

By MONICA SHAW, Editor

Savoring a strong balance sheet

With corporate debt under control, Weyerhaeuser's COO Richard Hanson looks forward to a value-enhancing strategy and potential expansion into the Southern Hemisphere.

After a string of acquisitions, a strong balance sheet is a great thing to have, and Weyerhaeuser has the strongest in the industry, says Weyerhaeuser's chief operating officer (COO) Richard Hanson. This isn't to say that the pain of asset rationalization is over, Hanson emphasizes, but the company is finally anticipating the ability to pursue a path of expansion in select businesses, as well as the opportunity to share newfound success with shareholders.

This May, for the first time in 10 years, Weyerhaeuser was able to give its "very patient" shareholders a dividend increase, says Hanson. The divestment of its B.C. Coastal Operations for \$1.1 billion allowed the company to further decrease its debt. The company is now ready to focus closely on a value-enhancing strategy in its pulp, fine paper, containerboard and pulp businesses, which have lagged the success of its building products and real estate businesses. And despite analyst urgings for more monetization of timberlands, these holdings retain a top priority in the company's overall strategy.

Hanson, now a 36-year veteran of the company, was elected executive vice president and COO in February 2003. During his tenure at Weyerhaeuser, he has held numerous management positions in the timberlands, wood products, and paper businesses. Most recently, he served as vice president of western timberlands (1996-1998) and executive vice president of timberlands and international (1998-2002). He also served as integration team leader following the 2002 acquisition of Willamette Industries.

Currently, Hanson oversees Weyerhaeuser's timberland and manufacturing operations, research and development activities, and procurement and transportation functions. As COO, Hanson has allowed CEO Steven Rogel to focus on future growth strategies and enhancing customer relations. It has also allowed Rogel, who, along with Hanson, reaches the

Hanson is pleased that Weyerhaeuser was able to give its "very patient" shareholders a dividend increase of 25% this May.



company's mandatory retirement age of 65 in a little over three years, to spend more time developing internal succession candidates.

"My role as COO," says Hanson, "is to provide leadership on the operations side so we can carry out the company's strategies effectively and deliver results."

Fostering Weyerhaeuser's emphasis on safety as a core value is yet another of Hanson's priorities (see *P&P*, August 2005, p.

64). *Pulp & Paper* recently spoke with Hanson regarding the company's direction in coming years, as well as about the company's plans for growth and its emphasis on the pulp and paper sector.

P&P: Weyerhaeuser's timber, wood products, and real estate operations have done extremely well compared with its pulp, paper and packaging sector, despite cost cutting, capacity rationalization efforts, and production improvements. In recent statements, you indicated that the company is seeking ways to "unlock value" from this sector. Does this value-added push mark a significant change in post-merger strategy?

The value-added emphasis has evolved, but let me first say that nothing has changed with regard to Weyerhaeuser's focus on efficiency in this capital-intensive business. We will continue to focus on reliability and asset utilization, and we have more work to do in asset utilization, both with our processes and in our portfolio. It's just a given that we must continue to shed non-competitive capacity in order to be successful.

But what's new here is that we recognized that we are simply not going to return cost of capital by saving our way to prosperity in the pulp and paper side of our business. We are going to have to focus more on our strengths, and our strengths are adding value in particular segments where we've had success. It's different by business, but we've gotten more scale and broader capabilities, so we can provide services and align product capability and attributes with major segments to bring them unique value.

P&P: Can you share examples of how this value-added strategy is playing out in your white paper, pulp, and packaging business sectors?

In the paper and pulp side of the business, our strategy is to look for markets that have evolved to a more consolidated customer base, just as they have on our wood products

side with Home Depot, Lowe's, and big production builders in housing. These types of customers match well with a company like Weyerhaeuser that can combine R&D, mill effort, and portfolio performance to create value for large market segments. This means that we are not going to approach everything as broadly as we have done historically.

For example, in packaging, one of the major areas where we have focused is produce markets such as those in California and Mexico. As far as services, we have equipment that strawberry growers can lease that will actually assemble boxes in the field at harvest time. This has been in development for at least 10 years and is an example how we have used R&D to serve a particular market.

On the product side, we have introduced recyclable ClimaSeries corrugated boxes for produce to replace wax boxes, which many retailers dislike because of landfill issues, leading them to turn to plastic returnable containers.

