2018
ANNUAL REPORT

CANFOR CORPORATION

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MESSAGE TO SHAREHOLDERS

FROM THE PRESIDENT AND CEO

2018 was a year of transformation and growth for Canfor. From our agreement to acquire 70% of the Vida Group of Sweden (Vida), to record operating income for Canfor Pulp, to our best safety results to date, we are positioning Canfor for long-term success and sustainability.

We are excited that our growing customers are looking to Canfor to supply their increasing demand for high-quality forest products. To meet that growing demand we knew we needed to expand and diversify our production capacity. In 2018, we reached agreements to acquire Vida and Elliott Sawmilling Company (Elliott) in South Carolina, adding over 1.3 billion board feet of additional capacity.

Vida will provide access to a high-quality sustainable fibre region and operations outside of North America. Vida's sawmills are strategically located near this fibre and produce 1.1 billion board feet of spruce and pine products annually. In addition, Vida brings established customers and markets in Europe, Australia, the Middle East and North Africa.

The Vida acquisition is transforming Canfor into a truly global forest products company. The acquisition successfully closed in February 2019.

The acquisition of Elliott, which is expected to close by the end of Q2 2019, will add a further 210 million board feet of high-value Southern Yellow Pine (SYP) to our annual capacity.

In addition, we are continuing to focus on organic growth at our mills in the US South. With the ongoing investment of US$125 million, we will increase annual production by 350 million board feet, while remaining committed to our high-value product strategy.

With these acquisitions and organic growth, Canfor will have an annual global production capacity of 7.2 billion board feet.

In 2018, the price of lumber peaked at a new high in the second quarter and then abruptly dropped to very low levels by the end of the year, highlighting the sometimes significant price volatility for our products. However, we expect the combination of market conditions and our focus on high-quality products to stabilize and gradually increase pricing through 2019. While Western Spruce Pine Fir (SPF) and SYP pricing has historically been volatile, pricing in Europe, which is the primary market Vida supplies, is much more stable.

The Western SPF market conditions, in combination with log supply challenges and log costs, resulted in the difficult decision to temporarily curtail some of our operations in British Columbia (BC) in late 2018 and early 2019. Log supply and costs were impacted by the worst BC wildfire season on record in the summer of 2018. This significantly reduced a portion of our standing timber inventory in certain areas of the province. We are proactively working with our industry partners and the BC provincial government to enhance fire prevention in the future and mitigate the impacts from future wildfires.

In the US, Hurricanes Florence and Michael passed near or over several of our operations. While we are thankful none of our employees were hurt and that we sustained only minimal damage to our operations, the hurricanes did significant damage to communities and fibre supplies which may have an impact over the long term.

For Canfor Pulp, the price of pulp began the year very strong with record-high pricing, before correcting sharply towards the end of the year, particularly in China. Pulp markets are projected to modestly improve through the first half of 2019, reflecting increasing demand and limited new supply.

We completed a $65 million capital project at Northwood Pulp Mill with the installation of a new 32-megawatt condensing turbo-generator that was commercialized in early 2019. This project will result in a significant improvement in overall mill energy efficiency and in a reduction in total fuel consumption. We also completed an energy-reduction capital project at our Taylor Pulp Mill by upgrading its refining line.

Canfor Pulp continues to make progress on the technology aimed at converting wood biomass into a renewable biocrude that could be refined into next-generation biofuels and biochemicals. This initiative is indicative of our commitment to innovation and the importance of renewable energy.

The year did come with some operating challenges at our pulp mills. We experienced unplanned downtime at our Northwood Pulp Mill to enable necessary tube replacements to the mill's No. 5 recovery boiler. As well, the explosion of a natural gas pipeline near Prince George impacted production at our pulp mills in that region.

We are pleased with the growth we are starting to see in mass timber construction, particularly with non-residential projects. This includes Canfor being the exclusive lumber supplier to Structurlam, a BC company, to produce cross laminated timber for the new Microsoft Silicon Valley Campus in California. I'm very proud Canfor was the only company that could deliver the product mix, volume and environmental certification required by Microsoft.

Engagement and partnership with Indigenous Nations continues to be an important component of our business in Canada. Last year, we entered into an agreement with the Takla Nation in northern BC that includes contracted forestry services and capacity building. We are excited about this enhanced relationship, which is forming the foundation for a long-term, mutually beneficial partnership.

As always, safety is our top priority and once again our employees delivered an outstanding safety performance in 2018. Our medical incident rates for Canfor and Canfor Pulp continue to decline. We are undertaking events to promote employee involvement in safety and raise awareness of the importance of workplace safety.

An integral component of Canfor's continuing success is our workforce. In 2018, we established the Diversity Council to bring together leaders from across our Canadian operations to address the gender gap in our organization. We recognize we have a long way to go, but we are committed to the work that is required to address the gender balance of our company. We believe gender diversity will make us stronger and more competitive.

Our senior leadership team continues to grow and strengthen. In January 2018, Kevin Pankratz was promoted to Senior Vice President, Sales and Marketing, following the retirement of Wayne Guthrie. In January 2019, Kevin's role was expanded to include overall responsibility for pulp and paper products, in addition to solid wood. In March, Katy Player rejoined Canfor as Vice President, People and Communications. In April, Patrick Elliott accepted the expanded position of Vice President, Corporate Finance and Strategy. In May, David Trent began reporting directly to me as Vice President, Technology and Digital. We were also pleased to welcome Dallas Ross and Dianne Watts to our Board of Directors in 2018.

While we experienced some challenges in the latter part of 2018, Canfor remains well-positioned to play a role in the shift to a more sustainable global economy.

I want to take this opportunity to thank our employees across the company for their contributions and to thank my outstanding executive and management team for their leadership and support. We look forward to welcoming the Vida and Elliott employees to the Canfor family. I would also like to extend my appreciation to our Board of Directors for their continued support and guidance.

Don Kayne
President and Chief Executive Officer

2018 MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the year ended December 31, 2018 relative to the year ended December 31, 2017, and the financial position of the Company at December 31, 2018. It should be read in conjunction with Canfor's Annual Information Form and its audited consolidated financial statements and accompanying notes for the years ended December 31, 2018 and 2017. The financial information contained in this MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which is the required reporting framework for Canadian publicly accountable enterprises.

Throughout this discussion, reference is made to Operating Income (Loss) before Amortization and Adjusted Operating Income (Loss) which Canfor considers to be a relevant indicator for measuring trends in the performance of each of its operating segments and the Company's ability to generate funds to meet its debt repayment and capital expenditure requirements. Reference is also made to Adjusted Shareholder Net Income (Loss) (calculated as Shareholder Net Income (Loss) less specific items affecting comparability with prior periods – for the full calculation, see reconciliation included in the section "Overview of Consolidated Results – 2018 Compared to 2017") and Adjusted Shareholder Net Income (Loss) per Share (calculated as Adjusted Shareholder Net Income (Loss) divided by the weighted average number of shares outstanding during the period). Operating Income (Loss) before Amortization, Adjusted Operating Income (Loss), Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share are not generally accepted earnings measures under IFRS and should not be considered as an alternative to net income (loss) or cash flows as determined in accordance with IFRS. As there is no standardized method of calculating these measures, Canfor's Operating Income (Loss) before Amortization, Adjusted Operating Income (Loss), Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of Operating Income (Loss) before Amortization to Operating Income (Loss) and Adjusted Shareholder Net Income (Loss) to Net Income (Loss) reported in accordance with IFRS are included in this MD&A.

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

All financial references are in millions of Canadian dollars unless otherwise noted. Certain comparative amounts have been reclassified to conform to current presentation. The information in this report is as at February 21, 2019.

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.

2018 HIGHLIGHTS

The Company generated strong financial results in 2018 with record-high pulp and paper segment earnings and solid lumber segment operating income. The latter was achieved despite major challenges presented by significant log supply challenges and log cost increases in British Columbia ("BC"), severe transportation issues in the first half of the year, extreme weather across North America and one of the worst forest fire seasons in BC, as well as significant market volatility during the year. Consolidated operating income was $608.6 million, which was the highest reported operating income in over 10 years, and up $51.2 million, or 9%, from 2017.

North American lumber demand was solid across all segments of the market over 2018 as a whole, with the US housing market continuing its ongoing, slow but gradual recovery. Strong underlying North American and offshore demand, in combination with weather-related supply constraints early in the year, resulted in limited available inventories and an unprecedented increase in Western Spruce/Pine/Fir ("Western SPF") and Southern Yellow Pine ("SYP") benchmark lumber prices, which reached record-high levels in the second quarter of 2018. As supply constraints slowly alleviated, lumber prices reversed sharply in the second half of 2018, as higher inventory levels throughout the supply chain coincided with modestly lower demand, in part attributable to higher mortgage rates and home prices. In the fourth quarter of 2018, a combination of significant erosion of Western SPF prices, a spike in market-based stumpage rates in BC, and log supply constraints resulting from the worst fire season in recorded history in BC, led to the Company curtailing approximately 100 million board feet of production at its BC lumber operations, with a further 95 million board feet of curtailment subsequently announced for the first quarter of 2019.

Notwithstanding the significant market volatility experienced through 2018, average benchmark lumber prices remained well ahead of 2017 levels. Western SPF and SYP prices reached record highs at $655/Mfbm and $623/Mfbm, respectively, in the second quarter of 2018, before declining dramatically to lows of $298/Mfbm and $417/Mfbm, respectively, in the fourth quarter, largely reflecting excess inventory and muted demand as a result of uncertainty in the housing market and growing global trade tensions.

As a result of the imposition of countervailing ("CVD") and anti-dumping duties ("ADD") by the US Department of Commerce ("DOC") in the latter half 2017, the Company has posted cumulative cash deposits on Canadian lumber exports destined to the US of $284.0 million as at December 31, 2018 reflecting the final published ADD rate of 7.28% and CVD rate of 13.24%, while the ADD expense has been accrued at 2.9% for the applicable 2017 and 2018 combined period, an increase of 1.8% from 2017. Accordingly, Canfor has recorded a countervailing and anti-dumping duty expense at a combined rate of 16.14%, which resulted in a net expense of $169.1 million being recorded in 2018, an increase of $124.8 million from 2017.

The sharp increase in Western SPF benchmark lumber prices in the first half of 2018, even after adjusting for the impact of duties, resulted in historically-high unit sales realizations, which subsequently translated into significant market-driven increases in stumpage in BC later in the year, particularly in the fourth quarter of 2018. Unit log costs in Western Canada through 2018 also reflected significant increases in purchased wood costs as the favourable lumber prices combined with declining fibre availability in the BC Interior, saw elevated bidding activity and competition for logs made available by BC Timber sales. In contrast, unit log costs for Canfor's operations in the US South region were stable, reflecting significant volumes of high-quality fibre in close proximity to its sawmills and muted market cost pressures.

Lumber production and shipments in 2018 reflected the impact of the aforementioned production curtailments, difficult winter weather conditions early in the year, another year of forest fires in BC, and two major hurricanes in the US South. Despite the challenging operating conditions, the Company continued to benefit from its top-line revenue and financial margin focus, aided by a continued shift into greener fibre in Western Canada, targeted capital spending and disciplined management of controllable costs.

Overall operating results for the lumber segment were $390.5 million, down $51.4 million from the previous year as significantly higher Western SPF and SYP lumber US-dollar prices through much of 2018 were more than offset by market-driven increases in unit log costs in Western Canada, increased duty expense year-over-year, as well as the impact of production curtailments in 2018 and a $36.7 million write-down of inventory reflecting the steep decline in lumber prices towards the end of the year.

Global pulp market conditions were favourable for pulp producers through most of 2018. Prices to China, the world's largest consumer of softwood pulp, stayed at historical-high levels for most of 2018 before a falloff in demand later in the year resulted in a sharp decline in prices. For the 2018 year as a whole, Northern Bleached Softwood Kraft ("NBSK") pulp list prices to China averaged US$878 per tonne, an increase of US$166 per tonne, or 23%, over 2017. Market fundamentals were also positive in North America and Europe, with prices increasing steadily in both regions over the year. North American NBSK pulp list prices averaged US$1,337 per tonne for 2018, up US$232 per tonne, or 21% from 2017, with discounts largely unchanged year-over-year. Bleached Chemi-Thermo Mechanical Pulp ("BCTMP") prices saw similarly strong markets throughout 2018 before a more modest decline near the end of the year.

Operating income for the pulp and paper segment were $246.6 million, up $92.0 million from the previous year, as higher NBSK pulp unit sales realizations more than offset the impact of unscheduled production outages in the latter part of 2018. The most significant outage related to an extended fall maintenance outage on one production line at Canfor Pulp Products Inc.'s ("CPPI") Northwood NBSK pulp mill to enable necessary tube replacements to its No. 5 recovery boiler, rectifying damage discovered during routine preventative maintenance inspections in the early fall. Capital-related downtime associated with CPPI's energy reduction project at its Taylor BCTMP mill, as well as a disruption following a third-party natural gas explosion near Prince George in the fall, also contributed to lower production year-over-year. Unit manufacturing costs reflected higher chemical, energy and maintenance spend related to the aforementioned downtime, as well as market-related increases in fibre costs.

The Company maintained its strong balance sheet position in 2018, as it continued to apply a disciplined approach to cash allocation, while retaining a focus on internal investment and growth. Solid progress continued to be made on its previously announced US$125 million organic growth initiative in the US South and included the completion of various capital projects at the Company's Moultrie, Fulton and Urbana sawmills. Recognizing challenging market conditions and inflationary construction cost pressures the Company has decided to defer its decision on the construction of a greenfield sawmill until at least the end of 2019.

On the acquisition front, during 2018, the Company entered into agreements to purchase 100% of Elliott Sawmilling Co. Inc., located in Estill, South Carolina ("Elliott"), and 70% of the VIDA Group ("VIDA"), Sweden's largest privately owned sawmill company, with an annual production capacity of 1.1 billion board feet. Following the anticipated completion of these acquisitions in the first half of 2019, Canfor's lumber production capacity will increase to approximately 7.2 billion board feet, which includes the Company's SYP lumber capacity growing to approximately 2.0 billion board feet as a result of the Elliott acquisition and organic growth in the US South.

In 2018, CPPI completed the installation of a new condensing turbo-generator at its Northwood NBSK pulp mill and a major upgrade of the refining line at the Taylor BCTMP mill at a combined cost of $100 million. These two projects will yield both a significant improvement in overall mill energy efficiency and a material reduction in total fuel consumption.

As part of its balance sheet management focus, the Company purchased a further $58.9 million of annuities through its defined benefit pension plans in 2018, significantly mitigating its exposure to future fluctuations in related pension obligations. The Company was also active in opportunistically repurchasing approximately 3.4 million common shares under its Normal Course Issuer Bid for $84.8 million. As a result of the strong cash generated by CPPI in 2017 and 2018, CPPI paid a special dividend of $2.25 per common share in 2018, in addition to its quarterly dividend of $0.0625 per common share.

The Company ended the year with cash and cash equivalents of $252.7 million, consolidated net debt of $155.7 million and a consolidated net debt to capitalization ratio of 6.2%.

Further discussion on the more significant developments is provided in the "Overview of 2018" section of this document.

COMPANY OVERVIEW

Canfor is a leading Canadian integrated forest products company based in Vancouver, British Columbia, involved primarily in the lumber business, with production facilities in BC, Alberta, and the US. Canfor also has a 54.8% interest in CPPI which is involved in the pulp and paper business with production facilities located in BC. As of December 31, 2018, Canfor employed 6,240 people, of which 1,278 are employed by CPPI.

Significant changes to the Company's business in 2018 include the following:

- On November 9, 2018, the Company announced that it had entered into an agreement to purchase Elliott for a purchase price of US$110 million, including working capital. The phased acquisition will be completed over a period of two years, with the first 49% acquired upon closing, and the remaining 51% acquired one year later.
- On November 15, 2018, the Company announced that it had entered into an agreement to purchase 70% of Sweden's largest privately-owned sawmill company, VIDA, for a purchase price of 3,990 million Swedish Krona, including working capital. The current owners of VIDA will retain a 30% interest and continue to manage the day-to-day operations.
- During late 2018 and into 2019, the Company announced that it would be temporarily curtailing sawmill operations in BC during the fourth quarter of 2018 and into the first quarter of 2019, due to log supply constraints, log costs and market conditions. Combined, these temporary curtailments are anticipated to reduce production by approximately 195 million board feet, of which approximately 100 million board feet related to curtailments in the fourth quarter of 2018.

Lumber

Canfor's lumber operations will have an annual production capacity of approximately 7.2 billion board feet of lumber reflecting Board approved near-term capital investments and the above noted planned acquisitions of Elliott and VIDA. The majority of lumber produced by Canfor from its facilities is construction and specialty grade dimension lumber that ranges in size from one by three inches to two by twelve inches and in lengths from six to twenty-six feet. A significant and increasing proportion of Canfor's lumber production is comprised of specialty products that command premium prices, and high-value products including Square Edge lumber for the North American market, J-grade lumber for the Japanese market, and machine stress rated ("MSR") lumber used in engineered applications such as roof trusses and floor joists. Canfor has expanded its product offering in recent years to include high-value engineered wood products, higher-grade MSR lumber, as well as premium one-inch boards.

Canfor's lumber operations also include one finger-joint plant, two glulam plants, one whole-log chipping plant and a trucking division. The Company, in partnership with Pacific BioEnergy Corporation, operates pellet plants at the Chetwynd and Fort St. John Sawmill sites. Canfor's lumber business segment also includes a 60% interest in the Houston Pellet Limited Partnership, which has an annual capacity of approximately 225,000 tonnes of wood pellets.

Canfor holds approximately 11.7 million cubic metres of annual harvesting rights for its solid wood operations under various forest tenures located in the interior region of BC and northern Alberta, and harvests logs from those tenures to supply its interior lumber operations. Any shortfalls in mill requirements are made up with wood purchased from other tenure holders in those areas. The wood fibre requirements in the US are met through open market purchases from private timberland owners.

Canfor markets lumber products throughout North America and overseas through its sales offices in Vancouver, Canada; Myrtle Beach, US; Mobile, US; El Dorado, US; Tokyo, Japan; and Shanghai, China. In addition to its own production, Canfor also markets lumber produced externally to complement its product line. While a significant proportion of Canfor's product is sold to markets in the United States, the proportion of shipments to offshore markets, particularly China, has risen significantly in recent years. The Company ships substantially all lumber destined for North America by truck and rail, while the vast majority of product sold offshore is transported by container ship.

Pulp and Paper

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

The CPPI mills have the annual capacity to produce approximately 1.1 million tonnes of NBSK pulp and approximately 220,000 tonnes of BCTMP. CPPI's paper machine, located at the Prince George pulp and paper mill, has an annual production capacity of approximately 140,000 tonnes of kraft paper.

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

Pulp produced by CPPI is sold by CPPI's sales offices in Vancouver, Canada, Tokyo, Japan, and Seoul, South Korea, to customers primarily in North America and Asia. European and Asian customers (excluding Japanese and Korean customers) are serviced mostly through a marketing cooperation agreement with UPM-Kymmene ("UPM"), and long-term sales agents. The significant majority of product sold to North America is shipped by rail, while product sold overseas is transported by container or breakbulk vessels.

Business Strategy

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

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

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

CPPI is focused on being a pulp and paper industry leader with strong financial performance accomplished through:

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

OVERVIEW OF 2018

Markets and Pricing

(i) Solid Wood

North American lumber demand was stable through much of 2018 as the US housing market continued its tepid recovery and demand strengthened in the repair and remodeling sector. The Canadian housing market remained near historical highs in 2018, while offshore lumber demand from China, Japan and other regions remained strong, reflecting steadily increasing demand for the Company's specialty and higher-value products. The combination of weather-related supply constraints early in the year and strong North American and offshore demand resulted in historically-high average US-dollar Western SPF and SYP benchmark lumber prices through the first two quarters of 2018. This was followed by steep declines in benchmark prices through the latter half of 2018, driven by increased supply chain inventory, combined with rising interest rates and increasing housing affordability concerns, (Chart 3). For 2018 as a whole, the North American benchmark Western SPF 2x4 #2&Btr lumber price averaged US$480 per Mfbm[1], up US$79 per Mfbm[1], or 20%, compared to 2017. The Western SPF 2x6 #2&Btr lumber price also increased modestly, up US$24 per Mfbm[1], or 6% from the prior year, with more pronounced increases seen in wider-width Western SPF products. The following table shows benchmark Random Lengths prices for selected key grades and widths of Western SPF lumber:

(Average Western SPF US$ price, per thousand board feet) [1]	2018	2017	Change
2x4 #2&Btr	**$ 480**	$ 401	$ 79
2x4 #3	**$ 372**	$ 323	$ 49
2x6 #2&Btr	**$ 426**	$ 402	$ 24
2x10 #2&Btr	**$ 446**	$ 386	$ 60

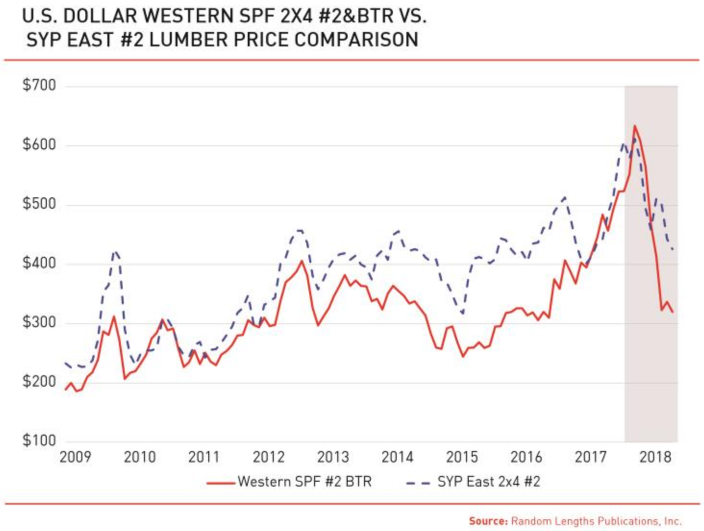
Southern Yellow Pine lumber prices also saw healthy gains in comparison to 2017, despite the significant downward pricing pressure in the second half of 2018. With improved demand more than offsetting a continued increase in capacity from brownfield and greenfield investments, the Random Length SYP East 2x4 #2 price was up US$69 per Mfbm[1], or 15%, compared to 2017, while the SYP East 2x6 #2 price was up US$30 per Mfbm[1], or 8%. Pricing for wider-width SYP lumber products saw similar increases as highlighted in the following table:

(Average SYP East US$ price, per thousand board feet) [1]	2018	2017	Change
2x4 #2	**$ 525**	$ 456	$ 69
2x6 #2	**$ 407**	$ 377	$ 30
2x8 #2	**$ 396**	$ 358	$ 38
2x10 #2	**$ 420**	$ 379	$ 41
2x12 #2	**$ 477**	$ 456	$ 21

As previously mentioned, prices for Western SPF and SYP products trended upwards through the first half of 2018, supported by improving market fundamentals. However, as weather-related supply constraints and weakening demand in Western Canada alleviated through the latter half of 2018, higher inventory levels throughout the supply chain resulted in material downward pressure on Western SPF pricing towards the end of the year. As a result, the historical spread between the prices of SYP East 2x4 #2 and Western SPF 2x4 #2&Btr lumber products returned in the second half of 2018 (see Chart 1).

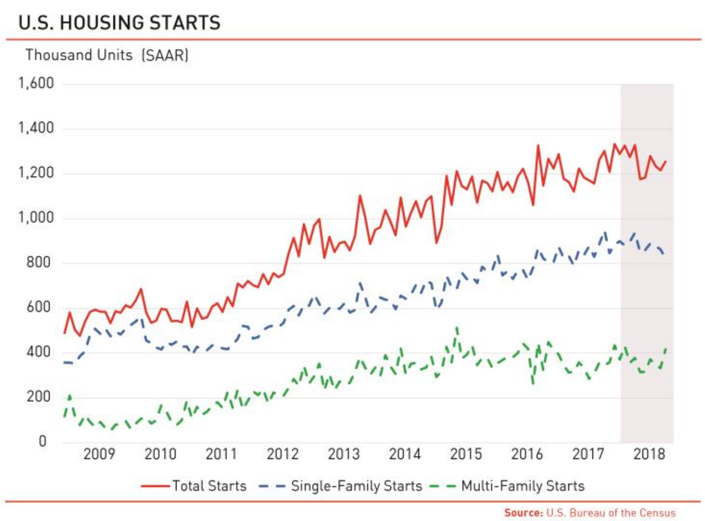
[1] Random Lengths Publications, Inc.

Chart 1



US housing starts averaged 1,264,000 units[2] in 2018 (as at November 2018), an increase of 5% from 2017, and the highest annual average since 2007 (Chart 2), with the increase in multi-family starts, which consume a smaller proportion of lumber, (up 7%), outpacing the increase in single-family starts (up 3%) year-over-year.

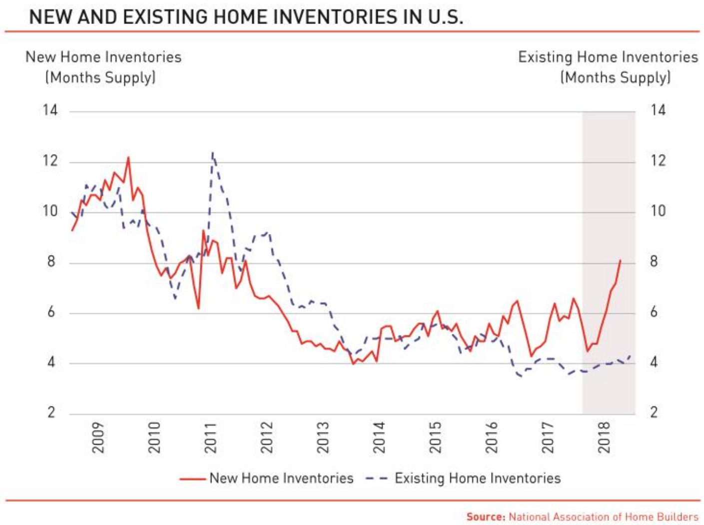
Chart 2



Notwithstanding the sharp increase in 2018, new home inventories remained below historical high levels, while existing home inventories remained steady at the historically low levels seen towards the end of 2017 (see Chart 3). Both metrics, along with new housing starts, highlight the improving US market fundamentals observed through much of 2018.

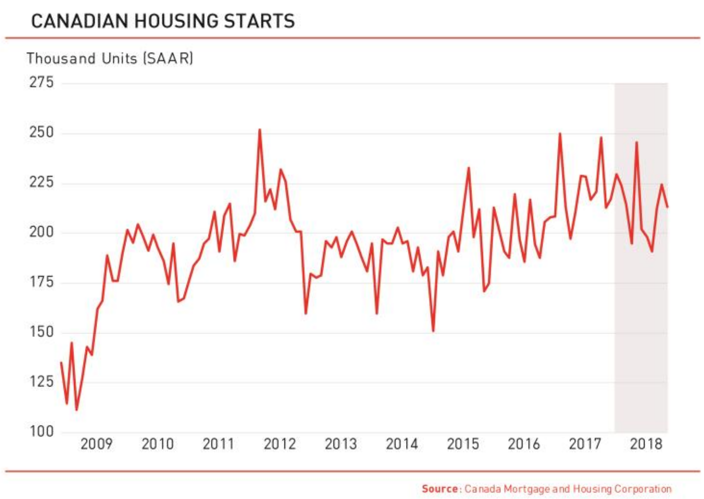
[2] Source: US Bureau of the Census. US housing starts updated to November 2018 due to US government shutdown

Chart 3



Despite continued strength in the Canadian housing market in 2018, housing starts, at 214,000 units[3], were down slightly from 2017 (Chart 4), largely reflecting higher interest rates and increased concern over housing affordability.

Chart 4



Strong underlying demand was evident in the Company's key offshore lumber markets, particularly for its higher-value products. The material change in the Company's geographical sales mix over the past ten years has enabled a more globally balanced distribution of sales in support of strategic growth objectives. Notwithstanding stronger US lumber demand in 2018 and the growth of the Company's US South lumber business in recent years, the Company's exposure to the US in 2018 remained well below where it was in 2007, with Western SPF lumber sales volume to North America down approximately 15% principally as a result of the Company's development of new markets for its lumber products, particularly in China.

The Canadian dollar remained relatively unchanged against the US-dollar in 2018, averaging $0.772[4] per US-dollar, in line with 2017.

