# 2019

MANAGEMENT'S DISCUSSION & ANALYSIS

CANFOR CORPORATION

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*This Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the year ended December 31, 2019 relative to the year ended December 31, 2018, and the financial position of the Company at December 31, 2019. It should be read in conjunction with Canfor's Annual Information Form and its audited consolidated financial statements and accompanying notes for the years ended December 31, 2019 and 2018 (available at www.canfor.com). The financial information contained in this MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which is the required reporting framework for Canadian publicly accountable enterprises.*

*Throughout this discussion, reference is made to Operating Income (Loss) before Amortization and Adjusted Operating Income (Loss) which Canfor considers to be a relevant indicator for measuring trends in the performance of each of its operating segments and the Company's ability to generate funds to meet its debt repayment and capital expenditure requirements. Reference is also made to Adjusted Shareholder Net Income (Loss) (calculated as Shareholder Net Income (Loss) less specific items affecting comparability with prior periods – for the full calculation, see reconciliation included in the section "Overview of Consolidated Results – 2019 Compared to 2018") and Adjusted Shareholder Net Income (Loss) per Share (calculated as Adjusted Shareholder Net Income (Loss) divided by the weighted average number of shares outstanding during the period). Operating Income (Loss) before Amortization, Adjusted Operating Income (Loss), Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share are not generally accepted earnings measures under IFRS and should not be considered as an alternative to net income (loss) or cash flows as determined in accordance with IFRS. As there is no standardized method of calculating these measures, Canfor's Operating Income (Loss) before Amortization, Adjusted Operating Income (Loss), Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of Operating Income (Loss) before Amortization to Operating Income (Loss) and Adjusted Shareholder Net Income (Loss) to Net Income (Loss) reported in accordance with IFRS are included in this MD&A.*

*Factors that could impact future operations are also discussed. These factors may be influenced by known and unknown risks and uncertainties that could cause the actual results to be materially different from those stated in this discussion. Factors that could have a material impact on any future oriented statements made herein include, but are not limited to: general economic, market and business conditions; product selling prices; raw material and other operating costs; currency exchange rates; interest rates; changes in law and public policy; the outcome of labour and trade disputes; and opportunities available to or pursued by Canfor.*

*All financial references are in millions of Canadian dollars unless otherwise noted. Certain comparative amounts have been reclassified to conform to current presentation. The information in this report is as at February 20, 2020.*

*<u>Forward Looking Statements</u>*
*Certain statements in this press release constitute "forward-looking statements" which involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from any future results, performance or achievements expressed or implied by such statements. Words such as "expects", "anticipates", "projects", "intends", "plans", "will", "believes", "seeks", "estimates", "should", "may", "could", and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are based on management's current expectations and beliefs and actual events or results may differ materially. There are many factors that could cause such actual events or results expressed or implied by such forward-looking statements to differ materially from any future results expressed or implied by such statements. Forward-looking statements are based on current expectations and Canfor assumes no obligation to update such information to reflect later events or developments, except as required by law.*

# 2019 HIGHLIGHTS

In contrast to the record-high lumber and pulp prices seen in 2018, weaker than anticipated global lumber and pulp demand for much of 2019 in combination with excess inventory levels gave rise to a sharp drop in market pricing for both lumber and pulp products in the current year. The deterioration in market conditions, in combination with ongoing fibre supply challenges and significant log cost increases in British Columbia ("BC") resulted in extensive temporary and permanent sawmill curtailments across BC, as well as summer curtailments at Canfor Pulp. On a more positive note, 2019 marked a year of transformational global diversification for Canfor with the acquisition of 70% of the Vida Group ("Vida") in early 2019, and the Company's continuing expansion in the US South, including the acquisition of Elliott Sawmilling Co., LLC ("Elliott"). For the 2019 year, the Company reported an operating loss of $294.3 million and a net loss of $2.10 per share, in sharp contrast to operating income of $608.6 million and net income of $2.78 per share reported for the year ended December 31, 2018.

The acquisition of Vida in early 2019 marked a significant milestone in the Company's strategic plan. Vida's nine sawmills in Sweden produce approximately 1.1 billion board feet of high-quality spruce and pine products and provide access to a sustainable supply of high-quality fibre which will support the growing demand of Canfor's customers in the future. In addition, Vida's established customers and markets in Europe, Australia, the Middle East and North Africa provide significant market opportunities for Canfor, with its geographic and product diversification contributing to more stable product pricing, compared to North America. Further discussion on this acquisition is provided in the "Overview of 2019 – Acquisition of Vida Group" section of this document.

In North America, lumber demand was impacted by severe weather early in 2019, which delayed the start of the spring construction season in many regions. Tepid demand, combined with excess inventory levels heading into 2019, resulted in significant downward pricing pressure throughout most of the year. Lumber demand gradually improved towards the end of 2019, largely in response to declining mortgage rates, an up-tick in US home construction and steady repair and remodeling activity. Offshore lumber demand was down, particularly in China, primarily reflecting a slow unwind of high inventory levels throughout the supply chain and market uncertainty stemming from the ongoing trade dispute between the US and China. European lumber demand was strong through the first half of 2019, leveraging the solid European market fundamentals carried over from 2018. In the second half of 2019, this region experienced some modest pricing pressure driven by an increase in central European inventory levels, partly due to the spruce beetle, combined with weaknesses in other global lumber markets spilling over to the region.

In response to the muted demand and elevated log costs in BC, a number of temporary and permanent sawmill curtailments were announced across the industry throughout 2019, including the Company's permanent capacity reductions and indefinite curtailments at the Vavenby, Mackenzie and Isle Pierre sawmills, which reduced the Company's Western Spruce/Pine/Fir ("Western SPF") annual capacity by 650 million board feet. As part of the Vavenby mill closure, the Company agreed to sell its forest tenure associated with its Vavenby sawmill to Interfor in June 2019, with approval and completion currently anticipated in the first quarter of 2020.

In total, industry-wide rationalization in BC has removed an estimated 2.1 billion board feet of annual Western SPF capacity to-date. The Company's reduction in its operational footprint in BC in 2019 was mitigated in part by an increase in Southern Yellow Pine ("SYP") capacity, both from the Company's previously announced US$125 million organic growth program and its acquisition of Elliott in May 2019. Following ramp-up of the remaining upgrades through 2020, the Company's US South capacity will reach approximately 2.0 billion board feet.

After the extreme price volatility seen in 2018, when the Western SPF 2x4 price reached a record-high of US$655[1] per Mfbm in the second quarter of 2018 before declining dramatically to US$298[1] per Mfbm towards the end of 2018, lumber pricing was much more moderated in 2019, slowly improving through the course of 2019 as the cumulative effect of industry-wide production curtailments began to gradually shift market supply towards a balanced range. The 2019 average benchmark Western SPF 2x4 #2&Btr and SYP 2x4 #2 prices averaged US$360[1] per Mfbm and US$407[1] per Mfbm, respectively, down 25% and 22% from 2018, while prices for other grades and dimensions also showed material year-over-year declines.

[1] Random Lengths Publications, Inc.

Record-high Western SPF benchmark lumber prices in 2018 combined with declining fibre availability in the BC Interior resulted in increased bidding activity and competition for logs in 2018 and 2019. This resulted in a material increase in stumpage costs in BC in 2019, which when combined with higher log hauling costs (mostly distance related) and weak lumber prices, contributed to significant operating losses in BC during the year. In response to the very challenging conditions, the Company took close to 1 billion board feet of production curtailments in 2019 (including approximately 300 million board feet in 2019 related to the aforementioned permanent and indefinite sawmill closures and capacity reductions). In contrast, unit log costs for Canfor's operations in the US South remained stable, reflecting significant volumes of available high-quality fibre in close proximity to its sawmills, while in Europe, unit log costs in the latter half of 2019 fell in response to the declines in European SPF prices over the same period.

In 2019, the Company continued to pay cash deposits on Canadian lumber exports destined to the US, as a result of the imposition of countervailing ("CVD") and anti-dumping duties ("ADD") by the US Department of Commerce ("DOC") in the latter half 2017. As of December 31, 2019, the Company had posted cumulative cash deposits of $421.4 million reflecting a published ADD rate of 7.28% and CVD rate of 13.24%.

In early 2020, the US Department of Commerce ("DOC") announced the preliminary results for the first period of review, which indicated that the Company's preliminary CVD cash deposit rate was 2.93% for 2017 and 2.61% for 2018 (versus a cash deposit rate of 13.24%), while the preliminary ADD cash deposit rate was 2.02% for the entire first period of review (versus a cash deposit rate of 7.28% and an estimated accrual rate of 2.6%). Upon finalization of these rates (anticipated in the third quarter of 2020), an additional recovery, estimated at $140.6 million (US$105.7 million), will be recognized in the Company's consolidated financial statements to reflect the difference between the combined accrual rate of 15.84% and DOC rates for the first period of review. In addition, once final, the Company's current combined cash deposit rate of 20.52% will be reset to the DOC rates based on the first period of review (currently estimated to be 4.63% based on the preliminary determination).

Canfor and other Canadian forest product companies, the Federal Government and Canadian Provincial Governments continue to categorically deny the US allegations and strongly disagree with the current countervailing and anti-dumping determinations made by the DOC. Canada has proceeded with legal challenges under NAFTA and through the World Trade Organization, where Canadian litigation has proven successful in the past. Despite the reduced preliminary rates for the first period of review, no cash duties will be refunded to the Company until such time as the litigation regarding the imposition of CVD and ADD has been settled. Further discussion on CVD and ADD is provided in the "Overview of 2019 – Countervailing and Anti-Dumping Duties" section of this document.

Reflecting the aforementioned factors in 2019, the Company reported an operating loss of $227.4 million for its lumber segment, compared to its operating income of $390.5 million for 2018.

Following record-high pulp prices and operating income in 2018, the pulp and paper segment saw a sharp reversal of market conditions in 2019, which along with the impact of significant sawmill curtailments on supply and costs, weighed heavily on financial results. For the 2019 year, Canfor Pulp Products Inc. ("CPPI") reported an operating loss of $31.0 million and a net loss of $0.47 per share, compared to operating income of $246.6 million and net income of $2.83 per share for the year ended December 31, 2018.

Global pulp market fundamentals were extremely challenging throughout 2019. Prices to China, the world's largest consumer of softwood pulp, fell US$330 per tonne, or 36%, from the mid-2018 peak to end 2019 at US$580[2] per tonne, their lowest level in over 10 years. The rapid decline reflected a combination of weaker than anticipated global demand, particularly in Europe where demand for printing and writing papers fell sharply, and continued elevated global pulp inventory levels. For the 2019 year as a whole, Northern Bleached Softwood Kraft ("NBSK") pulp list prices to China averaged US$634[2] per tonne, a decrease of US$244 per tonne, or 28%, from 2018, while North American NBSK pulp list prices averaged US$1,239[2] per tonne for 2019, down US$98 per tonne, or 7% from 2018 (before taking account of customer discounts). Bleached Chemi-Thermo Mechanical Pulp ("BCTMP") prices saw similar weakness in demand and pricing pressure throughout 2019, with US-dollar prices to China falling US$112 per tonne, or 19%, year-over-year.

[2] Resource Information Systems, Inc.

Operating losses in the pulp and paper segment, for the most part, reflected substantially lower average pulp unit sales realizations. To a lesser extent, results were also impacted by lower production and shipments in response to the deteriorating pulp market conditions and fibre supply disruptions, which necessitated CPPI taking phased summer curtailments at all of its NBSK pulp mills in Prince George, BC, as well as at its BCTMP mill in Taylor, BC, reducing NBSK pulp production and BCTMP production by 80,000 tonnes and 60,000 tonnes, respectively.

Higher pulp unit manufacturing costs primarily reflected reduced production in 2019, combined with increased fibre and energy costs, the latter mostly resulting from reduced residual supply related to the sawmill curtailments. For most of 2019, CPPI experienced significant fibre supply disruptions, driven largely from BC Interior sawmill curtailments, which led to higher fibre costs as CPPI sourced incremental volumes of materially higher-cost whole log chips. Recognizing the challenging market conditions and increased fibre costs, CPPI commenced a $40 million cost reduction initiative at the beginning of 2020, with targeted savings achieved through improving reliability, reducing overhead cost and improving fibre utilization, with the full amount of annualized savings anticipated by the end of 2021.

Through 2019, CPPI continued its quarterly dividends of $0.0625 per common share, returning a total of $16.4 million to shareholders in the year.

In August 2019, the Company received an unsolicited and non-binding proposal from Great Pacific Capital Corp. ("Great Pacific") to acquire all outstanding common shares of the Company at a price of $16.00 per common share. Following the evaluation by a special committee of independent directors established by Canfor's board of directors, including a formal independent valuation and fairness opinion and recommendation, Canfor's board of directors entered into an arrangement agreement with Great Pacific and recommended that Shareholders vote in favour of the transaction. The "majority of the minority" vote required to approve this arrangement agreement was not achieved, and as a result, Canfor agreed with Great Pacific to terminate the Arrangement in December 2019.

Looking ahead to 2020, the Company is focused on reducing debt levels and capitalizing on a projected gradual improvement in market conditions for lumber and pulp. Notwithstanding the current challenges in BC, the Company continues to focus on mitigating the fibre cost escalation in recent years.

Further discussion on the more significant developments is provided in the "Overview of 2019" section of this document.

# COMPANY OVERVIEW

Canfor is a leading Canadian integrated forest products company based in Vancouver, British Columbia, involved primarily in the lumber business, with production facilities in BC, Alberta, and the US, as well as in Sweden with its recent majority acquisition of Vida. Canfor also has a 54.8% interest in CPPI which is involved in the pulp and paper business with production facilities located in BC. As of December 31, 2019, Canfor employed 6,766 people, of which 1,292 are employed by CPPI.

Significant changes to the Company's business in 2019 include the following:

- On February 28, 2019, the Company announced that it had completed the purchase of 70% of Vida for a purchase price of 4,134 million Swedish Krona, including working capital (approximately CAD$590 million).
- On May 31, 2019, the Company announced that it had completed the first phase purchase of 49% of Elliott. The balance will be acquired on May 31, 2020.
- During late 2018 and throughout 2019, the Company announced temporary and permanent sawmill curtailments in BC in response to weak market conditions and high log costs, including the Company's permanent capacity reductions and indefinite curtailments at the Vavenby, Mackenzie, and Isle Pierre sawmills. The indefinite and permanent curtailments reduced the Company's Western SPF annual capacity by 650 million board feet.
- In response to a combination of weaker market conditions and short-term fibre constraints resulting from industry-wide sawmill curtailments in the BC Interior, CPPI announced temporary pulp mill curtailments at its Intercontinental, Northwood and Prince George NBSK pulp mills in Prince George, BC and at its BCTMP mill in Taylor, BC. These temporary curtailments reduced CPPI's NBSK pulp and BCTMP production by approximately 80,000 tonnes of NBSK pulp and 60,000 tonnes of BCTMP, respectively.

**Lumber**

Combined, Canfor's lumber operations have an annual production capacity of approximately 6.6 billion board feet of lumber reflecting organic growth capital investments in the US South and the above noted acquisitions of Elliott and Vida. The majority of lumber produced by Canfor from its facilities is construction and specialty grade dimension lumber that ranges in size from one by three inches to two by twelve inches and in lengths from six to twenty-six feet. A significant and increasing proportion of Canfor's lumber production is comprised of specialty products that command premium prices, and high-value products including Square Edge lumber for the North American market, J-grade lumber for the Japanese market, and machine stress rated ("MSR") lumber used in engineered applications such as roof trusses and floor joists. Canfor has expanded its product offering in recent years to include high-value engineered wood products, higher-grade MSR lumber, premium one-inch boards, as well as an array of custom specialty products stemming from the acquisition of Vida, including strength-rated trusses, beams, and tongue-and-groove timber.

Canfor's North American lumber operations also include one finger-joint plant, two glulam plants, one whole log chipping plant and a trucking division. The Company, in partnership with Pacific BioEnergy Corporation, operates pellet plants at the Chetwynd and Fort St. John sawmill sites. Canfor's North American lumber business segment also includes a 60% interest in the Houston Pellet Limited Partnership, which has an annual capacity of approximately 225,000 tonnes of wood pellets. Canfor's European lumber business segment also includes its 70% interest in Vida's nine value-added facilities (including the manufacturing and sale of wood packaging and modular housing, industrial products and energy).

Canfor holds approximately 11.0 million cubic metres of annual harvesting rights for its solid wood operations under various forest tenures located in the interior region of BC and northern Alberta, and harvests logs from those tenures to supply its interior lumber operations. Any shortfalls in mill requirements are made up with wood purchased from other tenure holders in those areas. The wood fibre requirements in the US and Europe are met through open market purchases, substantially from private timberland owners.

Canfor markets lumber products throughout North America and overseas through its sales offices in Canada, the US, Japan, China, Sweden, England, Denmark, Holland, and Australia. In addition to its own production, Canfor also markets lumber produced externally to complement its product line. While a significant proportion of Canfor's product is sold to markets in the United States, shipments into Europe have increased following the acquisition of Vida, while volumes to other offshore markets remain steady. The Company ships substantially all domestic lumber sales volumes by truck and rail, while the vast majority of product sold offshore is transported by container ship.

**Pulp and Paper**

Canfor's Pulp and Paper segment is comprised of three NBSK pulp mills and the Taylor BCTMP mill, all of which are owned and operated by CPPI in BC. CPPI produces NBSK pulp, BCTMP, and specialty paper. NBSK pulp is primarily a bleached product, although unbleached and semi-bleached grades are also produced at the Prince George pulp and paper mill.

CPPI mills have the annual capacity to produce approximately 1.1 million tonnes of NBSK pulp and approximately 230,000 tonnes of BCTMP. CPPI's paper machine, located at the Prince George pulp and paper mill, has an annual production capacity of approximately 140,000 tonnes of kraft paper.

Canfor supplies CPPI with residual wood chips and hog fuel (principally bark) produced at certain of its specified sawmills. Prices paid by CPPI for residual wood chips are based on a pricing formula to reflect market prices and conditions, with hog fuel purchased by CPPI at market prices. CPPI also has fibre supply agreements with third parties to supplement its supply of wood chips and hog fuel.

In prior years, CPPI's sales network represented and co-marketed UPM-Kymmene ("UPM") pulp products in North America, Japan and Korea, while UPM's pulp sales network represented and co-marketed CPPI's products in Europe and China, as part of a strategic sales and marketing cooperation agreement, named Fibre United. In 2019, CPPI and UPM made a joint decision to end this strategic sales and marketing cooperation agreement to enable the development of each company's strategic directions. For CPPI, this means conducting its own direct marketing to its markets including China, Japan and Korea. The cooperation remained in place until the end of 2019. The transition to the new marketing arrangements has gone smoothly.

**Business Strategy**

One of Canfor's primary objectives is to be the leading supplier of sustainable wood products to the building industry around the world. Canfor is focused on increasing its building products business in global markets, including key offshore markets such as China, Japan, and Korea, and on making higher value structural lumber and specialized products for specific customer needs. The acquisition of Vida has expanded Canfor's global markets to include Europe, Australia and Africa. The Company is also committed to being a major supplier to the retail segment of the lumber market, which includes serving major home centres.

Canfor's overall business strategy is to be a leader in the forest products industry, achieving top-quartile margin performance by:

- Expanding geographical markets, increasing market share of value-added products and building strong long-term partnerships with valued customers;
- Optimizing the extraction of high-margin products and value from its available fibre sources;
- Attaining world-class supply chain performance;
- Achieving and maintaining a low-cost structure and maintaining a strong financial position;
- Developing an enterprise-wide culture of safety, innovation and engagement;
- Capitalizing on attractive growth opportunities;
- Optimizing its green energy business and positioning the Company as a leading supplier of green, environmentally friendly building products; and
- Contributing to the climate change solution by supporting thriving forests that absorb carbon and producing sustainable wood products that store carbon.

CPPI's overall business strategy is to be a pulp and paper industry leader with strong financial performance, accomplished through:

- Optimizing the value from its premium quality pulp and paper products in specialty end use applications;
- Attaining world-class supply chain performance;
- Preserving its low-cost operating position and maintaining a strong financial position;
- Growing its green energy business;
- Contributing to the climate change solution by producing sustainable pulp products that support the bioeconomy;
- Developing an enterprise-wide culture of safety, innovation and engagement; and
- Capitalizing on accretive growth and diversification opportunities.

# OVERVIEW OF 2019

## Markets and Pricing

### (i) Solid Wood

As mentioned, the sharp decline in North American lumber demand and build of high inventories through the supply chain in the latter part of 2018 persisted into 2019. This weakness was further exacerbated by severe weather early in 2019 which delayed the start of the traditionally busy spring construction season in many regions and resulted in significant pricing pressure through much of 2019. Lumber market fundamentals showed modest signs of improvement towards the end of 2019, supported by favourable macro-economic indicators and a moderate up-tick in North American home construction activity, as well as the cumulative impacts of market downtime. The Canadian housing market reflected lower-trending multi-family housing starts in major Eastern Canadian cities, while offshore lumber demand was down throughout 2019, particularly in China and Japan, reflecting a slow unwind of high inventory levels throughout the supply chain and market uncertainty stemming from trade disputes. In Europe, lumber demand remained solid through the first half of 2019, however, an increase in central European supply and inventory levels (partly attributable to the spruce beetle epidemic in that region) placed downward pressure on pricing in the latter half of the year.

In 2019, average benchmark lumber prices were well below the record-high prices seen in 2018. Western SPF prices peaked at US$655 per Mfbm in the second quarter of 2018, before declining 54% to lows of US$298 per Mfbm towards the end of 2018. For 2019, the North American benchmark Western SPF 2x4 #2&Btr lumber price averaged US$360 per Mfbm, down US$120 per Mfbm, or 25%, compared to 2018. The Western SPF 2x6 #2&Btr lumber price also decreased significantly, down US$78 per Mfbm, or 18%, from the prior year, with more pronounced decreases seen in wider-width Western SPF products.

