

An aerial photograph of a logging yard. The ground is dark and heavily marked with tire tracks from heavy machinery. In the lower-left and center, there are large stacks of cut logs. A skidder is positioned in the center-right, and a truck is visible in the lower-left, both appearing to be in the process of moving or organizing the logs. The overall scene is one of active industrial work in a forest clearing.

British Columbia
Forest Products
Limited
Annual Report

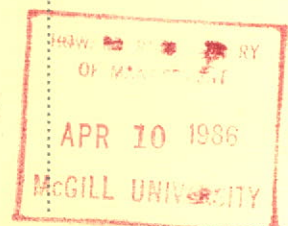
1985

Financial Highlights

British Columbia Forest Products Limited

For the year (in thousands of dollars)	1985	1984
Net Sales	\$1,139,963	\$1,014,726
Depreciation and depletion	62,260	61,512
Earnings before income taxes	73,082	22,287
Income taxes	42,997	13,097
Net earnings	30,085	9,190
<i>per common share</i>	\$0.60	\$0.18
Cash from operations	98,798	29,301
<i>per common share</i>	\$1.98	\$0.60
Return on net assets	6.0%	4.5%
Return on common shareholders' equity	7.1%	2.3%
Dividends paid		
common (stock dividends)	6,739	6,202
per share	\$0.13	\$0.13
preferred	308	347
per share	\$3.00	\$3.00
Capital expenditures	36,149	16,215
Salaries and wages	241,529	213,756*
Employee benefits	76,350	68,499*
Stumpage and royalty (to governments)	12,553	12,239
Property taxes	16,714	19,040
At year end		
Ratio of current assets to current liabilities	1.8	1.9
Ratio of long term debt to equity	1.2	1.6
Shareholders' equity per common share	\$8.80	\$7.98
Number of common shareholders	4,628	5,141
Number of preferred shareholders	655	734
Number of employees	7,090	7,066*
Assets per employee	\$170,000	\$172,000
<i>Canadian capital gains tax</i>		
<i>Valuation Day prices:</i>		
<i>Common shares (subdivided)</i>	\$ 2.47	
<i>6% Preferred shares</i>	41.50	
<i>Series B, 5½% debentures</i>	74.00	
<i>Series C, 6½% debentures</i>	80.50	
<i>Series D, 9¾% debentures</i>	106.00	

*Salaries, wages and benefits were lower in 1984 due to a 10-week labor dispute. Employees of Pinette & Therrien Mills Limited became employees of BCFP during 1985.



To Our Shareholders And Employees

The Company made good progress during 1985 recovering from the five years of recession in the British Columbia forest industry. The improvement was made by the determined effort of BCFP employees to increase productivity at every division of the Company in the face of continuing difficult market conditions for most products.

Consolidated net earnings for 1985 of \$30.1 million, or \$.60 per common share, were up substantially from earnings of \$9.2 million, or \$.18 per common share, in 1984. Although earnings were still well below an acceptable level, they do represent the best year the Company has had since 1980.

Competitive pressure in the pulp markets continued to erode prices throughout most of the year. The declining strength of the U.S. dollar and reduced inventories arrested falling prices by year end, but current prices for market pulp are still 12 per cent lower than they were five years ago. The lower pulp prices also adversely affected results of two partly-owned companies, Donohue St-Félicien Inc. and Finlay Forest Industries Ltd.

Newsprint demand improved toward the end of 1985, but competing imports into western North American markets resulted in some price concessions during the year.

Shipments of lightweight coated paper by the Company's wholly-owned subsidiary in Minnesota, Blandin Paper Company, were at a high level throughout most of the year but fell off in the last quarter due to reduced advertising volumes for U.S. publishers and an increase in the amount of European paper imports.

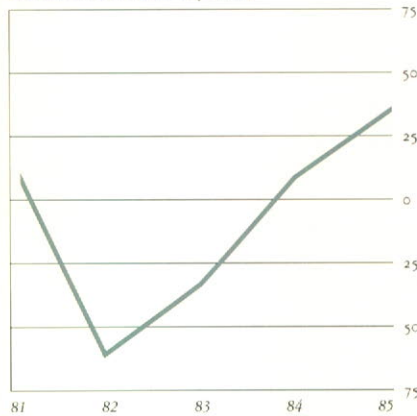
Lower interest rates failed to increase housing starts in the U.S., which remained at an annualized rate of 1.7 million units. Because of continued oversupply, prices for the Company's wood products remained relatively unchanged. There was some renewed activity in the offshore lumber markets, and price improvement was consistent with the strengthening of foreign currencies.

The spectre of trade restrictions on Canadian lumber exports to the U.S.

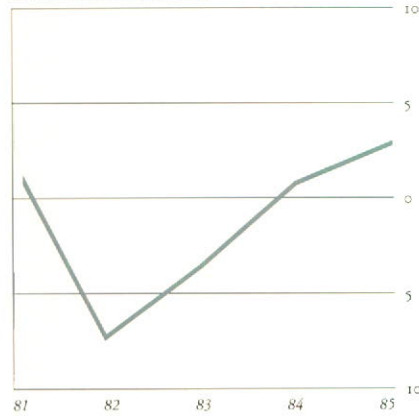
continues to be a threat to Canadian producers. Some members of the U.S. lumber industry allege that Canadian lumber competes unfairly and are seeking Congressional support for action which would severely inhibit the ability of Canadian lumber to compete in that country.

Among the many points made in support of the Canadian position is the fact that on three occasions over the past five years, agencies of the U.S. Government have conducted exhaustive investigations of Canadian policies and practices and not once has it been concluded that the Canadian industry is competing unfairly.

NET EARNINGS (In millions of dollars)



RETURN ON SALES (Per Cent)



It is hoped that negotiations for freer trade between the two countries will help to alleviate the pressure to impose quotas or duties on Canadian lumber.

During 1985 the B.C. forest industry was faced with continuing pressure in the management and harvesting of timberlands as a result of native land claims and the desire of some Canadians for more parks and wilderness areas. The Company is directly involved in several high-profile areas and indirectly involved in others through its partly-owned companies.

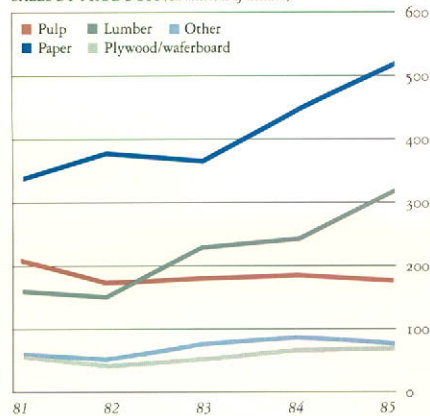
For years the Company has advocated the principle of multiple use of forest lands, which would continue to allow logging in disputed areas but would also preserve wilderness areas for generations to come. We believe most Canadians do not fully realize the high cost to all Canadian taxpayers from the loss of economic timber through the creation of additional parks and wilderness reserves which exclude the harvesting of mature timber.

Consistent with the Company's objective to improve its competitive

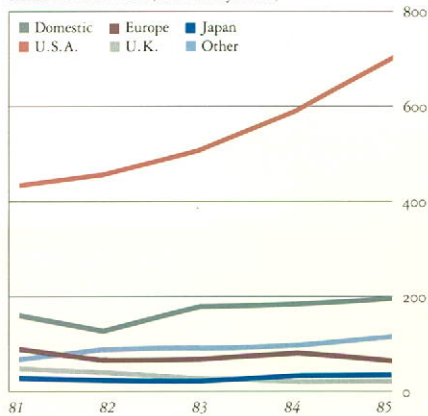
position, a total of \$36 million of capital spending was undertaken during the year to improve product quality and reduce costs. The program included process improvements in the pulp and paper operations, the largest of which is a \$14.3 million power boiler at Crofton that will be completed by mid-1986. The new boiler will result in a substantial reduction in energy costs and will alleviate production interruptions during periods of peak steam demand.

Capital improvements in the wood products sector include a \$2.5 million modification to Tilbury Sawmill to allow the mill to cut lumber up to

SALES BY PRODUCTS (In millions of dollars)



SALES BY MARKETS (In millions of dollars)



10-inch widths. The mill was originally designed to produce two-by-fours exclusively.