[3] Canada Mortgage and Housing Corporation ("CMHC")
[4] Bank of Canada (monthly average for the period)

(ii) Pulp

Positive pricing momentum and strong global pulp market conditions experienced in the latter part of 2017 continued well into 2018. NBSK pulp list prices to China for the year averaged US$878[5] per tonne, an historic high and US$166 per tonne, or 23%, higher than the 2017 average price, although prices weakened later in the year in response to slowing demand and oversupply in that region, ending the year at US$725[5] per tonne. North American pricing also saw steady positive momentum through 2018 with list prices rising from US$1,210[5] per tonne in January to US$1,435[5] per tonne in December, with discounts broadly unchanged year-over-year.

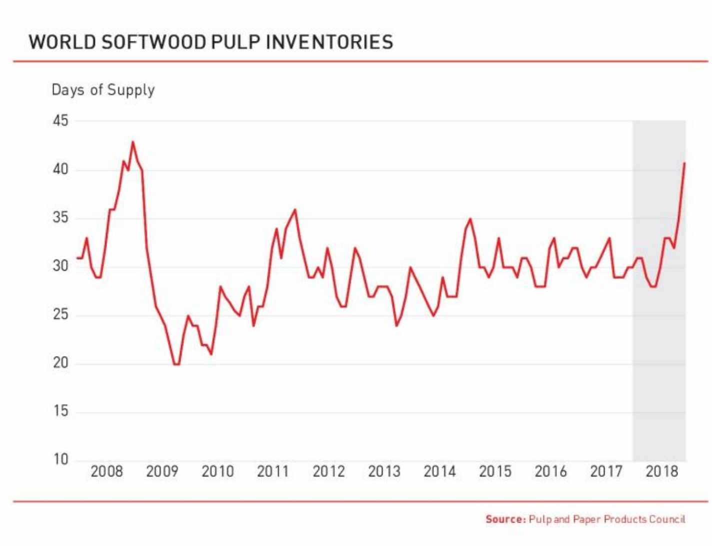
Despite strong demand in the first half of the year, global shipments of bleached softwood kraft pulp in 2018 saw modest decreases compared to 2017, partly due to hardwood pulp substitution that occurred at the elevated softwood pulp prices. Global softwood pulp producer inventories increased in the first quarter of 2018 as a result of major weather-related transportation constraints and minimal maintenance downtime, before declining through the spring maintenance period in the second quarter of 2018. In the latter part of 2018, mostly in response to the slowdown of demand from China, global pulp inventories increased steadily, ending the year at 41 days, well-above the balanced range of 27-30 days.

The following charts show the NBSK pulp list price movements in 2018, before taking account of customer discounts and rebates (Chart 5), and the global pulp inventory levels (Chart 6).

Chart 5

[5] Resource Information Systems, Inc.

Chart 6



CPPI's sales network represents and co-markets UPM-Kymmene ("UPM") pulp products in North America, Japan and Korea, while UPM's pulp sales network represents and co-markets CPPI's products in Europe and China, as part of a strategic sales and marketing cooperation agreement. This arrangement continued to serve both companies well in 2018, allowing both CPPI and UPM to sell a broader offering of pulp products and enhanced technical service to customers.

Countervailing and Anti-Dumping Duties

In 2016, a petition was filed by the US Lumber Coalition to the US Department of Commerce ("DOC") and the US International Trade Commission ("ITC") alleging certain subsidies and administered fees below the fair market value of timber that favour Canadian lumber producers. Canfor was selected by the DOC as a "mandatory respondent" to the countervailing and anti-dumping investigations and is subject to company specific countervailing and anti-dumping duties.

As a result of the DOC's investigation, preliminary countervailing duties ("CVD") and anti-dumping duties ("ADD"), were imposed on the Company's lumber exports to the United States applicable from April 28, 2017 to August 25, 2017. Final duty determinations were announced on November 2, 2017, resulting in a final ADD rate of 7.28% and CVD rate of 13.24%, effective December 28, 2017. Despite the final duty determinates made by the DOC in 2017, the final liability associated with duties will not be determined until the completion of administrative reviews performed by the DOC.

Cash deposits have been posted reflecting the final published ADD rate of 7.28% and CVD rate of 13.24%, with ADD expense accrued at 2.9% related to the first administrative review period. Cumulative cash duties paid to December 31, 2018 were $284.0 million. In addition, at December 31, 2018, Canfor has recorded a receivable of $76.6 million reflecting the difference between the current combined cash deposit rate of 20.52% and the current combined accrual rate for accounting purposes of 16.14%. Accordingly, Canfor has recorded a net expense of $169.1 million in 2018.

In 2019, Canfor will move into a new period of review, with the estimated ADD rate based on 2019 sales and cost data. Canfor will continue to reassess the ADD accrual estimate at each quarter-end, applying the DOC's methodology to updated sales and cost data as it becomes available.

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

External Growth

The Company continued to focus on growth and diversification in 2018. In November, it signed two purchased agreements, both of which advance its business strategy for the lumber business:

- An agreement to purchase 70% of VIDA, Sweden's largest privately-owned sawmill company for a purchase price of 3,990 million Swedish Krona (approximately CAD$580 million), including an estimated $125 million of working capital. VIDA operates nine sawmills in southern Sweden with an annual production capacity of approximately 1.1 billion board feet, in addition to nine value-added facilities which produce premium packaging, modular housing, industrial products and energy. This represents transformational growth and diversification for Canfor, providing a significant source of high quality spruce and pine fibre, access to new markets, and an increased global presence that will enable the Company to meet the growing demand of its strategic customers. The transaction is anticipated to close in the first quarter of 2019.
- An agreement to purchase Elliott, located in Estill, South Carolina, for a purchase price of US$110 million, including working capital. Elliott's access to high-quality fibre and focus on high-value products provides a strong cultural and strategic alignment with Canfor's existing operations in the US South, with an annual production capacity in excess of 210 million board feet. While the purchase price of Elliott will be paid in three equal instalments, ownership will be transferred to Canfor over a period of two years, with 49% acquired at closing (anticipated in the second quarter of 2019) and the remaining 51% acquired one year later.

Together, these acquisitions will increase Canfor's lumber capacity by approximately 1.3 billion board feet and will provide significant geographic and market diversification through access to new markets and increased exposure to higher-margin value-added products. The Company anticipates funding the transactions through a combination of cash on hand and existing credit facilities.

Solid Wood Operations

The Company's confidence in the longer-term prospects of the lumber industry has driven an investment strategy aimed at positioning itself as a top-quartile margin performer. In support of this objective, the Company has completed a number of targeted strategic capital initiatives at its sawmills since 2010, all aimed at enhancing the quality and value offering of products to its customers from a top-tier productivity and cost position. These strategic capital investments have been designed to support the Company's high-value focus, allowing the Company to optimize the financial margins and value from its strong fibre positions in Western Canada and the US South and, going forward, in Europe. Capital spending in the lumber segment for 2018 totaled $272.3 million, with an increasing proportion of capital deployed in the US South. Capital projects included major upgrades at the Company's sawmill operations in Arkansas, Alabama and Georgia as part of the Company's previously announced organic growth plans, as well as various smaller high-returning capital projects aimed at increasing drying capacity and productivity. Significant capital investment in recent years, combined with the Company's organic growth and planned acquisitions, is anticipated to increase annualized production by more than 50% compared to 2010.

In Western Canada, as mentioned previously, strong lumber prices through the first half of 2018 resulted in a significant increase in market-based stumpage and increased pricing pressure on non-quota (purchased) timber. Various challenges presented by weather and forest fires throughout the year, as well as a continued shift out of the Mountain Pine Beetle ("MPB") log profile and into greener fibre, resulted in material increases in log costs in 2018. The Company's continued focus on high-value and specialty products, combined with greener fibre and targeted capital spending, enabled the Company to produce a record percentage of prime (better than #2&Btr) products in 2018, materially improving the financial margins from this fibre base. The Company's continued focus on high-value dimension and speciality products resulted in further grade and margin improvements in the US South, where log costs continue to remain stable, reflecting a strong supply of high-quality fibre in close proximity to Canfor's sawmills.

Recent forecasts have predicted that annual allowable harvest rates in the BC Interior could be reduced by upwards of 30% from current levels, as a result of the degradation of pine timber resulting from the MPB infestation. The Company has taken various steps in recent years to secure access to high-quality fibre and ensure the viability and competitiveness of its operations. As a result of current log supply and demand dynamics in Western Canada, the Company remains focused on optimizing the usage of its fibre supply through targeted capital investments, improved fibre utilization, disciplined cost management and maximized residual fibre revenue. The Company also remains focused on ensuring strong operational performance at all of its operations, with continuous improvement initiatives complementing and maximizing the benefits from capital upgrades.

Pulp and Paper Operations

Total pulp and paper production in 2018 was down 91,000 tonnes, or 7%, when compared to the prior year, largely due to unscheduled production downtime in the last four months of the year. As highlighted earlier, Northwood extended its scheduled maintenance outage on one production line to enable necessary tube replacements to its recovery boiler. A third-party natural gas explosion near Prince George, also in the fall, impacted all of CPPI's NBSK mills and contributed to the lower production year-over-year. Scheduled downtime in 2018 included capital-related downtime in connection with the commissioning of the Taylor BCTMP mill's energy reduction project, and planned maintenance outages at its Northwood and Prince George NBSK pulp mills and Prince George paper mill.

Capital spending in 2018 totalled $120.5 million and included the completion of the Taylor mill energy reduction project and Northwood's installation and commissioning of a new 32 megawatt condensing turbo-generator at a combined cost of approximately $100 million, as well as several smaller high-return discretionary projects. Both projects were delivered on time and on budget. In 2019, CPPI anticipates increased energy efficiency and a material reduction in fuel consumption as a result of these projects.

OVERVIEW OF CONSOLIDATED RESULTS – 2018 COMPARED TO 2017

Selected Financial Information and Statistics

(millions of Canadian dollars, except for per share amounts)		2018		2017
Sales	**$**	**5,044.4**	$	4,563.3
Operating income before amortization	**$**	**879.1**	$	807.3
Operating income	**$**	**608.6**	$	557.4
Net income	**$**	**439.0**	$	393.6
Net income attributable to equity shareholders of the Company	**$**	**354.9**	$	345.4
Net income per share attributable to equity shareholders of the Company, basic and diluted	**$**	**2.78**	$	2.63
ROIC – Consolidated[6]		**18.9%**		20.6%
Average exchange rate (US$/CDN$)[7]	**$**	**0.772**	$	0.770

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

Selected Cash Flow Information

(millions of Canadian dollars)		2018		2017
Operating income (loss) by segment:				
Lumber	**$**	**390.5**	$	441.9
Pulp and Paper	**$**	**246.6**	$	154.6
Unallocated and Other	**$**	**(28.5)**	$	(39.1)
Total operating income	**$**	**608.6**	$	557.4
Add: Amortization[8]	**$**	**270.5**	$	249.9
Total operating income before amortization	**$**	**879.1**	$	807.3
Add (deduct):				
Working capital movements	**$**	**(82.8)**	$	(72.1)
Defined benefit plan contributions	**$**	**(28.2)**	$	(28.8)
Income taxes paid, net	**$**	**(222.4)**	$	(43.9)
Adjustment to accrued duties[9]	**$**	**(25.8)**	$	(44.9)
Other operating cash flows, net[10]	**$**	**16.2**	$	(7.5)
Cash from operating activities	**$**	**536.1**	$	610.1
Add (deduct):				
Additions to property, plant and equipment, timber and intangible assets, net	**$**	**(401.4)**	$	(252.1)
Acquisitions, net of disposals	**$**	**-**	$	(23.7)
Share purchases	**$**	**(88.5)**	$	(87.0)
Distributions paid to non-controlling interests	**$**	**(74.5)**	$	(10.0)
Finance expenses paid	**$**	**(23.3)**	$	(21.1)
Repayment of long-term debt, net	**$**	**(0.4)**	$	(44.3)
Acquisitions of non-controlling interests	**$**	**(0.1)**	$	(17.7)
Other, net[10]	**$**	**16.6**	$	5.4
Change in cash / operating loans	**$**	**(35.5)**	$	159.6

[8] Amortization includes amortization of certain capitalized major maintenance costs.
[9] Adjusted to true-up preliminary anti-dumping duty deposits the Company's current accrual rates.
[10] Further information on cash flows can be found in the Company's annual consolidated financial statements.

Analysis of Specific Items Affecting Comparability of Shareholder Net Income

After-tax impact, net of non-controlling interests (millions of Canadian dollars, except for per share amounts)		2018		2017
Shareholder Net Income, as reported	**$**	**354.9**	$	345.4
Foreign exchange (gain) loss on long-term debt	**$**	**4.3**	$	(7.7)
Loss on derivative financial instruments[11]	**$**	**6.1**	$	3.8
Countervailing and anti-dumping duty deposits[12]	**$**	**123.1**	$	32.8
Mill closure provisions recovery	**$**	**-**	$	(2.4)
Change in substantively enacted tax legislation	**$**	**-**	$	(5.1)
Gain on sale of Anthony EACOM Inc.	**$**	**-**	$	(3.4)
Net impact of above items	**$**	**133.5**	$	18.0
Adjusted shareholder net income	**$**	**488.4**	$	363.4
Shareholder net income per share (EPS), as reported	**$**	**2.78**	$	2.63
Net impact of above items per share	**$**	**1.05**	$	0.14
Adjusted shareholder net income per share	**$**	**3.83**	$	2.77

[11]The Company entered into Swedish Krona forward foreign exchange contracts in November 2018 and recorded a mark-to-market gain of $18.8 million in 2018, which was offset by realized and unrealized net losses of $17.7 million on lumber and energy future sales contracts.
[12]Adjusted for countervailing and anti-dumping duty deposits expensed for accounting purposes.

The Company recorded net income attributable to equity shareholders of $354.9 million, or $2.78 per share, for the year ended December 31, 2018, an increase of $9.5 million, or $0.15 per share, from $345.4 million, or $2.63 per share, reported for the year ended December 31, 2017. After taking account of specific items affecting comparability with prior periods, the Company's 2018 adjusted shareholder net income was $488.4 million, or $3.83 per share, up $125.0 million, or $1.06 per share, compared to similarly adjusted shareholder net income of $363.4 million, or $2.77 per share, for 2017.

Reported operating income for 2018 was $608.6 million, up $51.2 million from operating income of $557.4 million for 2017. These results were driven largely by record-high pulp and paper segment results offset, in part, by lower lumber segment operating earnings. Overall operating results for the lumber segment were down from the previous year, as significantly higher Western SPF and SYP lumber US-dollar prices in the first half of 2018 were more than offset by market-driven increases unit log costs in Western Canada, increased duty expense year-over-year, as well as the impact of production curtailments at our BC operations in the fourth quarter of 2018, and a $36.7 million write-down of inventory reflecting the material decline in lumber prices towards the end of the year. In the pulp and paper segment, operating income largely reflected historically high US-dollar NBSK prices, which more than offset market-related fibre cost increases, the impact of unscheduled production outages and increased chemical, energy and maintenance expenses associated with production downtime throughout 2018.

A more detailed review of the Company's operational performance and results is provided in the "Operating Results by Business Segment – 2018 compared to 2017" section, which follows this overview of consolidated results.

OPERATING RESULTS BY BUSINESS SEGMENT – 2018 COMPARED TO 2017

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

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

Lumber

Selected Financial Information and Statistics – Lumber

Summarized results for the Lumber segment for 2018 and 2017 are as follows:

(millions of Canadian dollars, unless otherwise noted)		2018		2017
Sales	**$**	**3,670.4**	$	3,365.6
Operating income before amortization	**$**	**581.3**	$	617.4
Operating income, as reported	**$**	**390.5**	$	441.9
Countervailing and anti-dumping duties	**$**	**169.1**	$	44.3
Inventory valuation adjustments	**$**	**36.7**	$	-
Mill closure provisions recovery	**$**	**-**	$	(3.2)
Adjusted operating income	**$**	**596.3**	$	483.0
Capital expenditures	**$**	**272.3**	$	163.6
Average SPF 2x4 #2&Btr lumber price in US$[13]	**$**	**480**	$	401
Average SPF 2x4 #2&Btr lumber price in Cdn$[13]	**$**	**622**	$	521
Average SYP 2x4 #2 lumber price in US$[14]	**$**	**525**	$	456
US housing starts (thousand units SAAR) [15]		**1,264**		1,208
Production – SPF lumber (MMfbm)[16]		**3,551.2**		3,744.2
Production – SYP lumber (MMfbm)[16]		**1,406.6**		1,410.9
Shipments – SPF lumber (MMfbm)[17]		**3,537.9**		3,689.4
Shipments – SYP lumber (MMfbm)[17]		**1,413.4**		1,440.2

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

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

[15] Source – US Census Bureau, seasonally adjusted annual rate ("SAAR"); Updated to November 2018 due to US government shutdown.

[16] Excluding production of trim blocks.

[17] Canfor-produced lumber, including lumber purchased for remanufacture and excluding trim blocks, excludes shipments of wholesale lumber.

Markets

North American lumber demand was solid across all segments of the market through much of 2018 as a whole, with the US housing market continuing its ongoing, slow but gradual recovery and strengthening demand in the repair and remodeling sector. US housing starts averaged 1,264,000 units in 2018 (as at November 2018), an increase of 5% from 2017, and the highest annual average since 2007. Contributing to improved lumber demand was a 3% increase in single-family starts combined with a 7% increase in multi-family starts compared to 2017 (single-family homes consume approximately three times more lumber than multi-family homes). Canadian housing construction activity remained near historical highs during 2018, yet was down slightly from the previous year, at an average of 214,000 units on a seasonally adjusted basis, partially reflecting increased concern over housing affordability given higher interest rates and home prices. Offshore lumber demand remained solid through 2018, particularly for the Company's higher-value lumber products, despite moderately lower shipment volumes in the current year, largely timing-related.

The combination of weather-related supply constraints early in the year and solid overall North American and offshore demand paved the way for historically-high average US-dollar Western SPF and SYP benchmark lumber prices in the first half of 2018. As supply constraints eased, however, prices fell sharply through the latter half of 2018 as higher inventory levels throughout the supply chain were met with slower demand.

The North American benchmark Western SPF 2x4 #2&Btr lumber price was up US$79 per Mfbm, or 20%, compared to 2017, while the Western SPF 2x6 #2&Btr lumber price was up US$24 per Mfbm, or 6%. Southern Yellow Pine lumber prices saw more moderated increases, as improved demand was offset in part by increased production volumes across the US South region. The Random Length SYP East 2x4 #2 price was up US$69 per Mfbm, or 15%, compared to 2017 with similar price increases seen for wider-width SYP lumber products.

Sales

Lumber segment revenues of approximately $3.7 billion for 2018 were up 9% compared to 2017, reflecting significantly higher Western SPF and SYP unit sales realizations, and notably higher residual revenue in Western Canada. Increased lumber unit sales realizations were offset, in part, by modestly lower shipment volumes in the current year, reflecting fewer operating hours and, to a lesser extent, weather-related operational challenges during 2018.

Total lumber shipments were approximately 4.95 billion board feet for the year, down 4% from 5.13 billion board feet shipped in the previous year, largely due to the 4% decline in total lumber production, principally due to the announced curtailments resulting in lower volumes available for sale in the current year.

As highlighted, Western SPF lumber unit sales realizations were up considerably from the prior year as higher average benchmark lumber prices and the benefit of a higher-value sales mix, more than offset the impact of increased countervailing and anti-dumping duty expenses in the current year. A continued focus on high-value products coupled with an increasing proportion of greener fibre and the benefits of recent capital expenditures resulted in the Company producing less low-grade products in 2018. Offshore sales unit realizations were also significantly higher than 2017 reflecting improved US-dollar lumber pricing and a higher-value sales mix.

Total residual fibre revenue for 2018 was substantially higher than the prior year primarily reflecting increased market-based pricing (linked to Canadian dollar NBSK pulp unit sales realizations). Pellet revenue was also higher than the prior year, largely a result of increased shipments in 2018.

Operations

Total lumber production for 2018 was 4.96 billion board feet, down 4% from the prior year, largely reflecting moderately lower production at the Company's BC sawmill operations as a result of production curtailments, and to a lesser extent, severe wildfires in Western Canada and hurricanes in the US South. As previously noted, in light of market and log challenges, the Company curtailed production at the Company's BC lumber operations in the fourth quarter of 2018 by approximately 100 million board feet. Production at the Company's US South sawmill operations was broadly in line with the prior year as hurricane-related downtime and unseasonably high rainfall during the winter months disrupted log deliveries and log profile, both of which reduced productivity in 2018, offsetting the benefits realized from capital upgrades.

Lumber unit manufacturing costs increased significantly compared to the previous year as the benefit of stable log costs in the US South mitigated the effects of materially higher unit log costs in Western Canada. Historically high Western SPF benchmark lumber prices gave rise to increased market-based stumpage, while the aforementioned fire-related challenges, in combination with declining fibre availability in BC, resulted in increased competition for purchased wood, increased log hauling costs and lower log deliveries in Western Canada. Unit cash conversion costs increased moderately year-over-year, principally reflecting the impacts of production curtailments and operational downtime.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[18]

Summarized results for the Pulp and Paper segment for 2018 and 2017 are as follows:

(millions of Canadian dollars, unless otherwise noted)	2018	2017
Sales	**$ 1,374.0**	$ 1,197.7
Operating income before amortization[19]	**$ 326.2**	$ 229.0
Operating income	**$ 246.6**	$ 154.6
Capital expenditures	**$ 120.5**	$ 83.1
Average NBSK pulp price delivered to China - US$[20]	**$ 878**	$ 712
Average NBSK pulp price delivered to China - Cdn$[20]	**$ 1,137**	$ 925
Production – pulp (000 mt)	**1,117.4**	1,205.0
Production – paper (000 mt)	**134.6**	138.0
Shipments – pulp (000 mt)	**1,131.7**	1,216.4
Shipments – paper (000 mt)	**130.2**	139.0

[18] Includes 100% of CPPI, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.
[19] Amortization includes amortization of certain capitalized major maintenance costs.
[20] Per tonne, NBSK pulp list price delivered to China (Resource Information Systems, Inc.); Average NBSK pulp price delivered to China – Cdn$ calculated as average NBSK pulp price delivered to China – US$ multiplied by the average exchange rate – Cdn$ per US$1.00 according to Bank of Canada monthly average rate for the period.

Markets

Positive pricing momentum and strong pulp market conditions, particularly in China, experienced in the latter part of 2017 continued well into 2018, before a marked slowdown in China led to a sharp decline in prices to that region through the last three months of 2018. Demand in North America and other regions, including Europe, was less volatile through 2018 with prices increasing steadily through the year.

Global softwood shipments declined 3.2% year-over-year[21], as total pulp deliveries to Western Europe and China dropped in the fourth quarter of 2018 with slowing market demand. The decrease in softwood shipments in 2018 is in contrast to a 4.2% increase in global hardwood shipments year-over-year[21], reflecting hardwood pulp substitution at the historically-high softwood pulp prices, particularly in China.

At the end of 2018, World 20[22] producers of bleached softwood pulp inventories were at 41 days of supply, an increase of eleven days from December 2017, for the most part, reflecting the slowdown of demand from China in the fourth quarter. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

Bleached kraft paper markets continued to show strength throughout 2018 as positive pricing momentum from 2017 continued into the first half of 2018 and remained steady through the balance of the year.

Sales

Pulp shipments in 2018 were 1.13 million tonnes, down 85,000 tonnes, or 7%, from 2017. Lower shipments in 2018 reflected the impact of higher scheduled and unscheduled downtime of production during the year, combined with slowing demand from China later in the year.

NBSK US-dollar pulp list prices to China averaged US$878 per tonne in 2018, a historic-high, and up US$166 per tonne, or 23%, compared to 2017. North American NBSK pulp list prices, averaged US$1,337 per tonne for 2018, up US$232 per tonne, or 21% from 2017, with the discounts largely unchanged year-over-year. Accordingly, NBSK pulp unit sales realizations were up significantly from 2017. Average BCTMP unit sales realizations also showed increases in 2018 from the prior year, reflecting strong BCTMP US-dollar pricing through most of 2018.

[21] As reported PPPC statistics.

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

Energy revenue for 2018 was down compared to the prior year primarily as a result of the previously discussed scheduled and unscheduled operational downtime in the second half of the year.

Paper shipments in 2018, at 130,000 tonnes, were down 9,000 tonnes from 2017 reflecting the impact of a maintenance outage in the second quarter (there was no scheduled maintenance outages in 2017), combined with the timing of shipments near year-end. Paper unit sales realizations for 2018 were significantly up from 2017 reflecting an improvement in US-dollar kraft paper prices, as well as proportionately higher prime bleached shipments year-over-year.

Operations

Pulp production in 2018, at 1.12 million tonnes, was down 88,000 tonnes, or 7%, from 2017. In 2018, CPPI completed scheduled maintenance outages at its Northwood and Prince George NBSK pulp mills. The largest contributing factor to the lower production during 2018 related to the aforementioned recovery boiler extended downtime at Northwood. Unscheduled downtime at CPPI's three NBSK pulp mills also resulted from a third-party natural gas pipeline explosion in the fourth quarter. Combined, these scheduled and unscheduled outages impacted NBSK pulp production by approximately 115,000 tonnes in 2018, compared to scheduled and unscheduled downtime of NBSK pulp production in 2017 of 52,000 tonnes. Pulp production in 2018 also reflected a decline in BCTMP production of approximately 25,000 tonnes year-over year, resulting from capital-related downtime taken for the commissioning of the Taylor BCTMP mill energy reduction project and its subsequent ramp up in the second half of the year, along with seven days of curtailed BCTMP production in December due to reduced residual fibre availability.

Pulp unit manufacturing costs were materially higher when compared to 2017, principally reflecting higher fibre costs, lower productivity and higher maintenance, energy and, chemical costs resulting from the aforementioned downtime. The increase in fibre costs compared to 2017 largely reflected higher market-based prices for sawmill residuals (linked to higher Canadian NBSK pulp prices), and, to a lesser extent, an increased proportion of higher-cost whole log chips.

Paper production in 2018 was 135,000 tonnes, down 3,000 tonnes from 2017, principally as a result of scheduled maintenance downtime during the year. Higher paper unit manufacturing costs in 2018 were the result of significant increases in slush pulp costs linked to higher Canadian dollar NBSK market pulp prices.

Unallocated and Other Items

(millions of Canadian dollars)		**2018**		**2017**
Operating loss of Panels operations[23]	**$**	**(1.8)**	$	(2.4)
Corporate costs	**$**	**(26.7)**	$	(36.7)
Finance expense, net	**$**	**(26.0)**	$	(30.8)
Foreign exchange gain (loss) on long-term debt and duties receivable	**$**	**(4.8)**	$	8.8
Gain (loss) on derivative financial instruments	**$**	**1.1**	$	(5.2)
Other income (expense), net	**$**	**9.9**	$	(3.8)

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

Corporate Costs

Corporate costs, which comprise corporate, head office and general and administrative expenses, were $26.7 million in 2018, down $10.0 million from 2017, largely reflecting lower legal fees and BC Lumber Trade Counsel ("BCLTC") dues associated with the expiry of the Softwood Lumber Agreement.

Finance Income and Expense

Net finance expense for 2018 was $26.0 million, down $4.8 million from 2017, largely reflecting increased interest income on term deposits in 2018 and lower pension related costs. See the "Liquidity and Financial Requirements" section for further discussion.

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

In 2018, the Company recognized a foreign exchange loss of $10.9 million on its US-dollar term debt held by Canadian entities, offset in part by a $6.1 million gain on US-denominated duties receivable, both due to the weaker Canadian dollar at the close of 2018 relative to the exchange rate at the close of 2017 (see further discussion on term debt in the "Liquidity and Financial Requirements" section).

Gain (Loss) on Derivative Financial Instruments

At times, the Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in lumber prices, energy costs, interest and foreign exchange rates. In 2018, the Company recorded a net gain of $1.1 million (2017 – net loss of $5.2 million) related to its derivative financial instruments, which largely reflected non-cash mark-to-market gains on outstanding Swedish Krona forward foreign exchange contracts, offset by mark-to-market losses on its lumber future contracts.

Forward foreign exchange contracts were entered into in the fourth quarter of 2018 and subsequent to year-end, to reduce exposure to fluctuations in the Swedish Krona versus the Canadian and US dollar as a result of the Company's commitment to acquire a 70% interest in VIDA in 2019 (see further discussion in the "Liquidity and Financial Requirements" and "Derivative Financial Instruments" section).

The following table summarizes the amounts of the various components for the comparable periods. Additional information on the derivative financial instruments in place at year end can be found in the "Liquidity and Financial Requirements" section, later in this document.

