**13,175**	5,010	5,255	7,773	9,813	7,589	7,056	7,816	5,677	3,087
—dividends	**2,391**	2,107	1,589	1,179	1,040	960	960	800	800	760
—repayment of long-term borrowing and other	**802**	1,040	3,098	1,089	1,139	195	13	763	608	—
	16,368	8,157	9,942	10,041	11,992	8,744	8,029	9,379	7,085	3,847
Net increase (decrease) in working capital	**$ (1,633)**	4,631	2,862	1,281	(2,582)	277	10,568	(1,874)	(1,037)	474
Financial Position										
Current assets	**$ 54,451**	52,530	42,421	33,307	33,727	31,215	25,960	23,416	13,974	13,248
Current liabilities	**35,189**	31,635	26,157	19,905	21,606	16,512	11,534	19,558	8,242	6,479
Working capital	**19,262**	20,895	16,264	13,402	12,121	14,703	14,426	3,858	5,732	6,769
Fixed assets at net book value	**60,387**	51,648	52,088	52,027	49,106	43,170	39,480	35,740	31,031	28,206
Long-term debt	**14,494**	15,296	16,336	19,286	20,354	21,464	21,633	10,636	11,400	12,000

*Years 1972-1977 have been restated to reflect a 3 for 1 share split on December 4, 1978.

Officers and Executive Management

GEORGE L. O'LEARY
Chairman, President & Chief Executive Officer
JAMES C. BOYLE
Division Vice President (Industrial Marketing)
W. MICHAEL FERRIE
Division Vice President (Corporate Personnel)
BERNARD A. GOULET
Group Vice President
SERGE GUAY
Division Vice President,
General Manager, Eastern Manufacturing Division
JOHN J. HERB
Secretary
DOUGLAS HOLME
Corporate Vice President (Corporate Development)
RALPH M. KITOS
Division Vice President,
General Manager, Western Manufacturing Division
PETER J. PETERS
Group Vice President & Treasurer
JOHN F. PHILIP
Division Vice President (Ventures)
JOHN M. REID
Controller
ROBERT T. STEWART
Group Vice President
DAVID H.R. STOWE
Corporate Vice President (Consumer Marketing)

Transfer Agent and Registrar

THE CANADA TRUST COMPANY
Vancouver, Calgary, Toronto, Montreal and Halifax

Stock Listings

Vancouver, Toronto and Montreal Stock Exchanges

Operating Subsidiary

West Tree Farms Limited

Joint Venture Company

50% Interest in Sancella Inc.

Board of Directors

H. CLARK BENTALL*
Chairman
Dominion Construction Co. Ltd.
Vancouver, B.C.
GILBERT C. CLARKE
Retired Businessman
London, Ontario
W. DOUGLAS H. GARDINER †
Retired Businessman
Vancouver, B.C.
BERNARD A. GOULET
Group Vice President
Vancouver, B.C.
CHESTER A. JOHNSON †
President and Chief Executive Officer
West Fraser Timber Co. Ltd.
Vancouver, B.C.
H. GORDON MACNEILL
President & Chief Executive Officer
Jannock Limited
Toronto, Ontario
GEORGE L. O'LEARY *†
Chairman, President
& Chief Executive Officer
Vancouver, B.C.
PETER J. PETERS *
Group Vice President
Vancouver, B.C.
ROBERT T. STEWART
Group Vice President
Vancouver, B.C.
MARCELLIN TREMBLAY
Vice President
L'Association Canadienne des Compagnies
D'Assurances de Personnes Inc.
Montreal, Quebec
WILLIAM S. WESSON *
President
Scott Paper International Inc.
Philadelphia, Pa.

* Member of the Executive Committee
† Member of the Audit Committee

Annual Meeting

The company's Annual Meeting of Shareholders will be held at 11:00 a.m. on April 22, 1982 in the Arbutus Room of the Four Seasons Hotel, Vancouver, British Columbia.

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