ROYER BRINGS NEW VISION TO DOMTAR

MATTHEW J. COLEMAN

CEO FOCUSING ON EXPANSION AND CUSTOMER NEEDS

RAYMOND ROYER IS THE "NEW KID ON THE BLOCK" in the sense that he is not from the paper industry but instead brings with him the success he had as the CEO of Bombardier, a Canadian aerospace company. To transition from aerospace to a basic industry like pulp and paper was an important choice for Royer and his approach to business reflects not only his background in his previous career, but how much he has learned from the paper industry. He has made Domtar one of the active players in the North American market and seeks to increase its size and influence in the years to come. His vision is focused but he still is aware of the scope of the industry he competes in. Certainly, the change to a more global industry with a greater emphasis on new business strategies will give us leaders with backgrounds very different from what we have seen in the past. Raymond Royer is one of the new leaders and one of the more emphatic change agents in an industry already in rapid change.

TAPPI JOURNAL: *From your perspective, what do you regard as the major challenges facing North American paper producers over the next decade?*
Royer: I believe the industry has to focus primarily on two priorities. First, we have to carefully scrutinize the way we utilize our fibre resources, to ensure that our products offer at least equal or-preferably-superior value to those offered by the competition. Incidentally, I consider "the competition," to include both paper and forest products companies elsewhere in the world as well as manufacturers that use rival materials like plastics to compete with us in packaging and other sectors.

The other priority I believe our industry must address without delay is the whole issue of markets. How do we best protect our traditional markets-and from whom? Where do the serious competitive threats lie? In a global industry like ours, we sometimes tend to forget that, while we are busy shipping our products to new markets, offshore rivals may well be looking to exploit opportunities to sell right into our own backyards.

I'm not sure at this point in time just what are the definitive answers to these challenges-although I do have some views. For starters, we have to be more innovative. At any rate, it is clear that we have to protect our traditional markets. And we have to be proactive in that regard, rather than simply responding in a defensive manner after the fact, when our livelihood already has been threatened.

TAPPI JOURNAL: *Looking now specifically at Domtar, what challenges does your own company face within the same 10-year timeframe?*
Royer: At Domtar the challenges are considerable, given that the Company had been unprofitable for much of the past 10 years. When I joined in 1996, it quickly became evident that we had specific challenges to address, most notably in terms of productivity and the commitment of the organization in general.

We have been very rigorous in addressing the cost and productivity challenge, and have achieved a lot–although we still must do even better. We also have made considerable progress in learning how we can support our customers by developing innovative new products that will help them gain sales in their own respective markets. In addition, we have made a start at changing the corporate culture within Domtar so that our peo-

ple will be more proactive. Here again, though, we still have a long way to go–and there are certain traditional values that you don't know whether or not you should even attempt to change.

So for the first part of the 21st century, Domtar's primary challenge remains learning how to better address the customers' situation. Of course, the positive results we anticipate from an improved customer focus will allow us to generate better returns for our shareholders. But this is an end result. The means to that end–the course of action–entails focusing on our customer.

Following up on a point I made in response to your question about industry challenges–namely, the need to optimize the use of fiber resources–I should note that Domtar also is doing something quite different in that regard. We've developed new pulping and processing recipes, a number of them based on the use of segregated fiber, which result in much better products than we were able to produce even three or four years ago.

TAPPI JOURNAL: *Where do you see Domtar in relation to other North American paper companies in terms of growth potential? Strategically, are you positioned where you want to be now that you have completed several acquisitions and restructured part of your operations?*

Royer: In terms of major strategic initiatives, we have accomplished two things. One involved consolidation of the packaging sector with the establishment of Norampac. We were able to create real value from that transaction, which positioned Norampac as the No. 1 corrugated packaging producer in Canada.

The other initiative entailed going after specialized markets. In that sense, E.B. Eddy precisely met the criteria of what we were looking for in an acquisition target. First and foremost, we wanted to achieve a better balance between commodity and specialized products in our portfolio of assets.

When I look at Domtar, I am confident that we can generate much better shareholder returns than we have in the past–particularly if we focus more on specialized markets that involve higher-margin, value-added products. Of course, if we produce better returns for our shareholders and the market capitalization of the company increases, it enables us to make further acquisitions and/or create new joint ventures where our methods, our way of doing business, will create yet more shareholder value.

