2014

Canfor Corporation

interim report

quarter four

for the three months ended dec 31, 2014

CANFOR

To Our Shareholders

Canfor Corporation ("CFP") reported net income attributable to shareholders ("shareholder net income") of $29.9 million, or $0.22 per share, for the fourth quarter of 2014, compared to $45.5 million, or $0.34 per share, for the third quarter of 2014 and $28.0 million, or $0.20 per share, for the fourth quarter of 2013. For the twelve months ended December 31, 2014, the Company's shareholder net income was $175.2 million, or $1.28 per share, compared to shareholder net income of $228.6 million, or $1.61 per share, reported for the comparable period of 2013.

The following table summarizes selected financial information for the Company for the comparative periods:

(millions of Canadian dollars, except per share amounts)	Q4 2014	Q3 2014	YTD 2014	Q4 2013	YTD 2013
Sales	**$ 860.4**	$ 838.0	**$ 3,347.6**	$ 809.5	$ 3,194.9
Operating income before amortization	**$ 108.9**	$ 132.7	**$ 511.8**	$ 98.7	$ 517.5
Operating income	**$ 62.0**	$ 85.6	**$ 329.3**	$ 53.8	$ 331.3
Net income attributable to equity shareholders of the Company	**$ 29.9**	$ 45.5	**$ 175.2**	$ 28.0	$ 228.6
Net income per share attributable to equity shareholders of the Company, basic and diluted	**$ 0.22**	$ 0.34	**$ 1.28**	$ 0.20	$ 1.61
Adjusted shareholder net income	**$ 35.1**	$ 50.7	**$ 188.9**	$ 48.8	$ 233.0
Adjusted shareholder net income per share, basic and diluted	**$ 0.26**	$ 0.38	**$ 1.38**	$ 0.35	$ 1.64

After adjusting for items affecting comparability with the prior periods, the Company's adjusted shareholder net income for the fourth quarter of 2014 was $35.1 million, or $0.26 per share, compared to an adjusted shareholder net income of $50.7 million, or $0.38 per share, for the third quarter of 2014. Canfor's adjusted shareholder net income for the fourth quarter of 2013 was $48.8 million, or $0.35 per share. For 2014, the Company's adjusted shareholder net income was $188.9 million, or $1.38 per share, compared to $233.0 million, or $1.64 per share, for 2013.

The Company reported operating income of $62.0 million for the fourth quarter of 2014, compared to operating income of $85.6 million for the third quarter of 2014. The Company's lumber segment was impacted by higher unit log costs in British Columbia and, to a lesser extent, seasonally higher maintenance activity and energy usage, which more than offset improved lumber sales realizations on Canadian exports attributable mostly to the weaker Canadian dollar during the quarter. Lumber shipments were down 3% from the third quarter in part reflecting lower lumber production in the fourth quarter. In the Company's pulp and paper segment, operating income was also lower compared to the previous quarter as the impact of a scheduled maintenance outage and higher fibre costs more than offset increased pulp shipments and the benefit of the weaker Canadian dollar on pulp and paper sales realizations.

Despite a modest decline in US dollar Western Spruce/Pine/Fir ("SPF") lumber prices which reflected the seasonally slower construction activity in North America during the fourth quarter, US housing starts were up 4% from the previous quarter averaging 1,075,000 units on a seasonally adjusted basis. Canadian housing starts were down 4% compared to the previous quarter at an average of 188,000 on a seasonally adjusted basis in the fourth quarter of 2014. Offshore lumber demand in China and Japan was relatively unchanged during the quarter while Canfor's offshore lumber shipments and sales realizations saw a small improvement compared to the previous quarter.

Overall, the Company's lumber sales realizations were up slightly compared to the third quarter of 2014 as the 4% weaker Canadian dollar more than offset lower benchmark lumber prices. The average North American Western SPF 2x4 #2&Btr price was down US$17 per Mfbm to US$340 per Mfbm, although price decreases in lower grade products were less pronounced. Sales realizations for Southern Yellow Pine ("SYP") products were modestly lower in the fourth quarter as the SYP 2x4 #2 benchmark price decreased US$11 per Mfbm to US$427 per Mfbm, with more marked decreases seen for wider dimension products.

Compared to the previous quarter, lumber shipments and production were down approximately 3% and 4%, respectively, and largely reflected additional statutory holidays during the quarter. Higher lumber unit manufacturing costs during the fourth quarter were primarily attributable to higher log costs in British Columbia reflecting longer hauling distances and higher purchased log costs as well as additional statutory holidays and seasonally higher maintenance activity and energy usage at the Company's sawmills in the fourth quarter.

Global softwood pulp markets were relatively stable in the fourth quarter of 2014, softening slightly towards the end of the quarter. Global softwood pulp producer inventory levels increased by 4 days in December 2014 to 31 days of supply, driven in part by strong producer operating rates (market conditions are generally considered balanced when inventories are in the 27-30 days of supply range). The North American average Northern Bleached Softwood Kraft ("NBSK") pulp list price decreased US$5 per tonne to US$1,025 and the list price to China decreased US$13 per tonne, while the NBSK pulp list price to Europe remained unchanged from the end of the previous quarter. Overall sales realizations were up modestly compared to the previous quarter, primarily reflecting the favourable impact of a 4% weaker Canadian dollar and improved customer mix, which more than offset the slightly lower NBSK pulp prices.

Pulp shipments were up 8% from the previous quarter, reflecting solid demand. Pulp production levels were down 3% from the previous quarter, reflecting the impact of a scheduled maintenance outage at the Northwood Pulp Mill in the quarter, which reduced market pulp production by 17,000 tonnes. This was offset somewhat by improved rates related in part to disruptions to operations early in the third quarter, which reduced market pulp production by 10,000 tonnes. Pulp unit manufacturing costs in the fourth quarter of 2014 were up moderately compared to the third quarter of 2014, mostly attributable to the maintenance outage in the current quarter and, to a lesser degree, a marginal increase in fibre costs, largely driven by an increased proportion of higher-cost whole log chips, and seasonally higher energy costs.

In January 2015, the Company completed the first phase of the acquisition of Beadles Lumber Company and Balfour Lumber Company Inc. ("Beadles & Balfour") representing an initial 55% ownership interest as well as the third phase of the acquisition of Scotch & Gulf Lumber, LLC ("Scotch Gulf") bringing the Company's ownership interest to 50%. Also during the quarter, the Company started construction of its pellet plants located in Chetwynd and Fort St. John both of which are forecast to commence production in the latter part of 2015 and will improve the Company's fibre utilization in northern BC.

Looking ahead, North American lumber demand is projected to continue to improve with the gradual recovery of the US housing market through 2015. For the first quarter of 2015, offshore markets are forecast to be impacted by the currently higher-than-normal inventory levels in China coupled with an increase in Russian supply due to the Russian currency devaluation benefitting Russian exports to offshore markets. The Company anticipates NBSK pulp list prices will continue to soften modestly through the first quarter of 2015. Sales realizations on Canadian exports in both the lumber and pulp and paper segments are currently projected to benefit from the continued weakening of the Canadian dollar in the first quarter of 2015.

Michael J. Korenberg
Chairman

Don B. Kayne
President and Chief Executive Officer

Canfor Corporation
Fourth Quarter 2014
Management's Discussion and Analysis

This interim Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the quarter ended December 31, 2014 relative to the quarters ended September 30, 2014 and December 31, 2013, and the financial position of the Company at December 31, 2014. It should be read in conjunction with Canfor's unaudited interim consolidated financial statements and accompanying notes for the quarters ended December 31, 2014 and 2013, as well as the 2013 annual MD&A and the 2013 audited consolidated financial statements and notes thereto, which are included in Canfor's Annual Report for the year ended December 31, 2013 (available at www.canfor.com). The financial information in this interim 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 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 "Analysis of Specific Material Items Affecting Comparability of Shareholder Net Income (Loss)") 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 and Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share are not generally accepted earnings measures and should not be considered as an alternative to net income 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 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 both 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 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. The information in this report is as at February 4, 2015.

Forward Looking Statements

Certain statements in this MD&A 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 the Company assumes no obligation to update such information to reflect later events or developments, except as required by law.

FOURTH QUARTER 2014 OVERVIEW

Selected Financial Information and Statistics

(millions of Canadian dollars, unless otherwise noted)	Q4 2014	Q3 2014	YTD 2014	Q4 2013	YTD 2013
Operating income (loss) by segment:					
Lumber	**$ 40.6**	$ 59.6	**$ 230.7**	$ 37.4	$ 285.1
Pulp and Paper	**$ 29.4**	$ 33.1	**$ 129.9**	$ 23.2	$ 72.2
Unallocated and Other	**$ (8.0)**	$ (7.1)	**$ (31.3)**	$ (6.8)	$ (26.0)
Total operating income	**$ 62.0**	$ 85.6	**$ 329.3**	$ 53.8	$ 331.3
Add: Amortization	**$ 46.9**	$ 47.1	**$ 182.5**	$ 44.9	$ 186.2
Total operating income before amortization[1]	**$ 108.9**	$ 132.7	**$ 511.8**	$ 98.7	$ 517.5
Add (deduct):					
Working capital movements	**$ 11.6**	$ (0.2)	**$ (73.6)**	$ (14.5)	$ (7.5)
Defined benefit plan contributions	**$ (3.9)**	$ (6.4)	**$ (29.7)**	$ (14.0)	$ (53.0)
Income taxes paid, net	**$ (3.1)**	$ (15.1)	**$ (39.5)**	$ (0.3)	$ (0.3)
Other operating cash flows, net[2]	**$ 3.2**	$ 8.5	**$ 23.4**	$ 28.9	$ 33.6
Cash from operating activities	**$ 116.7**	$ 119.5	**$ 392.4**	$ 98.8	$ 490.3
Add (deduct):					
Finance expenses paid	**$ (2.7)**	$ (3.3)	**$ (11.4)**	$ (5.9)	$ (17.4)
Share purchases	**$ -**	$ (1.2)	**$ (108.9)**	$ (33.4)	$ (60.0)
Distributions paid to non-controlling interests	**$ (2.5)**	$ (2.7)	**$ (10.2)**	$ (2.4)	$ (9.3)
Capital additions, net	**$ (54.7)**	$ (63.5)	**$ (234.3)**	$ (67.5)	$ (237.3)
Proceeds from the sale of Daaquam operation	**$ -**	$ 0.7	**$ 23.6**	$ -	$ -
Investment in Scotch & Gulf Lumber, LLC	**$ -**	$ (9.9)	**$ (9.9)**	$ (0.5)	$ (29.5)
Repayment from (Loan to) Scotch & Gulf Lumber, LLC	**$ 4.8**	$ 2.7	**$ 12.2**	$ 2.1	$ (31.9)
Change in restricted cash[3]	**$ (50.2)**	$ -	**$ (50.2)**	$ -	$ -
Proceeds from long-term debt	**$ 75.0**	$ -	**$ 75.0**	$ -	$ -
Repayment of long-term debt	**$ -**	$ -	**$ -**	$ (66.6)	$ (139.8)
Proceeds from sale of Canfor-LP OSB	**$ -**	$ -	**$ -**	$ -	$ 77.9
Other, net	**$ 2.5**	$ (5.6)	**$ (2.3)**	$ 0.4	$ 16.0
Change in cash / operating loans	**$ 88.9**	$ 36.7	**$ 76.0**	$ (75.0)	$ 59.0
ROIC – Consolidated period-to-date[4]	**2.6%**	3.5%	**13.3%**	2.0%	17.8%
Average exchange rate (US$ per C$1.00)[5]	**$ 0.881**	$ 0.918	**$ 0.905**	$ 0.953	$ 0.971

[1] Amortization includes certain capitalized major maintenance costs.
[2] Further information on operating cash flows can be found in the Company's unaudited interim consolidated financial statements.
[3] Change in restricted cash relates to amounts transferred into an escrow bank account for the first phase of the Beadles & Balfour acquisition which closed on January 2, 2015.
[4] 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 period. Invested capital is equal to capital assets, plus long-term investments and net non-cash working capital, all excluding minority interest components.
[5] Source – Bank of Canada (average noon rate for the period).

