EMPLOYEE COMMITMENT, INVOLVEMENT KEY TO FUTURE FOR JACK CREIGHTON, WEYERHAEUSER'S CEO

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A CANDID INTERVIEW ON ISSUES FACING THE INDUSTRY

Editor's Note: Weyerhaeuser is one of the giants of the industry. Based on the shores of Puget Sound in the state of Washington, Weyerhaeuser strives for a balance between its forest products and paper products. A recent article in Business Week *magazine described Weyerhaeuser's efforts to please both its shareholders and environmentalists. John W. "Jack" Creighton Jr., president and CEO of Weyerhaeuser, was interviewed after his keynote address to the TAPPI Environmental Conference on May 4, 1997. As the third in a* TAPPI JOURNAL *series of interviews with industry leaders, Creighton provides insight into a company that has accepted the challenge of operating in the spotlight of the sensitivities of the West Coast and the scrutiny of Wall Street without selling either community short.*

With more than US$ 11 billion dollars in sales in 1996, Weyerhaeuser's dependence on the natural resources of the areas it operates in have made it one of the most visible companies in the North American industry. Pioneering "a love affair with our forests," Weyerhaeuser's CEO has a high-profile position within the forest products industry, speaking at conferences and to those who follow the industry, to tell the story that the industry can and must view required capital expenditures for environmental purposes as opportunities for return for the shareholder. Pioneering employee stock ownership is just one of the ways that Weyerhaeuser has sought to enhance the creativity of its most important asset, its human capital.

Weyerhaeuser President and CEO John W. "Jack" Creighton Jr.

TAPPI JOURNAL: As the leader of Weyerhaeuser, what challenges do you see that face any North American paper-producing company between now and the turn of the century? What specific challenges face Weyerhaeuser?

CREIGHTON: The paper industry has done a terrible job financially in that it has not earned the cost of capital on average, over the last 10 years, and Weyerhaeuser isn't much different from the industry. So, based on track record, neither Weyerhaeuser nor the industry has done a very good job for its shareholders and that needs to change.

TAPPI JOURNAL: Why haven't we done that over the past two decades?

CREIGHTON: I think there have been some external factors but the primary reason is that we have not used our capital wisely. To some degree, management of the industry has been more interested in making pulp and paper mills than in making paper.

TAPPI JOURNAL: In your opinion, are we making the right product—is the industry still making a product that the market wants?

CREIGHTON: That is not an issue; paper is still a viable product.

TAPPI JOURNAL: In a recent speech, you talked about some of the issues that cyclicality causes in the industry. Do you believe that reducing the cyclicality would be a net positive for the entire industry?

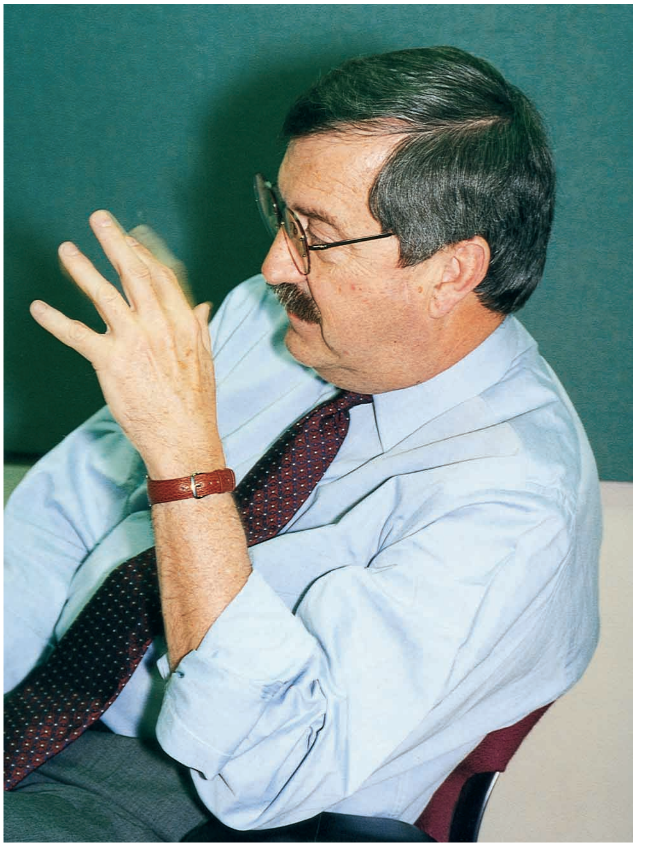
CREIGHTON: It would be a strong positive for the industry because when you have cyclicality there is a tendency to do things in a jerky fashion; you delay doing things and then all of a sudden you start them up or visa versa. To me there is a parallel with taking a mill down. In taking a mill down, there are costs associated with the shutdown, and bringing it back up is expensive. There are a lot of parallels between that and how people operate companies through cycles.