The following table shows benchmark Random Lengths prices for selected key grades and widths of Western SPF lumber:

| (Average Western SPF US$ price, per thousand board feet)[3] | **2019** | **2018** | **Change** |
|---|---|---|---|
| 2x4 #2&Btr | **$ 360** | $ 480 | $ (120) |
| 2x4 #3 | **$ 285** | $ 372 | $ (87) |
| 2x6 #2&Btr | **$ 348** | $ 426 | $ (78) |
| 2x10 #2&Btr | **$ 344** | $ 446 | $ (102) |

Southern Yellow Pine lumber prices experienced similar declines, due to the weaker global lumber market fundamentals. The Random Length SYP East 2x4 #2 price was down US$118 per Mfbm, or 22%, compared to 2018 with similar price decreases seen for most wider-width SYP lumber products as highlighted in the following table:

| (Average SYP East US$ price, per thousand board feet)[3] | **2019** | **2018** | **Change** |
|---|---|---|---|
| 2x4 #2 | **$ 407** | $ 525 | $ (118) |
| 2x6 #2 | **$ 310** | $ 407 | $ (97) |
| 2x8 #2 | **$ 304** | $ 396 | $ (92) |
| 2x10 #2 | **$ 321** | $ 420 | $ (99) |
| 2x12 #2 | **$ 487** | $ 477 | $ 10 |

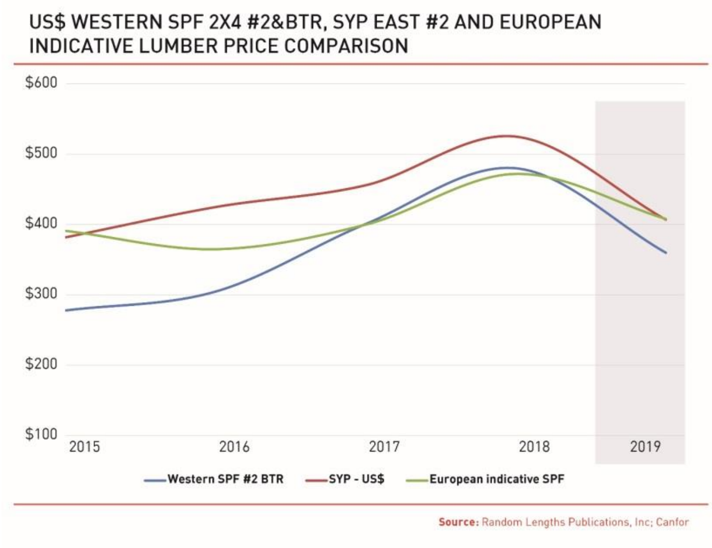
The average European indicative SPF lumber benchmark price (an internally generated benchmark based on delivered price to the largest continental market), at 3,860 Swedish Krona ("SEK") per Mfbm, was down SEK 251 per Mfbm, or 6%, from the prior year, largely reflecting more stable European demand throughout most of 2019, with an oversupply in central Europe lumber combining with weaker market conditions that spilled over from North America in the latter part of the year.

| (European indicative SPF SEK price, per thousand board feet)[4] | **2019** | **2018** | **Change** |
|---|---|---|---|
| European indicative SPF lumber price | **3,860** | 4,111 | (251) |

As mentioned, prices for Western SPF and SYP products declined sharply in 2019 while the European indicative SPF lumber price saw more modest declines. The spread between the prices of SYP East 2x4 #2 and Western SPF 2x4 #2&Btr lumber products narrowed during the year (see Chart 1).

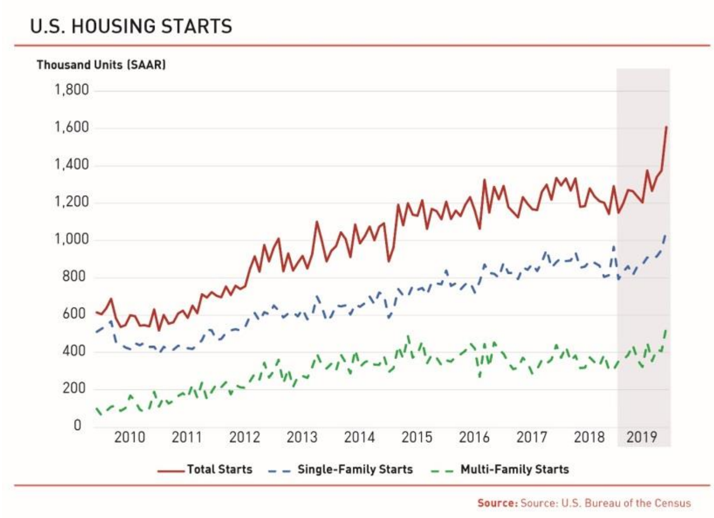
[3] Random Lengths Publications, Inc.
[4] European indicative lumber price is an internally generated benchmark based on delivered price to the largest continental market.

Chart 1




US housing starts, on a seasonally adjusted basis, averaged 1,298,000 units[5] in 2019, an increase of 4% from 2018, and representing the highest annual average since 2007 (Chart 2). Single-family starts, which consume a higher proportion of lumber, were up 3%, outpaced by multi-family starts which were up 8% year-over-year.

Chart 2



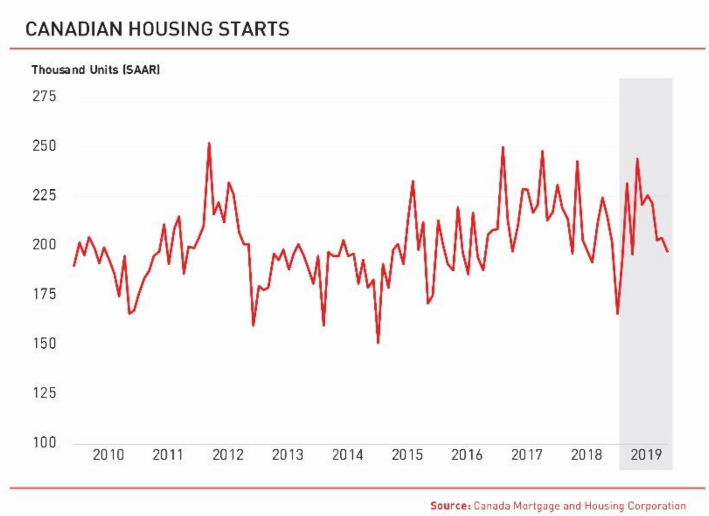

Notwithstanding a sharp increase in the fourth quarter of 2019, new home inventories remained below historical low levels, while existing home inventories remained steady at the historically low levels seen towards the end of 2018 (see Chart 3). Both metrics, along with new housing starts, highlight the slight improvement in US market fundamentals towards the end of 2019.

[5] Source: US Bureau of the Census.

Chart 3


Despite continued strength in the Canadian housing market in 2019, housing starts, at 209,000 units[6], were down slightly from 2018 (Chart 4), largely reflecting higher interest rates and increased concern over housing affordability.

Chart 4

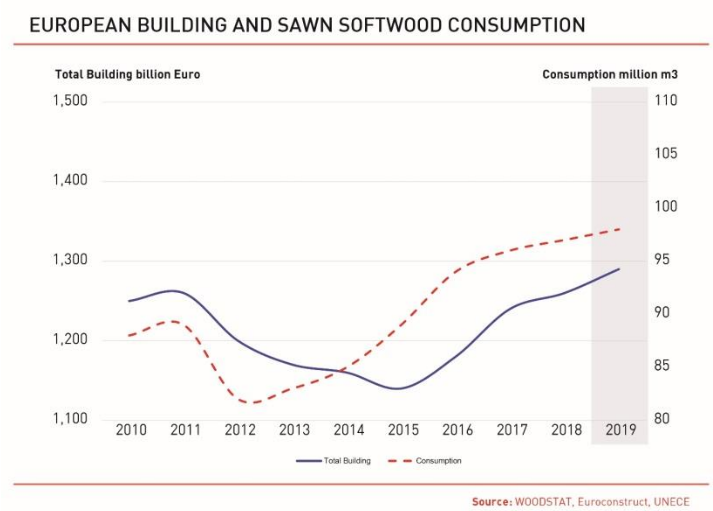



As mentioned, demand in the Company's offshore markets waned in 2019, particularly in China; however, demand for high-value products in certain offshore regions, particularly Japan, remained steady. Over the past 10 years, the Company through its offshore diversification strategy has enabled a more globally balanced distribution of sales in support of its strategic diversification objectives. The acquisition of Vida in 2019 further complements this geographic diversification strategy. As a result, the Company's exposure to North American markets has declined in excess of 19% since 2009.

[6] Canada Mortgage and Housing Corporation ("CMHC")

Leveraging solid European market fundamentals which carried over from 2018, European lumber demand was strong through the first half of 2019 before experiencing modest pricing pressure driven by an increase in central European inventory levels, partly due to the spruce beetle, combined with weaknesses in other global lumber markets spilling over to the region. Despite the recent pressures, building activity and lumber consumption[7] in the region remained solid (Chart 5).

Chart 5




The Canadian dollar weakened against the US-dollar in 2019, averaging $0.754[8] per US-dollar, down 2 cents, or 2%, from 2018, and strengthened against the SEK, averaging $7.127[8] per SEK, up 42 cents or 6%, from the prior year

**(ii) Pulp**

The elevated inventory levels experienced towards the end of 2018 persisted through 2019, as a sharp fall-off in pulp demand in the Americas and Europe negated a modest increase in Chinese demand. Markets and prices remained under pressure through most of the year, as European pulp producers looked to liquidate their excess inventories in offshore markets, particularly China. As mentioned, NBSK pulp list prices to China for the year averaged US$634 per tonne, US$244 per tonne, or 28%, lower than the 2018 average price. The pulp market weakness experienced in Asia in late 2018 spilled over to North America in 2019 as the year progressed; list prices to that region falling from US$1,405 per tonne in January to US$1,115 per tonne in December.

Global softwood pulp producer inventories started 2019 at a record-high 42 days of supply, well in excess of the balanced range of 27-33 days. As mentioned, although China demand somewhat improved through 2019, the slowdown in demand from other regions, particularly Europe, ensured that inventory levels remained above the balanced range during 2019; softwood inventories ended the year at 37 days of supply, five days lower than the beginning of 2019.

The following charts show the NBSK pulp list price movements in 2019, before taking account of customer discounts and rebates (Chart 6), global pulp shipments by destination (Chart 7) and the global pulp inventory levels (Chart 8).

[7] WOODSTAT, Euroconstruct, UNECE
[8] Bank of Canada (monthly average for the period)

Chart 6

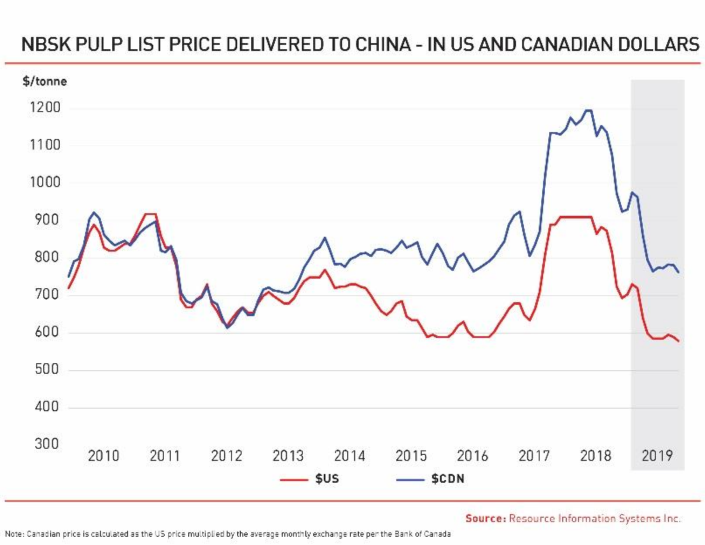
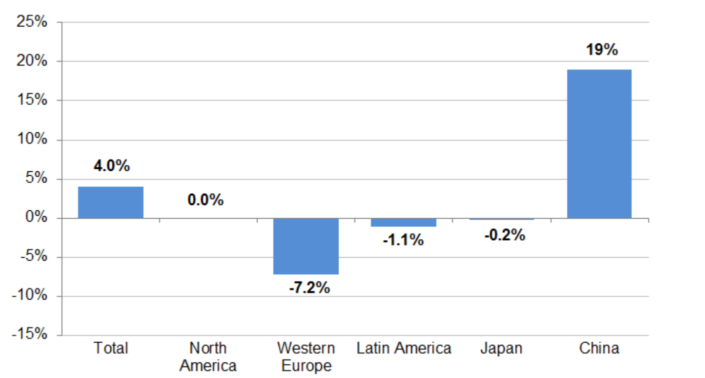


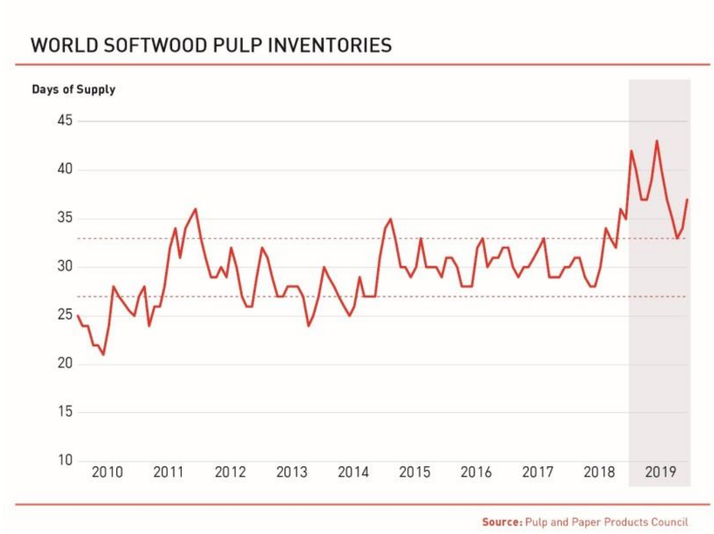

Chart 7

**World Chemical Market Pulp Shipments by destination**
**% growth – 12 months 2019 vs. 2018**




Source: PPPC

Chart 8



## Countervailing and Anti-Dumping Duties

In 2016, a petition was filed by the US Lumber Coalition to the DOC and the US International Trade Commission ("ITC") alleging certain subsidies and administered fees below the fair market value of timber that favour Canadian lumber producers. Canfor was selected by the DOC as a "mandatory respondent" to the countervailing and anti-dumping investigations and is subject to company specific countervailing and anti-dumping duties. As a result of the DOC's investigation, CVD and ADD were imposed on the Company's Canadian lumber exports to the United States beginning in 2017, with cash deposits posted at an ADD rate of 7.28% and CVD rate of 13.24%, resulting in a combined cash deposit rate of 20.52%. Cumulative cash deposits paid to December 31, 2019 were $421.4 million.

Canfor and other Canadian forest product companies, the Federal Government and Canadian Provincial Governments continue to categorically deny the US allegations and strongly disagree with the current countervailing and anti-dumping determinations made by the DOC. Canada has proceeded with legal challenges under NAFTA and through the World Trade Organization, where Canadian litigation has proven successful in the past.

**First Period of Review ("POR1"):**

Despite cash deposits being made at rates determined by the DOC in 2017 (20.52%), the final liability associated with duties is not determined until the completion of administrative reviews performed by the DOC. For the CVD rate, the first period of review was based on sales and cost data through 2017 and 2018, while the ADD rate was based off data from July 2017 to December 2018. For the first period of review, the Company accrued the ADD expense at an estimated rate of 2.6% and recorded the CVD expense at the DOC's cash deposit rate of 13.24%, for a combined CVD and ADD accrual rate of 15.84%.

In early 2020, the DOC announced the preliminary results for the first period of review. Accordingly, the Company's preliminary CVD cash deposit rate was determined to be 2.93% for 2017 and 2.61% for 2018 (versus a cash deposit rate of 13.24%), while the preliminary ADD cash deposit rate was 2.02% for the entire first period of review (versus a cash deposit rate of 7.28% and an estimated accrual rate of 2.6%). For the Company, the difference between the combined cash deposit rate of 20.52% and the combined preliminary DOC rates for POR1 is currently estimated at $217.3 million (US$163.3 million).

Upon finalization of these rates (currently anticipated in the third quarter of 2020), the Company's current combined cash deposit rate of 20.52% will be reset to the rates as determined in the first period of review (currently estimated to be 4.63% based on the preliminary determination). This new cash deposit rate will apply on the Company's Canadian lumber shipments destined to the United States until completion of the administrative review for the second period of review (anticipated in 2021).

A summary of the various rates is as follows:

| Time Period | Deposit Rate | Accrued Rate | Preliminary DOC Rate | Description |
|---|---|---|---|---|
| Apr. 2017 – Dec. 2018 | 20.52% | 15.84% | 4.63% | '1st Period of Review' |
| Jan. 2019 – Dec. 2019 | 20.52% | 29.24%[9] | Anticipated in 2021 | '2nd Period of Review' |
| Jan. 2020 – July 2020 | 20.52% | | Anticipated in 2022 | '3rd Period of Review' |
| **Aug. 2020 – Dec. 2020** | **4.63%**[10] | | | **New estimated cash deposit rate from POR1** |

In addition, upon finalization of these rates, an additional recovery will be recognized in the Company's consolidated financial statements to reflect the difference between the accrual rate of 15.84% and final rates as established for the first period of review. This additional recovery is currently estimated at $140.6 million (US$105.7 million).

[9] Includes Canfor's estimated ADD accrual rate determined by applying DOC methodology to current sales and cost data.
[10] Preliminary POR1 rate subject to review and finalization in 2020; final POR 1 rate currently anticipated to be effective in August 2020.

**Second Period of Review ("POR 2"):**

The second period of review is based on sales and cost data in 2019. While the Company is unable to estimate an applicable CVD rate separate from the cash deposit rate for this period, the ADD rate was expensed at a rate of 16.0% in 2019 reflecting the significant challenges experienced during the year, resulting in a combined accrual rate of 29.24% for 2019, while the cash deposit rate for 2019 remained at 20.52%.

**Summary:**

As at December 31, 2019 Canfor has paid cumulative cash deposits of $421.4 million. For accounting purposes, a net duty recoverable of $32.4 million is included on the Company's December 31, 2019 balance sheet reflecting differences between the cash deposit rate of 20.52%, the Company's POR1 accrual rate of 15.84% and the Company's POR2 accrual rate of 29.24%.

For the year-ended December 31, 2019, the Company recorded a net duty expense of $178.7 million, comprised of cash deposits paid of $137.4 million in 2019, and net additional expense of $41.3 million, largely reflecting the Company's estimated accrual rate for POR2.

| Effective Duties (millions of Canadian dollars) | | 2019 |
|---|---|---|
| Cash deposits paid in 2019 (20.52%) | $ | 137.4 |
| Incremental pre-tax expense attributable to POR2 – ADD (16.0% vs. 7.28%)[11] | | 45.6 |
| Duty recovery, net, POR1 – ADD (2.9% vs 2.6%)[12] | | (4.3) |
| Duty Expense, net | $ | 178.7 |

Canfor will continue to reassess the ADD accrual estimate at each quarter-end, applying the DOC's methodology to updated sales and cost data as this becomes available. Quarterly revisions to the ADD rate may result in a material adjustment to the consolidated statement of income (loss) while the Administrative Reviews are taking place. Changes to the DOC's existing CVD and ADD rates during the course of each Administrative Review may also result in material adjustments to the consolidated statement of income (loss). Despite the reduced preliminary rates for the first period of review, no cash duties will be refunded to the Company until such time as the litigation regarding the imposition of CVD and ADD has been settled.

Additional details on duties is provided in the "Risks and Uncertainties – Softwood Lumber Agreement" section of this document.

## Solid Wood Operations

As highlighted, the lumber industry in BC experienced significant headwinds in 2019. Record-high lumber prices in the previous year combined with the recent impact of severe forest fires and a continued shift out of the Mountain Pine Beetle ("MPB") log profile contributed to material increases in market-based stumpage and increased pricing pressure on non-quota (purchased) timber heading in 2019. As the infestation of the MPB has substantially run its course in Western Canada, harvesting is transitioning back to traditional patterns and operating areas, resulting in a reduction of the Annual Allowable Cut ("AAC") in the BC Interior. A declining timber supply, combined with the impacts of weak lumber pricing and elevated log costs resulted in significant sawmill rationalization across the industry in BC in 2019. In contrast to BC, log costs in the US South continued to remain stable, reflecting a strong supply of high-quality fibre in close proximity to Canfor's sawmills, while in Europe, unit log costs moved downwards during 2019, and were tightly correlated to European SPF benchmark pricing.

The Company's confidence in the longer-term prospects of the lumber industry has driven an investment strategy aimed at positioning itself as a top-quartile margin performer. Given current log supply and demand dynamics in Western Canada, the Company has also taken various steps in recent years to secure sustainable access to high-quality fibre and ensure the viability and competitiveness of its operations.

[11] Reflects Canfor's estimated ADD accrual rate for POR2 determined by applying DOC methodology to current sales and cost data.

[12] Reflects Canfor's estimated ADD accrual rate of 2.9% for POR1 (versus the DOC's ADD cash deposit rate of 7.28%) determined by applying DOC methodology to sales and cost data as of November 30, 2018. Following the addition of December 2018 sales and cost data, Canfor's estimated ADD accrual rate was revised to 2.6% for all of POR1, resulting in a recovery recognized in POR2.

The Company remains focused on optimizing the usage of its fibre supply through targeted capital investments, improved fibre utilization, disciplined cost management and maximized residual fibre revenue, and remains focused on ensuring strong operational performance at all of its operations.

Capital spending in the lumber segment for 2019 totaled $198.2 million, with an increasing proportion of capital deployed in the US South. Capital projects included major upgrades at the Company's sawmill operations in the US South, as part of the previously announced US$125 million organic growth program, which will be largely completed in early 2020. Following ramp-up through 2020, this program will add 300 million board feet of SYP capacity, which when combined with an additional 220 million board feet of SYP capacity acquired from Elliott, will increase the Company's US South capacity to approximately 2.0 billion board feet, with the full run-rate anticipated to be achieved in 2021.

## Acquisition of Vida Group

As mentioned, the Company continued to focus on global diversification in 2019. On February 28, 2019, the Company completed a 70% acquisition of Vida, Sweden's largest privately-owned sawmill company for a purchase price of $589.9 million, including working capital. Vida operates nine sawmills in southern Sweden with an annual production capacity of approximately 1.1 billion board feet, in addition to nine value-added facilities which produce premium packaging, modular housing, industrial products and energy.

Vida's product mix is primarily high-value structural timber, the majority of which is exported to markets other than North America. Vida's sawmills are strategically located in a high-quality sustainable fibre region, with fibre costs tightly correlated to European SPF market pricing. Supported by advanced technology and well capitalized assets, Vida is able to optimize its log supply, resulting in a consistent volume of high-value products. Vida's integrated packaging facilities provide an outlet for low-grade lumber production, with this value-added remanufacturing process optimizing revenue and ensuring maximum value is extracted from each log. A sustainable log supply, combined with Vida's high-value focus and strong market and product diversification, results in more stable earnings relative to the historical volatility experienced in North America. While an increase in central European inventory levels, partly due to the spruce beetle, combined with weakness in other global lumber markets contributed to some modest pricing pressure in the second half of 2019, Vida had solid results for 2019, generating operating income before amortization of $111.6[13] million for the full year 2019.

By leveraging the significantly enhanced market and geographic diversification, Canfor and Vida are well positioned to capitalize on a number of joint global market opportunities. Notwithstanding various challenges presented by global trade tensions, market uncertainty and sawmill rationalization in BC in 2019, an expanded global presence has allowed the Company to optimize its manufacturing and ensure a consistent supply of high-value products to its key markets and customers. The Vida acquisition represents transformational global diversification for Canfor, providing a significant source of high quality spruce and pine fibre, access to new markets, and an increased global presence that will enable the Company to meet the growing demand of its strategic customers going forward.

## Pulp and Paper Operations

Total pulp and paper production in 2019 was down 90,000 tonnes, or 7%, compared to the prior year. The aforementioned phased summer curtailments, which reduced pulp production by 140,000 tonnes, and, to a lesser extent, kiln-related operational upsets more than offset the loss of production from an extended recovery boiler outage at the Northwood pulp mill in the fall of 2018 (approximately 70,000 tonnes).

In light of the challenging market and operating conditions, Management in early 2020 commenced a $40 million cost reduction initiative aimed at reducing unit manufacturing costs. Most of the savings will be achieved from improving reliability, reducing overhead cost and improving fibre utilization, with the full amount of annualized savings targeted by the end of 2021.

[13] Includes proforma operating income before amortization as if the acquisition of Vida had occurred on January 1, 2019.

CPPI's supply of sawmill residual chips was significantly impacted in 2019, as weak global lumber market fundamentals, combined with a challenging log cost environment in BC, resulted in extensive permanent and temporary sawmill curtailments in the BC Interior during the year. Consequently, CPPI's fibre purchases included an increase in the proportion of higher-cost whole log chips. CPPI took a number of actions in response to sawmill rationalization in BC, and in the latter half of 2019, secured additional fibre supply, which will support its operations over the medium to long-term by ensuring a balanced and economical fibre supply for its pulp mills. Recognizing the BC Interior fibre dynamics, there has also been a significant focus on optimizing fibre procurement, as well as maximizing fibre utilization and recovery.