Analysis of Specific Material Items Affecting Comparability of Shareholder Net Income

After-tax impact, net of non-controlling interests (millions of Canadian dollars, except per share amounts)		Q4 2014		Q3 2014		YTD 2014		Q4 2013		YTD 2013
Shareholder net income, as reported	**$**	**29.9**	$	45.5	**$**	**175.2**	$	28.0	$	228.6
(Gain) loss on derivative financial instruments	**$**	**5.2**	$	0.7	**$**	**5.9**	$	0.1	$	(3.3)
Gain on sale of Daaquam operation	**$**	**-**	$	-	**$**	**(1.6)**	$	-	$	-
Mark-to-market adjustment to Canfor-LP OSB sale contingent consideration[6]	**$**	**-**	$	4.5	**$**	**9.4**	$	3.6	$	-
Gain on sale of Canfor-LP OSB (including contingent consideration)[6]	**$**	**-**	$	-	**$**	**-**	$	-	$	(28.8)
Canfor's 50% interest in Canfor-LP OSB's income, net of tax[6]	**$**	**-**	$	-	**$**	**-**	$	-	$	12.1
Foreign exchange loss on long-term debt	**$**	**-**	$	-	**$**	**-**	$	1.5	$	4.6
Mill closure provisions	**$**	**-**	$	-	**$**	**-**	$	14.8	$	14.8
One-time costs associated with collective agreements for the lumber business	**$**	**-**	$	-	**$**	**-**	$	0.8	$	0.8
Change in substantively enacted tax rate	**$**	**-**	$	-	**$**	**-**	$	-	$	4.2
Net impact of above items	**$**	**5.2**	$	5.2	**$**	**13.7**	$	20.8	$	4.4
Adjusted shareholder net income	**$**	**35.1**	$	50.7	**$**	**188.9**	$	48.8	$	233.0
Shareholder net income per share (EPS), as reported[6]	**$**	**0.22**	$	0.34	**$**	**1.28**	$	0.20	$	1.61
Net impact of above items per share[7]	**$**	**0.04**	$	0.04	**$**	**0.10**	$	0.15	$	0.03
Adjusted shareholder net income per share[7]	**$**	**0.26**	$	0.38	**$**	**1.38**	$	0.35	$	1.64

[6] The Company completed the sale of its 50% share of the Canfor-LP OSB Limited Partnership ("Canfor-LP OSB") in the second quarter of 2013 and recorded a gain of $33.4 million (after tax). As part of the sale, Canfor may receive additional annual consideration over a 3 year period, starting June 1, 2013, based on Peace Valley OSB's annual adjusted earnings before interest, tax, depreciation and amortization. An asset was recorded based on the fair value of this additional consideration and will be adjusted to current estimated fair value each reporting period. The estimated fair value of the contingent consideration at December 31, 2014 is nil.

[7] The year-to-date net impact of the adjusting items per share and adjusted shareholder net income per share does not equal the sum of the quarterly per share amounts due to rounding and the weighted average common shares outstanding during the applicable period.

The Company reported operating income of $62.0 million for the fourth quarter of 2014, compared to operating income of $85.6 million for the third quarter of 2014. The Company's lumber segment was impacted by higher unit log costs in British Columbia and, to a lesser extent, seasonally higher maintenance activity and energy usage, which more than offset improved lumber sales realizations on Canadian exports attributable mostly to the weaker Canadian dollar during the quarter. Lumber shipments were down 3% from the third quarter in part reflecting lower lumber production in the fourth quarter. In the Company's pulp and paper segment, operating income was also lower compared to the previous quarter as the impact of a scheduled maintenance outage and higher fibre costs more than offset increased pulp shipments and the benefit of the weaker Canadian dollar on pulp and paper sales realizations.

Despite a modest decline in US dollar Western Spruce/Pine/Fir ("SPF") lumber prices which reflected the seasonally slower construction activity in North America during the fourth quarter, US housing starts were up 4% from the previous quarter averaging 1,075,000 units on a seasonally adjusted basis. Canadian housing starts were down 4% compared to the previous quarter at an average of 188,000 on a seasonally adjusted basis in the fourth quarter of 2014. Offshore lumber demand in China and Japan was relatively unchanged during the quarter while Canfor's offshore lumber shipments and sales realizations saw a small improvement compared to the previous quarter.

Overall, the Company's lumber sales realizations were up slightly compared to the third quarter of 2014 as the 4% weaker Canadian dollar more than offset lower benchmark lumber prices. The average North American Western SPF 2x4 #2&Btr price was down US$17 per Mfbm to US$340 per Mfbm, although price decreases in lower grade products were less pronounced. Sales realizations for Southern Yellow Pine ("SYP") products were modestly lower in the fourth quarter as the SYP 2x4 #2 benchmark price decreased US$11 per Mfbm to US$427 per Mfbm, with more marked decreases seen for wider dimension products.

Compared to the previous quarter, lumber shipments and production were down approximately 3% and 4%, respectively, and largely reflected additional statutory holidays during the quarter. Higher lumber unit manufacturing costs during the fourth quarter were primarily attributable to higher log costs in British Columbia reflecting longer hauling distances and higher purchased log costs as well as additional statutory holidays and seasonally higher maintenance activity and energy usage at the Company's sawmills in the fourth quarter.

Global softwood pulp markets were relatively stable in the fourth quarter of 2014, softening slightly towards the end of the quarter. Global softwood pulp producer inventory levels increased by 4 days in December 2014 to 31 days of supply, driven in part by strong producer operating rates (market conditions are generally considered balanced when inventories are in the 27-30 days of supply range). The North American average Northern Bleached Softwood Kraft ("NBSK") pulp list price decreased US$5 per tonne to US$1,025 and the list price to China decreased US$13 per tonne, while the NBSK pulp list price to Europe remained unchanged from the end of the previous quarter. Overall sales realizations were up modestly compared to the previous quarter, primarily reflecting the favourable impact of a 4% weaker Canadian dollar and improved customer mix, which more than offset the slightly lower NBSK pulp prices.

Pulp shipments were up 8% from the previous quarter, reflecting solid demand. Pulp production levels were down 3% from the previous quarter, reflecting the impact of a scheduled maintenance outage at the Northwood Pulp Mill in the quarter, which reduced market pulp production by 17,000 tonnes. This was offset somewhat by improved rates related in part to disruptions to operations early in the third quarter, which reduced market pulp production by 10,000 tonnes. Pulp unit manufacturing costs in the fourth quarter of 2014 were up moderately compared to the third quarter of 2014, mostly attributable to the maintenance outage in the current quarter and, to a lesser degree, a marginal increase in fibre costs, largely driven by an increased proportion of higher-cost whole log chips, and seasonally higher energy costs.

Compared to the fourth quarter of 2013, operating income before one-time items in the current quarter was up $8.2 million, principally reflecting the Quesnel sawmill closure provision and costs associated with the collective labour agreement both of which were recorded in the lumber segment in the comparative quarter. Excluding these one-time items, operating income was down $12.9 million compared to the fourth quarter of 2013 as higher earnings in the pulp and paper segment were more than offset by lower earnings in the lumber segment which, for the most part, reflected higher logging and hauling costs, stumpage rates and purchased log costs in British Columbia. Partly offsetting the impact of unit log costs in the lumber segment were modestly higher sales realizations, which benefitted from an 8% weaker Canadian dollar, stronger SYP benchmark prices and, to a lesser extent, the absence of export tax on US bound shipments as well as productivity improvement following several major capital projects completed over the past few years. The increase in the pulp and paper segment earnings for the most part reflected higher pulp sales realizations arising from both the weaker Canadian dollar and higher US dollar pulp prices to most regions. Partly offsetting these gains in the pulp and paper segment were lower pulp shipments, higher fibre costs and the impact of a longer scheduled maintenance shut in the current quarter compared to the fourth quarter of 2013.

OPERATING RESULTS BY BUSINESS SEGMENT

Lumber

Selected Financial Information and Statistics – Lumber

(millions of Canadian dollars unless otherwise noted)	**Q4 2014**	Q3 2014	**YTD 2014**	Q4 2013	YTD 2013
Sales	**$ 564.4**	$ 570.5	**$ 2,245.1**	$ 533.7	$ 2,192.2
Operating income before amortization	**$ 70.6**	$ 88.7	**$ 345.8**	$ 66.1	$ 398.6
Operating income	**$ 40.6**	$ 59.6	**$ 230.7**	$ 37.4	$ 285.1
Mill closure provisions	**$ -**	$ -	**$ -**	$ 20.0	$ 20.0
One-time costs associated with collective agreements	**$ -**	$ -	**$ -**	$ 1.1	$ 1.1
Operating income excluding unusual items	**$ 40.6**	$ 59.6	**$ 230.7**	$ 58.5	$ 306.2
Average SPF 2x4 #2&Btr lumber price in US$[8]	**$ 340**	$ 357	**$ 349**	$ 370	$ 356
Average SPF price in Cdn$	**$ 386**	$ 389	**$ 383**	$ 388	$ 367
Average SYP 2x4 #2 lumber price in US$[9]	**$ 427**	$ 438	**$ 418**	$ 415	$ 413
Average SYP price in Cdn$	**$ 485**	$ 477	**$ 462**	$ 436	$ 425
U.S. housing starts (thousand units SAAR)[10]	**1,075**	1,030	**1,003**	1,025	930
Production – SPF lumber (MMfbm)[11]	**893.1**	926.3	**3,735.3**	944.8	4,058.1
Production – SYP lumber (MMfbm)[11]	**141.6**	150.4	**581.0**	135.3	526.3
Shipments – SPF lumber (MMfbm)[12]	**937.7**	956.2	**3,735.9**	961.1	4,027.8
Shipments – SYP lumber (MMfbm)[12]	**151.3**	162.2	**625.0**	142.4	545.2
Shipments – wholesale lumber (MMfbm)	**2.5**	6.0	**18.6**	5.7	24.8

[8] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.).
[9] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.).
[10] Source – U.S. Census Bureau, seasonally adjusted annual rate ("SAAR").
[11] Excluding production of trim blocks.
[12] Canfor-produced lumber, including lumber purchased for remanufacture and excluding trim blocks.

