

# 2017

CANFOR CORPORATION

ANNUAL REPORT



## IN THIS REPORT

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# FROM THE PRESIDENT AND CEO

During 2017, our continued execution of our strategy resulted in Canfor setting performance records for safety, production and operating income. We continued our path of growth in the US Southeast, expanded our production of high-value products and built on our industry-leading efforts to diversify global markets and applications for our quality lumber, pulp and paper products.

Our high-value product focus ensures we are able to maximize our use of fibre at every stage of the value chain – from the highest-value solid wood or engineered wood products to pulp, paper and energy. Our goal is to significantly increase our production of non-commodity lumber products, and continue to diversify high-value end use applications for our pulp and paper products.

When the Brock Commons student residence opened in Vancouver in July 2017, it was the tallest mass timber building in the world – and Canfor supplied the high-quality specialty lumber that went into this world class facility. We were also chosen as the supplier for the lumber required to produce cross laminated timber (CLT) panels for the new Microsoft modern campus in Mountain View, California. It will be the largest-ever North American mass timber project by volume and square footage, and another exciting example of wood being used in an application that would have traditionally used concrete and steel. We are a committed member of the Softwood Lumber Board, which is creating and expanding new markets for North American softwood lumber for use in non-residential and commercial applications.

We continue to expand our market development efforts, particularly in Asia, and our marketing teams in Seoul, Tokyo and Shanghai are working closely together to increase demand for higher-value applications across these regions. We are seeing results - China and other growing economies are increasingly using wood for both residential and non-residential construction. In China, wood is one of the preferred building materials endorsed by the central government, and is a critical solution for the country to meet the ambitious goals it has set related to prefabrication and green building.

In 2017, Canfor Pulp Products Inc. (Canfor Pulp) facilities generated 950,000 megawatt hours of power, nearing our goal of generating one million megawatt hours of energy annually. Our teams continue their innovative work exploring the potential to use the unique technology developed by Licella Fibre Fuel Pty Ltd. to convert residuals and by-products from kraft pulp mill production processes into a low-cost biocrude oil that could be refined into next-generation biofuels and biochemicals. In March of 2017, we received approval for up to \$13.2 million of funding from Sustainable Development Technology Canada, which supports the development and deployment of clean technology in Canada.

We continue to have confidence in our fibre position, cost structure and markets for Southern Yellow Pine and began a \$160 million organic capital program that will increase our production capacity in the US South by 350 million board feet by 2019. Early in 2018, we also announced plans to construct a 275 million board foot greenfield mill, further expanding our footprint in the US South.

We are building strong, mutually beneficial relationships with Aboriginal communities in traditional territories where we have operations. In 2017, we negotiated several key agreements with individual First Nations to grow business partnerships and economic opportunities. We also made progress on systems and programs to recruit and retain more aboriginal employees.

Canfor's goal is to be the forest sector partner of choice for First Nations in Canada, and we are committed to building on existing strong relationships and growing new partnerships.

At a time when competition for skilled workers is high, we took a number of steps in 2017 to support post-secondary institutions and raise awareness of the opportunities in our industry and our company. We supported technical schools in Arkansas and South Carolina, continued our longstanding support of post-secondary institutions in Canada and initiated several new projects to increase interest and enrollment of students into the trade professions, including support of the mobile trades training program in Northern British Columbia. We are also focused on diversifying our workforce and ensuring that we hire, promote and invest in the best employees, regardless of their race, religion, gender or any other element of diversity. We are committed to being an employer of choice for all talented people.

Canfor and Canfor Pulp understand that our strength comes from our skilled and dedicated employees, and we work hard to support their ongoing professional development. We have been recognized as one of BC's Top Employers for five years in a row, and were also selected as one of Canada's Best Employers for Recent Graduates in 2018.

Safety of our people is our single highest priority and focus, and we take great pride in the fact that our employees consistently keep us a safety leader in our industry. In 2017, we had a company-wide medical incident rate (MIR) of 1.68 – the lowest single year ever achieved. Our mills in Grande Prairie, AB; El Dorado and Urbana, AK; Graham, NC, and Jackson, AL, were all recognized for their safety achievements. Canfor Pulp achieved their lowest MIR in the past decade, and our New South Express trucking fleet received the Grand Truck Safety Award at the South Carolina Truck Safety Awards Banquet early in 2018 for being the safest fleet in South Carolina.

We continue to work closely with the Canadian and provincial governments to aggressively defend ourselves against unfair and unjustified trade action against our exports of softwood lumber to the United States. Our business is performing well in spite of these unwarranted duties on our shipments to the US market.

Looking ahead, our business is aligned with global efforts to build a more sustainable economy and we anticipate strong demand for all of our products – lumber, pulp, paper and energy. Overall, the global trends tell us we can look forward to long-term value action and further opportunities in our businesses.

My sincere thanks to the tremendous employees across all of our operations for their exceptional contributions, and to my executive and senior management team for their support and leadership. I would also like to extend my sincere appreciation to our Board of Directors. We are fortunate to have a Board that offers exceptional guidance and advice, and to have the opportunity to be part of the Jim Pattison Group, our largest shareholder.



A stylized handwritten signature in black ink, appearing to read 'DKayne'.

**Don Kayne**  
President and Chief Executive Officer

## 2017 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, 2017 relative to the year ended December 31, 2016, and the financial position of the Company at December 31, 2017. 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, 2017 and 2016. 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 before Amortization and Adjusted Operating Income 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 (calculated as Shareholder Net income less specific items affecting comparability with prior periods – for the full calculation, see reconciliation included in the section "Overview of Consolidated Results – 2017 Compared to 2016") and Adjusted Shareholder Net Income per Share (calculated as Adjusted Shareholder Net Income divided by the weighted average number of shares outstanding during the period). Operating Income before Amortization, Adjusted Operating Income, Adjusted Shareholder Net Income and Adjusted Shareholder Net Income per Share are not generally accepted earnings measures under IFRS and should not be considered as an alternative to net income or cash flows as determined in accordance with IFRS. As there is no standardized method of calculating these measures, Canfor's Operating Income before Amortization, Adjusted Operating Income, Adjusted Shareholder Net Income and Adjusted Shareholder Net Income per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of Operating Income before Amortization to Operating Income and Adjusted Shareholder Net Income to Net Income 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 22, 2018.*

### 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.*

## 2017 HIGHLIGHTS

Despite many challenges presented by extreme weather, forest fires and the introduction of softwood lumber duties on Canadian exports to the United States ("US"), the Company generated strong financial results in 2017 largely on the back of stronger lumber and pulp market prices and the Company's continued margin focus. Consolidated operating income at \$557.4 million was up \$251.3 million, or 82%, from 2016.

The Company remained focused on its high-value strategy in 2017, generating higher revenue and margins through increased market, customer and product diversification. North American lumber demand was solid across all segments of the market through 2017, as the US housing market continued its ongoing slow but gradual recovery. Strong underlying North American and offshore demand, in combination with supply constraints resulting from the worst fire season in recorded history in British Columbia ("BC"), as well as uncertainty surrounding the introduction of softwood lumber duties, gave rise to a significant increase in benchmark lumber prices in 2017.

Consistent with its top-line revenue and financial margin focus, the Company produced and shipped a record number of prime (better than #2&Btr) products in 2017, at both its Western Spruce/Pine/Fir ("Western SPF") and Southern Yellow Pine ("SYP") operations, aided by a continued shift into greener fibre in Western Canada and targeted capital spending. Despite extreme winter weather conditions, significant rainfall, forest fires and hurricanes through 2017, lumber production was maintained broadly in line with the prior year, with an increasing proportion of capital deployed in the US South contributing to higher productivity rates, and disciplined cost management offsetting the weather-related disruptions in Western Canada. Shipment volumes, particularly from the latter region, however, were adversely impacted by weather related transportation challenges in late 2017.

Market-driven increases in purchased wood costs and stumpage were major factors contributing to higher unit log costs in Western Canada in 2017. Log deliveries were impacted by the challenging weather conditions and forest fire season in BC, which disrupted both log procurement efforts and operations, and contributed to higher unit log costs and slightly lower production in Western Canada. 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 pressure on log costs.

Overall operating results for the lumber segment were well up in 2017 compared to 2016, as significantly higher lumber prices, a higher-value sales mix and stable log costs in the US South more than offset higher unit manufacturing costs in Western Canada.

Global pulp market conditions were relatively stable for the first half of 2017, but improved considerably in the latter part of the year, mostly as a result of a decision by the Chinese government to restrict recovered paper imports as well as various unforeseen global pulp supply disruptions. Northern Bleached Softwood Kraft ("NBSK") pulp list prices to China averaged US\$712 per tonne for the year, US\$113 per tonne higher than in 2016, and ended the 2017 year at a near-record high price of US\$890 per tonne. Prices to other regions saw more modest year-over-year gains. The appreciation of US-dollar prices across all regions significantly outweighed the effects of a modest strengthening of the Canadian dollar and increased discounts in North American markets during the year.

Operating results for the pulp and paper segment were \$154.6 million, up \$56.4 million from the previous year, as higher average NBSK pulp and Bleached Chemi-Thermo Mechanical Pulp ("BCTMP") unit sales realizations more than offset market-related increases in fibre costs, and higher chemical and energy costs.

The Company continued to preserve its strong financial position in 2017, applying a disciplined approach to cash allocation for internal investment and growth. The Company ended the year with cash and cash equivalents of \$288.2 million, consolidated net debt of \$97.5 million and a consolidated net debt to capitalization ratio of 4.6%, a decrease of \$221.9 million, or 10.9% compared to the prior year. In 2017, Canfor's Board of Directors approved a \$160 million capital investment program focused on expanding production capacity at its US South sawmill operations by approximately 350 million board feet by the end of 2019. Subsequent to year end, Canfor's Board of Directors also approved the construction of a new state-of-the-art US\$120 million greenfield sawmill in Georgia, with annual capacity of 275 million board feet. Upon completion, these capital investments will increase Canfor's lumber production capacity to approximately 6.1 million board feet, with the Company's Southern Yellow Pine lumber capacity growing to approximately 2.1 billion board feet, or one-third of total production. In mid-2017, Canfor Pulp Products Inc. ("CPPI") announced 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 \$105 million. These two projects will yield a significant improvement in overall mill energy efficiency and will result in a material reduction in total fuel consumption.

As part of its Balance Sheet management, the Company purchased a further \$136 million of annuities through its defined benefit pension plans in 2017, significantly mitigating its exposure to future volatility fluctuations in related pension obligations. The Company was also active in repurchasing shares through 2017, purchasing approximately 4.2 million common shares under its Normal Course Issuer Bid for \$90.7 million, at an average price of \$21.81 per share. CPPI, under its own normal course issuer bid, purchased approximately 1.4 million common shares for \$17.8 million (an average of \$12.29 per share).

Further discussion on the more significant developments is provided in the "Overview of 2017" 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, 2017, Canfor employed 6,284 people, of which 1,279 are employed by CPPI.

Significant changes to the Company's business in 2017 include the following:

- On January 2, 2017, the Company completed the final phase of its purchase of Beadles Lumber Company & Balfour Lumber Company Inc. ("Beadles & Balfour") located in Georgia, increasing its ownership from 55% to 100%. Beadles & Balfour operates two sawmills in an area with a high-quality fibre supply, with one sawmill focused primarily on one-inch lumber products and the other sawmill producing structural lumber, with combined annual production capacity of 250 million board feet following capital upgrades and additional shifting. The aggregate purchase price for Beadles & Balfour was \$93.4 million, including working capital.
- On March 31, 2017, the Company completed the sale of its 50% investment in Anthony EACOM Inc., an I-joist plant located in Sault Ste. Marie, Ontario with annual capacity of 54 million lineal feet, for net proceeds of \$21.1 million.
- In late 2015 and early 2016, the Company completed the construction of two pellet plants located at the Chetwynd and Fort St. John sawmill sites, in the Northern British Columbia interior (the "pellet plants") in partnership with Pacific BioEnergy Corporation ("Pacific BioEnergy"). As of December 31, 2017 Canfor owned an approximate 95% interest in the pellet plants while Pacific BioEnergy owned the remaining 5%. Subsequent to year end, on January 1, 2018, Pacific BioEnergy exercised its option to increase its ownership interest in the pellet plants to 15%.

### **Lumber**

Canfor's existing lumber operations will have an annual production capacity of approximately 6.1 billion board feet of lumber reflecting Board approved near-term capital investments and the announced greenfield sawmill. 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. As outlined above, the Company, in partnership with Pacific BioEnergy, 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; Mobile, US; Tokyo, Japan; Seoul, South Korea 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 northern softwood market kraft 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.

All 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, Europe and Asia. 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 preferred supplier of wood products to the building industry around the world, with a particular focus on North America and Asia. 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 Company is also committed to being a major supplier to the retail segment of the lumber market.

