Letter Circulating Eurocan (author unknown)

The biggest contributing factor to Eurocan's demise is management, both at the corporate (West Fraser – Vancouver) and local (Eurocan – Kitimat) level. West Fraser has stated that Eurocan has consistently lost money, with no hope of changing this in the future. I would disagree on both counts.

Firstly, West Fraser and Eurocan management have consistently told employees that even though the division was showing a loss (as opposed to a profit), it was for the most part "cash positive". It is quite a leap to go from "cash positive" directly and irrevocably to the doomsday scenario we now face. During the recent presentations to employees the West Fraser and Eurocan management dwelt heavily on a PowerPoint slide showing the past 10 years of profit/loss. On this slide there was only one year with a small profit (2002 I believe) with the other years showing losses. It was stressed how last year (2008) and this year (2009 projected) showed marked increases in the loss, and how this is indicative of the future. What was left unsaid is that Eurocan instituted a change in accounting practice for 2008 onwards which applied the concept of "net realizable value" to large working capital items like finished product inventories, chip inventories, pulp log inventories, etc. This change effectively magnified swings in the division's profit/loss position, with both appearing greater than before the change. The slide previously referred to therefore did not compare apples to apples. The losses for 2008 and the projected losses for 2009 were magnified in relation to the previous years' losses by this change in accounting practice. By this measure Eurocan's future is not as bleak as was stated. In any event, it is misleading to confuse profit/loss (in the accounting sense) with making/losing money.

Secondly, I disagree that there is no hope for the future. West Fraser and Eurocan management have routinely and consistently ignored obvious opportunities to improve the economics of the Eurocan operation. Some examples are as follows:

The Eurocan recovery boiler burns about $2,500,000 worth of fuel oil annually. If this boiler was converted to burn natural gas (capital cost about $350,000) the savings would be about $1.5-2,000,000 annually.

· Reactivation of the in-mill fibre recovery sump would save about 12-14 tons per day of fiber from going to sewer (capital cost about $1,500,000) and this fibre could then be made into paper. Benefits would be about $2,000,000 annually.

· The Eurocan electrical generator is presently shut down. West Fraser and Eurocan management have said this is because the generator is uneconomical to operate. This statement is simply not true. Even in the present circumstances where the generated power displaced electrical purchases at BC Hydro's tier 1 rate (about $25/MWh) the generator would realize benefits of about $1,000,000 annually. Given West Fraser's corporate operating scenario, with Quesnel River Pulp back to full operation, this means that the generated power would actually displace electrical purchases at BC Hydro's tier 2 rate (about $76/MWh), and benefits would therefore be about $3,000,000 annually. In addition, West Fraser was actively engaged in negotiations with BC Hydro to have the power generated at Eurocan credited at BC Hydro's

current rate for power calls (i.e. something in the order of $110/MWh), and one could therefore foresee an annual benefit in the order of $5,000,000 annually.

· A number of electrical energy conservation projects have been identified that could reduce Eurocan's electrical bill by $1,000,000 annually, with potential for annual savings of $2-3,000,000 with a bit more study.

· Eurocan has a number of outdoor tanks that are used to store hot process fluids, yet these tanks are uninsulated. This is unheard of in the industry, particularly in northern climes. Insulation of these tanks would cost about $500,000 and would give an annual benefit of at least $1,000,000.

· The Eurocan CMP (Chemi-Mechanical Pulp) mill presently vents the waste steam produced by the pulp refiners to atmosphere. Recovery and reuse of this steam (capital cost about $3,500,000) would give an annual benefit of about $2,700,000 annually.

· The Eurocan CMP was built in the late 1980's, and the depreciation of the plant started with the plant startup as 20 year straight line CCA. This should have finished almost 2 years ago but for unknown and highly questionable reasons West Fraser instructed Eurocan to continue depreciation charges beyond the 20 year period. These charges amount to some $3,000,000 annually, and are reflected directly Eurocan's profit/loss position. On the other hand, these charges obviously have no impact on Eurocan's cash position (beyond tax considerations). One could wonder of this is even legal, let alone ethical or justified.