Leasehold improvements totalling \$15.8 million were completed at the Vancouver Sawmill Division to improve both lumber recovery and productivity. The rebuilt mill commenced operations in August and encountered some start-up and break-in problems, but is expected to be running at rated capacity by mid-1986.

As part of its continuing objective to reduce debt, the Company sold the assets of Fraser River Pile Driving Company Limited in May for \$15.1 million. The proceeds of the sale were included in total long-term debt reduction of \$79 million in 1985.

It is essential that the Company modernize and expand the papermill of its wholly-owned subsidiary, Blandin Paper Company, to improve its overall competitive position in the U.S. lightweight coated paper industry. Before

embarking on such a major expansion program, however, BCFP intends to substantially reduce total debt. A preliminary prospectus for a public offering to sell a 50 per cent interest in Blandin Paper Company was filed in the U.S. and Canada in August with the intention that the proceeds of sale would be used to repay a portion of the Company's debt. Unfortunately, the offering entered the equity markets at a time when securities were in a steep decline and market conditions for lightweight coated paper were softening and the offer had to be withdrawn. The Blandin expansion remains a very high priority for the Company, and other approaches to reducing debt prior to starting the project are still under consideration.

Cash dividends were paid on preferred shares, but net income continued at a level insufficient to pay cash dividends on common shares. However, a stock dividend of \$.135 per common share was paid in November.

Two new officers were appointed during the year. In February Mr. John E. Longley was named Comptroller, and in December Mr. Thomas G. Torrance became Vice-President, Pulp and Paper Marketing.

Some price recovery is expected in 1986 for market pulp as a result of a modest increase in demand and a further weakening in the U.S. dollar.

Newsprint demand strengthened toward the end of 1985, and the increased operating rate of the Crofton newsprint mill is expected to continue well into 1986.

The weaker market for lightweight coated papers in the U.S. at the end of 1985 has extended into the early part of 1986, but overall it is expected that the industry operating rate will be slightly higher than in 1985.

Lumber markets generally remain depressed, but some improvement is expected in offshore markets as foreign currencies regain some strength relative to the U.S. and Canadian dollars.

Industry-wide negotiations with unions covering forest products employees in B.C. will be a critical issue facing the Company during 1986. Some bargaining structure changes, designed to improve the negotiations with pulp and paper unions, have already taken place. Negotiations with the

two pulp and paper unions commenced at the end of January with an objective of concluding a contract well in advance of the current contract expiry date in June. In view of the fragile recovery now in progress, an equitable and economically sound agreement is essential for the industry to continue to recover from the five years of recession.

A return to a reasonable profit position, further debt reduction and recommencement of cash dividends remain prime objectives for the Company. With another outstanding effort by employees and continued support of its customers, BCFP expects an improved performance in 1986.



On behalf of the Board, February 27, 1986

K. P. BENSON *Chairman and Chief Executive Officer*

GEORGE G. FLATER *President and Chief Operating Officer*

Forestry and Wood Supply

The Company was able to expand its basic forest management programs in 1985 with intensive forestry projects sponsored by the Provincial and Federal Governments.

Restocking of harvested forest land by forestry crews resulted in the planting of a total 8.1 million seedlings on the B.C. Coast, at Mackenzie in the B.C. Interior, and in Alberta. Eradication of brush and juvenile spacing work were carried out on a total 3,223 hectares of Company plantations while an additional 400 hectares were pruned by a Canada Works crew.

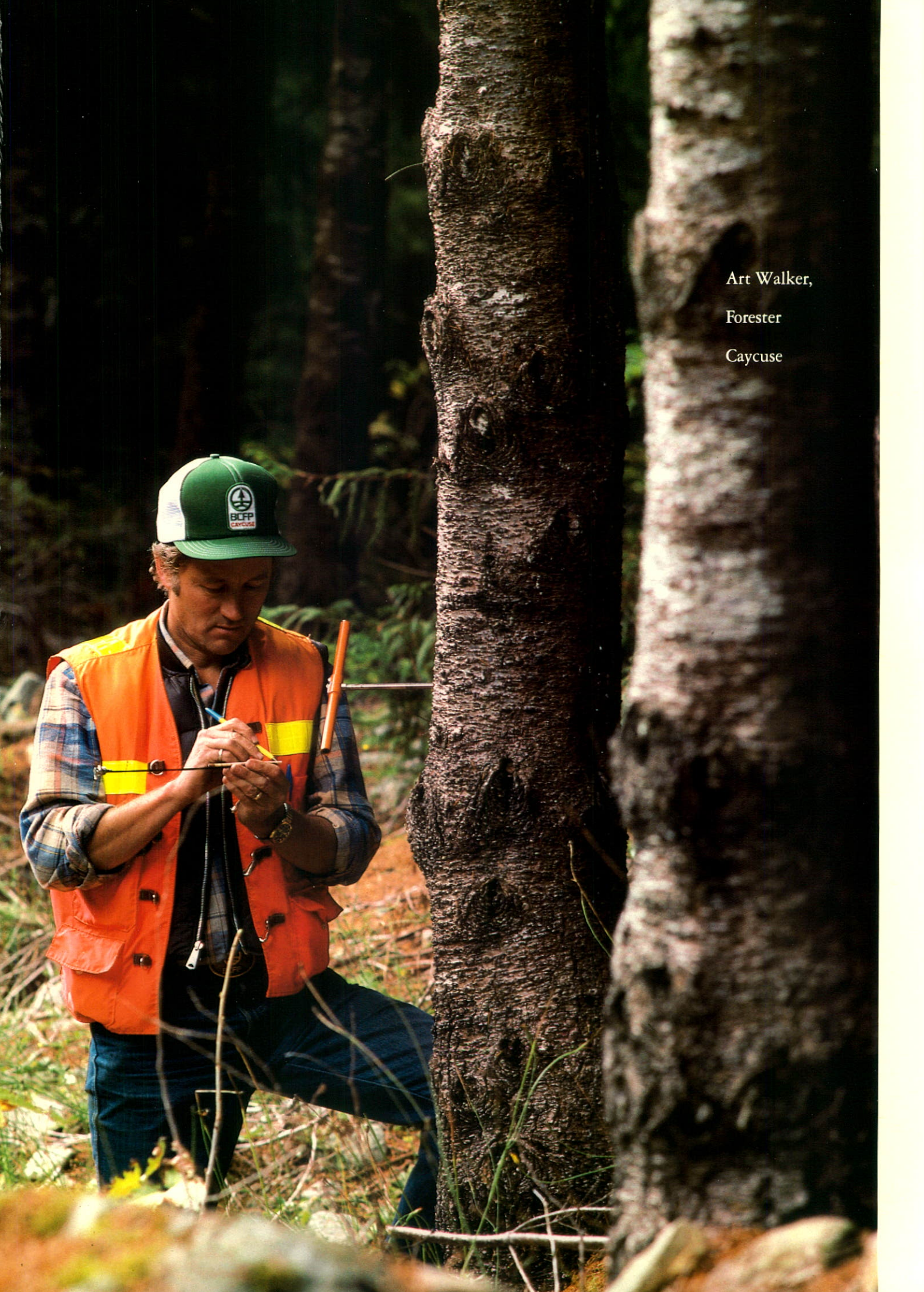
Stumpage and royalties for B.C. operations of \$12.5 million were offset by \$6 million of credits received under Section 88 of the Forest Act for road construction and silvicultural programs.

Timberlands personnel were directly involved with numerous hearings and presentations stemming from opposition to logging in areas designated for some of the



Advanced silviculture blends science and nature to yield productive and healthy forests. Management of the timberlands under our care requires thoughtful planning and diligent execution by knowledgeable professionals if the world's growing demand for forest products is to be met in future. Still, with mounting pressure coming to bear on existing timberlands, a new public awareness is necessary to bring into focus the multiple use concept which can serve both economic and conservationist interests.

Art Walker,
Forester
Caycuse



Company's operations. The most contentious of these areas to BCFP, the Stein River Valley, is being examined by a special government-appointed Wilderness Advisory Committee to which representations were made in defence of orderly harvesting and multiple use.