Another example of valued-added strategy is with our high absorbency pulps produced for buyers such as Kimberly-Clark and Procter & Gamble, for whom we develop proprietary pulps. And, in our paper segment, we are working with a major grocery chain to provide advice on environmental policy, packaging, printing, and collection of recovered paper.

P&P: What is Weyerhaeuser's asset rationalization strategy going forward? Is it regional or is it mostly on a mill-by-mill basis?

It hinges more on whether a particular mill is disadvantaged due to obsolescence or wood costs, so I would say it's more site-specific. But it also depends on what type of business it is and whether we want to invest capital to remedy the situation or whether we're better off to rationalize capacity.

Although the decision is first business and then site specific, regional issues are a factor. Obviously, Canadian producers are in a very

difficult situation with the strong Canadian dollar, which increases wood costs, as well as having high labor costs.

P&P: What is your R&D budget for 2005 and how does Weyerhaeuser structure this budget for its pulp and paper products?

Weyerhaeuser spends approximately \$55 million on R&D per year. Although that may be more than some in our industry spend, it's not a large number when compared with other U.S. industries. This seems to be the culture of the pulp and paper industry, which has traditionally looked more to chemical and equipment suppliers to provide technology advancements.

but we must still be a low-cost commodity producer. As one of our senior managers years ago said, you can have a specialty mentality but you can't ever forget that you must keep a commodity mentality in terms of your production cost base.

P&P: How has your approach to timberlands management changed in recent years?

A few years back, we saw ourselves first as softwood saw timber oriented in terms of our timberlands management strategy to realize the maximum integrated return for the timber resource. We maximized the softwood saw timber harvest, and a secondary consideration were the small tops, the pulp wood, for which

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In pulp and paper, specialty pulps get the largest share of the R&D budget. After that comes containerboard packaging, and then process technology in the mills, such as ways to improve runnability, sheet stability, and reduce curl in fine papers.

We also invest a great deal in our timberlands to improve silvicultural practices and fiber productivity, which leverages our unique strength and expertise as longtime owners and managers of timberlands. We also have a strong program of environmental research.

P&P: With conversion of Port Wentworth from paper to fluff pulp production this May, around 60% of Weyerhaeuser's market pulp production consists of specialty grades. Will that balance shift in the future?

We intend to continue to increase the specialty pulp component and move away from commodity pulps as much as we can,

we either had the facilities to convert or we were in a wood basket where there was adequate market take-away for the pulp wood.

What's changed is that we're in the hardwoods business now with what we refer to as our appearance wood products business, which is predominantly alder, but other species from the eastern U.S. as well, like oak, cherry and walnut. These species compete against each other in a hardwoods market. Also, we see saw timber opportunity now in eucalyptus. So, we can no longer call ourselves just the softwood company, although that's definitely the bulk of our timber ownership.

We're beginning to plant eucalyptus on 324,000 acres that we jointly own in Uruguay, and it's a saw timber strategy there. We see eucalyptus now as a very attractive saw timber source for furniture, and that's why we purchased the majority ownership in the Aracruz Produtos de Madeira sawmill in Brazil, which

produces the trademarked Lyptus brand of lumber to be used in furniture, flooring, cabinetry and other appearance applications. Lyptus comes from a eucalyptus hybrid that is grown on plantations.

While our first priority is to get the solid wood value, the structural and appearance values out of the timber stand, harvesting the pulpwood for pulp and paper is critical to getting the total return on timberlands. We're also optimistic about the pulp and paper demand from Uruguay, and there are a couple of players that have announced they're going to build pulp mills there: Ence and Botnia.

P&P: This year, Weyerhaeuser sold its B.C. Coastal Operations, including 635,000 acres and five sawmills, for \$1.1 billion. How has this impacted your debt-to-capital ratio and what does it imply for other timberland sales?

With the completion of the British Columbia divestiture, we're at our goal on debt-to-capital, which is between 30 and 40%. We have a strong balance sheet now, so we can focus on the long-term, and focus on our shareholders. They've been very patient. We raised the dividend in May by 25%, and that was the first time it had been increased in 10 years.