Capital spending in 2019 totalled $103.0 million and principally comprised Northwood pulp mill's commercialization of a new 32 megawatt condensing turbo-generator, construction of a new raw water treatment plant at CPPI's Intercontinental pulp mill (which is anticipated to be completed by the end of 2020), and a new ERP software system, which went live on schedule in May 2019. In 2020, Management currently anticipates lower capital spending in light of the current challenging market conditions, with the implementation and start-up of the raw water treatment plant and several lower-cost fibre-related projects being the key areas of focus. In addition, Management continues to assess and evaluate long-term recovery boiler solutions for its Northwood NBSK pulp mill.

# OVERVIEW OF CONSOLIDATED RESULTS – 2019 COMPARED TO 2018

Selected Financial Information and Statistics

| (millions of Canadian dollars, except for per share amounts) | | 2019 | | 2018 |
|---|---|---|---|---|
| Sales | **$** | **4,658.3** | $ | 5,044.4 |
| Operating income before amortization | **$** | **67.9** | $ | 879.1 |
| Operating income (loss) | **$** | **(294.3)** | $ | 608.6 |
| Net income (loss) | **$** | **(269.7)** | $ | 439.0 |
| Net income (loss) attributable to equity shareholders of the Company | **$** | **(263.0)** | $ | 354.9 |
| Net income (loss) per share attributable to equity shareholders of the Company, basic and diluted | **$** | **(2.10)** | $ | 2.78 |
| ROIC – Consolidated[14] | | **(8.7)%** | | 18.9% |
| Average exchange rate (US$ per C$1.00)[15] | **$** | **0.754** | $ | 0.772 |
| Average exchange rate (SEK per C$1.00)[15] | | **7.127** | | 6.704 |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.

[14] Consolidated Return on Invested Capital ("ROIC") is equal to operating income/loss, plus realized gains/losses on derivatives, equity income/loss from joint venture and other income/expense, all net of minority interest, divided by the average invested capital during the year. Invested capital is equal to capital assets, plus long-term investments and net non-cash working capital, all excluding minority interest components.

[15] Source – Bank of Canada (monthly average for the period).

Selected Cash Flow Information

| (millions of Canadian dollars) | 2019 | 2018 |
|---|---|---|
| Operating income (loss) by segment: | | |
| Lumber | **$ (227.4)** | $ 390.5 |
| Pulp and Paper | **$ (31.0)** | $ 246.6 |
| Unallocated and Other | **$ (35.9)** | $ (28.5) |
| **Total operating income (loss)** | **$ (294.3)** | $ 608.6 |
| Add: Amortization[16] | **$ 362.2** | $ 270.5 |
| **Total operating income before amortization** | **$ 67.9** | $ 879.1 |
| Add (deduct): | | |
| Working capital movements | **$ 114.4** | $ (82.8) |
| Restructuring, mill closure and severance costs paid | **$ (12.0)** | $ - |
| Defined benefit plan contributions, net | **$ (21.9)** | $ (28.2) |
| Income taxes paid, net | **$ (11.5)** | $ (222.4) |
| Adjustment to accrued duties[17] | **$ 41.3** | $ (25.8) |
| Other operating cash flows, net[18] | **$ 22.5** | $ 16.2 |
| **Cash from operating activities** | **$ 200.7** | $ 536.1 |
| Add (deduct): | | |
| Capital additions | **$ (302.8)** | $ (401.4) |
| Finance expenses paid | **$ (49.7)** | $ (23.3) |
| Distributions paid to non-controlling interests | **$ (27.8)** | $ (74.5) |
| Repayment of long-term debt, net | **$ (1.2)** | $ (0.4) |
| Payment of lease obligations[19] | **$ (17.9)** | $ - |
| Consideration paid for acquisition of Vida Group, net of cash acquired | **$ (562.3)** | $ - |
| Vida consideration holdback | **$ (9.7)** | $ - |
| Operating loan facilities acquired from Vida Group, net of foreign exchange | **$ (17.0)** | $ - |
| Consideration paid for the first phase investment in Elliott[20] | **$ (56.1)** | $ - |
| Elliott term loan facility advanced, net of repayment[20] | **$ (7.7)** | $ - |
| Proceeds from long-term debt | **$ 281.7** | $ - |
| Share purchases | **$ -** | $ (88.5) |
| Foreign exchange gain on cash and cash equivalents | **$ 1.4** | $ 8.6 |
| Other, net[18] | **$ (6.2)** | $ 7.9 |
| **Change in cash / operating loans** | **$ (574.6)** | $ (35.5) |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.

[16] Amortization includes amortization of certain capitalized major maintenance costs.

[17] Adjusted to true-up preliminary anti-dumping duty deposits the Company's current accrual rates.

[18] Further information on cash flows can be found in the Company's annual consolidated financial statements.

[19] On adoption of IFRS 16 *Leases*, payment of lease obligations represents cash payments towards reduction of outstanding lease obligations and related interest, which were previously included with cash from operating activities.

[20] Consideration paid includes the first phase investment in Elliott, consisting of a cash payment of $52.0 million (US$38.5 million) and $8.5 million (US$6.2 million) advanced under a term loan facility. An additional $21.1 million (US$15.6 million) has been recognized as an 'Other Current Liability' on the Company's consolidated balance sheet at the initial investment date. As at December 31, 2019, Elliott has repaid $0.8 million (US$0.6 million) of the term loan.

Analysis of Specific Items Affecting Comparability of Shareholder Net Income (Loss)

| After-tax impact, net of non-controlling interests<br>(millions of Canadian dollars, except for per share amounts) | | **2019** | | **2018** |
|---|---|---|---|---|
| **Shareholder Net Income (Loss), as reported** | **$** | **(263.0)** | $ | 354.9 |
| Foreign exchange (gain) loss on long-term debt | **$** | **(3.6)** | $ | 4.3 |
| Loss on derivative financial instruments | **$** | **24.0** | $ | 6.1 |
| Countervailing and anti-dumping duty deposits | **$** | **130.5** | $ | 123.1 |
| Restructuring, mill closure and severance costs | **$** | **15.5** | $ | - |
| Net impact of above items | **$** | **166.4** | $ | 133.5 |
| **Adjusted shareholder net income (loss)** | **$** | **(96.6)** | $ | 488.4 |
| **Shareholder net income (loss) per share (EPS), as reported** | **$** | **(2.10)** | $ | 2.78 |
| Net impact of above items per share | **$** | **1.33** | $ | 1.05 |
| **Adjusted shareholder net income (loss) per share** | **$** | **(0.77)** | $ | 3.83 |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.

# OPERATING RESULTS BY BUSINESS SEGMENT – 2019 COMPARED TO 2018

The following discussion of Canfor's operating results relates to the operating segments and the non-segmented items as per the Segmented Information note in the Company's consolidated financial statements.

Canfor's operations include the Lumber and Pulp and Paper segments. The results of the panels business are included in the Unallocated & Other segment.

## Lumber

**Selected Financial Information and Statistics – Lumber**

Summarized results for the Lumber segment for 2019 and 2018 are as follows:

| (millions of Canadian dollars, unless otherwise noted) | | **2019** | | **2018** |
|---|---|---|---|---|
| Sales[21] | **$** | **3,570.6** | $ | 3,670.4 |
| Operating income before amortization[21] | **$** | **40.9** | $ | 581.3 |
| Operating income (loss), as reported[21] | **$** | **(227.4)** | $ | 390.5 |
| Countervailing and anti-dumping duties[22] | **$** | **178.7** | $ | 169.1 |
| Inventory write-down (recovery) | **$** | **(8.6)** | $ | 36.7 |
| Restructuring, mill closure and severance costs[23] | **$** | **21.2** | $ | - |
| Adjusted operating income (loss) | **$** | **(36.1)** | $ | 596.3 |
| Capital expenditures | **$** | **198.2** | $ | 272.3 |
| Average SPF 2x4 #2&Btr lumber price in US$[24] | **$** | **360** | $ | 480 |
| Average SPF 2x4 #2&Btr lumber price in Cdn$[24] | **$** | **478** | $ | 622 |
| Average SYP 2x4 #2 lumber price in US$[25] | **$** | **407** | $ | 525 |
| Average European indicative SPF lumber price in SEK[26] | | **3,860** | | 4,111 |
| Average European indicative SPF lumber price in Cdn$[26] | **$** | **542** | $ | 614 |
| US housing starts (thousand units SAAR) [27] | | **1,298** | | 1,250 |
| Production – Western SPF lumber (MMfbm)[28] | | **2,760** | | 3,551 |
| Production – SYP lumber (MMfbm)[28] | | **1,438** | | 1,407 |
| Production – European SPF lumber (MMfbm)[28] | | **865** | | - |
| Shipments – Western SPF lumber (MMfbm)[29] | | **2,858** | | 3,538 |
| Shipments – SYP lumber (MMfbm)[29] | | **1,409** | | 1,413 |
| Shipments – European SPF lumber (MMfbm)[29] | | **854** | | - |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.

[21] 2019 includes sales of $724.5 million, operating income of $28.6 million and operating income before amortization of $82.3 million from European SPF lumber operations. If the acquisition of the Vida Group ("Vida") has occurred on January 1, 2019, it is estimated that for the year ended December 31, 2019, European SPF lumber sales would have been $885.2 million, with operating income of $50.6 million and operating income before amortization of $111.6 million. Operating income from the European SPF operations in 2019 includes $39.2 million in incremental amortization and other expenses driven by the purchase price allocation at acquisition date.

[22] Adjusted for countervailing and anti-dumping duties expensed for accounting purposes.

[23] Adjusted for restructuring, mill closure and severance costs related to permanent and indefinite curtailments at Vavenby, Mackenzie and Isle Pierre sawmills.

[24] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.); Average Western SPF 2x4 #2&Btr lumber price in Cdn$ calculated as average Western SPF 2x4 #2&Btr lumber price in US$ multiplied by the average exchange rate – Cdn$ per US$1.00 according to Bank of Canada monthly average for the period.

[25] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.).

[26] European indicative lumber price is an internally generated benchmark based on delivered price to the largest continental market; Average European indicative SPF lumber price in Cdn$ calculated as average European indicative lumber price in SEK multiplied by the average exchange rate – Cdn$ per SEK1.00 according to Bank of Canada monthly average rate for the period.

[27] Source – US Census Bureau, seasonally adjusted annual rate ("SAAR").

[28] Excluding production of trim blocks.

[29] Canfor or Vida produced lumber, including lumber purchased for remanufacture and engineered wood, excluding trim blocks, wholesale shipments and lumber sold on behalf of third parties.

Markets

As mentioned, in contrast to the record-high lumber prices seen in 2018, weaker than anticipated global lumber demand for much of 2019 and excess inventory levels resulted in a sharp drop in market pricing in the current year. In North America, lumber demand was impacted by severe weather early in 2019 which delayed the start of the spring construction season in many regions. Tepid demand, combined with excess inventory levels heading into 2019 resulted in significant downward pricing pressure throughout most of the year. Lumber demand gradually improved towards the end of 2019, in response to declining mortgage rates, an up-tick in US home construction and steady repair and remodeling activity. US housing starts, on a seasonally adjusted basis, averaged 1,298,000 units in 2019, up 4% from 2018, and representing the highest annual average since 2007. Single-family starts, which consume a higher proportion of lumber, were up 3% and multi-family starts were up 8% from 2018, contributing to the modest up-tick in lumber demand. In Canada, housing starts averaged 209,000 units on a seasonally adjusted basis, down 2% from the prior year, largely reflecting lower-trending housing starts in major Eastern Canadian cities.

Offshore lumber demand was down, particularly in China, primarily reflecting a slow unwind of high inventory levels throughout the supply chain and market uncertainty stemming from the ongoing trade dispute between the US and China. European lumber demand was strong through the first half of 2019, leveraging the solid European market fundamentals carried over from 2018. In the second half of 2019, this region experienced some modest pricing pressure driven by an increase in central European inventory levels, partly due to the spruce beetle, combined with weaknesses in other global lumber markets spilling over to the region.

Sales

Revenues for the lumber segment were $3.57 billion for 2019, down 3% compared to 2018, as the significant contribution made by European SPF lumber sales, following the acquisition of Vida, was more than offset by substantially lower Western SPF and SYP unit sales realizations, combined with lower Western SPF shipment volumes, driven by the aforementioned market-related curtailments and weather-related disruptions early in the year.

Total lumber shipments were approximately 5.12 billion board feet for the year, up 3% from 4.95 billion board feet shipped in the previous year, with the addition of European SPF shipments more than offsetting a 22% decline in Western SPF lumber production in the current year.

The considerable decline in Western SPF lumber unit sales realizations from the prior year reflected depressed average benchmark lumber prices and, to a lesser extent, increased duty expenses in the current year. As mentioned, 2019 average benchmark lumber prices were well below the record-high prices seen in 2018. Western SPF prices peaked at US$655 per Mfbm in the second quarter of 2018, before declining 55% to lows of US$298 per Mfbm towards the end of 2018. For 2019, the North American benchmark Western SPF 2x4 #2&Btr lumber price averaged US$360 per Mfbm, down US$120 per Mfbm, or 25%, compared to 2018. The Western SPF 2x6 #2&Btr lumber price also decreased significantly, down US$78 per Mfbm, or 18% from the prior year, with more pronounced decreases seen in wider-width Western SPF products.

Southern Yellow Pine lumber prices experienced similar significant declines, due to the weaker global lumber market fundamentals. The Random Length SYP East 2x4 #2 price was down US$118 per Mfbm, or 22%, compared to 2018, with comparable price decreases seen for most wider-width SYP lumber products.

The average European indicative SPF lumber benchmark price (an internally generated benchmark based on delivered price to the largest continental market), at 3,860 SEK per Mfbm, was down SEK 251 per Mfbm, or 6%, from the prior year, largely reflecting solid demand through most of 2019, with an oversupply in central Europe combining with weaker market conditions in the latter part of the year.

Other revenues for the lumber segment (which are primarily comprised of residual fibre, pulp log and pellet sales as well as the Company's European operations' other lumber-related revenues) increased year-over-year, principally reflecting the incremental European other lumber-related revenues in the current year, and to a lesser extent, timing of pellet shipments.

Operations

Total lumber production for 2019 was 5.06 billion board feet, up 2% from the prior year, as the benefit of incremental European SPF production more than offset the impacts of the aforementioned BC production curtailments and mill closures, which reduced Western SPF production capacity by 16%. As previously noted, in light of lackluster demand and elevated log costs in BC, a number of temporary, indefinite and permanent sawmill curtailments were announced during 2019, reducing production at the Company's BC lumber operations by close to 1 billion board feet in the current year. Production at the Company's US South sawmill operations was up slightly from the prior year reflecting improved productivity year-over-year, partially offsetting capital-related downtime.

Lumber unit manufacturing costs were moderately higher compared to the previous year, largely reflecting the effects of materially higher unit log costs in Western Canada, a modest increase in unit log costs in the US South, and, to a lesser extent, the impact on per unit fixed costs of production curtailments in BC. Fibre supply constraints in Western Canada resulted in increased competition for purchased wood which translated into a material increase in the July 1 Market Pricing System stumpage rate reset. Higher log hauling costs (mostly distance related) and lower log deliveries in the current year also contributed to higher unit log costs in 2019. In the US South, log costs saw a modest increase due to the prolonged wet weather conditions early in the year which resulted in increased competition for available purchased wood. Unit cash conversion costs were broadly in line with the prior year as the significant impact of production curtailments in BC on unit costs were mitigated by lower unit cash conversion costs at the Company's European operations.

# Pulp and Paper

**Selected Financial Information and Statistics – Pulp and Paper**[30]

Summarized results for the Pulp and Paper segment for 2019 and 2018 are as follows:

| (millions of Canadian dollars, unless otherwise noted) | | **2019** | | **2018** |
|---|---|---|---|---|
| Sales | **$** | **1,087.9** | $ | 1,374.3 |
| Operating income before amortization[31] | **$** | **61.9** | $ | 326.2 |
| Operating income (loss) | **$** | **(31.0)** | $ | 246.6 |
| Inventory write-downs | **$** | **10.7** | $ | - |
| Adjusted operating income (loss) | **$** | **(20.3)** | $ | 246.6 |
| Capital expenditures | **$** | **103.0** | $ | 120.5 |
| Average NBSK pulp price delivered to China - US$[32] | **$** | **634** | $ | 878 |
| Average NBSK pulp price delivered to China - Cdn$[32] | **$** | **841** | $ | 1,137 |
| Production – pulp (000 mt) | | **1,035** | | 1,117 |
| Production – paper (000 mt) | | **127** | | 135 |
| Shipments – pulp (000 mt) | | **1,027** | | 1,132 |
| Shipments – paper (000 mt) | | **119** | | 130 |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.

[30] Includes 100% of CPPI, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.

[31] Amortization includes amortization of certain capitalized major maintenance costs.

[32] Per tonne, NBSK pulp list price delivered to China (Resource Information Systems, Inc.); Average NBSK pulp price delivered to China – Cdn$ calculated as average NBSK pulp price delivered to China – US$ multiplied by the average exchange rate – Cdn$ per US$1.00 according to Bank of Canada monthly average rate for the period.

Markets

As mentioned, global pulp market fundamentals were extremely challenging throughout 2019. Prices to China, the world's largest consumer of softwood pulp, fell US$330 per tonne, or 36%, from the mid-2018 peak to end 2019 at US$580 per tonne. As the price weakness in Asia spilled over to North America in 2019, list prices (before taking account of customer discounts) to the latter region fell from US$1,405 per tonne in January to US$1,115 per tonne in December.

World 20[33] global softwood pulp producer inventories started 2019 at a record-high 42 days of supply, well in excess of the balanced range of 27-33 days. As mentioned, although China demand somewhat improved through 2019, a material slowdown in demand from several other regions, particularly Europe, ensured that inventory levels remained above the balanced range during 2019; softwood inventories ended the year at 37 days of supply, five days lower than the beginning of 2019.

[33] World 20 data is based on twenty producing countries representing 80% of the world chemical market pulp capacity and is based on information compiled and prepared by the Pulp and Paper Products Council ("PPPC").

Global bleached kraft paper markets came under pressure in 2019 with high paper inventory levels and weather-related challenges, particularly in North America, impacting demand and pricing. Offshore markets saw steady price declines through the year, while North American markets experienced weakness through the latter half of 2019.

Sales

CPPI's pulp shipments in 2019 were 1.03 million tonnes, down 105,000 tonnes, or 9%, from 2018, principally due to a 7% decrease in pulp production, largely curtailment related, when compared to the prior year. As mentioned, for the 2019 year as a whole, NBSK pulp list prices to China and North America were down sharply year-over-year. Accordingly, average NBSK pulp unit sales realizations were down significantly from 2018 with the sizeable drop in US-dollar list prices more than offsetting the benefit of the 2% weaker Canadian dollar in 2019. Average BCTMP unit sales realizations also reflected substantial price-related decreases in 2019 from the prior year.

Higher energy revenues in 2019 compared to the prior year reflected increased energy production, largely driven by the commercialization and ramp-up of the previously announced Turbo Generator Condensing turbine at the Northwood pulp mill in the first quarter of 2019, which more than offset the decrease in operating days associated with the aforementioned market-related pulp mill curtailments in the current year.

CPPI's paper shipments in 2019, at 119,000 tonnes, were down 11,000 tonnes from 2018, primarily reflecting the impact of a 6% production decrease in the current year. Paper unit sales realizations for 2019 were slightly higher than 2018, as the weaker Canadian dollar combined with a higher-value regional mix, more than offset declining US-dollar kraft paper prices in 2019.

Operations

Pulp production in 2019, at 1.03 million tonnes, was down 82,000 tonnes, or 7%, from 2018 principally reflecting phased summer production curtailments and, to a lesser extent, kiln-related operational challenges, which more than offset the unplanned recovery boiler outage at CPPI's Northwood pulp mill in the previous year. CPPI's Prince George pulp mill ("PG Pulp mill") ran well, while CPPI's other two kraft pulp mills at Intercontinental and Northwood experienced several operational upsets in 2019, the majority of which were kiln-related. CPPI's Taylor BCTMP mill, after a challenging start to the year, finished 2019 strongly, setting a new production record in the fourth quarter.

Higher pulp unit manufacturing costs in 2019 primarily reflected the lower year-over-year production, combined with increased fibre and energy costs. The moderate escalation in fibre costs compared to 2018 primarily reflected an increased proportion of higher-cost whole log chips, which more than offset lower market-based prices for sawmill residuals (linked to higher Canadian NBSK pulp prices).

Paper production in 2019 was 127,000 tonnes, down 8,000 tonnes, from 2018, principally as a result of a market and fibre-related extended mill scheduled outage in the early fall of 2019. Lower paper unit manufacturing costs in 2019 were the result of significant decreases in slush pulp costs (linked to substantially lower Canadian dollar NBSK pulp market prices), which more than offset the impacts from lower production levels and increased operating supply costs in 2019.

## Unallocated and Other Items

| (millions of Canadian dollars) | | **2019** | | **2018** |
|---|---|---|---|---|
| Operating loss of Panels operations[34] | **$** | **(2.3)** | $ | (1.8) |
| Corporate costs | **$** | **(33.6)** | $ | (26.7) |
| Finance expense, net | **$** | **(57.5)** | $ | (26.0) |
| Foreign exchange gain (loss) on long-term debt and duties recoverable, net | **$** | **3.7** | $ | (4.8) |
| Gain (loss) on derivative financial instruments | **$** | **(26.4)** | $ | 1.1 |
| Other income, net | **$** | **9.6** | $ | 9.9 |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.

[34] The Panels operations include the Company's PolarBoard oriented strand board ("OSB") plant, which is currently indefinitely idled and its Tackama plywood plant, which has been permanently closed.

## Corporate Costs

Corporate costs were $33.6 million in 2019, up $6.9 million from 2018, mostly reflecting higher legal fees associated with the ongoing Softwood Lumber Agreement, combined with legal and consulting costs incurred in connection with the Great Pacific proposal (for additional details refer to the "Non-Binding Bid from Great Pacific Capital Corp." section of this document).

## Finance Income and Expense

Net finance expense for 2019 was $57.5 million, up $31.5 million from 2018, primarily reflecting higher interest expense associated with the Company's higher debt levels resulting from the Vida acquisition, payment of the first phase of the acquisition of Elliott, and, to a lesser extent, interest expense on leases related to the prospective adoption of IFRS 16 on January 1, 2019. See the "Liquidity and Financial Requirements" section for further discussion.

## Foreign Exchange Gain (Loss) on Translation of Long-Term Debt and Duties Receivable

In 2019, the Company recognized a foreign exchange gain of $6.8 million on its US-dollar term debt held by Canadian entities, offset in part by a $3.1 million loss on US-denominated duties receivable, both due to the strengthening of the Canadian dollar at the close of 2019 relative to the exchange rate at the close of 2018 (see further discussion on term debt in the "Liquidity and Financial Requirements" section).

## Gain (Loss) on Derivative Financial Instruments

At times, the Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in lumber prices, energy costs, interest and foreign exchange rates. In 2019, the Company recorded a net loss of $26.4 million (2018 – net gain of $1.1 million) in relation to its derivative financial instruments, which principally reflected mark-to-market losses recognized upon settlement of SEK forward foreign exchange contracts in the first quarter of 2019 (gain of $18.8 million recognized in the fourth quarter of 2018), offset in part, by mark-to-market gains on lumber futures and energy derivative contracts (see further discussion in the "Liquidity and Financial Requirements" and "Derivative Financial Instruments" section).