(millions of Canadian dollars)		2018		2017
Lumber futures	**$**	**(17.9)**	$	(4.7)
Energy derivatives	**$**	**0.2**	$	(0.5)
Forward foreign exchange contracts	**$**	**18.8**	$	-
Gain (loss) on derivative financial instruments	**$**	**1.1**	$	(5.2)

Other Income and Expense, net

Other income, net in 2018 of $9.9 million and other expense, net in 2017 of $3.8 million principally reflected foreign exchange movements on US-dollar denominated cash, receivables and payables of Canadian operations. In 2017, the net expense was offset in part by a $3.7 million gain recorded on the Company's sale of its 50% interest in Anthony EACOM Inc. during the year.

Income Tax Expense

The Company recorded an income tax expense of $149.8 million in 2018, compared to an expense of $132.8 million in 2017, with an overall effective tax rate of approximately 25% (2017 - 25%).

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

(millions of Canadian dollars)		2018		2017
Net income before income taxes	**$**	**588.8**	$	526.4
Income tax expense at statutory rate of 27% (26% in 2017)	**$**	**(159.0)**	$	(136.9)
Add (deduct):				
Non-taxable income related to non-controlling interests		**0.2**		0.4
Entities with different income tax rates and other tax adjustments		**8.3**		(1.9)
Permanent difference from capital gains and losses and other non-deductible items		**0.7**		1.8
Change in substantively enacted legislation		**-**		3.8
Income tax expense	**$**	**(149.8)**	$	(132.8)

In 2017, the Provincial Government of British Columbia passed legislation increasing the provincial corporate tax rate from 11% to 12% effective January 1, 2018. In addition, the Federal Government of the United States passed tax reform legislation, which included a reduction of the federal corporate income tax rate from 35% to 21% effective January 1, 2018. Accordingly, a $3.8 million net tax recovery was recorded in net income in 2017 to record the impact of these rate changes on deferred taxes, with an additional $1.1 million being recorded in other comprehensive income (loss) as an income tax recovery on defined benefit plan actuarial losses.

In addition, a tax expense of $1.9 million in relation to the actuarial gains on the defined benefit plans (December 31, 2017 – expense of $6.1 million, before the tax rate adjustment) was recorded in other comprehensive income (loss) in 2018.

Other Comprehensive Income (Loss)

(millions of Canadian dollars)		**2018**		2017
Defined benefit plan actuarial gains, net of tax	**$**	**5.0**	$	19.1
Foreign exchange translation differences of foreign operations, net of tax		**50.4**		(33.8)
Other comprehensive income (loss), net of tax	**$**	**55.4**	$	(14.7)

Canfor measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. Any actuarial gains or losses which arise are recognized immediately by means of a credit or charge through other comprehensive income. For 2018, an after-tax gain of $5.0 million was recorded to other comprehensive income, as losses on the Company's defined benefit post-employment compensation plans were more than offset by gains on other non-pension post-employment benefits. The loss associated with the defined benefit post-employment compensation plans largely reflected a lower than anticipated return on plan assets, which was offset in part by the benefit of a higher discount rate used to value the net defined benefit obligation. The non-pension post-employment benefit gain reflected the impact of the higher discount rate and favourable actuarial experience adjustments as a result of the most recent actuarial valuation as at December 31, 2017, which was completed in 2018.

In 2018, the Company purchased $58.9 million of buy-in annuities through its defined benefit pension plans, increasing total annuities purchased to $481.8 million. Future cash flows from the annuities will match the amount and timing of benefits payable under the plans, substantially mitigating the exposure to future volatility in the related pension obligations. Transaction costs of $3.6 million related to the purchase were recognized in other comprehensive income (loss), principally reflecting the difference between the annuity rate compared to the discount rate used to value the obligations on a going concern basis.

When taking into account the impact of hedging, 52% of the change to the defined benefit pension plans is fully hedged against changes in discount rates and longevity risk (potential increases in life expectancy of plan members) through buy-in annuities, and a further 12% is partially hedged through the plan's investment in debt securities.

In 2017, an after-tax gain of $19.1 million was recorded to other comprehensive income, primarily reflecting a 50% reduction in Medical Service Plan ("MSP") premiums following a change in legislation in British Columbia. For more information, see the "Employee Future Benefits" part of the "Critical Accounting Estimates" section later in this report.

In addition, the Company recorded an after-tax gain of $50.4 million to other comprehensive income in 2018 related to foreign exchange differences for foreign operations, resulting from the weaker Canadian dollar at the end of 2018 compared to one-year earlier. This compared to an after-tax loss of $33.8 million in 2017 due to a stronger Canadian dollar relative to its US counterpart.

SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's financial position as at December 31, 2018 and 2017:

(millions of Canadian dollars, except for ratios)	2018	2017
Cash and cash equivalents	**$ 252.7**	$ 288.2
Operating working capital	**637.3**	448.5
Current portion of deferred reforestation	**(52.9)**	(49.5)
Net working capital	**837.1**	687.2
Property, plant and equipment	**1,607.2**	1,438.1
Timber licenses	**504.1**	518.3
Goodwill and other intangible assets	**268.3**	228.1
Retirement benefit surplus	**4.9**	7.9
Long-term investments and other	**110.4**	83.3
	$ 3,332.0	$ 2,962.9
Long-term debt	**$ 408.0**	$ 385.4
Retirement benefit obligations	**254.7**	272.0
Deferred reforestation obligations (long-term portion)	**63.9**	63.0
Other long-term liabilities	**24.6**	23.7
Deferred income taxes, net	**240.9**	217.8
Non-controlling interests	**283.5**	269.6
Equity attributable to shareholders of Company	**2,056.4**	1,731.4
	$ 3,332.0	$ 2,962.9
Ratio of current assets to current liabilities	**2.6 : 1**	2.3 : 1
Net debt to total capitalization	**6.2%**	4.6%

The ratio of current assets to current liabilities at the end of 2018 was 2.6:1 compared to 2.3:1 at the end of 2017, and principally reflected the Company's higher inventory balance at December 31, 2018 compared to December 31, 2017.

The Company's net debt to capitalization was 6.2% at December 31, 2018 (December 31, 2017 – 4.6%) and largely reflected the special dividend paid in 2018, part of which was distributed to non-controlling shareholders of CPPI..

CHANGES IN FINANCIAL POSITION

At the end of 2018, Canfor had $252.7 million of cash and cash equivalents.

(millions of Canadian dollars)	2018	2017
Cash generated from (used in)		
Operating activities	**$ 536.1**	$ 610.1
Financing activities	**(186.8)**	(207.6)
Investing activities	**(393.4)**	(266.4)
Increase (decrease) in cash and cash equivalents[24]	**$ (44.1)**	$ 136.1

[24] Increase (decrease) in cash and cash equivalents shown before foreign exchange translation on cash and cash equivalents.

The changes in the components of these cash flows during 2018 are discussed in the following sections.

Operating Activities

Canfor generated cash from operations of $536.1 million for the 2018 year, down $74.0 million from cash generated of $610.1 million in the previous year. The decrease in operating cash flows primarily reflected increased income tax payments as a result of higher cash earnings in 2018, and, to a lesser extent, increased inventories on hand at the end of the current year. Cash duty deposits paid in 2018 were $194.8 million compared to $89.2 million in the prior year.

Financing Activities

Financing activities in 2018 used net cash of $186.8 million compared to cash used of $207.6 million in 2017. The Company had no balance outstanding on its Canadian operating loan facility at the end of 2018 and 2017. The Company made cash distributions of $74.5 million to non-controlling shareholders in 2018, up $64.5 million from 2017; this was principally as a result of a special dividend of $2.25 per common share paid by CPPI on November 13, 2018. In 2017, CPPI made an early repayment of its $50.0 million term debt.

Cash used for financing activities also included share purchases under Canfor's and CPPI's Normal Course Issuer Bids. In 2018, Canfor purchased 3,425,580 common shares for $84.8 million (average price of $24.76 per common share) and paid an additional $3.7 million in relation to shares purchased in the prior year. Under a separate normal course issuer bid, CPPI purchased 500 common shares from non-controlling shareholders at an average of $13.01 per common share, and paid an additional $0.1 million in relation to shares purchased in the prior year.

During 2017, Canfor purchased 4,159,593 common shares for $90.7 million and under a separate normal course issuer bid, CPPI purchased 1,448,109 common shares from non-controlling shareholders for $17.8 million. See further discussion of the shares purchased under the Normal Course Issuer Bid in the following "Liquidity and Financial Requirements" section.

Investing Activities

In 2018, the Company used net cash for investing activities of $393.4 million, compared to $266.4 million in 2017. Additions to property, plant and equipment totaled $401.4 million, up $149.3 million from 2017. Most of this increase was in the lumber segment, where capital spending totaled $272.3 million and included additional capital deployed in the US South as part of the Company's US$125.0 million organic capital initiative, which will add an additional 350 million board feet of production capacity. Capital projects completed in 2018 included major upgrades at the Company's sawmill operations in Arkansas, Alabama, and Georgia, as well as various smaller, high-returning capital projects aimed at increasing drying capacity and productivity. In the pulp and paper segment, capital expenditures of $120.5 million were associated with several capital projects including the aforementioned Northwood and Taylor energy projects, the ongoing development of CPPI's new ERP software system, which is scheduled to go-live in 2019, as well as various other maintenance of business and other improvement projects.

LIQUIDITY AND FINANCIAL REQUIREMENTS

Operating Loans

At December 31, 2018, on a consolidated basis, the Company had cash of $252.7 million, with no amounts drawn on its operating loans, and an additional $68.5 million reserved for several standby letters of credit. Total available undrawn operating loans at year end were $551.5 million, including undrawn facilities for letters of credit.

Excluding CPPI, the Company's bank operating loans at December 31, 2018 totaled $450.0 million, of which no amounts were drawn, however $57.4 million was reserved for several standby letters of credit, the majority of which related to unregistered pension plans. In 2017, the Company's principal operating loans, excluding CPPI, were extended to September 28, 2022. On December 14, 2018, the operating loan was further extended to January 2, 2024, and the principal was increased by $100.0 million. Interest is payable on the operating loans at floating rates based on the lenders' Canadian prime rate, bankers' acceptances, US-dollar base rate or US-dollar LIBOR rate, plus a margin that varies with the Company's debt to total capitalization ratio.

At December 31, 2018, CPPI had an undrawn $110.0 million bank loan facility with $11.1 million reserved for several standby letters of credit under the operating loan facility. On April 6, 2018, the maturity date of CPPI's operating loan facility was extended from January 31, 2020 to April 6, 2022.

Term Debt

On December 14, 2018, the Company increased its Canadian dollar denominated floating interest rate term debt facility to $225.0 million (2017 - $125.0 million) and extended its maturity date from September 28, 2022 to January 2, 2024. The Company also increased its US-dollar denominated floating rate term debt facility to $200.0 million (2017 - $100.0 million) and extended its maturity date from September 28, 2025 to January 2, 2027. As at December 31, 2018, the incremental borrowing capacity available under both the Canadian dollar and US-dollar floating rate term debt was undrawn.

Debt Covenants

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

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

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

Management reviews results and forecasts in monitoring the Company's compliance with these covenant requirements. Canfor was in compliance with all its debt covenants for the year ended December 31, 2018.

Substantially all borrowings of CPPI's operating loans are non-recourse to other entities within the Company.

Normal Course Issuer Bid

On March 5, 2018, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 6,439,764 common shares or approximately 5% of its issued and outstanding common shares as of March 1, 2018. The renewed normal course issuer bid is set to expire on March 6, 2019. In 2018, Canfor purchased 3,425,580 common shares for $84.8 million (an average of $24.76 per common share). In December 2018, the Company decreased its share purchase activity under its normal course issuer bid following the announcement of the aforementioned planned acquisitions of VIDA and Elliott. In 2017, Canfor purchased 4,159,593 common shares for $90.7 million (an average of $21.81 per common share).

Under a separate normal course issuer bid, in 2018, CPPI purchased 500 common shares from non-controlling shareholders at an average of $13.01 per common share. As at December 31, 2017 and December 31, 2018 Canfor's ownership interest in CPPI was 54.8%.

2019 Projected Capital Spending and Debt Repayments

During the first half of 2019, the Company anticipates investing approximately $630.0 million in relation to the aforementioned VIDA and Elliott acquisitions. In addition, based on its current outlook, assuming no further deterioration in market conditions during the year, the Company anticipates it will invest approximately $300.0 million in 2019 in capital projects, which will consist primarily of various improvement projects and maintenance of business expenditures, with proportionately more capital being allocated to the Company's ongoing organic growth in its US South lumber business. There are no scheduled long-term debt payments in 2019. Canfor has sufficient liquidity in its cash reserves and operating loans to finance its planned investments and support its lumber and pulp operations during 2019.

Derivative Financial Instruments

As at December 31, 2018, the Company had the following significant derivative financial instruments outstanding:

a. Futures contracts for the sale of lumber with a total notional amount of 42.7 MMfbm at December 31, 2018. There were unrealized losses of $0.2 million at December 31, 2018 on these contracts.

	As at December 31, 2018	
	Notional Amount	**Average Rate**
Lumber Futures	(MMfbm)	(US dollars per Mfbm)
Future sales contracts		
0-12 months	**42.7**	**$343.14**

b. Canfor is subject to Swedish Krona ("SEK") foreign exchange risk associated with the commitment to purchase VIDA in 2019. In order to reduce its exposure to fluctuations in the Swedish Krona versus the Canadian and US dollar, Canfor entered into the following forward foreign exchange contracts in the fourth quarter of 2018:

		As at December 31, 2018	
	Notional Currency	**Notional Amount**	**Exchange Rates**
Swedish Krona Forward Contracts		(millions of dollars)	(rate of SEK to notional currency)
January 15 - February 28, 2019	USD	**$100.0**	**9.07**
January 15 - February 28, 2019	CAD	**$292.6**	**6.84**

Subsequent to year end, the Company continued to reduce its exposure to fluctuations in the Swedish Krona by entering into additional US and Canadian dollar forward foreign exchange contracts. Canadian dollar contracts were entered into with a total notional amount of $125.0 million, exchange rates ranging from 6.86 to 6.90 and settlement dates of February 28, 2019. US dollar contracts were also entered into with a total notional amount of US$25.0 million, an exchange rate of 9.06 and a settlement date of February 28, 2019.

At times, Canfor enters into interest swaps, commodity swaps, and oil collars to reduce its exposure to interest rate risk, energy price risk and diesel purchases, respectively. At December 31, 2018, none of these types of contracts were outstanding.

Commitments and Subsequent Events

The following table summarizes Canfor's financial contractual obligations excluding interest at December 31, 2018 for each of the next five years and thereafter:

(millions of Canadian dollars)	2019	2020	2021	2022	2023	Thereafter	Total
Long-term debt obligations	$ 0.4	$ 4.8	$ -	$ 0.7	$ -	$ 402.5	$ 408.4
Operating leases	14.7	11.0	8.6	6.3	5.0	6.5	52.1
	$ 15.1	$ 15.8	$ 8.6	$ 7.0	$ 5.0	$ 409.0	$ 460.5

Interest payments include interest of 4.4% on the Company's US$100.0 million fixed-rate term loan and interest of 1.3% on the Company's US$3.4 million debt to finance certain capital projects at its U.S. sawmills. Interest is also payable on floating rate debt, which depends on the lenders' Canadian prime rate or bankers' acceptance rate during the year of payment. Interest payments have been excluded from the above commitments.

Operating lease commitments will reflect the new leasing standard, IFRS 16, *Leases*, which becomes effective on January 1, 2019 (see further discussion under the "Future Changes in Accounting Policies" section).

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

- Contractual commitments totaling $137.9 million, which includes commitments for the construction of property, plant and equipment at the Company's sawmills.
- Purchase obligations and contractual obligations in the normal course of business. Purchase obligations of a more substantial dollar amount generally relate to the pulp business and are subject to "force majeure" clauses. In these instances, actual volumes purchased may vary significantly from contracted amounts depending on Canfor's requirements in any given year.
- Deferred reforestation, for which a liability of $116.8 million has been recorded at December 31, 2018. The reforestation liability is a fluctuating obligation, based on the area harvested. The future cash outflows are a function of the actual costs of silviculture programs and of harvesting and are based on, among other things, the location of the harvesting and the activities necessary to adequately stock harvested areas and achieve a "free-to-grow" state.
- Obligations to pay pension and other post-employment benefits, for which the net liability for accounting purposes at December 31, 2018 was $249.8 million. As at December 31, 2018, Canfor estimates that total contribution payments of $19.0 million will be made to its defined benefit plans in 2019.

- CPPI has energy agreements with a BC Energy Company (the "Energy Agreements") for three of CPPI's mills. These agreements are for the commitment of electrical load displacement and the sale of incremental power from the CPPI's pulp and paper mills. These Energy Agreements include incentive grants from the BC energy company for capital investments to increase electrical generation capacity, and also call for performance guarantees to ensure minimum required amounts of electricity are generated, with penalty clauses if they are not met. As part of these commitments, CPPI has entered into standby letters of credit for these guarantees. The standby letters of credit have variable expiry dates, depending on the capital invested and the length of the Energy Agreement involved. As at December 31, 2018 the Company had posted $6.7 million of standby letters of credit under these agreements, and had no repayment obligations under the terms of any of these agreements.

TRANSACTIONS WITH RELATED PARTIES

The Company undertakes transactions with various related entities. These transactions are in the normal course of business and are generally on the same terms as those accorded to unrelated third parties, except where noted otherwise.

The Jim Pattison Group is Canfor's largest shareholder. In August of 2018, the Jim Pattison Group's ownership interest of Canfor increased above 50%, ending the year at 50.9%. During 2018, subsidiaries owned by the Jim Pattison Group provided lease, insurance and other services to Canfor totalling $5.1 million with no amounts outstanding at December 31, 2018.

During 2018, CPPI sold paper to subsidiaries owned by the Jim Pattison Group totalling $3.0 million. No amounts related to these sales were outstanding as at December 31, 2018.

Additional details on related party transactions are contained in Note 23 to Canfor's 2018 consolidated financial statements.

LICELLA PULP JOINT VENTURE

On May 27, 2016, Canfor's subsidiary CPPI and Licella Fibre Fuel Pty Ltd. ("Licella") agreed to form a joint venture under the name Licella Pulp Joint Venture to investigate opportunities to integrate Licella's Catalytic Hydrothermal Reactor platform into CPPI's pulp mills to economically convert biomass into next generation biofuels and biochemicals. Licella is a subsidiary of Ignite Energy Resources Ltd. ("IER") an Australian energy technology development company.

In March 2017, the Canadian Federal Government through its Sustainable Development Technology Canada program announced the funding over several years of approximately $13.2 million, contingent on future spending to allow the Licella Pulp Joint Venture to further develop and demonstrate a technology that will economically convert biomass into biofuels and biochemical. In April 2018, the CPPI received the first instalment of funding in the amount of $1.9 million.

During 2018, CPPI, together with its joint venture partner, Licella, has actively continued to advance work associated with the feasibility study and risk reduction process for industrializing this biofuel and biochemical technology.

SELECTED QUARTERLY FINANCIAL INFORMATION

	Q4 2018	Q3 2018	Q2 2018	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017
Sales and income (millions of Canadian dollars)								
Sales	**$ 1,028.1**	**$ 1,323.3**	**$ 1,459.5**	**$ 1,233.5**	$ 1,156.0	$ 1,142.5	$ 1,159.6	$ 1,105.2
Operating income (loss)	**$ (79.1)**	**$ 201.8**	**$ 282.1**	**$ 203.8**	$ 214.2	$ 105.4	$ 131.0	$ 106.8
Net income (loss)	**$ (46.0)**	**$ 144.9**	**$ 198.6**	**$ 141.5**	$ 152.6	$ 72.6	$ 90.9	$ 77.5
Shareholder net income (loss)	**$ (52.4)**	**$ 125.3**	**$ 169.8**	**$ 112.2**	$ 131.8	$ 66.2	$ 81.3	$ 66.1
Per common share (Canadian dollars)								
Shareholder net income (loss) – basic and diluted	**$ (0.42)**	**$ 0.98**	**$ 1.32**	**$ 0.87**	$ 1.02	$ 0.51	$ 0.61	$ 0.50
Book value[25]	**$ 16.42**	**$ 16.66**	**$ 15.95**	**$ 14.52**	$ 13.46	$ 12.32	$ 12.14	$ 11.81
Common Share Repurchases								
Share volume repurchased (000 shares)	**1,123**	**2,283**	**-**	**20**	633	3,526	-	-
Shares Repurchased (millions of Canadian dollars)	**$ 20.6**	**$ 63.7**	**$ -**	**$ 0.5**	$ 15.7	$ 75.0	$ -	$ -
Statistics								
Lumber shipments (MMfbm)	**1,114**	**1,291**	**1,351**	**1,196**	1,205	1,334	1,333	1,237
Pulp shipments (000 mt)	**231**	**262**	**329**	**310**	300	303	276	337
Average exchange rate – US$/Cdn$	**$ 0.758**	**$ 0.765**	**$ 0.774**	**$ 0.791**	$ 0.786	$ 0.798	$ 0.744	$ 0.756
Average Western SPF 2x4 #2&Btr lumber price (US$)	**$ 327**	**$ 482**	**$ 598**	**$ 513**	$ 462	$ 406	$ 388	$ 348
Average SYP (East) 2x4 #2 lumber price (US$)	**$ 457**	**$ 488**	**$ 589**	**$ 566**	$ 455	$ 408	$ 476	$ 482
Average NBSK pulp list price delivered to China (US$)	**$ 805**	**$ 887**	**$ 910**	**$ 910**	$ 863	$ 670	$ 670	$ 645

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

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

(millions of Canadian dollars)	Q4 2018	Q3 2018	Q2 2018	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017
Operating income (loss) by segment:								
Lumber	**$ (87.7)**	**$ 148.9**	**$ 203.4**	**$ 125.9**	$ 154.9	$ 92.9	$ 110.4	$ 83.7
Pulp and Paper	**$ 15.6**	**$ 60.5**	**$ 85.4**	**$ 85.1**	$ 66.8	$ 21.1	$ 31.5	$ 35.2
Unallocated and Other[26]	**$ (7.0)**	**$ (7.6)**	**$ (6.7)**	**$ (7.2)**	$ (7.5)	$ (8.6)	$ (10.9)	$ (12.1)
Total operating income (loss)	**$ (79.1)**	**$ 201.8**	**$ 282.1**	**$ 203.8**	$ 214.2	$ 105.4	$ 131.0	$ 106.8
Add: Amortization[27]	**$ 70.0**	**$ 68.1**	**$ 67.6**	**$ 64.8**	$ 64.0	$ 61.5	$ 62.1	$ 62.3
Total operating income (loss) before amortization	**$ (9.1)**	**$ 269.9**	**$ 349.7**	**$ 268.6**	$ 278.2	$ 166.9	$ 193.1	$ 169.1
Add (deduct):								
Working capital movements	**$ (53.7)**	**$ 61.1**	**$ 61.9**	**$ (152.1)**	$ (63.9)	$ 4.7	$ 92.3	$ (105.2)
Defined benefit pension plan contributions	**$ (7.0)**	**$ (6.6)**	**$ (7.3)**	**$ (7.3)**	$ (10.4)	$ (5.8)	$ (6.6)	$ (6.0)
Income taxes received (paid), net	**$ (68.4)**	**$ (82.9)**	**$ (24.3)**	**$ (46.8)**	$ (4.2)	$ (21.6)	$ (19.3)	$ 1.2
Adjustment to accrued duties[28]	**$ 10.1**	**$ (12.9)**	**$ (10.1)**	**$ (12.9)**	$ (44.9)	$ -	$ -	$ -
Gain on sale of Anthony EACOM Inc. [29]	**$ -**	**$ -**	**$ -**	**$ -**	$ -	$ -	$ -	$ (4.0)
Other operating cash flows, net[31]	**$ 21.0**	**$ (27.5)**	**$ -**	**$ 22.7**	$ 1.8	$ (17.1)	$ (5.9)	$ 17.7
Cash from (used in) operating activities	**$ (107.1)**	**$ 201.1**	**$ 369.9**	**$ 72.2**	$ 156.6	$ 127.1	$ 253.6	$ 72.8
Add (deduct):								
Capital additions, net	**$ (140.2)**	**$ (117.2)**	**$ (87.6)**	**$ (56.4)**	$ (94.0)	$ (57.5)	$ (61.7)	$ (38.9)
Finance expenses paid	**$ (8.2)**	**$ (4.1)**	**$ (7.3)**	**$ (3.7)**	$ (6.7)	$ (4.8)	$ (6.4)	$ (3.2)
Distributions paid to non-controlling interests	**$ (68.6)**	**$ (2.1)**	**$ (2.0)**	**$ (1.8)**	$ (1.8)	$ (2.2)	$ (2.2)	$ (3.8)
Repayment of long-term debt	**$ (0.1)**	**$ (0.1)**	**$ (0.1)**	**$ (0.1)**	$ (50.1)	$ (0.1)	$ (0.1)	$ -
Share purchases	**$ (24.3)**	**$ (60.0)**	**$ -**	**$ (4.2)**	$ (12.0)	$ (75.0)	$ -	$ -
Proceeds received from sale of Anthony EACOM Inc. [29]	**$ -**	**$ -**	**$ -**	**$ -**	$ 13.1	$ 1.4	$ 1.2	$ 5.4
Acquisitions	**$ -**	**$ -**	**$ -**	**$ -**	$ (3.6)	$ -	$ (14.4)	$ (41.8)
Proceeds from long-term debt, net	**$ -**	**$ -**	**$ -**	**$ -**	$ 4.3	$ -	$ -	$ 1.7
Proceeds received from sale of Lakeland Winton[30]	**$ -**	**$ -**	**$ -**	**$ -**	$ -	$ -	$ 15.0	$ -
Foreign exchange gain (loss) on cash and cash equivalents	**$ 7.1**	**$ (1.8)**	**$ 1.9**	**$ 1.4**	$ 0.1	$ (2.5)	$ (2.0)	$ (0.1)
Other, net[31]	**$ 2.8**	**$ 2.7**	**$ 1.9**	**$ 0.5**	$ 3.5	$ (10.5)	$ (4.3)	$ 3.5
Change in cash / operating loans	**$ (338.6)**	**$ 18.5**	**$ 276.7**	**$ 7.9**	$ 9.4	$ (24.1)	$ 178.7	$ (4.4)

[26] Decrease in Unallocated and Other in 2018 largely attributable to lower legal costs and BCTLC dues related to the expiry of the Softwood Lumber Agreement.
[27] Amortization includes amortization of certain capitalized major maintenance costs.
[28] Adjusted to true-up anti-dumping duty deposits to the Company's current accrual rates.
[29] On March 31, 2017, Canfor sold its 50% interest in Anthony EACOM Inc. for net proceeds of $21.1 million and recognized a $3.7 million net gain.
[30] On July 1, 2015 Canfor sold its 33.3% interest in Lakeland Mills Ltd. and Winton Global Lumber Ltd for consideration of $30.0 million. The first installment of $15.0 million was received on July 1, 2015, and the second installment for $15.0 million was received in the second quarter of 2017.
[31] Further information on operating cash flows can be found in the Company's annual consolidated financial statements.

THREE-YEAR COMPARATIVE REVIEW

(millions of Canadian dollars, except per share amounts)	2018	2017	2016
Sales	**$ 5,044.4**	$ 4,563.3	$ 4,234.9
Net income	**$ 439.0**	$ 393.6	$ 203.9
Shareholder net income	**$ 354.9**	$ 345.4	$ 150.9
Total assets	**$ 3,845.1**	$ 3,488.3	$ 3,277.1
Term debt	**$ 408.4**	$ 385.7	$ 448.0
Shareholder net income per share, basic and diluted	**$ 2.78**	$ 2.63	$ 1.14

FOURTH QUARTER RESULTS

Overview of Operating Results

The Company reported a shareholder net loss for the fourth quarter of 2018 of $52.4 million, or $0.42 per share, compared to shareholder net income of $125.3 million, or $0.98 per share, for the third quarter of 2018 and shareholder net income of $131.8 million, or $1.02 per share, for the fourth quarter of 2017.

For the fourth quarter of 2018, the Company reported an operating loss of $79.1 million, down $280.9 million from reported operating income of $201.8 million for the third quarter of 2018, and down $293.3 million from reported operating income of $214.2 million for the fourth quarter of 2017.