The Company's logging sector overcame a lengthy forest fire season and an early winter to keep manufacturing inventory requirements on target.

Total log production from the Company's B.C. and Alberta operations was 6.3 million cubic metres, an increase over the 5.2 million cubic metres of logs harvested in 1984.

Operations on Vancouver Island, the mainland Coastal inlets and the Fraser Valley accounted for nearly 3 million cubic metres of production, a marginal increase over the 2.7 million cubic metres logged on the Coast

during the previous year. The Coastal volume included a monthly record of 504,352 cubic metres which was set in October when cool, damp weather returned to the province.

Productivity continued to improve in all Coastal operations, and logging costs trended down-

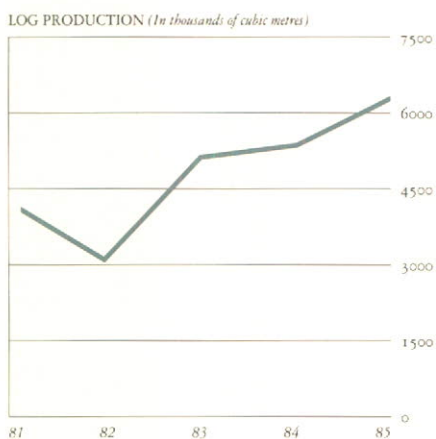
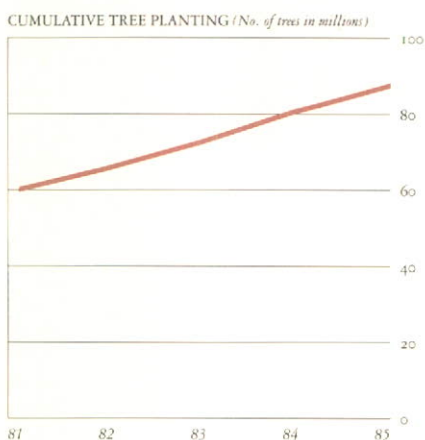
ward. The introduction of long-boomed, mobile yarders for wide right-of-way logging, and increased use of grapple yarders, contributed to improved efficiency.

The conversion to satellite land sorts was completed during 1985 with the construction of dry land sorting grounds at four mainland logging locations.

Boston Bar completed a record production year of 542,000 cubic metres compared with the previous record year of 447,000 cubic metres.

In the Interior, logging at Mackenzie of 1.7 million cubic metres was unchanged from the preceding year.

Logging at Grande Cache, Alberta reached a new high level of 431,000 cubic metres compared with 404,000 cubic metres in 1984. Low-quality timber assigned to the Company continued to create harvesting and sawmilling problems for the division.



Increased log barging for outside customers helped Swiftsure increase its volume for the Swiftsure Prince and the Forest Prince from 116 trips in 1984 to 128 trips in 1985. The Swiftsure tug fleet towed a total 1.8 million cubic metres of logs.

Wood Products

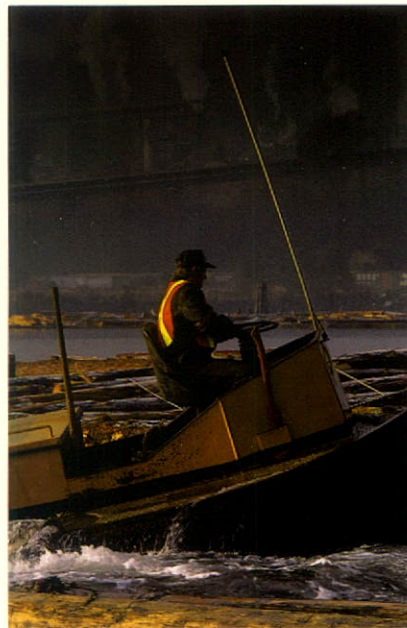
Despite higher consumption of lumber in North America, industry production volumes exceeded demand during 1985.

While new home building in the U.S. was similar to the previous year, consumption was favorably affected by an increase in residential renovations, general construction projects and packaging activity. Unfortunately, the supply side was more than able to meet this demand and prices in the U.S. remained at 1984 levels.

The rate of U.S. housing starts peaked at 1.9 million units on an annualized basis in April before slipping back to an average rate of 1.7 million units for the 12 months, unchanged from 1984

levels. Canadian housing starts of 160,000 units, although improved over 1984, were well below levels experienced during the 1970s.

As the second half of the year progressed, the U.S. dollar weakened against most foreign currencies and mill net prices in



Canadian dollars marginally improved for offshore sales.

Cedar and specialty product markets were reasonable throughout the year while domestic sales of sanded plywood were depressed due to oversupply.

Total lumber production from the Company's sawmills exceeded the one billion board feet mark during 1985 with a record 1.21 billion board feet compared with 970 million board feet produced in the preceding year.

Several major capital projects were completed which were aimed at achieving productivity increases. These included a modification of the sorter and Chip-N-Saw line at Boston Bar, the startup of the rebuilt Vancouver sawmill, and modifications at Tilbury to produce wider lumber.

The \$15.8 million Vancouver sawmill reconstruction was completed in mid-August after a five-month closure. Typical startup problems associated with new equipment were experienced initially but much improvement was achieved towards the end of the year. The new mill has a rated capacity of 135 million board feet per year.

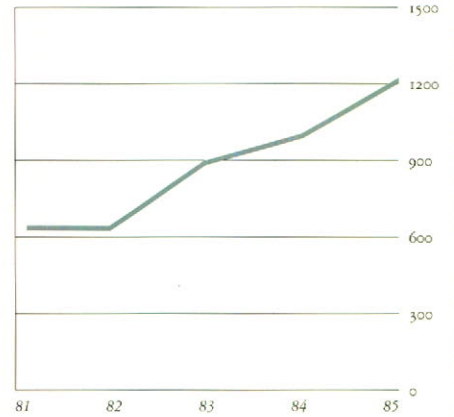


Commonly available, dependable and economical, wood products satisfy a basic human need for shelter. While frame structures are most often associated with North American homes, other countries are increasing their use of wood as a means to house their people. Traditionally, building materials have been targeted at the United States, the world's largest consumer of wood products. But with higher interest rates and an economy left uncertain by recession, home building in America has not returned to the levels of the 1970s. As a result, the Company continues to search out new markets to reflect these changing conditions.