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, and maintaining the premium quality of its products;
- 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
- Growing 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:

- Preserving its low-cost operating position;
- Maintaining the premium quality of its products;
- Growing its green energy business;
- Developing an enterprise-wide culture of safety, innovation and engagement; and
- Capitalizing on attractive growth opportunities.

## OVERVIEW OF 2017

### Markets and Pricing

#### (i) Solid Wood

North American lumber demand improved through 2017 as the US housing market continued its ongoing slow but gradual recovery, while demand continued to strengthen in the repair and remodeling sector. In Canada, housing construction activity reached historical highs in 2017, while offshore lumber demand from China, Japan and other regions remained strong, and reflected steadily increasing demand for the Company's higher-value lumber products. A combination of increased lumber consumption, constraints on Western SPF supply, and the imposition of countervailing and anti-dumping duties (see further discussion in the "Countervailing and Anti-dumping Duties" section of this document) resulted in significantly higher average US-dollar benchmark lumber prices through the year, particularly for Western SPF products.

The North American benchmark Western SPF 2x4 #2&Btr lumber price was up US\$96 per Mfbm<sup>1</sup>, or 31%, compared to 2016, while the Western SPF 2x6 #2&Btr lumber price was up US\$117 per Mfbm<sup>1</sup>, or 41%. Pricing for wider-width Western SPF products saw more modest increases. 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) <sup>1</sup>	2017	2016
2x4 #2&Btr	\$ 401	\$ 305
2x4 #3	\$ 323	\$ 240
2x6 #2&Btr	\$ 402	\$ 285
2x10 #2&Btr	\$ 386	\$ 322

Southern Yellow Pine lumber prices saw more modest increases, as improved demand was met in part by increased domestic production. The Random Length SYP East 2x4 #2 price was up US\$31 per Mfbm, or 7%, compared to 2016, with a similar increase seen for 2x6 #2. Pricing for wider-width SYP lumber products saw more modest increases, with the exception of the SYP East 2x12 #2 price, which was down 2%, as highlighted in the following table:

(Average SYP East US\$ price, per thousand board feet) <sup>1</sup>	2017	2016
2x4 #2	\$ 456	\$ 425
2x6 #2	\$ 377	\$ 343
2x8 #2	\$ 358	\$ 337
2x10 #2	\$ 379	\$ 369
2x12 #2	\$ 456	\$ 467

US housing starts averaged 1,207,000 units<sup>2</sup> in 2017, an increase of 3% from 2016, and the highest annual average since 2007 (Chart 1). Contributing to improved lumber demand was a significant increase in single-family unit starts, which consume a higher proportion of lumber, and were up 8% in 2017. Multi-family unit starts were moderately lower than 2016.

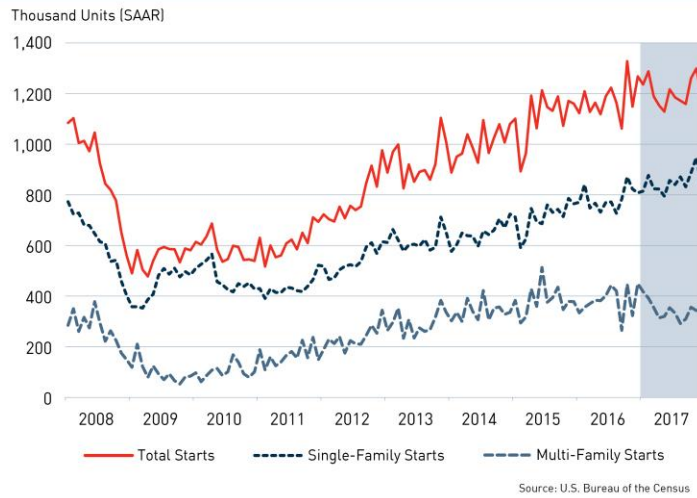
<sup>1</sup> Random Lengths Publications, Inc.

<sup>2</sup> Source: US Bureau of the Census



Chart 1

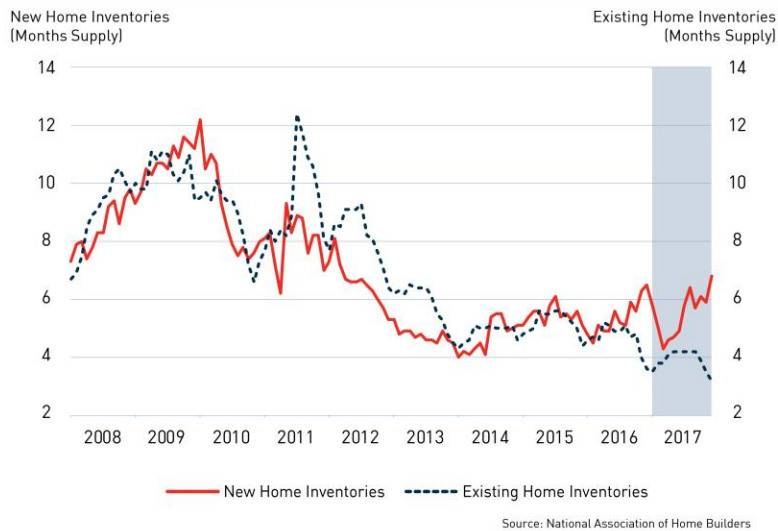
**U.S. HOUSING STARTS**



Despite a modest upward trend through 2017, new home inventory levels remained below normal historical levels, while existing home inventory decreased to historically low levels towards the end of the year (see Chart 2), with both metrics, along with new housing starts, highlighting the improving market fundamentals for the industry.

Chart 2

**NEW AND EXISTING HOME INVENTORIES IN U.S.**

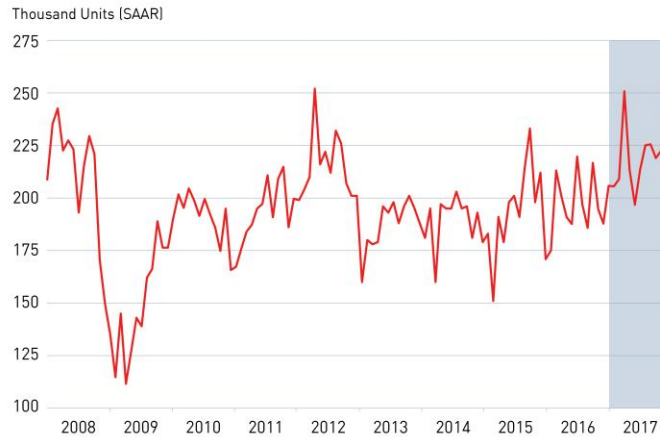


The Canadian housing market was strong through 2017, with housing starts at 220,000 units<sup>3</sup> in 2017, up 11% compared to 2016 (Chart 3), reflecting strength in the housing market across most regions through the year.

<sup>3</sup> Canada Mortgage and Housing Corporation ("CMHC")

Chart 3

CANADIAN HOUSING STARTS



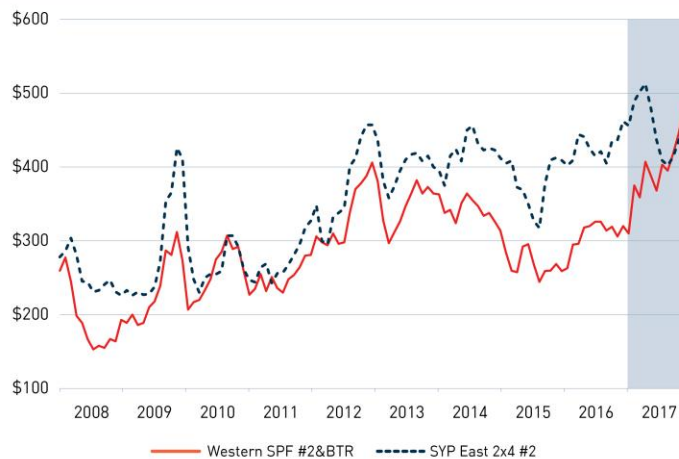
Source: Canada Mortgage and Housing Corporation

Canfor's lumber shipments to offshore markets were slightly higher than the prior year, with steady shipments to key offshore lumber markets reflecting strong demand, particularly for the Company's higher-value lumber 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 2017 and the growth of the Company's US South lumber business in recent years, the Company's exposure to the US in 2017 remained well below where it was in 2007, with Western SPF lumber sales to North America over the last 10 years down approximately 16% principally as a result of the Company's development of new markets for its lumber products, particularly in China.

As previously mentioned, prices for Western SPF and SYP products trended up during 2017, supported by improving market fundamentals. The introduction of duties on Canadian lumber exports to the US market, in addition to temporary fire-related supply constraints, resulted in a narrowing of the historical spread between the prices of SYP East 2x4 #2 and Western SPF 2x4 #2&Btr lumber products in 2017 (see Chart 4).

Chart 4

U.S. WESTERN SPF 2x4 #2&BTR AND SYP EAST #2 LUMBER PRICE COMPARISON



Source: Random Lengths Publications, Inc.

The Canadian dollar strengthened against the US-dollar in 2017, averaging \$0.770<sup>4</sup> per US-dollar, 2 cents, or 2%, higher than in 2016, modestly impacting unit sales realizations for all Canadian-produced exports.

<sup>4</sup>Bank of Canada

## (ii) Pulp

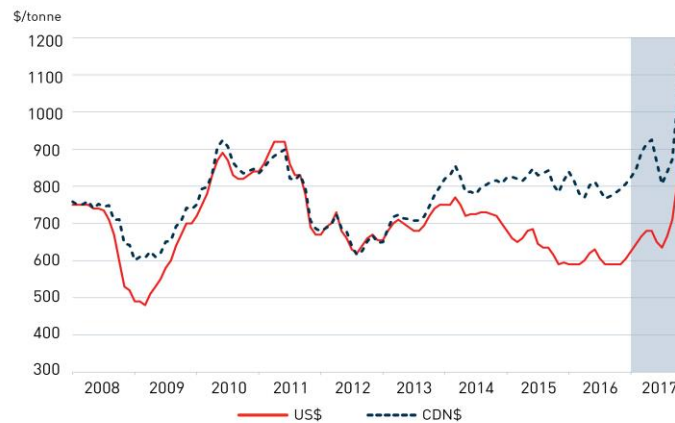
Global pulp market conditions were better than anticipated in 2017, particularly in the second half of the year. Against a backdrop of solid global demand and various unforeseen global supply disruptions, the Chinese government's decision to restrict imports of recycled mixed paper caught the market off-guard and led to domestic buyers increasing their demand for virgin pulp on short notice. As a result of this spike in demand, benchmark NBSK pulp list prices to China climbed US\$225 per tonne between August and December to reach a six-year high at the end of 2017. For the 2017 year as a whole, the China list price averaged US\$712 per tonne<sup>5</sup>, up US\$113 per tonne, or 19%, from 2016; transaction prices to North America and Europe saw more modest gains.

Overall, global shipments of bleached softwood kraft pulp saw modest increases in 2017 compared to 2016. Global softwood pulp producer inventories increased in the first quarter of 2017 with limited industry maintenance downtime, then fell through the spring maintenance period in the second quarter of 2017, and remained within the balanced range of 27-30 days through the second half of 2017.

The following charts show the NBSK pulp list price movements in 2017, before taking account of customer discounts and rebates (Chart 5), and the global pulp inventory levels (Chart 6).

Chart 5

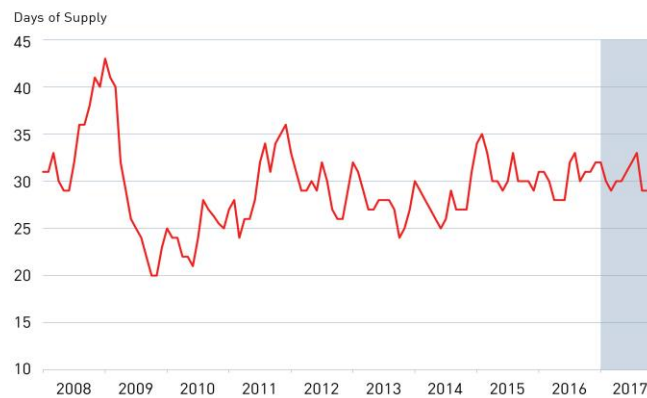
### NBSK PULP LIST PRICE DELIVERED TO CHINA – IN US AND CANADIAN DOLLARS



Note: Canadian price is calculated as the US price multiplied by the average monthly exchange rate per the Bank of Canada  
Source: Resource Information Systems Inc.

Chart 6

### WORLD SOFTWOOD PULP INVENTORIES



Source: Pulp and Paper Products Council

<sup>5</sup> Resource Information Systems, Inc.

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 continues to work well for both parties, allowing both CPPI and UPM to sell a broader offering of pulp products and enhanced technical service to customers.