Overview

Operating income for the lumber segment was $40.6 million for the fourth quarter of 2014, a decrease of $19.0 million compared to operating income of $59.6 million in the previous quarter, and a decrease of $17.9 million from operating income, adjusted for one-time items, of $58.5 million reported for the fourth quarter of 2013. Current quarter results reflected continued upward pressure on log costs in British Columbia and, to a lesser extent, seasonally higher maintenance activity and energy usage in the period. Partially offsetting higher costs in the quarter were slightly improved lumber sales realizations on Canadian exports which benefitted from the 4 cent, or 4%, weaker Canadian dollar compared to the third quarter of 2014. Lumber production volumes in the Company's Canadian and US South operations were down approximately 4% compared to the previous quarter principally reflecting additional statutory holidays in the fourth quarter.

Lumber segment results in the fourth quarter of 2013 included one-time costs related to the closure of the Quesnel Sawmill and one-time costs associated with the five year collective agreements ratified in the fourth quarter of 2013. Adjusting for these one-time items, lumber segment operating income was down $17.9 million, for the most part reflecting higher unit manufacturing costs at the Company's British Columbia operations due mostly to increased log costs. Lower production volume compared to the same quarter in 2013 mainly reflected the closure of the Quesnel Sawmill and sale of the Daaquam Sawmill in the first quarter of 2014, offset in part by increased production at several recently upgraded sawmill operations.

Markets

North American lumber demand was relatively stable with balanced lumber consumption from all segments of the market despite the seasonally slower construction period in the fourth quarter. The U.S. housing market continued its slow but gradual recovery, supported by lower mortgage rates, improved housing affordability and increasing consumer confidence. Total housing starts averaged 1,075,000 units[13] SAAR (seasonally adjusted annual rate), up 4% from the third quarter of 2014 and 5% from the same period in 2013. Single-family starts, which consume a higher proportion of lumber, increased 9% compared to the third quarter of 2014 to 708,000 units SAAR[13]. The repair and remodeling sector saw a modest increase, with sustained home improvement activities in North America.

In Canada, housing starts were down 4% compared to the previous quarter at an average of 188,000 SAAR[14] and down 5% from the same period in 2013.

Offshore lumber demand in China and Japan was relatively stable during the fourth quarter and Canfor's offshore lumber shipments saw a slight increase compared to the previous quarter. At period end, log and lumber inventory levels in China were higher-than-normal in part reflecting increased Russian supply late in the quarter as a result of the sharp devaluation of the Russian Ruble.

Sales

Sales for the lumber segment for the fourth quarter of 2014 were $564.4 million, compared to $570.5 million in the previous quarter and $533.7 million in the fourth quarter of 2013. The slight decrease in sales from the third quarter of 2014 was largely the result of lower lumber shipments offset by a slight improvement in overall lumber sales realizations quarter-over-quarter. Revenue in the lumber segment also reflected seasonally higher log sales in the current quarter. Compared to the fourth quarter of 2013, the increase in sales revenue was the result of higher unit sales realizations offset in part by lower lumber shipments.

Total lumber shipments in the fourth quarter of 2014, at just under 1.1 billion board feet, were down 3% from the previous quarter, in part reflecting lower production volume available for sale. Compared to the fourth quarter of 2013, lumber shipments were down 2%, largely reflecting the closure of the Quesnel Sawmill and sale of the Daaquam Sawmill in the first quarter of 2014 offset in part by additional shifts and modest productivity improvements following several major capital projects and related production ramp-ups.

Overall lumber sales realizations were up slightly from the third quarter of 2014, largely a result of the weaker average Canadian dollar offset by lower Western SPF and SYP benchmark lumber prices. North American Western SPF sales realizations improved marginally from the previous quarter, principally benefitting from a 4 cent or 4% weaker Canadian dollar offset by moderate decreases in most benchmark lumber prices during the quarter. The average Random Lengths Western SPF 2x4 #2&Btr price decreased by 5%, or US$17 per Mfbm, to US$340 per Mfbm in the current quarter, while price decreases in lower grade products were less pronounced. Offshore sales realizations also increased slightly from the previous quarter, in part reflecting favourable foreign exchange rates and the nature of offshore pricing, much of which is negotiated monthly or quarterly in advance. Sales realizations for SYP products were modestly lower in the fourth quarter due to an US$11 per Mfbm, or 3%, decrease in the benchmark SYP 2x4 #2 price coupled with more marked decreases in certain wide dimension products during the quarter.

Compared to the fourth quarter of 2013, overall lumber sales realizations benefitted moderately from a weaker Canadian dollar, stronger SYP lumber prices and, to a lesser extent, the absence of export tax on US bound shipments. The benchmark North American Random Lengths Western SPF 2x4 #2&Btr price was 8% or US$30 per Mfbm lower than the same quarter in the prior year. More than offsetting the decline in the Western SPF benchmark price was a 7 cent, or 8%, weaker Canadian dollar compared to the fourth quarter of 2013, as well as less pronounced price decreases in certain lumber grades and dimensions period-over-period. Current quarter sales realizations also included the positive impact of a higher percentage of prime products sold, largely reflecting the closure of the Company's Quesnel sawmill in the first quarter of 2014, and no export taxes on US bound shipments compared to a 2% duty in the comparative period. The benchmark SYP 2x4 #2 price was up US$12 per Mfbm, or 3%, from the fourth quarter of 2013 contributing to improved sales realizations at the Company's US South operations.

[13] U.S. Census Bureau
[14] CMHC – Canada Mortgage and Housing Corporation

Total residual fibre revenue was slightly lower in the current quarter compared to the third quarter of 2014, with lower shipments of sawmill residual chips, largely attributable to lower lumber production, coupled with a slight decrease in sawmill residual chip prices. Compared to the fourth quarter of 2013, residual revenue was up, principally due to a market-driven increase in sawmill residual chip prices, tied in part to higher NBSK pulp sales realizations.

Operations

Lumber production, at over 1.0 billion board feet, was down 4% from the previous quarter. Compared to the previous quarter, the lower lumber production was largely the result of additional statutory holidays during the quarter and downtime taken at the Company's US South operations for capital upgrades. Lumber production was also down 4% compared to the same period in 2013, primarily due to the closure of the Company's Quesnel Sawmill and sale of the Company's Daaquam Sawmill in the first quarter of 2014. Excluding the impact of the Quesnel closure and Daaquam sale, lumber production was up 5%, reflecting operating shifts added at certain operations earlier in 2014 and more downtime for capital installations and ramp-ups occurring in the comparable period of 2013.

Overall, unit manufacturing costs saw an increase from the previous quarter, reflecting both increased unit log costs and, to a lesser extent, higher unit cash conversion costs. During the quarter, the unit log costs were impacted by longer hauling distances and higher purchased log costs in the Company's Canadian operations offset somewhat by a slight drop in market-driven stumpage rates in British Columbia. Higher unit conversion costs reflected the lower production volumes as well as seasonally higher maintenance activity and energy usage during the period.

Compared to the fourth quarter of 2013, unit manufacturing costs were higher at the Canadian operations and relatively flat at the Company's US South operations. Higher unit log costs in the Canadian operations were primarily the result of increased logging and hauling rates, higher market-driven stumpage costs and higher purchased log costs compared to the same quarter in 2013. Higher unit cash conversion costs compared to the same period in 2013 principally reflected higher maintenance costs in part due to certain one-time projects completed during the quarter, continued dust management efforts and higher labour costs.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[15]

(millions of Canadian dollars unless otherwise noted)	**Q4 2014**	Q3 2014	**YTD 2014**	Q4 2013	YTD 2013
Sales	**$ 296.0**	$ 267.5	**$ 1,102.5**	$ 275.8	$ 999.4
Operating income before amortization[16]	**$ 45.0**	$ 49.9	**$ 194.5**	$ 39.2	$ 144.0
Operating income	**$ 29.4**	$ 33.1	**$ 129.9**	$ 23.2	$ 72.2
Average pulp price delivered to US – US$[17]	**$ 1,025**	$ 1,030	**$ 1,025**	$ 983	$ 941
Average price in Cdn$	**$ 1,164**	$ 1,122	**$ 1,133**	$ 1,032	$ 969
Production – pulp (000 mt)	**295.7**	305.3	**1,200.1**	299.5	1,192.9
Production – paper (000 mt)	**36.0**	35.9	**144.0**	30.8	134.7
Shipments – pulp (000 mt)	**314.0**	291.0	**1,175.4**	329.5	1,213.0
Shipments – paper (000 mt)	**35.8**	35.7	**142.5**	31.1	138.8

[15] Includes the Taylor Pulp Mill and 100% of Canfor Pulp Products Inc., which is consolidated in Canfor's results. Pulp production and shipment volumes presented are for both NBSK and bleached chemi-thermo mechanical pulp ("BCTMP").
[16] Amortization includes certain capitalized major maintenance costs.
[17] Per tonne, NBSK pulp list price delivered to US (Resource Information Systems, Inc.).

Overview

Operating income for the pulp and paper segment was $29.4 million for the fourth quarter of 2014, down $3.7 million from the previous quarter, and up $6.2 million from the fourth quarter of 2013.

Pulp and paper segment earnings were down compared to the previous quarter principally reflecting a moderate increase in unit manufacturing costs mainly attributable to a net increase in scheduled maintenance downtime in the current quarter and, to a lesser degree, increased fibre costs and seasonally higher energy costs. Partially offsetting the higher costs in the quarter were increased pulp shipment volumes, mostly driven by strong demand in the Asia market, coupled with a modest increase in sales realizations primarily attributable to the 4 cent, or 4%, weaker Canadian dollar. Operating income at the Company's paper operation were slightly higher compared to the previous quarter reflecting increased unit sales realizations offset by a moderate increase in manufacturing costs.

Compared to the fourth quarter of 2013, the pulp and paper segment's results were up with strong gains in pulp sales realizations offset by lower pulp shipment volumes and higher unit manufacturing costs. The higher pulp sales realizations were largely a result of the 8% weaker Canadian dollar and marginal improvements in pulp US dollar prices to most regions, while shipments for the last quarter of 2013 were at higher-than-normal levels. Unit manufacturing costs were up moderately, primarily reflecting higher market-driven fibre costs and the impact of a longer scheduled maintenance outage in the current quarter compared to a scheduled outage taken in the fourth quarter of 2013. The current quarter pulp operations results also included higher energy revenue compared to the fourth quarter of 2013. Results in the Company's paper business boosted the overall pulp and paper segment's earnings compared to same in quarter in 2013 largely reflecting higher paper shipment volumes and higher unit sales realizations coupled with lower unit manufacturing costs principally the result of higher production volumes in the current quarter due to a scheduled maintenance outage in the fourth quarter of 2013. These gains in the paper business were partially offset by market-driven increases in slush pulp costs in the current quarter.