The above are only a small sampling of the obvious opportunities that have been identified that could greatly improve Eurocan's economic performance. I have selected these opportunities to list here as they are relatively simple to explain to those who are unfamiliar with pulp and paper operations. Please believe me when I say that there is a long list of additional opportunities of similar magnitude that, if acted on, could help turn the situation around.

Some of these opportunities are so obvious that one would question why they would not be acted upon immediately. Why burn expensive fuel oil when natural gas is obviously so much cheaper? Why continue to charge depreciation against an already fully depreciated asset? Why continue to put valuable fibre in the sewer when it could easily be made into paper and sold?

I have no answer for this. It defies all logic, and one can only assume that it is either due to extraordinarily incompetent management, or it is an informed attempt to make the Eurocan operation look (unjustifiably) unviable. No doubt the former plays a significant role, and this could hopefully be remedied through the sale of the Eurocan asset to an interested party and subsequent replacement of the management. But for the moment let's focus on the latter.

One would question what possible motive there could be to make a viable operation appear unviable. For starters there is the recent federal government Green Transformation Programme (GTP) funding for the pulp and paper industry. As you know, Eurocan generated some $30 odd million in credits towards West Fraser's total allocation of $88 odd million. What perhaps you do not know is what West Fraser's plans are for that impending money.

West Fraser has long championed a second electrical cogeneration plant at Cariboo Pulp in Quesnel. This project was rejected in the previous BC Hydro call for power since it was not consistent with their stated objectives around procurement of “green” power. But times change. In the present context of the impending GTP the BC provincial government has directed BC Hydro to do whatever it takes to attract as much of this federal funding to BC as possible. BC Hydro has reacted by “reassessing” their position on the Quesnel project, and giving it more than favourable consideration.

Cariboo Pulp is a joint venture between West Fraser and Daishowa-Marubeni International Ltd. (DMI). DMI have looked at the GTP funding in the context of the federal government's stated GTP goals, meaning that they plan on using their allocation to execute projects based on long-term environmentally driven business goals rather than short-term payback. To DMI this means that they plan on using the bulk of their GTP credits to address motherhood type issues at their Peace River, AB, facility. Their take on the Cariboo cogeneration project is that the project should stand on its own merits as a high payback project, and should not be subject to GTP funding. West Fraser, on the other hand, sees this as an opportunity to take complete ownership of this particular project, and use something like $50-60,000,000 of their GTP credit allocation to execute the project. They will then reap 100% of the benefits, which are extraordinarily good due to the excessively high price currently offered by BC Hydro to purchase new generation power.

But back to Eurocan and its present demise. When an operating asset slips into unviability there are normally some warning signs, and typically corporations react in predictable and logical ways. First, and attempt is normally made to sell the asset to an interested buyer. If this fails then the next step is usually an indefinite idling of the asset. Permanent closure is normally the final step after all else has failed.

One could wonder why no attempt was made to sell Eurocan to an interested buyer. West Fraser has stated that there simply is no hope of making Eurocan viable. I hope I have managed to convince you that such hope does indeed exist, despite West Fraser's assertions.

One could also wonder why West Fraser has chosen to permanently close Eurocan rather than idling the asset, either for a definite period or indefinitely. Idling would have allowed West Fraser to avoid the bulk of the operating losses while waiting for improvements in the world economy and giving due consideration to alternatives other than permanent closure. We can only conclude that their mind was irrevocably made up prior to the announcement. But why?

Should interested parties come forward to consider the purchase of Eurocan it stands to reason that they would want a fair portion of the Eurocan-generated GTP credits to be included in the deal. Public and political pressure directed at saving the Eurocan jobs would have supported this position. If we postulate that something like $25-30,000,000 of West Fraser's GTP total credits would be attached to the Eurocan deal then the Cariboo cogeneration project would be put in jeopardy, much to West Fraser's chagrin.

It is also interesting to note that the current plans being put in place by Eurocan's management, and by extension endorsed by West Fraser's management, are such that the plant will become inoperable shortly after shutdown. There is presently no consideration given to maintaining the idle equipment in such a way as to allow reactivation some time in the future. It is not planned to keep the buildings heated. It is not planned to keep the turbine and generator rotating on the turning gear. It is not planned to rotate major pieces of equipment (paper machines, lime kiln, etc.) on a regular basis. If these equipments are simply left sitting then within a few weeks of the shut down shafts and journals will bend, bearings will develop flat spots, equipment will sag, and the plant will become impossible to start up again.