TAPPI JOURNAL: When you look at Weyerhaeuser as an organization, what is the current breakdown between the paper and the solid wood divisions in Weyerhaeuser, and are you comfortable with that in terms of your balance?

CREIGHTON: Depending on what point in the cycle we're at, the relationship is about 50–50. About half of our earnings potential is on the pulp and paper side and half of it is on raw materials and building materials. We have a small real estate operation, but the two major sectors are an even match. We think that gives us stability because obviously the cycle on raw material and building materials is normally slightly ahead of pulp and paper and packaging.

TAPPI JOURNAL: Following on in that vein, in your opinion, are companies with forest assets better positioned for growth and stability than those who depend strictly on market availability of fiber?

CREIGHTON: I think they are. We feel that investment in timberlands on a long-term basis provide excellent returns; when you go back almost 100 years and look at the real returns that we received on our timberlands, they are excellent.

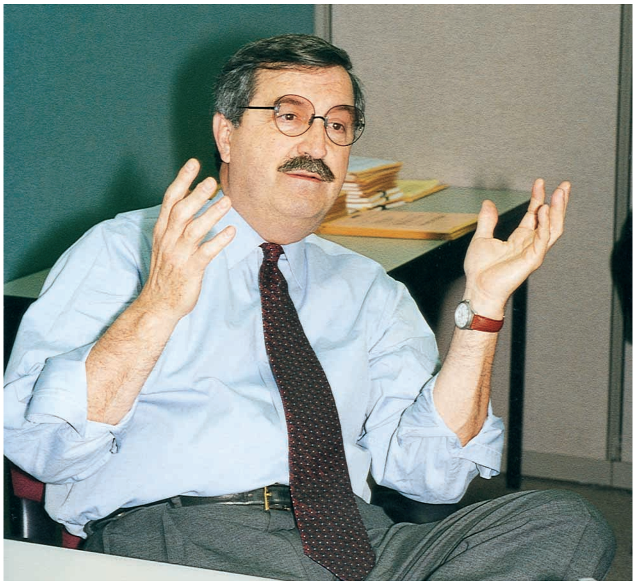


TAPPI JOURNAL: So, looking at your comment earlier on cyclicality, the broadness of the base, in your opinion, is part of what you're doing to dampen cyclicality for Weyerhaeuser.

CREIGHTON: Yes.

TAPPI JOURNAL: Shifting focus a little, how has the strength of the domestic market place affected, if at all, your overseas strategies for Weyerhaeuser? Has the domestic market kept you from seeking overseas markets because it's consumed a lot of the product, or has it forced you to seek them in order to offset the cyclicality variability?

CREIGHTON: In certain product lines, the demand by our domestic customers is outstripping our productive capacity so to some degree the strength of the domestic market has held us back from international markets. On the other hand, because of the positioning of a fair amount of our assets in the Pacific Northwest, Japan is a very natural market for us. We almost view Japan as a domestic market because of our proximity to the country, because of our long history in Japan, and because in some product lines we have a greater market share in Japan than we do in the United States.