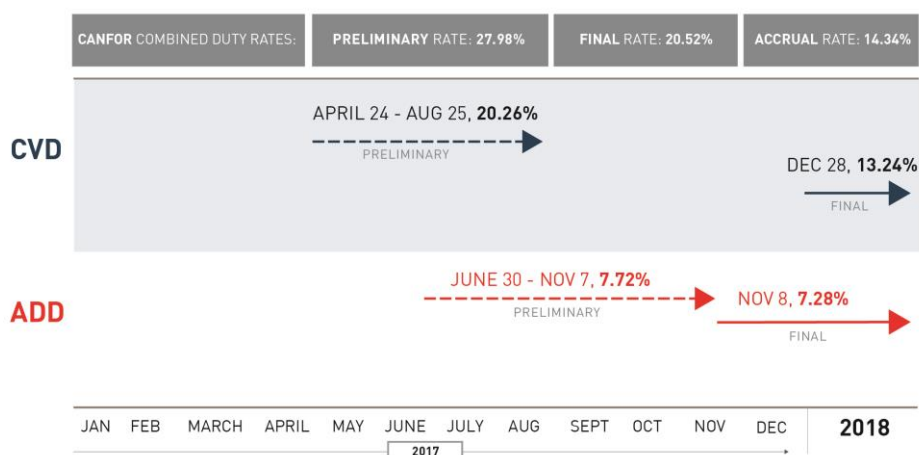
### Countervailing and Anti-dumping Duties

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, an assertion the Canadian industry and Provincial and Federal Governments strongly deny and have successfully disproven in international courts in the past. As a result of the DOC's investigation, preliminary countervailing duties ("CVD") of 20.26% were imposed on the Company's lumber exports to the United States from April 28, 2017 to August 25, 2017, with an additional anti-dumping duty ("ADD") of 7.72% effective on US-bound shipments beginning 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%, 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. The final rates as determined by the DOC were based on sales and cost data from the 2015 year for CVD, and sales and cost data from the fourth quarter of 2015 to third quarter of 2016 for ADD. 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. The first period of review will be based on sales and cost data from April 2017 to December 2018, and is currently anticipated to be completed in 2020.

Cash deposits are required at the published CVD and ADD rates as determined by the DOC (see Chart 7), resulting in cash deposits paid of \$89.2 million in 2017. While Canfor continues to categorically deny the US allegations and strongly disagrees with the current countervailing and anti-dumping determinations made by the DOC, it has updated its estimated ADD rate by applying the DOC's methodology to current sales and cost data (from April 2017 to December 2017), resulting in an ADD accrual rate of 1.1%. Accordingly, Canfor recorded a countervailing and anti-dumping duty expense at a combined rate of 14.34%, which resulted in a net expense of \$44.3 million being recorded in 2017. Canada has proceeded with legal challenges under NAFTA and through the WTO, where Canadian litigation has proven successful in the past.

Chart 7

### EFFECTIVE DUTY RATES - 2017



## **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 the industry. In support of this objective, the Company has completed several 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 capitalize on the Company's strong fibre positions in the BC Interior and the US South. Excluding acquisitions, capital spending in the lumber segment for 2017 totaled \$163.6 million and included various smaller high-returning capital projects aimed at increasing drying capacity and productivity. An increasing proportion of capital was deployed in the US South in 2017, including major upgrades at the Company's sawmill operations in Arkansas, Alabama and Georgia. In October 2017, the Company announced a \$160 million capital investment program focused on further enhancing the Company's high-value product offering through increasing drying capacity and sawmill and planer modernizations at several US South sawmill operations. This program, combined with the aforementioned new Greenfield sawmill operation in Washington, Georgia, will increase the Company's Southern Yellow Pine production capacity by 30%, to approximately 2.1 billion board feet by the end of 2019, enabling the Company to take further advantage of the strong operating margins in that region.

In Western Canada, the higher lumber prices in 2017 resulted in increased market-based stumpage, which along with increased pricing pressures on non-quota (purchased) timber, and various challenges presented by extreme weather and forest fires through much of the year, as well as a continued shift out of the Mountain Pine Beetle ("MPB") dominated log profile into greener fibre, resulted in material increases in log costs in 2017. Compared to 2016, this higher percentage of greener fibre, coupled with targeted capital spending, enabled the Company to produce significantly more higher-value products and less low-grade lumber, 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 remained stable again in 2017, 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 the degradation of pine timber resulting from the MPB infestation runs its full course. The Company has taken various steps in recent years to secure high-quality fibre and ensure the viability and competitiveness of its operations, and continues to focus on managing fibre costs through disciplined cost management, enhanced fibre utilization, and maximized residual fibre revenue. The Company 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 2017 was largely in line with 2016, while CPPI's energy business continued to increase its power generation, remaining focused on both expanding its power generating capability and improving its energy efficiency. During 2017, CPPI completed scheduled maintenance outages at its Northwood and Intercontinental NBSK pulp mills, as well as at its Taylor BCTMP mill (in the case of Taylor, this included preliminary work associated with the previously announced major energy project at that mill). During the fourth quarter of 2017, an unscheduled outage and subsequent repairs at the Northwood pulp mill, related to a tube leak in the facility's number five recovery boiler, resulted in a reduction in overall pulp production of approximately 11,000 tonnes.

Capital spending in the pulp and paper segment in 2017 totalled \$83.1 million, and included the completion of several smaller high-return discretionary projects, as well as the commencement of the Taylor and Northwood pulp mill energy projects. Heading into 2018, both projects are progressing as planned, with the Taylor project currently estimated to commence ramp up in the latter part of 2018, and the Northwood project remaining on track to be commissioned in early 2019.

# OVERVIEW OF CONSOLIDATED RESULTS – 2017 COMPARED TO 2016

## Selected Financial Information and Statistics

(millions of Canadian dollars, except for per share amounts)

	2017	2016
Sales	\$ 4,658.8	\$ 4,234.9
Operating income before amortization	\$ 807.3	\$ 548.4
Operating income	\$ 557.4	\$ 306.1
Net income	\$ 393.6	\$ 203.9
Net income attributable to equity shareholders of the Company	\$ 345.4	\$ 150.9
Net income per share attributable to equity shareholders of the Company, basic and diluted	\$ 2.63	\$ 1.14
ROIC – Consolidated <sup>6</sup>	20.6%	9.5%
Average exchange rate (US\$/CDN\$) <sup>7</sup>	\$ 0.770	\$ 0.755

<sup>6</sup> 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.

<sup>7</sup> Source – Bank of Canada (monthly average for the period).

(millions of Canadian dollars)

	2017	2016
Operating income (loss) by segment:		
Lumber	\$ 441.9	\$ 237.4
Pulp and Paper	\$ 154.6	\$ 98.2
Unallocated and Other	\$ (39.1)	\$ (29.5)
<b>Total operating income</b>	<b>\$ 557.4</b>	<b>\$ 306.1</b>
Add: Amortization <sup>8</sup>	\$ 249.9	\$ 242.3
<b>Total operating income before amortization</b>	<b>\$ 807.3</b>	<b>\$ 548.4</b>
Add (deduct):		
Working capital movements	\$ (72.1)	\$ 101.0
Defined benefit plan contributions	\$ (28.8)	\$ (33.3)
Income taxes paid, net	\$ (43.9)	\$ (29.9)
Adjustment to accrued duties <sup>9</sup>	\$ (44.9)	\$ -
Other operating cash flows, net <sup>10</sup>	\$ (7.5)	\$ (2.4)
<b>Cash from operating activities</b>	<b>\$ 610.1</b>	<b>\$ 583.8</b>
Add (deduct):		
Additions to property, plant and equipment, timber and intangible assets, net	\$ (252.1)	\$ (233.8)
Acquisitions, net of disposals	\$ (23.7)	\$ (83.9)
Share purchases	\$ (87.0)	\$ -
Acquisitions of non-controlling interests	\$ (17.7)	\$ (24.7)
Distributions paid to non-controlling interests	\$ (10.0)	\$ (28.5)
Finance expenses paid	\$ (21.1)	\$ (22.0)
Repayment of long-term debt, net	\$ (44.3)	\$ -
Advance to Licella	\$ -	\$ (7.0)
Other, net <sup>10</sup>	\$ 5.4	\$ 5.2
<b>Change in cash / operating loans</b>	<b>\$ 159.6</b>	<b>\$ 189.1</b>

<sup>8</sup> Amortization includes amortization of certain capitalized major maintenance costs.

<sup>9</sup> Adjusted to true-up preliminary countervailing and anti-dumping duty deposits expensed for accounting purposes in 2017 to current accrual rates.

<sup>10</sup> 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)

	<b>2017</b>	<b>2016</b>
<b>Shareholder Net Income, as reported</b>	<b>\$ 345.4</b>	\$ 150.9
Foreign exchange gain on long-term debt	<b>(7.7)</b>	(3.6)
(Gain) loss on derivative financial instruments	<b>3.8</b>	(2.1)
Mill closure provisions recovery <sup>11</sup>	<b>(2.4)</b>	(1.5)
Countervailing and anti-dumping duty deposits <sup>12</sup>	<b>32.8</b>	-
Change in substantively enacted tax legislation <sup>13</sup>	<b>(5.1)</b>	-
Gain on sale of Anthony EACOM Inc. <sup>14</sup>	<b>(3.4)</b>	-
Gain on legal settlement <sup>15</sup>	<b>-</b>	(6.9)
Net impact of above items	<b>18.0</b>	(14.1)
<b>Adjusted shareholder net income</b>	<b>\$ 363.4</b>	\$ 136.8
<b>Shareholder net income per share (EPS), as reported</b>	<b>\$ 2.63</b>	\$ 1.14
Net impact of above items per share	<b>0.14</b>	(0.11)
<b>Adjusted shareholder net income per share</b>	<b>\$ 2.77</b>	\$ 1.03

<sup>11</sup>In 2015, Canfor recorded one-time costs of \$19.4 million (before tax) associated with the announced closure of the Canal Flats sawmill. In 2017, \$3.2 million (before-tax) of the closure provision was reversed (2016: \$2.0 million), reflecting lower than estimated costs.

<sup>12</sup>Adjusted for countervailing and anti-dumping duty deposits expensed for accounting purposes in 2017.

<sup>13</sup>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 in 2017.

<sup>14</sup>In 2017, Canfor sold its 50% interest in Anthony EACOM Inc. for net proceeds of \$21.1 million and recognized a \$3.7 million gain (before-tax).

<sup>15</sup>Gain relates to a \$16.3 million settlement of a legal claim with respect to logistics services, net of a \$0.8 million impairment of related machinery and equipment and minority interest.

The Company recorded net income attributable to equity shareholders of \$345.4 million, or \$2.63 per share, for the year ended December 31, 2017, an increase of \$194.5 million, or \$1.49 per share, from \$150.9 million, or \$1.14 per share, reported for the year ended December 31, 2016. After taking account of specific items affecting comparability with prior periods, the Company's 2017 adjusted shareholder net income was \$363.4 million, or \$2.77 per share, up \$226.6 million, or \$1.74 per share, compared to similarly adjusted shareholder net income of \$136.8 million, or \$1.03 per share, for 2016.

Reported operating income for 2017 was \$557.4 million, up \$251.3 million from operating income of \$306.1 million for 2016, with the increase reflecting higher operating earnings in both the lumber and pulp and paper segments. Lumber segment results reflected the benefit of significantly higher Western SPF lumber US-dollar prices, modest increases in SYP lumber prices and a higher-value sales mix, all of which more than offset the slightly stronger dollar, duty expenses and higher unit log costs. In the pulp and paper segment, operating income largely reflected higher US-dollar NBSK pulp and BCTMP list prices, which more than offset the 2% stronger Canadian dollar and increased fibre (market-driven), chemical and energy costs.

A more detailed review of the Company's operational performance and results is provided in the "Operating Results by Business Segment – 2017 compared to 2016" section, which follows this overview of consolidated results.



