

PFI Integrated

PFI Integrated (PFI) operates mainly in the pulp and paper and lumber industries. PFI started out in the early 1900s as a series of sawmills, a small family-run business named Bois du Saguenay located in the Saguenay–Lac-Saint-Jean region. Founder Guy Dubois was a local resident who was committed to developing the economy in the region, which had an abundance of natural resources to meet its needs. A skilled entrepreneur, he maintained the company’s steady growth while at the helm. His successors also managed to stay the course as PFI continued growing for many years. As a result, PFI is now listed on the Toronto Stock Exchange (TSX).

The company is now a major economic player in several regions of Quebec, including Abitibi-Témiscamingue, Mauricie and, of course, Saguenay–Lac-Saint-Jean. PFI’s mission is to “efficiently produce products made from high-quality wood to meet the global need for pulp and paper and wood products.” To achieve this mission, PFI counts on its large production facilities—which include 9 pulp and paper mills and 10 sawmills—as well as 3,500 employees. The company, headquartered in downtown-Montréal, sells annually approximately \$590 million in paper and various wood products. Its paper sales are divided into two broad categories: newsprint, which is used for newspapers as well as flyers, advertising inserts, phone books, etc., and commercial printing papers, which are used to print books, magazines, leaflets, etc. It sells both virgin and recycled newsprint and commercial papers. As for its wood products, it offers a range of standard building materials, from 1 by 2 inch to 2 by 12 inch boards of lumber. In addition, the company manages forestland, from logging plans to reforestation, in order to meet part of its raw-material needs for its processing plants.

Description of operations

Forestry operations

Canadian law prohibits PFI from owning any forest land. However, the company is entitled to harvest the land it occupies with the government’s approval. Public forest land is allocated through long-term licences and management or harvesting agreements. Management plans generally cover 20 to 25 years, with renewal clauses every 5 years if the harvesting company has

fulfilled its reforestation and environmental performance obligations. PFI manages 7.6 million hectares of forest land in Quebec. Operations supply logs to sawmills and pulp and paper mills. Forest land management is the most heavily regulated aspect of all PFI's operations, given that it has many environmental and social impacts, partly because some cutting areas are inhabited by First Nations peoples.

The company uses fellers to cut trees. The fellers are transported from one region to another by tractor-trailer to carry out the wood felling operations. The fellers are generally operated an average of 15 to 20 days in one area before PFI transports them to another area. In order to operate properly, this specialized gas-powered machinery must be maintained by PFI employees on a very regular basis. Employees travel to the forest to perform maintenance during cutting periods to avoid any loss in productivity. Among other things, this maintenance involves changing oil and batteries, which are then collected by a firm specializing in handling toxic and hazardous materials. Nevertheless, due to a high level of maintenance and a lack of semi-skilled labour, the fellers are regularly affected by breakages, sometimes shutting down felling operations for several days. Last year, the equivalent of 12 days of production were lost, which resulted in more than \$486,000 in lost revenue.

The company designs and builds its own fellers to meet its specific needs, particularly the terrain where it operates and the tree species it fells. PFI purchases the 1,675 parts used to build the fellers (40% metal parts, 20% plastic parts and 35% electronic components) from over 235 different suppliers, most of whom are based in China.

PFI uses a variety of reforestation methods to ensure the harvested trees are replaced, but most frequently plants traditional seedlings through aerial and terrestrial seeding. The company chooses the best reforestation method based on the local conditions. Despite its efforts, it has yet to obtain forest management certification from the Forest Stewardship Council¹ (FSC), as the Council considers that the company uses inadequate methods, including leaving too much branch and leaf debris on

¹ <https://ca.fsc.org/en-ca>

the ground, which prevents the quick and hearty regrowth of new seedlings. Although the company makes sure to comply with current federal guidelines and observes imposed logging quotas, several studies led by pressure groups have shown that the forest is not being renewed at the rate it is being cut. PFI has determined that it would need to recover more than 400,000 tonnes of branch and leaf debris from the ground in order to comply with the FSC's more stringent guidelines. It estimates that it would cost \$1.5 million per year to collect and transport the debris and \$8 million per year to dispose of it.

Pulp and paper production

There are four key steps to production before products are shipped to clients.

1. Procurement:
 - a. Sawmill by-products like shavings and sawdust
 - b. Paper and cardboard to be recycled
2. Pulp manufacturing
3. Bleaching (optional)
4. Sheet shaping, drying and finishing

Pulp and paper production requires large quantities of water and energy as well as several dangerous chemicals, mainly for producing bleached paper, but also for de-inking recycled paper and cardboard for use as raw materials. Chemicals are also used for water treatment—the most important one being phosphate, which is known to cause damage to water bodies when present in high concentrations. The water used to make paper is filtered to remove all residue and is then treated using phosphate to make it potable. This water is then returned to its source, generally a river or lake. The company also throws out a large amount of plastic containers, which are used by suppliers to deliver raw materials such as chlorine and phosphorus.