I think the E. B. Eddy deal is an excellent example of the potential in that regard. The first thing I did after the Eddy transaction closed was to put everybody together and compare the practices of the two organizations. It took us about three months to identify what would work best for the new Domtar, and how we could improve on what the separate entities were doing before. Since then, we have realized tremendous synergies and, of course, have increased our market share, because customers that were doing business with us and not with Eddy now want to have Eddy products and vice versa. Collectively, we have created something that is considerably greater than just the sum of the two parts. And I believe we can do the same with other potential partners that are being run in a more traditional way. The challenge is for us to identify those companies, and to convince them that, together, we accomplish things that would not be possible on their own.

TAPPI JOURNAL: *I gather that you regard an increased customer focus as an integral element of your strategy at Domtar?*

Royer: Indeed, we do. And it is something we've been working very hard at in terms of communicating our thinking throughout the organization. I have personally met with employees at most of our facilities to talk about the importance of responding better to changing customer needs. As I put it to them, the issue is very simple: with no customer, there is no job. Once that is understood, you can draw similar conclusions in terms of the need to generate adequate returns for shareholders, i.e. if there is no shareholder, there is no company.

From there, it is a matter of comparing ourselves to the competition. We look at other companies and ask "Is that company better than we are?" Sometimes the answer is "yes," because of this or that factor. Almost always, though, it comes back to people. For instance, if another company has better machinery, it's most likely because their people selected better machinery. If they have better products, it's because their people conceive better products, and so on. Suddenly, it becomes clear to everyone. Inevitably, the difference between Company A and Domtar is the people–it's ourselves. Once your employees understand that, it's much easier to energize them, to have them work with you to find collective solutions to the issues and challenges we face. Of course, you first have to create confidence and trust, but after that it is relatively easy.

I think these recent attempts at consciousness-raising also help account for the fact that 27% of all employees now subscribe to Domtar's stock-purchase plan, up from just 10% a couple of years ago. We're very proud of that, because it indicates our people now believe that they can, in fact, deliver more than they did in the past. Without being presumptuous, I think that what we're doing here really can enable us to grow and assume a leadership position in Canada and North America, in terms of returns to our shareholders.

Another of our strengths is the success we have had in addressing operational aspects of our mills from a cost and productivity standpoint. For instance, we are introducing a Kaizen continuous improvement process that is scheduled to be fully implemented in all mills by the end of this year. We also have installed statistical process-control at a number of locations to help ensure consistent quality–a critical consideration in the specialty paper area.

***TAPPI JOURNAL:** Could you quantify Domtar's growth targets for us?*

Royer: Right now, Domtar's total annual revenues amount to some US$ 2 billion. I would like to see us attain a critical mass or threshold somewhere in the US$ 4-billion-to-US$ 6-billion range, which would clearly establish Domtar as a significant player in the markets we serve.

So, our aim is to double or triple the size we are now. Let me hasten to add, however, that I always make it clear when responding to questions from shareholders…that we have two very clear requirements for any acquisition: First, it has to be profitable from day one. Second, it must be done in such a way that we can maintain a debt-to-equity ratio not exceeding 45% average over a period of time. The two strategic initiatives I mentioned earlier (Norampac and E.B. Eddy) demonstrated that we can work within those limits.

***TAPPI JOURNAL:** You already can be considered a major player in North America. Where do you see Domtar in relationship to global companies?*

Royer: To me, north-south expansion is the key priority. “South of the Border,” for us, means first the United States and then the other countries of Latin and South America. I believe it is much easier for us to do business north-south than to go east-west, for a variety of reasons, including the management attention required and the complications of doing business in widely differing times zones. And there are ample opportunities these days both in the United States and further south.

If you are to work effectively in another country, you have to share a similar business approach and feel comfortable, especially when you're talking about joint ventures or collaborations. You need to feel comfortable with the values of the people you are talking to. This is considerably more difficult if you go to Asia or some other non-western country. In China or Asia, the basic values are different. I am not questioning the values themselves, simply noting that that they are different, less familiar. So I feel less comfortable even though, in my previous business life, I had very good relationships and collaborations with Japanese companies.

***TAPPI JOURNAL:** The next question concerns the strategic mix of Domtar products. You have a strong position in fine papers, business papers and specialty papers, along with a very strong position in wood products as well as in containerboard and containers through Norampac. Is this mix something you expect to remain stable? Will you continue to grow in those areas, or are you looking to change that mix as you survey the marketplace?*

Royer: For me there is no single “gold” product that we would want to count on to generate all our revenue. However, we are very comfortable with what people sometimes describe as communication and specialty papers. So any product that is related to these segments and that could bring additional returns to the company is of interest-as is any potential partner involved in these segments which might benefit from the way Domtar does business. We are especially interested in growing our business in those areas.