## OPERATING RESULTS BY BUSINESS SEGMENT – 2017 COMPARED TO 2016

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 2017 and 2016 are as follows:

(millions of Canadian dollars, unless otherwise noted)	<b>2017</b>	<b>2016</b>
Sales	\$ <b>3,461.1</b>	\$ 3,133.2
Operating income before amortization	\$ <b>617.4</b>	\$ 401.8
Operating income, as reported	\$ <b>441.9</b>	\$ 237.4
Countervailing and anti-dumping duties	\$ <b>44.3</b>	\$ -
Mill closure provisions recovery	\$ <b>(3.2)</b>	\$ (2.0)
Gain on legal settlement, net	\$ <b>-</b>	\$ (15.5)
Adjusted operating income	\$ <b>483.0</b>	\$ 219.9
Capital expenditures	\$ <b>163.6</b>	\$ 168.8
Average SPF 2x4 #2&Btr lumber price in US\$ <sup>16</sup>	\$ <b>401</b>	\$ 305
Average SPF price in Cdn\$	\$ <b>521</b>	\$ 404
Average SYP 2x4 #2 lumber price in US\$ <sup>17</sup>	\$ <b>456</b>	\$ 425
US housing starts (thousand units SAAR) <sup>18</sup>	<b>1,207</b>	1,177
Production – SPF lumber (MMfbm) <sup>19</sup>	<b>3,744.2</b>	3,786.8
Production – SYP lumber (MMfbm) <sup>19</sup>	<b>1,410.9</b>	1,335.6
Shipments – SPF lumber (MMfbm) <sup>20</sup>	<b>3,831.6</b>	3,932.0
Shipments – SYP lumber (MMfbm) <sup>20</sup>	<b>1,399.7</b>	1,377.4

<sup>16</sup> Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.).

<sup>17</sup> Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.).

<sup>18</sup> Source – US Census Bureau, seasonally adjusted annual rate ("SAAR").

<sup>19</sup> Excluding production of trim blocks.

<sup>20</sup> Canfor-produced lumber, including lumber purchased for remanufacture and excluding trim blocks, excludes shipments of wholesale lumber.

#### Markets

North American lumber demand improved through 2017 reflecting the ongoing gradual recovery in the US housing market and improving repair and remodeling sector. US housing starts averaged 1,207,000 units in 2017, an increase of 3% from 2016, and the highest annual average since 2007. Contributing to improved lumber demand was a 8% increase in single-family starts from the previous year. Multi-family starts were down 10% compared to 2016 (single-family homes consume approximately three times more lumber than multi-family homes). Canadian housing construction activity was strong during 2017, up 11% compared to the previous year, at an average of 220,000 units on a seasonally adjusted basis. Offshore lumber demand remained strong through 2017, particularly for the Company's higher-value lumber products, with steady shipment volumes to China and Japan and other key markets through 2017.

In addition to solid underlying North American and offshore demand, the imposition of countervailing and anti-dumping duties, as well as limited available supply due to the severe forest fire season in Western Canada, resulted in significantly higher average Western SPF lumber prices through the year. The North American benchmark Western SPF 2x4 #2&Btr lumber price was up US\$96 per Mfbm, or 31%, compared to 2016, while the Western SPF 2x6 #2&Btr lumber price was up US\$117 per Mfbm, or 41%. Southern Yellow Pine lumber prices saw more modest 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\$31 per Mfbm, or 7%, compared to 2016 with a similar increase seen for 2x6 #2, while pricing for wider-width SYP lumber products saw more modest increases.

## Sales

Lumber segment revenues of approximately \$3.5 billion for 2017 were up 10% compared to 2016, reflecting higher Western SPF unit sales realizations, and modestly higher SYP unit sales realizations. Increased lumber unit sales realizations were offset, in part, by slightly lower shipment volumes in the current year, reflecting weather-related transportation challenges in late 2017 and, to a lesser extent, slightly lower residual fibre revenue in the US South.

Total lumber shipments were approximately 5.2 billion board feet for the year, down 2% from 5.3 billion board feet shipped in the previous year, as slightly higher shipments in the US South were more than offset by lower shipments in Western Canada as a result of the aforementioned weather challenges.

Western SPF lumber unit sales realizations showed a solid increase compared to the prior year as higher average benchmark lumber prices and a higher-value sales mix more than offset the impact of a 2 cent, or 2%, stronger Canadian dollar, and the introduction of countervailing and anti-dumping duties in the current year. As previously mentioned, a continued focus on high-value products, coupled with an increasing proportion of greener fibre and benefits of recent capital expenditures, resulted in the Company producing less low grade products in 2017. Offshore sales realizations were also higher than 2016 reflecting improved lumber pricing, and the higher-value sales mix.

Total residual fibre revenue for 2017 was slightly lower than the prior year as increased pricing for sawmill residual chips in Western Canada was more than offset by the dampening effects of increased supply on residual chip prices in the US South. Pellet revenue was slightly higher than the prior year following the ramp up of the Fort St. John and Chetwynd pellet plants in 2016.

## Operations

Total lumber production for 2017 was 5.2 billion board feet, in line with the prior year, as moderately higher production at the Company's US South sawmill operations following several capital upgrades was partially offset by lower production in Western Canada. As previously highlighted, significant challenges and disruptions presented by weather and the BC Interior forest fires, impacted log deliveries, log profile and drying capacity in Western Canada through much of the year. These challenges resulted in lower productivity in 2017, offsetting the benefits realized from capital upgrades.

Lumber unit manufacturing costs increased compared to the previous year as the benefit of improved productivity and stable log costs in the US South mitigated upward pressure on unit log costs in Western Canada. Higher Western SPF lumber sales realizations resulted in increased market-based stumpage, while the aforementioned weather and fire-related challenges resulted in increased competition for purchased wood, increased log hauling costs and lower log deliveries in Western Canada. Unit cash conversion costs increased slightly, as productivity improvements in the US South and disciplined cost management helped to offset the challenging operating conditions in Western Canada.

# Pulp and Paper

## Selected Financial Information and Statistics – Pulp and Paper<sup>21</sup>

Summarized results for the Pulp and Paper segment for 2017 and 2016 are as follows:

(millions of Canadian dollars, unless otherwise noted)	<b>2017</b>	<b>2016</b>
Sales	\$ <b>1,197.7</b>	\$ 1,101.7
Operating income before amortization <sup>22</sup>	\$ <b>229.0</b>	\$ 172.0
Operating income	\$ <b>154.6</b>	\$ 98.2
Capital expenditures	\$ <b>83.1</b>	\$ 64.0
Average NBSK pulp price delivered to China - US\$ <sup>23</sup>	\$ <b>712</b>	\$ 599
Average NBSK pulp price delivered to China - Cdn\$	\$ <b>925</b>	\$ 794
Production – pulp (000 mt)	<b>1,205.0</b>	1,217.9
Production – paper (000 mt)	<b>138.0</b>	135.8
Shipments – pulp (000 mt)	<b>1,216.4</b>	1,201.5
Shipments – paper (000 mt)	<b>139.0</b>	142.5

<sup>21</sup> 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.

<sup>22</sup> Amortization includes amortization of certain capitalized major maintenance costs.

<sup>23</sup> Per tonne, NBSK pulp list price delivered to China (Resource Information Systems, Inc.).

### Markets

As mentioned above, overall global pulp demand in 2017 was unexpectedly strong, particularly in the second half of the year, driven in part by China and its new regulations restricting the import of recycled mixed paper. Despite the additional capacity that came on-line in 2017, unforeseen global pulp supply disruptions led to less capacity being available for global pulp markets. These factors resulted in significant upward pressure on average pulp list prices most notably in the latter part of the year. For the year as a whole, global shipments of bleached softwood kraft pulp saw modest increases in 2017 compared to 2016, primarily to Asian markets (including China), and North America<sup>24</sup>. Bleached kraft paper markets were balanced throughout 2017.

At the end of December 2017, World 20<sup>25</sup> producers of bleached softwood pulp inventories were within the balanced range, at 30 days' supply. By comparison, December 2016 inventories were at 32 days' supply. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

### Sales

Pulp shipments in 2017 were 1,216,400 tonnes, in line with 2016.

As previously mentioned, China US-dollar NBSK pulp list prices averaged US\$712 per tonne in 2017, up US\$113 per tonne, or 19% compared to 2016. Consequently, average NBSK pulp unit sales realizations saw solid increases year over year, principally reflecting the increase in US-dollar pricing, which more than offset increases in customer discounts, the 2% stronger Canadian dollar and a lag in the timing of shipments (versus orders). Average BCTMP unit sales realizations were notably higher in 2017 compared to the previous year, reflecting strong BCTMP demand and US-dollar pricing throughout most of the 2017 year, partially offset by the stronger Canadian dollar.

In 2017, energy revenue was up compared to the prior year, primarily reflecting higher energy pricing combined with stronger power generation, particularly over the winter months, which more than offset operational challenges at the Northwood NBSK pulp mill in the fourth quarter of 2017.

Paper shipments in 2017 were broadly in line with 2016 at 139,000 tonnes. Prime bleached paper shipments represented 88% of prime sales volumes in 2017, up 2% from 2016. Paper unit sales realizations for 2017 were broadly in line with 2016, reflecting the improvement in US-dollar kraft paper prices as well as the proportionately higher prime bleached shipments, offset by the unfavourable impact of the stronger Canadian dollar.

<sup>24</sup> As reported PPPC statistics.

<sup>25</sup> 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").

## Operations

Pulp production in 2017, at 1,205,000 tonnes, was broadly in line with that produced in 2016, with total pulp production comparable year-over-year after adjusting for scheduled and unplanned maintenance outages. In 2017, CPPI completed scheduled outages at its Northwood and Intercontinental NBSK pulp mills, as well as at its Taylor BCTMP mill, which, in part, included preliminary work associated with the previously announced energy project at that mill. During the fourth quarter of 2017, an unscheduled outage and subsequent repairs at the Northwood pulp mill, related to a tube leak in the facility's number five recovery boiler, resulted in a reduction in overall pulp production of approximately 11,000 tonnes.

Pulp unit manufacturing costs modestly increased when compared to 2016, reflecting moderately higher fibre costs, combined with a significant increase in chemical costs and, to a lesser extent, higher energy costs. The increase in fibre costs compared to 2016 reflected higher market prices for delivered sawmill residual chips (linked to Canadian dollar NBSK pulp sales realizations) combined with a marginal increase in the proportion of higher-cost whole log chips.

Paper production in 2017 was 138,000 tonnes, up 2,200 tonnes, or 2%, from 2016, as a slight decline in operating rates was more than offset by the favourable impact on paper production of no scheduled maintenance outages in 2017 (in 2016, scheduled maintenance outages reduced paper production by approximately 5,100 tonnes). Paper unit manufacturing costs were moderately higher compared to 2016, largely reflecting a significant increase in slush pulp costs (linked to higher Canadian dollar NBSK market pulp prices) and, to a lesser extent, higher routine maintenance spend in 2017, offset in part by the favourable impact of increased paper production in the current year.

## **Unallocated and Other Items**

(millions of Canadian dollars)	2017	2016
Operating loss of Panels operations <sup>26</sup>	\$ (2.4)	\$ (2.0)
Corporate costs	\$ (36.7)	\$ (27.5)
Finance expense, net	\$ (30.8)	\$ (32.8)
Foreign exchange gain on long-term debt	\$ 8.8	\$ 4.1
Gain (loss) on derivative financial instruments	\$ (5.2)	\$ 2.9
Other expense, net	\$ (3.8)	\$ (12.5)

<sup>26</sup> 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 \$36.7 million in 2017, up \$9.2 million from 2016, largely due to higher legal costs related to the expiry of the Softwood Lumber Agreement which more than offset the benefit of cost reductions realized in the current year.

## **Finance Income and Expense**

Net finance expense for 2017 was \$30.8 million, down \$2.0 million from 2016. The decrease largely reflected lower amounts drawn on the Company's operating loans in 2017. See the "Liquidity and Financial Requirements" section for further discussion.

## **Foreign Exchange Gain on Translation of Long-Term Debt**

In 2017, the Company recognized a foreign exchange gain of \$8.8 million on its US-dollar term debt held by Canadian entities due to the stronger Canadian dollar at the close of 2017 relative to the exchange rate at the close of 2016 (see further discussion on term debt in the "Liquidity and Financial Requirements" section).

## **Gain (Loss) on Derivative Financial Instruments**

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in lumber prices, energy costs, and interest rates.

In 2017, the Company recorded a net loss of \$5.2 million (2016: net gain of \$2.9 million) related to its derivative financial instruments, which largely reflected realized losses on its lumber future hedge position arising from the escalation in market prices in 2017.

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)	<b>2017</b>	<b>2016</b>
Lumber Futures	\$ (4.7)	\$ 3.5
Energy derivatives	\$ (0.5)	\$ (0.8)
Interest rate swaps	\$ -	\$ 0.2
Gain (loss) on derivative financial instruments	\$ (5.2)	\$ 2.9

### Other Expense, net

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, 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. Other expense, net in 2016 of \$12.5 million principally reflected CPPI's write-down of research and development related advances to Licella and a loss relating to foreign exchange movements on US-dollar denominated cash, receivables and payables of Canadian operations.

### Income Tax Expense

The Company recorded an income tax expense of \$132.8 million in 2017, compared to \$63.9 million in 2016, with an overall effective tax rate of 25% (2016 - 24%).