Regarding the British Columbia divestiture, that business was really not a fit for Weyerhaeuser. It was large timber, softwood appearance products, and our softwood business now in the U.S. is structural, aimed at the home centers and production builders.

Also, the timberlands we divested in Georgia, for example, and the western Carolinas, were non-strategic. When we acquired Willamette Industries, we acquired an additional 1.6 million acres of timberland,

some of which were hardwoods, which were not core to us. With these, it was a nice fit in our need to reduce debt and to prune our portfolio to stick with strategic timberlands. Overall, we haven't sold any timberlands that we wouldn't have otherwise sold with regard to our portfolio strategy.

Hanson cites the recyclable ClimaSeries corrugated boxes as an example of its value-enhancing strategy in the corrugated containers market, which he describes as a "battle for survival of the fittest" going forward.



P&P: As Weyerhaeuser examines its strong balance sheet and focuses more on the long-term, what are you considering as far as expansions?

We believe that if you're going to be a major player in this industry over the next decade, you're going to have to have a position in the Southern Hemisphere in fiber growing, which we've already begun in Uruguay. We're also building a plywood plant in Uruguay, and we'll continue to build out the infrastructure to monetize that plantation investment. So, we think that whether or not we enter into joint ventures or invest, we will grow in the Southern Hemisphere because

it's going to be a low-cost production area.

How do we specifically do that? There is a range of options that we haven't settled on yet, such as acquisitions versus greenfield facilities. If you look at what's happening in the whole cost structure in South America and in the temperate zones, hardwood pulps

are going to be displacing the higher cost Northern Hemisphere pulps. A likely scenario is that there will be paper machines in the Northern Hemisphere marketplace using Southern Hemisphere hardwood pulps to feed those machines.

Next in order of priority is Asia, which is going to need fiber for quite some time. Asia will most likely obtain the fiber that they need from the Southern Hemisphere, as well as recycled purchases

because the plantations aren't going to be at a level to source their needs for a long time. So we see ourselves as a fiber supplier to non-Japan Asia as well, but primarily China in an interim period, and by interim period I mean a decade or so. And so whether or not we would then eventually take a position in manufacturing in China will just be based on analysis at the right time.

P&P: One hundred-percent of Weyerhaeuser's U.S. forests are certified as meeting the standards of the Sustainable Forestry Initiative (SFI). Is there a particular reason SFI standards were chosen as goals as opposed to those of the Forest Stewardship Council (FSC)? Is the SFI choice a potential

TABLE 1.

Hanson says that asset rationalization is first a matter of the business type, followed by site-specific issues, and then regional considerations. This table ranks Weyerhaeuser mill's cost performance based on data from Paperloop's Benchmarking Service.

Grade	Product	Location	Quartile
Bleached Hardwood Kraft Pulp (BHKP)	Northern BHKP	Hawesville, Ky.	2nd
		Kamloops, B.C.	2nd
		Longview, Wash.	3rd
		Prince Albert, Sask.	3rd
		Bennettville, S.C.	4th
Bleached Softwood Kraft Pulp (BSKP)	Fluff	Columbus, Miss.	2nd
		New Berg, N.C.	4th
		Ogelthorpe, Ga.	2nd
		Plymouth, N.C.	3rd
		Port Wentworth, Ga.	2nd
		Dryden, Ont.	4th
	Northern (BSKP)	Grand Prairie, B.C.	2nd
		Kamloops, B.C.	2nd
		Longview, Wash.	1st
	Southern (BSKP)	Prince Albert, Sask.	3rd
		Bennettville, S.C.	3rd
		Columbus, Miss.	2nd
		Port Wentworth, Ga.	1st
Coated Mechanical	40 lb. No. 5 CM	Columbus, Miss.	1st
Corrugating Medium	Corrugating Medium	Cedar Rapids, Iowa	2nd
		North Bend, Ore.	3rd
		Oxnard, Calif.	4th
		Pine Hill, Ala.	2nd
		Valliant, Okla.	1st
Kraft	Unbleached Bag	Albany, Ore.	1st
Linerboard	Unbleached Linerboard	Albany, Ore.	4th
		Campiti, La.	1st
		Cedar Rapids, Iowa	2nd
		Henderson, Ky.	3rd
		Pine Hill, Ala.	1st
		Plymouth, N.C.	3rd
		Springfield, Ore.	4th
		Valliant, Okla.	2nd
	White Top Linerboard	Albany, Ore.	4th
		Springfield, Ore.	4th
Uncoated Freesheet	Printing & Converting Roll cost for offset, business forms, envelope, etc.	Dryden, Ont.	3rd
		Hawesville, Ky.	2nd
		Johnsonburg, Pa.	3rd
		Plymouth, N.C.	2nd
		Prince Albert, Sask.	2nd
		Rothschild, Wis.	4th
		Bennettville, S.C.	2nd
	Value Added including such grades as: cover & text, premium opaque, etc.	Dryden, Ont.	4th
		Johnsonburg, Pa.	3rd
		Plymouth, N.C.	3rd
		Rothschild, Wis.	4th
		Bennettville, S.C.	1st
		Dryden, Ont.	3rd
	Xerographic Base roll coll cost for cut size	Hawesville, Ky.	2nd
		Johnsonburg, Pa.	3rd
		Kingsport, Tenn.	2nd
		Plymouth, N.C.	2nd
Prince Albert, Sask.		2nd	
Rothschild, Wis.		4th	

