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raymond royer

# The Remaking of Domtar

In a little over 10 years, Raymond Royer, without a doubt, has turned Domtar around. So how'd he do it?

By John O'Brien, Managing Editor

**T**he evolution of Domtar over the past ten years has been nothing short of remarkable. From a company in the '90s with too broad a product mix, frequent management changes and seemingly no clear direction, to what it has become today—the largest producer of uncoated freesheet (UFS) in North America and a company that thrives on a management philosophy focused on customers, shareholders and employees.

**W**ho's been driving the "New Domtar" for over a decade now? Raymond Royer—a firm believer in people and that a mindset for continuous improvement must flow throughout the company.

In fact, Mr. Royer embraces and credits Kaizen—a Japanese methodology of continuous improvement and problem solving—as one the key elements to well-functioning teams working within Domtar.

He has also pushed the company to the front of the class in environmental stewardship, and on behalf of Domtar, was honored in 2006 by FSC Canada with its first "Winds of Change Award," which recognizes exceptional contributions to safeguarding the future of our forests.

During his tenure as president and CEO, Royer has engineered some big deals that have helped Domtar gain inroads to U.S. markets and a bigger slice of UFS pie—the latest feat being the \$3.3 billion transaction that combined the assets of Weyerhaeuser's fine paper division with Domtar. There have been other moves along the way, the most notable being the 2001 acquisition of four Georgia-Pacific pulp and paper mills in the U.S. for \$1.65 billion.

In an exclusive interview, Raymond Royer talks about the internal workings at Domtar, the integration of Weyerhaeuser's fine paper business, and his views on how Domtar can get even better.

### **You joined Domtar in 1996. What brought you to the company?**

The people.

I've always believed that in a competitive environment, the difference between a company and its competitors rests on the strengths and the quality of the forces in play—the teams.

So in 1996, when I was asked to join Domtar, the company was involved in several different businesses and was in a challenging financial position with 10 years of negative return on equity. The company was at a crossroad so to speak. And despite several years of restructuring efforts and divestitures that usually impact the morale of employees, there was one thing I thought Domtar had that could help drive a successful turnaround—and that was the employees—a motivated group of people who wanted to succeed and who were ready to take an active role in the consolidation of the fine paper market.

So the good paper mills that we had and the distribution business in Canada were the foundation of our strategic plan of growing organically and through acquisitions in the North American uncoated freesheet market. You know, paper is a people business and looking back at all the great men and

women I had the chance to cross paths with in this company, thank god I accepted the job!

### **How would you describe your style of management?**

Well, I'd say focused and participative. I will usually set and have people embrace a common objective and then what I prefer is to literally ignite the discussion on strategic orientation to identify the best possible route to attain our objectives. I guess some of my colleagues would qualify me as a visionary and a catalyst.

You know, I am not a papermaker, and what I strive to be is a value generator. The two have not always been successfully reconciled. So I came in as an outsider in this fascinating industry with very few misconceptions and no given or prepared answers to any specific challenges or issues.

### **EXECUTIVE HONOR**

Raymond Royer, president and chief executive officer of Domtar Corporation, has been named *PaperAge's* "Executive Papermaker of the Year." He will be honored at a ceremony in New York City on March 31 during AF&PA's Paper Week.

Mr. Royer has served as president and CEO of Domtar since joining the company in 1996. He is also a member of the company's Board of Directors.

After beginning his career as a financial analyst and corporate manager, Mr. Royer joined Bombardier in 1974 to set up the Mass Transit Division, which he headed until 1986. He was subsequently appointed president and COO, a position he held until 1996. Mr. Royer has a Master of Commerce, Bachelor of Civil Law and a Master of Accountancy from Université de Sherbrooke. Mr. Royer is a member of the Board of Directors of Domtar Corporation and Power Financial Corporation.

Mr. Royer is a member of the Québec Order of Chartered Accountants, the Canadian Institute of Chartered Accountants, the Québec Bar and The Canadian Bar Association, as well as a Fellow of the Québec Order of Chartered Accountants. He is a Governor of the Faculty of Business Administration at Université de Sherbrooke, Emeritus Governor of the foundation of the Centre Hospitalier de l'Université de Sherbrooke and is also a member of the International Advisory Board of McGill University's Faculty of Management.