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

(millions of Canadian dollars)	<b>2017</b>	<b>2016</b>
Net income before income taxes	\$ 526.4	\$ 267.8
Income tax expense at statutory rate of 26%	\$ (136.9)	\$ (69.6)
Add (deduct):		
Non-taxable income related to non-controlling interests	0.4	6.7
Entities with different income tax rates and other tax adjustments	(1.9)	(0.4)
Permanent difference from capital gains and losses and other non-deductible items	1.8	(0.6)
Change in substantively enacted legislation	3.8	-
Income tax expense	\$ (132.8)	\$ (63.9)

In the fourth quarter of 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 (loss) as an income tax recovery on defined benefit plan actuarial losses.

### Other Comprehensive Income (Loss)

(millions of Canadian dollars)	<b>2017</b>	<b>2016</b>
Defined benefit plan actuarial gains (losses), net of tax	\$ 19.1	\$ (37.7)
Foreign exchange translation differences for foreign operations, net of tax	(33.8)	(11.1)
Other comprehensive income (loss), net of tax	\$ (14.7)	\$ (48.8)

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 2017, an after-tax gain of \$19.1 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 discount rate used to value the net defined benefit obligation, offset in part by the return generated on plan assets. The gain related to the non-pension post-employment benefits principally reflected a 50% reduction in Medical Services Plan ("MSP") premiums following a

change in legislation in British Columbia, and to a lesser extent, a reduction in the MSP growth trend rate used to value the obligation, offset in part by a 0.5% lower discount rate.

In 2017, the Company purchased \$136.3 million of buy-in annuities through its defined benefit pension plans, increasing total annuities purchased to \$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 \$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.

When taking into account the impact of hedging, 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 10% is partially hedged through the plan's investment in debt securities.

In 2016, an after-tax loss of \$37.7 million was recorded to other comprehensive income, primarily reflecting a lower discount rate used to value the net defined benefit obligation. For more information, see the "Employee Future Benefits" part of the "Critical Accounting Estimates" section later in this report.

In addition, the Company recorded a loss after-tax of \$33.8 million to other comprehensive income in 2017 related to foreign exchange differences for foreign operations, resulting from the strengthening of the Canadian dollar at the end of 2017 compared to one-year earlier. This compared to an after-tax loss of \$11.1 million in 2016 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, 2017 and 2016:

(millions of Canadian dollars, except for ratios)	<b>2017</b>	<b>2016</b>
Cash and cash equivalents	\$ 288.2	\$ 156.6
Operating working capital	448.5	418.2
Current portion of deferred reforestation	(49.5)	(48.5)
Net working capital	687.2	526.3
Property, plant and equipment	1,438.1	1,460.8
Timber licenses	518.3	532.7
Goodwill and other intangible assets	228.1	238.8
Retirement benefit surplus	7.9	5.9
Long-term investments and other	83.3	50.7
Forward purchase liability	-	(41.7)
	<b>\$ 2,962.9</b>	<b>\$ 2,773.5</b>
Long-term debt	\$ 385.4	\$ 448.0
Retirement benefit obligations	272.0	302.2
Deferred reforestation obligations (long-term portion)	63.0	56.9
Other long-term liabilities	23.7	23.7
Deferred income taxes, net	217.8	204.2
Non-controlling interests	269.6	254.8
Equity attributable to shareholders of Company	1,731.4	1,483.7
	<b>\$ 2,962.9</b>	<b>\$ 2,773.5</b>
Ratio of current assets to current liabilities	<b>2.3 : 1</b>	2.0 : 1
Net debt to total capitalization	<b>4.6%</b>	15.5%

The ratio of current assets to current liabilities at the end of 2017 was 2.3:1 compared to 2.0:1 at the end of 2016, and largely reflected the Company's improved cash at December 31, 2017 compared to December 31, 2016.

The Company's net debt to capitalization was 4.6% at December 31, 2017 (December 31, 2016: 15.5%), primarily reflecting the Company's strong cash earnings and debt reduction focus in 2017.

## CHANGES IN FINANCIAL POSITION

At the end of 2017, Canfor had \$288.2 million of cash and cash equivalents.

(millions of Canadian dollars)	2017	2016
Cash generated from (used in)		
Operating activities	\$ 610.1	\$ 583.8
Financing activities	(207.6)	(205.2)
Investing activities	(266.4)	(317.8)
Increase in cash and cash equivalents <sup>27</sup>	\$ 136.1	\$ 60.8

<sup>27</sup> Increase 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 2017 are discussed in the following sections.

### Operating Activities

Canfor generated cash from operations of \$610.1 million for the 2017 year, up \$26.3 million from cash generated of \$583.8 million in the previous year. The increase in operating cash flows largely reflected an increase in cash earnings in the current year, offset in part by increased lumber inventories at the end of the year as a result of weather-related transportation challenges, and increased income tax payments during 2017.

### Financing Activities

Financing activities in 2017 used net cash of \$207.6 million compared to cash used of \$205.2 million in 2016. The Company had no balance outstanding on its Canadian operating loan facility at the end of 2017, reflecting a decrease of \$28.0 million from the end of 2016. During the current year, the Company obtained \$6.0 million in net financing related to certain capital projects at its US sawmills, while CPPI made an early repayment of its \$50.0 million term debt (see "Liquidity and Financial Requirements" section for more details). The Company made cash distributions of \$10.0 million to non-controlling shareholders in 2017, down \$18.5 million from 2016 following the completion of the Company's phased acquisitions in the US South.

Cash used for financing activities also included share purchases under Canfor's and CPPI's Normal Course Issuer Bids. In 2017, Canfor purchased 4,159,593 common shares for \$90.7 million, of which \$87.0 million was paid in the year (average price of \$21.81 per common share). Under a separate normal course issuer bid, CPPI purchased 1,448,109 common shares from non-controlling shareholders for \$17.8 million (average price of \$12.29 per common share). During 2016, Canfor did not purchase any common shares, while CPPI purchased 2,252,504 common shares from non-controlling shareholders for \$24.4 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 2017, the Company used net cash for investing activities of \$266.4 million, compared to \$317.8 million in 2016. Additions to property, plant and equipment totaled \$252.1 million, up \$18.3 million from 2016. In the lumber segment, capital spending of \$163.6 million included various smaller high-returning capital projects aimed at increasing drying capacity and productivity, with an increasing proportion of capital deployed in the US South, including costs related to upgrades at the Company's sawmills in Arkansas, Georgia and Alabama. In the pulp and paper segment, capital expenditures of \$83.1 million were associated with several capital projects including the previously announced Northwood and Taylor energy projects, as well as maintenance of business and other improvement projects.

As previously highlighted, during 2017, the Company completed the final phase of the acquisition of Beadles & Balfour, increasing its ownership interest from 55% to 100% for cash consideration of \$41.8 million. Investing activities in 2017 also included final payments of \$18.0 million related to the Company's acquisition (in April 2016) of Wynndel Box and Lumber Ltd. ("Wynndel"), net proceeds of \$21.1 million related to the sale of the Company's 50% investment in Anthony EACOM Inc., and proceeds of \$15.0 million related to the July 2015 sale of the Company's investment in Lakeland Mills Ltd. and Winton Global Ltd. Investing activities in 2016 included a \$61.6 million payment related to the Company's final instalment on its phased acquisition of Scotch & Gulf Lumber, LLC, and a payment of \$22.3 million related to the Wynndel acquisition.



# LIQUIDITY AND FINANCIAL REQUIREMENTS

## Operating Loans

At December 31, 2017, the Company on a consolidated basis had cash of \$288.2 million, no amounts drawn on its operating loans, and an additional \$53.2 million reserved for several standby letters of credit. Total available undrawn operating loans at year end were \$456.8 million.

Excluding CPPI, the Company's bank operating loans at December 31, 2017 totaled \$350.0 million, of which no amounts were drawn, and an additional \$44.0 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. 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, 2017, CPPI had an undrawn \$110.0 million bank loan facility with a maturity date of January 31, 2020 and \$9.2 million in letters of credit outstanding under the operating loan facility.

## Term Debt

During 2017, the Company extended the maturity date on its Canadian dollar denominated \$125.0 million term loan from September 28, 2020 to September 28, 2022, and extended the maturity date on its US-dollar denominated \$100.0 million floating rate term loan from September 28, 2023 to September 28, 2025. In 2017, the Company obtained \$4.3 million (US\$3.4 million) in net financing at an interest rate of 1.3% related to certain capital projects at its US sawmills. On December 29, 2017, CPPI repaid the full principal balance of its term debt of \$50.0 million.

## 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, 2017.

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

## Normal Course Issuer Bid

On March 7, 2017, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 6,640,227 common shares or approximately 5% of its issued and outstanding common shares as of March 1, 2017. The renewed normal course issuer bid is set to expire on March 6, 2018. In 2017, Canfor purchased 4,159,593 common shares for \$90.7 million (an average of \$21.81 per common share). In 2016, Canfor did not purchase any common shares. Under a separate normal course issuer bid, CPPI in 2017 purchased common shares from non-controlling shareholders increasing Canfor's ownership of CPPI from 53.6% at December 31, 2016 to 54.8% at December 31, 2017.

## 2018 Projected Capital Spending and Debt Repayments

Based on its current outlook, assuming no deterioration in market conditions during the year, the Company anticipates it will invest approximately \$430.0 million in 2018 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 growth in its US South lumber business, including anticipated spend in 2018 related to the announced state-of-the-art Greenfield sawmill. There are no scheduled long-term debt payments in 2018. Canfor has sufficient liquidity in its cash reserves and operating loans to finance its planned capital expenditures as required during 2018.

## Derivative Financial Instruments

As at December 31, 2017, the Company had the following derivatives:

- Futures contracts for the sale of lumber with a total notional amount of 24.3 MMfbm. There were unrealized losses of \$0.3 million at December 31, 2017 on these contracts.

	As at December 31, 2017	
	Notional Amount	Average Rate
<b>Lumber</b>	(MMfbm)	(US-dollars per Mfbm)
Futures sales contracts <i>0 – 12 months</i>	<b>24.3</b>	<b>\$436.41</b>

- Canfor uses interest rate swaps to reduce its exposure to interest rate risk associated with financial obligations bearing variable interest rates. At December 31, 2017 the Company had no interest rate swaps outstanding.
- 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. There were unrealized losses of \$0.5 million related to this contract at December 31, 2017.
- Canfor, at times, uses Brent oil and Western Texas Intermediate ("WTI") oil contracts as a proxy to hedge its diesel purchases. At December 31, 2017 the Company had no oil collars outstanding.

## Commitments and Subsequent Events

The following table summarizes Canfor's financial contractual obligations at December 31, 2017 for each of the next five years and thereafter:

(millions of Canadian dollars)	2018	2019	2020	2021	2022	Thereafter	Total
Long-term debt obligations	\$ 0.3	\$ -	\$ 4.3	\$ -	\$ 126.0	\$ 255.1	\$ 385.7
Operating leases	12.2	9.3	6.7	4.3	3.4	6.6	42.5
	\$ 12.5	\$ 9.3	\$ 11.0	\$ 4.3	\$ 129.4	\$ 261.7	\$ 428.2

Interest payments include interest of 4.4% on the Company's US\$100.0 million 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.

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

- Contractual commitments totaling \$54.1 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 \$112.5 million has been recorded at December 31, 2017. 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, 2017 was \$264.1 million. As at December 31, 2017, Canfor estimated that it would make total contribution payments of \$24.2 million to its defined benefit plans in 2018.
- 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, 2017 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. During 2017, subsidiaries owned by the Jim Pattison Group provided lease, insurance and other services to Canfor totalling \$5.3 million with \$0.5 million outstanding at December 31, 2017.

During 2017, CPPI sold paper to subsidiaries owned by the Jim Pattison Group totalling \$3.5 million. No amounts related to these sales were outstanding as at December 31, 2017.

Additional details on related party transactions are contained in Note 23 to Canfor’s 2017 consolidated financial statements.

## **LICELLA PULP JOINT VENTURE**

In May 2016, CPPI and 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. This additional residue stream refining would allow the Company to further optimize pulp production capacity. This agreement follows a successful program of preliminary trials conducted on feedstock from the Company at Licella’s pilot plants located in New South Wales, Australia, in which wood residue streams from CPPI’s kraft process were successfully converted into a stable biocrude oil. In conjunction with the joint venture agreement, CPPI provided a \$7.0 million convertible credit facility to IER, the parent company of Licella, which matures on June 21, 2019. In 2016, the Company’s net income included the pre-tax write-down of \$7.0 million of advances made in connection with the biofuels initiative to Licella. Notwithstanding the future benefits that may result from this innovative effort, the write-down reflected the research and development nature of the advances.

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 biochemicals. During 2017, CPPI, together with its joint venture partner, Licella, has actively continued to evaluate and advance work associated with the feasibility study and risk reduction process for industrializing this biofuel and biochemical technology.