In the future, Weyerhaeuser plans "to increase the specialty pulp component," says Hanson, but "keep a commodity mentality in terms of the production cost base."



problem or advantage with customers?

The U.S. forests are certified to the ISO 14001 standard as well. We believe SFI contains the best mix of the three legs of sustainability — environmental, social and economic — that are really in the interest of the public as well as the industry.

On the other hand, FSC would make us non-competitive on a global basis. The FSC standards vary by region, and those in the more productive forests of the U.S. — the South and Pacific Northwest — are not economically sustainable. They would require us to take a great deal of land out of production — 20 to 40% — and otherwise reduce our investments in practices that boost forest productivity, practices they would allow elsewhere.

So while we have had FSC certifications in British Columbia and at our composite panel plant in Ireland, we believe SFI and CSA in Canada find the right balance for sustainability and competitiveness of our North American industry.

Our customers have fully supported our

certification decisions. We have spent time with them to explain that we know how to manage forests while protecting the environment. We explain the requirements of the different standards and we go into the very specific management protocols that have to be followed and audited by third parties for both SFI and CSA. Our customers typically come away convinced that these are good standards.

P&P: What is your outlook for the North American pulp and paper industry and how does this impact investment at your mills?

Both fine paper and corrugated containers are in a battle of survival of the fittest. You also have to pay attention to the global economics that are at work now with lower cost hardwood pulps coming from the Southern Hemisphere for fine papers. This is why our emphasis will continue to be on the softwood specialty pulps and fluff pulp, in terms of growth and in terms of where we'll put our investments from the restructuring into the Southern Hemisphere.

As I have said, most of our investment in the mills will either be improving product performance in the fluff and high absorbency pulps or paper machine runnability in the segments we've selected. Outside of that, we will invest in high-return mill projects. Energy is obviously the number one criteria now, and we are currently installing a Turbo-Gen at Kingsport and planning other high-return energy projects.

Also, we've put in wood yard systems that are much more efficient for our mills, such as those in Flint River, Ga.; Valliant, Okla.; Plymouth, N.C.; New Bern, N.C.; and Pine Hill, Ala. Those projects have very high returns because they're automated out-stock and reclaim systems as opposed to systems that destroy a lot of wood fiber and require excessive labor to operate.

P&P: In Weyerhaeuser's and other company's quarterly statements, there are statements regarding the financial impact of the Sarbanes-Oxley Act, which seeks to regulate public companies' accounting. Has that been a big hit for Weyerhaeuser? Do you think the requirements will be streamlined?

It's been significant. Dick Taggart, our CFO, says we have spent \$7-\$8 million this year just to comply with Sarbanes-Oxley. That's in one year. But I think it's more than the \$7-\$8 million. It takes a great deal of management time in addition to the reports, and it puts us at a disadvantage relative to our global competitors who aren't faced with the same kinds of requisites around reporting.

I don't know what the outlook is. As in other critical situations, there's been a reaction, and justly so, to the Enron phenomena, but I think there may have been an overreaction and that perhaps the pendulum might adjust some. But right now the public is pretty impatient with the kind of earnings manipulation that occurred, and corporations must address that.

P&P