Markets

Global softwood pulp markets were relatively stable in the fourth quarter of 2014, softening slightly towards the end of the quarter, with pricing down modestly in North America and China and solid demand in most regions through the quarter. Global softwood pulp producer inventory levels remained balanced during the first two months of the quarter before increasing in December 2014 to 31 days of supply, up 4 days from September 2014[18], driven in part by strong producer operating rates. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

Global shipments of bleached softwood kraft pulp were relatively unchanged from both the third quarter of 2014 and the fourth quarter of 2013, with increased shipments to China and North America offset in part by lower shipments to Europe compared to the previous quarter, while stable demand was seen to most regions compared to the same period in 2013[19].

Sales

The Company's pulp shipments in the fourth quarter of 2014 totalled 314,000 tonnes, an increase of 23,000 tonnes, or 8%, from the previous quarter, reflecting increased shipments to Asia coupled with solid demand in most other regions through the current quarter. Compared to the same period in 2013, pulp shipments were down 15,500 tonnes, or 5%, due in part to higher-than-normal shipments into China in the fourth quarter of 2013, partly offset by improved demand in North America. Paper shipments at 35,800 tonnes in the fourth quarter of 2014 were in line with the previous quarter, and up 4,700 tonnes, or 15%, compared to the same quarter in 2013, principally reflecting higher production levels.

NBSK pulp list prices in North America and China reflected the slight softening of global softwood pulp markets towards the end of the year. The North American average NBSK pulp list price decreased US$5 per tonne to US$1,025 and the list price to China decreased US$13 per tonne, while the NBSK pulp list price to Europe remained unchanged from the end of the previous quarter at US$935 per tonne. Discount levels were consistent with the previous quarter. Overall current quarter pulp sales realizations were up modestly, primarily reflecting the favourable impact of the 4% weaker Canadian dollar and an improved customer mix in Asia and North America, which more than offset the slightly lower NBSK pulp prices. Energy revenue was up from the third quarter of 2014, reflecting increased energy production and seasonal increases in prices. Bleached chemi-thermo mechanical pulp ("BCTMP") average sales realizations decreased modestly from the previous quarter as market prices for BCTMP declined in the fourth quarter of 2014. Paper unit sales realizations saw a marginal increase from the third quarter of 2014 as the impact of the weaker Canadian dollar more than offset a decrease in higher-value prime bleached product shipments.

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

Compared to the fourth quarter of 2013, pulp sales realizations showed strong gains, largely as a result of the 8% weaker Canadian dollar, increased US-dollar pulp prices in most regions, and increased shipments to higher-margin regions. The average NBSK pulp list price to North America increased US$42 per tonne, or 4%, with list prices to Europe seeing similar gains. Partially offsetting these gains were increased discounts in North America and a 3% decrease in the average list price to China. Higher energy revenue compared to the same period in 2013 continued to reflect output from the upgrades to the Northwood Pulp Mill turbines, completed in early 2014, as well as increased power generation from the turbine at the Company's Prince George Pulp Mill facility. BCTMP sales realizations experienced modest gains compared to the fourth quarter of 2013, reflecting the weaker Canadian dollar offset in part by lower market prices. Paper unit sales realizations were well up compared to the same quarter in 2013, largely the result of the weaker Canadian dollar as well as increased prices and higher prime bleached paper shipments.

<u>Operations</u>

Pulp production in the current quarter was 295,700 tonnes, down 9,600 tonnes, or 3%, from the previous quarter, and down 3,800 tonnes, or 1%, from the fourth quarter of 2013. The current quarter included a scheduled maintenance outage at the Northwood Pulp Mill which resulted in reduced market pulp production of 17,000 tonnes. In comparison, the third quarter of 2014 pulp production included some disruptions to operations early in the quarter, which reduced pulp production by 10,000 tonnes. Production in the fourth quarter of 2013 reflected a scheduled maintenance outage at the Prince George Pulp Mill, which resulted in reduced market pulp production of 4,000 tonnes. Current quarter production levels were favourably impacted by higher operating rates than both comparable periods. Paper production in the fourth quarter of 2014 was 36,000 tonnes, in line with the previous quarter and up 5,200 tonnes, or 17%, from the fourth quarter of 2013, mostly due to a scheduled maintenance outage at the Company's paper machine in October 2013.

Pulp unit manufacturing costs saw a moderate increase from the previous quarter, reflecting the higher costs attributable to the maintenance outage in the current quarter, including the unfavourable impact of lower production volumes and, to a lesser degree, higher energy usage in part attributable to the scheduled outage in the quarter as well as a seasonal increase. Fibre costs showed a marginal increase compared to the third quarter of 2014, driven primarily by an increased proportion of higher-cost whole log chips. Paper unit manufacturing costs increased moderately from the previous quarter, reflecting higher slush pulp costs along with the timing of spend on maintenance and operating supplies in the current quarter, mitigated slightly by lower energy costs.

Compared to the fourth quarter of 2013, unit manufacturing costs were up, reflecting the impact of higher fibre costs coupled with higher costs attributable to the longer maintenance outage in the current quarter. The higher fibre costs resulted largely from market-driven increases in sawmill residual and whole log chip prices and, to a lesser extent, an increased proportion of higher-cost whole log chips. Paper unit manufacturing costs showed a marginal increase compared to the same quarter in 2013, as higher costs for slush pulp and chemicals in the current quarter were partly offset by lower maintenance and operating costs, mostly due to a scheduled maintenance outage in the comparative period.

Unallocated and Other Items

<u>Selected Financial Information</u>

(millions of Canadian dollars)	**Q4 2014**	Q3 2014	**YTD 2014**	Q4 2013	YTD 2013
Operating loss of Panels operations[20]	**$ (0.8)**	$ (0.7)	**$ (3.9)**	$ (0.5)	$ (1.7)
Corporate costs	**$ (7.2)**	$ (6.4)	**$ (27.4)**	$ (6.3)	$ (24.3)
Finance expense, net	**$ (4.6)**	$ (4.8)	**$ (18.2)**	$ (6.4)	$ (27.9)
Foreign exchange loss on long-term debt	**$ -**	$ -	**$ -**	$ (3.4)	$ (8.9)
Gain (loss) on derivative financial instruments	**$ (7.4)**	$ (1.1)	**$ (8.9)**	$ (0.2)	$ 4.4
Gain on sale of Canfor–LP OSB joint venture	**$ -**	$ -	**$ -**	$ -	$ 38.3
Other income (expense), net	**$ 3.1**	$ 0.2	**$ (4.2)**	$ (3.1)	$ 1.5

[20] The Panels operations include the Company's PolarBoard oriented strand board ("OSB") plant, which is currently indefinitely idled and its Tackama plywood plant, which was closed in January 2012.

Corporate costs were $7.2 million for the fourth quarter of 2014, up $0.8 million from the previous quarter and $0.9 million from the fourth quarter of 2013 partly reflecting increased share based compensation costs.

Net finance expense at $4.6 million for the fourth quarter of 2014 was in line with the previous quarter and down $1.8 million from the fourth quarter of 2013. The decrease compared to the same quarter in 2013 reflects lower employee future benefit net interest costs, due in part to the improved financial position of most of the Company's defined benefit plans.

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs, lumber prices, pulp prices and interest rates. In the fourth quarter of 2014, the Company recorded a net loss of $7.4 million related to its derivatives instruments, principally reflecting unrealized losses on crude oil collars stemming from the sharp decline in oil prices at the end of 2014, with oil prices declining further early in 2015. Also contributing to the loss, to a lesser degree, were losses on US dollar foreign exchange collars as a result of the weakening of the Canadian dollar at the close of the current quarter relative to the exchange rate at the close of the third quarter of 2014. These losses were partly offset by realized gains on lumber futures contracts settled during the quarter.

Other income, net of $3.1 million in the fourth quarter of 2014, principally reflected foreign exchange gains on US dollar denominated working capital resulting from the weakening of the Canadian dollar relative to the US dollar over the course of the quarter.

Other Comprehensive Income (Loss)

The following table summarizes Canfor's Other Comprehensive Income (Loss) for the comparable periods:

(millions of Canadian dollars)	**Q4 2014**	Q3 2014	**YTD 2014**	Q4 2013	YTD 2013
Foreign exchange translation differences for foreign operations, net of tax	**$ 10.9**	$ 11.2	**$ 22.7**	$ 8.0	$ 15.0
Defined benefit actuarial gains (losses), net of tax	**$ (46.4)**	$ 11.7	**$ (85.2)**	$ 40.4	$ 91.7
Other comprehensive income (loss), net of tax	**$ (35.5)**	$ 22.9	**$ (62.5)**	$ 48.4	$ 106.7

In the fourth quarter of 2014, the Company recorded an after-tax loss of $46.4 million in relation to changes in the valuation of the Company's employee future benefit plans. The loss principally reflects a lower discount rate used to value the net defined benefit obligation and actuarial experience adjustments related to certain defined benefit pension plans, offset in part by a return on plan assets. In the previous quarter, an after-tax gain of $11.7 million was recorded principally reflecting a modest return on plan assets and a slightly higher discount rate used to value the net defined benefit obligation. In the fourth quarter of 2013, an after-tax actuarial gain of $40.4 million was recorded in Other Comprehensive Income.

In addition, the Company recorded $10.9 million of other comprehensive gain in the quarter for foreign exchange differences for foreign operations, reflecting favourable foreign exchange movements during the quarter. This compared to a foreign exchange gain of $11.2 million in the previous quarter and $8.0 million in the fourth quarter of 2013.

SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's cash flow and selected ratios for and as at the end of the following periods:

(millions of Canadian dollars, except for ratios)	**Q4 2014**	Q3 2014	**YTD 2014**	Q4 2013	YTD 2013
Increase (decrease) in cash and cash equivalents	**$ 11.9**	$ 38.7	**$ 68.8**	$ (0.4)	$ 106.6
Operating activities	**$ 116.7**	$ 119.5	**$ 392.4**	$ 98.8	$ 490.3
Financing activities	**$ (7.2)**	$ (7.2)	**$ (64.7)**	$ (33.8)	$ (181.4)
Investing activities	**$ (97.6)**	$ (73.6)	**$ (258.9)**	$ (65.4)	$ (202.3)
Ratio of current assets to current liabilities			**2.1:1**		1.7:1
Net debt to capitalization			**5.1%**		8.0%
ROIC - Consolidated period-to-date	**2.6%**	3.5%	**13.3%**	2.0%	17.8%

Changes in Financial Position

Cash generated from operating activities was $116.7 million in the fourth quarter of 2014, compared to cash generated of $119.5 million in the previous quarter of 2014 and $98.8 million generated in the same quarter of 2013. The decrease in operating cash flows from the previous quarter principally reflected lower cash earnings, partially offset by lower income tax installment payments and a decrease in non-cash working capital in the current quarter. The latter included higher trade receivable collections and prepaid expenses offset by an increase in accounts payable and accrued liabilities reflecting the timing of payments. Log and lumber finished inventories also increased in part reflecting seasonally higher harvesting activity. Compared to the fourth quarter of 2013, the increase in operating cash flows was mostly attributable to changes in non-cash working capital and reduced salary pension contributions, partially offset by lower cash earnings in the current quarter.