TAPPI JOURNAL: What about other parts of Asia?

CREIGHTON: There are two drivers, in my opinion, to any international strategy. One is the fiber and there you are talking about the Southern Hemisphere. The second is demand and there you're talking about Asia, so from our standpoint, the two big factors in an international strategy are raw material and the customer.

TAPPI JOURNAL: In your opinion, is export preferable to locating production facilities overseas? In other words, is there a net advantage for you as Weyerhaeuser to make it here and sell it there?

CREIGHTON: There is no single answer to that question. Obviously when I talk about fiber and fast-growing softwood and hardwood, I'm talking about the Southern Hemisphere. Although we're the largest exporter of forest products from the United States, ultimately you've got to source your large customers from more than one point. Therefore, it makes sense to put some of your productive capacity in places other than North America.

TAPPI JOURNAL: Strategically, where do you see Weyerhaeuser relative to other North American companies or world companies, in terms of growth potential?

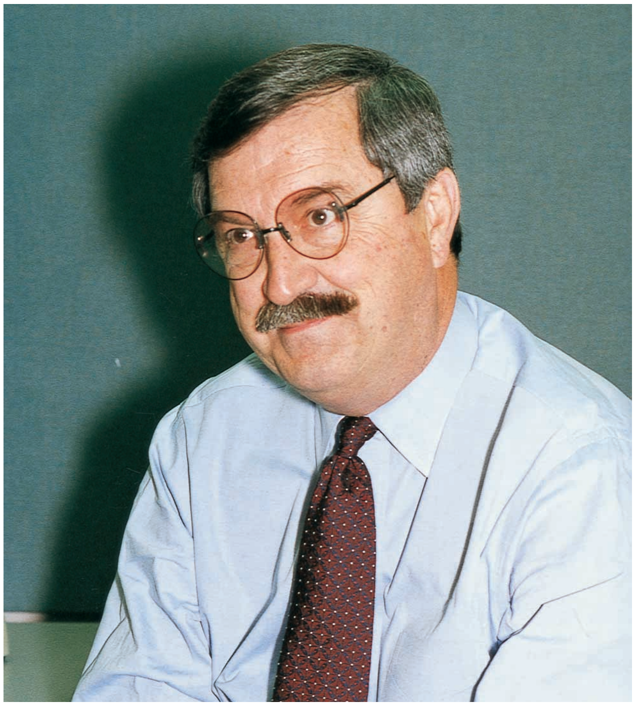
CREIGHTON: Our growth potential is above average. I say that, one, because we have a very strong balance sheet so we have the financial ability to grow. Second, we do sell products in about 60–70 countries in the world, so we have developed market access and channels of distribution overseas. Third is sort of the match between the fact that we're the largest exporter to Asia, and Asia is where the big demand growth is going to come from in the future. Our ability to grow is strong; the key is to grow profitably and I think that part of the problem, going back to your first question, is often times you get enamored with growth and forget about the bottom line. Our commitments are to growth and to profitability.

TAPPI JOURNAL: What distinguishes Weyerhaeuser from other pulp and paper companies? What makes you unique?

CREIGHTON: The most unique characteristic of Weyerhaeuser is its love affair with the forests, with the softwood forests, and also uniquely looking at trees primarily as a building material first and then as pulp and paper material second. I don't mean to downplay our fiber businesses, but we go after extraction of the highest value from the tree now.

TAPPI JOURNAL: That's real consistent with your advertising campaigns over the years. I think they've always been really good about that. Is it true that you have less dominance or less concentration in the Northwest than you did a decade or so ago?

CREIGHTON: Yes.



TAPPI JOURNAL: In your speech in Brazil, you listed three imperatives for our industry. One was to be profitable, number two was to perform well environmentally, three was listen to our stakeholders. If the industry did that, what in your opinion would be the outcome?

CREIGHTON: I think it would be an industry that is very viable, that would have the returns to attract capital, that would have the money to keep its mills operating very efficiently and effectively and very environmentally sound. I think it would be a growth industry because there is a huge demand out there for pulp and paper packaging products on a world scale and I think it would allow us to continue our world leadership in this industry.