Mr. Royer is an Officer of the Order of Canada, an Officer of the Ordre national du Québec and a Commander of the Order of Leopold II of Belgium. He also holds honorary doctorates from Université de Sherbrooke, Université de Montréal (École Polytechnique) and Université Laval.



The paper and forest products industry is a mature industry with processes that are evolving, but the main principles have stayed relatively static. In this environment, I have worked hard throughout these years to encourage our employees to think outside the box on things like capital investments, an area where I have forced people to take risks when trying to solve problems. I don't like deep pockets thinking in capital intensive industries and I truly believe that spending other peoples' money is too easy a solution.

**Substantial changes have taken place at Domtar under your watch. When you first came to the company, what was your first order of business, so to speak, in redirecting its course?**

The one thing I am a believer in is continuous improvement workshops—Kaizens—that I have experienced in my previous career.

#### **Why Kaizens?**

The one reason I have long preferred Kaizens over other methodologies is that it all starts internally. In this case, the problem solving is developed by the best resources you have: your employees. Kaizens will then be organized gathering a group of people from all spheres of the company and from different locations all working together for two weeks toward identifying and proposing solutions, sometimes requiring

investments. Then they conclude the session by making a presentation to management at the end of the two weeks. I must admit that some of these presentations by people, sometimes in remote locations, standing in front of a large group for the first time in their life and walking through their thought process and their findings is one of the things that has been the most rewarding for me over the years.

**You engineered the huge deal to combine Weyerhaeuser's Fine Papers business with Domtar Inc., which was initially announced in August 2006 and finalized in March 2007. Currently, where are you in the integration process? How much is left to go?**

I'd say for the most part integration is history now. At the operational level, we've consolidated our sales organization within less than 100 days after the March 7th closing, we've conducted a review of our operations resulting in the streamlining of our portfolio of assets, we've identified and launched several projects aimed at reducing costs as part of the synergy exercise and achieved and surpassed our first-year synergy target.

On the corporate side, we've completed a bond exchange and tender offers to simplify our capital structure, we have built our infrastructure and exited the transition service agreements (TSAs) we had in place for finance and HR and we have generated close to 500 million dollars of free cash flow allowing us to strengthen our balance sheet.

So we've done a lot, and I'd say the time has come to reap the benefits of the 625+ projects that will hopefully bring \$200 million worth of synergies.

**As the two businesses were brought together, did you find that there was a big difference in the corporate culture of Weyerhaeuser compared to that of Domtar?**

It takes two to tango and this is clearly a risk with such transactions because a combination is more about people than the assets.

In this deal, there were no major differences between the two cultures and the risks were minimized because the forces at play—our people—have participated in several transactions in the past. They were eager to make the best out of the combination. There were no discussions about the “how to,” the discussions were about the “best way to.”

**What “positives” did each company bring to the table, and how did you handle this?**

For example, in occupational health & safety one side of the organization was excessively stringent in the application of

OH&S policies with some impressive results. We can apply these principles to all the mills. As for the go-to-market approach, one side of the organization was geared toward providing differentiated service solutions, such as supply-chain management collaborations providing sustainable advantages to the customers and this expertise is now shared across the entire organization.

**Domtar Corp. realized synergies of \$130 million in 2007 and you're expecting to hit \$200 million in 2008. What areas will deliver the 2008 synergies?**

There are six main categories where we have identified more than 625 projects for potential benefits of more than \$200 million. These would include best-in-class practices, SG&A expenses, transportation and logistics, process optimization, procurement and maintenance. As of now, we believe our achievement rate on the potential savings from the projects will be high given the success-to-date and I am confident that we will achieve the \$200 by the end of 2008.



**Domtar's head office is in Montreal, but its operations center is in Fort Mill, South Carolina. Do you get to Fort Mill often? Have there been discussions about moving the company's headquarters to the U.S.?**

In an industry where employee attraction and retention is a challenge in itself, the expertise at all levels of our 13,000-employees and six billion dollar sales company is an asset, including corporate functions.