Cash used for financing activities was $7.2 million in the current quarter, in line with the previous quarter and down $26.6 million compared to cash used of $33.8 million in the fourth quarter of 2013. During the quarter, the Company completed a $75.0 million debt financing for the construction of the recently announced pellet plants in Fort St. John and Chetwynd and various energy projects in the lumber segment. Also during the fourth quarter 2014, the Company repaid $77.0 million against its operating loan facility bringing the amount outstanding down to $68.0 million at the end of the year. Finance expenses paid in the quarter were $2.7 million, down $0.6 million from the previous quarter and $3.2 million from the fourth quarter of 2013. No share purchases were made during the quarter by Canfor or Canfor Pulp under its Normal Course Issuer Bid.

Cash used for investing activities was $97.6 million in the current quarter, compared to $73.6 million in the prior quarter and $65.4 million in the same quarter of 2013. Cash used for capital additions was $54.7 million, down $8.8 million from the previous quarter and $12.8 million from the fourth quarter of 2013. Current quarter capital expenditures included spending on the Company's Polar Sawmill rebuild and the construction of the pellet plants in Chetwynd and Fort St. John (see further discussion on the pellet plants in the following "Commitments and Subsequent Events" section). In the pulp and paper segment, capital expenditures related primarily to the Intercontinental Pulp Mill turbine upgrade. Investing activities in the current quarter also included the transfer of $50.2 million into an escrow account in connection with the first phase of the purchase of Beadles Lumber Company and Balfour Lumber Company Inc. ("Beadles & Balfour") (see further discussion on the Beadles & Balfour acquisition in the following "Commitments and Subsequent Events" section) and a $4.8 million repayment received on the term loan issued to Scotch & Gulf Lumber Company, LLC ("Scotch Gulf"). In the previous quarter of 2014, cash flow from investing activities included the second payment of $9.9 million for the phased purchase of Scotch Gulf. Subsequent to year end, on January 30, 2015, Canfor completed the third phase of the acquisition of Scotch Gulf increasing its interest to 50%.

Liquidity and Financial Requirements

At December 31, 2014, the Company on a consolidated basis had cash of $208.5 million (including $50.2 million of restricted cash for the first phase of the acquisition of Beadles & Balfour which closed on January 2, 2015), $68.0 million drawn on its operating loans, and an additional $26.0 million reserved for several standby letters of credit. Total available undrawn operating loans at year end were $423.5 million. During the third quarter of 2014, Canfor extended the maturity date of its principal operating loan facility from February 28, 2018 to February 28, 2019.

On November 7, 2014, the Company completed a $75.0 million unsecured term debt financing, which is repayable on November 14, 2019, with no penalty for early repayment. The interest rate on the new term debt is based on the lender's Canadian prime rate or bankers' acceptance rate in the year of payment. Also in November 2014, the Company entered into a $37.5 million facility for letters of credit to support funding of certain pension plans. In addition, Canfor has $100.0 million of floating interest rate term debt, repayable in February 2017 and CPPI has $50.0 million of floating interest rate term debt, repayable in November 2018.

The Company and CPPI remained in compliance with the covenants relating to their operating loans and long-term debt during the quarter, and expect to remain so for the foreseeable future.

The Company's consolidated net debt to total capitalization at the end of 2014 was 5.1%. For Canfor, excluding CPPI, net debt to capitalization at the end of 2014 was 7.6%.

On March 5, 2014, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 6,995,228 common shares or approximately 5% of its issued and outstanding common shares as of February 28, 2014. The renewed normal course issuer bid is set to expire on March 4, 2015. During the fourth quarter of 2014, no common shares were purchased under the Normal Course Issuer Bid. For the twelve months ended December 31, 2014, Canfor purchased 4,527,600 common shares for $108.9 million (an average of $24.05 per common share).

Commitments and Subsequent Events

In August 2014, the Company completed the second phase of the purchase of the lumber business of Scotch Gulf increasing its ownership to 33%. Subsequent to year end, on January 30, 2015, the Company completed the third phase of the acquisition increasing its ownership to 50%. The final phase, whereby the Company will own 100% of Scotch Gulf, is scheduled to close in August 2016. The aggregate purchase price for Scotch Gulf is US$80.0 million plus working capital.

In August 2014, the Company entered into a phased purchase agreement with Beadles & Balfour. The transaction will involve the phased purchase of the operating assets of Beadles & Balfour over a 2 year period, at an aggregate purchase price, excluding working capital, of US$62.0 million. Subsequent to year end, on January 2, 2015, the first phase of the acquisition closed representing an initial 55% ownership interest in Beadles & Balfour. The final phase whereby Canfor will wholly own Beadles & Balfour is scheduled to close at the beginning of 2017.

In September 2014, the Company entered into a purchase agreement with Southern Lumber Company Inc. ("Southern Lumber"). The transaction will involve the purchase of all operating assets of Southern Lumber, at an aggregate purchase price, excluding working capital, of US$48.7 million. The transaction is subject to standard closing conditions and is currently anticipated to close in April 2015.

Also in September 2014, the Company announced plans to construct a pellet plant at both the Chetwynd and Fort St. John Sawmill sites, in the northern British Columbia interior (the "Pellet Plants"). The total investment cost is estimated to be $58.0 million and production is scheduled to commence in the second half of 2015. In October 2014, Canfor and Pacific BioEnergy Corporation, a pellet plant operator in British Columbia, entered into a Limited Partnership Agreement (the "Agreement") to construct and operate the Pellet Plants. Upon execution of the Agreement, Canfor owns an approximate 95% interest in the Pellet Plants. Pacific BioEnergy Corporation has an option under the Agreement to increase its ownership interest in the Pellet Plants up to a total of 30% over a three year period.

On January 30, 2015, Canfor completed the sale of its BCTMP Taylor Pulp Mill to CPPI for cash proceeds of approximately $15.0 million including working capital. The transaction also includes a long-term fibre supply agreement under which Canfor will supply fibre to the Taylor Pulp Mill at prices that approximate fair market value. In addition to the cash proceeds, Canfor may also receive contingent consideration over a 3 year period, starting January 31, 2015, based on the Taylor Pulp Mill's annual adjusted operating income before amortization. On the acquisition date the fair value of the contingent consideration was approximately $1.8 million. CPPI recognized long-term assets acquired net of liabilities assumed of approximately $2.8 million and net working capital of approximately $14.0 million. From CPPI's perspective, the acquisition has been accounted for in accordance with IFRS 3 *Business Combinations*.

OUTLOOK

Lumber

For 2015, North American lumber demand is expected to improve with the steady recovery in the US housing market. Stronger economic fundamentals, notably employment growth, low mortgage rates and moderate home prices will support higher US housing demand. The offshore markets are forecast to ease with softer demand in Asia coupled with higher-than-normal inventory levels in China at the end of 2014 and an increase in Russian supply due to the Russian currency devaluation benefitting Russian exports to offshore markets. Sales realizations on Canadian exports are currently projected to benefit from the continued weakening of the Canadian dollar in the first quarter of 2015.

Pulp and Paper

For the month of January 2015, NBSK pulp list prices were down from December 2014, with the NBSK pulp list price to North America at US$1,010 per tonne, down US$10 per tonne, and the list prices to China and Europe down US$20 per tonne at US$680 per tonne and US$915 per tonne, respectively. For the month of February 2015, CPPI has announced a NBSK pulp list price of US$1,000 per tonne in North America. There are no maintenance outages planned for the first quarter of 2015. NBSK pulp list prices are anticipated to continue to soften modestly through the first quarter of 2015, with a modest growth in producer inventories due in part to minimal industry maintenance during the first quarter and NBSK pulp production facilities running at or near capacity; however, the continued weakening of the Canadian dollar is currently projected to outweigh the forecast declines in NBSK pulp list prices. For the second quarter of 2015, producer inventories are forecast to decline during the industry's spring maintenance period.

Maintenance outages are currently planned at the Intercontinental and Prince George Mills in the second quarter of 2015 with a projected 10,000 tonnes of reduced production and at the Northwood Mill in the fourth quarter of 2015 with a projected 25,000 tonnes of reduced production.

Canfor Corporation
Condensed Consolidated Balance Sheets

(millions of Canadian dollars, unaudited)		**As at December 31, 2014**		As at December 31, 2013
ASSETS				
Current assets				
Cash and cash equivalents	**$**	**158.3**	$	89.5
Restricted cash (Note 15(b))		**50.2**		-
Accounts receivable - Trade		**91.3**		112.6
- Other		**38.8**		39.3
Inventories (Note 2)		**517.7**		471.9
Prepaid expenses and other assets		**46.3**		39.1
Total current assets		**902.6**		752.4
Property, plant and equipment		**1,216.1**		1,151.9
Timber licenses		**519.5**		534.6
Goodwill and other intangible assets		**105.0**		93.5
Retirement benefit surplus (Note 5)		**0.6**		42.2
Long-term investments and other (Note 3)		**101.3**		112.5
Deferred income taxes, net		**1.7**		6.2
Total assets	**$**	**2,846.8**	$	2,693.3
LIABILITIES				
Current liabilities				
Operating loans (Note 4(a))	**$**	**68.0**	$	74.6
Accounts payable and accrued liabilities		**305.8**		321.8
Current portion of deferred reforestation obligations		**52.1**		44.1
Total current liabilities		**425.9**		440.5
Long-term debt (Note 4(b))		**228.6**		153.1
Retirement benefit obligations (Note 5)		**263.2**		200.5
Deferred reforestation obligations		**60.0**		69.8
Other long-term liabilities		**19.6**		14.9
Deferred income taxes, net		**211.9**		217.1
Total liabilities	**$**	**1,209.2**	$	1,095.9
EQUITY				
Share capital	**$**	**1,068.0**	$	1,103.7
Contributed surplus		**31.9**		31.9
Retained earnings		**260.1**		234.2
Accumulated foreign exchange translation differences		**27.2**		4.5
Total equity attributable to equity holders of the Company		**1,387.2**		1,374.3
Non-controlling interests		**250.4**		223.1
Total equity	**$**	**1,637.6**	$	1,597.4
Total liabilities and equity	**$**	**2,846.8**	$	2,693.3

Commitments (Notes 13 & 15) & **Subsequent Events** (Notes 14 & 15)

The accompanying notes are an integral part of these condensed consolidated financial statements.