Pinette & Therrien Mills

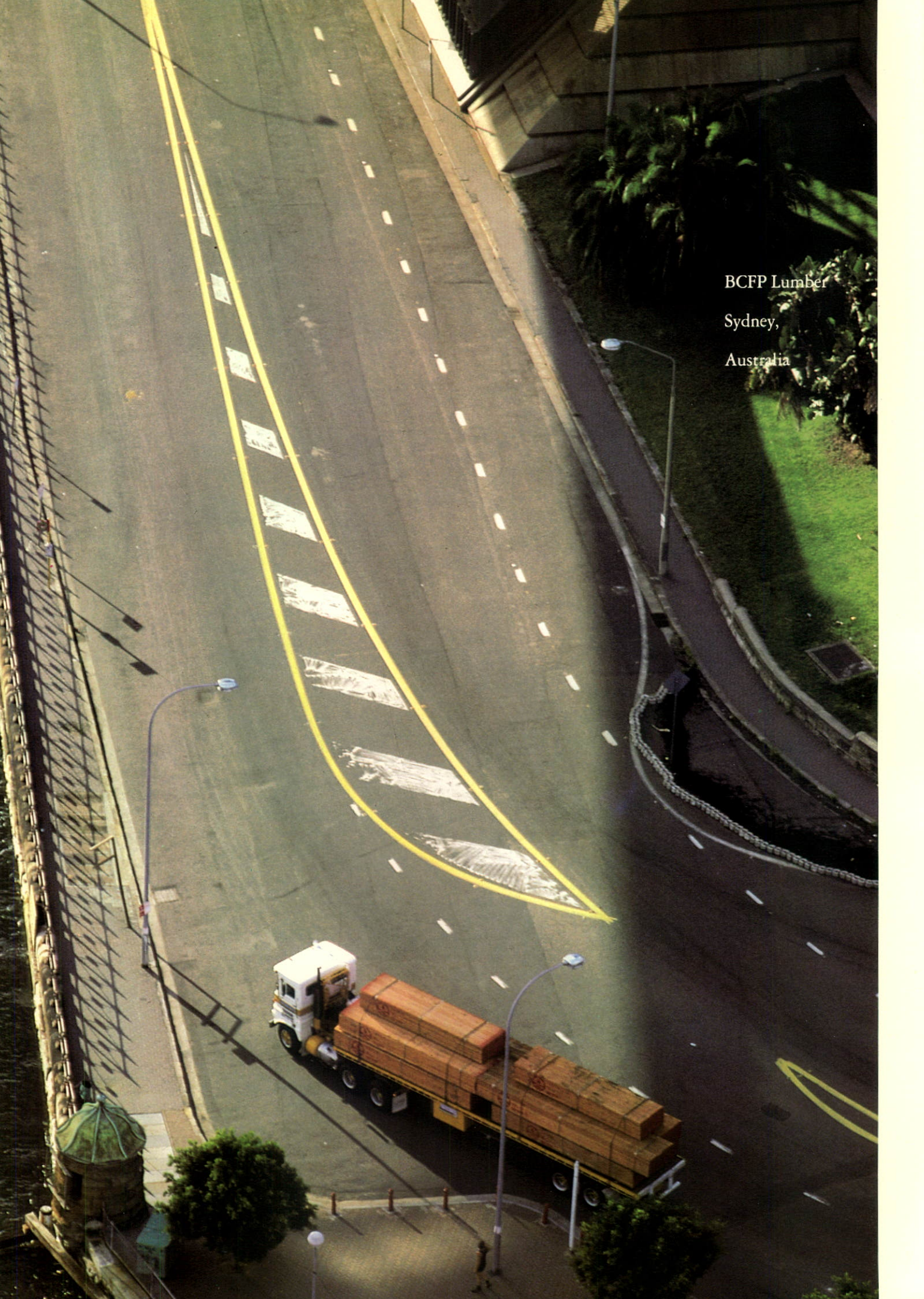
Limited, of Williams Lake, B.C. operated for 11 months during 1985 as a wholly-owned BCFP subsidiary. Total production of 171 million board feet was 14 million board feet higher than the previous year due to increased stud production.

LUMBER PRODUCTION (In millions of board feet)



The Grande Cache, Alberta sawmill experienced another difficult year of operation due to small log size and poor log quality which resulted in lower-grade production and correspondingly lower mill net prices. Despite these obstacles, the mill achieved its highest level of production in its three years of operation.

Plywood production of 69 million square feet ($\frac{3}{8}$ inch basis) at Delta Plywood was down from 73 million square feet in 1984 as



BCFP Lumber
Sydney,
Australia



Engineering, chemistry and knowhow combine to create the marvel of kraft pulp, the essential ingredient for thousands of useful products. BCFP continues to look for new ways to improve productivity, lower costs and conserve energy. Representative of the Company's progress in these areas is the construction of the new No. 5 power boiler at Crofton which will increase the mill's efficient production of steam. With markets made dismal by currency imbalances, these achievements are even more pressing as competition from abroad increases.

poor market conditions persisted throughout most of the year.

Subsequent to the sale of the assets of Fraser River Pile Driving Company Limited, the name of the company was changed to BCFP Coast Sawmills Limited and it now owns and operates the Cowichan, Victoria, Tilbury and Hammond Sawmills.

Pulp and Newsprint

Industry capacity continued to exceed demand for pulp and newsprint during 1985, creating increased competition in the marketplace. However, excellent productivity, the declining U.S. dollar and improved cost control helped the Company's pulp and paper sector complete a moderately successful year.

Except for some downtime for inventory correction, both Crofton and Mackenzie pulp mills operated without major interruptions. Total combined production of 426,000 tonnes was 94 per cent of capacity, well above the 356,000 tonnes produced in 1984 when operations were affected by a 10-week labor dispute.

A high-angle, low-key photograph of a welder working on a complex steel structure. The welder is positioned in the center-right of the frame, viewed from behind. They are wearing a light-colored, heavy-duty protective suit, a yellow and green safety helmet, and yellow safety boots. The welder's hands are positioned to work on a joint of the steel beams. The structure consists of numerous parallel steel beams, some of which are being welded together. The lighting is dramatic, with strong highlights on the welder's gear and the steel beams, and deep shadows elsewhere. The overall atmosphere is industrial and focused.

Steel Decking

No. 5 Power

Boiler

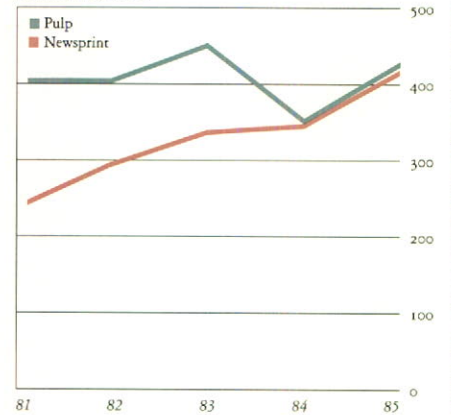


Markets for newsprint remain intensely competitive. Product quality and a secure supply are often the determining factors in obtaining and maintaining customers. Crofton newsprint is highly-regarded by publishers in North America and overseas for achieving these standards. Our newsprint machines produced a record 411,000 tonnes during this last year, a tribute to efficiency and productivity.

The decline in the value of the U.S. dollar, in relation to European and Japanese currencies, helped stem the downward pressure on prices due to oversupply by reducing the burden of exchange for the Company's offshore pulp customers.

Newsprint consumption in the

MARKET PULP/NEWSPRINT PRODUCTION
(In thousands of tonnes)



U.S. remained unchanged through 1985 but there were serious market incursions by competitors in the U.S. Western Region, which prevented any price increases.

High quality and market diversification permitted record production of newsprint at Crofton of 411,000 tonnes. New production records were set for daily average production and the No. 3 machine added in 1982 is up to capacity.

Kevin Eriksen

No. 3 News

Machine



FELOIT



Newstands throughout North America feature magazines that have become household names, many of them customers of Blandin Paper Company. It is a list of titles that keeps growing as the U.S. publishing industry continues to expand. A tradition of excellence and a dedication to customer requirements kept Blandin at the forefront as a leading producer of lightweight coated paper during 1985. Despite tougher market conditions in the second half of the year, the long-range prospects remain bright for Blandin paper.

More progress was achieved in manufacturing cost reductions at Crofton and Mackenzie with the completion of selective capital projects. Work began on Crofton's No. 5 power boiler in the fall and the project remains on budget and on schedule for an early summer 1986 startup. The new \$14.3 million boiler will permit greater use of hog fuel in Crofton's other power boilers while meeting peak steam demands.

A 16-day shutdown at Mackenzie in March permitted several projects to be completed, the largest of which was the retubing of the recovery boiler. Despite this downtime, Mackenzie completed the second best production year in its history.

Blandin Paper Company

Although market conditions were affected by foreign imports, Blandin's production and sales of lightweight coated paper were conducted at reasonable levels.

With imports into the U.S. reaching an annualized rate of 500,000 short tons, the domestic

market for magazine and catalogue grade papers began to soften in the second half. However, Blandin's order file remained strong until October, when declining demand forced a reduction of production to 90 per cent of capacity.

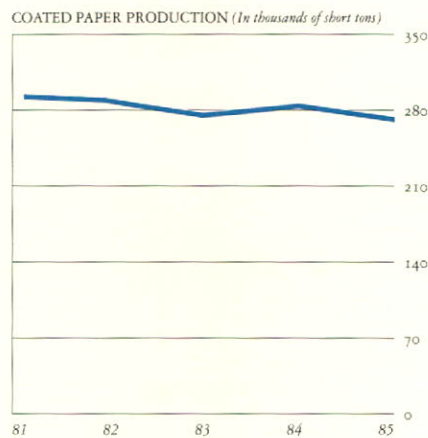
Paper prices came under pressure during the fourth quarter with widespread discounting.

Total production was 270,000 short tons, down from the 283,000 tons produced in 1984.