## SELECTED QUARTERLY FINANCIAL INFORMATION

	Q4 2017	Q3 2017	Q2 2017	Q1 2017	Q4 2016	Q3 2016	Q2 2016	Q1 2016
<b>Sales and income</b>								
(millions of Canadian dollars)								
Sales	\$ 1,182.2	\$ 1,165.2	\$ 1,185.2	\$ 1,126.2	\$ 1,043.5	\$ 1,101.2	\$ 1,022.3	\$ 1,067.9
Operating income	\$ 214.2	\$ 105.4	\$ 131.0	\$ 106.8	\$ 74.0	\$ 97.4	\$ 69.6	\$ 65.1
Net income	\$ 152.6	\$ 72.6	\$ 90.9	\$ 77.5	\$ 44.2	\$ 66.4	\$ 51.0	\$ 42.3
Shareholder net income	\$ 131.8	\$ 66.2	\$ 81.3	\$ 66.1	\$ 38.0	\$ 50.9	\$ 36.0	\$ 26.0
<b>Per common share</b> (Canadian dollars)								
Shareholder net income – basic and diluted	\$ 1.02	\$ 0.51	\$ 0.61	\$ 0.50	\$ 0.29	\$ 0.38	\$ 0.27	\$ 0.20
Book value <sup>28</sup>	\$ 13.46	\$ 12.32	\$ 12.14	\$ 11.81	\$ 11.17	\$ 10.70	\$ 9.92	\$ 9.91
<b>Common Share Repurchases</b>								
Share volume repurchased (000 shares)	633	3,526	-	-	-	-	-	-
Shares Repurchased (millions of Canadian dollars)	\$ 15.7	\$ 75.0	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
<b>Statistics</b>								
Lumber shipments (MMfbm)	1,239	1,367	1,355	1,271	1,278	1,343	1,351	1,362
Pulp shipments (000 mt)	300	303	276	337	275	320	287	319
Average exchange rate – US\$/Cdn\$	\$ 0.786	\$ 0.798	\$ 0.744	\$ 0.756	\$ 0.750	\$ 0.766	\$ 0.776	\$ 0.728
Average Western SPF 2x4 #2&Btr lumber price (US\$)	\$ 462	\$ 406	\$ 388	\$ 348	\$ 315	\$ 322	\$ 311	\$ 272
Average SYP (East) 2x4 #2 lumber price (US\$)	\$ 455	\$ 408	\$ 476	\$ 482	\$ 445	\$ 414	\$ 437	\$ 407
Average NBSK pulp list price delivered to China (US\$)	\$ 863	\$ 670	\$ 670	\$ 645	\$ 595	\$ 595	\$ 617	\$ 590

<sup>28</sup> 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 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 2017	Q3 2017	Q2 2017	Q1 2017	Q4 2016	Q3 2016	Q2 2016	Q1 2016
Operating income (loss) by segment:								
Lumber	\$ 154.9	\$ 92.9	\$ 110.4	\$ 83.7	\$ 57.4	\$ 75.1	\$ 71.5	\$ 33.4
Pulp and Paper	\$ 66.8	\$ 21.1	\$ 31.5	\$ 35.2	\$ 22.9	\$ 31.0	\$ 5.2	\$ 39.1
Unallocated and Other <sup>29</sup>	\$ (7.5)	\$ (8.6)	\$ (10.9)	\$ (12.1)	\$ (6.3)	\$ (8.7)	\$ (7.1)	\$ (7.4)
<b>Total operating income</b>	<b>\$ 214.2</b>	<b>\$ 105.4</b>	<b>\$ 131.0</b>	<b>\$ 106.8</b>	<b>\$ 74.0</b>	<b>\$ 97.4</b>	<b>\$ 69.6</b>	<b>\$ 65.1</b>
Add: Amortization <sup>30</sup>	\$ 64.0	\$ 61.5	\$ 62.1	\$ 62.3	\$ 63.6	\$ 60.6	\$ 57.5	\$ 60.6
<b>Total operating income before amortization</b>	<b>\$ 278.2</b>	<b>\$ 166.9</b>	<b>\$ 193.1</b>	<b>\$ 169.1</b>	<b>\$ 137.6</b>	<b>\$ 158.0</b>	<b>\$ 127.1</b>	<b>\$ 125.7</b>
Add (deduct):								
Working capital movements	\$ (63.9)	\$ 4.7	\$ 92.3	\$ (105.2)	\$ 28.1	\$ 2.1	\$ 128.8	\$ (58.0)
Defined benefit pension plan contributions	\$ (10.4)	\$ (5.8)	\$ (6.6)	\$ (6.0)	\$ (7.7)	\$ (15.2)	\$ (5.2)	\$ (5.2)
Income taxes received (paid), net	\$ (4.2)	\$ (21.6)	\$ (19.3)	\$ 1.2	\$ 0.2	\$ (13.5)	\$ (3.0)	\$ (13.6)
Adjustment to accrued duties <sup>31</sup>	\$ (44.9)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Gain on sale of Anthony EACOM Inc. <sup>32</sup>	\$ -	\$ -	\$ -	\$ (4.0)	\$ -	\$ -	\$ -	\$ -
Cash received from legal settlement	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 16.3	\$ -	\$ -
Gain on legal settlement, net <sup>33</sup>	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (15.5)	\$ -
Other operating cash flows, net <sup>35</sup>	\$ 1.8	\$ (17.1)	\$ (5.9)	\$ 17.7	\$ 2.8	\$ 0.9	\$ (8.9)	\$ 2.0
<b>Cash from (used in) operating activities</b>	<b>\$ 156.6</b>	<b>\$ 127.1</b>	<b>\$ 253.6</b>	<b>\$ 72.8</b>	<b>\$ 161.0</b>	<b>\$ 148.6</b>	<b>\$ 223.3</b>	<b>\$ 50.9</b>
Add (deduct):								
Finance expenses paid	\$ (6.7)	\$ (4.8)	\$ (6.4)	\$ (3.2)	\$ (7.5)	\$ (3.5)	\$ (6.9)	\$ (4.1)
Distributions paid to non-controlling Interests	\$ (1.8)	\$ (2.2)	\$ (2.2)	\$ (3.8)	\$ (5.4)	\$ (11.6)	\$ (7.3)	\$ (4.2)
Capital additions, net	\$ (94.0)	\$ (57.5)	\$ (61.7)	\$ (38.9)	\$ (63.4)	\$ (57.1)	\$ (66.2)	\$ (47.1)
Proceeds received from sale of Anthony EACOM Inc. <sup>32</sup>	\$ 13.1	\$ 1.4	\$ 1.2	\$ 5.4	\$ -	\$ -	\$ -	\$ -
Repayment of long-term debt	\$ (50.1)	\$ (0.1)	\$ (0.1)	\$ -	\$ -	\$ -	\$ -	\$ -
Acquisitions	\$ (3.6)	\$ -	\$ (14.4)	\$ (41.8)	\$ -	\$ (64.2)	\$ (19.7)	\$ -
Proceeds from long-term debt, net	\$ 4.3	\$ -	\$ -	\$ 1.7	\$ -	\$ -	\$ -	\$ -
Share purchases	\$ (12.0)	\$ (75.0)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Proceeds received from sale of Lakeland Winton <sup>34</sup>	\$ -	\$ -	\$ 15.0	\$ -	\$ -	\$ -	\$ -	\$ -
Advances to Licella	\$ -	\$ -	\$ -	\$ -	\$ (3.5)	\$ -	\$ (3.5)	\$ -
Foreign exchange gain on cash and cash equivalents	\$ 0.1	\$ (2.5)	\$ (2.0)	\$ (0.1)	\$ 1.8	\$ 0.7	\$ (0.3)	\$ (3.9)
Other, net <sup>35</sup>	\$ 3.5	\$ (10.5)	\$ (4.3)	\$ 3.5	\$ (0.2)	\$ 4.4	\$ (18.6)	\$ (3.4)
<b>Change in cash / operating loans</b>	<b>\$ 9.4</b>	<b>\$ (24.1)</b>	<b>\$ 178.7</b>	<b>\$ (4.4)</b>	<b>\$ 82.8</b>	<b>\$ 17.3</b>	<b>\$ 100.8</b>	<b>\$ (11.8)</b>

<sup>29</sup> Increase in Unallocated and Other in 2017 largely attributable to higher legal costs related to the expiry of the Softwood Lumber Agreement.

<sup>30</sup> Amortization includes amortization of certain capitalized major maintenance costs.

<sup>31</sup> Adjusted to true-up preliminary countervailing and anti-dumping duty deposits expensed for accounting purposes in 2017 to current accrual rates.

<sup>32</sup> 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.

<sup>33</sup> Gain relates to a \$16.3 million settlement of a legal claim with respect to logistics services, net of a \$0.8 million impairment of related machinery and equipment and minority interest.

<sup>34</sup> 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.

<sup>35</sup> 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)	2017	2016	2015
Sales	\$ 4,658.8	\$ 4,234.9	\$ 3,925.3
Net income	\$ 393.6	\$ 203.9	\$ 91.9
Shareholder net income	\$ 345.4	\$ 150.9	\$ 24.7
Total assets	\$ 3,488.3	\$ 3,277.1	\$ 3,294.6
Term debt	\$ 385.7	\$ 448.0	\$ 456.2
Shareholder net income per share, basic and diluted	\$ 2.63	\$ 1.14	\$ 0.18

## FOURTH QUARTER RESULTS

### Overview of Operating Results

The Company shareholder net income for the fourth quarter of 2017 was \$131.8 million, or \$1.02 per share, compared to shareholder net income of \$66.2 million, or \$0.51 per share, in the third quarter of 2017 and shareholder net income of \$38.0 million, or \$0.29 per share, in the fourth quarter of 2016.

The Company reported operating income of \$214.2 million for the fourth quarter of 2017, up \$108.8 million from reported operating income of \$105.4 million for the third quarter of 2017, and up \$140.2 million from reported operating income of \$74.0 million in the fourth quarter of 2016.

Reported results in the fourth quarter of 2017 include a net duty recovery of \$23.4 million, including a \$14.0 million true-up of the preliminary countervailing duty to the final countervailing duty rate as published by the US Department of Commerce and a further \$30.9 million true-up of the preliminary anti-dumping duty expense to a lower accrual rate, estimated by applying the DOC's methodology to updated sales and cost data. Reported results in the third quarter of 2017 included \$32.1 million relating to the expensing of preliminary countervailing and anti-dumping duties, in addition to a \$3.2 million (Q4 2016: \$2.0 million) recovery related to lower estimated Canal Flats closure costs following the sale of the closed facility. After adjusting for the aforementioned items, operating income was \$190.8 million for the fourth quarter of 2017, up \$56.5 million from the third quarter of 2017, and up \$118.8 million from the fourth quarter of 2016.

An overview of the results by business segment for the fourth quarter of 2017 compared to the third quarter of 2017 and fourth quarter of 2016 follows.

### Lumber

#### Selected Financial Information and Statistics – Lumber

Summarized results for the Lumber segment for the fourth quarter of 2017, third quarter of 2017 and fourth quarter of 2016 were as follows:

(millions of Canadian dollars, unless otherwise noted)	<b>Q4 2017</b>	<b>Q3 2017</b>	<b>Q4 2016</b>
Sales	\$ <b>859.3</b>	\$ 880.4	\$ 785.7
Operating income before amortization	\$ <b>200.1</b>	\$ 136.1	\$ 101.0
Operating income	\$ <b>154.9</b>	\$ 92.9	\$ 57.4
Countervailing and anti-dumping duty deposits, net of recovery <sup>36</sup>	\$ <b>(23.4)</b>	\$ 32.1	\$ -
Mill closure provision recovery <sup>37</sup>	\$ -	\$ (3.2)	\$ (2.0)
Adjusted operating income	\$ <b>131.5</b>	\$ 121.8	\$ 55.4
Average SPF 2x4 #2 & Btr lumber price in US\$ <sup>38</sup>	\$ <b>462</b>	\$ 406	\$ 315
Average SPF price in Cdn\$	\$ <b>588</b>	\$ 509	\$ 420
Average SYP 2x4 #2 lumber price in US\$ <sup>39</sup>	\$ <b>455</b>	\$ 408	\$ 445
US housing starts (thousand units SAAR) <sup>40</sup>	<b>1,251</b>	1,172	1,216
Production – SPF lumber (MMfbm) <sup>41</sup>	<b>903.4</b>	952.9	912.2
Production – SYP lumber (MMfbm) <sup>41</sup>	<b>335.4</b>	355.4	323.9
Shipments – SPF lumber (MMfbm) <sup>42</sup>	<b>911.0</b>	993.6	939.7
Shipments – SYP lumber (MMfbm) <sup>42</sup>	<b>327.5</b>	373.0	332.1

<sup>36</sup> Adjusted for preliminary countervailing and anti-dumping duty deposits expensed for accounting purposes in the third quarter of 2017 and a recovery in the fourth quarter of 2017 to true-up the preliminary duties to a current countervailing and anti-dumping duty rate.