Reported results for the fourth quarter of 2018 include a net duty expense of $39.9 million, at a current cumulative effective countervailing duty ("CVD") and anti-dumping duty ("ADD") rate of 16.14%, compared to $42.6 million reported in the third quarter of 2018 and a net duty recovery of $23.4 million reported in the fourth quarter of 2017. Reported results in the fourth quarter of 2018 also include a $36.7 million inventory valuation adjustment, representing the excess of the carrying cost of year-end lumber and log inventory over net realizable value. After adjusting for the aforementioned items, the Company's operating loss was $2.5 million for the fourth quarter of 2018, down $246.9 million from similarly adjusted operating income in the third quarter of 2018, and down $193.3 million from similarly adjusted operating income in the fourth quarter of 2017.

An overview of the results by business segment for the fourth quarter of 2018 compared to the third quarter of 2018 and fourth quarter of 2017 follows.

Lumber

Selected Financial Information and Statistics – Lumber

Summarized results for the Lumber segment for the fourth quarter of 2018, third quarter of 2018 and fourth quarter of 2017 were as follows:

(millions of Canadian dollars, unless otherwise noted)	**Q4 2018**	Q3 2018	Q4 2017
Sales	**$ 738.4**	$ 994.9	$ 833.1
Operating income (loss) before amortization	**$ (38.2)**	$ 196.7	$ 200.1
Operating income (loss)	**$ (87.7)**	$ 148.9	$ 154.9
Countervailing and anti-dumping duty deposits, net of recovery[32]	**$ 39.9**	$ 42.6	$ (23.4)
Inventory valuation adjustment[33]	**$ 36.7**	$ -	$ -
Adjusted operating income (loss)	**$ (11.1)**	$ 191.5	$ 131.5
Average SPF 2x4 #2 & Btr lumber price in US$[34]	**$ 327**	$ 482	$ 462
Average SPF 2x4 #2 & Btr lumber price in Cdn$[34]	**$ 432**	$ 630	$ 588
Average SYP 2x4 #2 lumber price in US$[35]	**$ 457**	$ 488	$ 455
US housing starts (thousand units SAAR)[36]	**1,237**	1,234	1,259
Production – SPF lumber (MMfbm)[37]	**793.0**	921.8	903.4
Production – SYP lumber (MMfbm)[37]	**334.4**	353.6	335.4
Shipments – SPF lumber (MMfbm)[38]	**782.8**	933.8	911.0
Shipments – SYP lumber (MMfbm)[38]	**330.9**	357.5	327.5

32 Adjusted for countervailing and anti-dumping duty deposits expensed for accounting purposes in the fourth and third quarter of 2018 and a recovery in the fourth quarter of 2017 to true-up the preliminary anti-dumping duties to the estimated countervailing and anti-dumping duty rate based on the Company's sales and cost data.

33 Adjusted for write-down of inventory representing the excess of the carrying cost of year-end lumber and log inventory over its net realizable value.

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

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

36 Source – US Census Bureau, seasonally adjusted annual rate; Updated to November 2018 due to US government shutdown.

37 Excluding production of trim blocks.

38 Canfor-produced lumber, including lumber purchased for remanufacture and excluding trim blocks and wholesale shipments.

Markets

North American lumber consumption was down slightly in the fourth quarter of 2018, in part reflecting waning demand as the quarter progressed. US housing starts, on a seasonally adjusted basis, averaged 1,237,000 units (as at November 2018), in line with the previous quarter but down slightly from the fourth quarter of 2017. Single-family starts were down 4%, while multi-family starts were up 8% compared to the third quarter of 2018. Demand in the repair and remodeling sector continued to be very strong through the fourth quarter of 2018. In Canada, housing starts remained near historical highs, averaging 217,000 units on a seasonally adjusted basis, up 10% from the previous quarter and down 5% from the same period in 2017. Offshore lumber consumption remained solid, with shipments to China increasing in the quarter.

Sales

Sales for the lumber segment for the fourth quarter of 2018 were $738.4 million, compared to $994.9 million for the previous quarter and $833.1 million for the fourth quarter of 2017. The 26% decrease in sales revenue compared to the prior quarter principally reflected substantial declines in Western SPF and SYP unit sales realizations combined with lower shipment volumes. The 11% decrease in sales revenue compared to the fourth quarter of 2017 was primarily due to significantly lower Western SPF benchmark lumber prices in the fourth quarter of 2018 and, to a lesser extent, reduced shipments, offset in part by higher residual revenue in Western Canada.

Total lumber shipments, at 1.11 billion board feet, were 14% lower than the previous quarter, largely due to announced curtailments resulting in lower volumes available for sale, with a higher proportion of volumes sold offshore.

The slowing North American demand coupled with an excess of supply placed significant downward pressure on prices through the fourth quarter; the average benchmark North American Random Lengths Western SPF 2x4 #2&Btr price was down US$155 per Mfbm, or 32%, from the previous quarter, at US$327 per Mfbm, with similar decreases also seen across most Western SPF wider-width dimensions. As a result, Western SPF lumber unit sales realizations were also significantly down quarter-over-quarter, as the sharp declines in benchmark Western SPF lumber prices more than offset the 1 cent, or 1%, weaker Canadian dollar and a higher-value sales mix. SYP lumber unit sales realizations were also materially lower than the prior quarter reflecting increased available supply in the US South region, a 6% decrease in the SYP East 2x4 #2 price, and more pronounced declines in wider SYP dimensions.

Compared to the fourth quarter of 2017, Western SPF lumber unit sales realizations were down significantly as lower US-dollar benchmark lumber prices more than offset the benefit of a 4% weaker Canadian dollar in the current quarter. The average North American Random Lengths Western SPF 2x4 #2&Btr price was down US$135 per Mfbm, or 29%, with similar impacts to wider-width dimensions. SYP lumber unit sales realizations were moderately lower primarily reflecting SYP benchmark lumber price declines. The average North American Random Lengths SYP East 2x4 #2 price was in line with the comparative period, while wider width dimension products saw moderate declines.

Total residual fibre revenue in the current quarter was moderately lower than the previous quarter as higher market-based pricing for sawmill residual chips was offset by lower production-related volumes. Residual revenue was moderately higher than the fourth quarter of 2017, largely reflecting increased market-based chip pricing, tied to higher Canadian NBSK pulp sales realizations. Log sales were notably higher than the third quarter of 2018, primarily reflecting moderately higher sales realizations and increased log sales volume, and were broadly in line with the fourth quarter of 2017.

Operations

Total lumber production, at 1.13 billion board feet, was down 12% from the previous quarter reflecting the impacts of the aforementioned temporary production curtailments at the Company's Western Canada operations, reduced shifts and, to a lesser extent, additional statutory holidays in the current quarter. In addition, inclement weather in the US South impacted log deliveries and log profile, both of which contributed to lower productivity in the current quarter. Total lumber production was down 9% from the fourth quarter of 2017, for the most part reflecting the impacts of the aforementioned reduced production in Western Canada.

Lumber unit manufacturing costs in the fourth quarter of 2018 were moderately higher than the previous quarter, largely reflecting the effects of timing of market-based stumpage increases, log supply and profile shortages, combined with reduced sawmill productivity and production, and, to a lesser extent, seasonally higher energy costs. Log costs in the US South remained in line with the previous quarter. Compared to the fourth quarter of 2017, unit manufacturing costs were significantly higher primarily as a result of market-based stumpage increases in Western Canada combined with substantial increases in purchased wood costs driven by log supply constraints quarter-over-quarter.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[39]

Summarized results for the Pulp and Paper segment for the fourth quarter of 2018, third quarter of 2018 and fourth quarter of 2017 were as follows:

(millions of Canadian dollars, unless otherwise noted)	Q4 2018	Q3 2018	Q4 2017
Sales	**$ 289.7**	$ 328.4	$ 322.9
Operating income before amortization[40]	**$ 36.1**	$ 80.7	$ 85.6
Operating income	**$ 15.6**	$ 60.5	$ 66.8
Average NBSK pulp price delivered to China – US$[41]	**$ 805**	$ 887	$ 863
Average NBSK pulp price delivered to China – Cdn$	**$ 1,062**	$ 1,160	$ 1,098
Production – pulp (000 mt)	**223.9**	285.3	307.6
Production – paper (000 mt)	**35.6**	34.1	35.0
Shipments – pulp (000 mt)	**230.7**	262.4	299.7
Shipments – paper (000 mt)	**32.0**	33.6	35.8

[39] Includes 100% of CPPI, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.
[40] Amortization includes amortization of certain capitalized major maintenance costs.
[41] Per tonne, NBSK pulp price delivered to China (RISI).

Markets

Reflecting weaker demand from China, global softwood pulp market demand was down in the fourth quarter of 2018, with global softwood pulp producer inventory levels remaining above normal through the quarter. US-dollar NBSK pulp list prices to China averaged US$805 per tonne, down 9% from the prior quarter, with prices ending the year at US$725 per tonne. Global softwood pulp producer inventory levels were well above the balanced range at 41 days of supply in December 2018[42], an increase of 8 days from August 2018, for the most part reflecting a sharp decline in demand from China (generally considered balanced when inventories are in the 27-30 days of supply range).

Global shipments of bleached softwood pulp for 2018 declined 3.2%[43] when compared to 2017, largely reflecting the decline in demand and timing of shipments in the latter part of the year.

Global kraft paper markets were steady through the fourth quarter of 2018 following positive pricing and demand momentum in the North American and Asian markets through the first three quarters of 2018.

Sales

Pulp shipments for the fourth quarter of 2018 totalled 230,700 tonnes, down 31,700 tonnes, or 12%, from the previous quarter and down 69,000 tonnes, or 23%, from the fourth quarter of 2017. The decline in pulp shipments versus the previous quarter reflected the impact of the aforementioned downtime, partly offset by a drawdown of pulp inventories through the period. The anticipated benefit of a slipped vessel shipment from the previous quarter into the fourth quarter was offset by a delayed vessel shipment over the year end. Compared to the fourth quarter of 2017, the decrease in pulp shipments was mostly attributable to operational downtime and weaker market demand from China in the latter part of the current quarter.

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

The average US-dollar NBSK pulp list price to China of US$805 per tonne, as published by RISI, was down US$82 per tonne, or 9%, from the third quarter of 2018, and down US$58 per tonne, or 7%, from the fourth quarter of 2017. NBSK pulp unit sales realizations were broadly in line with the prior quarter as the lower US-dollar NBSK pulp list pricing to China was largely offset by higher US-dollar NBSK pulp list pricing to North America through the quarter, up US$51 per tonne (before the effect of discounts), or 4%, as published by RISI, proportionately higher shipments to North America and a 1 cent, or 1%, weaker Canadian dollar. BCTMP US-dollar pricing came under modest downward pressure during the current quarter; however CPPI's sales realizations remained steady quarter-over-quarter reflecting the timing of shipments (versus orders) and a weaker Canadian dollar.

NBSK pulp unit sales realizations were up significantly from the fourth quarter of 2017, principally reflecting the timing of shipments (versus orders) in the fourth quarter of 2017 and a 3 cent, or 4%, weaker Canadian dollar in the current quarter.

Energy revenues were broadly in line with the third quarter of 2018, principally reflecting seasonally higher energy prices offset by reduced power generation at Northwood due to the previously mentioned production downtime in the current quarter. Compared to the fourth quarter of 2017, energy revenues were down substantially, primarily due to reduced power generation largely correlated with the decline in pulp production quarter-over-quarter.

Paper shipments in the fourth quarter of 2018 were 32,000 tonnes, down 1,600 tonnes, or 5%, from the previous quarter and down 3,800 tonnes, or 11% from the fourth quarter of 2017, principally reflecting the timing of shipments quarter-over-quarter. Paper unit sales realizations in the fourth quarter of 2018 were broadly in line with the previous quarter, with lower market-driven US-dollar pricing offsetting a 1% weaker Canadian dollar. Compared to the same quarter of 2017, paper unit sales realizations were up significantly as favourable US-dollar pricing, combined with the weaker Canadian dollar, more than offset higher freight costs.

<u>Operations</u>

Pulp production was down 61,400 tonnes, or 22%, from the previous quarter. This lower production primarily reflected the continuation of the scheduled maintenance outage at Northwood from the previous quarter, the aforementioned recovery boiler extended downtime at Northwood, unscheduled downtime taken as a result of a third-party natural gas pipeline explosion, which impacted CPPI's three NBSK pulp mills, and, to a lesser extent, several other operational challenges during the current quarter. Combined, the scheduled and unscheduled outages impacted NBSK pulp production by approximately 90,000 tonnes. In addition, in late December, CPPI curtailed production at its Taylor BCTMP mill for seven days in light of reduced residual fibre availability resulting from various sawmill curtailments in the region, which impacted BCTMP production by approximately 5,000 tonnes. In the third quarter of 2018, a scheduled maintenance outage at Northwood and ramp up at Taylor following the commissioning of the energy reduction project, reduced pulp production by approximately 30,000 tonnes.

Compared to the fourth quarter of 2017, pulp production was down 83,700 tonnes, or 27%, primarily due to the above noted scheduled and unscheduled outages in the fourth quarter of 2018.

At the end of December, CPPI experienced kiln-related operational disruptions at two of its NBSK pulp mills. While these challenges have now been resolved, the related production loss was approximately 20,000 tonnes early in the first quarter of 2019.

NBSK pulp unit manufacturing costs were up significantly from the previous quarter, in large measure due to reduced productivity in the current quarter as well as higher related maintenance, energy and chemical costs associated with the unscheduled outages. Fibre costs were broadly in line with the third quarter of 2018.

Compared to the fourth quarter of 2017, pulp unit manufacturing costs saw a significant increase, principally due to higher fibre costs, combined with decreased productivity as well as increased maintenance spend and higher energy and chemical costs as a result of the aforementioned downtime. The increased fibre costs in the current quarter, when compared to the same period in the prior year, largely reflected significantly higher market-related prices for sawmill residual and whole log chips.

Paper production for the fourth quarter of 2018 was 35,600 tonnes, up 1,500 tonnes, or 4%, from the prior quarter, and broadly in line with production from the fourth quarter of 2017, principally reflecting a solid operating performance in the current quarter despite unscheduled downtime related to a third-party natural gas explosion near Prince George during the current quarter. Paper unit manufacturing costs were broadly in-line with the third quarter of 2018. Compared to the fourth quarter of 2017, paper unit manufacturing costs showed a significant increase largely due to higher slush pulp costs associated with the increased NBSK pulp sales realizations in the current quarter.

Unallocated and Other Items

(millions of Canadian dollars)		**Q4 2018**		Q3 2018		Q4 2017
Operating loss of Panels operations[44]	**$**	**(0.5)**	$	(0.4)	$	(0.8)
Corporate costs	**$**	**(6.5)**	$	(7.2)	$	(6.7)
Finance expense, net	**$**	**(7.6)**	$	(5.5)	$	(6.9)
Foreign exchange gain (loss) on long-term debt and duties receivable	**$**	**(2.3)**	$	0.9	$	(0.7)
Gain (loss) on derivative financial instruments	**$**	**18.3**	$	(1.6)	$	(6.5)
Other income (expense), net	**$**	**5.4**	$	(4.1)	$	1.5

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

Corporate costs were $6.5 million for the fourth quarter of 2018, down slightly from both comparative periods.

Net finance expense at $7.6 million was up $2.1 million from the previous quarter and up $0.7 million from the fourth quarter of 2017 reflecting higher fees associated with the extension of the Company's credit facilities and, in part, decreased interest income on term deposits in the current quarter. In the fourth quarter of 2018, the Company recognized a foreign exchange loss on its US-dollar term debt held by Canadian entities, offset in part by a gain on US-denominated duties receivable, both due to the weaker Canadian dollar at the end of the quarter compared to the end of September (see further discussion on the term debt financing in the "Liquidity and Financial Requirements" section).

The Company uses a variety of derivative financial instruments to reduce its exposure against unfavourable changes in energy costs, lumber prices, interest rates and foreign exchange rates. During the current quarter, the Company entered into forward foreign exchange contracts to reduce its exposure to fluctuations in the Swedish Krona versus the Canadian and US dollar as a result of the Company's commitment to acquire a 70% interest in VIDA in 2019. In the fourth quarter of 2018, the Company recorded a net gain of $18.3 million related to its derivative instruments, primarily reflecting a mark-to-market gain on its outstanding Swedish Krona forward foreign exchange contracts.

Other income, net of $5.4 million in the fourth quarter of 2018 reflected, in part, foreign exchange gains on US-dollar denominated working capital resulting from the weakening of the Canadian dollar relative to the US-dollar when compared to the end of the third quarter of 2018.

Other Comprehensive Income (Loss)

(millions of Canadian dollars)		**Q4 2018**		Q3 2018		Q4 2017
Defined benefit actuarial gain (loss), net of tax	**$**	**(9.1)**	$	3.0	$	29.7
Foreign exchange translation differences for foreign operations, net of tax		**33.6**		(10.8)		2.6
Other comprehensive income (loss), net of tax	**$**	**24.5**	$	(7.8)	$	32.3

In the fourth quarter of 2018, the Company recorded an after-tax loss of $9.1 million in relation to changes in the valuation of the Company's employee future benefit plans, down $12.1 million from the third quarter of 2018, primarily as a result of lower than anticipated returns on plan assets.

In comparison to the fourth quarter of 2017, the after-tax gain decreased by $38.8 million, largely reflecting the benefit of a 50% reduction in Medical Service Plan ("MSP") premiums realized in the fourth quarter of 2017, following a change in legislation in British Columbia.

During the fourth quarter of 2018, the Company purchased $58.9 million of annuities through its defined benefit plans to mitigate its exposure to the future volatility fluctuations in the related pension obligations. At purchase of these annuities, transaction costs of $3.6 million were recognized in other comprehensive income principally reflecting the difference in the annuity rate as compared to the discount rate used to value the pension obligations on a going concern basis. For more information, see the "Employee Future Benefits" part of the "Critical Accounting Estimates" section later in this report.

In addition, the Company recorded an accounting gain of $33.6 million in the fourth quarter of 2018 related to foreign exchange differences for foreign operations due to the weakening of the Canadian dollar relative to the US-dollar at the end of the quarter. This compared to a loss of $10.8 million in the previous quarter and a gain of $2.6 million in the fourth quarter of 2017.

CHANGES IN FINANCIAL POSITION

At the end of 2018, Canfor had $252.7 million of cash and cash equivalents.

(millions of Canadian dollars)	Q4 2018	Q3 2018	Q4 2017
Cash generated from (used in)			
Operating activities	**$ (107.1)**	$ 201.1	$ 156.6
Financing activities	**$ (101.2)**	$ (66.3)	$ (65.8)
Investing activities	**$ (137.4)**	$ (114.5)	$ (81.5)
Increase (decrease) in cash and cash equivalents[45]	**$ (345.7)**	$ 20.3	$ 9.3

[45] Increase (decrease) in cash and cash equivalents shown before foreign exchange translation on cash and cash equivalents.

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

Operating Activities

Cash used in operating activities was $107.1 million in the fourth quarter of 2018, compared to cash generated of $201.1 million in the previous quarter and $156.6 million in the fourth quarter of 2017. The decrease in operating cash flows from the previous quarter primarily reflected a decline in operating cash earnings in the current quarter, combined with higher investments in working capital, driven by seasonally higher log inventories and increased lumber inventories. Cash duty deposits paid in the current quarter of 2018 were $29.7 million, compared to $55.5 million in the prior quarter and $21.5 million in the same quarter of 2017.

Compared to the fourth quarter of 2017, operating cash flows were down $263.7 million reflecting a decrease in cash earnings quarter-over-quarter and accelerated income tax payments in the current quarter.

Financing Activities

Cash used in financing activities was $101.2 million in the current quarter, compared to cash used of $66.3 million in the previous quarter and cash used of $65.8 million in the fourth quarter of 2017. During the current quarter, the Company made cash distributions of $68.6 million to non-controlling shareholders, up $66.5 million from with the previous quarter and up $66.8 million from the fourth quarter of 2017, reflecting a special dividend of $2.25 per common share paid by CPPI on November 13, 2018, as a result of strong cash generated by the pulp business over 2017 and 2018. In the fourth quarter of 2017 CPPI made an early repayment of its $50.0 million term debt. The Company had no balance outstanding on its operating loan facilities at the end of the fourth quarter of 2018, consistent with the prior quarter and the fourth quarter of 2017.

Cash used for financing activities also included share purchases under Canfor's Normal Course Issuer Bid. In the fourth quarter of 2018, Canfor purchased 1,123,490 common shares for $20.6 million (an average of $18.33 per share) and paid $3.7 million relating to shares purchased in the prior quarter. In the third quarter of 2018, Canfor purchased 2,282,590 common shares for $63.7 million (an average of $27.91 per share). In the fourth quarter of 2017, Canfor purchased 633,176 common shares for $15.7 million (an average of $24.80 per share). See further discussion of the shares purchased under the Normal Course Issuer Bid in the following "Liquidity and Financial Requirements" section.

Investing Activities

Cash used for investing activities was $137.4 million in the current quarter, compared to $114.5 million in the previous quarter and $81.5 million in the same quarter of 2017. Capital additions were $140.2 million, up $23.0 million from the previous quarter and up $46.2 million from the fourth quarter of 2017. Current quarter capital expenditures included various smaller high-returning capital projects aimed at increasing drying capacity and productivity, in combination with more significant upgrades at the Company's sawmills in Georgia and Alabama. In the pulp and paper segment, capital expenditures primarily related to several capital projects including the aforementioned energy project at CPPI's Northwood NBSK pulp mill as well as CPPI's ongoing development of a new ERP software system. Investing activities in the fourth quarter of 2017 included final proceeds of $13.1 million related to the March 2017 sale of the Company's 50% investment in Anthony EACOM Inc., and a final payment of $3.6 million related to the Company's acquisition of Wynndel.

SPECIFIC ITEMS AFFECTING COMPARABILITY

Specific Items Affecting Comparability of Shareholder Net Income (Loss)

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

After-tax impact, net of non-controlling interests

(millions of Canadian dollars, except for per share amounts)	Q4 2018	Q3 2018	Q2 2018	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017
Shareholder net income (loss), as reported	**$ (52.4)**	**$ 125.3**	**$ 169.8**	**$ 112.2**	$ 131.8	$ 66.2	$ 81.3	$ 66.1
Foreign exchange (gain) loss on long-term debt	**$ 2.1**	**$ (0.7)**	**$ 1.0**	**$ 1.9**	$ 0.6	$ (4.4)	$ (2.9)	$ (1.0)
Countervailing and anti-dumping duty deposits, net of accrued recovery[46]	**$ 28.8**	**$ 31.1**	**$ 37.7**	**$ 25.5**	(17.3)	$ 23.8	$ 26.3	$ -
(Gain) loss on derivative financial instruments[47]	**$ (6.5)**	**$ 1.2**	**$ 5.6**	**$ 5.8**	$ 4.8	$ 1.4	$ -	$ (2.4)
Change in substantively enacted tax rates[48]	**$ -**	**$ -**	**$ -**	**$ -**	$ (5.1)	$ -	$ -	$ -
Mill closure provisions [49]	**$ -**	**$ -**	**$ -**	**$ -**	$ -	$ (2.4)	$ -	$ -
Gain on sale of Anthony EACOM Inc. [50]	**$ -**	**$ -**	**$ -**	**$ -**	-	$ -	$ -	$ (3.4)
Net impact of above items	**$ 24.4**	**$ 31.6**	**$ 44.3**	**$ 33.2**	$ (17.0)	$ 18.4	$ 23.4	$ (6.8)
Adjusted shareholder net income (loss)	**$ (28.0)**	**$ 156.9**	**$ 214.1**	**$ 145.4**	$ 114.8	$ 84.6	$ 104.7	$ 59.3
Shareholder net income (loss) per share (EPS), as reported	**$ (0.42)**	**$ 0.98**	**$ 1.32**	**$ 0.87**	$ 1.02	$ 0.51	$ 0.61	$ 0.50
Net impact of above items per share[51]	**$ 0.19**	**$ 0.25**	**$ 0.34**	**$ 0.26**	$ (0.13)	$ 0.14	$ 0.18	$ (0.05)
Adjusted net income (loss)per share[51]	**$ (0.23)**	**$ 1.23**	**$ 1.66**	**$ 1.13**	$ 0.89	$ 0.65	$ 0.78	$ 0.45

[46] Adjusted for countervailing and anti-dumping duty deposits expensed for accounting purposes.
[47] The Company entered into Swedish Krona forward foreign exchange contracts in November 2018 and recorded a mark-to-market gain of $18.8 million in the fourth quarter of 2018, which was offset by realized and unrealized losses of $0.5 million on lumber and energy future sales contracts.
[48] During the fourth quarter of 2017, the Company recorded a $5.1 million decrease, net of minority interest, in deferred tax balances as a result of legislative changes in both Canada and the US.
[49] In the third quarter of 2017, $3.2 million (before-tax) of the closure provision related to Canal Flats sawmill was reversed.
[50] On March 31, 2017, Canfor sold its 50% interest in Anthony EACOM Inc. for net proceeds of $21.1 million and recognized a $3.7 million net gain (before-tax).
[51] The year-to-date net impact of the adjusting items per share and adjusted 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.

OUTLOOK

Lumber Markets

On January 30, 2019, the Company announced additional temporary curtailments at three of its British Columbia sawmills, which will further reduce production volumes by approximately 40 million board feet, for an estimated total impact on production of 95 million board feet in the first quarter of 2019.

Looking further ahead, the US housing market is currently forecast to show a modest recovery through 2019, while the repair and remodeling sector in the US is projected to record solid growth. North American lumber prices are anticipated to improve through the first quarter of 2019 primarily reflecting low inventories in the supply chain as a result of production curtailments and seasonally stronger demand during the traditionally busy spring building season. For the Company's key offshore lumber markets, demand is anticipated to remain solid through the first quarter of 2019. Prices in Europe are projected to be more stable reflecting solid demand in that region. Results through 2019 are anticipated to be impacted by continued log cost pressure in Western Canada as a result of ongoing log supply constraints.

Pulp and Paper Markets

Notwithstanding high inventory levels, global softwood kraft pulp markets are projected to be steady through the first half of 2019, reflecting an anticipated pick-up in demand from China and reduced supply during the traditional spring maintenance period. The BCTMP market is projected to be steady in the first half of 2019.

CPPI has no maintenance outages planned for the first quarter of 2019. Maintenance outages are currently planned at the Intercontinental NBSK pulp mill in the second quarter of 2019 with a projected 12,000 tonnes of reduced NBSK pulp production. Additional maintenance outages are scheduled at the Prince George NBSK pulp mill and the Taylor BCTMP mill in the third and fourth quarters of 2019 with a projected 6,000 tonnes of reduced NBSK pulp production and projected 5,000 tonnes of reduced BCTMP production, respectively. No scheduled maintenance outages are planned for CPPI's Northwood NBSK pulp mill in 2019.

Bleached kraft paper demand is expected to remain solid through the first quarter of 2019. A maintenance outage is currently planned at CPPI's paper machine during the third quarter of 2019 with a projected 4,000 tonnes of reduced paper production.

CRITICAL ACCOUNTING ESTIMATES

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

Employee Future Benefits

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

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

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

	December 31, 2018		December 31, 2017	
	Defined Benefit Pension Plans	**Other Benefit Plans**	Defined Benefit Pension Plans	Other Benefit Plans
Discount rate	**3.6%**	**3.6%**	3.4%	3.4%
Rate of compensation increases	**3.0%**	**n/a**	3.0%	n/a
Initial medical cost trend rate	**n/a**	**5.5%**	n/a	6.5%
Ultimate medical cost trend rate	**n/a**	**4.5%**	n/a	4.5%
Year ultimate rate is reached	**n/a**	**2022**	n/a	2022

In addition to the significant assumptions listed in the table above, the average life expectancy of a 65-year-old at December 31, 2018 is between 21.1 years and 24.2 years (2017 - 21.0 years and 24.1 years). As at December 31, 2018, the weighted average duration of the defined benefit obligation, which reflects the average age of the plan members, is 12.0 years (2017 - 12.3 years). The weighted average duration of the other benefit plans is 13.3 years (2017 - 14.2 years).

