

**SPEECH TO ABCFP  
HARRISON HOT SPRINGS  
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The forest industry has been the cornerstone of B.C.'s economy for more than 100 years. It is the number one job producer in this Province, a primary source of government revenue, and a major contributor to our social infrastructure.

But, the challenges and opportunities we face in the industry today are very different than those we've seen in the past.

And, the choices we make regarding future direction will have a significant impact on our industry as well as the people who work in it, our communities and on our Provincial economy.

In recent weeks we've seen:

- Don Roberts, one of Canada's top-ranked forest products analysts, state publicly that he wouldn't invest in the Coastal industry, and forecast a 50% drop in production from the Interior industry by 2010;
- Clark Binkley, the former dean of forestry at UBC and a world-renowned expert in timberland investment advocating major changes in tenure policy in BC;
- Controversy over log exports; and
- Major announcements regarding environmental set-asides and EBM in the Central and North Coast and Haida Gwaii

Superimpose on top of this, a significant downturn in housing activity in the U.S. and the new Softwood Agreement.

What does it all mean?

I can't speak for the industry or anyone else, in general.

But, I can speak for Interfor.

And I'm pleased to do so – because, along with the challenges we face, I believe there are some opportunities here that are very exciting.

And, in speaking for Interfor, I'm speaking for a company that operates on the B.C. Coast, in the Interior and in the US PNW.

That wasn't always the case.

When I joined Interfor in 1998, 90% of our business was on the Coast; and we had one relatively small sawmill in the B.C. Interior. Production in 1998 was just over 500 million board feet.

Over the last 6 or 7 years we have actively and intentionally downsized our Coastal business and invested in areas which we felt held greater promise.

By the end of 2006, the Coast accounted for less than 40% of our capacity. We have a major investment – with 3 mills in the US PNW – and our Interior mill now produces close to 300 million feet per year. In total, Interfor produced almost 1.2 bbf in 2006, making us one of the 10 or 12 top producers in North America.

And we've refined our business model.

We're no longer directly involved in the conventional logging business, and at the end of last year, we sold our helicopter logging company.

Most important, Interfor is now debt free. From a near bankrupt state in 1998, we now have \$100 million in cash and \$300 million in financial capacity, and we're actively looking for opportunities to grow our business.

Our criteria in this regard is simple.

We're looking to generate returns that exceed our cost of capital.

As a publicly-traded company, the capital we manage belongs to our shareholders, and we have an obligation to protect that money and to invest it in a way that generates returns greater than can be achieved on risk free investments.

And there's the rub.

With only minor exceptions, the forest products industry has done a lousy job generating returns on the capital it has invested.

And the Coastal industry has done a particularly poor job in this regard.

In the face of this, many people ask if we're planning to sell our remaining Coastal operations.

The answer to that question is **NO**.

We have significantly restructured and repositioned our Coastal business, and believe it has the potential to generate acceptable returns in the years ahead.

The key word here is potential.

In fact, at a time when the MPB is forcing a major re-think about the future of our Interior forests and forest industry, I believe Coastal forests and the Coastal forest industry contain some of the most exciting potential anywhere in N. American and possibly the world.

In 2003, I joined with the CEO's of TimberWest and Weyco's Coastal Business to articulate a new vision for the Coastal industry.

We identified opportunities for world-class sawmills and a vibrant value-added industry. Branded products, environmental leadership and an increased role for First Nations and small business. And more stable jobs and increased revenue for government.

And, we laid out the types of reforms we thought necessary to create the investment climate that would be needed to make the vision a reality.

I have heard criticism that our vision was a public relations exercise. Or that it was all for naught.

Others have suggested the policy reforms put in place by the Liberal government in recent years have broken the social contract between tenure holders and the Crown, and have contributed to mill closures and increased log exports.

The reality is ... we've been living with mill curtailments, job los and instability for years.

15-20 years of decline simply can't be turned around overnight.

What I see happening today is the transition that needs to occur.

It is the 1<sup>st</sup> stage of rebuilding and retooling the industry into one which can be truly competitive on a global scale. Provided we have the will to do the things necessary to move beyond potential to attract the capital necessary to rebuild the industry.

For years, forest policy in BC was designed to promote social objectives in isolation of commercial reality.

Policies – like super stumpage, the prescriptive FPC and the Jobs & Timber Accord – were well-intentioned but added cost for limited value.

And, when the Japanese market collapsed in the mid 1990's the industry was incapable of responding or retooling.

We need a policy environment that encourages the creation of a dynamic and vigorous industry ... one that is constantly adjusting to or leading changes in the global marketplace, rather than policies which attempt to isolate our industry from the marketplace, regardless of how noble the cause.

So, where are we now?

The introduction of market based policies in 2003 has allowed the transition process to begin.

Old, inefficient mills are closing – as they should have a long time ago.

And, after 10 very tough years, investment capital has started to creep back into the Coastal industry.

Interfor invested \$26 million in 2005 to rebuild our sawmill in New Westminster, and we're looking at additional investment in that plant later this year or next. And Western has invested in its Cowichan Bay Sawmill.

Significantly, the softwood dispute with the U.S. was resolved in 2006.

The agreement is not perfect, but it is reasonably fair for producers on both sides of the border. Most important, it creates clear rules of access to the world's most important lumber market.