The following table summarizes the gain (loss) recognized in the consolidated statement of income (loss) for each of the various components during the comparable periods.

| (millions of Canadian dollars) | | **2019** | | **2018** |
|---|---|---|---|---|
| Lumber futures | **$** | **5.7** | $ | (17.9) |
| Forward foreign exchange contracts | **$** | **(32.1)** | $ | 18.8 |
| Energy derivatives | **$** | **-** | $ | 0.2 |
| Gain (loss) on derivative financial instruments | **$** | **(26.4)** | $ | 1.1 |

During the year ended December 31, 2019 a gain of $3.9 million was recognized in other equity on the Company's consolidated balance sheet following remeasurement of the put liability.

Additional information on financial instruments in place at year end can be found in the "Liquidity and Financial Requirements" section, later in this document.

## Other Income, net

Other income, net of $9.6 million in 2019, down slightly from 2018, reflected the 2019 receipt of $8.0 million in net insurance proceeds related to a kiln fire at the Company's Urbana sawmill in the US South in August of 2018, offset in part by unfavourable foreign exchange movements on US-dollar denominated cash and receivables of Canadian operations. In 2018, other income, net of $9.9 million principally reflected favourable foreign exchange movements on US-dollar denominated cash, receivables and payables.

### Income Tax Recovery (Expense)

The Company recorded an income tax recovery of $95.2 million in 2019, compared to an expense of $149.8 million in 2018, with an overall effective tax rate of approximately 27% (2018 - 27%).

The reconciliation of income taxes calculated at the statutory rate to the actual income tax provision is as follows:

| (millions of Canadian dollars) | | 2019 | | 2018 |
|---|---|---|---|---|
| Net income (loss) before income taxes | **$** | **(364.9)** | $ | 588.8 |
| Income tax recovery (expense) at statutory rate of 27% (27% in 2018) | **$** | **98.5** | $ | (159.0) |
| Add (deduct): | | | | |
| Non-taxable income related to non-controlling interests | | **0.1** | | 0.2 |
| Entities with different income tax rates and other tax adjustments | | **2.8** | | 8.3 |
| Permanent difference from capital gains and losses and other non-deductible items | | **(6.2)** | | 0.7 |
| Income tax recovery (expense) | **$** | **95.2** | $ | (149.8) |

In addition to the amounts recorded in net income (loss), a tax expense of $4.4 million was recorded to other comprehensive income (loss) in relation to actuarial gains on the defined benefit plans in 2019 (December 31, 2018 – expense of $1.9 million).

## Other Comprehensive Income (Loss)

| (millions of Canadian dollars) | | 2019 | | 2018 |
|---|---|---|---|---|
| Defined benefit plan actuarial gains, net of tax | **$** | **11.8** | $ | 5.0 |
| Foreign exchange translation differences of foreign operations, net of tax | | **(39.6)** | | 50.4 |
| Other comprehensive income (loss), net of tax | **$** | **(27.8)** | $ | 55.4 |

Canfor measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. Any actuarial gains or losses which arise are recognized immediately by means of a credit or charge through other comprehensive income (loss).

For 2019, an after-tax gain of $11.8 million ($16.2 million before-tax) was recorded to other comprehensive income (loss), as losses on the Company's defined benefit pension plans were more than offset by gains on other non-pension post-employment benefits. Gains on the Company's non-pension post-employment benefits primarily related to a 50% reduction in Medical Services Plan ("MSP") premiums following a change in legislation in BC. The 50% reduction in MSP in 2019, when combined with the initial 50% reduction recognized in 2017, resulted in a gain of $95.6 million, or $0.76 per common share ($70.5 million after tax, or $0.56 per common share), reflected as a reduction in the Company's non-pension post-retirement benefit obligation. The losses associated with the defined benefit pension plans principally reflected unfavourable actuarial experience adjustments and a 0.6% reduction in the discount rate in the current year, offset in part by a higher than anticipated return on plan assets.

In 2018, an after-tax gain of $5.0 million ($6.9 million before-tax) was recorded to other comprehensive income (loss), as losses on the Company's defined benefit pension plans were more than offset by gains on other non-pension post-employment benefits. The losses associated with the defined benefit pension plans largely reflected a lower than anticipated return on plan assets, which was offset in part by the benefit of a higher discount rate used to value the net defined benefit obligation. The non-pension post-employment benefit gain reflected the impact of the higher discount rate and favourable actuarial experience adjustments as a result of the most recent actuarial valuation performed as at December 31, 2017 and completed in 2018.

In 2018, the Company purchased $58.9 million of buy-in annuities through its defined benefit pension plans, increasing total annuities purchased to $481.8 million. In 2018, transaction costs of $3.6 million related to the purchase were recognized in other comprehensive income (loss). In 2019, no buy-in annuities were purchased by the Company. Future cash flows from the annuities will match the amount and timing of benefits payable under the plans, substantially mitigating the exposure to future volatility in the related pension obligations.

When taking into account the impact of annuities, 50% of the change to the defined benefit pension plans is fully offset against changes in discount rates and longevity risk (potential increases in life expectancy of plan members) through buy-in annuities, and a further 13% is partially offset through the plan's investment in debt securities.

For more information, see the "Employee Future Benefits" part of the "Critical Accounting Estimates" section later in this report.

In addition, the Company recorded an after-tax loss of $39.6 million to other comprehensive income (loss) in 2019 related to foreign exchange differences for foreign operations, resulting from the strengthening of the Canadian dollar at the end of 2019 relative to the SEK and the US dollar, compared to one-year earlier. This compared to an after-tax gain of $50.4 million in 2018 due to a weaker Canadian dollar relative to its US counterpart.

# SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's financial position as at December 31, 2019 and 2018:

| (millions of Canadian dollars, except for ratios) | **2019** | 2018 |
|---|---|---|
| Cash and cash equivalents | **$ 60.1** | $ 252.7 |
| Operating working capital | **433.9** | 637.3 |
| Current portion of deferred reforestation | **(51.0)** | (52.9) |
| Net working capital | **443.0** | 837.1 |
| Property, plant and equipment | **1,974.5** | 1,607.2 |
| Right-of-use assets | **68.5** | - |
| Timber licenses | **445.7** | 504.1 |
| Goodwill and other intangible assets | **447.3** | 268.3 |
| Retirement benefit surplus | **5.9** | 4.9 |
| Long-term investments and other | **173.7** | 110.4 |
| | **$ 3,558.6** | $ 3,332.0 |
| Long-term debt | **$ 681.7** | $ 408.0 |
| Retirement benefit obligations | **237.0** | 254.7 |
| Lease obligations | **50.9** | - |
| Deferred reforestation obligations (long-term portion) | **56.3** | 63.9 |
| Other long-term liabilities | **32.9** | 24.6 |
| Put liability | **111.9** | - |
| Deferred income taxes, net | **319.0** | 240.9 |
| Non-controlling interests | **423.6** | 283.5 |
| Equity attributable to shareholders of Company | **1,645.3** | 2,056.4 |
| | **$ 3,558.6** | $ 3,332.0 |
| Ratio of current assets to current liabilities | **1.5 : 1** | 2.6 : 1 |
| Net debt to total capitalization | **32.9%** | 6.2% |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.

The ratio of current assets to current liabilities at the end of 2019 was 1.5:1 compared to 2.6:1 at the end of 2018, as a significant reduction in the Company's cash balances was offset in part by an increase in inventories, trade receivables and current liabilities, mainly driven by the acquisition of Vida. Higher current liabilities in 2019 compared to 2018 also reflected the draw-down of the Company's operating line facilities in the current year to finance the Vida and Elliott acquisitions, as well as the weak market conditions.

The Company's net debt to capitalization was 32.9% at December 31, 2019 (December 31, 2018 – 6.2%) and principally reflected the lower cash earnings, capital spending and the drawdown on the Company's operating loan and long-term debt facilities to finance the aforementioned acquisitions early in the year.

# CHANGES IN FINANCIAL POSITION

At the end of 2019, Canfor had $60.1 million of cash and cash equivalents.

| (millions of Canadian dollars) | **2019** | 2018 |
|---|---|---|
| Decrease in cash and cash equivalents[35] | **$ (194.0)** | $ (44.1) |
| Operating activities | **$ 200.7** | $ 536.1 |
| Financing activities | **$ 549.9** | $ (186.8) |
| Investing activities | **$ (944.6)** | $ (393.4) |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.

[35] Decrease in cash and cash equivalents shown before foreign exchange translation on cash and cash equivalents.

The changes in the components of these cash flows during 2019 are discussed in the following sections.

## Operating Activities

For the 2019 year, Canfor generated cash from operations of $200.7 million, down $335.4 million from cash generated of $536.1 million in the previous year. The decrease in operating cash flows primarily reflected materially lower cash earnings in 2019, offset in part by significantly reduced income tax installment payments and favourable movements in non-cash working capital (after adjusting for the initial investment in Vida included in 'Investing Activities' below). The latter principally reflected lower inventory and accounts receivable balances, partially offset by timing-related increases in accounts payable. Cash duty deposits paid in 2019 were $137.4 million compared to $194.8 million in the prior year.

## Financing Activities

Financing activities in 2019 generated cash of $549.9 million compared to cash used of $186.8 million in 2018. Financing activities in 2019 principally related to the draw-down of the Company's operating loan and long-term debt facilities used to finance the Vida and Elliott acquisitions in the first half of 2019, and to service working capital requirements thereafter, offset in part by increased interest payments associated with the Company's increased borrowings, distributions to non-controlling shareholders and the payment of lease obligations. Cash distributions of $27.8 million to non-controlling shareholders in 2019 were down $46.7 million from 2018 as a result of the special dividend of $2.25 per common share paid by CPPI in the prior year, offset in part by distributions to Vida's non-controlling shareholders in the current year.

Financing activities in 2018 consisted of the above mentioned distributions to CPPI's non-controlling shareholders, share purchases totaling $88.5 million under Canfor and CPPI's Normal Course Issuer Bids, and to a lesser extent, the payment of interest on the Company's long-term debt facilities.

For a discussion of the shares purchased under the Normal Course Issuer Bids, refer to the "Liquidity and Financial Requirements" section.

## Investing Activities

In 2019, the Company used net cash for investing activities of $944.6 million, compared to $393.4 million in 2018. The significant increase was primarily due to the $562.3 million consideration paid for the acquisition of Vida (net of cash acquired) (see further discussions in the "Acquisition of Vida Group" section later in this document) and the completion of the first phase of the acquisition of Elliott which included a cash payment of $56.1 million (US$41.6 million), including a net working capital adjustment, and a net advance of $7.7 million (US$5.6 million) to Elliott under a loan agreement (see further discussions in the "Phased Purchase of Elliott Sawmilling Co., LLC" section later in this document).

Additions to property, plant and equipment totaled $302.8 million in 2019, down $98.6 million from 2018. Most of this decrease was in the lumber segment. Capital projects in the lumber segment completed in 2019 included major upgrades at the Company's sawmill operations in Alabama and South Carolina, reflecting the continuation of the US$125 million organic growth program, as well as various smaller, high-returning capital projects aimed at increasing drying capacity and productivity.

In the pulp and paper segment, capital expenditures of $103.0 million were principally associated with Northwood pulp mill's commercialization of a new 32 megawatt condensing turbo-generator, construction of a new raw water treatment plant at CPPI's Intercontinental pulp mill (which is anticipated to be completed by the end of 2020), and a new ERP software system, which went live in May 2019.

# LIQUIDITY AND FINANCIAL REQUIREMENTS

## Operating Loans

*Operating Loans - Consolidated*

At December 31, 2019, on a consolidated basis, the Company had cash of $60.1 million, with $382.0 million drawn on its operating loan facilities, and an additional $78.4 million reserved for several standby letters of credit. Total available undrawn operating loans at year end were $462.1 million, including the undrawn revolving facility and undrawn facilities for letters of credit.

On September 30, 2019, Canfor, excluding Vida and CPPI, increased the principal of its committed operating loan facility by $100.0 million to $550.0 million, with a maturity date of January 2, 2024.

On March 5, 2019, Canfor, excluding Vida and CPPI, entered into a committed revolving credit facility of $100.0 million with a maturity date of February 28, 2020. On October 30, 2019, the maturity date of the committed revolving facility was extended to October 30, 2020. Terms of the revolving facility are largely consistent with Canfor's existing committed operating loan facility.

Interest is payable on Canfor's committed operating loan and revolving facilities, excluding Vida and CPPI, at floating rates based on the lenders' Canadian prime rate, bankers' acceptances, US-dollar base rate or US-dollar LIBOR rate, plus a margin that varies with the Company's debt to total capitalization ratio.

As at December 31, 2019, Canfor, excluding Vida and CPPI, had available operating loan facilities totaled $720.0 million, with $350.0 million drawn on its principal committed operating loan facility and $65.2 million reserved for several standby letters of credit, the majority of which related to unregistered pension plans. No amounts were drawn on the revolving credit facility as at December 31, 2019.

*Operating Loans – Vida*

Vida's operating loan facilities are denominated in various currencies, with interest payable at fixed rates ranging from 1.0% to 1.3%. Vida also has separate overdraft facilities with fixed interest rates ranging from 1.7% to 4.7%. Vida's operating loan facilities have certain financial covenants including minimum equity and interest coverage ratios.

At December 31, 2019, Vida had $18.0 million drawn on its $92.5 million operating loan facilities, leaving $74.5 million available and undrawn at the end of the year.

*Operating Loans – CPPI*

The terms of CPPI's operating loan facility include interest payable at floating rates that vary depending on the ratio of debt to total capitalization and is based on lenders' Canadian prime rate, bankers' acceptances, US-dollar base rate or US-dollar LIBOR rate, plus a margin.

On April 6, 2018, the maturity date of CPPI's principal operating loan facility was extended from January 3, 2020 to April 6, 2022. On September 30, 2019, the maturity date of CPPI's principal operating loan facility was extended from April 6, 2022 to April 6, 2023.

At December 31, 2019, CPPI had drawn $14.0 million from its $110.0 million operating loan facility, with $13.2 million reserved for several standby letters of credit under the operating loan facility, leaving $82.8 million available and undrawn on its operating loan facility at the end of the year.

## Term Debt

Canfor's and CPPI's long-term debt, excluding Vida, is unsecured. Vida's long-term debt is secured by its property, plant and equipment assets.

On February 25, 2019, Canfor, excluding Vida and CPPI, drew the remaining $100.0 million from its Canadian dollar floating interest rate term debt facility, increasing the long-term debt balance to $225.0 million. Canfor, excluding Vida and CPPI, also drew the remaining US$100.0 million from its US-dollar floating interest rate term debt facility, increasing the debt balance to US$200.0 million. The increase in debt levels was to finance the Vida acquisition, first phase purchase of Elliott, and to service working capital requirements.

On February 28, 2019, Vida's long-term debt was consolidated into the Company's balance sheet, with a balance of $20.2 million at December 31, 2019.

On September 30, 2019, CPPI entered into a new non-revolving term loan for $50.0 million, repayable on September 30, 2022, with the calculation of interest and covenants consistent with CPPI's existing committed operating loan facility.

## Debt Covenants

Canfor, excluding Vida, has certain financial covenants on its debt obligations that stipulate maximum debt to total capitalization ratios. The debt to total capitalization is calculated by dividing total debt by shareholders' equity plus total debt. Debt obligations are held by various entities within the Canfor group and the individual debt agreements specify the entities within the group that are to be included in the covenant calculations.

In circumstances when debt to total capitalization exceeds a certain threshold, Canfor is subject to an interest coverage ratio that requires a minimum amount of earnings before interest, taxes, depreciation and amortization relative to net interest expense. Canfor is not currently subject to this test.

Provisions contained in Canfor's long-term borrowing agreements also limit the amount of indebtedness that the Company may incur and the amount of dividends it may pay on its common shares. The amount of dividends the Company is permitted to pay under its long-term borrowing agreements is determined by reference to consolidated net earnings less certain restricted payments.

Vida is also subject to certain financial covenants, including minimum equity and interest coverage ratios.

Management reviews results and forecasts in monitoring the Company's compliance with these covenant requirements. Canfor, Vida and CPPI were fully in compliance with all of debt covenants for the year ended December 31, 2019 and expect to remain so for the foreseeable future.

Substantially all borrowings of Vida and CPPI are non-recourse to other entities within the Company.

## Normal Course Issuer Bid

On March 4, 2019, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 6,260,970 common shares or approximately 5% of its issued and outstanding common shares as of March 1, 2019. The renewed normal course issuer bid is set to expire on March 6, 2020. The Company does not currently intend to renew the normal course issuer bid following its expiry.

In December 2018, the Company decreased its share purchase activity under its normal course issuer bid following the announcement of the acquisitions of Vida and Elliott, and in 2019, no shares were purchased under Canfor's Normal Course Issuer Bid.

In 2018, Canfor purchased 3,425,580 common shares for $84.8 million (an average price of $24.76 per common share) and paid an additional $3.7 million in relation to shares purchased in 2017.

Under a separate normal course issuer bid, CPPI purchased 500 common shares from non-controlling shareholders in 2018 at an average price of $13.01 per common share, and paid an additional $0.1 million in relation to shares purchased in 2017. In 2019, CPPI purchased 17,200 common shares at an average price of $10.67 per common share.

As at December 31, 2019 and February 20, 2020 there were 125,219,400 common shares of the Company outstanding, and Canfor's ownership interest in CPPI was 54.8% (December 31, 2018 – 54.8%).

## Acquisition of Vida Group

On February 28, 2019, the Company completed the acquisition of 70% of Vida, Sweden's largest privately-owned sawmill company, for $589.9 million (4,134 million SEK), including a net working capital adjustment of $0.3 million, plus transaction and closing costs. The acquisition method of accounting was applied in accordance with IFRS 3 *Business Combinations*, when Canfor acquired control of Vida on February 28, 2019.

The Company incurred acquisition-related costs of $4.2 million, principally relating to external legal fees and due diligence costs, which have been included in 'Selling and Administrative Costs'. These amounts were recorded in the Company's consolidated statement of income (loss) when incurred.

Balances that have required significant fair value adjustments for purchase price accounting included goodwill, deferred income taxes, property, plant and equipment and inventory. Including retrospective adjustments following the completion of an external valuation in the fourth quarter of 2019, goodwill of $195.7 million has been recognized as part of the purchase, calculated as the excess of the aggregate consideration transferred and the amount of non-controlling interests, over the fair value of the estimated identifiable assets acquired and liabilities assumed. The goodwill arising from the acquisition is attributable to management strength, expected future income and cash-flow projections, access to new international markets and the ability to further diversify Canfor's current product offering. As part of the consolidation of Vida, a net deferred tax liability of $67.2 million was recognized for differences between tax and accounting values of property, plant and equipment and inventory. None of the goodwill recognized is deductible for tax purposes.

Additional details on the acquisition of Vida are contained in Note 29(b) to Canfor's 2019 consolidated financial statements.

## Phased Purchase of Elliott Sawmilling Co., LLC

On May 31, 2019, the Company completed the first of a two-phase purchase of Elliott, located in Estill, South Carolina, for an aggregate purchase price of US$110.5 million, plus a net working capital adjustment of US$3.1 million. In accordance with IAS 28 *Investments in Associates and Joint Ventures*, the first phase purchase of 49% was recognized as an equity investment, accounted for under the equity method, consisting of an initial cash payment of $52.0 million (US$38.5 million), a subsequent working capital payment of $4.1 million (US$3.1 million), and an additional $21.1 million (US$15.6 million) included as an 'Other Current Liability' on Canfor's consolidated balance sheet at the initial investment date.

As part of the first phase of the transaction, Canfor advanced $8.5 million (US$6.2 million) to Elliott in the form of a term loan facility during the second quarter of 2019. The term loan facility has an interest rate equal to the floating rate on Canfor's principal committed operating loan facility, plus 1.0%, and is secured by Elliott's operating assets. The term loan receivable has been offset against the balance of the above mentioned 'Other Current Liability'. As at December 31, 2019, Elliott has repaid $0.8 million (US$0.6 million) of the term loan.

After adjusting for changes in foreign exchange between the initial investment date and December 31, 2019, a net other current liability of $13.0 million (US$10.0 million) was recorded on Canfor's consolidated balance sheet. Equity income and transactions costs of $0.9 million were recognized during the year ended December 31, 2019.

On May 31, 2020, Canfor will increase its ownership interest to 100%, at which time Elliott's results and balances are expected to be consolidated into Canfor's. Canfor will pay the second instalment payment of US$37.0 million upon closing of the second phase purchase on May 31, 2020, and the third and final instalment payment of US$35.0 million on May 31, 2021.

Additional details on the phased purchase of Elliott are contained in Note 29(a) to Canfor's 2019 consolidated financial statements.

## Commitments – Assets Held for Sale & Restructuring Provision

On June 3, 2019, the Company announced that it had entered into an agreement to sell its forest tenure associated with its Vavenby sawmill located in BC to Interfor Corporation for proceeds of $60.0 million. Also on June 3, 2019, the Company announced its intention to permanently close the Vavenby sawmill following the sale, which is currently anticipated to close in the first quarter of 2020, subject to customary closing conditions, including the consent of the Minister of Forests.

During the second quarter of 2019, as a result of the planned closure and pending sale of Vavenby, the Vavenby sawmill assets and forest tenure of $57.9 million (together, "Vavenby disposal group"), were reclassified to 'Assets Held for Sale' and the reforestation provision associated with the forest tenure of $2.8 million was reclassified to 'Liabilities Held for Sale' on the Company's consolidated balance sheet.

On November 13, 2019, Canfor entered into a separate agreement with a third party to sell certain Vavenby sawmill assets, not included within the existing Vavenby disposal group, as well as one other non-operating asset for total proceeds of $9.7 million. The Company expects the sale to close in conjunction with the aforementioned forest tenure sale to Interfor. Accordingly, during the fourth quarter of 2019, these additional assets totalling $11.1 million were reclassified to assets held for sale and an additional $0.5 million was reclassified to liabilities held for sale.

At December 31, 2019, assets and liabilities for sale totalled $69.0 million and $3.3 million, respectively.

Upon initial classification as held for sale, the carrying values of the assets were assessed for impairment in accordance with IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations*, with no adjustments required.

On July 18, 2019, the Company announced further capacity reductions at two of its BC sawmills. The Mackenzie sawmill was indefinitely curtailed effective July 18, 2019, and one of two shifts was permanently eliminated at the Isle Pierre sawmill effective September 20, 2019.

Due to the aforementioned closure of the Vavenby sawmill and indefinite curtailments, restructuring, mill closure and severance costs ("restructuring costs") of $21.2 million have been recognized for the year ended December 31, 2019. Of the total restructuring costs, $12.0 million was paid in 2019, with $7.6 million included in 'Accounts Payable and Accrued Liabilities' and $1.6 million recognized in 'Other Long-Term Liabilities' on the Company's consolidated balance sheet as at December 31, 2019.

## 2020 Projected Capital Spending and Debt Repayments

Based on its current outlook, assuming no further deterioration in market conditions during the year, the Company anticipates it will invest approximately $150.0 million in 2020 in capital projects, which will consist primarily of various improvement projects and maintenance of business expenditures, with proportionately more capital being allocated to the high-returning discretionary projects in US South and European lumber regions. There are $13.0 million of long-term debt payments scheduled for 2020. The Company currently plans to utilize its cash flow from operations and its available cash and operating loans to finance its capital expenditures during 2020.