Wood product production

PFI's forestry operations supply logs that are sent to sawmills to make lumber. The logs are generally stripped of their bark before being cut into 1- to 2-inch thick boards with a band saw.

An edger is then used to cut the boards to the desired size. The wood chip and sawdust waste is used to produce paper.

Governance

PFI's board of directors (BOD) is made up of five members, and its composition complies with the legislation regarding the independence of directors of public corporations and all other relevant legislation that applies to the composition of BODs. The table below presents all of the members of the BOD. Last year, seven members sat on the board; two members have since retired and have yet to be replaced.

Name	Role	Short biography
Richard Smith	Chair	Mr. Smith completed a PhD in energy economics at the University of Massachusetts and has considerable expertise in corporate governance. He held several senior management roles with Olcan, a multinational aluminum manufacturer, and was later an independent director for another Canadian aluminum manufacturer.
Michael Jadzinsk	Member	Mr. Jadzinsk has worked for a forestry company since 1970, where he has held a variety of positions, including financial analyst and vice-president. He also sits on the boards of directors of a few North American mining companies.
Donald Martin	Member	Mr. Martin has worked as an independent consultant for forestry companies for approximately ten years. Prior to that, he was Chief Executive Officer of Fleur-de-Lys Wood Products, a small company he acquired in the 1990s.
Marco Jackson	Member	Mr. Jackson worked for the <i>New Jersey Times</i> for nearly 35 years, almost 10 of which as Vice-President of Operations. He has considerable expertise in paper procurement.
Paul Laforest	Member and CEO of the company	Mr. Laforest has sat on the board of directors for nearly three years and has also been President and Chief Executive Officer for two years. He was CEO of Vantar Papier Ltd. for almost five years, and prior to that, he held a variety of senior management roles with different forestry companies.

The BOD is in charge of the compensation policy for senior management. The policy, dedicated to all managers in PFI's many mills, is based entirely on them adhering to their respective budgets. At every meeting, board members receive budget information as well as the corporate Balanced Scorecard, composed of 10 indicators concerning financial performance (% return on sales, %

growth in sales by product, % reduction in cost by product), client satisfaction (rate of return on sold products, number of complaints, degree of client satisfaction), internal procedures (rate of non-compliance by type of product manufactured, average rate of productivity by product) and skills and abilities (amount invested in employee training, time to compile strategic information).

Most of today's senior and mid-level PFI managers are mostly unaware of sustainable development issues. They view environmental issues as a necessary evil with no long-term advantages. The BOD generally shares the same opinion, believing that sustainable development is nothing more than a passing fad. For the most part, the BOD is concerned solely with the company's profitability.

Economic performance

In light of the difficult economic context the Canadian forestry industry is facing, PFI has seen sales decrease for all its products except the range of commercial printing papers made of more than 50% recycled fibres, which experienced relatively significant sales growth. PFI has reported significant net losses over the past three years. This past year was particularly disastrous due to a return on equity of approximately -14%, which greatly impacted the company's market value.

Stakeholders

SHAREHOLDERS

PFI is listed on the Toronto Stock Exchange (TSX). Given that the company has been an economic driver in the province for many years, the Québec-based Riverland investment fund acquired a major stake in the company to ensure some level of control over its decisions. The fund has always been perceived as dedicated to creating jobs, supporting the Canadian economy and fostering environmental responsibility as a result of its investment decisions and advertising campaigns. Given how important of a shareholder the fund is—it holds nearly 32% of PFI's voting shares—it is crucial that the company take into account the preferences of this major institutional investor when making decisions. The remaining portion of shares is split among several small investors, with none owning more than a 5% stake in PFI.

Contrary to PFI's management team, several shareholders, including the Riverland investment fund, believe that the company needs, among other things, to improve its environmental and social performance to become profitable once again.

CUSTOMERS

PFI has customers in over 30 countries around the world, although more than 60% of its sales are made in Canada and the United States. Its customers include publishers (commercial papers), business brokers (newsprint) and distribution chains (lumber) that serve as intermediaries with end users—an increasing number of whom are asking for eco-friendly and certified products. PFI's customers put increasing pressure on the company to offer these types of product. In 2016, two customers even stopped using PFI as their supplier because its products were not FSC certified.

PRESSURE GROUPS

Environmental pressure groups, such as PeaceGreen and Friends of the Forest, have made tremendous communication efforts in recent years to raise awareness among paper and lumber consumers about the issue of forest protection and renewal. Moreover, relations have been quite tense between PFI and these groups for a few years now. Recently, PeaceGreen and Friends of the Forest took passive action to temporarily halt forestry operations in Saguenay by chaining themselves to trees. Through this action, these groups called for greater respect for nature during harvesting to ensure the renewal of plant life and the survival of species. They condemned PFI's lack to communication with the public as well as the lack of forestry certifications. The event generated a lot of negative press against PFI.

MEDIA

PFI again made headlines when an investigative journalist reported on the poor working conditions at key Chinese suppliers of maintenance parts for PFI's machinery. The journalist also revealed on the soil and water pollution caused by the dismantling of PFI machinery by other Asian companies that purchase the equipment at the end of its service life to salvage select parts for resale.