***TAPPI JOURNAL:** Are companies like Domtar that have large holdings of forest assets better positioned in the marketplace than those who rely solely on access to market fiber?*

Royer: I believe that control of the forest asset is key if you really want to have complete control over the quality

of the products you produce. You can buy a lot of market pulp, but there are no real standards–is this one 10% better or 5% better? In some products, it will not matter to the ultimate customer whether the pulp you use is 10% better or not. However, in the markets we serve, it does make a difference. Our Windsor offset paper has a very strong reputation for quality, as does our Plainfield Premium Plus paper. And that is mainly because we are very rigorous in terms of controlling the mix of pulp that goes into our products. Another example is in our offset products: at the end of the day, we want to be certain that our customer can use our paper and count on completing a full press run without having any paper breaks. We both know that, if he uses somebody else's paper and encounters problems because of breaks, his total costs will end up much higher than if he had paid a 1% premium to buy our superior-quality sheet. More and more customers are coming to appreciate that. They tell me that, when they have a job that really calls for tight deadline etc., they want to use only our paper, nothing else. If the customer is overly concerned with costs, they might consider a lower cost/lower quality paper, knowing that they will have to run their presses more slowly to avoid breaks. However, when it comes to really demanding jobs, they will go with Domtar paper.

***TAPPI JOURNAL:** When you look at Asia, do you view it as a source of potential competition, or as a potential export market for Domtar?*

Royer: I view it more as a source of competition than as a potential market. Of course, there is some market potential there. But it really comes down to choosing what markets you wish to serve. And, as I indicated earlier, the markets I regard as priorities are North and South America. We do sell some building products and lumber in Japan, and I'm very proud of that. But it's not paper. Nor do I see much potential for our paper in the rest of Asia.

On the other hand, I do view Asia as a source of competitive concerns, because the market rules they go by can be very different than the ones under which we generally operate.

***TAPPI JOURNAL:** Given that paper producers in Asia and South America can produce certain grades of paper with bleached hardwood pulp as efficiently as anyone in North America, does that affect your long-term strategy for the use of hardwood at Domtar?*

Royer: It is true they have some efficient producers. However, that does not affect our strategy in any substantial way. Our goal is–and must remain–oriented towards the customer and the end-user. If I can utilize market pulp that I make or buy in South America and blend it with some of our own pulp to produce an even better sheet, I'm open to that. The forest assets we have will still be there–and will continue to be there year after year, which gives us security and stability. What we have to do is determine the best way to utilize the fiber that's available. If it's within Domtar, that's fine. But if it's not within Domtar, I need not be overly worried because, at the end of the day, those fibre assets are carried on our books without any value ascribed to them. So if they can create a competitive advantage for me at a given time, fine. If not, they are still there, and we will find other uses for them. It's not like an asset that you have to depreciate every year.

***TAPPI JOURNAL:** Do you have any specific strategies for dealing with the competition from Asia and elsewhere?*

Royer: The way we have organized ourselves, Domtar's primary market is the United States, where we distribute our products through a network of some 235 independent distributors whose typical annual sales would fall in the $100-million-to-$300-million range. These are significant distributors and obviously very important customers for us. We look after them extremely well. Individually, however, none of them are so dominant that that we rely on them for a disproportionately large share of our total sales. So if somebody wants to displace us from the U.S. market, they would have to set out to recruit each and every one of those 235 independent distributors, most of them extremely loyal Domtar customers. That is unlikely to happen.