Assumed discount rates and medical cost trend rates have a significant effect on the accrued benefit obligation and related plan assets. A one percentage point change in these assumptions would have the following effects on the accrued retirement benefit obligation, taking into account the hedging impact of plan annuity assets, for 2018:

(millions of Canadian dollars)	1% Increase	1% Decrease
Defined benefit pension plan liabilities, net of annuity assets		
Discount rate	$ (48.0)	$ 59.0
Other benefit plan liabilities		
Discount rate	$ (13.1)	$ 16.1
Initial medical cost trend rate	$ 8.5	$ (7.6)

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

Deferred Reforestation

Canfor accrues an estimate of its future liability to perform forestry activities, defined to mean those silviculture treatments or activities that are carried out to ensure the establishment of a free-growing stand of young trees, including logging road rehabilitation on its forestry tenures in BC and Alberta. An estimate is recorded in the financial statements based on the number of hectares of timber harvested in the period and the estimated costs of fulfilling Canfor's obligation. Payments in relation to reforestation are expected to occur over periods of up to 15 years (the significant majority occurring in the first seven years) and have been discounted accordingly at risk-free rates ranging from 1.9% to 2.1%. The actual costs that will be incurred in the future may vary based on, among other things, the actual costs at the time of silviculture activities.

Deferred Taxes

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

Asset Retirement Obligations

Canfor records the estimated fair value of a liability for asset retirement obligations, such as landfill closures, in the period when it is incurred. For landfill closure costs, the fair value is determined using estimated closure costs discounted over the estimated useful life. Payments relating to landfill closure costs are expected to occur at periods ranging from 1 to 33 years and have been discounted at risk-free rates ranging from 1.9% to 2.2%. The actual closure costs and periods of payment may differ from the estimates used in determining the year-end liability. On initial recognition, the fair value of the liability is added to the carrying amount of the associated asset and amortized over its useful life. The liability is accreted over time through charges to earnings and reduced by actual costs of settlement.

Environmental Remediation Costs

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

Impairment of Goodwill

Goodwill, which is the excess of the cost of an acquisition over the fair value of the net identifiable assets acquired, is not amortized, but is assessed annually for impairment or more frequently if events or circumstances indicate that it may be impaired.

An impairment loss is recognized in net income at the amount that the carrying value, including goodwill, of the relevant operating division exceeds its recoverable amount. The recoverable amount is the higher of the unit's fair value less costs to sell and value in use. For Canfor's goodwill (which is allocated to the lumber segment), the recoverable amount of the relevant assets is determined by estimating the future expected discounted cash flows of the unit as a whole on an annual basis, and more often if required. As part of this process, assumptions are made in relation to forecast product prices and exchange rates. Price forecasts are determined with management estimates. Other significant assumptions include the discount rate. For 2018, a pre-tax discount rate of 8%, based on the Company's current weighted average cost of capital and US denominated risk-adjusted internal borrowing rate, has been used in its goodwill assessment. The net present value of the future expected cash flows is compared to the carrying value of the Company's investment in these assets, including goodwill, at year end.

Based upon the analysis performed in 2018, the net present value of the estimated discounted future cash flows exceeded the carrying value of each of the cash generating units tested for impairment, and therefore no impairments to goodwill were required. If actual results are materially lower than the forecast assumptions, there is a possibility that an impairment of goodwill may be required in future periods.

Valuation of Log and Finished Product Inventories

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

FUTURE CHANGES IN ACCOUNTING POLICIES

In January 2016, the IASB issued IFRS 16, *Leases*, which will supersede IAS 17 Leases and related interpretations. The required adoption date for IFRS 16 is January 1, 2019. IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognizes a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. In addition, the nature of expenses related to those leases will change as IFRS 16 replaces straight-line operating lease expense with an amortization expense for right-of-use assets and interest expense on lease liabilities.

IFRS 16 may be applied retrospectively to each prior period presented (full retrospective approach), or with the cumulative effect of adoption recognized at initial application (modified retrospective approach). The Company has elected to apply the modified retrospective approach upon adoption at January 1, 2019, measuring the right-of-use asset at its carrying amount had the standard been applied at commencement of the lease. The short-term and low-value recognition exemptions available under the standard will be utilized, along with certain practical expedients.

Based on lease data as at December 31, 2018, IFRS 16 is estimated to have the following financial statement impact on the Company's consolidated balance sheet at transition on January 1, 2019, with no material impact to 2019 net income:

(millions of Canadian dollars)			As at January 1, 2019
Right-of-use asset, net of accumulated amortization	Increase in assets	$	42.2
Lease obligation	Increase in liabilities		44.3
Deferred income tax	Decrease in liabilities		0.5
Retained earnings	Decrease in equity		1.6

The full quantification of the new standard will be disclosed in the condensed consolidated interim financial statements for the first quarter of 2019.

RISKS AND UNCERTAINTIES

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

Indigenous Relations

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

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

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

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

Capital Requirements

The forest products industry is capital intensive, and the Company regularly incurs capital expenditures to expand its operations, maintain its equipment, increase its operating efficiency and comply with environmental laws. The Company's total capital expenditures during 2018 were $401.4 million. The Company anticipates available cash resources and cash generated from operations will be sufficient to fund its operating needs and capital expenditures in the foreseeable future.

Climate Change

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

Competitive Markets

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

Currency Exchange Risk

The Company's operating results are sensitive to fluctuations in the exchange rate of the Canadian dollar to the US-dollar, as prices for the Company's products are denominated in US-dollars or linked to prices quoted in US-dollars. Therefore, an increase in the value of the Canadian dollar relative to the US-dollar reduces the amount of revenue in Canadian dollar terms realized by the Company from sales made in US-dollars, which in turn, reduces the Company's operating margin and the cash flow available. Following the planned acquisition of VIDA in the first half of 2019, the Company's operating results will also be sensitive to fluctuations of the Canadian dollar to the Swedish Krona.

Cyclicality of Product Prices

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

Employee Future Benefits

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

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

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

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

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

For Canfor's pension benefit plans, a one percentage point increase in the discount rate used in calculating the actuarial estimate of future liabilities would reduce the accrued benefit obligation, net of annuity assets, by an estimated $48.0 million and a one percentage point decrease in the discount rate would increase the accrued benefit obligation, net of annuity assets, by an estimated $59.0 million. These changes would only impact the Company's funding requirements in years where a new actuarial funding valuation was performed and regulatory approval for a change in funding contributions was obtained.

Environmental Issues

Canfor's operations are subject to environmental regulation by federal, provincial, state and local authorities, including specific environmental regulations relating to air emissions and pollutants, wastewater (effluent) discharges, solid waste, landfill operations, forestry practices, site remediation and the protection of endangered species and critical habitat. Canfor has incurred, and will continue to incur, capital expenditures and operating costs to comply with environmental laws and regulations. No assurance can be given that changes in these laws and regulations or their application will not have a material adverse effect on Canfor's business, operations, financial condition and operational results. Similarly, no assurance can be given that capital expenditures necessary for future compliance with existing and new environmental laws and regulations could be financed from Canfor's available cash flow. In addition, Canfor may discover currently unknown environmental issues, contamination, or conditions relating to historical or present operations. This may require site or other remediation costs to maintain compliance or remedy issues or result in governmental or private claims for damage to person, property or the environment, which could have a material adverse effect on Canfor's business, financial condition and operational results.

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

Canfor has in place internal policies and procedures under which all its forestry and manufacturing operations are regularly audited for compliance with laws and accepted standards and with its environmental management system requirements. CPPI's pulp mills and Canfor's woodlands operations and wood product facilities employ environmental management systems and the pulp mills are certified under the ISO 14001 Environmental Management System Standard. Further, approximately 99% of Canfor's forest tenures in Canada are third-party certified to the Canadian Standards Association ("CSA"), the Forest Stewardship Council ("FSC") or the Sustainable Forestry Initiative ("SFI") sustainable forest management standards. Canfor's operations and its ability to sell its products could be adversely affected if those operations did not, or were perceived by the public as failing to, comply with applicable laws and standards, and following responsible environmental and sustainable forest management practices. Further discussion of environmental issues is included in the Company's Annual Information Form, incorporated by reference herein.

Fibre Cost and Availability

The Company's fibre costs are affected by a number of different factors which could have a significant impact on operating results. Lumber market fluctuations and log market speculative bidding each play a significant role in both fibre supply and costs. In Western Canada, in areas where the amount of pine left to be salvaged as a result of the MPB infestation has significantly declined (i.e. shelf-life has been reached), harvesting is transitioning back to traditional harvesting patterns and operating areas (See "Forest Health" below for more commentary regarding MPB). While this shift out of the MPB stands has the benefit of improving the quality of fibre and in some cases may also provide relief in the form of reduced harvesting costs, it will also result in increased log transportation, road construction and reforestation costs. The current log supply and demand factors will dictate timber auction and log market behavior and, in the shorter term, until existing manufacturing capacity is rationalized to match available log supply, Canfor expects to see this also contributing to higher log costs in Western Canada in the near future. In addition, the Company's ability to harvest fibre for use in its operations could be adversely impacted by natural events such as forest fires, severe weather conditions or insect infestations. In the event that sufficient volumes of economically viable fibre cannot be provided to an operation, it may be necessary to close that operation for a period of time, or even permanently. Such closures could result in significant costs to the Company. The Company is not insured for loss of standing timber. Canfor has secured its fibre position in Western Canada relative to its existing sawmill capacity and no shortage of supply is anticipated at any of the Company's operations at this time.

Financial Risk Management and Earnings Sensitivities

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

Financial Risk Management

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

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

(a) Credit risk:

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

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

Canfor utilizes credit insurance to mitigate the risk associated with some of its trade accounts receivables. As at December 31, 2018, approximately 46% of the outstanding trade accounts receivables are covered by credit insurance. Canfor's trade accounts receivable balance at December 31, 2018 is $186.5 million before a loss allowance of $4.4 million. At December 31, 2018, approximately 98% of the trade accounts receivable balance are within Canfor's established credit terms.

(b) Liquidity risk:

Liquidity risk is the risk that Canfor will be unable to meet its financial obligations as they come due. Canfor manages liquidity risk through regular cash flow forecasting in conjunction with an adequate committed operating loan facility.

At December 31, 2018, Canfor had no amount drawn on its operating loans, and accounts payable and accrued liabilities of $458.9 million, all of which are due within twelve months of the balance sheet date.

(c) Market risk:

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

(i) *Interest Rate risk*:

Canfor is exposed to interest rate risk through its current financial assets and financial obligations bearing variable interest rates.

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

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

(ii) *Currency risk:*

Canfor is exposed to foreign exchange risk primarily related to the US-dollar, as Canfor's products are sold principally in US-dollars. In addition, Canfor holds financial assets and liabilities primarily related to its US entities in US-dollars.

A portion of the currency risk associated with US-dollar denominated sales is naturally offset by US-dollar denominated expenses. A portion of the remaining exposure is sometimes reduced by foreign exchange collar contracts that effectively limit the minimum and maximum Canadian dollar recovery related to the sale of those US-dollars (see "Derivative Financial Instruments" section later in this document).

Canfor is also subject to Swedish Krona foreign exchange risk associated with the commitment to purchase VIDA in the first half of 2019. In order to reduce its exposure to fluctuations in the Swedish Krona versus the Canadian and US dollar, Canfor entered into forward foreign exchange contracts in 2018 (see "Liquidity and Financial Requirements" section and see "Derivative Financial Instruments" section later in this document).

(iii) *Commodity price risk:*

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

(iv) *Energy price risk:*

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

The annual exposure may be hedged up to 100% through the use of floating to fixed swap contracts or option contracts with maturity dates up to a maximum of three years. In the case of diesel, Canfor uses Brent oil and WTI oil contracts to hedge its exposure (see "Derivative Financial Instruments" section later in this document).

Derivative Financial Instruments

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

Earnings Sensitivities

Estimates of the sensitivity of Canfor's pre-tax results to currency fluctuations and prices for its principal products, based on 2019 forecast production and year end foreign exchange rates, are set out in the following table:

(millions of Canadian dollars)	**Impact on annual pre-tax earnings**
SPF lumber – US$10 change per Mfbm[52, 53]	$ 40
SYP lumber – US$10 change per Mfbm[52, 53]	$ 16
Softwood Lumber Duties – 5% change	$ 40
Pulp – US$10 change per tonne[54, 55]	$ 13
Canadian dollar – US$0.01 change per Canadian dollar[54, 55]	$ 24

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

Forest Health

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

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

In response to more recent MPB activity, some management units have seen temporary increases in the annual allowable harvest rates. This includes Tree Farm License 30 in the Prince George region (25% increase for up to 10 years), Mackenzie TSA (48% increase for up to 10 years) and Tree Farm License 48 in the Chetwynd area (72% increase for 5 years). Some Northern Alberta harvest rates have been temporarily increased to deal with the rising MPB infestation and additional temporary increases could be made for the same reason in other areas of the province. The significant AAC increase approved for the quota area has maximized the opportunity to harvest infected pine stands before significant reduction in log quality occurs. In addition, the Alberta Government has committed funds for the rehabilitation of dead pine stands that have not been harvested due to merchantability limitations.

The recent outbreak of spruce beetle in the Mackenzie TSA and northeastern portion of the Prince George TSA has caused Canfor to shift its harvesting into stands under imminent threat or of high susceptibility to beetle infestation. Canfor is working collaboratively with other forest companies and with local and Provincial Government agencies to develop planning and harvesting tactics and strategies to arrest the spread and limit the damage caused by this pest. At this time Canfor has sufficient capacity to handle the outbreak within its operating areas and has offered its assistance to neighbouring operators who lack the capacity to address the issue.

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

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

Government and Other Regulations

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

Information Technology

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

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

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

Labour Agreements and Competition for Professional Skilled Labour

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

Canfor's collective agreements with the United Steelworkers ("USW") expired on June 30, 2018. The Company is encouraged that a Memorandum of Agreement ("MOA") for a new five-year term has been reached with the USW. The MOA includes seven of Canfor's certified mills in BC. The USW will be conducting ratification votes on the MOA during the first quarter of 2019.

In addition, Canfor has three mills represented in the negotiation process being led by the Interior Forest Labour Relations Association ("IFLRA"). Canfor remains optimistic that a settlement will be reached between the IFLRA and the USW.

The new collective agreements may result in increased operating costs because of higher wages or benefits paid to unionized workers. Continuation of the negotiations could result in rotating strikes or work stoppage by the affected workers. For all operations regional labour market conditions may cause shortages of both professional and skilled labour, which could have an adverse impact on the operation and management of Canfor's facilities.

The Company's collective agreement with the PPWC (Public and Private Workers of Canada) at its Mackenzie lumber operation expires June 30, 2019.

Maintenance Obligations and Facility Disruptions

Canfor's manufacturing processes are vulnerable to operational problems that could impair its ability to manufacture its products. Canfor could experience a breakdown in any of its machines, or other important equipment, and from time to time, planned or unplanned maintenance outages that cannot be performed safely or efficiently during operations must be conducted. Such disruptions could cause a significant loss of production, which could have a material adverse effect on Canfor's business, financial condition and operating results.

Residual Fibre Revenues

Wood chips are a residual product of Canfor's lumber manufacturing process and are primarily sold to CPPI. These chips are the principal raw material utilized by CPPI in its pulp manufacturing operations. Canfor has two Fibre Supply Agreements with CPPI, which contain pricing formulas that currently result in CPPI paying Canfor a price for wood chips based on pulp markets and CPPI's product mix. In 2018, Canfor provided approximately 66% of CPPI's chip requirements. If market conditions caused CPPI to cease pulp operations for an extended period of time, Canfor would have a limited market and/or reduced value for its chip supply and this could affect its ability to run its sawmills economically. Similarly, if lumber market conditions or fibre availability were such that Canfor or other suppliers were unable to provide the current volume of chips to CPPI as a result of AAC reductions, lower sawmill production or sawmill closures, whether temporary or permanent, CPPI's chip supply, chip cost and production results could be materially affected.

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

Sales of sawdust and shavings are made primarily to other customers and the demand is increasing and robust. To enhance fibre utilization in northern BC, Canfor completed the construction and since 2016, has been operating two new wood fuel pellet plants in the BC Interior.

Softwood Lumber Agreement

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

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

Final countervailing and anti-dumping duty determinations were announced by the DOC on November 2, 2017, while the ITC issued an affirmative determination of injury on December 7, 2017. As a result, Canfor was issued a final ADD rate of 7.28% (after taking account of ministerial errors) effective November 8, 2017 and was subject to countervailing duties on Canadian lumber exports destined to the US at a reduced rate of 13.24%, effective December 28, 2017. Notwithstanding the final rates established in the DOC's investigation, the final liability for the assessment of CVD and ADD will not be determined until an official administrative review of the respective period is complete. For the CVD rate, the first Administrative Review is anticipated to be based on sales and cost data through 2017 and 2018, with the ADD rate expected to be based off data from July 2017 to December 2018. These two CVD and ADD Administrative Reviews are currently anticipated to be completed in 2020.

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

Species at Risk

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

In May 2018, the federal Minister of Environment and Climate Change Canada determined that 10 Local Population Units of Southern Mountain Caribou (essentially a collection of contiguous herds) were at imminent threat of recovery of the species. Under SARA, the Minister must now recommend to the Governor in Council (Cabinet) that an emergency order be levied. It remains uncertain of both the scope and locations of activities that will be recommended for prohibition as well as if the Cabinet will accept or modify those recommendations.

Canada and British Columbia are seeking to strike a bilateral SARA Section 11 conservation agreement, whilst simultaneously engaging with two local First Nations to develop a caribou conservation plan in the South Peace area. Those negotiations are ongoing, and it remains uncertain precisely what the final outcomes and subsequent impacts will be; however, it is anticipated that portions of the timber harvesting land base (THLB) will be protected in a way that will preclude timber harvesting and related activities and that this will eventually result in a reduction of Allowable Annual Cut in the affected management units.

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

Stumpage Rates

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

The BC Government is scheduled to make its next annual update to the MPS on July 1, 2019. Further changes to the BC Interior market driven stumpage system and resultant stumpage rates could have a material impact on Canfor's business. The Alberta Government will be reviewing their provincial stumpage rates (timber dues); however, the Company is not aware of any planned changes at this point in time.

Transportation Services

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

Wood Dust Management

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

OUTSTANDING SHARE DATA

At February 21, 2019, there were 125,219,400 common shares issued and outstanding.

DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Board of Directors and the Audit Committee. The Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have evaluated the effectiveness of these disclosure controls and procedures for the year ended December 31, 2018 and have concluded that they are effective.

The CEO and CFO acknowledge responsibility for the design of ICFR and confirm that there were no changes in these controls that occurred during the year ended December 31, 2018, which materially affected, or are reasonably likely to materially affect, the Company's ICFR. Based upon their evaluation of these controls for the year ended December 31, 2018, the CEO and CFO have concluded that these controls are operating effectively.

During the year ended December 31, 2018, the Company successfully completed the implementation of a new general ledger system across all of its divisions and locations. The Company's internal controls were maintained or supplemented by controls added during this system implementation and related process improvements.

Additional information about the Company, including its 2018 Annual Information Form, is available at www.sedar.com or at www.canfor.com.

CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT'S RESPONSIBILITY

The information and representations in these consolidated financial statements are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements were prepared by management in accordance with International Financial Reporting Standards and, where necessary, reflect management's best estimates and judgments at this time. It is reasonably possible that circumstances may arise which cause actual results to differ.

Canfor Corporation maintains systems of internal controls over financial reporting, policies and procedures to provide reasonable assurance as to the reliability of the financial records and the safeguarding of its assets.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out these activities primarily through its Audit Committee.

The Audit Committee is comprised of four Directors who are not employees of the Company. The Audit Committee meets periodically throughout the year with management, external auditors and internal auditors to review their respective responsibilities, results of the reviews of internal controls over financial reporting, policies and procedures and financial reporting matters. The external and internal auditors meet separately with the Audit Committee.

The consolidated financial statements have been reviewed by the Audit Committee and approved by the Board of Directors. The consolidated financial statements have been audited by KPMG LLP, the external auditors, whose report follows.

February 21, 2019

Don B. Kayne	Alan Nicholl
President and Chief Executive Officer	Chief Financial Officer

KPMG LLP
PO Box 10426 777 Dunsmuir Street
Vancouver BC V7Y 1K3
Canada
Telephone (604) 691-3000
Fax (604) 691-3031

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Canfor Corporation

Opinion

We have audited the consolidated financial statements of Canfor Corporation (the "Company"), which comprise:

- the consolidated balance sheets as at December 31, 2018 and December 31, 2017;
- the consolidated statements of income for the years then ended;
- the consolidated statements of comprehensive income for the years then ended;
- the consolidated statements of changes in equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and,
- notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2018 and December 31, 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the **"*Auditors' Responsibilities for the Audit of the Financial Statements*"** section of our auditors' report.

We are independent of the Company in accordance with the ethical requirements that are relevant to or audit of the financial statements in Canada and we have fulfilled our other responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.
- the information, other than the financial statements and the auditors' report thereon, included in the "2018 Canfor Corporation Annual Report".

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

The 2018 Canfor Corporation Annual Report is expected to be made available to us after the date of this auditors' report. If, based on the work we will perform on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact to those charged with governance for the financial statements.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance for the financial statements are responsible for overseeing the Company's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

– Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

– Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

– Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

– Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.

– Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

– Communicate with those charged with governance for the financial statements regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

– Provide those charged with governance for the financial statements with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

KPMG

– Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company (which is the Group Entity) to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

KPMG LLP

Chartered Professional Accountants

The engagement partner on the audit resulting in this auditors' report is John Desjardins.

Vancouver, Canada
February 21, 2019

Canfor Corporation
Consolidated Balance Sheets

(millions of Canadian dollars)		**As at December 31, 2018**		As at December 31, 2017
ASSETS				
Current assets				
Cash and cash equivalents	**$**	**252.7**	$	288.2
Accounts receivable - Trade		**182.1**		193.0
- Other		**52.4**		42.7
Income taxes receivable		**32.5**		-
Inventories (Note 6)		**762.5**		628.9
Prepaid expenses and other		**67.1**		54.2
Total current assets		**1,349.3**		1,207.0
Property, plant and equipment (Note 7)		**1,607.2**		1,438.1
Timber licenses (Note 8)		**504.1**		518.3
Goodwill and other intangible assets (Note 9)		**268.3**		228.1
Long-term investments and other (Note 10)		**110.4**		83.3
Retirement benefit surplus (Note 14)		**4.9**		7.9
Deferred income taxes, net (Note 21)		**0.9**		5.6
Total assets	**$**	**3,845.1**	$	3,488.3
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities (Note 11)	**$**	**458.9**	$	470.0
Current portion of deferred reforestation obligations (Note 15)		**52.9**		49.5
Current portion of long-term debt (Note 13)		**0.4**		0.3
Total current liabilities		**512.2**		519.8
Long-term debt (Note 13)		**408.0**		385.4
Retirement benefit obligations (Note 14)		**254.7**		272.0
Deferred reforestation obligations (Note 15)		**63.9**		63.0
Other long-term liabilities		**24.6**		23.7
Deferred income taxes, net (Note 21)		**241.8**		223.4
Total liabilities	**$**	**1,505.2**	$	1,487.3
EQUITY				
Share capital (Note 17)	**$**	**987.9**	$	1,014.9
Contributed surplus and other equity		**31.9**		31.9
Retained earnings		**931.1**		629.5
Accumulated other comprehensive income		**105.5**		55.1
Total equity attributable to equity shareholders of the Company		**2,056.4**		1,731.4
Non-controlling interests (Note 18)		**283.5**		269.6
Total equity	**$**	**2,339.9**	$	2,001.0
Total liabilities and equity	**$**	**3,845.1**	$	3,488.3

Commitments and Contingencies (Note 25) and **Subsequent Event** (Note 26)

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

APPROVED BY THE BOARD

Director, R.S. Smith

Director, C.A. Pinette

Canfor Corporation
Consolidated Statements of Income

(millions of Canadian dollars, except per share data)		Years ended December 31, **2018**		2017
Sales	**$**	**5,044.4**	$	4,563.3
Costs and expenses				
Manufacturing and product costs		**3,244.5**		2,959.9
Freight and other distribution costs		**643.7**		637.6
Countervailing and anti-dumping duty expense, net of recovery (Note 30)		**169.1**		44.3
Amortization		**270.5**		249.9
Selling and administration costs		**108.0**		114.2
		4,435.8		4,005.9
Operating income		**608.6**		557.4
Finance expense, net (Note 20)		**(26.0)**		(30.8)
Foreign exchange gain (loss) on long-term debt		**(10.9)**		8.8
Foreign exchange gain on duties receivable		**6.1**		-
Gain (loss) on derivative financial instruments (Note 27)		**1.1**		(5.2)
Other income (expense), net		**9.9**		(3.8)
Net income before income taxes		**588.8**		526.4
Income tax expense (Note 21)		**(149.8)**		(132.8)
Net income	**$**	**439.0**	$	393.6
Net income attributable to:				
Equity shareholders of the Company	**$**	**354.9**	$	345.4
Non-controlling interests (Note 18)		**84.1**		48.2
Net income	**$**	**439.0**	$	393.6
Net income per common share: (in Canadian dollars)				
Attributable to equity shareholders of the Company				
- Basic and diluted (Note 17)	**$**	**2.78**	$	2.63

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

Canfor Corporation
Consolidated Statements of Other Comprehensive Income

(millions of Canadian dollars)		Years ended December 31, **2018**		2017
Net income	**$**	**439.0**	$	393.6
Other comprehensive income				
Items that will not be recycled through net income:				
Defined benefit plan actuarial gains (Note 14)		**6.9**		24.1
Income tax expense on defined benefit plan actuarial gains (Note 21)		**(1.9)**		(5.0)
	$	**5.0**	$	19.1
Items that may be recycled through net income:				
Foreign exchange translation of foreign operations, net of tax		**50.4**		(33.8)
Other comprehensive income (loss), net of tax		**55.4**		(14.7)
Total comprehensive income	**$**	**494.4**	$	378.9
Total comprehensive income attributable to:				
Equity shareholders of the Company	**$**	**408.5**	$	322.2
Non-controlling interests (Note 18)		**85.9**		56.7
Total comprehensive income	**$**	**494.4**	$	378.9

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

Canfor Corporation
Consolidated Statements of Changes in Equity

(millions of Canadian dollars)	Years ended December 31, **2018**	2017
Share capital		
Balance at beginning of year	**$ 1,014.9**	$ 1,047.7
Share purchases (Note 17)	**(27.0)**	(32.8)
Balance at end of year (Note 17)	**$ 987.9**	$ 1,014.9
Contributed surplus and other equity		
Balance at beginning of year	**$ 31.9**	$ (4.6)
Forward purchase liability related to acquisitions (Note 29(a))	**-**	36.5
Balance at end of year	**$ 31.9**	$ 31.9
Retained earnings		
Balance at beginning of year	**$ 629.5**	$ 351.7
Net income attributable to equity shareholders of the Company	**354.9**	345.4
Defined benefit plan actuarial gains, net of tax	**3.2**	10.6
Share purchases (Note 17)	**(57.8)**	(57.9)
Elimination of non-controlling interests (Note 29(a))	**-**	(16.6)
Acquisition of non-controlling interests (Note 17)	**-**	(3.7)
Non-controlling interests arising from change in partnership interest in pellet plants	**1.3**	-
Balance at end of year	**$ 931.1**	$ 629.5
Accumulated other comprehensive income		
Balance at beginning of year	**$ 55.1**	$ 88.9
Foreign exchange translation of foreign operations, net of tax	**50.4**	(33.8)
Balance at end of year	**$ 105.5**	$ 55.1
Total equity attributable to equity shareholders of the Company	**$ 2,056.4**	$ 1,731.4
Non-controlling interests		
Balance at beginning of year	**$ 269.6**	$ 254.8
Net income attributable to non-controlling interests	**84.1**	48.2
Defined benefit plan actuarial gains attributable to non-controlling interests, net of tax	**1.8**	8.5
Distributions to non-controlling interests	**(74.5)**	(8.4)
Elimination of non-controlling interests (Note 29(a))	**-**	(19.9)
Acquisition of non-controlling interests (Note 17)	**-**	(14.1)
Non-controlling interests arising from investment	**-**	0.5
Non-controlling interests arising from change in partnership interest in pellet plants	**2.5**	-
Balance at end of year (Note 18)	**$ 283.5**	$ 269.6
Total equity	**$ 2,339.9**	$ 2,001.0

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

Canfor Corporation
Consolidated Statements of Cash Flows

(millions of Canadian dollars)		Years ended December 31, 2018		2017
Cash generated from (used in):				
Operating activities				
Net income	**$**	**439.0**	$	393.6
Items not affecting cash:				
Amortization		**270.5**		249.9
Income tax expense		**149.8**		132.8
Long-term portion of deferred reforestation obligations		**(0.3)**		5.4
Foreign exchange (gain) loss on long-term debt		**10.9**		(8.8)
Foreign exchange gain on duties receivable (Note 10)		**(6.1)**		-
Adjustment to accrued duties (Note 30)		**(25.8)**		(44.9)
Changes in mark-to-market value of derivative financial instruments		**(19.1)**		0.9
Employee future benefits expense		**11.7**		11.0
Finance expense, net		**26.0**		30.8
Other, net		**12.9**		(15.8)
Defined benefit plan contributions, net		**(28.2)**		(28.8)
Income taxes paid, net		**(222.4)**		(43.9)
		618.9		682.2
Net change in non-cash working capital (Note 22)		**(82.8)**		(72.1)
		536.1		610.1
Financing activities				
Change in operating bank loans (Note 12)		**-**		(28.0)
Proceeds from long-term debt, net (Note 13)		**-**		6.0
Repayment of long-term debt (Note 13)		**(0.4)**		(50.3)
Finance expenses paid		**(23.3)**		(21.1)
Share purchases (Note 17)		**(88.5)**		(87.0)
Acquisition of non-controlling interests (Note 17)		**(0.1)**		(17.7)
Cash distributions paid to non-controlling interests (Note 18)		**(74.5)**		(10.0)
Other, net		**-**		0.5
		(186.8)		(207.6)
Investing activities				
Additions to property, plant and equipment, timber and intangible assets, net		**(401.4)**		(252.1)
Proceeds on disposal of property, plant and equipment		**2.6**		11.4
Proceeds on sale of Anthony EACOM Inc., net (Note 10)		**-**		21.1
Proceeds on sale of Lakeland Winton (Note 10)		**-**		15.0
Acquisition of Beadles and Balfour and Wynndel (Notes 29(a) and (b))		**-**		(59.8)
Other, net		**5.4**		(2.0)
		(393.4)		(266.4)
Foreign exchange gain (loss) on cash and cash equivalents		**8.6**		(4.5)
Increase (decrease) in cash and cash equivalents*		**(35.5)**		131.6
Cash and cash equivalents at beginning of year*		**288.2**		156.6
Cash and cash equivalents at end of year*	**$**	**252.7**	$	288.2

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

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

1. Reporting Entity

Canfor Corporation is a company incorporated and domiciled in Canada and listed on The Toronto Stock Exchange. The address of the Company's registered office is 100-1700 West 75th Avenue, Vancouver, British Columbia, Canada, V6P 6G2. The consolidated financial statements of the Company as at and for the year ended December 31, 2018 comprise the Company and its subsidiaries (together referred to as "Canfor" or "the Company") and the Company's interests in associates and jointly controlled entities.