EMPLOYEES

Relations with employees and employee unions have historically been good. The company hires many of First Nations workers who believe it is important that PFI's practices respect the environment and would not hesitate to express their concerns to management or even other residents of First Nations reserves in the event of problems that affected their working conditions. Several employees recently complained about the many industrial accidents associated with felling activities, blaming the lack of training on how to use existing machinery and the dangers inherent in its use.

Meanwhile, PFI is experiencing recruitment problems, especially in small municipalities where the aging demographic continues to reduce the number of working-age people available in the labour market. In addition, the most recent employee survey revealed that workers had a moderate sense of belonging and identification towards PFI.

FIRST NATIONS COMMUNITIES

The First Nations communities in areas where PFI operates are aware that the presence of this large company is very important for the local economy, since it provides stable, well-paid jobs. The company also invests in First Nations communities by organizing, among other things, fundraisers for local libraries and community centres. Nevertheless, First Nations communities are also aware that PFI's activities have negative impacts on the community, such as polluting the air and water, reducing biodiversity and destroying plant life. The communities experience these impacts directly and are thus keen to see environmental protection incorporated in PFI's activities.

First Nations communities have been highly critical of how PFI manages forests. The First Nations say that the cutting and reforestation methods used are not sufficient to ensure renewal and that this affects the ecosystems where PFI operates. The areas harvested by PFI are often ancestral hunting and fishing grounds or even important places of worship for the First Nations. The presence of cutting machinery disturbs the habits of the wildlife. Some species, like the caribou,

are almost endangered in certain areas due to the modifications being imposed on their natural habitat. This animal occupies a special place in the First Nations people's culture and diet.

GOVERNMENT

The government is responsible for awarding forestlands and legislate industry practices. To date, it has issued a variety of standards to regulate natural resource consumption and pollutant emission. For PFI, these standards specifically address its water consumption, wastewater discharge and greenhouse gas (GHG) emissions.

A carbon emission cap-and-trade program was recently implemented by the Quebec government, applicable to all of Quebec's major manufacturing facilities. Participation in the program is mandatory for PFI under the law.

Energy

The company uses hydroelectricity to generate over 75% of its electricity, 5% of which comes from a new hydroelectric dam that the company operates on a river next to a sawmill in Mauricie. The rest of its energy comes from the natural gas it uses to heat its sawmills.

The company recently considered acquiring biomass generators. Biomass is any plant-based material (branches, grass, leaves, hay, etc.) or animal waste from which it is possible to extract energy, which is produced by burning the biomass. This combustion generates electricity and heat, which can be used as part of the industrial process or to heat facilities. The company estimates it would cost \$250,000 a year for the collection and transportation of 70 000 tonnes of debris from branches and leaves from the forest to the biomass generator (including the wages of three full-time employees).

Generating energy using biomass would enable PFI to reduce its natural gas and hydroelectricity consumption, saving \$400,000 and \$125,000, respectively. It would also enable the company to reduce its GHG emissions associated with natural gas consumption and hydroelectricity.

Several employees are keen to pursue the biomass project. PFI believes that such a project could

strengthen its employees' sense of belonging and save the company roughly \$5,000 a year in costs associated with staff turnover.

Making use of biomass from cleaning up the forest would also enable PFI to facilitate government inspections relating to logging quotas. The company estimates that it could save \$15,000 a year with regard to the preparation and performance of these inspections.

Aside from the acquisition cost of a biomass generator (\$1,700,000), connection costs (\$200,000) and hiring costs (100 000\$ - two employees to maintain the generators) will have to be incurred. The generator acquisition cost is eligible for a \$600,000 government subsidy. The generator is not expected to retain any salvage value after 15 years. PFI believes biomass generators could be installed at six of its mills. PFI's weighted average cost of capital is 10%. The company's average tax rate is 30%.

Voluntary disclosure

A few years ago, PFI decided to market its products as environmentally and socially responsible. In support of this green marketing strategy, the company started disclosing environmental and social information on its website. The following excerpts are examples of its overarching message:

- "We recognize that the long-term health of our company and the communities in which we operate depends on the sustainability of the natural resources at our disposal and the performance of our facilities."
- "Operational, social and environmental efficiency is at the heart of our concerns at PF Integrated."

No performance indicators are currently published, and the disclosed information is not audited.

Some informed stakeholders therefore started to doubt and criticize the company's claims, especially after whistleblowing articles appeared in the media. They concluded that PFI's voluntary disclosure did nothing to lend credibility to the company's performance. PFI thus lost

a lot of credibility among various stakeholders. Customers who thought they were buying environmentally responsible products felt like they had been duped by PFI representatives. Shareholders, who were already concerned about the company's profitability, questioned management's transparency. Pressure groups and First Nations groups took advantage of the opportunity to accentuate their complaints about the company. Suppliers wondered about the impact of their association with PFI on their sustainable performance.