## Derivative Financial Instruments

As at December 31, 2019, the Company had the following significant derivative financial instruments outstanding:

a. Futures contracts for the sale of lumber with a total notional amount of 4.1 MMfbm at December 31, 2019. There were unrealized losses of $0.6 million at December 31, 2019 on these contracts.

| | **As at December 31, 2019** | |
|---|---|---|
| **Maturity Date** | **Notional Amount** | **Average Rate** |
| **Lumber Futures Contracts** | (MMfbm) | (US dollars per Mfbm) |
| Future sales contracts | | |
| *0-12 months* | **4.1** | **$415.2** |

b. In the fourth quarter of 2018, in anticipation of the closing of the Vida transaction, the Company entered into forward foreign exchange contracts to reduce its exposure to fluctuations in SEK versus the Canadian and US dollar, resulting in the recognition of an unrealized gain of $18.8 million at December 31, 2018. During the first quarter of 2019 the Company entered into additional US and Canadian dollar forward foreign exchange contracts and upon closing of the Vida acquisition on February 28, 2019, settled all of the aforementioned contracts and realized a net loss of $15.7 million.

   Although Vida primarily transacts in its functional currency of SEK, some of its products are sold in US dollars, British Pounds ("GBP"), Australian dollars ("AUD") and Euros ("EUR"). In addition, Vida holds US, GBP, AUD and EUR denominated operating loan and long-term debt facilities. Its limited exposure to foreign exchange risk is sometimes reduced by forward foreign exchange contracts.

   At December 31, 2019, the following forward foreign exchange contracts held by Vida, were outstanding:

| | | **As at December 31, 2019** | |
|---|---|---|---|
| **Maturity Date** | **Notional Amount Currency** | **Notional Amount** | **Exchange Rates** |
| **Forward Foreign Exchange Contracts** | | (millions) | (rate of SEK to notional currency) |
| *January 31, 2020 - March 31, 2020* | GBP | **£11.0** | **12.43** |
| *January 31, 2020 - April 30, 2020* | USD | **$24.0** | **9.50** |
| *January 31, 2020* | EUR | **€2.5** | **10.74** |

At times, Canfor enters into interest swaps, commodity swaps, and oil collars to reduce its exposure to interest rate risk, energy price risk and diesel purchases, respectively. At December 31, 2019, none of these types of contracts were outstanding.

## Other Commitments

The following table summarizes Canfor's long-term debt obligations excluding interest at December 31, 2019 for each of the next five years and thereafter:

| (millions of Canadian dollars) | 2020 | 2021 | 2022 | 2023 | 2024 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Long-term debt obligations | $ 13.0 | $ 4.5 | $ 50.9 | $ 43.4 | $ 268.4 | $ 314.5 | $ 694.7 |

Interest payments include interest of 4.4% on the Company's US$100.0 million fixed-rate term loan and interest of 1.3% on the Company's US$7.7 million debt to finance certain capital projects at its U.S. sawmills. Interest is also payable on floating rate debt. Interest payments have been excluded from the above commitments.

Other contractual obligations not included in the table above or highlighted previously are:

- Other contractual commitments total $134.0 million, which includes commitments for the construction of capital assets and other working capital items. Commitments related to leases of property, plant and equipment are detailed in Note 7 of Canfor's 2019 consolidated financial statements.
- Deferred reforestation, for which a liability of $107.3 million has been recorded at December 31, 2019. The reforestation liability is a fluctuating obligation, based on the area harvested. The future cash outflows are a function of the actual costs of silviculture programs and of harvesting and are based on, among other things, the location of the harvesting and the activities necessary to adequately stock harvested areas and achieve a "free-to-grow" state.
- Obligations to pay pension and other post-employment benefits, for which the net liability for accounting purposes at December 31, 2019 was $231.1 million. As at December 31, 2019, Canfor estimates that total contribution payments of $19.5 million will be made to its defined benefit plans in 2020.
- CPPI has energy purchase agreements with a BC energy company (the "Energy Agreements") for all three of CPPI's kraft pulp mills. Two of these agreements are for the sale of incremental electrical energy and the third agreement is for load displacement. One of these Energy Agreements included an incentive funding from BC Hydro to support capital investments for the new turbo generator. All agreements include performance guarantees to ensure minimum contractual amounts of electricity are generated, with penalty clauses if they are not met. As part of these commitments, CPPI has entered into standby letters of credit for these guarantees. The standby letters of credit have variable expiry dates, depending on the capital invested and the length of the Energy Agreement involved. As at December 31, 2019, CPPI had posted $7.2 million of standby letters of credit under these agreements, and had no repayment obligations under the terms of any of these agreements.
- Purchase obligations and contractual obligations in the normal course of business. Purchase obligations of a more substantial dollar amount generally relate to the pulp business and are subject to "force majeure" clauses. In these instances, actual volumes purchased may vary significantly from contracted amounts depending on Canfor's requirements in any given year.

# TRANSACTIONS WITH RELATED PARTIES

The Company undertakes transactions with various related entities. These transactions are in the normal course of business, except where noted otherwise.

The Jim Pattison Group is Canfor's largest shareholder with an ownership interest of 50.9% at December 31, 2019. During 2019, subsidiaries owned by The Jim Pattison Group provided lease, insurance and other services to Canfor totaling $5.7 million with $0.3 million outstanding at December 31, 2019.

During 2019, CPPI sold paper to subsidiaries owned by the Jim Pattison Group totaling $3.7 million. No amounts related to these sales were outstanding as at December 31, 2019.

Additional details on related party transactions are contained in Note 24 to Canfor's 2019 consolidated financial statements.

# NON-BINDING PROPOSAL FROM GREAT PACIFIC CAPITAL CORP.

On August 10, 2019, Canfor received an unsolicited and non-binding proposal from Great Pacific pursuant to which Great Pacific would be willing to acquire all outstanding common shares of the Company (excluding those already directly or indirectly owned by Great Pacific) at a price of $16.00 per common share (the "Indicative Offer").

Canfor's board of directors established a special committee of independent directors (the "Special Committee") to review the Indicative Offer and, in consultation with its legal and financial advisors, consider Canfor's strategic alternatives, including Canfor's response, if any, to the Indicative Offer.

Following the conclusion of the evaluation, including a formal independent valuation and fairness opinion and recommendation from the Special Committee, Canfor's board of directors entered into an arrangement agreement (the "Arrangement") with Great Pacific and resolved to recommend that Shareholders vote in favour of the transaction.

Following receipt of votes cast by proxy, it was determined that the "majority of the minority" vote required to approve the Arrangement pursuant to Multilateral Instrument 61-101 - *Protection of Minority Security Holders in Special Transaction*, was not achieved, and as a result, Canfor agreed with Great Pacific to terminate the Arrangement in December 2019.

# SELECTED QUARTERLY FINANCIAL INFORMATION

| | Q4 2019 | Q3 2019 | Q2 2019 | Q1 2019 | Q4 2018 | Q3 2018 | Q2 2018 | Q1 2018 |
|---|---|---|---|---|---|---|---|---|
| **Sales and income** (millions of Canadian dollars) | | | | | | | | |
| Sales | **$ 1,105.2** | **$ 1,091.4** | **$ 1,313.0** | **$ 1,148.7** | $ 1,028.1 | $ 1,323.3 | $ 1,459.5 | $ 1,233.5 |
| Operating income (loss) | **$ (59.6)** | **$ (120.3)** | **$ (50.1)** | **$ (64.3)** | $ (79.1) | $ 201.8 | $ 282.1 | $ 203.8 |
| Net income (loss) | **$ (46.1)** | **$ (103.9)** | **$ (40.7)** | **$ (79.0)** | $ (46.0) | $ 144.9 | $ 198.6 | $ 141.5 |
| Shareholder net income (loss) | **$ (39.1)** | **$ (88.5)** | **$ (48.8)** | **$ (86.6)** | $ (52.4) | $ 125.3 | $ 169.8 | $ 112.2 |
| **Per common share** (Canadian dollars) | | | | | | | | |
| Shareholder net income (loss) – basic and diluted | **$ (0.31)** | **$ (0.71)** | **$ (0.39)** | **$ (0.69)** | $ (0.42) | $ 0.98 | $ 1.32 | $ 0.87 |
| Book value[36] | **$ 13.14** | **$ 13.33** | **$ 14.15** | **$ 14.71** | $ 16.42 | $ 16.66 | $ 15.95 | $ 14.52 |
| **Common Share Repurchases** | | | | | | | | |
| Share volume repurchased (000 shares) | **-** | **-** | **-** | **-** | 1,123 | 2,283 | - | 20 |
| Shares Repurchased (millions of Canadian dollars) | **$ -** | **$ -** | **$ -** | **$ -** | $ 20.6 | $ 63.7 | $ - | $ 0.5 |
| **Statistics** | | | | | | | | |
| Lumber shipments (MMfbm)[37] | **1,224** | **1,232** | **1,474** | **1,190** | 1,114 | 1,291 | 1,351 | 1,196 |
| Pulp shipments (000 mt) | **267** | **213** | **288** | **259** | 231 | 262 | 329 | 310 |
| Average exchange rate – US$/Cdn$ | **$ 0.758** | **$ 0.757** | **$ 0.748** | **$ 0.752** | $ 0.758 | $ 0.765 | $ 0.774 | $ 0.791 |
| Average exchange rate – SEK/Cdn$ | **7.281** | **7.262** | **7.059** | **6.905** | 6.842 | 6.844 | 6.720 | 6.413 |
| Average Western SPF 2x4 #2&Btr lumber price (US$) | **$ 380** | **$ 356** | **$ 333** | **$ 372** | $ 327 | $ 482 | $ 598 | $ 513 |
| Average SYP (East) 2x4 #2 lumber price (US$) | **$ 406** | **$ 410** | **$ 393** | **$ 416** | $ 457 | $ 488 | $ 589 | $ 566 |
| Average European indicative SPF lumber price in SEK[38] | **3,540** | **3,652** | **4,003** | **4,111** | 4,235 | 4,284 | 4,145 | 3,815 |
| Average NBSK pulp list price delivered to China (US$) | **$ 588** | **$ 585** | **$ 653** | **$ 710** | $ 805 | $ 887 | $ 910 | $ 910 |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.
2019 results also include final adjustments to the Vida purchase price allocation, on a retrospective basis. Comparative periods have been restated.

[36] Book value per common share is equal to shareholders' equity at the end of the period, divided by the number of common shares outstanding at the end of the period.

[37] Canfor or Vida produced lumber, including lumber purchased for remanufacture and engineered wood, excluding trim blocks, wholesale shipments and lumber sold on behalf of third parties.

[38] European indicative lumber price is an internally generated benchmark based on delivered price to the largest continental market.

In addition to exposure to changes in product prices and foreign exchange, the Company's financial results are impacted by seasonal factors such as weather and building activity. Adverse weather conditions, including hurricanes, flooding, and forest fires, can cause logging curtailments, which can affect the supply of raw materials to sawmills and pulp mills. Market demand also varies seasonally to some degree. For example, building activity and repair and renovation work, which affects demand for lumber products, is generally stronger in the spring and fall months. Shipment volumes are affected by these factors as well as by global supply and demand conditions.

| (millions of Canadian dollars) | **Q4 2019** | **Q3 2019** | **Q2 2019** | **Q1 2019** | **Q4 2018** | **Q3 2018** | **Q2 2018** | **Q1 2018** |
|---|---|---|---|---|---|---|---|---|
| Operating income (loss) by segment: | | | | | | | | |
| Lumber | **$ (27.5)** | **$ (66.5)** | **$ (60.9)** | **$ (72.5)** | $ (87.7) | $ 148.9 | $ 203.4 | $ 125.9 |
| Pulp and Paper | **$ (23.5)** | **$ (44.0)** | **$ 18.4** | **$ 18.1** | $ 15.6 | $ 60.5 | $ 85.4 | $ 85.1 |
| Unallocated and Other[39] | **$ (8.6)** | **$ (9.8)** | **$ (7.6)** | **$ (9.9)** | $ (7.0) | $ (7.6) | $ (6.7) | $ (7.2) |
| **Total operating income (loss)** | **$ (59.6)** | **$ (120.3)** | **$ (50.1)** | **$ (64.3)** | $ (79.1) | $ 201.8 | $ 282.1 | $ 203.8 |
| Add: Amortization[40] | **$ 95.2** | **$ 92.9** | **$ 93.2** | **$ 80.9** | $ 70.0 | $ 68.1 | $ 67.6 | $ 64.8 |
| **Total operating income (loss) before amortization** | **$ 35.6** | **$ (27.4)** | **$ 43.1** | **$ 16.6** | $ (9.1) | $ 269.9 | $ 349.7 | $ 268.6 |
| Add (deduct): | | | | | | | | |
| Working capital movements | **$ 73.3** | **$ 63.1** | **$ 141.3** | **$ (163.3)** | $ (53.7) | $ 61.1 | $ 61.9 | $ (152.1) |
| Restructuring, mill closure and severance costs paid | **$ (3.5)** | **$ (8.5)** | **$ -** | **$ -** | $ - | $ - | $ - | $ - |
| Defined benefit pension plan contributions, net | **$ (5.5)** | **$ (5.7)** | **$ (6.0)** | **$ (4.7)** | $ (7.0) | $ (6.6) | $ (7.3) | $ (7.3) |
| Income taxes received (paid), net | **$ (4.0)** | **$ (6.1)** | **$ 8.2** | **$ (9.6)** | $ (68.4) | $ (82.9) | $ (24.3) | $ (46.8) |
| Adjustment to accrued duties[41] | **$ 10.4** | **$ 19.9** | **$ 7.9** | **$ 3.1** | $ 10.1 | $ (12.9) | $ (10.1) | $ (12.9) |
| Other operating cash flows, net[42] | **$ 20.6** | **$ (17.3)** | **$ 10.6** | **$ 8.6** | $ 21.0 | $ (27.5) | $ - | $ 22.7 |
| **Cash from (used in) operating activities** | **$ 126.9** | **$ 18.0** | **$ 205.1** | **$ (149.3)** | $ (107.1) | $ 201.1 | $ 369.9 | $ 72.2 |
| Add (deduct): | | | | | | | | |
| Capital additions, net | **$ (69.7)** | **$ (76.4)** | **$ (82.0)** | **$ (74.7)** | $ (140.2) | $ (117.2) | $ (87.6) | $ (56.4) |
| Finance expenses paid | **$ (15.4)** | **$ (12.7)** | **$ (14.4)** | **$ (7.2)** | $ (8.2) | $ (4.1) | $ (7.3) | $ (3.7) |
| Distributions paid to non-controlling interests | **$ (10.2)** | **$ (2.1)** | **$ (10.5)** | **$ (5.0)** | $ (68.6) | $ (2.1) | $ (2.0) | $ (1.8) |
| Repayment of long-term debt | **$ (0.6)** | **$ (0.2)** | **$ (0.2)** | **$ (0.2)** | $ (0.1) | $ (0.1) | $ (0.1) | $ (0.1) |
| Payment of lease obligations[43] | **$ (6.0)** | **$ (4.6)** | **$ (4.0)** | **$ (3.3)** | $ - | $ - | $ - | $ - |
| Consideration paid for acquisition of Vida, net of cash acquired | **$ -** | **$ -** | **$ -** | **$ (562.3)** | $ - | $ - | $ - | $ - |
| Vida consideration holdback | **$ -** | **$ -** | **$ -** | **$ (9.7)** | $ - | $ - | $ - | $ - |
| Operating loan facilities acquired from Vida, net of foreign exchange | **$ (0.5)** | **$ 0.8** | **$ 0.5** | **$ (17.8)** | $ - | $ - | $ - | $ - |
| First phase investment in Elliott[44] | **$ (4.1)** | **$ -** | **$ (52.0)** | **$ -** | $ - | $ - | $ - | $ - |
| Term loan to Elliott (advanced) repaid[44] | **$ -** | **$ 0.8** | **$ (8.5)** | **$ -** | $ - | $ - | $ - | $ - |
| Proceeds from long-term debt | **$ -** | **$ 50.0** | **$ -** | **$ 231.7** | $ - | $ - | $ - | $ - |
| Share purchases | **$ -** | **$ -** | **$ -** | **$ -** | $ (24.3) | $ (60.0) | $ - | $ (4.2) |
| Foreign exchange gain (loss) on cash and cash equivalents | **$ 0.6** | **$ 0.1** | **$ (1.0)** | **$ 1.7** | $ 7.1 | $ (1.8) | $ 1.9 | $ 1.4 |
| Other, net[42] | **$ 1.4** | **$ 0.2** | **$ (7.8)** | **$ -** | $ 2.8 | $ 2.7 | $ 1.9 | $ 0.5 |
| **Change in cash / operating loans** | **$ 22.4** | **$ (26.1)** | **$ 25.2** | **$ (596.1)** | $ (338.6) | $ 18.5 | $ 276.7 | $ 7.9 |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.
2019 results also include final adjustments to the Vida purchase price allocation, on a retrospective basis. Comparative periods have been restated.

[39] Increase in 'Unallocated and Other' in 2019 mostly reflecting higher legal costs associated with the ongoing Softwood Lumber Agreement and legal and consulting fees incurred in connection with Great Pacific proposal.

[40] Amortization includes amortization of certain capitalized major maintenance costs.

[41] Adjusted to true-up anti-dumping duties expensed for accounting purposes to current accrual rates.

[42] Further information on cash flows may be found in the Company's annual consolidated financial statements.

[43] On adoption of IFRS 16 *Leases*, payment of lease obligations represents cash payments towards reduction of outstanding lease obligations and related interest, which were previously included with cash from operating activities.

[44] Consideration paid includes the first phase investment in Elliott, consisting of a cash payment of $52.0 million (US$38.5 million) and $8.5 million (US$6.2 million) advanced under a term loan facility. An additional $21.1 million (US$15.6 million) has been recognized as an 'Other Current Liability' on the Company's consolidated balance sheet at the initial investment date. As at December 31, 2019, Elliott has repaid $0.8 million (US$0.6 million) of the term loan.

# THREE-YEAR COMPARATIVE REVIEW

| (millions of Canadian dollars, except per share amounts) | **2019** | 2018 | 2017 |
|---|---|---|---|
| Sales | **$ 4,658.3** | $ 5,044.4 | $ 4,563.3 |
| Net income (loss) | **$ (269.7)** | $ 439.0 | $ 393.6 |
| Shareholder net income (loss) | **$ (263.0)** | $ 354.9 | $ 345.4 |
| Total assets | **$ 4,527.0** | $ 3,845.1 | $ 3,488.3 |
| Term debt | **$ 694.7** | $ 408.4 | $ 385.7 |
| Shareholder net income (loss) per share, basic and diluted | **$ (2.10)** | $ 2.78 | $ 2.63 |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.

# FOURTH QUARTER RESULTS

## Overview of Operating Results

The Company reported a shareholder net loss for the fourth quarter of 2019 of $39.1 million, or $0.31 per share, compared to a shareholder net loss of $88.5 million, or $0.71 per share, for the third quarter of 2019 and a shareholder net loss of $52.4 million, or $0.42 per share, for the fourth quarter of 2018.

For the fourth quarter of 2019, the Company reported an operating loss of $59.6 million, halving the operating loss of $120.3 million for the third quarter of 2019. These results reflected improved earnings in the lumber and pulp and paper segments as global lumber and pulp markets showed signs of bottoming out through the current quarter and supply and demand fundamentals improved at the end of the year.

Reported results for the fourth quarter of 2019 include a net duty expense of $43.7 million, at a current cumulative effective countervailing duty ("CVD") and anti-dumping duty ("ADD") accrual rate of 29.24% (versus a combined cash deposit rate of 20.52%), compared to $53.5 million reported in the third quarter of 2019 at the same combined rate.

Reported results in the fourth quarter of 2019 also include a net $19.9 million recovery in inventory write-down provisions and restructuring, mill closure and severance costs of $3.3 million. After adjusting for the aforementioned items, the Company's operating loss was $32.5 million for the fourth quarter of 2019, compared to the similarly adjusted operating loss of $65.7 million for the third quarter of 2019.

Adjusted operating income for the lumber segment for the fourth quarter of 2019 primarily reflected solid results from the Company's European SPF operations, offset in part, by a more challenging quarter for the Company's US South operations, largely a result of seasonally weaker prices across most grades and the impact of capital related downtime at several of its sawmills. The Company's Western Canadian operations continued to be impacted by prolonged market-related challenges despite a modest upward trend in Western SPF benchmark lumber prices, taking a further 115 million board feet of temporary production curtailments in that operating region during the current quarter.

Results for the fourth quarter of 2019 in the pulp and paper segment principally reflected higher pulp shipments and lower pulp unit manufacturing costs, both factors largely attributable to increased production at CPPI's NBSK pulp and BCTMP mills, following market-related pulp mill curtailments throughout the prior quarter. To a lesser degree, results also reflected modestly lower NBSK pulp unit sales realizations in the current quarter.

An overview of the results by business segment for the fourth quarter of 2019 compared to the third quarter of 2019 and fourth quarter of 2018 follows.

## Lumber

**Selected Financial Information and Statistics – Lumber**

Summarized results for the Lumber segment for the fourth quarter of 2019, third quarter of 2019 and fourth quarter of 2018 were as follows:

| (millions of Canadian dollars, unless otherwise noted) | Q4 2019 | Q3 2019 | Q4 2018 |
|---|---|---|---|
| Sales[45] | **$ 857.8** | $ 874.6 | $ 738.4 |
| Operating income (loss) before amortization[45] | **$ 43.7** | $ 2.5 | $ (38.2) |
| Operating loss[45] | **$ (27.5)** | $ (66.5) | $ (87.7) |
| Countervailing and anti-dumping duty deposits, net of recovery[46] | **$ 43.7** | $ 53.5 | $ 39.9 |
| Inventory write-down (recovery) | **$ (16.9)** | $ (5.3) | $ 36.7 |
| Restructuring, mill closure and severance costs[47] | **$ 3.3** | $ 6.4 | $ - |
| Adjusted operating income (loss) | **$ 2.6** | $ (11.9) | $ (11.1) |
| Average SPF 2x4 #2 & Btr lumber price in US$[48] | **$ 380** | $ 356 | $ 327 |
| Average SPF 2x4 #2 & Btr lumber price in Cdn$[48] | **$ 501** | $ 470 | $ 432 |
| Average SYP 2x4 #2 lumber price in US$[49] | **$ 406** | $ 410 | $ 457 |
| Average European indicative SPF lumber price in SEK[50] | **3,540** | 3,652 | 4,235 |
| Average European indicative SPF lumber price in Cdn$[50] | **$ 486** | $ 503 | $ 619 |
| US housing starts (thousand units SAAR)[51] | **1,441** | 1,282 | 1,185 |
| Production – Western SPF lumber (MMfbm)[52] | **606** | 595 | 793 |
| Production – SYP lumber (MMfbm)[52] | **354** | 365 | 334 |
| Production – European SPF lumber (MMfbm)[52] | **286** | 220 | - |
| Shipments – Western SPF lumber (MMfbm)[53] | **624** | 644 | 783 |
| Shipments – SYP lumber (MMfbm)[53] | **342** | 365 | 331 |
| Shipments – European SPF lumber (MMfbm)[53] | **258** | 223 | - |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.
2019 results also include final adjustments to the Vida purchase price allocation, on a retrospective basis. Comparative periods have been restated.

[45] Q4 2019 includes sales of $199.2 million, operating income of $11.0 million and operating income before amortization of $27.4 million from European SPF lumber operations (Q3 2019 – sales of $201.2 million, operating loss of $6.1 million and operating income before amortization of $13.4 million). Operating income from the European SPF operations in Q4 2019 includes $9.6 million (Q3 2019 - $12.8 million) in incremental amortization and other expenses driven by the purchase price allocation at acquisition date.

[46] Adjusted for countervailing and anti-dumping duties expensed for accounting purposes.