Blandin Wood Products completed a stronger year of sales and shipments of aspen wafer-board with production of 274 million square feet ($\frac{3}{8}$ inch basis) in 1985 compared with 232 million square feet in the previous year.

Major changes to the wafer-board plant's woodroom were completed, including a new log forwarding system and centralization of the debarkers. These improvements helped reduce manpower and improve productivity.

Elsewhere in the plant, additional ventilation equipment was installed and further progress was achieved in dust containment. Plans were developed during the year to make production line changes to permit the manufacture of oriented strandboard, a higher-value product. The \$1.5



million project is scheduled for completion in mid-1986.

Transportation

Forest product shipments from the Company's Crofton dock complex increased over 1984 levels with a record 222 vessels calling at the wharves.

Total pulp and paper shipments of 423,000 tonnes were significantly higher than the 335,000 tonnes shipped during the previous year. Lumber shipments also rose from 271 million

board feet in 1984 to 278 million board feet in 1985.

BCFP's charter newsprint vessel, Ferncroft, completed her 100th voyage for the Company in October, one of 38 round trips between Crofton and California ports sailed during the year. The Ferncroft, a specially-equipped, side-loading vessel, carried cargo of 147,000 tonnes of Crofton newsprint bound for Western U.S. customers.

More than 16,000 rail cars were also used to ship the Company's products to a variety of North American locations.

Croftech Inc.

A wholly-owned subsidiary of BCFP, Croftech manages the engineering and construction of major pulp and paper projects for the Company, its subsidiaries and associate companies.

At Western Pulp Limited Partnership's Squamish pulp mill, Croftech continued to supervise the major rebuild program. During 1985, a new bleach

plant was completed while a new recovery boiler, lime kiln and re-causticizing plant remain on schedule for startup in March, 1986.

A \$15 million program of improvement projects at Western Pulp's Port Alice sulphite mill was substantially completed, including a new hog fuel handling system, a rebuilt hog fuel boiler and an effluent treatment system.

Another major Croftech project is the installation of the new No. 5 power boiler at BCFP's Crofton division.

Associate Companies

In Quebec, Donohue St-Félicien Inc., performed well despite difficult market conditions for kraft pulp and lumber. The Company has a 45 per cent interest in DSF which operates a kraft pulp mill and four sawmills in the Lac St-Jean region of the province.

Pulp production of 290,000 tonnes was only slightly off the record 292,000 tonnes set in

1984, still well above the mill's original designed capacity of 240,000 tonnes per year.

As one of Eastern Canada's largest lumber manufacturers, DSF's four sawmills at Girardville, Chibougamau, Notre-Dame-de-la-Doré, and St-Thomas-Didyme, were subject to



curtailment several times during the year due to oversupply in the marketplace. Consequently, total lumber production of 294 million board feet was down from 319 million board feet in the previous year.

Finlay Forest Industries Ltd.,

in which the Company holds a 42.7 per cent interest, operates a refiner groundwood pulp mill and two sawmills at Mackenzie.

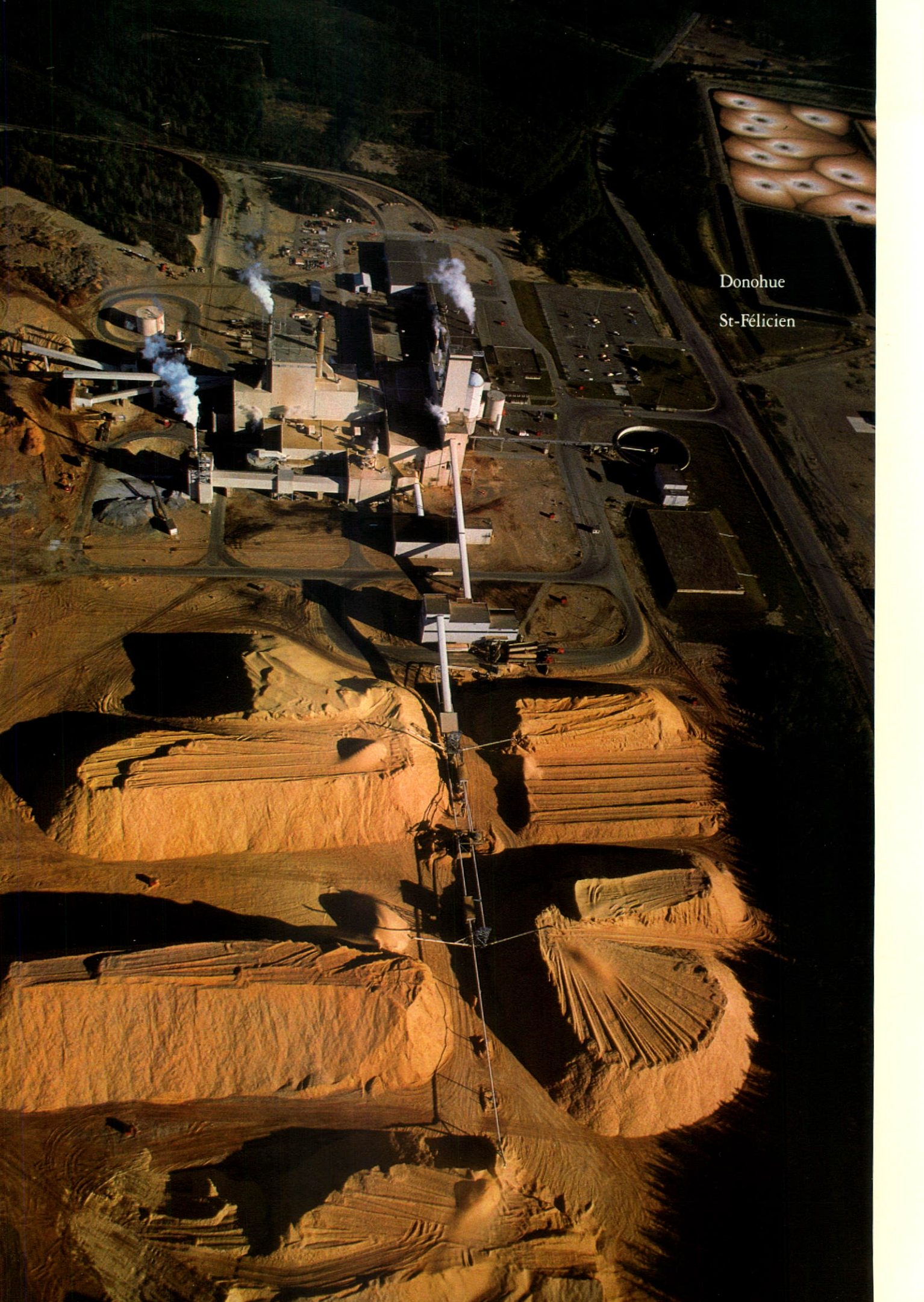
Improved production in both product lines led to a better year at FFI with groundwood pulp production of 121,000 tonnes, compared with 87,000 tonnes in 1984, and lumber production of 240 million board feet compared with 183 million in 1984.

Major capital improvements at FFI included a new edger and the installation of scanners on one line at the Site 2 sawmill and a new sodium hydrosulphite bleaching system for the groundwood mill.

Employee Relations

Encouraging progress was achieved in the area of accident prevention during the year with a 28 per cent company-wide reduction in accident frequency over the previous year.

Most improved was the wood products manufacturing group which realized a 35 per cent decline in the number of lost-time accidents.



Donohue
St-Félicien

Art Boyd,
Faller



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Financial Review

Statement of Earnings

Net earnings in 1985 were \$30.1 million or \$.60 per share compared with \$9.2 million or \$.18 per share in 1984. Sales increased to a record level for the third consecutive year in 1985 at \$1.14 billion compared with \$1.01 billion in 1984 which was adversely affected by a labor dispute. Improved coated paper prices in the first nine months of the year and record shipments of newsprint at slightly higher prices than in 1984 were major contributors to the increased sales. Lumber sales improved due to increased shipments and modest price increases while pulp sales were relatively unchanged as significant price declines offset increases in shipment volumes.

Total costs and expenses were \$1.09 billion compared with \$1.01 billion in 1984. Cost of products sold at \$902.1 million in 1985 was 79% of sales, 2% lower than 1984. Labor costs increased by 4½% at mid-year as union agreements entered the final year of a three year contract. Interest costs decreased due to lower interest rates and debt levels during most of 1985.