Canfor is an integrated forest products company with facilities in Canada and the United States ("US"). The Company produces softwood lumber, pulp and paper products, remanufactured lumber products, engineered wood products, wood pellets, and energy.

2. Basis of Preparation

Statement of compliance

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements were authorized for issue by the Board of Directors on February 21, 2019.

Basis of measurement

The consolidated financial statements have been prepared on a historical cost basis, except for the following material items:

- Financial instruments classified as measured at fair value;
- Equity investments are initially recognized at cost and subsequently increased or decreased to recognize the investor's share of the investee's equity;
- Asset retirement obligations and deferred reforestation obligations are measured at the discounted value of expected future cash flows; and
- The retirement benefit surplus and obligation related to the defined benefit pension plans are the net of the accrued benefit obligation and the fair value of the plan assets.

Use of estimates and judgments

The preparation of the consolidated financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Canfor regularly reviews its estimates and assumptions; however, it is possible that circumstances may arise which may cause actual results to differ from management estimates. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about the significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements is included in the applicable notes:

- Note 7 – Property, Plant and Equipment;
- Note 8 – Timber Licenses;
- Note 9 – Goodwill and Other Intangible Assets;
- Note 10 – Long-Term Investments and Other;
- Note 14 – Employee Future Benefits;
- Note 15 – Deferred Reforestation Obligations;
- Note 16 – Asset Retirement Obligations;
- Note 21 – Income Taxes;
- Note 28 – Licella Pulp Joint Venture; and
- Note 29 – Acquisitions.

Certain comparative amounts for the prior year have been reclassified to conform to the current year's presentation.

3. Significant Accounting Policies

The following accounting policies have been applied to the financial information presented.

Basis of consolidation

Subsidiaries are entities controlled by the Company. Control exists when Canfor is able to govern the financial and operating activities of those other entities to generate returns for the Company. Inter-company transactions, balances and unrealized gains and losses on transactions between different entities within the Company are eliminated. Significant subsidiaries include Canadian Forest Products Ltd. and Canfor Southern Pine, Inc. ("CSP"), which are wholly owned, and Canfor Pulp Products Inc. ("CPPI"), which was 54.8% owned at December 31, 2018.

Associates are those entities in which Canfor exercises significant influence, but not control, over financial and operating policies. Unless circumstances indicate otherwise, significant influence is presumed to exist when Canfor holds between 20 and 50 percent of the voting power of another entity. Associates are accounted for using the equity method and are recognized initially at cost. The consolidated financial statements include Canfor's share of the post-acquisition income and expenses and equity movement of these equity accounted investees. Joint ventures are accounted for using the equity method of accounting.

Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date. Canfor measures goodwill at the acquisition date as the fair value of the consideration transferred, including any non-controlling interest when applicable, less the fair value of the identifiable assets acquired and liabilities assumed. When the excess is negative, a bargain purchase gain is recognized immediately in net income. Transaction costs in connection with business combinations are expensed as incurred.

Cash and cash equivalents

Cash and cash equivalents include cash in bank accounts and liquid money market instruments with original maturities, or redemption dates, of three months or less from the date of acquisition, and are valued at amortized cost, which approximates market value. Cash is presented net of unpresented cheques. When the amount of unpresented cheques is greater than the amount of cash, the net amount is presented as cheques issued in excess of cash on hand. Interest is earned at variable rates dependent on the amount, credit quality and term of the Company's deposit.

Financial Instruments

Financial instruments comprise cash and cash equivalents, trade and other accounts receivables, investments in debt and equity securities, derivative instruments, accounts payable and accrued liabilities, operating loans and long-term debt. Canfor uses derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange, interest rate, lumber price, and energy price risk. Canfor's policy is not to utilize derivative financial instruments for trading or speculative purposes. Canfor's derivative financial instruments are not designated as hedges for accounting purposes.

Canfor's financial instruments are classified and measured as follows:

Financial Assets:	
Cash and cash equivalents	Amortized cost
Trade and other accounts receivables	Amortized cost
Investments in debt and equity securities	FVTPL
Futures contracts (lumber and energy)	FVTPL
Foreign exchange forward contracts	FVTPL
Financial Liabilities:	
Accounts payable and accrued liabilities	Amortized cost
Operating loans	Amortized cost
Long-term debt	Amortized cost

Classification and measurement of financial assets

Financial assets are classified as either measured at amortized cost, fair value through other comprehensive income ("FVOCI"), or fair value through net income ("FVTPL") based on the business model in which a financial asset is managed, its contractual cash flow characteristics and when certain conditions are met:

- Amortized cost – measured at amortized cost using the effective interest rate method. Where applicable, amortized cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognized in net income.
- FVOCI – measured at FVOCI if not designated as FVTPL. Interest income, foreign exchange gains and losses and impairment are recognized in net income. Other net gains and losses are recognized in other comprehensive income ("OCI"). On derecognition, gains and losses accumulated in OCI are reclassified to net income.
- FVTPL – measured at FVTPL if not classified as amortized cost or FVOCI with net gains and losses, including any interest or dividend income, recognized in net income.

Equity investments are required to be classified as measured at fair value. However, on initial recognition of an equity investment that is not held-for-trading, the Company may irrevocably elect to present subsequent changes in the investments fair value in OCI. This election is made on an investment by investment basis. The Company currently records gains and losses on its equity investments in net income.

Classification and measurement of financial liabilities

Financial liabilities are classified as either measured at amortized cost or FVTPL. A financial liability is classified as FVTPL if it is held-for-trading, a derivative or it is designated as such on initial recognition. Financial liabilities at FVTPL are measured at fair value with net gains and losses, including interest expense, recognized in net income. Other financial liabilities are subsequently measured at amortized cost using the effective interest rate method. Interest expense and foreign exchange gains and losses are recognized in net income. Any gains or losses on derecognition are also recognized in net income.

Impairment

The Company applies the simplified approach in determining expected credit losses ("ECLs"), which requires a probability-weighted estimate of expected lifetime credit losses to be recognized upon initial recognition of financial assets measured at amortized cost, contract assets and debt investments at FVOCI. Credit losses are measured as the present value of cash shortfalls from all possible default events, discounted at the effective interest rate of the financial asset. Loss allowances for financial assets at amortized cost are deducted from the gross carrying amount of the assets.

Inventories

Inventories include logs, lumber, engineered wood products, pulp, kraft paper, wood pellets, chips, and materials and supplies. These are measured at the lower of cost and net realizable value and are presented net of applicable write-downs. The cost of inventories is based on the weighted average cost principle, and includes raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expenses.

Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated amortization and impairment losses.

Cost includes expenditures which are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, borrowing costs (as applicable), and any other costs directly attributable to bringing assets to the location and condition necessary for it to be used in the manner intended by management.

The cost of replacing a major component of an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to Canfor and its cost can be measured reliably. The carrying amount of the replaced component is removed. The costs of the day-to-day servicing of property, plant and equipment are recognized in net income as incurred.

Amortization is recognized in net income on a straight-line basis over the estimated useful lives of each component of an item of property, plant and equipment, as set out in the table below. Land is not amortized. The majority of Canfor's amortization expense for property, plant and equipment relates to manufacturing and product costs.

Amortization methods, useful lives and residual values are reviewed, and adjusted if appropriate, at each reporting date. The following rates have been applied to Canfor's capital assets:

Buildings	5 to 50 years
Pulp and kraft paper machinery and equipment	8 to 20 years
Sawmill machinery and equipment	5 to 15 years
Logging machinery and equipment	4 to 20 years
Logging roads and bridges	5 to 25 years
Mobile and other equipment	5 to 10 years

Timber licenses

Timber licenses include tree farm licenses, forest licenses and timber licenses with the Provinces of British Columbia and Alberta. Timber licenses are carried at cost less accumulated amortization. Renewable licenses are amortized using the straight-line method over 50 years, while non-renewable licenses are amortized over the period of the license.

Other intangible assets

Goodwill

Goodwill represents the excess of the cost of a business acquisition over the fair value of Canfor's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill is tested annually for impairment and carried at cost less any accumulated impairment losses.

Computer software

Software development costs relate to major software systems purchased or developed by the Company. These costs are amortized on a straight-line basis over periods of four to ten years.

Government assistance

Government assistance relating to the acquisition of property, plant and equipment is recorded as a reduction of the cost of the asset to which it relates, with any amortization calculated on the net amount. Government grants related to income are recognized as income or a reimbursement of costs on a systematic basis over the periods necessary to match them with the related costs which they were intended to compensate.

Asset impairment

Canfor's property, plant and equipment, timber licenses and other intangible assets are reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized in net income at the amount the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows that are largely independent of cash inflows from other assets or groups of assets (cash-generating unit or "CGU").

Non-financial assets, other than goodwill, for which impairment was recorded in a prior period, are reviewed for possible reversal of the impairment at each reporting date. When an impairment loss is reversed, the increased carrying amount of the asset cannot exceed the carrying amount that would have been determined (net of amortization) had no impairment loss been recognized in prior years.

For the purpose of impairment testing, goodwill is allocated to the Company's operating divisions which represent the lowest level within the Company at which the goodwill is monitored for internal management purposes.

Employee future benefits

Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which an entity makes contributions to a separate entity and has no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution plans are recognized as an employee future benefits expense when they are earned.

For hourly employees covered by forest industry union defined contribution or benefit plans, the statement of income is charged with the Company's contributions required under the collective agreements.

Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. Canfor has various defined benefit plans that provide both pension and other non-pension post-retirement benefits to certain salaried employees, and certain hourly employees not covered by forest industry union plans. The other non-pension post-retirement benefits include certain health care benefits and pension bridging benefits to eligible retired employees.

The surplus and / or obligation recognized in the balance sheet in respect of a defined benefit pension plan is the net of the accrued benefit obligation and the fair value of the plan assets. The accrued benefit obligation, the related service cost and, where applicable, the past service cost is determined separately for each defined benefit pension plan based on actuarial determinations using the projected unit credit method. Under the projected unit credit method, the accrued benefit obligation is calculated as the present value of each member's prospective benefits earned in respect of credited service prior to the valuation date and the related service cost is calculated as the present value of the benefits the member is assumed to earn for credited service in the ensuing year. The actuarial assumptions used in these calculations, such as salary escalation and health care inflation, are based upon best estimates selected by Canfor. The discount rate assumptions are based on the yield at the reporting date on high quality corporate bonds that have maturity dates approximating the terms of Canfor's obligations.

Actuarial gains and losses can arise from differences between actual and expected outcomes or changes in the actuarial assumptions or legislated amounts payable. Actuarial gains and losses, including the return on plan assets, are recognized in other comprehensive income in the period in which they occur.

Provisions

Canfor recognizes a provision if, as a result of a past event, it has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. The provision recorded is management's best estimate of the expenditure required to settle the present obligation at the end of the reporting period. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The expense arising from the unwinding of the discount due to the passage of time is recorded as a finance expense. The main classes of provisions recognized by Canfor are as follows:

Asset retirement obligations

Canfor recognizes a liability for asset retirement obligations in the period in which they are incurred. The site restoration costs are capitalized as part of the cost of the related item of property, plant and equipment and amortized on a basis consistent with the expected useful life of the related asset. Asset retirement obligations are discounted at the risk-free rate in effect at the balance sheet date.

Deferred reforestation obligations

Forestry legislation in British Columbia and Alberta requires Canfor to incur the cost of reforestation of its forest, timber and tree farm licenses and forest management agreements. Accordingly, Canfor records an expense and a liability for the costs of reforestation in the period in which the timber is harvested. In periods subsequent to the initial measurement, changes in the liability resulting from the passage of time and revisions to management's estimates are recognized in net income as they occur. Deferred reforestation obligations are discounted at the risk-free rate in effect at the balance sheet date.

Share-based compensation

Canfor has one share-based compensation plan, as described in Note 19. Compensation expense is recognized for Canfor's Deferred Share Unit ("DSU") Plan when the DSUs are granted, with a corresponding increase to liabilities. The liability is remeasured at each reporting date and at settlement date, with any changes in the fair value of the liability recognized as a compensation expense or recovery in net income. The fair value of the DSUs is determined with reference to the market price of Canfor's shares as at the date of valuation.

Revenue recognition

Canfor's revenues are derived from the sale of lumber, engineered wood products, pulp, kraft paper, residual fibre, logs, wood pellets, and energy. Revenue is measured based on the consideration specified in a contract with a customer, net of applicable sales taxes, returns, rebates and discounts and after eliminating sales within the Company. Revenue is recognized when the Company transfers control of products to customers. The timing of transfer of control to customers varies depending on the individual terms of the contract of sale, but is typically as follows for Canfor's principal revenue generating activities:

- *Lumber* – At the time lumber is loaded onto a truck or rail carrier, upon vessel departure, or when lumber has been picked up by the buyer at a designated transfer point at the Company's mill or warehouse. The amount of revenue recognized is adjusted for volume rebates and discounts at the point in time control is transferred.
- *Pulp and Paper* – At the time pulp and paper is loaded onto a truck or rail carrier, upon vessel departure, or when pulp and kraft paper has been picked up by the buyer at a designated transfer point at the Company's mill or warehouse. The amount of revenue recognized is adjusted for commissions, volume rebates and discounts at the point in time control is transferred.

Amounts charged to customers for shipping and handling are recognized as revenue, and shipping and handling costs incurred by Canfor are reported as a component of freight and other distribution costs. Countervailing and anti-dumping duties are recorded as a component of operating income.

Income taxes

Income tax expense comprises current and deferred taxes. Current and deferred taxes are recognized in net income except to the extent that they relate to items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the period, using the tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous periods.

Canfor recognizes deferred income tax in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred income tax is measured at tax rates expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred income tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred income tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized. Investment tax credits are credited to manufacturing and product costs in the period in which it becomes reasonably assured that the Company is entitled to them. Unused investment tax credits are recorded as other current or long- term assets in the Company's balance sheet, depending upon when the benefit is expected to be received.

Foreign currency translation

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

The majority of Canfor's sales are denominated in foreign currencies, principally the US dollar. Transactions in foreign currencies are translated to the functional currency at exchange rates on the dates of transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate on that date. Foreign currency differences arising on translation are recognized in net income.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to the Canadian dollar at exchange rates on the reporting date. The income and expenses of foreign operations are translated to the Canadian dollar at exchange rates on the transaction dates. Foreign exchange differences are recognized in other comprehensive income and recorded to the accumulated foreign exchange translation account. Canfor's foreign operations include CSP and all entities owned or partly owned by this entity.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. Segment results reported to the chief operating decision-maker include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items mainly comprise interest-bearing liabilities, head office expenses, and income tax assets and liabilities. Segment capital expenditure is the total cost incurred during the period to acquire property, plant and equipment, timber licenses and intangible assets, other than goodwill.

4. Changes in significant accounting policies

IFRS 9 – Financial Instruments

Effective January 1, 2018, the Company adopted IFRS 9, *Financial Instruments* which supersedes IAS 39, *Financial Instruments: Recognition and Measurement,* and sets out requirements for the recognition, measurement, impairment and derecognition of financial assets and liabilities, as well as general hedge accounting.

While the existing requirements for the classification and measurement of financial liabilities are largely retained under IFRS 9, financial assets are required to be classified as measured at amortized cost, FVOCI or FVTPL. The table below outlines the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Company's financial instruments at January 1, 2018:

	Original Classification Under IAS 39	New Classification Under IFRS 9
Financial Assets:		
Cash and cash equivalents	Loans and receivables	Amortized cost
Trade and other accounts receivables	Loans and receivables	Amortized cost
Investments in debt securities	FVTPL	FVTPL
Investments in equity securities	Available-for-sale	FVTPL
Futures contracts (lumber and energy)	FVTPL	FVTPL
Foreign exchange forward contracts	FVTPL	FVTPL
Financial Liabilities:		
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Operating loans	Other liabilities	Amortized cost
Long-term debt	Other liabilities	Amortized cost

There have been no changes to the carrying values of our financial instruments at January 1, 2018, or to previously reported figures as a result of the classification changes outlined above. There was no impact of the new hedging requirements, as Canfor's derivative instruments are not designated as hedges for accounting purposes.

IFRS 9 also replaces the incurred loss impairment model under IAS 39 with an ECL model. The Company has elected to apply the simplified approach in determining expected credit losses ECLs, which requires a probability-weighted estimate of expected lifetime credit losses to be recognized upon initial recognition of financial assets measured at amortized cost, contract assets and debt investments at FVOCI. Credit losses are measured as the present value of cash shortfalls from all possible default events, discounted at the effective interest rate of the financial asset. Loss allowances for financial assets at amortized cost are deducted from the gross carrying amount of the assets. At January 1, 2018, the identified impairment losses were not significant or material and therefore no changes in loss allowances were recognized.

IFRS 15 – Revenue from Contracts with Customers

Effective January 1, 2018, the Company adopted IFRS 15, *Revenue from Contracts with Customers,* which supersedes IAS 18, *Revenue*, IAS 11, *Construction Contracts* and related interpretations, and establishes a comprehensive framework for determining whether, how much and when revenue is recognized.

In the comparative period, revenue was measured at the fair value of consideration received or receivable, net of applicable sales tax, rebates and discounts and after eliminating sales within the Company. Revenue was previously recognized when the significant risks and rewards of ownership had been transferred to the buyer, recovery of consideration was probable, the associated costs and possible returns of the goods could be reliably estimated, there was no continuing management involvement with the goods, and the amount of revenue could be reliably measured.

Under the new standard, however, revenue from the sale of goods is measured based on the consideration specified in a contract with a customer and is recognized when a customer obtains control of the goods or services.

The Company has applied the full retrospective method upon transition to IFRS 15, with no resulting quantitative impact to the consolidated financial statements.

5. Accounting Standards Issued and Not Applied

In January 2016, the IASB issued IFRS 16 *Leases*, which will supersede IAS 17 *Leases* and related interpretations. The required adoption date for IFRS 16 is January 1, 2019. IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognizes a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. In addition, the nature of expenses related to those leases will change as IFRS 16 replaces straight-line operating lease expense with an amortization expense for right-of-use assets and interest expense on lease liabilities.

IFRS 16 may be applied retrospectively to each prior period presented (full retrospective approach), or with the cumulative effect of adoption recognized at initial application (modified retrospective approach). The Company has elected to apply the modified retrospective approach upon adoption at January 1, 2019, measuring the right-of-use asset at its carrying amount had the standard been applied at commencement of the lease. The short-term and low-value recognition exemptions available under the standard will be utilized, along with certain practical expedients.

Based on lease data as at December 31, 2018, IFRS 16 is estimated to have the following financial statement impact on the Company's consolidated balance sheet at transition on January 1, 2019, with no material impact to 2019 net income:

(millions of Canadian dollars)			As at January 1, 2019
Right-of-use asset, net of accumulated amortization	Increase in assets	$	42.2
Lease obligation	Increase in liabilities		44.3
Deferred income tax	Decrease in liabilities		0.5
Retained earnings	Decrease in equity		1.6

The full quantification of the new standard will be disclosed in the condensed consolidated interim financial statements for the first quarter of 2019.

6. Inventories

(millions of Canadian dollars)		**As at December 31, 2018**		As at December 31, 2017
Logs	**$**	**199.5**	$	132.1
Finished products		**389.3**		354.6
Residual fibre		**44.8**		20.8
Materials and supplies		**128.9**		121.4
	$	**762.5**	$	628.9

The above inventory balances are stated after inventory write-downs from cost to net realizable value, which mostly reflect significant declines in prices for solid wood products at the end of 2018.

The write-downs for the various components of inventory at December 31 were:

(millions of Canadian dollars)		**2018**		2017
Logs	**$**	**11.1**	$	-
Finished products		**25.6**		-
	$	**36.7**	$	-

Inventory expensed in 2018 includes manufacturing and product costs and amortization.

7. Property, Plant and Equipment

(millions of Canadian dollars)		Land		Pulp and kraft paper mills		Solid wood operations[2]		Logging assets and other equipment		Construction in progress		Total
Cost												
Balance at January 1, 2017	$	51.9	$	1,620.0	$	1,884.2	$	224.7	$	33.4	$	3,814.2
Additions[1]		0.1		-		19.4		0.2		218.2		237.9
Disposals		(1.8)		(64.1)		(25.2)		(7.4)		-		(98.5)
Transfers		1.0		52.1		87.4		17.6		(158.1)		-
Effect of movements in exchange rates		(1.9)		-		(30.7)		(0.6)		(1.7)		(34.9)
Balance at December 31, 2017	$	49.3	$	1,608.0	$	1,935.1	$	234.5	$	91.8	$	3,918.7
Additions[1]		-		0.4		1.1		0.8		395.1		397.4
Disposals		(0.1)		(54.7)		(29.5)		(5.7)		-		(90.0)
Transfers		1.4		139.2		214.4		17.1		(372.1)		-
Effect of movements in exchange rates		2.3		-		43.5		0.7		5.6		52.1
Balance at December 31, 2018	$	52.9	$	1,692.9	$	2,164.6	$	247.4	$	120.4	$	4,278.2
Amortization												
Balance at January 1, 2017	$	(2.5)	$	(1,125.0)	$	(1,056.1)	$	(169.8)	$	-	$	(2,353.4)
Amortization for the year		-		(74.3)		(143.2)		(12.6)		-		(230.1)
Disposals		-		62.5		19.8		6.9		-		89.2
Transfers		-		-		2.0		(2.0)		-		-
Effects of movements in exchange rates		-		-		13.5		0.2		-		13.7
Balance at December 31, 2017	$	(2.5)	$	(1,136.8)	$	(1,164.0)	$	(177.3)	$	-	$	(2,480.6)
Amortization for the year		-		(79.1)		(157.6)		(12.2)		-		(248.9)
Disposals		-		53.4		23.9		2.2		-		79.5
Transfers		-		-		(2.0)		2.0		-		-
Effect of movements in exchange rates		-		-		(20.6)		(0.4)		-		(21.0)
Balance at December 31, 2018	$	(2.5)	$	(1,162.5)	$	(1,320.3)	$	(185.7)	$	-	$	(2,671.0)
Carrying Amounts												
At January 1, 2017	$	49.4	$	495.0	$	828.1	$	54.9	$	33.4	$	1,460.8
At December 31, 2017	$	46.8	$	471.2	$	771.1	$	57.2	$	91.8	$	1,438.1
At December 31, 2018	**$**	**50.4**	**$**	**530.4**	**$**	**844.3**	**$**	**61.7**	**$**	**120.4**	**$**	**1,607.2**

[1]Net of capital expenditures by CPPI that are financed by government grants.
[2]Solid Wood operations include those sawmills, pellet plants, engineered wood products plants, plywood and oriented strand board plants that are consolidated on a line-by-line basis.

8. Timber Licenses

(millions of Canadian dollars)		
Cost		
Balance at January 1, 2017	$	868.8
Additions		1.2
Balance at December 31, 2017	$	870.0
Additions		1.4
Balance at December 31, 2018	$	871.4
Amortization		
Balance at January 1, 2017	$	(336.1)
Amortization for the year		(15.6)
Balance at December 31, 2017	$	(351.7)
Amortization for the year		(15.6)
Balance at December 31, 2018	$	(367.3)
Carrying amounts		
At January 1, 2017	$	532.7
At December 31, 2017	$	518.3
At December 31, 2018	**$**	**504.1**

9. Goodwill and Other Intangible Assets

(millions of Canadian dollars)		Goodwill		Other intangible assets		Total
Cost						
Balance at January 1, 2017	$	209.1	$	100.3	$	309.4
Additions		-		8.2		8.2
Disposals and transfers		-		(1.8)		(1.8)
Effect of movement in exchange rates		(13.7)		(3.4)		(17.1)
Balance at December 31, 2017	$	195.4	$	103.3	$	298.7
Additions and transfers		-		29.1		29.1
Disposals		-		(39.8)		(39.8)
Effect of movement in exchange rates		17.0		4.1		21.1
Balance at December 31, 2018	$	212.4	$	96.7	$	309.1
Amortization						
Balance at January 1, 2017	$	-	$	(70.6)	$	(70.6)
Amortization for the year		-		(4.2)		(4.2)
Disposal and transfers		-		1.8		1.8
Effect of movement in exchange rates		-		2.4		2.4
Balance at December 31, 2017	$	-	$	(70.6)	$	(70.6)
Amortization for the year		-		(6.0)		(6.0)
Disposals and transfers		-		39.0		39.0
Effect of movement in exchange rates		-		(3.2)		(3.2)
Balance at December 31, 2018	$	-	$	(40.8)	$	(40.8)
Carrying amounts						
At January 1, 2017	$	209.1	$	29.7	$	238.8
At December 31, 2017	$	195.4	$	32.7	$	228.1
At December 31, 2018	**$**	**212.4**	**$**	**55.9**	**$**	**268.3**

Goodwill relates to Canfor's US subsidiaries and is denominated in US dollars. Goodwill is allocated separately to each acquired business and tested at that level for impairment purposes. The recoverable amount of the goodwill is determined based on an assessment of the value in use, which is estimated using a discounted cash flow model.

As part of the goodwill impairment assessment, assumptions are made in relation to forecast prices and exchange rates. Key assumptions used in the cash flow models include forecast prices and foreign exchange rates, which the Company's management determined with reference to internal and external publications, respectively.

A pre-tax discount rate of 8.0% (2017 – 11.0%), based on the Company's current weighted average cost of capital and US denominated risk-adjusted internal borrowing rate, and a cost inflation rate of 2.0% (2017 – 2.0%) was used for the purpose of the 2018 calculation. The net present value of the future expected cash flows is compared to the carrying value of the Company's investment in these assets, including goodwill, at year end. Based upon management's analysis, no impairment of goodwill was required in 2018 or 2017.

10. Long-Term Investments and Other

(millions of Canadian dollars)		**As at December 31, 2018**		As at December 31, 2017
Investments	**$**	**21.0**	$	22.5
Anti-dumping duties receivable (Note 30)		**76.6**		44.9
Other deposits, loans, advances and long-term assets		**12.8**		15.9
	$	**110.4**	$	83.3

The anti-dumping duties receivable balance represents anti-dumping cash deposits paid in excess of the calculated expense accrued, and interest, at December 31, 2018 (Note 30).