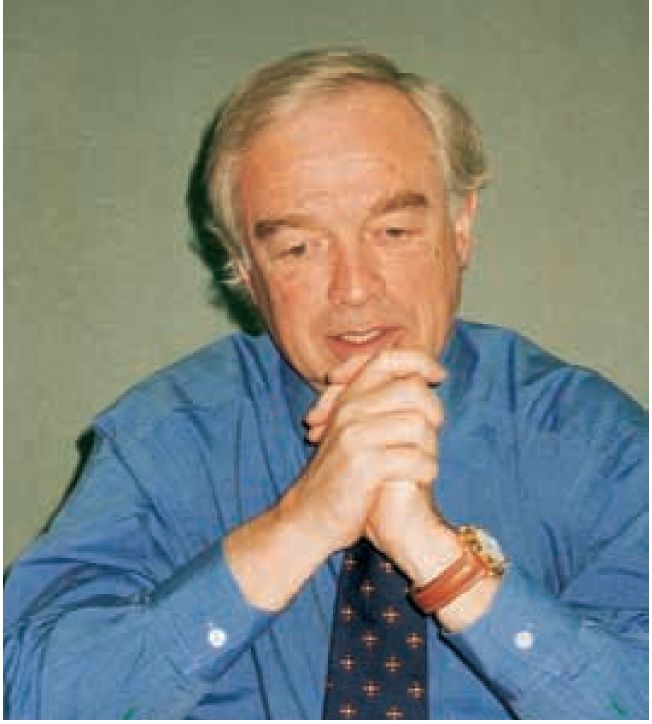
The very number of individual accounts involved represents a barrier of entry to any Asian company who wants to come in with very large volumes and sell to large-volume customers. At any rate, most of those volume-oriented accounts don't buy from us. The U.S. customers who do (buy from Domtar) generally are looking for something they cannot find elsewhere, either in the quality of our papers, in the service we provide, or in the access to know-how and technical support that we make available to them. We provide our distributors with a level of support that would be difficult for them to improve on elsewhere, including access to the technology in our mills and research center, to help them better serve their own customers.

TAPPI JOURNAL: *Where do you see the future of research and development at Domtar?*
Royer: In the past, Domtar rightly took pride in putting a lot of emphasis on the "R" in R&D. However, we have learned that the "D" part of the equation has to be carried out in close collaboration with customers. Recognition of this fact has necessitated some change in the way our organization–and our renowned research center–approach R&D. Many of the people attached to the Research Center are now actually situated at our various mills, from where they can work more closely with the customer. And most have found the change stimulating, in that they now are in a position to be more proactive on the "D"–to see the potential in solutions they never tried to push before. This clearly works to the benefit of the ultimate customer.

TAPPI JOURNAL: *If you could acquire any pulp or paper producer in the world, would you acquire one in North America or somewhere else? And if you had a philosophy, would you be willing to tell us?*
Royer: As I indicated earlier, I strongly believe that the key to success when it comes to collaborations with customers and suppliers is shared values. You must have a common understanding of what you are trying to achieve, of what is really important at the end of the day. So to have the best chance of success, an acquisition or a joint venture would have to be with people who share similar values. From that perspective, of course, North America is my choice as a prime target. Specifically, I would look in the United States.

Incidentally, aside from the considerations I just mentioned, there is another reason I would look first to the United States. At the moment, Domtar has only one U.S. mill, even though 70% or more of our paper is sold there. As a customer-oriented individual, I happen to believe that I should have more of a presence in a market that I wish to serve. I cannot always export from Canada.

TAPPI JOURNAL: *What do you feel has been your greatest success and what has been the greatest challenge that you've had to face making the transition from a very different kind of industry?*
Royer: The biggest challenge was to make our personnel believe that we could be quite a different Company without resorting to drastic measures like firing large numbers of people. It really was a tough sell convincing them



we could achieve our goals simply by taking a close look at what we were doing and asking ourselves: "Could we do that better without spending more?" However, the majority eventually did buy into the concept that substantial gains could be made simply by utilizing our collective brains better than we had in the past. Indeed, the response has been overwhelming. Now, even the union representatives want to be involved. They say "yes, we can do better–and we're not talking about giving us more money or this or that."

The first thing we scrutinized was the working environment. Did we have a proper working environment where, if I asked our people to give 100%, they could actually give it–not just 75%, because they didn't have the proper tools or the required training or proper supervision? I think that was the biggest challenge, and I believe is in place now to really move ahead.

At the moment, of course, product prices remain fairly weak. However, I have always believed it is futile to worry unduly about things over which you have no control, and that's the attitude I urge our employees to adopt. Once people accept that there is little they can do about the state of the economy and the price of our products, they can turn their attention to factors they can influence or control. When people start thinking that way, they find a lot of ways to be more creative and proactive in trying to address the things under our control–costs, efficiency, quality, service etc.

One of the things I find very refreshing about this industry is the loyalty of our customers-provided you deliver in terms of quality and service. You're ostensibly in a commodity business. But in reality you are not, because consistently superior quality and service can separate you from the pack. You still will be subject to commodity prices, of course, but you will enjoy the support and loyalty of your customers. **TJ**

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