TAPPI JOURNAL: When we talked about capital intensity, one thing that struck me in your speech was that you said, "with capital at Weyerhaeuser, one thing you try to evaluate is, are you better off to acquire an existing facility rather than build a new one." To what extent is that driven by the fact that the technology has not moved forward to the point that a 20- to 25-year-old facility is still productive and viable?

CREIGHTON: There is a caveat to that statement. It's cheaper to buy than build when you buy a good-running, environmentally sound mill. In this business, it makes no sense to buy a tired, worn-out facility, because the environmental capital requirements in the future, when added to what might appear to be a bargain purchase price, make it less than a bargain. Personally, I don't think that the economics work that well for the "build, don't buy" philosophy when it comes to marginal facilities. And the second thing is, in addition to buying something that has good hardware, you want to buy a facility that has a good human resource system.

Now, the advantage in buying an up-and-running mill is that you have cash flow the first day you own it. You could even have profitability the first day. With a greenfield facility, it takes you—between permitting and construction— two to three years or even longer before that mill ever starts to have a positive cash flow. In buying a tired, worn-out facility I believe you have the same situation.

TAPPI JOURNAL: If you could make a call to the members of TAPPI who are involved in driving and leading the technology development area, what would you ask them to do in terms of technology as it relates to the issue of capital intensity?

CREIGHTON: I think the real challenge there is how are we going to either marry or match the environmental improvements with the need for economic return. The remarks today talked about environmental expenditures as an investment, not as a cost. I think it takes some creativity to change it from a cost into an investment, and I didn't mean to say that putting something into the mill that improves the environment is automatically going to give you a return; there's got to be creativity on the part of the planners, engineers, operators, and financial people. You need to look at the whole mill and how you can get environmental benefits and still have economic returns. That isn't an easy task but I believe that's the real challenge for the people who develop and implement technology.

TAPPI JOURNAL: In an earlier speech, you stated that one of the best ways to improve profitability is by "aligning the interests of our employees more closely with those of our shareholders." You have instituted a profit sharing plan and changed the bonus plan for company leaders. Is that a key?

CREIGHTON: Yes. It's not just profit sharing; it's profit sharing coupled with stock ownership. People have to see that the operations of the company have a direct impact on them financially.

TAPPI JOURNAL: Your approach is very different than many other industry leaders in terms of the involvement of the employees and the stakeholders issue. What are

your beliefs about that? As you follow through on that, what are your long-term goals; what do you expect to see come from your approach?

CREIGHTON: I would hope to see a more committed work force, a work force who understands the economics of a manufacturing company, especially a forest-based manufacturing company. I would like every employee in the company to understand the concept of return on net assets (RONA). And also understand how they, in their job or set of responsibilities, can positively impact that return on assets.

There is a lot of rhetoric in American business today about employees being empowered, employees taking ownership of their job and their responsibilities. However, sooner or later the employee is going to say, "what is in it for me?" What we're saying at Weyerhaeuser is, "we're willing to share ownership of this company with you." Every employee that worked for us for 12 months in 1996 was awarded shares of Weyerhaeuser common stock. I believe that the more we can get Weyerhaeuser employees thinking like shareholders, the better off the company will be.

TAPPI JOURNAL: The paper industry traditionally has a long-term payback horizon, but has a near-term investment horizon. Isn't that almost an apparent contradiction there between the interest in investment and the interest of the industry in terms of being more long-term?

CREIGHTON: People on Wall Street like the concept of the senior managers having to own stock in the company. We've got a requirement, depending on where you are in the senior management, that you have to own a certain amount of stock. For example, I am required to own three times my salary in Weyerhaeuser stock. Investment analysts like that concept and they like bonuses that are tied to profitability. However, I think the concept of spreading that to all employees is probably not as palatable to them, partly because analysts don't appear to believe that rank and file employees can impact the profits. We made the change to employee stock ownership about three or four years ago; Boeing did it last year with a little different wrinkle to it—stock options. We're ahead of the curve on this.