And, the move in the Canadian dollar – which increased in value by more than 1/3<sup>rd</sup> between 2002 and 2005 – appears to be stabilizing in the 85-90 cent range (at least for now).

In my view – we are at a crossroads on the Coast.

Have we reached the point that investment capital will begin to flow back into the Coastal industry, or will reinvestment continue to be under-funded?

I'd like to talk to you for a few minutes about some of the things I believe need to fall into place to create a truly attractive investment climate on the Coast. And, while items like tax rates and labour environment are important, I'll save that speech for the Chamber of Commerce.

What I would like to talk to you about today is the issue of timber supply, the factors which affect that supply, and how capital providers view and react to these factors.

And, to put the issue into context, I can tell you that it costs upwards of \$100 million to build a world-class sawmill, and no one will put that kind of money at risk without knowing there is an adequate supply of logs available at a competitive price – not just now, but for 15 to 20 years at minimum – to pay for the investment, and to provide the return that justifies the investment in the first place.

So, let's look at the situation as it is today on the Coast.

Most certainly, there is a fabulous timber resource on the Coast.

The growing inventory of 2<sup>nd</sup> growth, in particular, is highly attractive.

The quality of the wood and the growth rates are world class.

In many respects, this timber is being allowed to grow to long. To the point that some stands no longer suit modern sawmilling technology.

There is an opportunity being missed here.

Clearly, a strategy is needed to accelerate the transition to 2<sup>nd</sup> growth.

But the issue is more fundamental than that.

Continuing uncertainty over land use remains a major consideration. And until there is greater clarity and certainty regarding the land base available for commercial timber production, capital providers will be reluctant to put significant money at risk.

Building on that theme, our tenure arrangements need to be modernized. Volume agreements make less sense than area based agreements from a commercial standpoint, and I believe, from a forest management standpoint as well. And, the terms of these agreements do not encourage investment in the land base or in capital equipment.

We also need to simplify the regulatory model and drive unnecessary costs out of the business.

I know this is challenging – particularly on a public land model. But, it is folly to equate prescriptive regulation with good forest management, or the public interest. And we need to understand the costs of trying to manage the forests for multiple uses.

I want to be absolutely clear here. Good stewardship is a cost of doing business. And, I would like to believe that Interfor meets and exceeds its responsibilities in this regard.

I am extremely proud of our forest professionals. But, I also see the frustration they experience trying to balance a competitive business environment with a prescriptive, multiple use regulatory environment.

And, as we move towards the introduction of EBM on the Central and North Coasts, we need to ensure that environmental prescriptions take account of social and economic factors. Anything less will undermine the commercial viability of the resource base in the area and lead to consequences that we haven't anticipated or would embrace.

I have two more items for you and then I'll turn the panel over to the other speakers.

The first is the importance of a dynamic log market.

In the U.S., we buy 100% of our log supply on the open market. And, we are comfortable in that environment because we know there is an adequate supply of logs around, and enough log sellers to create a competitive marketplace.

In B.C., the degree of integration between tenure holders and mills, and the growing level of tenure concentration is beginning to have a negative impact on the supply of logs in the open market. Our cedar mill in Maple Ridge – which is otherwise a profitable operation – is currently shut down, due to a lack of logs. This is not healthy from an industry standpoint, and I don't believe it is healthy from the standpoint of public policy.

And finally, I would like to touch on the thorny subject of log exports.

At the end of the day, I'd like to believe we are free traders.

We can't expect to have open access to the world's markets for our finished products and at the same time restrict access to our raw materials. Why do we restrict the export of logs, but not wheat, or coal?

The caveat here is the playing field must be level.

And, today, it is not.

The increase in log exports in the last 7 or 8 years from the Coastal region is a direct result of the distortions created by the softwood trade dispute with the U.S., and today would be sufficient to supply 4 – 6 world class sawmills, and the jobs and economic spin-offs that go with them.

Between 1996 and 2001, lumber shipments to the U.S. were constrained by quotas, with a punitive tax rate applied against volumes over and above our allowed limits.

From 2002 to late last year, duties of up to 27% were applied on our lumber shipments to the U.S. while log exports from Crown land were subject only to a minor fee which came nowhere close to the export tax on lumber. And, private land logs were exportable without any fee at all.

This situation has created a separation in log values north and south of the border and a windfall for any log producer able to access the US market. Frankly, it is no wonder log export volumes have increased 10-fold in the last 10 years.

And, under the recently signed SLA, the log export issue has been entrenched, with domestic lumber producers paying export taxes of up to 15%, and logs paying only minor fees, if at all.

Leveling the playing field between logs and lumber is a critical public policy issue and we are pleased that Forests Minister Rich Coleman has a review process underway on this matter.

Without resolution, capital will continue to flow into the industry in the US PNW that might otherwise have been invested on the BC Coast.

At the end of the day, I believe there is great potential on the Coast. And it is happening at a time when the MPB is undermining opportunities in the Interior region.

And, Interfor is in great shape and looking for investment opportunities.

For the first time in 10 years, or maybe 20, the Coastal industry is showing signs of life.

We are not without challenges, but, I would hope that the province's policy makers and industry can work together to build on the progress that has already been made and set the stage to attract the capital necessary to move the industry to the next stage in it's rejuvenation.

At Interfor, we have pledged to do everything we can to make this opportunity a reality.

And we're excited about the prospects.