Total other income increased by \$2.4 million in the year. The gain on sale of the assets of Fraser River Pile Driving Limited and exchange gains recorded due to the weakening of the Canadian dollar in relation to the U.S. dollar offset a decline in earnings from associate companies as lower pulp prices sharply reduced earnings of Donohue St-Félicien Inc.

The consolidated income tax rate of 58.8% was unchanged from the prior year. The tax provision in both years is higher than the statutory rate due to the inclusion of withholding taxes paid on dividends from Blandin Paper Company.

Changes in Financial Position

Cash from operations increased in 1985 to \$98.8 million from \$29.3 million. Improved earnings represented \$20.9 million of this increase. Cash required for operating working capital decreased \$26.1 million as decreased cash requirements for accounts receivable and accounts payable were offset by increased inventories and income tax payments.

Improved cash flows resulted in a reduction of term loans by \$78.2 million in addition to payments of \$15.7 million on funded debt.

Capital expenditures increased \$19.9 million in 1985 to \$36.1 million and continued to be closely controlled. Logging road construction costs were \$4.8 million. Several projects intended to improve productivity, increase energy production and protect the environment were undertaken in the Company's operations.

Long term investments and advances decreased by \$4.6 million due to the acquisition of the remaining 50% interest in

Pinette & Therrien Mills Limited by the issue of common shares.

The Board of Directors declared a stock dividend of \$6.7 million in November of 1985. Preferred share dividends were paid at the rate \$3.00 per outstanding share.

The cash position decreased during the year by \$17.9 million to \$3.3 million.

Financial Position

The ratio of current assets to current liabilities declined to 1.8 at year end from 1.9 at December 31, 1984.

Investment in associate companies decreased to \$42.8 million in 1985 due to the acquisition of Pinette & Therrien Mills Limited and the receipt of dividends from Donohue St-Félicien Inc.

Long term debt decreased in 1985 by \$78.8 million to \$539.2 million. At December 31, 1985, the ratio of long term debt to equity was 1.2 compared with 1.6 at the previous year end.

Deferred income taxes increased to \$40.3 million from \$31.2 million as a result of recording depreciation for tax purposes in excess of depreciation charged against income.

Preferred share equity decreased by \$1.1 million as 22,200 shares were purchased for cancellation during the year. Common shares outstanding increased \$14.7 million primarily due to the common stock dividend of \$6.7 million and shares issued to acquire the remaining 50% interest in Pinette & Therrien Mills Limited.

The foreign currency adjustment increased to \$36.5 million from \$19.7 million due to the weakening of the Canadian dollar and the reclassification of a hedge applicable to U.S. dollar debt.

Common shareholders' equity at December 31, 1985 totalled \$446.4 million or \$8.80 per common share for 50,719,750 outstanding common shares. At the end of 1984, common share equity was \$391.9 million or \$7.98 per common share for 49,102,070 common shares. The trading of the Company's shares on the Vancouver, Alberta, Toronto and Montreal Stock Exchanges amounted to 12,113,422 common and 42,960 preferred shares. The price range during 1985 on The Toronto Stock Exchange for common shares was \$8.38 to \$12.50 and for preferred shares \$32.00 to \$41.00. At year end there were 4,628 common and 655 preferred shareholders holding 50,719,750 and 91,700 shares respectively.

Consolidated Statement of Earnings and Earnings Reinvested in the Business

British Columbia Forest Products Limited

For the Year Ended December 31, 1985
(in thousands of dollars)

	1985	1984
Net Sales	<u>\$1,139,963</u>	<u>\$1,014,726</u>
Costs and expenses		
Cost of products sold	902,144	819,783
Depreciation and depletion	62,260	61,512
Selling and administration	57,392	50,808
Interest on long term debt	59,994	71,919
Other interest	5,625	6,599
	<u>1,087,415</u>	<u>1,010,621</u>
	52,548	4,105
Other income		
Earnings from associate companies before income taxes	395	10,165
Gain on disposal of fixed assets	5,728	396
Investment and other income	14,411	7,621
	<u>73,082</u>	<u>22,287</u>
Earnings Before Income Taxes	<u>73,082</u>	<u>22,287</u>
Income taxes (Note 9)		
Current	36,536	27,212
Deferred	5,388	(18,600)
Share of income taxes of associate companies	1,073	4,485
	<u>42,997</u>	<u>13,097</u>
Net Earnings	30,085	9,190
<i>Per common share</i>	\$0.60	\$0.18
Earnings reinvested in the business at beginning of year	<u>212,934</u>	<u>210,288</u>
	243,019	219,478
Dividends		
6% preferred shares	292	342
Common shares (Note 8)	6,739	6,202
	<u>7,031</u>	<u>6,544</u>
Earnings Reinvested in the Business at End of Year	<u>\$ 235,988</u>	<u>\$ 212,934</u>

Consolidated Balance Sheet

British Columbia Forest Products Limited

As at December 31, 1985
(in thousands of dollars)

	1985	1984
Assets		
Current Assets		
Cash and short term investments	\$ 3,319	\$ 21,174
Accounts receivable	130,009	147,639
Inventories (Note 2)	170,520	148,731
Prepaid expense	5,707	6,039
	<u>309,555</u>	<u>323,583</u>
Long Term Investments and Advances		
Investment in associate companies (Note 3)	42,785	54,801
Other investments and advances (Note 4)	36,445	36,324
	<u>79,230</u>	<u>91,125</u>
Fixed Assets (Note 5)		
Property, plant and equipment	611,797	616,027
Timberlands and logging roads	171,688	170,440
	<u>783,485</u>	<u>786,467</u>
Deferred Charges (Note 6)	<u>31,888</u>	<u>15,998</u>
	<u>\$1,204,158</u>	<u>\$1,217,173</u>

Approved by the Directors



Director



Director

Consolidated Balance Sheet

British Columbia Forest Products Limited

As at December 31, 1985
(in thousands of dollars)

	1985	1984
Liabilities		
Current Liabilities		
Bank loans (Note 7)	\$ 55,842	\$ 56,101
Accounts payable and accrued liabilities	104,565	94,325
Dividends payable	69	85
Income taxes payable	256	8,991
Current portion of long term debt	12,911	10,952
	<u>173,643</u>	<u>170,454</u>
Long Term Debt (Note 7)	<u>539,188</u>	<u>617,989</u>
Deferred Income Taxes	<u>40,318</u>	<u>31,177</u>
Shareholders' Equity		
Share Capital (Note 8)		
6% cumulative preferred shares of \$50 par value, redeemable at \$53 Authorized — 240,000 shares Outstanding — 91,700 shares (1984 — 113,900 shares)	4,585	5,695
Common shares without par value Authorized — 60,000,000 shares Outstanding — 50,719,750 shares (1984 — 49,102,070 shares)	<u>173,981</u>	<u>159,254</u>
	178,566	164,949
Earnings Reinvested in the Business	235,988	212,934
Foreign Currency Adjustment (Note 10)	36,455	19,670
	<u>451,009</u>	<u>397,553</u>
	<u>\$1,204,158</u>	<u>\$1,217,173</u>
Commitments and Contingencies (Notes 8 and 12)		

Consolidated Statement of Changes in Financial Position

British Columbia Forest Products Limited

For the Year Ended December 31, 1985
(in thousands of dollars)

	1985	1984
Cash Provided By (Used For)		
Operations		
Net earnings	\$ 30,085	\$ 9,190
Items not requiring an outlay of cash		
Depreciation and depletion	62,260	61,512
Deferred income taxes	5,388	(18,600)
Associate companies (Earnings) losses	678	(5,680)
Dividends received	6,873	7,016
Other	(4,164)	4,243
	<u>101,120</u>	<u>57,681</u>
Cash generated from (used for) operating working capital (below)	(2,322)	(28,380)
	<u>98,798</u>	<u>29,301</u>
<i>Per common share</i>	<u>\$1.98</u>	<u>\$0.60</u>
Financing		
(Decrease) increase in term loans	(78,162)	14,831
Repayment of long term debt	(15,726)	(10,785)
(Decrease) increase in current bank loans	(259)	318
Issue of common shares		
For cash	429	299
On acquisition of subsidiary (Note 8)	7,602	—
Purchase of preferred shares	(860)	(239)
Dividends paid	(351)	(370)
	<u>(87,327)</u>	<u>4,054</u>
Investment		
Additions to fixed assets	(36,149)	(16,215)
Proceeds from disposal of fixed assets	11,418	1,425
Investments and advances	(4,595)	(587)
	<u>(29,326)</u>	<u>(15,377)</u>
(Decrease) Increase in Cash	<u>(17,855)</u>	<u>17,978</u>
Cash at Beginning of Year	<u>21,174</u>	<u>3,196</u>
Cash at End of Year	<u>\$ 3,319</u>	<u>\$ 21,174</u>
Cash generated from (used for) operating working capital		
Accounts receivable	17,630	(24,027)
Income taxes payable	(8,735)	2,236
Inventories	(21,789)	(4,594)
Prepaid expenses	332	(504)
Accounts payable	10,240	(1,491)
	<u>\$ (2,322)</u>	<u>\$(28,380)</u>

(Cash is defined to include cash and short term investments.)