[47] Adjusted for restructuring, mill closure and severance costs related to permanent and indefinite curtailments at Vavenby, Mackenzie and Isle Pierre sawmills.

[48] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.); Average Western SPF 2x4 #2&Btr lumber price in Cdn$ calculated as average Western SPF 2x4 #2&Btr lumber price in US$ multiplied by the average exchange rate – Cdn$ per US$1.00 according to Bank of Canada monthly average for the period.

[49] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.).

[50] European indicative lumber price is an internally generated benchmark based on delivered price to the largest continental market; Average European indicative SPF lumber price in Cdn$ calculated as average European indicative lumber price in SEK multiplied by the average exchange rate – Cdn$ per SEK1.00 according to Bank of Canada monthly average rate for the period.

[51] Source – US Census Bureau, seasonally adjusted annual rate ("SAAR").

[52] Excluding production of trim blocks.

[53] Canfor or Vida produced lumber, including lumber purchased for remanufacture and engineered wood, excluding trim blocks, wholesale shipments and lumber sold on behalf of third parties.

### Markets

As mentioned, during the fourth quarter of 2019, global lumber market fundamentals showed a modest improvement, particularly in the US, where favourable macro-economic indicators, a moderate up-tick in North American home construction activity and steady demand in the repair and remodeling sector supported a measured recovery in lumber demand. US housing starts, on a seasonally adjusted basis, averaged 1,441,000 units, up 12% from the previous quarter. Single-family starts, which consume a higher proportion of lumber, were up 9%, while multi-family starts were up 20% compared to the third quarter of 2019. In Canada, housing starts averaged 202,000 units on a seasonally adjusted basis, down 10% from the previous quarter primarily due to low-trending multi-family starts in Eastern Canada. The modest improvement in overall demand was tempered by the impact of increased US South capacity and additional imports from Europe.

Offshore lumber demand for Western SPF lumber products remained muted through the current quarter, particularly in China, primarily reflecting the uncertainties resulting from the ongoing trade dispute between the US and China, while demand from Japan and other Asian markets remained steady. European lumber demand remained subdued through the current quarter, reflecting both Brexit uncertainty and weaker economic activity in several European countries, which together with increased supply of lower-cost fibre related to the spruce beetle outbreak in central Europe, resulted in continued pricing pressure for European SPF lumber.

Sales

Sales for the lumber segment for the fourth quarter of 2019 were $857.8 million, compared to $874.6 million for the previous quarter and $738.4 million for the fourth quarter of 2018. The 2% decrease in sales revenue compared to the prior quarter largely reflected lower SYP and European SPF unit sales realizations. The 16% increase in sales revenue compared to the fourth quarter of 2018 was primarily due to notably higher Western SPF benchmark lumber prices in the fourth quarter of 2019 and, to a lesser extent, increased shipments, largely due to the incremental benefit of European SPF lumber sales in the current period.

Total lumber shipments of 1.22 billion board feet were broadly in line with the previous quarter, principally reflecting increased production in Western Canada and at the Company's European operations in the current quarter, partially offset by a build in inventories in Western Canada arising from an eight-day rail strike later in the period.

Total lumber shipments were 10% higher than the fourth quarter of 2018, as the accretive benefit of European SPF lumber shipment volumes more than offset reduced shipment volumes associated with the BC curtailments in the current quarter.

The average benchmark North American Random Lengths Western SPF 2x4 #2&Btr price was up US$24 per Mfbm, or 7%, from the previous quarter, at US$380 per Mfbm, with similar increases also seen across most Western SPF wider-width dimensions. As a result, Western SPF lumber unit sales realizations also experienced a moderate up-tick quarter-over-quarter, further aided by a higher-value sales mix.

SYP lumber unit sales realizations were modestly lower than the prior quarter as a relatively flat SYP East 2x4 #2 price, at US$406 per Mfbm, combined with more pronounced declines in certain wider SYP dimensions.

The average European indicative SPF lumber benchmark price (an internally generated benchmark based on delivered price to the largest continental market), at 3,540 SEK per Mfbm, was down SEK 112 per Mfbm, or 3%, from the previous quarter. The Company's European SPF unit sales realizations for the fourth quarter of 2019 were moderately lower than the previous quarter reflecting this decline in the European benchmark pricing.

Compared to the fourth quarter of 2018, the average North American Random Lengths Western SPF 2x4 #2&Btr price was up US$53 per Mfbm, or 16%; however, Western SPF lumber unit sales realizations saw a more modest increase, as the benefit of higher US-dollar benchmark lumber prices was mostly offset by lower offshore unit sales realizations. SYP lumber unit sales realizations were moderately lower principally reflecting SYP benchmark lumber price declines as the average North American Random Lengths SYP East 2x4 #2 price was down US$51 per Mfbm, or 11%, from the comparative period. European SPF lumber unit sales realizations were lower compared to the fourth quarter of 2018 reflecting a SEK 695 per Mfbm, or 16%, decline in the average European indicative SPF benchmark lumber price and a 6% strengthening of the Canadian dollar against the SEK, moderated in part by that regions' high-value product mix.

Other revenues for the Company's lumber segment (which are primarily comprised of residual fibre, pulp log and pellets sales, as well as the Company's European operations' other lumber-related revenues) increased when compared to the previous quarter largely due to the impact of the seasonal production downtime taken at the Company's European operations in the previous period, offset in part by a decline in residual fibre revenue in the current quarter, reflecting lower market-based pricing for sawmill residual chips (tied to softened Canadian NBSK pulp sales realizations). Compared to the fourth quarter of 2018, other revenues increased, principally due to the inclusion of the European other lumber-related revenues.

Operations

Total lumber production, at 1.25 billion board feet, was up 6% from the previous quarter largely reflecting reduced market-related downtime in BC and increased operating days at the Company's European operations, following the seasonal downtime taken in the prior period. Production in the US South was down slightly as improved productivity was offset by capital-related downtime at the Company's Camden and Conway sawmills in the current quarter.

Total lumber production was up 11% from the fourth quarter of 2018, for the most part reflecting the incremental production from the Company's European operations, which more than offset the impact of curtailments in BC in the current period.

Lumber unit manufacturing costs in the fourth quarter of 2019 were broadly in line with the previous quarter, as the incremental effect of lower production volumes in the US South, were largely offset by lower European lumber unit manufacturing costs, reflecting a combination of log cost declines (correlated with European SPF lumber prices) and the benefit of lower unit fixed costs due to increased operating days in the current period. Log costs in Western Canada and the US South remained broadly in line with the previous quarter.

Compared to the fourth quarter of 2018, lumber unit manufacturing costs declined modestly, largely reflecting market-based stumpage decreases in BC quarter-over-quarter, combined with a significantly lower proportion of high-cost purchased wood.

## Pulp and Paper

**Selected Financial Information and Statistics – Pulp and Paper**[54]

Summarized results for the Pulp and Paper segment for the fourth quarter of 2019, third quarter of 2019 and fourth quarter of 2018 were as follows:

| (millions of Canadian dollars, unless otherwise noted) | | **Q4 2019** | | Q3 2019 | | Q4 2018 |
|---|---|---|---|---|---|---|
| Sales | **$** | **247.5** | $ | 216.9 | $ | 289.7 |
| Operating income (loss) before amortization[55] | **$** | **0.1** | $ | (20.3) | $ | 36.1 |
| Operating income (loss) | **$** | **(23.5)** | $ | (44.0) | $ | 15.6 |
| Average NBSK pulp price delivered to China – US$[56] | **$** | **588** | $ | 585 | $ | 805 |
| Average NBSK pulp price delivered to China – Cdn$ | **$** | **776** | $ | 773 | $ | 1,062 |
| Production – pulp (000 mt) | | **286** | | 174 | | 224 |
| Production – paper (000 mt) | | **28** | | 28 | | 36 |
| Shipments – pulp (000 mt) | | **267** | | 213 | | 231 |
| Shipments – paper (000 mt) | | **26** | | 27 | | 32 |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.

[54] Includes 100% of CPPI, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.

[55] Amortization includes amortization of certain capitalized major maintenance costs.

[56] Per tonne, NBSK pulp price delivered to China (RISI).

Markets

Global pulp prices remained at depressed levels through the fourth quarter of 2019, with weak pricing in Asia spilling over to North America and Europe as the quarter progressed. Purchasing activity from China picked up during the quarter, but elsewhere demand remained weak, particularly in Europe. US-dollar NBSK pulp list prices to China averaged US$588 per tonne, broadly in line with the prior quarter, reflecting the aforementioned demand and supply factors. Average US-dollar NBSK pulp list prices to North America experienced a decline of US$55 per tonne, or 5%, averaging US$1,115 per tonne in the current quarter (before discounts, which were largely unchanged from the previous quarter), as published by RISI.

Global softwood pulp producer inventory levels remained above the balanced range during the current quarter and were at 37 days[57] of supply in December 2019, an increase of 2 days from September 2019; market conditions are generally considered balanced when inventories are in the 27-33 days of supply range.

Global kraft paper markets continued to remain weak through the fourth quarter of 2019 in most key markets, particularly for bleached kraft paper.

[57] World 20 data is based on twenty producing countries representing 80% of the world chemical market pulp capacity and is based on information compiled and prepared by the PPPC.

Sales

CPPI's pulp shipments for the fourth quarter of 2019 totalled 267,000 tonnes, up 54,000 tonnes, or 25%, from the previous quarter and up 36,000 tonnes, or 16%, from the fourth quarter of 2018. Pulp shipments in the current quarter principally reflected an increase in pulp production when compared to both comparative quarters, offset in part by a rebuild of pulp inventories to more normal levels in the current quarter after material drawdowns in both comparative periods.

Average NBSK pulp unit sales realizations were modestly lower than the prior quarter, principally reflecting lower prices to North America. BCTMP unit sales realizations showed a modest increase from the previous quarter as BCTMP prices edged upwards in the latter part of the quarter.

Compared to the fourth quarter of 2018, CPPI's average NBSK pulp unit sales realizations were well down, primarily driven by the US$217 per tonne, or 27%, decrease in the average US-dollar NBSK pulp list price to China, combined with a decline in the average US-dollar price to North America by US$313 per tonne (before discounts), or 22%. Average BCTMP unit sales realizations also showed a sharp decline compared to the fourth quarter of 2018, reflecting lower BCTMP US-dollar pricing in the current quarter.

Energy revenues were up compared to the third quarter of 2019, principally reflecting seasonally higher energy prices combined with an increase in operating days in the current quarter, following the pulp mill downtime taken in the summer months. Compared to the fourth quarter of 2018, energy revenues were up significantly, primarily due to the increased power generation at the Northwood pulp mill and additional operating days in the current quarter.

CPPI's paper shipments in the fourth quarter of 2019 were 26,000 tonnes, broadly in line with the previous quarter. Compared to the fourth quarter of 2018 paper shipments were down 6,000 tonnes, or 19%, principally reflecting lower production at CPPI's PG pulp and paper mill in the current quarter.

Paper unit sales realizations in the fourth quarter of 2019 were moderately lower than the previous quarter and significantly lower than the same quarter of 2018, primarily reflecting sustained weak US-dollar prices throughout most of the current period.

Operations

Pulp production was 286,000 tonnes for the fourth quarter of 2019, up 112,000 tonnes, or 64%, from the third quarter of 2019, largely reflecting phased summer curtailments taken in the previous quarter, offset in part by an extended market-related curtailment in early October at CPPI's PG Pulp mill. To a lesser extent, improved productivity at CPPI's PG Pulp mill and at its Taylor BCTMP mill, which set a new record-high for production in the current quarter, largely offset kiln-related operational disruptions at CPPI's Northwood and Intercontinental pulp mills in December.

Compared to the fourth quarter of 2018, pulp production was up 62,000 tonnes, or 28%, primarily reflecting CPPI's extended Northwood recovery boiler maintenance outage in the comparative period.

Pulp unit manufacturing costs were down significantly compared to both comparative quarters, primarily reflecting increased production offset, in part, by seasonally higher energy costs. Fibre costs were slightly lower than the third quarter of 2019 and significantly lower than the fourth quarter of 2018, principally driven by lower market-based prices for sawmill residual chips (linked to falling Canadian dollar NBSK pulp sales realizations), which more than offset an increased proportion of higher-cost whole log chips, reflecting ongoing sawmill-related fibre supply disruptions.

Paper production for the fourth quarter of 2019 was 28,000 tonnes, broadly in line with the prior quarter, and down 8,000 tonnes, or 22%, from the fourth quarter of 2018, principally due to the quarter-over-quarter impact of downtime, which in the current quarter related to a two week market-related curtailment at the beginning of October, a continuation from the prior quarter.

Paper unit manufacturing costs were moderately lower than the third quarter of 2019 reflecting lower slush pulp costs associated with the decreased Canadian dollar NBSK pulp unit sales realizations, combined with lower unit manufacturing costs in the current quarter, principally driven by the scheduled maintenance outage completed in the previous quarter. Compared to the fourth quarter of 2018 paper unit manufacturing costs showed a significant decline principally due to materially lower slush pulp costs, offset in part by the impact of the downtime, which contributed to higher paper unit manufacturing costs in the current quarter.

## Unallocated and Other Items

| (millions of Canadian dollars) | Q4 2019 | Q3 2019 | Q4 2018 |
|---|---|---|---|
| Operating loss of Panels operations[58] | **$ (1.1)** | $ (0.3) | $ (0.5) |
| Corporate costs | **$ (7.5)** | $ (9.5) | $ (6.5) |
| Finance expense, net | **$ (16.3)** | $ (16.1) | $ (7.6) |
| Foreign exchange gain (loss) on long-term debt and duties recoverable, net | **$ 3.9** | $ (2.2) | $ (2.3) |
| Gain (loss) on derivative financial instruments | **$ (0.5)** | $ (0.1) | $ 18.3 |
| Other income, net | **$ 7.6** | $ 1.2 | $ 5.4 |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.
2019 results also include final adjustments to the Vida purchase price allocation, on a retrospective basis. Comparative periods have been restated.
[58] The Panels operations include the Company's PolarBoard oriented strand board ("OSB") plant, which is currently indefinitely idled and its Tackama plywood plant, which has been permanently closed.

Corporate costs were $7.5 million for the fourth quarter of 2019, down $2.0 million from the third quarter of 2019, reflecting lower legal fees associated with the Softwood Lumber dispute, partially offset by increased legal and consulting costs in connection with the Great Pacific proposal (for additional details refer to the "Non-Binding Bid from Great Pacific Capital Corp." section of this document).

Net finance expense of $16.3 million was broadly in line with the previous quarter. Compared to the fourth quarter of 2018, net finance expense was up $8.7 million largely reflecting increased interest expense associated with the Company's higher debt levels resulting from the Vida acquisition, first phase acquisition of Elliott, and, to a lesser extent, interest expense on leases related to the prospective adoption of IFRS 16 *Leases* ("IFRS 16") on January 1, 2019.

In the fourth quarter of 2019, the Company recognized a foreign exchange gain on its US-dollar term debt held by Canadian entities, offset in part by a loss on US-denominated duties receivable, both due to the weaker Canadian dollar at the end of the quarter compared to the end of September 2019 (see further discussion on the term debt financing in the "Liquidity and Financial Requirements" section).

At times, the Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in energy costs, lumber prices, interest rates and foreign exchange rates. In the fourth quarter of 2019, the Company recognized a net loss of $0.5 million related to its derivative instruments, primarily reflecting realized losses on lumber future contracts, and broadly in line with the previous quarter. The net loss of $0.5 million in the fourth quarter of 2019 compared to a net gain of $18.3 million in the fourth quarter of 2018. The gain in the comparative period principally reflected an unrealized mark-to-market gain on SEK forward foreign exchange contracts, which, as mentioned, were one-time contracts entered into by the Company for the purpose of reducing the Company's risk against fluctuations in the SEK associated with the acquisition of Vida.

Other income, net, was $7.6 million in the fourth quarter of 2019 reflected the aforementioned receipt of insurance proceeds, partially offset by unfavourable foreign exchange movements on US-dollar denominated working capital resulting from the weakening of the Canadian dollar relative to the US-dollar for the Canadian operations.

# Other Comprehensive Income (Loss)

| (millions of Canadian dollars) | Q4 2019 | Q3 2019 | Q4 2018 |
|---|---|---|---|
| Defined benefit actuarial gain (loss), net of tax | **$ 3.9** | $ 4.2 | $ (9.1) |
| Foreign exchange translation differences for foreign operations, net of tax | **7.6** | (18.5) | 33.6 |
| Other comprehensive income (loss), net of tax | **$ 11.5** | $ (14.3) | $ 24.5 |

2019 results also include final adjustments to the Vida purchase price allocation, on a retrospective basis. Comparative periods have been restated.

In the fourth quarter of 2019, the Company recorded a gain of $5.3 million (before tax) in relation to changes in the valuation of the Company's employee future benefits plans, primarily reflecting a higher than anticipated return on plan assets, partially offset by unfavourable actuarial experience adjustments, and, to a lesser extent, increased interest and service costs.

This compared to a gain of $5.8 million (before tax) recognized in the third quarter of 2019, largely attributable to a return on plan assets greater than the discount rate, and in part, a 50% reduction in MSP premiums in the second quarter of 2019 following a change in legislation in BC, which led to reduced interest and service costs reflected in the second and third quarters of 2019.

In the fourth quarter of 2018, the Company recorded a loss of $12.4 million (before tax) as a result of lower than anticipated returns on plan assets. Also during the fourth quarter of 2018, the Company purchased $58.9 million of annuities through its defined benefit plans to mitigate its exposure to the future volatility fluctuations in the related pension obligations. At purchase of these annuities in 2018, transaction costs of $3.6 million were recognized in other comprehensive income (loss) principally reflecting the difference in the annuity rate as compared to the discount rate used to value the pension obligations on a going concern basis. For more information, see the "Employee Future Benefits" part of the "Critical Accounting Estimates" section later in this report.

In addition, the Company recorded an accounting gain of $7.6 million in the fourth quarter of 2019 related to foreign exchange differences for foreign operations due to the combination of a weakening Canadian dollar relative to the US-dollar and strengthening of the Canadian dollar relative to the Swedish Krona at the end of the quarter. This compared to a loss of $18.5 million in the previous quarter and a gain of $33.6 million in the fourth quarter of 2018.

# CHANGES IN FINANCIAL POSITION

At the end of 2019, Canfor had $60.1 million of cash and cash equivalents.

| (millions of Canadian dollars) | **Q4 2019** | Q3 2019 | Q4 2018 |
|---|---|---|---|
| Increase (decrease) in cash and cash equivalents[59] | **$ (36.8)** | $ 55.5 | $ (345.7) |
| Operating activities | **$ 126.9** | $ 18.0 | $ (107.1) |
| Financing activities | **$ (91.3)** | $ 112.7 | $ (101.2) |
| Investing activities | **$ (72.4)** | $ (75.2) | $ (137.4) |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.
2019 results also include final adjustments to the Vida purchase price allocation, on a retrospective basis. Comparative periods have been restated.
[59] Increase (decrease) in cash and cash equivalents shown before foreign exchange translation on cash and cash equivalents.

The changes in the components of these cash flows are discussed in the following sections.

## Operating Activities

Cash generated from operating activities was $126.9 million in the fourth quarter of 2019, compared to cash generated of $18.0 million in the previous quarter and cash used of $107.1 million in the fourth quarter of 2018. The increase in operating cash flows from the previous quarter primarily reflected improved cash earnings in the current quarter, and, to a lesser extent, favourable movements in non-cash working capital. Cash duty deposits paid in the current quarter of 2019 were $33.2 million, compared to $33.7 million in the prior quarter and $29.7 million in the same quarter of 2018.

Compared to the fourth quarter of 2018, operating cash flows were up $234.0 million reflecting decreased income tax payments combined with higher investments in working capital in the comparative period.

## Financing Activities

Cash used in financing activities was $91.3 million in the current quarter, compared to cash generated of $112.7 million in the previous quarter and cash used of $101.2 million in the fourth quarter of 2018. In the fourth quarter of 2019 financing activities primarily included repayments of amounts drawn on the Company's operating loan facility combined with an increase in interest expenses paid. Cash distributions to non-controlling shareholders in the current quarter of $10.2 million, were up $8.1 million when compared to the previous quarter, principally due to distributions in the current quarter to Vida's non-controlling shareholders. Compared to the fourth quarter of 2018, cash distributions to non-controlling shareholders were down $58.4 million, reflecting a special dividend of $2.25 per share paid by CPPI in the comparative period.

## Investing Activities

Cash used for investing activities was $72.4 million in the current quarter, compared to $75.2 million in the previous quarter and $137.4 million in the same quarter of 2018. Capital additions were $69.7 million, down $6.7 million from the previous quarter and down $70.5 million from the fourth quarter of 2018. Current quarter capital expenditures included various smaller high-returning capital projects aimed at increasing drying capacity and productivity, in combination with the completion of more significant upgrades at the Company's sawmills in Alabama and South Carolina. In the pulp and paper segment, capital expenditures primarily related to several capital projects including the raw water treatment project at CPPI's Intercontinental NBSK pulp mill.

# SPECIFIC ITEMS AFFECTING COMPARABILITY

## Specific Items Affecting Comparability of Shareholder Net Income (Loss)

Factors that impact the comparability of the quarters are noted below:

After-tax impact, net of non-controlling interests

| (millions of Canadian dollars, except for per share amounts) | Q4 2019 | Q3 2019 | Q2 2019 | Q1 2019 | Q4 2018 | Q3 2018 | Q2 2018 | Q1 2018 |
|---|---|---|---|---|---|---|---|---|
| **Shareholder net income (loss), as reported** | **$ (39.1)** | **$ (88.5)** | **$ (48.8)** | **$ (86.6)** | $ (52.4) | $ 125.3 | $ 169.8 | $ 112.2 |
| Foreign exchange (gain) loss on long-term debt and duty deposits recoverable, net | **$ (3.6)** | **$ 2.1** | **$ (2.9)** | **$ 0.8** | $ 2.1 | $ (0.7) | $ 1.0 | $ 1.9 |
| Countervailing and anti-dumping duty deposits, net of duties recoverable | **$ 31.9** | **$ 39.1** | **$ 33.0** | **$ 26.5** | 28.8 | $ 31.1 | $ 37.7 | $ 25.5 |
| (Gain) loss on derivative financial instruments | **$ 0.2** | **$ 0.1** | **$ (1.7)** | **$ 25.4** | $ (6.5) | $ 1.2 | $ 5.6 | $ 5.8 |
| Restructuring, mill closure and severance costs | **$ 2.4** | $ **4.7** | **$ 8.4** | **$ -** | $ - | $ - | $ - | $ - |
| Net impact of above items | **$ 30.9** | **$ 46.0** | **$ 36.8** | **$ 52.7** | $ 24.4 | $ 31.6 | $ 44.3 | $ 33.2 |
| **Adjusted shareholder net income (loss)** | **$ (8.2)** | **$ (42.5)** | **$ (12.0)** | **$ (33.9)** | $ (28.0) | $ 156.9 | $ 214.1 | $ 145.4 |
| **Shareholder net income (loss) per share (EPS), as reported** | **$ (0.31)** | **$ (0.71)** | **$ (0.39)** | **$ (0.69)** | $ (0.42) | $ 0.98 | $ 1.32 | $ 0.87 |
| Net impact of above items per share | **$ 0.25** | **$ 0.37** | **$ 0.29** | **$ 0.42** | $ 0.19 | $ 0.25 | $ 0.34 | $ 0.26 |
| **Adjusted net income (loss)per share** | **$ (0.06)** | **$ (0.34)** | **$ (0.10)** | **$ (0.27)** | $ (0.23) | $ 1.23 | $ 1.66 | $ 1.13 |

2019 results include the adoption of IFRS 16 *Leases*, from January 1, 2019, on a prospective basis. Comparative periods have not been restated.
2019 results also include final adjustments to the Vida purchase price allocation, on a retrospective basis. Comparative periods have been restated.