<sup>37</sup> Adjusted for a recovery related to lower estimated Canal Flats closure costs following the sale of the closed facility.

<sup>38</sup> Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.).

<sup>39</sup> Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.).

<sup>40</sup> Source – US Census Bureau, seasonally adjusted annual rate.

<sup>41</sup> Excluding production of trim blocks.

<sup>42</sup> Canfor-produced lumber, including lumber purchased for remanufacture and excluding trim blocks and wholesale shipments.

### Markets

North American lumber demand remained solid in the fourth quarter of 2017, with US housing starts, on a seasonally adjusted basis, averaging 1,251,000 units, up 7% from the previous quarter and in line with the fourth quarter of 2016. Single-family starts were up 5% from the previous quarter, while multi-family starts were up 12% compared to the third quarter of 2017. In Canada, housing starts remained near historical highs, averaging 233,000 units on a

seasonally adjusted basis, up 4% from the previous quarter and up 16% from the same period in 2016. Offshore lumber demand remained steady, particularly in Japan.

### Sales

Sales for the lumber segment for the fourth quarter of 2017 were \$859.3 million, compared to \$880.4 million for the previous quarter and \$785.7 million for the fourth quarter of 2016. The 2% decrease in sales revenue compared to the prior quarter principally reflected lower shipments, which more than offset the positive impact of improved Western SPF and SYP unit sales realizations. The 9% increase in sales revenue compared to the fourth quarter of 2016 was largely due to higher benchmark lumber prices, which more than offset the impact of lower shipments in the current quarter.

Total lumber shipments, at 1.24 billion board feet, were 9% lower than the previous quarter reflecting lower productivity, capital related downtime in the US South, increased statutory holidays, and weather-related transportation challenges in Western Canada, which placed constraints on railcar and truck availability.

Before taking account of the aforementioned duty recovery recorded in the current quarter, Western SPF lumber unit sales realizations were well up compared to the third quarter of 2017 reflecting higher average Western SPF lumber prices, a 1 cent, or 1%, weaker Canadian dollar and a higher-value sales mix. Solid underlying demand and limited available supply continued to support improved benchmark Western SPF lumber prices, with the average benchmark North American Random Lengths Western SPF 2x4 #2&Btr price up US\$56 per Mfbm, or 14%, from the previous quarter, at US\$462 per Mfbm, with similar increases seen across most wider dimensions. SYP lumber unit sales realizations were modestly higher compared to the prior quarter as a higher-value sales mix, a 12% increase in the SYP East 2x4 #2 price and strong 2x6 pricing more than offset seasonally lower pricing in wider dimensions.

Compared to the fourth quarter of 2016, Western SPF lumber unit sales realizations were up significantly as higher US-dollar benchmark lumber prices more than offset the impact of duties and a 5% stronger Canadian dollar in the current quarter. The average North American Random Lengths Western SPF 2x4 #2&Btr price was up US\$147 per Mfbm, or 47%, with similar increases seen across wider-width dimensions. SYP lumber unit sales realizations were up slightly, as a higher-value sales mix and modest gains in narrow dimension pricing more than offset price declines in certain wider dimensions.

Total residual fibre revenue in the current quarter was in line with the previous quarter as higher pricing for sawmill residual chips was offset by lower volumes in the current quarter. Residual revenue was moderately higher than the fourth quarter of 2016, largely reflecting improved chip pricing, tied in part to higher NBSK pulp sales realizations. Log sales were slightly lower than the previous quarter of 2017 as a result of reduced logging and hauling activity in Western Canada due to the adverse weather conditions. Log sales were in line with the fourth quarter of 2016. Pellet sales revenues in the current quarter were lower than both comparative quarters mostly as a result of weather-related disruptions to operations and transportation.

### Operations

Total lumber production, at 1.2 billion board feet, was down 5% from the previous quarter, reflecting the impacts of the adverse weather on productivity, as well as additional statutory holidays and capital related downtime taken at the Company's operations in Alabama, Arkansas and Georgia. The inclement weather in Western Canada impacted log deliveries, log profile and drying capacity, all of which contributed to lower productivity in that region in the current quarter. Total lumber production was in line with the fourth quarter of 2016, for the most part reflecting increased production in the US South, which offset lower production in Western Canada.

Lumber unit manufacturing costs in the fourth quarter of 2017 were moderately higher than the previous quarter, largely reflecting the effects of the weather-related challenges on log delivery volumes and profile, purchased wood and log hauling costs, and sawmill productivity in Western Canada. Higher cash conversion costs also reflected seasonally higher energy costs. Log costs in the US South were in line with the previous quarter. Compared to the fourth quarter of 2016, unit manufacturing costs were moderately higher primarily reflecting market-based increases in purchased wood costs and stumpage in Western Canada.



## Pulp and Paper

### Selected Financial Information and Statistics – Pulp and Paper<sup>43</sup>

Summarized results for the Pulp and Paper segment for the fourth quarter of 2017, third quarter of 2017 and fourth quarter of 2016 were as follows:

(millions of Canadian dollars, unless otherwise noted)	<b>Q4 2017</b>	<b>Q3 2017</b>	<b>Q4 2016</b>
Sales	\$ 322.9	\$ 284.8	\$ 257.8
Operating income before amortization <sup>44</sup>	\$ 85.6	\$ 39.4	\$ 42.1
Operating income	\$ 66.8	\$ 21.1	\$ 22.9
Average NBSK pulp price delivered to China – US\$ <sup>45</sup>	\$ 863	\$ 670	\$ 595
Average NBSK pulp price delivered to China – Cdn\$	\$ 1,098	\$ 839	\$ 794
Production – pulp (000 mt)	307.6	305.1	304.0
Production – paper (000 mt)	35.0	34.8	36.0
Shipments – pulp (000 mt)	299.7	303.3	275.4
Shipments – paper (000 mt)	35.8	34.0	33.6

<sup>43</sup> 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.

<sup>44</sup> Amortization includes amortization of certain capitalized major maintenance costs.

<sup>45</sup> Per tonne, NBSK pulp price delivered to China (RISI).

### Markets

Global softwood pulp markets experienced a strong surge in demand which commenced late in the third quarter of 2017 and continued through the fourth quarter of 2017. This growth in demand, principally from China, was partly in response to China's new regulations restricting the import of recycled mixed paper. This incremental demand, combined with various unforeseen global supply disruptions, contributed to a significant increase in market prices in the second half of 2017. At the end of December 2017, global softwood pulp producer inventory levels were in a balanced range at 30 days of supply<sup>46</sup>. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

Global shipments of bleached softwood pulp increased by 3.0% for 2017 when compared to 2016, driven primarily by increased year-over-year shipments to North America and Asian countries, including China<sup>47</sup>.

Global kraft paper markets were balanced through the fourth quarter of 2017. The positive momentum from North American markets experienced in the first half of 2017 continued through the back half of 2017, while certain offshore markets, particularly Asia, saw increasing demand.

### Sales

Pulp shipments for the fourth quarter of 2017 totalled 299,700 tonnes, broadly in line with the third quarter of 2017 and up 24,300 tonnes, or 9%, from the fourth quarter of 2016. Pulp shipments in the current quarter included a 14,000 tonne vessel shipment slippage from September; however, this was offset by a weather-related 14,000 tonne vessel delay at the end of December. Compared to the fourth quarter of 2016, the increase in pulp shipments was mostly attributable to the delayed shipment from September into October 2017, coupled with the drawdown of inventories at the end of the current quarter.

The average China US-dollar NBSK pulp list price of US\$863 per tonne, as published by RISI, was up US\$193 per tonne, or 29%, from the third quarter of 2017, which was the principal reason for significantly higher average NBSK pulp unit sales realizations quarter over quarter, more than offsetting the effect of timing of shipments (vs. orders), as prices increased in the period. Average BCTMP unit sales realizations also experienced a healthy increase when compared to the previous quarter, reflecting improved BCTMP markets combined with the benefit of a 1% weaker Canadian dollar.

<sup>46</sup> 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.

<sup>47</sup> As reported by PPPC statistics.

Compared to the fourth quarter of 2016, the average China US-dollar NBSK pulp list price was up \$268 per tonne, or 45%. NBSK pulp unit sales realizations saw a substantial increase when compared to the fourth quarter of 2016, primarily reflecting the notable strengthening in US-dollar prices, offset in part by a 4 cent or 5% stronger Canadian dollar combined with the unfavourable impact of the timing of shipments (versus orders) and increased customer discounts in North America. Average BCTMP unit sales realizations also increased significantly when compared to the fourth quarter of 2016, primarily reflecting the improvement in BCTMP market demand, which more than offset the stronger Canadian dollar.

Energy revenues increased during the fourth quarter of 2017 compared to the previous quarter, reflecting seasonally higher energy prices combined with strong power generation at CPPI's Intercontinental and Prince George NBSK pulp mills, offset in part by reduced power generation at the Northwood NBSK pulp mill due to the unscheduled outage in the current period. Energy revenues in the current quarter were in line with the the fourth quarter of 2016, primarily due to comparable power generation quarter over quarter, largely correlated to pulp production variances between the periods.

Paper shipments in the fourth quarter of 2017 were 35,800 tonnes, up 1,800 tonnes, or 5%, from the previous quarter and up 2,200 tonnes, or 7% from the fourth quarter of 2016, principally reflecting the favourable timing of shipments. Paper unit sales realizations in the fourth quarter of 2017 saw a modest increase when compared to the previous quarter, reflecting higher market-driven US-dollar pricing combined with the 1% weaker Canadian dollar. Compared to the same quarter of 2016, paper unit sales realizations saw a slight improvement, as favourable pricing more than offset the 5% stronger Canadian dollar.

#### Operations

Pulp production in the fourth quarter at 307,600 tonnes was broadly in line with both comparative periods. Production in the current quarter reflected an unscheduled outage and subsequent repairs on one production line at CPPI's Northwood NBSK pulp mill as a result of a tube leak in the number five recovery boiler, which reduced pulp production by approximately 11,000 tonnes. In addition, CPPI completed a planned scheduled outage at the Taylor BCTMP mill, which reduced pulp production by approximately 3,000 tonnes. An efficient start-up following the downtime and improved operating rates during the quarter partly offset the impact of these outages on pulp production in the current quarter. In the third quarter of 2017, CPPI completed a scheduled maintenance outage at the Intercontinental NBSK pulp mill, which reduced pulp production by approximately 10,000 tonnes. In the comparative fourth quarter of 2016, CPPI experienced a lower operating rate, primarily due to extreme cold weather challenges during that comparative period.

Pulp unit manufacturing costs were largely consistent with the third quarter of 2017, as increased maintenance spend combined with higher energy usage in the current quarter, primarily due to the aforementioned unplanned outage, were offset by improved productivity in the latter part of the quarter and lower chemical costs. Fibre costs were relatively flat compared to the third quarter of 2017 as higher market prices for delivered sawmill residual chips (linked to Canadian dollar NBSK pulp sales realizations), coupled with a modest increase in the proportion of higher-cost whole log chips in the current quarter, were offset by seasonal pricing adjustments arising from the adverse weather conditions in the current quarter.

Compared to the fourth quarter of 2016, pulp unit manufacturing costs saw a modest increase, principally due to higher fibre costs, and to a lesser extent, higher chemical pricing and increased maintenance spend in the current quarter, partially offset by improved productivity and lower energy costs. Increased fibre costs in the current quarter largely reflected significantly higher market prices for delivered sawmill residual chips combined with a larger proportion of higher-cost whole log chips.

Paper production for the fourth quarter of 2017 of 35,000 tonnes, was broadly in line with the previous quarter, and down 1,000 tonnes, or 3%, when compared to the fourth quarter of 2016, principally reflecting a slightly lower operating rate in the current quarter. Paper unit manufacturing costs increased compared to both the third quarter of 2017 and the fourth quarter of 2016. The increase compared to the immediately prior quarter were primarily driven by significantly higher slush pulp costs, associated with higher average NBSK sales realizations, in the current quarter. Compared to the fourth quarter of 2016, the increase in paper unit manufacturing costs principally reflected the higher slush pulp costs and, to a lesser extent, increases in maintenance spend and higher chemical costs in the current quarter.