The transaction we closed March '07 was the combination of a piece of the business of a large centralized public

company with the old Domtar that already had the infrastructure to support all corporate functions such as Finance, Human Resources, Information Technology and Legal, to name a few. Throughout the integration, we have not faced any major operational issues related to the TSA exits and this speaks to the success of our employees who have worked hard to make it a seamless transition. I do spend a lot of time in Fort Mill and I tour the mills regularly, but there have been no discussions concerning the need to move our Head Office from Montreal.

**What measures has/is Domtar taking to compete globally and possibly tap into developing areas of the world?**

Sometimes I think the world can be a distraction if you are losing your edge in your own market. I believe the weak dollar against other currencies like the Euro is giving us a window to position ourselves and leverage our distribution in North America with a supply-chain equal to none. All our actions are geared towards defending and protecting our own market. Our current business model could be exported at some point but clearly our priority is to be the preferred supplier of our North American customers.

**Moving forward, what will Domtar continue to do to improve its competitiveness?**

We are continuously hard at work on many initiatives but let me say that one of our current activities is to review our product lines and eliminate competing products using the best ones as a base to implement our commercial match where products of the same recognized brands such as Lynx or Husky are manufactured at several locations with a standardized quality. This gives us a tremendous advantage over our competition because of our geographical footprint, reducing the average freight distance to reach our customers and the efficient assets that we have making Domtar a fierce competitor in terms of delivered cost position.

**Currently, is there an export market for Domtar's products? ...or do the logistics make it a cost-prohibitive situation? I think I remember hearing during your 4th quarter presentation that the export of cut-size showed promise over that of rolls. Could you elaborate on that?**

No doubt the exchange rate makes it more interesting than ever to tackle the export market, but logistics and transportation costs are definitely an important part of the mill nets. The one thing worth mentioning is that it's not just a simple arbitrage between list prices, transportation costs and currencies. Your willingness to commit volume quarter after quarter on a sustained basis to your prospective customers

abroad is also key. Indeed for a customer to decide to build a position with a new supplier, the commitment you make to be a consistent supplier will impact your price realizations versus quoted list prices.

On that, Domtar does not have an extensive infrastructure overseas in terms of distribution, and given the balance we're seeing between supply and demand in North America, the volume we have available for the export market is very limited. Our priority is to service our North American customers first and I'd say our approach with exports is one that is tactical more than strategic, so the volumes are low.

**The deal to sell Domtar's forest products business to Conifex didn't work out due to forest license rights of two sawmills. Could you shed some light on the situation?**

As you know, the softwood lumber industry in Eastern Canada relies on fiber harvested on public lands so the true value of a sawmilling business is in the harvesting licenses and not so much on the fixed assets. The main issue in Quebec is that the industry operates on an old business model that hooks cutting rights to specific sawmills. What this means is that when there are reductions in overall harvesting volumes, like the 20% cut-backs from the province in the last years, the end result is a network of mills not running at full capacity. In a high fixed-cost environment, with high transportation costs and with a strong Canadian dollar, there are obvious changes in the system that could be implemented to improve the competitiveness of the industry so that you can transfer harvested fiber to the most efficient mills to have them operate on three shifts. British Columbia has done it, Quebec is not ready yet and that is unfortunate.

**Is the forest products business still for sale, and what will you do with it in the meantime?**

We had an agreement to sell the business to Conifex and it didn't go through but this does not change our view of the challenges that we face. We are actively looking to find a new home for our business and our employees, I've made it a priority for this year. In the meantime, we have a decentralized approach and we are working on initiatives on which we have control like recovery factors and labor costs.

**In regards to a price increase, how does Domtar convince a customer that the increase is necessary and that the customer will be getting their money's worth?**

Cost inflation in our industry is a real issue for all manufacturers, mainly because of the run up in energy prices affecting direct costs for fiber, chemicals and energy. For example, in the southern U.S. we have to cover longer distances to secure softwood fiber because the weak housing market has forced sawmill closures and this removes residual chips from the market. Starch prices are also going up mainly because of corn prices increasing with policies and incentives being

granted for the production of ethanol. Rising prices for caustic soda have also been impacting our costs. Caustic soda is a by-product of chlorine and demand for chlorine used in the plastic and vinyl industry is decreasing because of the weak housing market.