# OUTLOOK

## Lumber Markets

Looking ahead, the recovery in demand in the US housing sector experienced late in the fourth quarter of 2019 is anticipated to continue into the first half of 2020, in part reflecting strong US housing starts coupled with seasonally stronger demand during the traditionally busy spring building season, steady projected demand in the repair and remodeling sector and growing demand for mass timber. Increased supply into the North American market is projected to somewhat temper North American lumber prices for 2020, reflecting the combined impacts of incremental European lumber imports into the US and further incremental capacity coming online in the US South. For the Company's offshore lumber markets in Asia, particularly Japan, demand is anticipated to remain stable through 2020 and prices are projected to return to more normalized levels. In Europe, pricing in the first quarter of 2020 is anticipated to remain broadly in line with the fourth quarter of 2019, with a modest up-tick in pricing projected during the second quarter of 2020, reflecting improved demand.

## Pulp and Paper Markets

Recognizing the challenging markets, CPPI launched a $40 million cost reduction initiative at the beginning of 2020, aimed at reducing unit manufacturing costs. Most of the savings will be achieved through improving reliability, reducing overhead cost and improving fibre utilization, with the full amount of annualized savings targeted by the end of 2021.

Looking forward, while global softwood kraft pulp markets are projected to remain fairly challenging for the first part of 2020, market conditions and prices should gradually improve through the balance of the year as global inventories become more in-line with demand. The potential impact of the emerging coronavirus on global pulp demand, particularly from China, is uncertain, and CPPI continues to monitor the situation. Bleached kraft paper demand is currently anticipated to stabilize in the first half of 2020 as inventories within the market return to more normalized levels. Given the fibre dynamics in the BC Interior, fibre costs are projected to remain under pressure, particularly for incremental pulp log supply. On a more positive note, however, as a result of additional sawmill residual and pulp log fibre supply secured in the latter part of 2019, CPPI is not currently anticipating any material fibre-related curtailments in 2020.

CPPI has no maintenance outages planned for the first quarter of 2020. A maintenance outage is currently planned at the Northwood NBSK pulp mill in the second quarter of 2020 with a projected 30,000 tonnes of reduced NBSK pulp production. In addition, maintenance outages are scheduled at the Intercontinental NBSK pulp mill and the Taylor BCTMP mill in the third quarter of 2020 with a projected 10,000 tonnes of reduced NBSK pulp production and a projected 5,000 tonnes of reduced BCTMP production, respectively.

# CRITICAL ACCOUNTING ESTIMATES

*The preparation of financial statements in conformity with International Financial Reporting Standards ("IFRS") requires management to make estimates and assumptions that affect the amounts recorded in the financial statements. Management regularly reviews these estimates and assumptions based on currently available information. While it is reasonably possible that circumstances may arise, which cause actual results to differ from these estimates, management does not believe it is likely that any such differences will materially affect Canfor's financial position, other than the possibility of material effects to the income statement from the Company's estimated ADD net duty deposits recoverable as discussed in Notes 10 and 31 of the consolidated financial statements. Unless otherwise indicated, the critical accounting estimates discussed affect all of the Company's reportable segments.*

## Adoption of New Accounting Standards

Effective January 1, 2019, the Company has adopted IFRS 16, which supersedes IAS 17 *Leases* ("IAS 17") and related interpretations. Under IAS 17, leases were previously classified as either operating or financing for lessees based on an assessment of whether the lease transferred significantly all of the risks and rewards incidental to ownership of the underlying asset to the Company. As the Company's leases were previously classified as operating, straight-line operating lease expense was recognized over the lease term in the comparative period.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees, with a right-of-use asset ("ROU asset") representing the Company's right to use the underlying asset, and a lease obligation representing its obligation to make lease payments. Amortization expense for ROU assets and interest expense for lease obligations replaces the straight-line operating lease expense recognized under IAS 17.

The Company has applied IFRS 16 using the modified retrospective approach, under which the cumulative effect of initial application is recognized in retained earnings at January 1, 2019. Short-term and low-value recognition exemptions were applied, as well as certain practical expedients allowing for the use of hindsight to assess the lease term for contracts with extension options, the exclusion of initial direct costs from measurement of the ROU asset and the exclusion of leases with a term of less than one year remaining at the transition date.

On adoption of IFRS 16, the Company recognized $46.1 million of ROU assets, $48.3 million of lease obligations and deferred tax assets of $0.6 million, with the difference of $1.6 million recognized in retained earnings.

## Employee Future Benefits

Canfor has various defined benefit and defined contribution plans providing both pension and other non-pension post-retirement benefits to most of its salaried employees and certain hourly employees not covered by forest industry union plans. Canfor also provides certain health care benefits and pension bridging benefits to eligible retired employees. The costs and related obligations of the pension and other retirement benefit plans are accrued in accordance with the requirements of IFRS.

Canfor uses independent actuarial firms to perform actuarial valuations of the fair value of pension and other retirement benefit plan obligations. The application of IFRS requires judgments regarding certain assumptions that affect the accrued benefit provisions and related expenses, including the discount rate used to calculate the present value of the obligations, the rate of compensation increase, mortality assumptions, and the assumed health care cost trend rates. Management evaluates these assumptions quarterly based on experience and the recommendations of its actuarial firms. Changes in these assumptions result in actuarial gains or losses, which are recognized in full in each period with an adjustment through other comprehensive income (loss).

The actuarial assumptions used in measuring Canfor's benefit plan provisions and benefit costs are as follows:

| | **December 31, 2019** | | December 31, 2018 | |
|---|---|---|---|---|
| | **Defined Benefit Pension Plans** | **Other Benefit Plans** | Defined Benefit Pension Plans | Other Benefit Plans |
| Discount rate | **3.0%** | **3.0%** | 3.6% | 3.6% |
| Rate of compensation increases | **3.0%** | **n/a** | 3.0% | n/a |
| Initial medical cost trend rate | **n/a** | **5.5%** | n/a | 5.5% |
| Ultimate medical cost trend rate | **n/a** | **4.5%** | n/a | 4.5% |
| Year ultimate rate is reached | **n/a** | **2022** | n/a | 2022 |

Assumed discount rates and medical cost trend rates have a significant effect on the accrued benefit obligation and related plan assets. In addition, the average life expectancy of a 65-year-old at December 31, 2019 and December 31, 2018, is between 21.1 years and 24.2 years. As at December 31, 2019, the weighted average duration of the defined benefit obligation, which reflects the average age of the plan members, is 12.8 years (2018 - 12.0 years). The weighted average duration of the other benefit plans is 13.7 years (2018 – 13.3 years).

See "Liquidity and Financial Requirements" section for further discussion regarding the funding position of Canfor's pension plans.

## Deferred Reforestation

Canfor accrues an estimate of its future liability to perform forestry activities, defined to mean those silviculture treatments or activities that are carried out to ensure the establishment of a free-growing stand of young trees, including logging road rehabilitation on its forestry tenures in BC and Alberta. An estimate is recorded in the financial statements based on the number of hectares of timber harvested in the period and the estimated costs of fulfilling Canfor's obligation. Payments in relation to reforestation are expected to occur over periods of up to 15 years (the significant majority occurring in the first seven years) and have been discounted accordingly at risk-free rates ranging from 1.7% to 1.8%. The actual costs that will be incurred in the future may vary based on, among other things, the actual costs at the time of silviculture activities.

## Deferred Taxes

In accordance with IFRS, Canfor recognizes deferred income tax assets when it is probable that the deferred income tax assets will be realized. This assumption is based on management's best estimate of future circumstances and events. If these estimates and assumptions are changed in the future, the value of the deferred income tax assets could be reduced or increased, resulting in an income tax expense or recovery. Canfor re-evaluates its deferred income tax assets on a regular basis.

## Asset Retirement Obligations

Canfor records the estimated fair value of a liability for asset retirement obligations, such as landfill closures, in the period when it is incurred. For landfill closure costs, the fair value is determined using estimated closure costs discounted over the estimated useful life. Payments relating to landfill closure costs are expected to occur at periods ranging from 1 to 32 years and have been discounted at risk-free rates ranging from 1.7% to 1.8%. The actual closure costs and periods of payment may differ from the estimates used in determining the year-end liability. On initial recognition, the fair value of the liability is added to the carrying amount of the associated asset and amortized over its useful life. The liability is accreted over time through charges to earnings and reduced by actual costs of settlement.

## Environmental Remediation Costs

Costs associated with environmental remediation obligations are accrued and expensed when there exists a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Such accruals are adjusted as further information develops or circumstances change. Costs of future expenditures for environmental remediation obligations are discounted to their present value when the amount and timing of expected cash payments are reliably determinable.

## Impairment of Goodwill

Goodwill, which is the excess of the cost of an acquisition over the fair value of the net identifiable assets acquired, is not amortized, but is assessed annually for impairment, or more frequently if events or circumstances indicate that it may be impaired. Canfor's goodwill relates to its US subsidiaries, as well as its European subsidiary following the February 28, 2019 acquisition of Vida.

Goodwill is allocated separately to each acquired business and tested at that level for impairment purposes. An impairment loss is recognized in net income (loss) at the amount that the carrying value, including goodwill, of the relevant operating division exceeds its recoverable amount. The recoverable amount of the goodwill is determined based on an assessment of the value in use, estimated using a discounted cash flow model.

As part of this process, assumptions are made in relation to forecast product prices and exchange rates. Key assumptions used in the cash flow models include forecast prices and foreign exchange rates, which the Company's management determined with reference to both internal and external publications. Other significant assumptions include the discount rate.

For the 2019 goodwill impairment assessment of the Company's US subsidiaries, a pre-tax discount rate of 8.0% was utilized, based on the Company's current weighted average cost of capital and US risk-adjusted internal borrowing rate, with a cost inflation rate of 1.0%. The net present value of the future expected cash flows was compared to the carrying value of the Company's investment in these assets, including goodwill, at year end. Based upon the analysis performed for the US subsidiaries in 2019, the net present value of the estimated discounted future cash flows exceeded the carrying value of each of the cash generating units tested for impairment, and therefore no impairments to goodwill were required. If actual results are materially lower than the forecast assumptions, there is a possibility that an impairment of goodwill may be required in future periods.

Management will assess the Company's newly acquired European subsidiary for impairment annually, beginning with the year ending December 31, 2020.

## Valuation of Log and Finished Product Inventories

Log and finished product inventories are recorded at the lower of cost and net realizable value. For inventories of solid wood products, the net realizable value is determined by taking into account outlook prices and forecast exchange rates for the period over which the inventories are expected to be sold. Outlook prices are determined using management's estimates at the end of the period end, and may differ from the actual prices at which the inventories are sold.

# RISKS AND UNCERTAINTIES

*Risks and uncertainties fall into the general business areas of markets, international commodity prices, competition, currency exchange rates, environmental issues, forest land base, government regulations, public policy and labour disputes, and, for Canadian companies, a history of trade disputes and issues and Indigenous land claims. The future impact of the various uncertainties and potential risks described in the following paragraphs (together with the risks and uncertainties identified under each of the Company's business segments) cannot be quantified or predicted with certainty. However, Canfor does not foresee unmanageable adverse effects on its business operations from, and believes that it is well positioned to deal with, such matters as may arise. The risks and uncertainties are set out in alphabetical order.*

## Capital Requirements

The forest products industry is capital intensive, and the Company regularly incurs capital expenditures to expand its operations, maintain its equipment, increase its operating efficiency and comply with environmental laws. The Company's total capital expenditures during 2019 were $302.8 million. The Company anticipates available cash and operating loans, as well as cash generated from operations, will be sufficient to fund its operating needs and capital expenditures in the foreseeable future.

## Climate Change

The Company's operations are subject to adverse events brought on by both natural and human-made disasters. These events include, but are not limited to, severe weather conditions, forest fires, hurricanes, earthquakes and timber diseases and insect infestations. These events could damage or destroy the Company's operating facilities, adversely affect Canfor's timber supply or result in reduced transportation availability. These events could have similar effect on the facilities of the Company's suppliers and customers. Any of the damage caused by these events could increase costs and decrease production capacity at the Company's operations having an adverse effect on the Company's financial results. The Company believes there are reasonable insurance arrangements in place to cover certain outcomes of such incidents; however, there is no guarantee that these arrangements will fully protect the Company against such losses. As is common practice in the industry, the Company does not insure loss of standing timber for any cause.

## Competitive Markets

The Company's products are sold primarily in the US, Canada, Europe and Asia. The markets for the Company's products are highly competitive on a global basis, with various major companies competing in each market with no company holding a dominant position. Competitive factors include quality of product, product mix, reliability of supply and customer service. The Company's competitive position is influenced by: the availability, quality, and cost of raw materials; energy and labour costs; free access to markets; currency exchange rates; productivity; transportation costs and customer service in relation to its competitors.

## Currency Exchange Risk

At the consolidated level, the Company's operating results are sensitive to fluctuations in the exchange rate of the Canadian dollar to the US-dollar, as prices for the Company's products are denominated in US-dollars or linked to prices quoted in US-dollars. Therefore, an increase in the value of the Canadian dollar relative to the US-dollar reduces the amount of revenue in Canadian dollar terms realized by the Company from sales made in US-dollars, which in turn, reduces the Company's operating margin and the cash flow available.

As a result of the acquisition of Vida on February 28, 2019, the operating results of the Company's European subsidiary are also subject to foreign exchange fluctuations. Although Vida primarily transacts in its functional currency of SEK, some of its products are sold in US dollars, GBP, AUD and EUR. Therefore, any increase in the value of the SEK relative to these currencies reduces the amount of revenue in SEK terms realized by the Company's European SPF lumber operations, which in turn reduces the operating margin and available cash flows.

## Cyclicality of Product Prices

The Company's financial performance is dependent upon the selling prices of its products, which have fluctuated significantly in the past. The markets for these products are cyclical and may be characterized by (i) periods of excess product supply due to industry capacity additions, variable production rates or capacity utilization and other factors; and (ii) periods of insufficient demand due to weak general economic conditions. The economic climate of each region where the Company's products are sold has a significant impact upon the demand, and therefore, the prices.

## Employee Future Benefits

Canfor has several defined benefit plans, which provide pension and other post-retirement benefits to certain salaried and hourly employees. Pension plan benefits are based on years of service and final average salary (for salaried employees), and flat rate benefit and years of service (for hourly employees). Canfor's other non-pension post-retirement benefit plans are non-contributory and include a range of health care and other benefits. Canfor also provides pension bridge benefits to certain eligible former employees.

Cash payments required to fund the pension plan are determined through an actuarial valuation completed at least once every three years, with the most recent actuarial valuation for the largest plan completed as of December 31, 2017. Other non-pension post-retirement benefit plans are unfunded, and the Company makes payments as required to cover liabilities as they arise.

The funded surplus (deficit) of each defined benefit plan is calculated as the difference between the value of any plan assets and an actuarial estimate of future liabilities. Any deficit in the registered pension plans determined following an actuarial valuation must be funded in accordance with regulatory requirements, normally over 5 or 15 years. Some of the unregistered plans are also partially funded.

Through its pension funding requirements, Canfor is exposed to the risk of fluctuating market values for the securities making up the plan assets, and to changes in prevailing interest rates which determine the discount rate used in calculating the estimated future liabilities. The funding requirements may also change to the extent that other assumptions used are revised, such as inflation rates or mortality assumptions.

The Company utilizes investments in buy-in annuities to reduce its exposure to these risks. Future cash flows from the annuities match the amount and timing of benefits payable under the plans, substantially mitigating the exposure to future volatility in the related pension obligations.

For Canfor’s pension benefit plans, a one percentage point increase in the discount rate used in calculating the actuarial estimate of future liabilities would reduce the accrued benefit obligation, net of annuity assets, by an estimated $53.7 million and a one percentage point decrease in the discount rate would increase the accrued benefit obligation, net of annuity assets, by an estimated $66.7 million. These changes would only impact the Company’s funding requirements in years where a new actuarial funding valuation was performed and regulatory approval for a change in funding contributions was obtained.

## Environmental Issues

Canfor's operations are subject to environmental regulation by federal, provincial, state and local authorities, including specific environmental regulations relating to air emissions and pollutants, wastewater (effluent) discharges, solid waste, landfill operations, forestry practices, site remediation and the protection of endangered species and critical habitat. Canfor is also subject to risks associated with its European SPF lumber operations, arising from the acquisition of a 70% interest in Vida on February 28, 2019. The Company’s European SPF lumber operations are subject to laws and regulations of the Swedish Government and more broadly, the European Union, with its forest operations governed by the *Swedish Forestry Act*, *Land Acquisition Act* and the *Swedish Environmental Code*.

Canfor has incurred, and will continue to incur, capital expenditures and operating costs to comply with these environmental laws and regulations. No assurance can be given that changes in these laws and regulations or their application will not have a material adverse effect on Canfor's business, operations, financial condition and operational results. Similarly, no assurance can be given that capital expenditures necessary for future compliance with existing and new environmental laws and regulations could be financed from Canfor's available cash flow. In addition, Canfor may discover currently unknown environmental issues, contamination, or conditions relating to historical or present operations. This may require site or other remediation costs to maintain compliance or remedy issues or result in governmental or private claims for damage to person, property or the environment, which could have a material adverse effect on Canfor's business, financial condition and operational results.

Canfor has systems in place to identify, account for and appropriately address potential environmental liabilities. The Company also has governance in place including an Environmental, Health and Safety Committee of the Board, a Corporate Environmental Management Committee including Officers of the Company, and environmental professionals on staff to manage potential risks, issues and liabilities.

Canfor has in place internal policies and procedures under which all its forestry and manufacturing operations are regularly audited for compliance with laws and accepted standards and with its environmental management system requirements. CPPI’s pulp mills and Canfor’s woodlands operations and wood product facilities employ environmental management systems and the pulp mills are certified under the ISO 14001 Environmental Management System Standard. Further, approximately 99% of Canfor’s forest tenures in Canada are third-party certified to the *Sustainable Forestry Initiative* (“SFI”), or the *Forest Stewardship Council* (“FSC”) sustainable forest management standards. The Company’s European SPF lumber operations comply with their internal environmental policies and employ environmental management systems, with raw materials certified through the *Swedish Forest Stewardship Council* (“FSC”) and *Program for the Endorsement of Forest Certification* (“PFEC”). In addition, there is governance in place over the European SPF lumber operations through various committees, including Vida’s Board of Directors.

Canfor’s operations and its ability to sell its products could be adversely affected if those operations did not, or were perceived by the public as failing to, comply with applicable laws and standards, and following responsible environmental and sustainable forest management practices. Further discussion of environmental issues is included in the Company’s Annual Information Form, incorporated by reference herein.

## Fibre Cost and Availability

The Company's fibre costs are affected by a number of different factors which could have a significant impact on operating results. Lumber market fluctuations and log market speculative bidding each play a significant role in both fibre supply and costs. In Western Canada, in areas where the amount of pine left to be salvaged as a result of the MPB infestation has significantly declined (i.e. shelf-life has been reached), harvesting has now transitioned back to traditional harvesting patterns and operating areas (See "Forest Health" below for more commentary regarding MPB). While this shift out of the MPB stands has the benefit of improving the quality of fibre and in some cases may also provide relief in the form of reduced harvesting costs, it will also result in increased log transportation, road construction and reforestation costs. AAC have been reduced in many areas, but in some cases, license AAC volumes have not yet been apportioned by Government, resulting in a log supply and demand imbalance. As a result, the existing manufacturing capacity continues to outstrip the available timber supply and until this is rationalized to match available log supply, Canfor expects to see a continuation of higher log costs in Western Canada in the near future.

Canfor's ability to access timber could be impacted by unsettled land and title claims by various Indigenous Nations in British Columbia. Recently passed legislation *(Declaration on the Rights of Indigenous People Act)* to implement the United Nations Declaration on the Rights of Indigenous Peoples commits the government to the achievement of free and informed consent of Indigenous peoples prior to approval of any resource-based project.

In addition, the Company's ability to harvest fibre for use in its operations could be adversely impacted by natural events such as forest fires, severe weather conditions or insect infestations. In the event that sufficient volumes of economically viable fibre cannot be provided to an operation, it may be necessary to close that operation for a period of time, or even permanently. Such closures could result in significant costs to the Company. The Company is not insured for loss of standing timber. Canfor has secured its fibre position in Western Canada relative to its existing sawmill capacity and no shortage of supply is anticipated at any of the Company's operations at this time.

In the Company's US South and European operations, fibre requirements are satisfied primarily through log purchases on open markets, principally from private timber owners. The prices for these fibre purchases are subject to adverse weather and other market forces, including regional demand, which may reduce the supply of logs available and subsequently put upward pressure on log prices negatively impacting the Company's results. In addition, decreased demand, primarily from pulp, paper and pellet mills for residual products produced by the Company's operations, may adversely impact the prices received for those residual products which could negatively impact results.

## Financial Risk Management and Earnings Sensitivities

Demand for forest products, both wood products and pulp and paper, is closely related to global business conditions and tends to be cyclical in nature. Product prices can be subject to volatile change. Canfor, like the majority of the Canadian forest products industry, competes in a global market and the majority of its products are sold in US-dollars. Consequently, changes in foreign currency relative to the Canadian dollar can impact Canfor's revenues and earnings.

***Financial Risk Management***

Canfor is exposed to a number of risks as a result of holding financial instruments. These risks include credit risk, liquidity risk and market risk.

Canfor's internal Risk Management Committee manages risk in accordance with a Board approved Price Risk Management Controls Policy. This policy provides the framework for risk management related to commodity price, foreign exchange, interest rate and counterparty credit risk of Canfor.

*(a) Credit risk:*

Credit risk is the risk of financial loss to Canfor if a counterparty to a financial instrument fails to meet its contractual obligations.

Financial instruments that are subject to credit risk include cash and cash equivalents, trade and other accounts receivable, and certain investments and advances. Contract assets are also subject to credit risk. Cash and cash equivalents include cash held through major Canadian and international financial institutions as well as temporary investments with an original maturity date, or redemption date, of three months or less.

Canfor utilizes credit insurance to mitigate the risk associated with some of its trade accounts receivables. As at December 31, 2019, approximately 28% of the outstanding trade accounts receivables are covered by credit insurance. Canfor's trade accounts receivable balance at December 31, 2019 is $264.0 million before a loss allowance of $4.3 million. At December 31, 2019, approximately 94% of the trade accounts receivable balance are within Canfor's established credit terms.

*(b) Liquidity risk:*

Liquidity risk is the risk that Canfor will be unable to meet its financial obligations as they come due. Canfor manages liquidity risk through regular cash flow forecasting in conjunction with adequate operating loan and long-term debt facilities.

At December 31, 2019, Canfor had $382.0 million drawn on its operating loans and facilities, accounts payable and accrued liabilities of $478.4 million, and long-term debt of $694.7 million. For details of the Company's long-term debt obligations and maturities refer to the "Other Commitments and Subsequent Events" section of this document.

*(c) Market risk:*

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates, foreign currency, commodity prices and energy.

(i) *Interest Rate risk*:

Canfor is exposed to interest rate risk through its current financial assets, operating loan facilities and long-term debt that bear variable interest rates.

Canfor may from time to time use interest rate swaps to reduce its exposure to interest rate risk associated with financial obligations bearing variable interest rates (see "Derivative Financial Instruments" section later in this document).

As noted earlier in this section (under "Employee Future Benefits"), Canfor is also exposed to interest rate risk in relation to the measurement of the Company's pension liabilities.