APPROVED BY THE BOARD

Director, R.S. Smith

Director, M.J. Korenberg

Canfor Corporation
Condensed Consolidated Statements of Income

(millions of Canadian dollars, except per share data, unaudited)	3 months ended December 31, **2014**	2013	12 months ended December 31, **2014**	2013
Sales	**$ 860.4**	$ 809.5	**$ 3,347.6**	$ 3,194.9
Costs and expenses				
Manufacturing and product costs	**591.8**	528.8	**2,201.9**	2,036.8
Freight and other distribution costs	**137.7**	137.3	**548.6**	540.4
Export taxes	**-**	2.7	**-**	9.2
Amortization	**46.9**	44.9	**182.5**	186.2
Selling and administration costs	**20.5**	21.8	**78.5**	67.9
Restructuring, mill closure and severance costs	**1.5**	20.2	**6.8**	23.1
	798.4	755.7	**3,018.3**	2,863.6
Operating income	**62.0**	53.8	**329.3**	331.3
Finance expense, net	**(4.6)**	(6.4)	**(18.2)**	(27.9)
Foreign exchange loss on long-term debt	**-**	(3.4)	**-**	(8.9)
Gain (loss) on derivative financial instruments (Note 6)	**(7.4)**	(0.2)	**(8.9)**	4.4
Gain on sale of Canfor-LP OSB joint venture (Note 11)	**-**	-	**-**	38.3
Other income (expense), net	**3.1**	(3.1)	**(4.2)**	1.5
Net income before income taxes	**53.1**	40.7	**298.0**	338.7
Income tax expense (Note 7)	**(12.6)**	(5.6)	**(76.2)**	(88.2)
Net income	**$ 40.5**	$ 35.1	**$ 221.8**	$ 250.5
Net income attributable to:				
Equity shareholders of the Company	**$ 29.9**	$ 28.0	**$ 175.2**	$ 228.6
Non-controlling interests	**10.6**	7.1	**46.6**	21.9
Net income	**$ 40.5**	$ 35.1	**$ 221.8**	$ 250.5
Net income per common share: (in Canadian dollars)				
Attributable to equity shareholders of the Company				
- Basic and diluted (Note 8)	**$ 0.22**	$ 0.20	**$ 1.28**	$ 1.61

The accompanying notes are an integral part of these condensed consolidated financial statements.

Canfor Corporation
Condensed Consolidated Statements of Other Comprehensive Income (Loss)

(millions of Canadian dollars, unaudited)	3 months ended December 31, **2014**	3 months ended December 31, 2013	12 months ended December 31, **2014**	12 months ended December 31, 2013
Net income	**$ 40.5**	$ 35.1	**$ 221.8**	$ 250.5
Other comprehensive income (loss)				
Items that will not be recycled through net income:				
Defined benefit plan actuarial gains (losses) (Note 5)	**(63.2)**	54.6	**(115.7)**	123.9
Income tax recovery (expense) on defined benefit plan actuarial gains (losses) (Note 7)	**16.8**	(14.2)	**30.5**	(32.2)
	(46.4)	40.4	**(85.2)**	91.7
Items that may be recycled through net income:				
Foreign exchange translation differences for foreign operations, net of tax	**10.9**	8.0	**22.7**	15.0
Other comprehensive income (loss), net of tax	**(35.5)**	48.4	**(62.5)**	106.7
Total comprehensive income	**$ 5.0**	$ 83.5	**$ 159.3**	$ 357.2
Total comprehensive income attributable to:				
Equity shareholders of the Company	**$ 0.5**	$ 68.4	**$ 122.2**	$ 322.3
Non-controlling interests	**4.5**	15.1	**37.1**	34.9
Total comprehensive income	**$ 5.0**	$ 83.5	**$ 159.3**	$ 357.2

The accompanying notes are an integral part of these condensed consolidated financial statements.

Canfor Corporation
Condensed Consolidated Statements of Changes in Equity

(millions of Canadian dollars, unaudited)	3 months ended December 31, 2014	3 months ended December 31, 2013	12 months ended December 31, 2014	12 months ended December 31, 2013
Share capital				
Balance at beginning of period	**$ 1,068.0**	$ 1,115.4	**$ 1,103.7**	$ 1,126.2
Share purchases (Note 8)	**-**	(11.7)	**(35.7)**	(22.5)
Balance at end of period	**$ 1,068.0**	$ 1,103.7	**$ 1,068.0**	$ 1,103.7
Contributed surplus				
Balance at beginning and end of period	**$ 31.9**	$ 31.9	**$ 31.9**	$ 31.9
Retained earnings				
Balance at beginning of period	**$ 270.5**	$ 195.5	**$ 234.2**	$ (35.1)
Net income attributable to equity shareholders of the Company	**29.9**	28.0	**175.2**	228.6
Defined benefit plan actuarial gains (losses), net of tax	**(40.3)**	32.4	**(75.7)**	78.7
Share purchases (Note 8)	**-**	(21.7)	**(73.2)**	(37.5)
Acquisition of non-controlling interests (Note 8)	**-**	-	**(0.4)**	(0.5)
Balance at end of period	**$ 260.1**	$ 234.2	**$ 260.1**	$ 234.2
Accumulated foreign exchange translation differences				
Balance at beginning of period	**$ 16.3**	$ (3.5)	**$ 4.5**	$ (10.5)
Foreign exchange translation differences for foreign operations, net of tax	**10.9**	8.0	**22.7**	15.0
Balance at end of period	**$ 27.2**	$ 4.5	**$ 27.2**	$ 4.5
Total equity attributable to equity holders of the Company	**$ 1,387.2**	$ 1,374.3	**$ 1,387.2**	$ 1,374.3
Non-controlling interests				
Balance at beginning of period	**$ 246.4**	$ 210.4	**$ 223.1**	$ 199.4
Net income attributable to non-controlling interests	**10.6**	7.1	**46.6**	21.9
Defined benefit plan actuarial gains (losses) attributable to non-controlling interests, net of taxes	**(6.1)**	8.0	**(9.5)**	13.0
Distributions to non-controlling interests	**(2.5)**	(2.4)	**(10.2)**	(9.3)
Acquisition of non-controlling interests	**-**	-	**(1.6)**	(1.9)
Non-controlling interests arising on construction of Pellet Plants (Note 13)	**2.0**	-	**2.0**	-
Balance at end of period	**$ 250.4**	$ 223.1	**$ 250.4**	$ 223.1
Total equity	**$ 1,637.6**	$ 1,597.4	**$ 1,637.6**	$ 1,597.4

The accompanying notes are an integral part of these condensed consolidated financial statements.

Canfor Corporation
Condensed Consolidated Statements of Cash Flows

(millions of Canadian dollars, unaudited)	3 months ended December 31, **2014**	3 months ended December 31, 2013	12 months ended December 31, **2014**	12 months ended December 31, 2013
Cash generated from (used in):				
Operating activities				
Net income	**$ 40.5**	$ 35.1	**$ 221.8**	$ 250.5
Items not affecting cash:				
Amortization	**46.9**	44.9	**182.5**	186.2
Income tax expense	**12.6**	5.6	**76.2**	88.2
Long-term portion of deferred reforestation obligations	**(11.2)**	(0.3)	**(10.9)**	(9.6)
Changes in mark-to-market value of derivative financial instruments	**7.4**	0.2	**9.1**	(4.4)
Employee future benefits	**2.7**	2.7	**12.4**	13.0
Net finance expense	**4.6**	6.4	**18.2**	27.9
Foreign exchange loss on long-term debt	**-**	3.4	**-**	8.9
Mill closure provisions	**-**	20.0	**-**	20.0
Gain on sale of joint venture (Note 11)	**-**	-	**-**	(38.3)
Other, net	**8.6**	9.6	**25.9**	8.7
Defined benefit plan contributions	**(3.9)**	(14.0)	**(29.7)**	(53.0)
Income taxes paid, net	**(3.1)**	(0.3)	**(39.5)**	(0.3)
	105.1	113.3	**466.0**	497.8
Net change in non-cash working capital (Note 9)	**11.6**	(14.5)	**(73.6)**	(7.5)
	116.7	98.8	**392.4**	490.3
Financing activities				
Change in operating bank loans (Note 4(a))	**(77.0)**	74.6	**(7.2)**	47.6
Proceeds from long-term debt (Note 4(b))	**75.0**	50.0	**75.0**	53.1
Repayment of long-term debt	**-**	(116.6)	**-**	(192.9)
Finance expenses paid	**(2.7)**	(5.9)	**(11.4)**	(17.4)
Share purchases (Note 8)	**-**	(33.4)	**(108.9)**	(60.0)
Acquisition of non-controlling interests	**-**	-	**(2.0)**	(2.4)
Cash distributions paid to non-controlling interests	**(2.5)**	(2.4)	**(10.2)**	(9.3)
Other, net	**-**	(0.1)	**-**	(0.1)
	(7.2)	(33.8)	**(64.7)**	(181.4)
Investing activities				
Additions to property, plant and equipment and intangible assets, net	**(54.7)**	(67.5)	**(234.3)**	(237.3)
Repayment from (loan to) Scotch & Gulf Lumber, LLC (Note 15(a))	**4.8**	2.1	**12.2**	(31.9)
Change in Restricted Cash (Note 15(b))	**(50.2)**	-	**(50.2)**	-
Proceeds on sale of Daaquam operation (Note 12)	**-**	-	**23.6**	-
Investment in Scotch & Gulf Lumber, LLC (Note 15(a))	**-**	(0.5)	**(9.9)**	(29.5)
Proceeds on sale of Canfor-LP OSB joint venture (Note 11)	**-**	-	**-**	77.9
Distributions from joint venture (Note 11)	**-**	-	**-**	16.5
Other, net	**2.5**	0.5	**(0.3)**	2.0
	(97.6)	(65.4)	**(258.9)**	(202.3)
Increase (decrease) in cash and cash equivalents*	**11.9**	(0.4)	**68.8**	106.6
Cash and cash equivalents at beginning of period*	**146.4**	89.9	**89.5**	(17.1)
Cash and cash equivalents at end of period*	**$ 158.3**	$ 89.5	**$ 158.3**	$ 89.5

*Cash and cash equivalents include cash on hand less unpresented cheques.

The accompanying notes are an integral part of these condensed consolidated financial statements.

Canfor Corporation
Notes to the Condensed Consolidated Financial Statements
(unaudited, millions of Canadian dollars unless otherwise noted)

1. Basis of Preparation

These condensed consolidated interim financial statements (the "financial statements") have been prepared in accordance with International Accounting Standard ("IAS") 34, *Interim Financial Reporting*, and include the accounts of Canfor Corporation and its subsidiary entities, hereinafter referred to as "Canfor" or "the Company".