In 2017, the Company received the final instalment of $15.0 million related to the July 1, 2015 sale of the Company's 33.3% investment in Lakeland Mills Ltd. And Winton Global Lumber Ltd. ("Lakeland Winton") for aggregate consideration of $30.0 million.

In 2017, the Company sold its 50% investment in Anthony EACOM Inc. to EACOM Timber Corporation for net proceeds of $21.1 million and recognized a $3.7 million gain (pre-tax), with the cash proceeds paid by EACOM Timber Corporation to the Company in 2017. Prior to the sale, the Company's interest in Anthony EACOM Inc. was classified as a joint venture and accounted for using the equity method of accounting.

11. Accounts Payable and Accrued Liabilities

(millions of Canadian dollars)		**As at December 31, 2018**		As at December 31, 2017
Trade payables and accrued liabilities	**$**	**328.8**	$	291.9
Accrued payroll and related liabilities		**130.1**		117.6
Income tax payable		**-**		60.5
	$	**458.9**	$	470.0

12. Operating Loans

(millions of Canadian dollars)		**As at December 31, 2018**		As at December 31, 2017
Canfor (excluding CPPI)				
Available operating loans:				
Operating loan facility	**$**	**450.0**	$	350.0
Facility for letters of credit		**60.0**		50.0
Total operating loan facility		**510.0**		400.0
Letters of credit		**(57.4)**		(44.0)
Total available operating loan facility - Canfor	**$**	**452.6**	$	356.0
CPPI				
Available operating loans:				
Operating loan facility	**$**	**110.0**	$	110.0
Letters of credit		**(11.1)**		(9.2)
Total available operating loan facility - CPPI	**$**	**98.9**	$	100.8
Consolidated:				
Total operating loan facilities	**$**	**620.0**	$	510.0
Total available operating loan facilities	**$**	**551.5**	$	456.8

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

In 2017, Canfor's principal operating loan (excluding CPPI) was extended to September 28, 2022. On December 14, 2018, the operating loan was further extended to January 2, 2024, with the principal increased by $100.0 million to $450.0 million at December 31, 2018. At December 31, 2018, the Company had total available undrawn operating loans of $551.5 million, including undrawn facilities for letters of credit.

Canfor (excluding CPPI) has a separate facility to cover letters of credit. On February 28, 2018, the Company increased its facility by $10.0 million, which can be drawn in either Canadian or US dollars. At December 31, 2018, $54.9 million of letters of credit outstanding are covered under this facility with the balance of $2.5 million covered under Canfor's general operating loan facility.

The terms of CPPI's operating loan facility include interest payable at floating rates that vary depending on the ratio of debt to total capitalization and is based on lenders' Canadian prime rate, bankers' acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin. On April 6, 2018, the maturity date of CPPI's principal operating loan facility was extended from January 31, 2020 to April 6, 2022.

Both Canfor's and CPPI's operating loan facilities have certain financial covenants, including maximum debt to total capitalization ratios. As at December 31, 2018, the Company and CPPI are in compliance with all covenants relating to their operating loan facilities. Substantially all borrowings of CPPI are non-recourse to other entities within the Company.

13. Long-Term Debt

Canfor has the following long-term debt, all of which is unsecured:

(millions of Canadian dollars)		As at December 31, 2018		As at December 31, 2017
Canfor Corporation				
CAD$225.0 million (CAD$125.0 million drawn), floating interest, repayable January 2, 2024	**$**	**125.0**	$	125.0
US$200.0 million (US$100.0 million drawn), floating interest, repayable January 2, 2027		**136.4**		125.5
US$100.0 million, fixed interest of 4.4%, repayable in three equal tranches on October 2, 2023, 2024 and 2025		**136.4**		125.5
Other (US$7.7 million)[3]		**10.6**		9.7
Long-term debt at end of year	**$**	**408.4**	$	385.7
Less: Current portion		**(0.4)**		(0.3)
Long-term portion	**$**	**408.0**	$	385.4

[3] Amount relates to net financing for specific capital projects at Canfor's U.S. sawmills.

On December 14, 2018, the Company increased its Canadian dollar denominated floating interest rate term debt facility to $225.0 million (2017 - $125.0 million) and extended its maturity date from September 28, 2022 to January 2, 2024. The Company also increased its US-dollar denominated floating rate term debt facility to $200.0 million (2017 - $100.0 million) and extended its maturity date from September 28, 2025 to January 2, 2027. As at December 31, 2018, the incremental borrowing capacity available under both the Canadian dollar and US-dollar floating rate term debt was undrawn.

On December 29, 2017, the Company's subsidiary CPPI repaid the full principal balance of its term debt of $50.0 million.

All borrowings of the Company feature similar financial covenants, including a maximum debt to total capitalization ratio. As at December 31, 2018, the Company is in compliance with all covenants relating to its long-term debt.

Fair value of total long-term debt

At December 31, 2018, the fair value of the Company's long-term debt is $402.9 million (December 31, 2017 - $389.1 million). The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

14. Employee Future Benefits

The Company has several funded and unfunded defined benefit pension plans and defined contribution plans that provide benefits to substantially all salaried employees and certain hourly employees. Benefits are also provided to certain salaried and hourly employees through the Company's non-pension post-retirement benefit plans, which are unfunded. The defined benefit pension plans are based on years of service and final average salary. Canfor's other non-pension post-retirement benefit plans are non-contributory and include a range of health care and other benefits. Canfor also provides pension bridge benefits to certain eligible former employees.

Total cash payments for employee future benefits for 2018 were $64.0 million (December 31, 2017 - $61.1 million), consisting of cash contributed by Canfor to its funded pension plans, cash payments directly to beneficiaries for its unfunded other non-pension post-retirement benefit plans, and cash contributed to its defined contribution and other plans.

Defined benefit plans

Canfor measures its accrued retirement benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year.

As at December 31, 2018, Canfor has four registered defined benefit pension plans for which actuarial valuations are performed at least every three years. The largest pension plan underwent an actuarial valuation for funding purposes as of December 31, 2017, which was completed in 2018. The next actuarial valuation for funding purposes is currently scheduled for December 31, 2020, to be completed in 2021. In addition, Canfor has other non-contributory benefit plans that provide certain non-pension post-retirement benefits to its members. The majority of the other non-contributory plans underwent actuarial valuations as of December 31, 2018, to be completed in 2019.

Information about Canfor's defined benefit plans, in aggregate, is as follows:

Fair market value of plan assets	**2018**		2017	
(millions of Canadian dollars)	**Defined Benefit Pension Plans**	**Other Benefit Plans**	Defined Benefit Pension Plans	Other Benefit Plans
Beginning of year	**$ 717.5**	**$ -**	$ 697.0	$ -
Interest income on plan assets	**24.1**	**-**	26.7	-
Return on plan assets greater (less) than discount rate	**(31.1)**	**-**	19.9	-
Employer contributions	**23.8**	**4.4**	19.3	9.5
Employee contributions	**0.6**	**-**	0.4	-
Benefit payments	**(45.5)**	**(4.4)**	(43.8)	(9.5)
Administration expense	**(0.6)**	**-**	(1.0)	-
Other	**1.6**	**-**	(1.0)	-
End of year	**$ 690.4**	**$ -**	$ 717.5	$ -

Plan assets consist of the following:	**As at December 31, 2018**	As at December 31, 2017
	Percentage of Plan Assets	
Asset category		
Equity securities	**23%**	31%
Debt securities	**13%**	12%
Annuities	**63%**	56%
Cash and cash equivalents	**1%**	1%
	100%	100%

Accrued benefit obligations	**2018**		2017	
(millions of Canadian dollars)	**Defined Benefit Pension Plans**	**Other Benefit Plans**	Defined Benefit Pension Plans	Other Benefit Plans
Beginning of year	**$ 853.6**	**$ 126.0**	$ 812.4	$ 179.3
Current service cost	**9.1**	**2.2**	8.8	3.3
Settlement adjustment	**-**	**-**	-	(3.0)
Plan amendment	**-**	**-**	1.1	-
Interest cost	**28.4**	**4.0**	30.9	6.8
Employee contributions	**0.6**	**-**	0.4	-
Benefit payments	**(45.5)**	**(4.4)**	(43.8)	(9.5)
Actuarial loss (gain)	**(20.4)**	**(17.4)**	45.3	(50.0)
Other	**1.9**	**(0.4)**	(1.5)	(0.9)
End of year	**$ 827.7**	**$ 110.0**	$ 853.6	$ 126.0

Of the defined benefit pension plan obligation of $827.7 million (December 31, 2017 - $853.6 million), $749.3 million (December 31, 2017 - $773.2 million) relates to plans that are wholly or partly funded and $78.4 million (December 31, 2017 - $80.4 million) relates to plans that are wholly unfunded, with letters of credit securing $48.3 million (December 31, 2017 - $41.3 million) of the unfunded liability.

The total obligation for the non-pension post-retirement benefit plans of $110.0 million (December 31, 2017 - $126.0 million) is unfunded.

Annuity contracts

The Company purchased $58.9 million (December 31, 2017 - $136.3 million) of buy-in annuities through its defined benefit pension plans during the year, increasing total annuities purchased to $481.8 million at December 31, 2018 (December 31, 2017 - $422.9 million). Future cash flows from the annuities will match the amount and timing of benefits payable under the plans, substantially mitigating the exposure to future volatility in the related pension obligations. Transaction costs of $3.6 million (December 31, 2017 - $4.9 million) related to the purchase were recognized in other comprehensive income (loss), principally reflecting the difference between the annuity rate compared to the discount rate used to value the obligations on a going concern basis.

Voluntary Retiree Buyout Program

In October 2017, certain non-pension post-retirement benefit plan members of Canfor and CPPI were given an offer to receive lump-sum payment in exchange for settlement of their future non-pension post-retirement benefit obligations under the Voluntary Retiree Buyout Program ("the Program"). Acceptance of the offer constitutes an irrevocable election to terminate future benefit obligations by plan members, and as such, settlement was recorded at the time of election by members. The deadline for elections made under the Program was October 31, 2017, and the resulting payments were made from November 2017 through January 2018. Under the program, $7.4 million of non-pension post-retirement benefit obligations were settled and derecognized in 2017, resulting in a settlement adjustment of $3.0 million, which was included in operating income. For the year ended December 31, 2018, $1.1 million was paid out under the Program (December 31, 2017 - $3.3 million).

Medical Services Plan changes

On November 2, 2017, the Legislative Assembly of British Columbia enacted the *Budget Measures Implementation Act, 2017,* which included a 50% reduction in Medical Services Plan ("MSP") premiums effective January 1, 2018. This change in legislation was recognized in actuarial financial assumptions in 2017 and resulted in a $49.0 million pre-tax reduction of the non-pension post-retirement benefit obligation and a corresponding gain recognized through other comprehensive income.

In addition, in measuring the accrued benefit obligation at December 31, 2017, the MSP growth trend rate actuarial financial assumption was reduced from 4.5% to 2.0% resulting in an additional $14.7 million pre-tax gain recognized through other comprehensive income in 2017.

Reconciliation of funded status of defined benefit plans to amounts recorded in the financial statements

	December 31, 2018		December 31, 2017	
(millions of Canadian dollars)	**Defined Benefit Pension Plans**	**Other Benefit Plans**	Defined Benefit Pension Plans	Other Benefit Plans
Fair market value of plan assets	**$ 690.4**	**$ -**	$ 717.5	$ -
Accrued benefit obligations	**(827.7)**	**(110.0)**	(853.6)	(126.0)
Funded status of plans – deficit	**$ (137.3)**	**$ (110.0)**	$ (136.1)	$ (126.0)
Other pension plans	**(2.5)**	**-**	(2.0)	-
Total accrued benefit liability, net	**$ (139.8)**	**$ (110.0)**	$ (138.1)	$ (126.0)

The net accrued benefit liability is included in Canfor's balance sheet as follows:

	December 31, 2018		December 31, 2017	
(millions of Canadian dollars)	**Defined Benefit Pension Plans**	**Other Benefit Plans**	Defined Benefit Pension Plans	Other Benefit Plans
Retirement benefit surplus	**$ 4.9**	**$ -**	$ 7.9	$ -
Retirement benefit obligations	**(144.7)**	**(110.0)**	(146.0)	(126.0)
Total accrued benefit liability, net	**$ (139.8)**	**$ (110.0)**	$ (138.1)	$ (126.0)

At December 31, 2018 and December 31, 2017, certain defined benefit pension plans are in a surplus position reflecting the return on plan assets, actuarial gains and employer contributions to the pension plans during 2018 and 2017. The plans with a net retirement surplus have been classified as non-current assets on the balance sheet.

Components of pension cost

The following table shows the before tax impact on net income and other comprehensive income of the Company's defined benefit pension and other non-pension post-retirement benefit plans:

	2018		2017	
(millions of Canadian dollars)	**Defined Benefit Pension Plans**	**Other Benefit Plans**	Defined Benefit Pension Plans	Other Benefit Plans
Recognized in net income				
Current service cost	**$ 9.1**	**$ 2.2**	$ 8.8	$ 3.3
Settlement adjustment	**-**	**-**	-	(3.0)
Plan amendment	**-**	**-**	1.1	-
Administration expense	**0.8**	**-**	0.5	-
Interest cost	**4.3**	**4.0**	4.2	6.8
Other	**-**	**(0.4)**	-	0.3
Total expense included in net income	**$ 14.2**	**$ 5.8**	$ 14.6	$ 7.4
Recognized in other comprehensive income				
Actuarial loss (gain) – experience	**$ 1.0**	**$ (8.5)**	$ (6.0)	$ (0.4)
Actuarial gain – demographic assumptions	**(0.1)**	**-**	(0.1)	-
Actuarial loss (gain) – financial assumptions	**(21.3)**	**(8.9)**	51.4	(49.6)
Return on plan assets less (greater) than discount rate	**31.1**	**-**	(19.9)	-
Administrative costs greater (less) than expected	**(0.2)**	**-**	0.5	-
Total loss (gain) in other comprehensive income	**$ 10.5**	**$ (17.4)**	$ 25.9	$ (50.0)

Significant assumptions

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

	December 31, 2018		December 31, 2017	
	Defined Benefit Pension Plans	**Other Benefit Plans**	Defined Benefit Pension Plans	Other Benefit Plans
Discount rate	**3.6%**	**3.6%**	3.4%	3.4%
Rate of compensation increases	**3.0%**	**n/a**	3.0%	n/a
Initial medical cost trend rate	**n/a**	**5.5%**	n/a	6.5%
Ultimate medical cost trend rate	**n/a**	**4.5%**	n/a	4.5%
Year ultimate rate is reached	**n/a**	**2022**	n/a	2022

In addition to the significant assumptions listed in the table above, the average life expectancy of a 65-year-old at December 31, 2018 is between 21.1 years and 24.2 years (December 31, 2017 – 21.0 years and 24.1 years). As at December 31, 2018, the weighted average duration of the defined benefit obligation, which reflects the average age of the plan members, is 12.0 years (December 31, 2017 - 12.3 years). The weighted average duration of the other benefit plans is 13.3 years (December 31, 2017 - 14.2 years).

Sensitivity analysis

Assumed discount rates and medical cost trend rates have a significant effect on the accrued retirement benefit obligation and related plan assets. A one percentage point change in these assumptions would have the following effects on the accrued retirement benefit obligation, including the hedging impact of plan annuity assets, for 2018:

(millions of Canadian dollars)	1% Increase	1% Decrease
Defined benefit pension plan liabilities, net of annuity assets		
Discount rate	$ (48.0)	$ 59.0
Other benefit plan liabilities		
Discount rate	$ (13.1)	$ 16.1
Initial medical cost trend rate	$ 8.5	$ (7.6)

When taking into account the impact of hedging, 52% (December 31, 2017 – 46%) of the change to the defined benefit pension plans is fully hedged against changes in discount rates and longevity risk (potential increases in life expectancy of plan members) through buy-in annuities, and a further 12% (December 31, 2017 - 10%) is partially hedged through the plan's investment in debt securities.

As at December 31, 2018, contribution payments of $19.0 million are estimated to be made to the Company's defined benefit pension plans in 2019 based on the last actuarial valuation for funding purposes.

Defined contribution and other plans

The total expense recognized in 2018 for Canfor's defined contribution plans was $12.8 million (December 31, 2017 - $9.5 million). Canfor contributes to various forest industry union benefit plans providing both pension and other retirement benefits. These plans are accounted for as defined contribution plans. Contributions to these plans, not included in the expense for defined contribution plans above, amounted to $23.0 million in 2018 (December 31, 2017 - $22.8 million).

15. Deferred Reforestation Obligations

The following table provides a reconciliation of the deferred reforestation obligations as at December 31, 2018 and December 31, 2017:

(millions of Canadian dollars)		**2018**		2017
Reforestation obligations at beginning of year	**$**	**112.5**	$	105.4
Expense for year		**50.3**		49.9
Accretion expense		**1.2**		0.7
Changes in estimates		**(0.7)**		(1.6)
Paid during the year, net		**(46.5)**		(41.9)
Reforestation obligations at end of year	**$**	**116.8**	$	112.5
Less: Current portion		**(52.9)**		(49.5)
Long-term portion	**$**	**63.9**	$	63.0

The total undiscounted amount of the estimated cash flows required to settle the obligations at December 31, 2018 is $121.8 million (December 31, 2017 - $117.8 million) with payments expected to occur over 15 years. Due to the general long-term nature of the liability, the most significant area of uncertainty in estimating the provision is the future costs that will be incurred. The estimated cash flows have been adjusted for inflation and discounted using risk-free rates ranging from 1.9% to 2.1% at December 31, 2018 (December 31, 2017 – 1.5% to 2.1%).

16. Asset Retirement Obligations

The following table provides a reconciliation of the asset retirement obligations as at December 31, 2018 and December 31, 2017:

(millions of Canadian dollars)		**2018**		2017
Asset retirement obligations at beginning of year	**$**	**10.3**	$	9.9
Accretion expense		**0.2**		0.2
Changes in estimates		**0.5**		0.2
Asset retirement obligations at end of year	**$**	**11.0**	$	10.3
Less: Current portion		**(0.3)**		-
Long-term portion	**$**	**10.7**	$	10.3

Canfor's asset retirement obligations include $6.0 million in relation to landfill closure costs of CPPI. CPPI's obligations represent estimated undiscounted future payments of $9.3 million to remediate landfills at the operations at the end of their useful lives. The payments are expected to occur over periods ranging from 1 to 33 years and have been discounted at risk-free rates ranging from 1.9% to 2.2% (December 31, 2017 – 1.9% to 2.3%).

Canfor's asset retirement obligations, excluding CPPI's, represent estimated undiscounted future payments of $7.9 million to remediate landfills at the operations at the end of their useful lives. The payments are expected to occur over periods ranging from 3 to 52 years and have been discounted at risk-free rates ranging from 1.9% to 2.2% (December 31, 2017 – 1.8% to 2.3%).

Canfor has certain assets that have indeterminable retirement dates and, therefore, there is an indeterminate settlement date for the related asset retirement obligations. As a result, no asset retirement obligations are recorded for these assets. These assets include wastewater and effluent ponds that will have to be drained once the related operating facility is closed and storage sites for which removal of chemicals, fuels and other related materials will be required once the related operating facility is closed. When the retirement dates of these assets become determinable and an estimate of fair value can be made, an asset retirement obligation will be recorded.

It is possible that changes in future conditions could require a material change in the recognized amount of the asset retirement obligations. The asset retirement obligations balance is included in other long-term liabilities on the balance sheet.

17. Share Capital

Authorized

10,000,000 preferred shares, with a par value of $25 each.
1,000,000,000 common shares without par value.

Issued and fully paid

	2018		2017	
(millions of Canadian dollars, except number of shares)	**Number of Shares**	**Amount**	Number of Shares	Amount
Common shares at beginning of year	**128,644,980**	**$ 1,014.9**	132,804,573	$ 1,047.7
Common shares purchased	**(3,425,580)**	**(27.0)**	(4,159,593)	(32.8)
Common shares at end of year[4]	**125,219,400**	**$ 987.9**	128,644,980	$ 1,014.9

[4]Based on trade date.

The holders of common shares are entitled to vote at all meetings of shareholders of the Company, except meetings at which only holders of preferred shares would be entitled to vote. The common shareholders are entitled to receive dividends as and when declared on the common shares. The holders of preferred shares are not generally entitled to receive notice of, or to attend or vote at, general meetings of shareholders of the Company. Preferred shareholders are entitled to preference over the common shares with respect to payment of dividends and upon any distribution of assets in the event of liquidation, dissolution and winding-up of the Company. The Company does not have any preferred shares outstanding.

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. The weighted average number of common shares outstanding for 2018 was 127,742,297 (December 31, 2017 – 131,449,999), and reflects common shares purchased under the Company's normal course issuer bid.

Normal course issuer bid

On March 5, 2018, the Company renewed its normal course issuer bid whereby up to 6,439,764 common shares or approximately 5% of its issued and outstanding common shares as of March 1, 2018 could be purchased for cancellation. The renewed normal course issuer bid is set to expire on March 6, 2019.

In 2018, Canfor purchased 3,425,580 common shares for $84.8 million (an average of $24.76 per common share), of which $27.0 million was charged to share capital and $57.8 million was charged to retained earnings. Cash payments for shares purchased during the year totaled $84.8 million. The Company paid an additional $3.7 million of cash in relation to shares purchased in the prior year.

In 2017, under a previous normal course issuer bid, the Company purchased 4,159,593 common shares for $90.7 million (an average of $21.81 per common share), of which $32.8 million was charged to share capital and $57.9 million was charged to retained earnings.

As at February 21, 2019 there were 125,219,400 common shares of the Company outstanding.

Under a separate normal course issuer bid, during the year ended December 31, 2018, CPPI purchased 500 common shares at an average of $13.01 per common share from non-controlling shareholders, and paid an additional $0.1 million in relation to shares purchased in the prior year. During the year ended December 31, 2017, CPPI purchased 1,448,109 common shares at an average of $12.29 per common share from non-controlling shareholders.

As at December 31, 2018 and February 21, 2019, Canfor's ownership interest in CPPI was 54.8% (December 31, 2017 – 54.8%).

18. Non-Controlling Interests

The following table summarizes the non-controlling financial information for the Company's lumber operations and CPPI before inter-company eliminations:

Summarized Balance Sheets:

Amounts presented below represent non-controlling % (millions of Canadian dollars)	**As at December 31, 2018**			As at December 31, 2017		
	Lumber[5]	CPPI[6]	**Total**	Lumber[5]	CPPI[6]	Total
Current assets	$ 9.5	$ 158.3	**$ 167.8**	$ 7.8	$ 165.0	$ 172.8
Non-current assets	10.9	263.0	**273.9**	6.7	238.3	245.0
Total assets	$ 20.4	$ 421.3	**$ 441.7**	$ 14.5	$ 403.3	$ 417.8
Current liabilities	$ 3.0	$ 82.3	**$ 85.3**	$ 1.9	$ 73.0	$ 74.9
Non-current liabilities	3.6	69.3	**72.9**	1.3	72.0	73.3
Total liabilities	$ 6.6	$ 151.6	**$ 158.2**	$ 3.2	$ 145.0	$ 148.2
Total equity	$ 13.8	$ 269.7	**$ 283.5**	$ 11.3	$ 258.3	$ 269.6
Total liabilities and equity	$ 20.4	$ 421.3	**$ 441.7**	$ 14.5	$ 403.3	$ 417.8

Summarized Statements of Income and Other Comprehensive Income:

Amounts presented below represent non-controlling % (millions of Canadian dollars)	**Year ended December 31, 2018**			Year ended December 31, 2017		
	Lumber[5]	CPPI[6]	**Total**	Lumber[5]	CPPI[6]	Total
Sales	$ 18.3	$ 621.2	**$ 639.5**	$ 13.6	$ 546.8	$ 560.4
Net income	0.8	83.3	**84.1**	1.7	46.5	48.2
Other comprehensive income	-	1.8	**1.8**	-	8.5	8.5
Total comprehensive income	$ 0.8	$ 85.1	**$ 85.9**	$ 1.7	$ 55.0	$ 56.7
Dividends paid to non-controlling interests	$ 0.7	$ 73.8	**$ 74.5**	$ 2.4	$ 7.6	$ 10.0

Summarized Statements of Cash Flows:

Amounts presented below represent non-controlling % (millions of Canadian dollars)	**Year ended December 31, 2018**			Year ended December 31, 2017		
	Lumber[5]	CPPI[6]	**Total**	Lumber[5]	CPPI[6]	Total
Cash flows from operating activities	$ 2.7	$ 97.3	**$ 100.0**	$ 3.1	$ 88.9	$ 92.0
Cash flows from financing activities	$ (0.4)	$ (53.5)	**$ (53.9)**	$ (0.4)	$ (39.9)	$ (40.3)
Cash flows from investing activities	$ (0.7)	$ (75.3)	**$ (76.0)**	$ (1.1)	$ (37.6)	$ (38.7)

[5]Lumber non-controlling interest includes non-controlling interest related to Houston Pellet Limited Partnership (40%), CSP Moultrie Investment, LLC (5%), and Canfor Energy North Limited Partnership (15%) (December 31, 2017 – 5%).
[6]CPPI purchased shares from non-controlling CPPI shareholders under a normal course issuer bid. However, due to the small number purchased, Canfor's ownership interest of 54.8% at December 31, 2018 remained unchanged from December 31, 2017 (Note 17).

On January 1, 2018, Pacific BioEnergy Corporation ("PBEC") exercised its option to purchase from Canfor an additional 10% of the outstanding shares of Canfor Energy North Limited Partnership ("CENLP") for consideration of $3.5 million, which was received in December 2017, thereby increasing their ownership from approximately 5% to 15%.

Accordingly, the non-controlling interest of CENLP was increased by $2.5 million to reflect PBEC's 15% total ownership from January 1, 2018 onwards. A net gain of $1.3 million was recorded as a credit to equity in the first quarter of 2018 representing the difference between the adjustment to Canfor's investment in CENLP and the consideration paid, and the associated tax effects.

19. Share-Based Compensation

The value of the Company's DSUs, when redeemed, is equal to the market value of the shares on the redemption date, including the value of dividends paid on the Company's common shares, if any, as if they had been reinvested in additional DSUs on each payment date. The DSUs may only be redeemed upon a director's retirement from the Company, its subsidiaries or any affiliated entity. Effective July 27, 2011, the Board ceased the issuance of DSUs for non-employee directors. The total recovery recorded in relation to the DSUs for 2018 was $0.6 million due to the revaluation of existing units (December 31, 2017 - expense of $1.1 million). The value of outstanding DSUs at December 31, 2018 is $1.0 million (December 31, 2017 - $2.8 million).

20. Finance Expense, Net

(millions of Canadian dollars)		**2018**		2017
Interest expense on borrowings	**$**	**(25.0)**	$	(21.5)
Interest expense on retirement benefit obligations, net		**(8.3)**		(11.0)
Interest income		**8.8**		2.7
Other		**(1.5)**		(1.0)
Finance expense, net	**$**	**(26.0)**	$	(30.8)

21. Income Taxes

The components of income tax expense are as follows:

(millions of Canadian dollars)		**2018**		2017
Current	**$**	**(132.9)**	$	(120.7)
Deferred		**(16.9)**		(12.1)
Income tax expense	**$**	**(149.8)**	$	(132.8)

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

(millions of Canadian dollars)		**2018**		2017
Income tax expense at statutory rate of 27.0% (2017 – 26.0%)	**$**	**(159.0)**	$	(136.9)
Add (deduct):				
Non-taxable income related to non-controlling interests		**0.2**		0.4
Entities with different income tax rates and other tax adjustments		**8.3**		(1.9)
Permanent difference from capital gains and losses and other non-deductible items		**0.7**		1.8
Change in substantively enacted tax legislation		**-**		3.8
Income tax expense	**$**	**(149.8)**	$	(132.8)

In 2017, the Provincial Government of British Columbia passed legislation increasing the provincial corporate tax rate from 11% to 12% effective January 1, 2018. In addition, the Federal Government of the United States passed tax reform legislation, which included a reduction of the federal corporate income tax rate from 35% to 21% effective January 1, 2018. Accordingly, a $3.8 million net tax recovery was recorded in net income in 2017 to reflect the impact of these rate changes on deferred taxes, with an additional $1.1 million being recorded in other comprehensive income as an income tax recovery on defined benefit plan actuarial losses.