I'd say that it's all about quality. We are working hard to preserve our low delivered-cost position but we are not willing to compromise on quality and this is where our customers get their money's worth. They can rely on the consistency in the quality of our products.



**Domtar has taken the high road in the environmental arena, and you, personally, have taken a bit**

**of heat in the past few years from industry colleagues for sitting down and talking with some of the green groups and working with them. Do you see a change in the overall attitude within the North American paper industry towards the environmental movement?**

Yes, I believe mindsets and the attitude toward the environment are certainly changing with people no longer debating on whether climate change is real or not but now debating on ways to minimize their footprint.

Fiber is essential to the papermaking process and sustainability in the forest is essential to ensure the viability of the industry. Our organization adopted Forest Stewardship Council (FSC) standards several years ago because it was the only certification that was chain-of-custody, third-party audited certification starting from the forest, to the mills, distributors and finally to the printers. Today other certification systems, like the Sustainable Forest Initiative (SFI), are

also adopting third-party audits and this is something environmental groups are asking for.

As a large organization, we have multiple stakeholders, so collaborating with environmental groups just like any other group may not be an obligation, but I firmly believe that it is an integral part of our strategic positioning and frankly, there are benefits to engaging in dialogue with them.

**Markets Initiative, an environmental group that lobbies to protect ancient forests, published a report that states sales for Domtar FSC paper doubled from 2006 to 2007. Is this true? And, do you see this as evidence that the buying habits of small and large consumers' are finally swinging towards environmentally-friendly products?**

It is true that we are selling more of our FSC-certified papers, notably in premium printing and publication grades for applications like annual reports, envelopes, direct mail and business forms. Larger companies understand that part



of their equity value is in the market awareness of their brands and logos so they are factoring in the corporate reputation in their risk management policies. One way to minimize these risks, which can affect corporate image, is to implement procurement policies geared toward sustainability, including for paper purchases.

This is where Domtar meets the customers' needs. We recently announced that our premium grades such as our Cougar premium opaque, our Lynx Opaque and our Colors to name a few, would all be FSC-certified, and this is a

major announcement in the industry. This is an example that working with environmental groups helps us create new market opportunities.

**You have said that 2007 was a "historic year" for Domtar. How do you follow that up in 2008?**

We want to offer our customers quality products and service solutions that provide them with competitive advantages at the best possible price, while providing our shareholders with reasonable returns on their investments. The year 2007 has been historic. We demonstrated that running our assets closer to their operating capacity and properly matching supply with customer demand was both possible and necessary. Moreover, we have done it smoothly throughout the integration process and without putting our customers on reservations programs. This is critical, we have to do this in a predictable way to earn the trust of our customers and by successfully achieving this, we are demonstrating that the industry can create value for all its stakeholders and 2007 was very constructive in this regard.

**Where do you see Domtar a few years down the road?**

This is a tricky one because a succession process is about to take place!

There are market trends that I believe will accelerate in the coming years such as the pull on environmental papers from large corporate end-users or costs of logistics that will further increase the barriers to entry in the North American market.

You know Domtar is the result of ten years of executing a clear business plan of growing in fine papers, and while I believe there is room for further consolidation in uncoated freesheet, I don't think there would be much benefit for Domtar to participate.

Over the years, we've gathered the expertise and a set of assets from E.B. Eddy Papers, Great Northern Nekoosa, Willamette, Georgia-Pacific, Weyerhaeuser and Domtar which have provided us with competitive strengths that can hardly be matched. As I do not foresee a significant pullback in energy prices and with the currency where it is against the Euro, our coverage and proximity to customers in the world's largest paper market are going to help us win over the competition.

I think our organization has what it takes to earn the trust of its customers and consolidate its leadership position in North America and to confirm the investment thesis that it is possible to generate returns to shareholders in a mature industry. ■