These financial statements do not include all of the disclosures required by International Financial Reporting Standards ("IFRS") for annual financial statements. Additional disclosures relevant to the understanding of these financial statements, including the accounting policies applied, can be found in Canfor's Annual Report for the year ended December 31, 2013, available at www.canfor.com or www.sedar.com.

Canfor's financial results are impacted by seasonal factors such as weather and building activity. Adverse weather conditions 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 solid wood products, are generally stronger in the spring and summer months. Shipment volumes are affected by these factors as well as by global supply and demand conditions.

Accounting Standards Issued and Not Applied

In July 2014, the International Accounting Standards Board ("IASB") issued IFRS 9, *Financial Instruments*. The required adoption date for IFRS 9 is January 1, 2018 and the Company is in process of assessing the impact, if any, on the financial statements of this new standard.

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*, which will supersede IAS 18, *Revenue*, IAS 11, *Construction Contracts* and related interpretations. The new standard is effective for annual periods beginning on or after January 1, 2017. The Company is in the process of assessing the impact, if any, on the financial statements of this new standard.

2. Inventories

(millions of Canadian dollars)	**As at December 31, 2014**	As at December 31, 2013
Logs	**$ 122.6**	$ 134.5
Finished products	**281.0**	222.3
Residual fibre	**10.3**	14.9
Processing materials and supplies	**103.8**	100.2
	$ 517.7	$ 471.9

3. Long-Term Investments and Other

(millions of Canadian dollars)	**As at December 31, 2014**	As at December 31, 2013
Investments	**$ 64.4**	$ 53.8
Term loan to Scotch & Golf Lumber, LLC (Note 15(a))	**23.2**	33.0
Contingent consideration (Note 11)	**-**	11.4
Other deposits, loans and advances	**13.7**	14.3
	$ 101.3	$ 112.5

Included in Long-Term Investments and Other is Canfor's 33.3% interest in Scotch & Gulf Lumber, LLC ("Scotch Gulf") and a term loan receivable from Scotch Gulf (Note 15(a)). Investments also include the Company's 33.3% investment in Lakeland Mills Ltd. and Winton Global Lumber Ltd. for which the Company does not exercise significant influence and records as a level 3 financial instrument measured at fair value, which is determined based on the future expected cash flows of the underlying investments.

4. Operating Loans

(a) Available Operating Loans

(millions of Canadian dollars)		**As at December 31, 2014**		As at December 31, 2013
Canfor (excluding CPPI)				
Available Operating Loans:				
Total operating loans - Canfor (excluding CPPI)	**$**	**350.0**	$	350.0
Facility for letters of credit related to pension plans - Canfor (excluding CPPI)		**37.5**		-
Total operating loans - Canfor (excluding CPPI)	**$**	**387.5**	$	$350.0
Drawn		**(68.0)**		(64.0)
Letters of credit (principally unregistered pension plans)		**(13.8)**		(14.8)
Total available operating loans - Canfor (excluding CPPI)	**$**	**305.7**	$	271.2
CPPI				
Available Operating Loans:				
Operating loan facility	**$**	**110.0**	$	110.0
Facility for letters of credit related to energy agreements		**20.0**		20.0
Total operating loans - CPPI		**130.0**		130.0
Drawn		**-**		(10.6)
Energy letters of credit		**(12.2)**		(12.2)
Total available operating loans - CPPI	**$**	**117.8**	$	107.2
Consolidated:				
Total operating loans	**$**	**517.5**	$	480.0
Total available operating loans	**$**	**423.5**	$	378.4

During 2014, Canfor extended the maturity date of its principal operating loan facility from February 28, 2018 to February 28, 2019. All other terms of the operating loan facility remained unchanged. Interest is payable 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 net debt to total capitalization ratio. In November 2014, Canfor entered into a $37.5 million letter of credit to support funding of the Company's Pension Plans.

The terms of CPPI's operating loan facility include interest payable at floating rates that vary depending on the ratio of net 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. The maturity date of this facility is January 31, 2018.

Both Canfor's and CPPI's operating loan facilities have certain financial covenants that stipulate maximum net debt to total capitalization ratios and minimum net worth amounts based on shareholders' equity.

CPPI has a separate facility with a maturity date of June 30, 2015 to cover energy-related letters of credit. At December 31, 2014, $9.4 million of energy-related letters of credit were covered under this facility with the balance of $2.8 million covered under CPPI's general operating loan facility.

As at December 31, 2014, the Company and CPPI were in compliance with all covenants relating to their operating loans. Substantially all borrowings of CPPI (operating loans and long-term debt) are non-recourse to other entities within the Company.

(b) Long-Term Debt

On November 7, 2014, Canfor completed a $75.0 million unsecured non-revolving term debt financing for the construction of the recently announced Pellet Plants in Fort St. John and Chetwynd (Note 13) and various energy projects in the lumber segment. The debt is repayable on November 14, 2019 with no penalty for early repayment. The interest rate on the new term debt is based on the lenders' Canadian prime rate or bankers' acceptance rate in the year of payment.

5. Employee Future Benefits

For the three months ended December 31, 2014, a defined benefit actuarial loss of $63.2 million (before-tax) was recognized in other comprehensive income. The loss recorded in the fourth quarter of 2014 principally reflects a lower discount rate used to value the net retirement benefit obligations and actuarial experience adjustments related to certain defined benefit pension plans, offset in part by a return on plan assets. For the twelve months ended December 31, 2014, a defined benefit actuarial loss of $115.7 million (before-tax) was recognized in other comprehensive income. During the second quarter of 2014, actuarial funding valuations were completed for a number of the Company's employee future benefit plans resulting in revisions to actuarial assumptions and adjustments for plan member experience. For the three and twelve months ended December 31, 2013, gains of $54.6 million (before-tax) and $123.9 million (before-tax) were recognized in other comprehensive income, respectively.

For the Company's employee future benefit plans, a one percentage point increase in the discount rate used in calculating the actuarial estimate of future liabilities would decrease the accrued benefit obligation by an estimated $113.0 million.

The discount rate assumptions used to estimate the changes in net retirement benefit obligations were as follows:

	Pension Benefit Plans	**Other Benefit Plans**
December 31, 2014	**3.90%**	**3.90%**
September 30, 2014	4.40%	4.40%
December 31, 2013	4.80%	4.90%
September 30, 2013	4.70%	4.80%
December 31, 2012	4.20%	4.40%

6. Financial Instruments

Canfor's cash and cash equivalents, accounts receivable, other deposits, loans and advances, operating loans, accounts payable and accrued liabilities, and long-term debt are measured at amortized cost subsequent to initial measurement. At December 31, 2014, the fair value of the Company's long-term debt approximates its amortized cost of $228.6 million (December 31, 2013 - $153.1 million).

Derivative instruments are measured at fair value. IFRS 13, *Fair Value Measurement,* requires classification of financial instruments within a hierarchy that prioritizes the inputs to fair value measurement.

The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly;

Level 3 – Inputs that are not based on observable market data.

The following table summarizes Canfor's financial instruments measured at fair value at December 31, 2014 and 2013, and shows the level within the fair value hierarchy in which they have been classified:

(millions of Canadian dollars)	Fair Value Hierarchy Level	**As at December 31, 2014**	As at December 31, 2013
Financial assets			
Derivative financial instruments – held for trading	Level 2	**$ 0.3**	$ 0.6
Royalty receivable – available for sale	Level 3	**2.9**	5.3
Contingent consideration – available for sale (Note 11)	Level 3	**-**	12.8
		$ 3.2	$ 18.7
Financial liabilities			
Derivative financial instruments – held for trading	Level 2	**9.1**	0.3
		$ 9.1	$ 0.3

The royalty receivable and contingent consideration are measured at fair value at each reporting period and are presented in Other Accounts Receivable and Long-Term Investments and Other on the consolidated balance sheet, depending on their respective liquidity. The fair value of the royalty receivable is determined by discounting future expected cash flows based on energy price assumptions and future sales volume assumptions until the termination of the royalty agreement in September 2015. The fair value of the contingent consideration is determined by discounting future expected cash flows based on forecast oriented strand board ("OSB") prices, sales volumes, foreign exchange rates and margins for the Peace Valley OSB operation (Note 11).

The Company uses a variety of derivative financial instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, lumber prices, pulp prices, energy costs, and floating interest rates on long-term debt.

At December 31, 2014, the fair value of derivative financial instruments was a net liability of $8.8 million (December 31, 2013 - net asset of $0.3 million). The fair value of these financial instruments was determined based on prevailing market rates for instruments with similar characteristics.

The following table summarizes the gain (loss) on derivative financial instruments for the three and twelve month periods ended December 31, 2014 and 2013:

	3 months ended December 31,		12 months ended December 31,	
(millions of Canadian dollars)	**2014**	2013	**2014**	2013
Foreign exchange collars and forward contracts	**$ (0.5)**	$ 0.3	**$ (1.6)**	$ 0.2
Energy derivatives	**(7.5)**	0.1	**(7.8)**	0.2
Lumber futures	**0.8**	0.2	**2.2**	4.2
Pulp futures	**-**	(0.1)	**(0.8)**	(0.1)
Interest rate swaps	**(0.2)**	(0.7)	**(0.9)**	(0.1)
	$ (7.4)	$ (0.2)	**$ (8.9)**	$ 4.4

7. Income Taxes

	3 months ended December 31,		12 months ended December 31,	
(millions of Canadian dollars)	**2014**	2013	**2014**	2013
Current	**$ (12.0)**	$ (10.0)	**$ (50.4)**	$ (21.6)
Deferred	**(0.6)**	4.4	**(25.8)**	(66.6)
Income tax expense	**$ (12.6)**	$ (5.6)	**$ (76.2)**	$ (88.2)

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

	3 months ended December 31,		12 months ended December 31,	
(millions of Canadian dollars)	**2014**	2013	**2014**	2013
Income tax expense at statutory rate 2014 – 26.0% (2013 – 25.75%)[1]	**$ (13.8)**	$ (10.5)	**$ (77.5)**	$ (87.2)
Add (deduct):				
Non-taxable income related to non-controlling interests in limited partnerships	**0.1**	-	**0.6**	0.3
Entities with different income tax rates and other tax adjustments	**1.2**	5.4	**0.8**	0.5
Permanent difference from capital gains and losses and other non-deductible items	**(0.1)**	(0.5)	**(0.1)**	3.6
Change in substantively enacted tax rate[1]	**-**	-	**-**	(5.4)
Income tax expense	**$ (12.6)**	$ (5.6)	**$ (76.2)**	$ (88.2)

[1]In the second quarter of 2013, the Provincial Government of British Columbia increased the corporate tax rate from 10% to 11%.

In addition to the amounts recorded to net income, a tax recovery of $16.8 million was recorded to other comprehensive income for the three month period ended December 31, 2014 (three months ended December 31, 2013 – tax expense of $14.2 million) in relation to the actuarial gains (losses) on defined benefit employee compensation plans. For the twelve months ended December 31, 2014, the tax recovery was $30.5 million (twelve months ended December 31, 2013 – tax expense of $32.2 million). Also included in other comprehensive income for the year is an expense of $2.4 million related to foreign exchange gains on investments in affiliates (2013 – Nil).