In addition, a tax expense of $1.9 million in relation to actuarial gains on the defined benefit plans (December 31, 2017 - expense of $6.1 million, before the tax rate adjustment) was recorded in other comprehensive income for the year ended December 31, 2018.

Also included in other comprehensive income for the 2018 year is a tax expense of $3.2 million related to foreign exchange differences on translation of investments in foreign operations (December 31, 2017 - recovery of $2.3 million).

The tax effects of the significant components of temporary differences that give rise to deferred income tax assets and liabilities are as follows:

(millions of Canadian dollars)		**As at December 31, 2018**		As at December 31, 2017
Deferred income tax assets				
Accruals not currently deductible	**$**	**44.3**	$	44.4
Loss carryforwards		**3.4**		3.3
Retirement benefit obligations		**66.0**		69.9
Goodwill and other intangible assets, net		**9.4**		11.3
Other		**6.3**		8.0
	$	**129.4**	$	136.9
Deferred income tax liabilities				
Depreciable capital assets	**$**	**(335.2)**	$	(332.7)
Other		**(35.1)**		(22.0)
	$	**(370.3)**	$	(354.7)
Total deferred income taxes, net	**$**	**(240.9)**	$	(217.8)
Less: Entities in a net deferred income tax asset position		**0.9**		5.6
Deferred income tax liability, net	**$**	**(241.8)**	$	(223.4)

Deferred income tax assets are recognized for tax loss carry-forwards to the extent that the realization of the related tax benefit through future taxable profits is probable. This assumption is based on management's best estimate of future circumstances and events. If these estimates and assumptions changed in the future, the value of the deferred income tax assets could be reduced, resulting in an income tax expense.

22. Net Change in Non-Cash Working Capital

(millions of Canadian dollars)		**2018**		2017
Accounts receivable	**$**	**25.5**	$	(28.3)
Inventories		**(126.5)**		(85.7)
Prepaid expenses		**(11.0)**		0.2
Accounts payable, accrued liabilities and current portion of deferred reforestation obligations		**29.2**		41.7
Net increase in non-cash working capital	**$**	**(82.8)**	$	(72.1)

23. Related Party Transactions

Canfor undertakes transactions with various related entities. These transactions are in the normal course of business and are generally on the same terms as those accorded to unrelated third parties, except where noted otherwise.

The Jim Pattison Group is Canfor's largest shareholder. In August of 2018, The Jim Pattison Group's ownership interest of Canfor increased above 50%, ending the year at 50.9%. During 2018, subsidiaries owned by The Jim Pattison Group provided lease, insurance and other services to Canfor totalling $5.1 million (December 31, 2017 - $5.3 million) with no amounts outstanding at December 31, 2018 (December 31, 2017 - $0.5 million).

During 2018, CPPI sold paper to subsidiaries owned by The Jim Pattison Group totalling $3.0 million (December 31, 2017 - $3.5 million). No amounts related to these sales were outstanding as at December 31, 2018 or December 31, 2017.

During 2018, Canfor also made contributions to certain post-employment benefit plans for the benefit of Canfor employees and CPPI provided services to its joint venture with Licella Fibre Fuel Pty. Ltd. See Note 14, Employee Future Benefits, and Note 28, Licella Pulp Joint Venture, for further details.

Key management personnel

Key management includes members of the Board of Directors and the senior executive management team. The compensation expense for key management for services is as follows:

(millions of Canadian dollars)		**2018**		2017
Short-term benefits	**$**	**8.7**	$	8.3
Post-employment benefits		**0.2**		0.1
Share-based payments		**(0.6)**		1.1
	$	**8.3**	$	9.5

Short-term benefits for members of the Board of Directors include an annual retainer as well as attendance fees.

24. Segment Information

Canfor has two reportable segments, as described below, which offer different products and are managed separately because they require different production processes and marketing strategies. The following summary describes the operations of each of the Company's reportable segments:

- *Lumber* – Includes logging operations, and manufacturing and sale of various grades, widths and lengths of lumber, engineered wood products, wood chips and wood pellets; and
- *Pulp and Paper* – Includes purchase of residual fibre, and production and sale of pulp and paper products, including Northern Bleached Softwood Kraft ("NBSK") and Bleached Chemi-Thermo Mechanical Pulp ("BCTMP") as well as energy revenues. This segment includes 100% of CPPI.

Information regarding the operations of each reportable segment is included in the table below. The accounting policies of the reportable segments are described in Note 3.

In accordance with the new revenue standard, IFRS 15, described in Note 4, sales from contracts with customers have been disaggregated by segment. 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. There was no quantitative financial statement impact as a result of the adoption of IFRS 15.

The Company's interest-bearing liabilities are not considered to be segment liabilities but rather are managed centrally by the treasury function. Other liabilities are not split by segment for the purposes of allocating resources and assessing performance.

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
Year ended December 31, 2018										
Sales from contracts with customers	**$**	**3,670.4**	**$**	**1,374.0**	**$**	**-**	**$**	**-**	**$**	**5,044.4**
Sales to other segments		**249.5**		**0.3**		**-**		**(249.8)**		**-**
Operating income (loss)		**390.5**		**246.6**		**(28.5)**		**-**		**608.6**
Amortization		**190.8**		**79.6**		**0.1**		**-**		**270.5**
Capital expenditures[7]		**272.3**		**120.5**		**8.6**		**-**		**401.4**
Identifiable assets		**2,499.4**		**919.3**		**426.4**		**-**		**3,845.1**
Year ended December 31, 2017										
Sales from contracts with customers	$	3,365.6	$	1,197.7	$	-	$	-	$	4,563.3
Sales to other segments		173.1		0.2		-		(173.3)		-
Operating income (loss)		441.9		154.6		(39.1)		-		557.4
Amortization		175.5		74.4		-		-		249.9
Capital expenditures[7]		163.6		83.1		5.4		-		252.1
Identifiable assets		2,285.1		815.6		387.6		-		3,488.3

[7]Capital expenditures represent cash paid for capital assets during the periods. Pulp & Paper includes capital expenditures by CPPI that were partially financed by government grants.

Geographic information

Canfor operates manufacturing facilities in both Canada and the US. Canfor's products are marketed worldwide, with sales made to customers in a number of different countries. In presenting information on the basis of geographical location, sales are based on the geographical location of customers and assets are based on the geographical location of the assets.

(millions of Canadian dollars)		**2018**		2017
Sales by location of customer				
Canada	**$**	**592.6**	$	551.0
Asia		**1,514.4**		1,346.3
United States		**2,734.8**		2,503.9
Europe		**95.9**		74.7
Other		**106.7**		87.4
	$	**5,044.4**	$	4,563.3

(millions of Canadian dollars)		**As at December 31, 2018**		As at December 31, 2017
Property, plant and equipment, timber licenses, and goodwill and other intangible assets by location				
Canada	**$**	**1,719.4**	$	1,650.6
United States		**660.1**		533.8
Asia and other		**0.1**		0.1
	$	**2,379.6**	$	2,184.5

25. Commitments and Contingencies

At the end of the year, Canfor had contractual commitments for $137.9 million (December 31, 2017 - $54.1 million). The majority of these commitments are expected to be settled over the following year.

In addition, Canfor has committed to operating leases for property, plant and equipment with future minimum lease payments under these operating leases as follows:

(millions of Canadian dollars)		**As at December 31, 2018**		As at December 31, 2017
Within one year	**$**	**14.7**	$	12.2
Between one and five years		**30.9**		23.7
Beyond five years		**6.5**		6.6
Total	**$**	**52.1**	$	42.5

During the year ended December 31, 2018, $22.5 million (December 31, 2017 - $20.4 million) was recognized as an expense for operating leases.

In the ordinary course of its business activities, the Company may be subject to, or enter into, legal actions and claims with customers, unions, suppliers or others.

In circumstances where the Company is not able to determine the outcome of a legal action and claim, no amount is recognized in the consolidated financial statements, with an amount accrued only when a reliable estimate of the obligation can be made. Although there can be no assurance as to the disposition of a legal action and claim, it is the opinion of the Company's management, based upon the information available at this time, that the expected outcome of a legal action and claim, individually or in aggregate, is unlikely to have a material adverse effect on the operating results and financial condition of the Company as a whole.

26. Financial Risk and Capital Management

Financial risk management

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

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

Credit risk:

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

Financial instruments that are subject to credit risk include cash and cash equivalents, accounts receivable, contract assets and certain investments in debt securities. Cash and cash equivalents include cash held through major Canadian and international financial institutions as well as temporary investments with an original maturity date, or redemption date, of three months or less. The cash and cash equivalents balance at December 31, 2018 is $252.7 million (December 31, 2017 - $288.2 million).

Canfor utilizes credit insurance to mitigate the risk associated with some of its trade accounts receivables. As at December 31, 2018, approximately 46% (December 31, 2017 - 40%) of the outstanding trade accounts receivables are covered by credit insurance. Canfor's trade accounts receivable balance at December 31, 2018 is $186.5 million, before a loss allowance of $4.4 million (December 31, 2017 - $196.5 million and $3.5 million, respectively).

At December 31, 2018, approximately 98% (December 31, 2017 - 99%) of the trade accounts receivable balance are within Canfor's established credit terms.

Liquidity risk:

Liquidity risk is the risk that Canfor will be unable to meet its financial obligations as they come due. Canfor manages liquidity risk through regular cash flow forecasting in conjunction with an adequate committed operating loan facility.

At December 31, 2018, Canfor had no amount drawn on its operating loan facility (December 31, 2017 – nil), and accounts payable and accrued liabilities of $458.9 million (December 31, 2017 - $470.0 million), all of which are due within twelve months of the balance sheet date.

Market risk:

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

(i) Interest rate risk:

Canfor is exposed to interest rate risk through its current financial assets and financial obligations bearing variable interest rates.

Canfor may use interest rate swaps to reduce its exposure to interest rate risk associated with financial obligations bearing variable interest rates. At December 31, 2018, and December 31, 2017, Canfor had no fixed interest rate swaps outstanding.

(ii) Currency risk:

Canfor is exposed to foreign exchange risk primarily related to the US dollar, as Canfor's products are sold principally in US dollars. In addition, Canfor holds financial assets and liabilities primarily related to its US entities in US dollars.

An increase (decrease) in the value of the Canadian dollar by US$0.01 would result in a pre-tax: (i) loss (gain) of approximately $1.4 million in relation to working capital balances denominated in US dollars at year end (including cash, accounts receivable and accounts payable); and a (ii) gain (loss) of approximately $1.8 million in relation to long-term debt denominated in US dollars at year end.

A portion of the currency risk associated with US dollar denominated sales is naturally offset by US dollar denominated expenses. A portion of the remaining exposure is sometimes reduced by foreign exchange collar contracts that effectively limit the minimum and maximum Canadian dollar recovery related to the sale of those US dollars. At December 31, 2018 and December 31, 2017, the Company had no foreign exchange collar contracts outstanding.

Canfor is also subject to Swedish Krona ("SEK") foreign exchange risk associated with the commitment to purchase the VIDA Group (Note 29(d)). In order to reduce its exposure to fluctuations in the Swedish Krona versus the Canadian and US dollar, Canfor entered into forward foreign exchange contracts in the fourth quarter of 2018.

At December 31, 2018, Canfor had the following forward foreign exchange contracts outstanding:

	As at December 31, 2018		
	Notional Amount Currency	**Notional Amount**	**Exchange Rates**
Swedish Krona Forward Contracts		(millions of dollars)	(rate of SEK to notional dollar)
January 15 - February 28, 2019	USD	**$100.0**	**9.07**
January 15 - February 28, 2019	CAD	**$292.6**	**6.84**

No forward foreign exchange contracts were outstanding at December 31, 2017.

Subsequent to year end, the Company continued to reduce its exposure to fluctuations in the Swedish Krona by entering into additional US and Canadian dollar forward foreign exchange contracts. Canadian dollar contracts were entered into with a total notional amount of $125.0 million, exchange rates ranging from 6.86 to 6.90 and settlement dates of February 28, 2019. US dollar contracts were also entered into with a total notional amount of US$25.0 million, an exchange rate of 9.06 and a settlement date of February 28, 2019.

(iii) Commodity price risk:

Canfor is exposed to commodity price risk principally related to the sale of lumber, pulp and paper. From time to time, Canfor enters into futures contracts on the Chicago Mercantile Exchange for lumber and forward contracts direct with customers or on commodity exchanges for pulp. Under the Company's Price Risk Management Controls Policy, up to 15% of lumber sales and 1% of pulp sales may be sold in this way.

Canfor had the following lumber futures contracts at December 31, 2018 and December 31, 2017:

	As at December 31, 2018		As at December 31, 2017	
	Notional Amount	**Average Rate**	Notional Amount	Average Rate
Lumber	(MMfbm)	(US dollars per Mfbm)	(MMfbm)	(US dollars per Mfbm)
Future sales contracts				
0-12 months	**42.7**	**$343.14**	24.3	$436.41

An increase (decrease) in the futures market price of lumber of US$10 per Mfbm would result in a pre-tax gain (loss) of approximately $0.6 million in relation to the lumber futures held at year end.

Canfor

(iv) Energy price risk:

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

The annual exposure is from time to time hedged up to 100% through the use of floating to fixed swap contracts or option contracts with maturity dates up to a maximum of three years. In the case of diesel, Canfor uses Brent oil and Western Texas Intermediate ("WTI") oil contracts to hedge its exposure.

At December 31, 2018, and December 31, 2017, the Company had no oil collars outstanding.

Canfor is also exposed to energy price risk on the sale of electricity in Canada. Prices are set by third-party regulatory bodies. In 2017, Canfor entered into a commodity swap transaction to transfer 61,320 megawatt hours ("MWh") at a rate of $46.25 per MWh, effective January 1, 2018 through December 31, 2018.

Capital management

Canfor's objectives when managing capital are to maintain a strong balance sheet and a globally competitive cost structure that ensures adequate liquidity to maintain and develop the business throughout the commodity price cycle.

Canfor's capital is comprised of net debt and shareholders' equity:

(millions of Canadian dollars)		**As at December 31, 2018**		As at December 31, 2017
Total debt (including operating loans)	**$**	**408.4**	$	385.7
Less: Cash and cash equivalents		**(252.7)**		(288.2)
Net debt	**$**	**155.7**	$	97.5
Total equity		**2,339.9**		2,001.0
	$	**2,495.6**	$	2,098.5

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

Canfor's strategy is to ensure it remains in compliance with all of its existing debt covenants, so as to ensure continuous access to capital. Canfor was in compliance with all its debt covenants for the years ended December 31, 2018 and December 31, 2017.

The Company manages its capital structure through rigorous planning, budgeting and forecasting processes, and ongoing management of operations, investments and capital expenditures. In 2018, to meet Canfor's operating, growth and return on invested capital objectives, the Company's management of capital comprised investment in the Company's operations, development of energy and sustainable working capital and cost management initiatives. Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

27. Financial Instruments

Canfor's cash and cash equivalents, trade and other accounts receivables, investments in debt and equity securities, derivative instruments, accounts payable and accrued liabilities, operating loans, and long-term debt are classified as measured at amortized cost in accordance with IFRS 9, adopted by the Company on January 1, 2018 (Note 4). The carrying amounts of these instruments at December 31, 2018, approximate fair value.

Derivative instruments are classified as measured at FVTPL. 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, 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, 2018 and December 31, 2017, 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, 2018**		As at December 31, 2017
Financial assets measured at fair value					
Investments	Level 1	**$**	**20.1**	$	21.8
Derivative financial instruments	Level 2		**18.8**		-
		$	**38.9**	$	21.8
Financial liabilities measured at fair value					
Derivative financial instruments	Level 2	**$**	**0.6**	$	0.8
		$	**0.6**	$	0.8

Canfor invests in equity and debt securities, which are traded in an active market and valued using closing prices on the measurement date with gains or losses recognized through net income.

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

At December 31, 2018, the fair value of derivative financial instruments is a net asset of $18.2 million (December 31, 2017 - net liability of $0.8 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 years ended December 31, 2018 and December 31, 2017:

(millions of Canadian dollars)		**2018**		2017
Lumber futures	**$**	**(17.9)**	$	(4.7)
Energy derivatives		**0.2**		(0.5)
Foreign exchange forward contracts		**18.8**		-
Gain (loss) on derivative financial instruments	**$**	**1.1**	$	(5.2)

The following table summarizes the fair value of the derivative financial instruments included in the balance sheets at December 31, 2018 and December 31, 2017:

(millions of Canadian dollars)		**As at December 31, 2018**		As at December 31, 2017
Lumber futures	**$**	**(0.6)**	$	(0.3)
Energy derivatives		**-**		(0.5)
Foreign exchange forward contracts		**18.8**		-
Total asset (liability), net		**18.2**		(0.8)
Less: Current portion asset (liability), net		**18.2**		(0.8)
Long-term asset (liability), net	**$**	**-**	$	-

There were no transfers between fair value hierarchy levels in 2018 or 2017.

28. Licella Pulp Joint Venture

On May 27, 2016, Canfor's subsidiary CPPI and Licella Fibre Fuel Pty Ltd. ("Licella") agreed to form a joint venture under the name Licella Pulp Joint Venture to investigate opportunities to integrate Licella's Catalytic Hydrothermal Reactor platform into CPPI's pulp mills to economically convert biomass into next generation biofuels and biochemicals. Licella is a subsidiary of Ignite Energy Resources Ltd. ("IER") an Australian energy technology development company.

Under IFRS 11, *Joint Arrangements*, the joint venture is classified as a joint operation and CPPI will recognize its assets, liabilities and transactions, including its share of those incurred jointly, in its consolidated financial statements. For the year ended December 31, 2018, CPPI's share of the joint venture's expenses was $2.1 million (December 31, 2017 - $1.1 million), which have been recognized in manufacturing and product costs. CPPI is required to contribute the first $20.0 million of any funding requirements, including cash and non-cash contributions, to the joint venture, of which $3.8 million has been contributed as at December 31, 2018.

In March 2017, the Canadian Federal Government through its Sustainable Development Technology Canada program announced the funding over several years of approximately $13.2 million, contingent on future spending. Advance funding of $1.9 million was received in April 2018 for the period October 1, 2017 through to the time at which the terms of funding have been met, which is currently estimated as March 31, 2019. Of this amount, $0.7 million has been recognized as an offset to costs within manufacturing and product costs during the year ended December 31, 2018.

29. Acquisitions

(a) Beadles Lumber Company & Balfour Lumber Company Inc.

On January 2, 2015, the Company completed the first phase of the acquisition of Beadles Lumber Company & Balfour Lumber Company Inc. ("Beadles & Balfour") for total consideration of $51.6 million (US$44.0 million), representing an initial 55% interest.

On January 2, 2017, the Company completed the final phase of the acquisition of Beadles & Balfour for $41.8 million (US$31.1 million) bringing Canfor's interest in Beadles & Balfour to 100%. Upon completion of the final phase of the acquisition, the forward purchase liability of $41.8 million and non-controlling interest of $19.9 million were derecognized, and $36.5 million was recorded in other equity. In addition, $16.6 million was charged to retained earnings reflecting Canfor's election to account for the non-controlling interest related to Beadles & Balfour as the non-controlling share of the fair value of the net identifiable assets at the acquisition date.

The acquisition was accounted for in accordance with IFRS 3, *Business Combinations*.

(b) Wynndel Box and Lumber Ltd.

On April 15, 2016, the Company completed the acquisition of the assets of Wynndel Box and Lumber Ltd. ("Wynndel") for total consideration of $40.3 million. The acquisition has been accounted for in accordance with IFRS 3, *Business Combinations*.

At the acquisition date, the Company paid $19.7 million, and a working capital true-up payment of $2.6 million was paid in early July 2016. On April 5, 2017, the Company paid an instalment of $14.4 million. The final instalment of $3.6 million was paid on October 13, 2017.

(c) Elliott Sawmilling Co., Inc.

On November 9, 2018, the Company announced that it had entered into an agreement to purchase Elliott Sawmilling Co., Inc., ("Elliott") located in Estill, South Carolina for total consideration of $150.0 million (US$110.0 million). The transaction will be completed in two phases, with 49% acquired upon closing, and the remaining 51% being acquired one year later. Elliott has an annual production capacity in excess of 210 million board feet, with the sawmill consisting of both large and small log lines.

The transaction is anticipated to close during Q2 2019, following the completion of due diligence, completion of certain transaction documents and other customary closing conditions.

(d) VIDA Group of Sweden

On November 15, 2018, the Company announced that it had entered into an agreement to purchase 70% of the VIDA Group ("VIDA") for total consideration of $580.0 million (3,990 million Swedish Krona). VIDA is Sweden's largest privately-owned sawmill company, operating nine sawmills in southern Sweden and producing up to 1.1 billion board feet of high-quality spruce and pine products annually. In addition, VIDA operates nine value added facilities that include premium packaging, modular housing, industrial products and energy.

The transaction is anticipated to close during Q1 2019 following the completion of due diligence, completion of certain transaction documents and other customary closing conditions.

30. Countervailing and Anti-Dumping Duties

On November 25, 2016, a petition was filed by the US Lumber Coalition to the US Department of Commerce ("DOC") and the US International Trade Commission ("ITC") alleging certain subsidies and administered fees below the fair market value of timber that favour Canadian lumber producers, an assertion the Canadian industry and Provincial and Federal Governments strongly deny and have successfully disproven in international courts in the past. Canfor was selected by the DOC as a "mandatory respondent" to the countervailing and anti-dumping investigations and is subject to company specific countervailing and anti-dumping duties.

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

Final countervailing and anti-dumping duty determinations were announced by the DOC on November 2, 2017, while the ITC issued an affirmative determination of injury on December 7, 2017. As a result, Canfor was issued a final ADD rate of 7.28% effective November 8, 2017 and was subject to countervailing duties on Canadian lumber exports destined to the US at a reduced rate of 13.24%, effective December 28, 2017. Notwithstanding the final rates established in the DOC's investigation, the final liability for the assessment of CVD and ADD will not be determined until an official administrative review of the respective period is complete. For the CVD rate, the first Administrative Review is anticipated to be based on sales and cost data through 2017 and 2018, with the ADD rate expected to be based off data from July 2017 to December 2018. These two CVD and ADD Administrative Reviews are currently anticipated to be completed in 2020.

In 2017, the Company reduced its countervailing expense accrual by $14.0 million reflecting the difference in the DOC's preliminary and final countervailing duty rates. In the case of the ADD, cash deposits were posted at the final published ADD rate of 7.28% as determined by the DOC, however for accounting purposes, the expense was accrued at 1.1% reflecting Canfor's best estimate of the rate applicable to its product shipment profile, as determined by applying the DOC's methodology to current sales and cost data. As Canfor is unable to determine a current CVD accrual rate for accounting purposes, an expense was recorded at the CVD deposit rate. Accordingly, the Company reduced its anti-dumping duty accrual by $30.9 million reflecting the difference in the DOC's preliminary rate of 7.72%, and the Company's estimated accrual rate of 1.1% for the applicable period in 2017.

In 2018, cash deposits were posted reflecting the final published ADD rate of 7.28% and CVD rate of 13.24%, with ADD expense accrued at 2.9% for the applicable 2017 and 2018 combined period. Cumulative cash duties paid to December 31, 2018 were $284.0 million. The estimated ADD rate at December 31, 2018, increased by 1.8% from 2017 as a result of applying the DOC's methodology to current period sales and cost data included in the first period of review. In 2019, Canfor will move into a new period of review, with the estimated ADD rate based on 2019 sales and cost data. Canfor will continue to reassess the ADD accrual estimate at each quarter-end, applying the DOC's methodology to updated sales and cost data as this becomes available. Quarterly revisions to the ADD rate may result in a material adjustment to the Income Statement while the Administrative Reviews are taking place. Changes to the DOC's existing CVD and ADD rates during the course of each Administrative Review may also result in material adjustments to the Income Statement. At December 31, 2018, Canfor has recorded a receivable of $76.6 million (Note 10) reflecting the difference over the eighteen-month period of review between the current combined cash deposit rate of 20.52% and the current combined accrual rate for accounting purposes of 16.14%.

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

ADDITIONAL INFORMATION

DIRECTORS AND OFFICERS

DIRECTORS

The name and municipality, province/state and country of residence of the Directors of the Company and their principal occupations as at December 31, 2018 are as below. For more information visit www.canfor.com.

John Baird[3][4][5]
Corporate Director
Toronto, Ontario, Canada

Ryan Barrington-Foote[1][2][3]
Managing Director, Accounting
The Jim Pattison Group
Vancouver, British Columbia, Canada

Peter Bentley, O.C., O.B.C., LL.D.[2][3][4][5]
Chairman Emeritus
Canfor Corporation
Vancouver, British Columbia, Canada

Glen Clark[3][4][5]
President and Chief Operating Officer
The Jim Pattison Group
Vancouver, British Columbia, Canada

Ross Smith, FCPA, FCA [1][2]
Corporate Director
West Vancouver, British Columbia, Canada

Donald Kayne
President and Chief Executive Officer
Canfor Corporation
Tsawwassen, British Columbia, Canada

Dallas Ross[1][4]
Founder and General Partner
Kinetic Capital Partners
Vancouver, British Columbia, Canada

William Stinson[1][2][4][5]
Chairman and Chief Executive Officer
Westshore Terminals Investment Corporation
Vancouver, British Columbia, Canada

J. Mack Singleton, BA[4][5]
Corporate Director
Myrtle Beach, South Carolina, United States

Conrad Pinette
Chairman
Canfor Corporation
Vancouver, British Columbia, Canada

Dianne Watts
Corporate Director
Surrey, British Columbia, Canada

OFFICERS

The name and municipality, province/state and country of residence of the Chair Emeritus and the executive officers of the Company and the offices held by them as at December 31, 2018 are as below. For more information visit www.canfor.com.

Peter Bentley
Chairman Emeritus
Vancouver, British Columbia, Canada

Mark Feldinger
Senior Vice President,
Global Supply Chain
Surrey, British Columbia, Canada

Stephen Mackie
Senior Vice President, Operations Canada
Prince George, British Columbia, Canada

David Calabrigo, Q.C.
Senior Vice President, Corporate Development,
Legal Affairs and Corporate Secretary
Vancouver, British Columbia, Canada

Kevin Pankratz
Senior Vice President, Sales and Marketing
North Vancouver, British Columbia, Canada

Donald Kayne
President and Chief Executive Officer
Tsawwassen, British Columbia, Canada

Bob Hayes
Vice President, Transportation
Global Supply Chain
Delta, British Columbia, Canada

Frederick Stimpson III
President, Canfor Southern Pine
Mobile, Alabama, United States

Alan Nicholl
Chief Financial Officer and Executive Vice
President, Finance and Canfor Pulp Operations
West Vancouver, British Columbia, Canada

Conrad Pinette
Chairman
Vancouver, British Columbia, Canada

David Trent
Vice President, Technology and Digital
West Vancouver, British Columbia, Canada

Patrick Elliott
Vice President, Corporate
Finance and Strategy
Vancouver, British Columbia, Canada

Katy Player
Vice President, People and Communications
North Vancouver, British Columbia, Canada

Kevin Horsnell
Vice President, Woodlands Canada
Prince George, British Columbia, Canada

[1] Member of the Audit Committee, which reviews the Company's financial statements, the scope and results of the external auditor's work, the adequacy of internal accounting and audit programs and compliance with accounting and reporting standards.
[2] Member of the Joint Management Resources and Compensation Committee, which oversees compensation policies approved by the Board and makes recommendations to the Board regarding executive compensation.
[3] Member of the Joint Corporate Governance Committee, which ensures that the Company through its Board of Directors sustains an effective approach to corporate governance.
[4] Member of the Joint Environmental, Health and Safety Committee, which develops, reviews and makes recommendations on matters related to the Company's environmental, health and safety policies, and monitors compliance with those policies and with government regulation.
[5] Member of the Joint Capital Expenditure Committee, which reviews proposed capital expenditures.

The term of office of each Director expires on the date of the next Annual General Meeting of the Company.

CORPORATE AND SHAREHOLDER INFORMATION

Annual General Meeting

The Annual General Meeting of Canfor Corporation will be held at the Westin Wall Centre at 3099 Corvette Way, Richmond BC, on Wednesday, May 1, 2019 at 1:00 p.m.

Auditors
KPMG LLP
Vancouver, BC

Transfer Agent and Registrar
AST Trust Company (Canada)
1600 - 1066 W. Hastings St.
Vancouver, BC V6E 3X1

Stock Listing
Toronto Stock Exchange
Symbol: CFP

Canfor also produces an Annual Information Form. To obtain this publication or more information about the Company, please contact Canfor Corporation or visit our website at http://canfor.com/investor-relations.

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