(ii) *Currency risk:*

At a consolidated level, Canfor is exposed to foreign exchange risk related to the US dollar, as Canfor's products are sold principally in US dollars. In addition, Canfor holds US-dollar denominated financial assets and liabilities.

An increase (decrease) in the value of the Canadian dollar by US$0.01 would result in a pre-tax: (i) loss (gain) of approximately $1.5 million in relation to working capital balances denominated in US dollars at year end (including cash, accounts receivable and accounts payable); and a (ii) gain (loss) of approximately $1.7 million in relation to long-term debt denominated in US dollars at year end.

A portion of the currency risk associated with US dollar denominated sales is naturally offset by US dollar denominated expenses. A portion of the remaining exposure is sometimes reduced by foreign exchange collar contracts that effectively limit the minimum and maximum Canadian dollar recovery related to the sale of those US dollars.

(iii) *Commodity price risk:*

Canfor is exposed to commodity price risk principally related to the sale of lumber and lumber-related products, pulp and paper. From time to time, Canfor enters into futures contracts on the Chicago Mercantile Exchange for lumber and forward contracts direct with customers or on commodity exchanges for pulp. Under the Company's Price Risk Management Controls Policy, up to 15% of lumber sales and 1% of pulp sales may be sold in this way. Canfor is also exposed to commodity price risk on the sale of electricity in Canada. Prices are set by third-party regulatory bodies (see "Derivative Financial Instruments" section later in this document).

(iv) *Energy price risk:*

Canfor is exposed to energy price risk relating to purchases of natural gas and diesel oil for use in its operations.

The annual exposure is from time to time hedged up to 100% through the use of floating to fixed swap contracts or option contracts with maturity dates up to a maximum of three years (see "Derivative Financial Instruments" section later in this document).

***Derivative Financial Instruments***

Subject to risk management policies approved by its Board of Directors, Canfor, from time to time, uses derivative instruments, such as forward foreign exchange contracts and option contracts to reduce its exposure to future movements of exchange rates and interest rates, and futures and forward contracts to reduce its exposure to commodity prices and energy costs. See section "Liquidity and Financial Requirements" for details of Canfor's derivative financial instruments outstanding at year end.

***Earnings Sensitivities***

Estimates of the sensitivity of Canfor's pre-tax results to currency fluctuations and prices for its principal products, based on 2020 forecast production and year end foreign exchange rates, are set out in the following table:

| (millions of Canadian dollars) | **Impact on annual pre-tax earnings** |
|---|---|
| Western SPF lumber – US$10 change per Mfbm[60, 61] | $ 34 |
| SYP lumber – US$10 change per Mfbm[60, 61] | $ 20 |
| European SPF lumber – SEK100 change per Mfbm[60, 61] | $ 13 |
| Softwood Lumber Duties – 5% change | $ 31 |
| Pulp – US$10 change per tonne [62] | $ 10 |
| Canadian dollar – US$0.01 change per Canadian dollar[62, 63] | $ 11 |
| Canadian dollar – SEK100 change per Canadian dollar[62, 63] | $ 6 |

[60] Based on sales of Canfor-produced product, before softwood lumber duties.
[61] Excluding impacts of exchange rate, freight, discounting, potential change in fibre costs and other deductions.
[62] Includes 100% of CPPI.
[63] Represents impact on operating income. Decrease of US$0.01 or SEK100 per Canadian dollar results in an increase to pre-tax annual earnings and an increase of US$0.01 or SEK100 per Canadian dollar results in a decrease to pre-tax annual earnings.

## Forest Health

Timber affected by the MPB directed Canfor's harvesting activities in central and northern BC for nearly two decades, but given the economic and biological shelf-life expiry of the dead pine stands, the focus has now shifted to other coniferous species stands. To ensure that sufficient dead pine was being harvested to sustain the current allowable harvest rates and minimize impacts to the mid-term timber supply, the Chief Forester of British Columbia established "AAC partitions" in a number of Timber Supply Areas ("TSA"). These partitions cap or restrict the harvest of non-pine species and are being revisited during upcoming Timber Supply Reviews ("TSR") as the viability of the merchantable dead pine stands further decline. Now however, upon reaching the end of shelf-life for the most severely impacted stands, the Chief Forester has commenced the reduction of the AAC of the MPB-impacted TSA. The Company anticipates this trend will continue over the next five to ten years.

In Alberta, detection surveys in 2016 have indicated the rate of MPB spread is increasing in certain areas. The largest active beetle populations are found in the West Central and Northwestern parts of the Province, particularly within the Jasper National Park boundary. An accelerated harvest of susceptible pine on the Canfor Forest Management Agreement ("FMA") area since 2009 in conjunction with government control efforts, has helped contain the spread in this area. On the other hand, pine mortality in areas north of the Peace River, including the Canfor quota area, has been extensive and harvesting objectives are now focused on salvage rather than spread prevention.

As the shelf life of the impacted stands have reached their expiry, all of the TSA and Tree Farm Licenses that had a temporary AAC uplift are not having their AAC adjusted downward. Some Northern Alberta harvest rates have been temporarily increased to deal with the rising MPB infestation and additional temporary increases could be made for the same reason in other areas of the province. The significant AAC increase approved for the quota area has maximized the opportunity to harvest infected pine stands before significant reduction in log quality occurs. In addition, the Alberta Government has committed funds for the rehabilitation of dead pine stands that have not been harvested due to merchantability limitations.

The recent outbreak of spruce beetle in the southern and eastern portions of the Mackenzie TSA and northeastern portion of the Prince George TSA has caused Canfor to shift its harvesting into stands under imminent threat or of high susceptibility to beetle infestation. Canfor is working collaboratively with other forest companies and with local and Provincial Government agencies to develop planning and harvesting tactics and strategies to arrest the spread of this pest as well as endeavor to maximize the salvage of the dead timber before its economic shelf life expires. At this time Canfor has sufficient capacity to handle the outbreak within its operating areas and has offered its assistance to neighbouring operators who lack the capacity to address the issue.

A variety of tactics are being deployed to mitigate the spread and impact of the spruce beetle, including aerial and ground reconnaissance, trap trees, pheromone baiting, log yard and log transportation management, sanitation harvest (focused on leading edge attack zones) and finally salvage harvest. Canfor has also swiftly increased its capacity to harvest steep slopes where much of the spruce beetle outbreak currently exists.

The impact of the infestation on Canfor's operations continues to be manageable in the short-term and the Company has taken steps to minimize its exposure to reductions in annual allowable harvests and to ensure a sufficient supply for its existing operations.

## Government and Other Regulations

Canfor is subject to a wide range of general and industry-specific environmental, health and safety, building and product standards and other laws and regulations imposed by federal, provincial and local authorities, including those governing the use, storage, handling, generation, treatment, emission, release, discharge and disposal of certain hazardous materials and wastes, the remediation of contaminated soil and ground water, the use and design values of Canfor's products and the health and safety of employees. Further, certain agreements and contracts relating to the ownership or transfer of forestry tenures and licenses are subject to review by applicable regulatory bodies. If Canfor is unable to extend or renew a material license or permit required by such laws, any transfer is challenged by a regulatory body, or if there is a delay in renewing any material approval, license or permit, Canfor's business, financial condition, results of operations and cash flows could be materially adversely affected. Future events such as any changes in these laws and regulations or any change in their interpretation or enforcement, or the discovery of currently unknown conditions, may give rise to additional expenditures or liabilities.

## Indigenous Relations

Canadian judicial decisions have recognized the continued existence of Indigenous rights and title to lands continuously and exclusively used or occupied by Indigenous groups. In November of 2019, the Government of British Columbia passed legislation (*Declaration on the Rights of Indigenous People Act*) to implement the United Nations Declaration on the Rights of Indigenous Peoples. The legislation aims to create a path forward that respects the human rights of Indigenous peoples while introducing better transparency and predictability to the work the BC government and Indigenous peoples do together. This work aims to foster increased and lasting certainty on the land base while ensuring that the benefits of sustainable forest harvesting are realized equitably by those engaged in and impacted by the forestry industry.

In June 2014, the Supreme Court of Canada, for the first time, recognized Indigenous title for the Tsilhqot'in Nation over approximately 1,750 square kilometres of land in central BC ("William decision"). It found that provisions of BC's Forest Act, dealing with the disposition or harvest of Crown timber, no longer applied to timber located on these lands, but also confirmed provincial law can apply on Indigenous title lands.

While Indigenous title had previously been assumed to exist over specific, intensively occupied areas such as villages, the William decision marks the first time Canada's highest court has recognized Indigenous title over a specific piece of land and, in so doing, affirmed a broader territorial use-based approach to Indigenous title. The decision also further defines what Indigenous title means and the types of land uses consistent with this form of collective ownership.

Presently, Indigenous title has not been established by law in any areas overlapping Canfor's tenure areas; however, Indigenous rights continue to exist over traditional territories, and Canfor cannot assure that this will not affect its timber harvesting rights. Forest harvesting operations are continuing to proceed under these current requirements. The Government of BC delegates procedural aspects of consultation to tenure holders, including Canfor, and Canfor works to establish productive and mutually beneficial relationships with Indigenous Nations whose traditional territories overlap Canfor operating areas. The Government of BC has also taken steps to improve certainty and access to timber resources through interim agreements with Indigenous Nations that include timber rights. Canfor holds numerous agreements with individual Indigenous Nations whereby it manages and/or purchases their timber.

The impacts of the *Declaration on the Rights of Indigenous Peoples Act* and the William decision on the timber supply from Crown lands and on Canfor's operations is unknown at this time, and Canfor does not know if the decision will lead to changes in BC laws or policies. However, as issues relating to Indigenous rights and title develop and be resolved in Canadian courts, Canfor will continue to engage, cooperate and exchange information and views with Indigenous Nations and Government to foster good relationships and minimize risks to Canfor's tenures and operational plans.

## Information Technology

Canfor's information technology systems serve an important role in the operation of its business. Canfor relies on various technologies to access fibre, operate its production facilities, interact with customers, vendors and employees and to report on its business. Interruption, failure or unsuccessful implementation and integration of Canfor's information technology systems could result in material and adverse impacts on the Company's financial condition, operations, production, sales, and reputation and could also result in environmental and physical damage to Company operations or surrounding areas.

Canfor's information technology systems and networks could be interrupted or fail due to a variety of causes, such as natural disaster, fire, power outages, vandalism, or cyber-based attacks. Any such interruption or failure could result in operational disruptions or the misappropriation of sensitive or proprietary data that could subject Canfor to civil and criminal penalties, litigation or have a negative impact on the Company's reputation. There can be no assurance that such disruptions or misappropriations and the resulting repercussions will not negatively impact the Company's cash flows and have a material adverse effect on its business, operations, financial condition and operational results.

Although to date Canfor has not experienced any material losses relating to cyber risks, there can be no assurance that the Company will not incur such losses in the future. Canfor's risk and exposure cannot be fully mitigated due to the nature of these threats. The Company continues to develop and enhance internal controls, policies and procedures designed to protect systems, servers, computers, software, data and networks from attack, damage or unauthorized access remain a priority. Canfor has established a Management Cyber Risk Committee to assess and monitor risk mitigation efforts and to respond to emerging threats. As cyber threats continue to evolve, the Company may be required to expend additional resources to continue to modify or enhance protective measures or to investigate and remediate any security vulnerabilities.

## Labour Agreements and Competition for Professional Skilled Labour

Any labour disruptions and any costs associated with labour disruptions at the Company's mills could have a material adverse effect on the Company's production levels and results of operations. Any inability to negotiate acceptable contracts with the unions as they expire could result in a strike or work stoppage by the affected workers, and increased operating costs as a result of higher wages or benefits paid to unionized workers.

A new collective agreement with the United Steelworkers ("USW"), which represents the majority of the workers of the British Columbia operations, was ratified in August of 2019. The new agreement will expire on June 30, 2023.

The contract with the Public and Private Workers of Canada ("PPWC"), which represents workers at Canfor's Mackenzie operation, expired on June 30, 2019. As the sawmill was indefinitely curtailed before the contract expired, an agreement was reached with the PPWC to postpone negotiations until the status of the sawmill changes.

In 2017 Canfor negotiated its labour agreement with UNIFOR at its Grande Prairie lumber operation; the new agreement expires October 1, 2022. Canfor Pulp Ltd. negotiated its collective agreements with UNIFOR and PPWC at its Prince George operations in 2017; the new labour agreements expire on April 30, 2021.

## Maintenance Obligations and Facility Disruptions

Canfor's manufacturing processes are vulnerable to operational problems that could impair its ability to manufacture its products. Canfor could experience a breakdown in any of its machines, or other important equipment, and from time to time, planned or unplanned maintenance outages that cannot be performed safely or efficiently during operations must be conducted. Such disruptions could cause a significant loss of production, which could have a material adverse effect on Canfor's business, financial condition and operating results. The Company believes there are reasonable insurance arrangements in place to cover certain outcomes of such incidents; however, there can be no guarantees that these arrangements will fully protect the Company against such losses.

## Residual Fibre Revenues

Wood chips are a residual product of Canfor's lumber manufacturing process and are primarily sold to CPPI. These chips are the principal raw material utilized by CPPI in its pulp manufacturing operations. Canfor has two Fibre Supply Agreements with CPPI, which contain pricing formulas that currently result in CPPI paying Canfor a price for wood chips based on pulp markets and CPPI's product mix. In 2019, Canfor provided approximately 70% of CPPI's chip requirements. If market conditions caused CPPI to cease pulp operations for an extended period of time, Canfor would have a limited market and/or reduced value for its chip supply and this could affect its ability to run its sawmills economically. Similarly, if lumber market conditions or fibre availability were such that Canfor or other suppliers were unable to provide the current volume of chips to CPPI as a result of AAC reductions, lower sawmill production or sawmill closures, whether temporary or permanent, CPPI's chip supply, chip cost and production results could be materially affected.

Bark hog is another residual product of Canfor's lumber manufacturing process. Bark hog has exhibited increasing value to Canfor over the past several years. It is utilized in Canfor's bark-fueled thermal oil energy systems to dry lumber or, in the case of Canfor's cogeneration facilities, to produce heat and electricity. Surplus bark hog is sold predominantly to Pulp customers, including CPPI, to be used in the generation of steam to manufacture power and heat.

Sales of sawdust and shavings are made primarily to other customers and the demand is increasing and robust. To enhance fibre utilization in northern BC, Canfor has three wood fuel pellet plants in the BC Interior: a facility in Houston, BC, owned and operated in partnership with Pinnacle Pellet Inc. and the Moricetown Indian Band, and facilities in Chetwynd, BC and Fort St. John, BC, owned in partnership with Pacific Bioenergy Corporation.

## Softwood Lumber Agreement

The Softwood Lumber Agreement expired on October 12, 2015 without being renewed or replaced. On November 25, 2016, a petition was filed by the US Lumber Coalition to the US Department of Commerce and the US International Trade Commission alleging certain subsidies and administered fees below the fair market value of timber that favour Canadian lumber producers, an assertion the Canadian industry and Provincial and Federal Governments strongly deny and have successfully disproven in international courts in the past. Canfor was selected by the DOC as a "mandatory respondent" to the countervailing and anti-dumping investigations and is subject to company specific countervailing and anti-dumping duties.

On April 24, 2017, the DOC announced its preliminary countervailing duty of 20.26% specific to Canfor, to be posted by cash deposits or bonds on the exports of softwood lumber to the US effective April 28, 2017 to August 25, 2017. Following this period, CVD duties were not applicable on lumber shipments destined to the US from August 26, 2017 to December 27, 2017. On June 23, 2017, the DOC announced its preliminary anti-dumping duty determination of 7.72% specific to Canfor, to be posted by cash deposits or bonds on the exports of softwood lumber to the US effective June 30, 2017.

Final countervailing and anti-dumping duty determinations were announced by the DOC on November 2, 2017, while the ITC issued an affirmative determination of injury on December 7, 2017. As a result, Canfor was issued a final ADD rate of 7.28% (after taking account of ministerial errors) effective November 8, 2017 and was subject to countervailing duties on Canadian lumber exports destined to the US at a reduced rate of 13.24%, effective December 28, 2017. Notwithstanding the final rates established in the DOC's investigation, the final liability for the assessment of CVD and ADD will not be determined until an official administrative review of the respective period is complete. For the CVD rate, the first Administrative Review is anticipated to be based on sales and cost data through 2017 and 2018, with the ADD rate expected to be based off data from July 2017 to December 2018.

In early 2020, the DOC announced the preliminary results for the first period of review (i.e. 2017 and 2018), which indicated that the Company's preliminary CVD cash deposit rate was determined to be 2.93% for 2017 and 2.61% for 2018 (versus a cash deposit rate of 13.24%), while the preliminary ADD cash deposit rate was 2.02% for the entire first period of review (versus a cash deposit rate of 7.28% and an estimated accrual rate of 2.6%).

Upon finalization of these rates (currently anticipated in the third quarter of 2020), the Company's current combined cash deposit rate of 20.52% will be reset to the final rates as determined in the first period of review (currently estimated to be 4.63% based on the preliminary determination).

Canfor and other Canadian forest product companies, the Federal Government and Canadian Provincial Governments continue to categorically deny the US allegations and strongly disagree with the current countervailing and anti-dumping determinations made by the DOC. Canada has proceeded with legal challenges under NAFTA and through the WTO, where Canadian litigation has proven successful in the past. Despite the reduced preliminary rates for the first period of review, no cash duties will be refunded to the Company until such time as the litigation regarding the imposition of CVD and ADD has been settled.

## Species at Risk

The Government of Canada pursuant to its authority under the Species at Risk Act ("SARA"), has determined several wildlife species to be critically imperiled and has listed them as Endangered or Threatened. The Environment and Climate Change Canada ("ECCC") ministry is required under SARA to create and publish a Recovery Strategy for such listed species. In 2012 and in 2014, Canada published a Recovery Strategy for the Boreal Caribou (Rangifer Tarandus Caribou – Boreal population) and the Southern Mountain Caribou (Rangifer Tarandus Caribou) – Southern Mountain population), each of which are species native to large tracts the boreal forests of northern British Columbia and Alberta, and of the mountains of British Columbia and the western slopes of the Rocky Mountains in Alberta, respectively. The Recovery Strategy identifies critical habitat and prescribes that each Province must develop and implement an action plan to recover the species and protect its critical habitat. If Canada determines that a Province is not providing for adequate protection for a species, then Canada reserves the right to levy protection orders that would prohibit activities deemed harmful to the species or destructive to its critical habitat.

In May 2018, the federal Minister of Environment and Climate Change Canada determined that 10 Local Population Units of Southern Mountain Caribou (essentially a collection of contiguous herds) were at imminent threat of recovery of the species. Under Section 80 of SARA, the Minister must now recommend to the Governor in Council (Cabinet) that an emergency order be levied that would prohibit certain activities. To date, the recommendation for an emergency order has not yet been tabled in Parliament therefore it remains uncertain what the scope and locations of activities that will be recommended for prohibition, nor is it known what decision the Cabinet will make in accepting, rejecting, or modifying the Minister's recommendations.

Canada and British Columbia have agreed to enter into a bilateral SARA Section 11 conservation agreement, contingent upon final signing of a draft trilateral Caribou Recovery Partnership Agreement (the "Partnership Agreement") that will encompass several Caribou herds in the south Peace River region of the Province. The parties to this trilateral agreement are two local area Indigenous Nations, the government of Canada, and the government of British Columbia. The Partnership Agreement has created the obligation on BC to preserve certain sections of land from all resource, commercial, and recreational use and will ultimately result in a reduction of Allowable Annual Cut in the three affected timber management units.

The impacts of the protection measures being contemplated for species at risk generally and Southern Mountain Caribou and Boreal Caribou, in particular, remain unknown. Canfor continues to work with all governments (federal, provincial, municipal) and with its provincial and national forest associations in an effort to minimize economic impacts that could result from these land use decisions.

## Stumpage Rates

Stumpage is the fee that businesses or individuals pay the Government for harvested timber from Crown land in BC. Stumpage rates in BC are determined using a transaction evidence-based timber pricing system known as the Market Pricing System ("MPS"). MPS uses market forces, such as lumber market pricing and the results and characteristics of competitively sold BC Timber Sales ("BCTS") auctions of timber, to establish the market value of timber (and ultimately stumpage rates in BC). For cutting authorities harvested under long-term tenure agreements, an adjustment is made for tenure obligation costs imposed on and incurred by licensees (such as forest management administration and silviculture) before determining final stumpage rates.

The BC Government is scheduled to make its next annual update to the MPS on July 1, 2020. Further changes to the BC Interior market driven stumpage system and resultant stumpage rates could have a material impact on Canfor's business. The Alberta Government will be reviewing their provincial stumpage rates (timber dues); however, the Company is not aware of any planned changes at this point in time.

### Transportation Services

Canfor relies primarily on third parties for transportation of its products, as well as delivery of raw materials, a significant portion of which are transported by railroad, trucks and ships. If any of Canfor's third-party transportation providers were to fail to deliver the raw materials or products or distribute them in a timely manner, Canfor may be unable to sell those products at full value, or at all, or unable to manufacture its products in response to customer demand, which could have a material adverse effect on Canfor's financial condition and operating results. In addition, if any of these third parties were to cease operations, suffer labour-related disruptions, or cease doing business with Canfor, the Company's operations or cost structure may be adversely impacted. Transportation services may also be impacted by seasonal factors, which could impact the timely delivery of raw materials and distribution of products to customers and have a resulting material adverse impact on Canfor's financial condition and operating results. As a result of increased government regulation on truck driver work hours and rail capacity constraints, access to adequate transportation capacity has at times been strained and could affect Canfor's ability to move its log, lumber and wood chips at market competitive prices.

### Wood Dust Management

The wood products industry and government regulators continue to make the management of combustible wood dust within sawmill manufacturing facilities a high priority. Specifically, Canfor continues to take extensive steps to mitigate the risks of a combustible dust incident in our facilities, including significant capital investment, a formalized wood dust control program, and extensive employee training. Regulatory agencies across the Province of British Columbia, including WorkSafe BC, Technical Safety BC, and the Office of the Fire Commissioner have implemented various regulatory and inspection initiatives related to wood dust management. While these initiatives remain active in place today, inspectional activity has begun to normalize as wood products manufacturers have implemented and maintained robust wood dust management programs. Nonetheless, additional regulatory initiatives up to and including stop work conditions within the industry have occurred and remain a possibility.

## OUTSTANDING SHARE DATA

At February 20, 2020, there were 125,219,400 common shares issued and outstanding.

## DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Board of Directors and the Audit Committee. The Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have evaluated the effectiveness of these disclosure controls and procedures for the year ended December 31, 2019 and have concluded that they are effective.

The CEO and CFO acknowledge responsibility for the design of internal controls over financial reporting ("ICFR"). With the recent acquisitions of 70% of Vida and 49% of Elliott, the scope of the Company's design of disclosure controls and procedures ("DC&P") and ICFR has excluded the controls, policies and procedures of Vida and Elliott as at December 31, 2019. The Company intends to include such controls, policies and procedures within the design of DC&P and ICFR in 2020. Additional information about the acquisitions is provided under Note 29 of Canfor's consolidated financial statements.

Other than the aforementioned acquisitions, there were no changes in the Company's internal controls over financial reporting during the year ended December 31, 2019 that materially affected, or would be reasonably likely to materially affect, such controls.

Based upon their evaluation of these controls for the year ended December 31, 2019, the CEO and CFO have concluded that these controls are operating effectively.

Additional information about the Company, including its 2019 Annual Information Form, is available at www.sedar.com or at www.canfor.com.