Notes to Consolidated Financial Statements

British Columbia Forest Products Limited

1. Significant Accounting Policies

(a) Basis of Consolidation

The consolidated financial statements include Blandin Paper Company, BCFP Coast Sawmills Limited (formerly Fraser River Pile Driving Company Limited which sold its pile driving business in 1985), Croftech Inc., Pinette & Therrien Mills Limited (50% owned at December 31, 1984), Stuart Channel Transportation Limited and Swiftsure Towing Company Ltd., all of which are wholly owned.

(b) Inventories

Inventories, other than supplies which are valued at cost, are valued at the lower of average cost and net realizable value.

(c) Investment in Associate Companies

Investments in Donohue St-Félicien Inc. (45% owned), and Finlay Forest Industries Ltd. (42.7% owned) are accounted for by the equity method, whereby the Company takes into earnings and reflects in the investment account its share of the earnings or losses; dividends received are credited to the investment account. In the statement of earnings the equity in earnings or losses of associate companies is shown before income taxes with income taxes shown separately. The investment in Pinette & Therrien Mills Limited during 1984 was accounted for by the equity method.

(d) Fixed Assets

Fixed assets are stated at cost, which for major expansion projects includes interest on funds borrowed for their construction. Plants, buildings and equipment are depreciated on a straight-line basis at rates (ranging from 3% to 15% per annum) which reflect estimates of the economic life of the assets. Timberlands and logging roads are amortized in a systematic manner based on the utilization of the timber resources.

(e) Foreign Currency Transactions

The assets and liabilities of the Company's Canadian operations denominated in foreign currencies are translated at the year end exchange rates. Gains or losses on translation of current assets and current liabilities are reflected in net earnings for the year. Unrealized foreign currency losses on long term debt are recorded as a deferred charge. For U.S. funds long term debt not hedged by forward contracts, the Company utilizes a revenue stream hedge whereby exchange losses are recorded when repayments are made.

The assets and liabilities of self-sustaining foreign subsidiaries are translated at the year end rates of exchange with the resulting foreign currency adjustment forming part of shareholders' equity. Revenue and expense items are translated at the rates of exchange prevailing during the year.

(f) Income Taxes

Commencing in 1985, investment tax credits are amortized over the life of the assets to which they relate.

2. Inventories

<i>(in thousands of dollars)</i>	1985	1984
Logs and wood chips	\$ 77,982	\$ 63,347
Lumber and other wood products	29,529	29,103
Pulp, paper and newsprint	21,755	17,603
Supplies	41,254	38,678
	<u>\$170,520</u>	<u>\$148,731</u>

3. Investment in Associate Companies

<i>(in thousands of dollars)</i>	1985	1984
Donohue St-Félicien Inc.	\$ 41,214	\$ 46,520
Finlay Forest Industries Ltd.	1,571	4,339
Pinette & Therrien Mills Limited	—	3,942
	<u>\$ 42,785</u>	<u>\$ 54,801</u>

Notes to Consolidated Financial Statements

British Columbia Forest Products Limited

Condensed financial information for associate companies accounted for by the equity method has been summarized below for 1985, with comparative figures excluding Pinette & Therrien Mills Limited for 1984.

<i>(in thousands of dollars)</i>	December 31, 1985	December 31, 1984
Working capital	\$ 85,129	\$ 91,715
Fixed assets	209,282	225,874
Deferred charges	23,598	19,752
Other assets	943	2,933
	<u>318,952</u>	<u>340,274</u>
Less: Long term debt	205,488	210,429
Deferred taxes	40,044	41,411
Shareholders' equity	<u>\$ 73,420</u>	<u>\$ 88,434</u>
Net Sales	<u>\$280,080</u>	<u>\$288,169</u>
Net Earnings	<u>\$ 259</u>	<u>\$ 12,400</u>
BCFP's Share of Net Earnings	<u>\$ 191</u>	<u>\$ 5,852</u>

The Company has not guaranteed any debts of associate companies at December 31, 1985.

4. Other Investments and Advances

<i>(in thousands of dollars)</i>	1985	1984
Western Forest Products Limited	\$ 24,513	\$ 25,521
Other, at cost	11,932	10,803
	<u>\$ 36,445</u>	<u>\$ 36,324</u>

The Western Forest Products Limited investment represents a 19.4% voting interest and is the carrying value at January 1, 1984 less subsequent amortization of interest charges deferred during the initial reorganization.

5. Fixed Assets

<i>(in thousands of dollars)</i>			1985
	Cost	Accumulated Depreciation and Depletion	Net Book Value
1985			
Property, plant and equipment			
Pulp and paper mills	\$ 713,899	\$333,981	\$379,918
Sawmill and other wood products plants	355,936	161,791	194,145
Logging buildings and equipment	63,894	46,123	17,771
Other equipment and facilities	16,374	11,786	4,588
Land	15,375	—	15,375
	<u>\$1,165,478</u>	<u>\$553,681</u>	<u>\$611,797</u>
Timberlands and logging roads	<u>\$ 262,211</u>	<u>\$ 90,523</u>	<u>\$171,688</u>
1984			
Property, plant and equipment			
Pulp and paper mills	\$ 685,899	\$301,409	\$384,490
Sawmill and other wood products plants	319,592	131,132	188,460
Logging buildings and equipment	63,220	42,606	20,614
Other equipment and facilities	25,225	17,089	8,136
Land	14,327	—	14,327
	<u>\$1,108,263</u>	<u>\$492,236</u>	<u>\$616,027</u>
Timberlands and logging roads	<u>\$ 253,167</u>	<u>\$ 82,727</u>	<u>\$170,440</u>

6. Deferred Charges

<i>(in thousands of dollars)</i>	1985	1984
Unrealized foreign exchange losses on long term debt	\$ 30,942	\$ 14,929
Unamortized debt discount and expenses	946	1,069
	<u>\$ 31,888</u>	<u>\$ 15,998</u>

Notes to Consolidated Financial Statements

British Columbia Forest Products Limited

7. Long Term Debt

<i>(in thousands of Canadian dollars)</i>	1985	1984
British Columbia Forest Products Limited		
Sinking fund debentures		
Series B, 5½% due 1989	\$ 4,459	\$ 5,070
Series C, 6½% due 1992	7,689	8,378
Series D, 9¾% due 1992	11,236	11,613
Series E, 9% due 1995	25,105	26,862
Series F, 8.95% due 1997 (U.S. \$33,400,000; 1984 — U.S. \$34,720,000)	46,677	45,879
Series G, 11½% due 2001 (U.S. \$58,020,000; 1984 — U.S. \$60,000,000)	81,083	79,284
	<u>176,249</u>	<u>177,086</u>
Purchase money mortgage due 1986-1990 (U.S. \$21,331,000; 1984 — U.S. \$23,998,000)	29,810	31,711
18-month notes due to bank, secured (including U.S. \$60,000,000; 1984 — U.S. \$95,000,000)	142,955	180,717
Bankers' acceptances and notes payable due in following year	179,600	220,000
Other	8,462	2,249
	<u>537,076</u>	<u>611,763</u>
Blandin Paper Company		
Notes payable, 10¼% due 1986-1988, unsecured (U.S. \$10,750,000; 1984 — U.S. \$13,000,000)	15,023	17,178
	<u>552,099</u>	<u>628,941</u>
Less current portion of long term debt	12,911	10,952
	<u>\$539,188</u>	<u>\$617,989</u>

Subject to fixed charges granted on specific assets, the sinking fund debentures are secured by a first floating charge on the assets of the Company. The bank loans, the 18-month bank notes and the bankers' acceptances are secured by a charge on inventory, an assignment of accounts receivable and, in the case of 18-month notes and bankers' acceptances included under long term debt, by a \$350 million second floating charge debenture on all other assets of the Company. The purchase money mortgage is secured by the shares of Blandin Paper Company.