This seems to fly in the face of what might be considered best business practice. One would think that good businessmen would be motivated to realize the maximum return from even a non-performing asset. In Eurocan's case this should firstly mean selling the operating plant to an interested party; secondly selling the idle plant in its entirety to an interested party; and thirdly selling the equipment piecemeal over a period of say 12 months prior to permanent closure. Why, then, is West Fraser seemingly in such a hurry to wipe Eurocan from the map? I certainly am not party to their thinking. I can only speculate that there is a direct link to the possibility that any attempt to rehabilitate or resurrect Eurocan could interfere with West Fraser's capability to proceed with the cogeneration project at Cariboo using federal GTP funding. Any interested party will require a reasonable period of time to execute due diligence scrutiny, put financing in place, obtain shareholder/board approvals, obtain government approvals, etc. It is not reasonable to expect any credible organization to execute these steps in the 3 month period from West Fraser's announcement to the final plant shut down. This is compounded by the fact that West Fraser is not actively seeking nor encouraging interested parties to come forward.

<u>To summarize:</u>

· *West Fraser have shown that they are determined to wipe Eurocan off the map. They have bypassed all logical business steps by announcing without warning the permanent closure of Eurocan, with only the absolute minimum notice required by law. This notice period is so short that any interested parties will find it difficult or impossible to properly assess the possibilities of purchasing Eurocan as an operating asset before the plant is shut down. The method of shutting the plant is such that the plant will not be able to be restarted in the future, meaning that a sale after the plant closure date will be next to impossible.*

· *Eurocan in its present form could be made viable. Many opportunities have already been identified to optimize the operation, yet these have been consistently ignored by Eurocan and West Fraser management. Acting on these opportunities would require capital investment. Eurocan's share of GTP funding credits would go a long way in financing the needed changes and making Eurocan a viable operation.*

· *West Fraser is planning on using the lion's share of their aggregate GTP funding credits to unilaterally execute a high payback cogeneration project at Cariboo Pulp in Quesnel. The GTP is supposed to be about improving the sustainability and environmental performance of the Canadian pulp and paper industry, not about supporting high payback projects that should stand on their own merits, and West Fraser's plans are therefore not consistent with the stated GTP goals. Furthermore, BC Hydro's participation (after initial rejection of the project) is based on a desire by the BC government to attract as much GTP funding to BC as possible, however if these actions contribute to the permanent shutdown of Eurocan then obviously the best interests of BC* *(and indeed Canada) are not being served.*

The reality of the situation is that something like 500 Eurocan employees will lose their livelihood and to add insult to injury many will lose their savings due to the attendant collapse of the Kitimat real estate market. My number is lower than the total of Eurocan employees because a small number of employees are in a position where their termination package will bridge them into retirement. I am also not including the Eurocan managers, as they are obviously well looked after by West Fraser through all of this. Regardless, this seems like a very high price for the common people to pay for mismanagement and greed on behalf of the company management.

What is needed is the following:

· *the headlong rush to permanently and irrevocably close Eurocan as quickly as possible must be stopped. Sufficient time should be given so that interested parties can come forward and develop a realistic plan for acquiring Eurocan and turning it into a viable operation. Permanent closure should be viewed as the last option, rather than the first.*

· *Eurocan should be endowed with its fair share of GTP credit funding to aid in attracting interested parties and returning the operation to viability.*

There is one other obstacle faced by Eurocan that I have not yet touched on, and that is fibre supply. In the past Eurocan was supplied almost exclusively with residual chips from West Fraser's sawmills in the area. West Fraser had to divest itself of some of its sawmills in the area as a consequence of its takeover of Weldwood, and this combined with the idling of West Fraser's sawmill in Terrace means that Eurocan has become less integrated in West Fraser's overall fibre chain of supply. Regardless, looking to the future I do not see fibre supply as being an insurmountable problem. Lumber markets will come back, and the supply of residual chips will reestablish itself. Perhaps any future deal for Eurocan could include the Terrace sawmill as well. Some thought needs to be given to this issue, and that thought requires time. West Fraser seem bent on ensuring that sufficient time is not available for due consideration.