TAPPI JOURNAL: This is one of the "technical" questions. If you could take the top 50% of your mills and your paper machines, only the newest ones, the best and the fastest, and double their speed tomorrow, what impact would you see that having on productivity and capital intensity? Would the infrastructure that you've built for your mills be able to handle that impact?

CREIGHTON: I don't know that we would have enough wood to service them. Fiber supply in most areas of the country is currently in balance and this would almost double fiber demand. The future fiber picture at Weyerhaeuser Co. is bright since we were the first company to start high-yield forestry. If you look out to the year 2002, the yield levels in our forests really start to ramp up and by the year 2020, which isn't that far off, we will be harvesting anywhere between 50–70% more wood off our lands than we can today.

TAPPI JOURNAL: In other words, lowering the capital intensity is not simply a matter of increasing the throughput in existing facilities?

CREIGHTON: Lowering the capital intensity and requirements of the industry is not easy. One reason is over-capacity. This industry has too much capacity.

TAPPI JOURNAL: From a standpoint of capital intensity and utilization, is there any benefit in taking existing capital and dramatically increasing production from it? Or is it in the future that we have to worry? For instance, if you have to replace a paper machine, the cost is 50 million, not a quarter of a million dollars.

CREIGHTON: That is part of it. The industry has taken the easy route in this area. Our typical answer is "let's build a big, new greenfield mill, the widest and the fastest and lower our incremental costs of production." I'm saying, "let's look at the assets we've got; let's wring more production out of those assets, and let's make more efficient use of scarce capital." So, we're looking at efficiency improvements as one way of dealing with the future.

TAPPI JOURNAL: In the time you've spent with Weyerhaeuser and in the industry what do you consider your greatest achievements?

CREIGHTON: I think the greatest personal achievement is getting Weyerhaeuser aligned with the requirements of the 21st Century. That seemed a long way off in 1991.

TAPPI JOURNAL: What has given you the most satisfaction as part of the pulp and paper industry?

CREIGHTON: Spending time with employees on the mill floor and in the forests and offices. I don't know exactly how to put it but to a great extent it's the interaction with our people. I think that too often, people associate leadership with talking, with one-way communication. I think it's critical for a leader to listen. I think it's critical for a company to listen, to understand what's on people's minds, whether they're employees or shareholders, customers, or people in our communities. Probably the most interesting thing I've done as leader at Weyerhaeuser is our "Town Hall" meetings. Through newspaper ads and personalized invitations, we invited citizens in general and business, government, and environmental leaders to attend a meeting whose primary purpose was to seek their input on how Weyerhaeuser was doing in their community. You also get that same honesty out in the mill. I've had guys out in the forests talk about a subject and they tell me "it stinks" and I need to hear that. I think too often there are too many buffers, either by reason of Weyerhaeuser employees who don't want me to hear bad news, not because it's going to reflect negatively on me, they just want to relieve me of the pain of hearing it. A leader has to be out there in the traffic and listen.

TAPPI JOURNAL: Lastly, we appreciate you coming to a TAPPI conference and speaking to the members of the industry on the technical side. If they were not here and I asked you this question, "what do you see as TAPPI's role, both at Weyerhaeuser and in the industry and how can it better serve the industry?"

CREIGHTON: Many people in Seattle, home of Microsoft and Boeing, have the tendency to think of the forest products industry as a dinosaur. They don't realize, particularly on the pulp and paper side—and the forestry side—the technology that is employed there, how they currently operate, and how we're going to operate in the future. So it seems to me that TAPPI, the membership of TAPPI, the people involved in TAPPI, the companies and the suppliers and other people, have played and are going to play a very critical role in the future of this industry, not only in the environmental arena, but in the arena of productivity and effectiveness and efficiency. It's very, very important.

Coleman is director of journals at TAPPI.