The purchase money mortgage and the U.S. dollar 18-month notes due to bank bear interest at rates (averaging 9.6% on December 31, 1985) which fluctuate with the lender's prime rate or, at the Company's option, rates which are fixed for varying periods and based on Eurodollar rates. The balance of the 18-month notes bear interest at prime rates plus ¼ of 1%.

Arrangements with the Company's bankers permit the Company to repay the bankers' acceptances and notes payable due in 1986 out of the proceeds of bank loans which would be due 18 months from the date of issue. Accordingly, the bankers' acceptances and notes payable, which bear interest at an average rate of 9.9%, are classified as long term debt and are included in the principal due in 1987.

The U.S. dollar 18-month notes due to bank are hedged by specific forward contracts. Unrealized exchange losses on the Series F and G sinking fund debentures and the purchase money mortgage are hedged by future revenue streams.

Payments on long term debt required to 1990 are as follows:

(in thousands of dollars)

1986	\$ 12,911
1987	336,000
1988	21,000
1989	19,000
1990	22,000

Notes to Consolidated Financial Statements

British Columbia Forest Products Limited

8. Share Capital

(a) Issue of Additional Common Shares

In February, 1985 the Company issued 760,227 common shares at \$10.00 per share to purchase the remaining 50% interest in Pinette & Therrien Mills Limited.

In November, 1985 the Company paid a stock dividend consisting of 783,129 common shares at \$8.55 per share.

At December 31, 1985 there were options outstanding under the terms of the Company's Employee Share Option Incentive Plan to purchase an aggregate of 1,019,851 common shares. The options are exercisable over a ten year period, on a cumulative basis commencing one year after the date of grant. Option prices, which range from \$5.00 to \$14.25 per share, are not less than the price at which the last board lot traded on The Toronto Stock Exchange immediately preceding the date of each grant. In 1985 74,324 shares were issued under this plan for \$428,434.

Under an agreement with the partners of the Western Pulp Limited Partnership, the Company is contingently obligated to issue a maximum of 1,955,555 common shares commencing April 1, 1987 in exchange for units of the Partnership. The maximum dilutive effect of this exchange to the Company is 4% of the common shares outstanding at December 31, 1985.

(b) Purchase of Preferred Shares

The Company is obligated, subject to certain relief provisions, to purchase 7,200 preferred shares annually for cancellation when available at \$50 per share or less including costs of purchase. In 1985, 22,200 shares were purchased and cancelled at an average cost of \$38.74 per share, reducing preferred share capital by \$1,110,000.

9. Income Taxes

The Company's income tax provision is as follows:

	1985	1984
Statutory rate of Federal and Provincial taxes, net of manufacturing and processing credit of 6%	<u>46.9%</u>	<u>46.0%</u>
<i>(in thousands of dollars)</i>		
Expected income taxes	\$ 34,275	\$ 10,252
Differences from expected taxes:		
Inventory allowance deduction	(1,490)	(1,401)
Foreign taxes in excess of Canadian taxes	2,464	1,468
Withholding tax on dividends	7,044	2,725
Miscellaneous	<u>704</u>	<u>53</u>
Income tax provision	<u>\$ 42,997</u>	<u>\$ 13,097</u>
Effective rate of income tax	<u>58.8%</u>	<u>58.8%</u>

Notes to Consolidated Financial Statements

British Columbia Forest Products Limited

10. Foreign Currency Adjustment

The Company's foreign currency adjustment is comprised of the following:

Balance at beginning of year	\$19,670
Increase resulting from change in exchange rates through 1985	10,818
Effect of reclassifying hedge applicable to certain U.S. dollar debt	5,967
	<u>\$36,455</u>

11. Related Party Transactions

Related parties as defined by the Canadian Institute of Chartered Accountants include The Mead Corporation, Scott Paper Company and Finlay Forest Industries Ltd. (and Pinette & Therrien Mills Limited to December 31, 1984), together with their subsidiaries and affiliates.

Sales to related parties for the years 1985 and 1984 amounted to \$67,258,000 and \$72,433,000 respectively. Purchases from related parties for the years 1985 and 1984 amounted to \$21,878,000 and \$24,426,000 respectively.

The prices and terms of these transactions are in accordance with normal trade practice. The net amount of trade receivables from these companies at December 31, 1985 was \$8,353,000 and at December 31, 1984 was \$21,014,000.

12. Commitments and Contingencies

(a) Under a contingency fund agreement, the Company may be called upon to loan Western Pulp Limited Partnership up to \$10,000,000 which reduces to \$5,000,000 effective October 1, 1986 and decreases thereafter to June 30, 1990 when the commitment terminates.

(b) Under certain conditions, the Company is obligated, commencing March 31, 1986, to purchase up to \$10,000,000 of convertible preferred shares of Western Forest Products Limited.

(c) The Company has no additional material commitments or contingencies other than those incurred in the ordinary course of business, except for those disclosed in Note 8.

13. Employee Retirement Plans

The Company and its Canadian subsidiaries maintain pension plans open to all salaried employees and hourly employees not covered by union pension plans. The Company's U.S. subsidiary maintains various pension plans which cover substantially all of its employees. Based on actuarial evaluations of these plans as of December 31, 1984 and August 1, 1984 respectively there was no unfunded liability for past services.

14. Segmented Information

Information concerning the Company's business on a segmented basis is set out in the Statement of Segmented Information which follows:

Notes to Consolidated Financial Statements

British Columbia Forest Products Limited

14. Segmented Information (Continued)

Year ended December 31, 1985
(in millions of Canadian dollars)

	Canada		United States		Consolidated	
	1985	1984	1985	1984	1985	1984
Revenue						
Sales to external customers	<u>\$799.6</u>	<u>\$709.4</u>	<u>\$340.4</u>	<u>\$305.3</u>	<u>\$1,140.0</u>	<u>\$1,014.7</u>
Earnings						
Earnings before interest and income taxes	<u>\$ 53.5</u>	<u>\$ 40.6</u>	<u>\$ 85.2</u>	<u>\$ 60.2</u>	<u>\$ 138.7</u>	<u>\$ 100.8</u>
Interest					(65.6)	(78.5)
Income taxes					(43.0)	(13.1)
Net earnings					<u>\$ 30.1</u>	<u>\$ 9.2</u>
Total Assets	<u>\$938.7</u>	<u>\$939.0</u>	<u>\$265.5</u>	<u>\$278.2</u>	<u>\$1,204.2</u>	<u>\$1,217.2</u>
Depreciation and Depletion	<u>\$ 44.1</u>	<u>\$ 44.3</u>	<u>\$ 18.2</u>	<u>\$ 17.2</u>	<u>\$ 62.3</u>	<u>\$ 61.5</u>
Additions to Fixed Assets	<u>\$ 28.9</u>	<u>\$ 10.0</u>	<u>\$ 7.2</u>	<u>\$ 6.2</u>	<u>\$ 36.1</u>	<u>\$ 16.2</u>

Revenue

Canadian sales include export sales amounting to \$602.3 million (1984 — \$533.9 million).

Management Comments

Forest products operations in Canada are fully integrated, involving extensive transfers of logs and chips among divisions. In view of the total dependence of manufacturing plants on an adequate supply of suitable raw materials, the profitability of any individual business unit may not represent the value of the product to the Company as a whole. For this reason the Company views its forest products business as a unitary business and believes it can be best understood as presented above.

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