8. Earnings Per Share and Normal Course Issuer Bid

Basic net income per share is calculated by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the period.

	3 months ended December 31,		12 months ended December 31,	
	2014	2013	**2014**	2013
Weighted average number of common shares	**135,376,993**	140,691,040	**137,293,281**	141,959,473

On March 5, 2014, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 6,995,228 common shares or approximately 5% of its issued and outstanding common shares as of February 28, 2014. The renewed normal course issuer bid is set to expire on March 4, 2015. During the fourth quarter of 2014, no common shares were purchased under the normal course issuer bid. For the twelve months ended December 31, 2014, Canfor purchased 4,527,600 common shares for $108.9 million (an average of $24.05 per common share). As at February 4, 2015 there were 135,376,993 common shares outstanding.

9. Net Change in Non-Cash Working Capital

	3 months ended December 31,		12 months ended December 31,	
(millions of Canadian dollars)	**2014**	2013	**2014**	2013
Accounts receivable	**$ 24.6**	$ 21.0	**$ 24.2**	$ 10.6
Inventories	**(10.3)**	(22.9)	**(64.0)**	(39.0)
Prepaid expenses and other assets	**9.6**	6.4	**(15.8)**	(8.1)
Accounts payable, accrued liabilities and current portion of deferred reforestation obligations	**(12.3)**	(19.0)	**(18.0)**	29.0
Net decrease (increase) in non-cash working capital	**$ 11.6**	$ (14.5)	**$ (73.6)**	$ (7.5)

10. Segment Information

Canfor has two reportable segments (lumber segment and pulp and paper segment) which offer different products and are managed separately because they require different production processes and marketing strategies.

Sales between segments are accounted for at prices that approximate fair value. These include sales of residual fibre from the lumber segment to the pulp and paper segment for use in the pulp production process.

The Company's panels business does not meet the criteria to be reported fully as a separate segment and is included in Unallocated & Other below.

(millions of Canadian dollars)		Lumber	Pulp & Paper	Unallocated & Other	Elimination Adjustment		Consolidated
3 months ended December 31, 2014							
Sales to external customers	**$**	**564.4**	**296.0**	**-**	**-**	**$**	**860.4**
Sales to other segments	**$**	**41.7**	**-**	**-**	**(41.7)**	**$**	**-**
Operating income (loss)	**$**	**40.6**	**29.4**	**(8.0)**	**-**	**$**	**62.0**
Amortization	**$**	**30.0**	**15.6**	**1.3**	**-**	**$**	**46.9**
Capital expenditures	**$**	**41.6**	**11.5**	**1.6**	**-**	**$**	**54.7**
3 months ended December 31, 2013							
Sales to external customers	$	533.7	275.8	-	-	$	809.5
Sales to other segments	$	32.6	-	-	(32.6)	$	-
Operating income (loss)	$	37.4	23.2	(6.8)	-	$	53.8
Amortization	$	28.7	16.0	0.2	-	$	44.9
Capital expenditures	$	43.5	20.1	3.9	-	$	67.5
12 months ended December 31, 2014							
Sales to external customers	**$**	**2,245.1**	**1,102.5**	**-**	**-**	**$**	**3,347.6**
Sales to other segments	**$**	**148.0**	**-**	**-**	**(148.0)**	**$**	**-**
Operating income (loss)	**$**	**230.7**	**129.9**	**(31.3)**	**-**	**$**	**329.3**
Amortization	**$**	**115.1**	**64.6**	**2.8**	**-**	**$**	**182.5**
Capital expenditures	**$**	**166.6**	**58.0**	**9.7**	**-**	**$**	**234.3**
Identifiable assets	**$**	**1,856.7**	**768.1**	**222.0**	**-**	**$**	**2,846.8**
12 months ended December 31, 2013							
Sales to external customers	$	2,192.2	999.4	3.3	-	$	3,194.9
Sales to other segments	$	131.9	-	-	(131.9)	$	-
Operating income (loss)	$	285.1	72.2	(26.0)	-	$	331.3
Amortization	$	113.5	71.8	0.9	-	$	186.2
Capital expenditures	$	164.7	62.6	10.0	-	$	237.3
Identifiable assets	$	1,715.8	770.3	207.2	-	$	2,693.3

11. Sale of Canfor-LP OSB Joint Venture

On May 31, 2013, the Company completed the sale of its 50% share in Canfor-LP OSB, which owns the Peace Valley OSB mill ("Peace Valley OSB"), to Louisiana-Pacific Corporation for cash proceeds of $77.9 million including working capital. A pre-tax gain on sale of $38.3 million was recorded in the second quarter of 2013 which included recognition of Canfor's share of the operating income for the first half of 2013. As part of the sale, Canfor may receive additional annual consideration over a 3 year period, starting June 1, 2013, contingent on Peace Valley OSB's annual adjusted earnings before interest, tax, depreciation and amortization. At December 31, 2014, the fair value of the contingent consideration is nil (Note 3). During 2014, Canfor recorded a $12.8 million negative fair value adjustment in Other Expense related to the contingent consideration.

12. Sale of Daaquam Operation

On March 28, 2014, the Company completed the sale of its Daaquam operation. Total gross proceeds related to the disposition of the Daaquam operation were $25.0 million. A pre-tax gain of $2.2 million was recorded in the first quarter of 2014 in Other Income.

13. Construction of Pellet Plants

In September 2014, the Company announced plans to construct a pellet plant at both the Chetwynd and Fort St. John Sawmill sites, in the Northern British Columbia interior ("the Pellet Plants") under the Canfor Energy North Limited Partnership ("Partnership"). The total investment cost is estimated to be $58.0 million and production is scheduled to commence in the second half of 2015. In October 2014, Canfor and Pacific BioEnergy Corporation ("Pacific BioEnergy"), a pellet plant operator in British Columbia, entered into a Limited Partnership Agreement ("the Agreement") to construct and operate the Pellet Plants. Upon execution of the Agreement, Canfor owns an approximate 95% interest in the Pellet Plants. Pacific BioEnergy has an option under the Agreement to increase its ownership interest in the Pellet Plants up to a total of 30% over a three year period by purchasing Partnership units from Canfor at a fixed price. Pacific BioEnergy's option to purchase additional interest in the Partnership from Canfor represents a derivative financial instrument which has a fair value of nil at December 31, 2014.

14. Sale of Taylor Pulp Mill

On January 30, 2015, Canfor completed the sale of its BCTMP Taylor Pulp Mill to CPPI for cash proceeds of approximately $15.0 million including working capital. The transaction also includes a long-term fibre supply agreement under which Canfor will supply fibre to the Taylor Pulp Mill at prices that approximate fair market value. In addition to the cash proceeds, Canfor may also receive contingent consideration over a 3 year period, starting January 31, 2015, based on the Taylor Pulp Mill's annual adjusted operating income before amortization. On the acquisition date the fair value of the contingent consideration was approximately $1.8 million. CPPI recognized long-term assets acquired net of liabilities assumed of approximately $2.8 million and net working capital of approximately $14.0 million. From CPPI's perspective, the acquisition has been accounted for in accordance with IFRS 3 *Business Combinations*.

15. US South Acquisitions

(a) Phased Purchase of Scotch Gulf

On August 9, 2013, Canfor completed the first phase of the phased purchase of Scotch Gulf of Mobile, Alabama, representing an initial 25% interest in Scotch Gulf. On August 1, 2014, Canfor completed the second phase of the acquisition of Scotch Gulf for $9.9 million increasing its ownership to 33.3%. Subsequent to year end, on January 30, 2015, Canfor completed the third phase of the acquisition for US$18.3 million bringing Canfor's interest in Scotch Gulf to 50%. Upon obtaining a 50% interest in Scotch Gulf, Canfor was deemed to have control and the acquisition method of accounting will be applied with an acquisition date of January 30, 2015. Canfor was deemed to have control of Scotch Gulf due to its 50% interest in the company, various debt arrangements and its commitment to purchase 100% of the company by August 2016. As a result of the acquisition, Canfor will recognize approximately US$27.0 million of working capital and US$80.0 million of long-term assets acquired net of liabilities assumed. Given the acquisition date, Canfor will be completing the purchase price allocation in the first quarter of 2015. As at December 31, 2014 the carrying value of the investment in Scotch Gulf was $40.9 million. Scotch Gulf's results are reported in the lumber segment.

Scotch Gulf has an option under the purchase agreement to accelerate the final closing of the phased purchase to a date earlier than August 2016 under certain conditions. The aggregate purchase price for Scotch Gulf is US$80.0 million, plus working capital. Canfor's commitment to purchase Scotch Gulf at a fixed price represents an equity financial instrument.

As part of the transaction, Scotch Gulf borrowed $34.0 million from Canfor in the form of a term loan that will be repaid from the distribution of cash earnings over the course of the phased purchase agreement with any net outstanding amount at August 2016 applied against the final phase purchase price payment. The term loan has an interest rate equal to the floating rate on Canfor's principal operating loans plus 1.0% and is secured by Scotch Gulf's operating assets. At December 31, 2014, $23.2 million was outstanding on the term loan receivable which is included in Long-Term Investments and Other on the consolidated balance sheet (Note 3).

(b) Phased Purchase of Beadles Lumber Company & Balfour Lumber Company Inc. ("Beadles & Balfour")

In August 2014, the Company entered into a phased purchase agreement with Beadles & Balfour located in Georgia. Subsequent to year end, on January 2, 2015, the Company completed the first phase of the purchase for $50.2 million, representing an initial 55% interest in Beadles & Balfour, plus transaction closing costs and a proportionate share of working capital. The aggregate purchase price for Beadles & Balfour is US$62.0 million, plus working capital. Canfor's commitment to purchase Beadles & Balfour at a fixed price represents an equity financial instrument. As at December 31, 2014, the cash consideration of $50.2 million was held in an escrow bank account for the purchase of Beadles & Balfour and is classified as restricted cash on the balance sheet. Canfor's initial 55% interest will increase to 100% after two years.

Upon obtaining a 55% interest in Beadles & Balfour, Canfor was deemed to have control and the acquisition method of accounting will be applied with an acquisition date of January 2, 2015. As a result of the acquisition, Canfor will recognize approximately US$5.0 million of working capital and US$62.0 million of long-term assets acquired net of liabilities assumed. Given the acquisition date, Canfor will be completing the purchase price allocation in the first quarter of 2015.

(c) Purchase of Southern Lumber Company Inc. ("Southern Lumber")

In September 2014, the Company entered into a purchase agreement with Southern Lumber located in Mississippi. The transaction will involve the purchase of all operating assets of Southern Lumber, at an aggregate purchase price, excluding working capital, of US$48.7 million. The transaction is subject to standard closing conditions and is currently anticipated to close in April 2015.