## Unallocated and Other Items

(millions of Canadian dollars)	Q4 2017	Q3 2017	Q4 2016
Operating loss of Panels operations <sup>48</sup>	\$ (0.8)	\$ (0.4)	\$ (0.6)
Corporate costs	\$ (6.7)	\$ (8.2)	\$ (5.7)
Finance expense, net	\$ (6.9)	\$ (8.1)	\$ (8.0)
Foreign exchange gain (loss) on long-term debt	\$ (0.7)	\$ 5.0	\$ (3.1)
Gain (loss) on derivative financial instruments	\$ (6.5)	\$ (1.9)	\$ 2.1
Other income (expense), net	\$ 1.5	\$ (4.3)	\$ (4.1)

<sup>48</sup> 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 \$6.7 million for the fourth quarter of 2017, down \$1.5 million from the previous quarter for the most part reflecting lower costs associated with the Softwood Lumber Agreement and a settlement adjustment on certain non-pension post-retirement benefit plan members under a voluntary retiree buyout program in the fourth quarter of 2017.

Net finance expense at \$6.9 million was down \$1.2 million from the previous quarter and down \$1.1 million from the fourth quarter of 2016 reflecting, in part, higher interest income in the current quarter. In the fourth quarter of 2017, the Company recognized a foreign exchange loss on its US-dollar term debt held by Canadian entities 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 as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs, lumber prices and interest rates. In the fourth quarter of 2017, the Company recorded a net loss of \$6.5 million related to its derivatives instruments, primarily reflecting realized losses on lumber future contracts.

Other income, net of \$1.5 million in the fourth quarter of 2017 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 compared to the end of the third quarter of 2017.

## Other Comprehensive Income (Loss)

(millions of Canadian dollars)	Q4 2017	Q3 2017	Q4 2016
Defined benefit actuarial gains, net of tax	\$ 29.7	\$ 13.0	\$ 15.0
Foreign exchange translation differences for foreign operations, net of tax	2.6	(19.9)	10.4
Change in fair value of available-for-sale financial assets, net of tax	-	-	(0.2)
Other comprehensive income (loss), net of tax	\$ 32.3	\$ (6.9)	\$ 25.2

In the fourth quarter of 2017, the Company recorded an after-tax gain of \$29.7 million in relation to changes in the valuation of the Company's employee future benefit plans. The gain in the current quarter of 2017 primarily reflected a 50% reduction in MSP premiums following a change in legislation in British Columbia, and to a lesser extent, a reduction in the MSP growth trend rate used to value the obligation and the return generated on plan assets. These factors more than offset a 0.4% decrease in the discount rate used to value the employee future benefit plans. The gain compared to an after-tax gain of \$13.0 million in the previous quarter and an after-tax gain of \$15.0 million in the fourth quarter of 2016, in both cases largely reflecting higher discount rates.

During the fourth quarter of 2017, the Company purchased \$45.8 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 \$1.3 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 \$2.6 million in the fourth quarter of 2017 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 \$19.9 million in the previous quarter and a gain of \$10.4 million in the fourth quarter of 2016.

## CHANGES IN FINANCIAL POSITION

At the end of 2017, Canfor had \$288.2 million of cash and cash equivalents.

(millions of Canadian dollars)	Q4 2017	Q3 2017	Q4 2016
Cash generated from (used in)			
Operating activities	\$ 156.6	\$ 127.1	\$ 161.0
Financing activities	(65.8)	(89.6)	(80.9)
Investing activities	(81.5)	(59.1)	(67.1)
Increase (decrease) in cash and cash equivalents <sup>49</sup>	\$ 9.3	\$ (21.6)	\$ 13.0

<sup>49</sup> Increase (decrease) in cash and cash equivalents shown before foreign exchange translation on cash and cash equivalents.

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

### Operating Activities

Cash generated from operating activities was \$156.6 million in the fourth quarter of 2017, compared to \$127.1 million in the previous quarter and \$161.0 million in the fourth quarter of 2016. The increase in operating cash flows from the previous quarterly primarily reflected higher cash earnings in the current quarter, offset in part by seasonally higher log inventories, and increased lumber inventories, in part reflecting the weather-related transportation constraints towards the end of 2017.

Compared to the fourth quarter of 2016, operating cash flows were down \$4.4 million as higher cash earnings in the current quarter were more than offset by higher lumber inventories, and income tax payments in the fourth quarter of 2017.

### Financing Activities

Cash used in financing activities was \$65.8 million in the current quarter, compared to cash used of \$89.6 million in the previous quarter and cash used of \$80.9 million in the fourth quarter of 2016. During the current quarter, the Company obtained \$4.3 million (US\$3.4 million) in net financing related to certain capital projects at its US sawmills, while CPPI made an early repayment of its \$50.0 million term debt (see "Liquidity and Financial Requirements" section for more details). The Company had no balance outstanding on its Canadian operating loan facility at the end of the fourth quarter of 2017, similar to the prior quarter and a decrease of \$28.0 million from the end of 2016. During the current quarter, the Company made cash distributions of \$1.8 million to non-controlling shareholders, in line with the previous quarter and down \$3.6 million from the fourth quarter of 2016, largely reflecting the completion of the Company's phased acquisitions in the US South at the beginning of 2017.

In the fourth quarter of 2017, Canfor purchased 633,176 common shares under its Normal Course Issuer Bid for \$15.7 million, of which \$12.0 million was paid during the period. In the third quarter of 2017, Canfor purchased 3,526,387 common shares for \$75.0 million, while CPPI purchased 568,425 common shares from non-controlling shareholders for \$7.2 million. No common shares were purchased in the fourth quarter of 2016. 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 \$81.5 million in the current quarter, compared to \$59.1 million in the previous quarter and \$67.1 million in the same quarter of 2016. Capital additions were \$94.0 million, up \$36.5 million from the previous quarter and up \$30.6 million from the fourth quarter of 2016. Current quarter capital expenditures included various smaller high-returning capital projects aimed at increasing drying capacity and productivity, including upgrades at the Company's sawmills in Georgia, Arkansas and Alabama. In the pulp and paper segment, capital expenditures primarily related to several capital projects including the previously announced energy projects at the Company's Northwood and Taylor pulp mills. 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

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 2017	Q3 2017	Q2 2017	Q1 2017	Q4 2016	Q3 2016	Q2 2016	Q1 2016
<b>Shareholder net income, as reported</b>	\$ 131.8	\$ 66.2	\$ 81.3	\$ 66.1	\$ 38.0	\$ 50.9	\$ 36.0	\$ 26.0
Foreign exchange (gain) loss on long-term debt	\$ 0.6	\$ (4.4)	\$ (2.9)	\$ (1.0)	\$ 2.7	\$ 0.9	\$ (0.3)	\$ (6.9)
Countervailing and anti-dumping duty deposits, net of accrued recovery <sup>50</sup>	\$ (17.3)	\$ 23.8	\$ 26.3	\$ -	\$ -	\$ -	\$ -	\$ -
(Gain) loss on derivative financial instruments	\$ 4.8	\$ 1.4	\$ -	\$ (2.4)	\$ (1.5)	\$ (0.1)	\$ (2.3)	\$ 1.8
Change in substantively enacted tax rates <sup>51</sup>	\$ (5.1)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Mill closure provisions <sup>52</sup>	\$ -	\$ (2.4)	\$ -	\$ -	\$ (1.5)	\$ -	\$ -	\$ -
Gain on sale of Anthony EACOM Inc. <sup>53</sup>	\$ -	\$ -	\$ -	\$ (3.4)	\$ -	\$ -	\$ -	\$ -
Gain on legal settlement, net <sup>54</sup>	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (6.9)	\$ -
Net impact of above items	\$ (17.0)	\$ 18.4	\$ 23.4	\$ (6.8)	\$ (0.3)	\$ 0.8	\$ (9.5)	\$ (5.1)
<b>Adjusted shareholder net income</b>	\$ 114.8	\$ 84.6	\$ 104.7	\$ 59.3	\$ 37.7	\$ 51.7	\$ 26.5	\$ 20.9
<b>Shareholder net income per share (EPS), as reported</b>	\$ 1.02	\$ 0.51	\$ 0.61	\$ 0.50	\$ 0.29	\$ 0.38	\$ 0.27	\$ 0.20
Net impact of above items per share <sup>55</sup>	\$ (0.13)	\$ 0.14	\$ 0.18	\$ (0.05)	\$ -	\$ 0.01	\$ (0.07)	\$ (0.04)
<b>Adjusted net income per share<sup>55</sup></b>	\$ 0.89	\$ 0.65	\$ 0.78	\$ 0.45	\$ 0.29	\$ 0.39	\$ 0.20	\$ 0.16

<sup>50</sup> Adjusted for preliminary countervailing and anti-dumping duty deposits expensed for accounting purposes in the third quarter of 2017 and an accrued recovery in the fourth quarter of 2017 to true-up the preliminary duties to current countervailing and anti-dumping duty rates. Duty expenses recorded in the third and second quarter of 2017 were reclassified to conform to the current quarter's presentation.

<sup>51</sup> 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.

<sup>52</sup> During the third quarter of 2015, the Company recorded one-time costs of \$19.4 million (before-tax) associated with the announced closure of the Canal Flats sawmill. In the third quarter of 2017, \$3.2 million (before-tax) of the closure provision was reversed, and in the fourth quarter of 2016, \$2.0 million (before-tax) of the closure provision was reversed as a result of lower estimated costs.

<sup>53</sup> 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).

<sup>54</sup> Gain relates to a \$16.3 million settlement of a legal claim with respect to logistics services, net of a \$0.8 million impairment of related machinery and equipment and minority interest.

<sup>55</sup> 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

Looking ahead, the US housing market is forecast to continue its ongoing gradual recovery through 2018. North American lumber prices are projected to remain at current historical-high levels in the first quarter of 2018, reflecting low inventories, solid demand and weather-related challenges in Western Canada. For the Company's key offshore lumber markets, demand is anticipated to remain solid through the first quarter of 2018, particularly in Japan. The various disruptions presented by weather to-date in 2018 are projected to result in lower production and shipment volumes for the first quarter of 2018.

### Pulp and Paper Markets

Global softwood kraft pulp markets are projected to remain well positioned through the first quarter of 2018, with continued strong shipments into Asian markets, particularly China, and sustained demand in other markets. CPPI has announced NBSK pulp list price increases of US\$10 per tonne to China for January 2018, and two consecutive price increases to North America, each of US\$30 per tonne, for February and March 2018. A balanced kraft pulp market is projected to continue into the second quarter of 2018, when many pulp producers have their traditional spring maintenance outages. The BCTMP market is seeing some reduced demand in the first quarter of 2018, which is resulting in downward price pressure. Early 2018 weather related transportation disruptions are projected to result

in delayed shipments and modestly higher costs for the first quarter of 2018. The pulp outlook for the remainder of the year is more uncertain given incremental pulp capacity currently projected to come online and the potential for the reinstatement of some import permits for recovered paper in China through 2018.

CPPI has no maintenance outages planned for the first quarter of 2018. Maintenance outages are currently planned at the Prince George NBSK pulp mill and at the Taylor BCTMP mill in the second quarter of 2018 with a projected 5,000 tonnes of reduced NBSK pulp production and 11,000 tonnes of reduced BCTMP production, respectively. The scheduled outage at the Taylor BCTMP mill will include work associated with the previously announced energy project. A maintenance outage at the Northwood NBSK pulp mill is scheduled in the third quarter of 2018 with a projected 22,000 tonnes of reduced NBSK pulp production. A maintenance outage is currently planned at CPPI's paper machine during the second quarter of 2018 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, 2017		December 31, 2016	
	Defined Benefit Pension Plans	Other Benefit Plans	Defined Benefit Pension Plans	Other Benefit Plans
Discount rate	3.4%	3.4%	3.9%	3.9%
Rate of compensation increases	3.0%	n/a	3.0%	n/a
Initial medical cost trend rate	n/a	6.5%	n/a	7.0%
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, 2017 is between 21.0 years and 24.1 years (2016 - 20.9 years and 24.1 years). As at December 31, 2017, the weighted average duration of the defined benefit obligation, which reflects the average age of the plan members, is 12.3 years (2016 - 12.1 years). The weighted average duration of the other benefit plans is 14.2 years (2016 - 14.6 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 2017:

(millions of Canadian dollars)	1% Increase	1% Decrease
Defined benefit pension plan liabilities, net of annuity assets		
Discount rate	\$ (59.3)	\$ 59.8
Other benefit plan liabilities		
Discount rate	\$ (15.9)	\$ 19.9
Initial medical cost trend rate	\$ 13.9	\$ (11.7)

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 1.5% 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 reevaluates 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 4 to 53 years and have been discounted at risk-free rates ranging from 1.8% to 2.3%. 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. 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 2017, 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 forecast prices and exchange rates for the period over which the inventories are expected to be sold. Forecast prices are determined using management's estimates as at the period end, and may differ from the actual prices at which the inventories are sold. There were no inventory write-downs at December 31, 2017.

### **Allowance for Doubtful Accounts**

An allowance for doubtful accounts of \$3.5 million has been recorded at December 31, 2017 which reflects management's assessment of risks attached to the collection of receivable balances. While significant bad debts have not been experienced in prior years, the provision is considered appropriate due to several risks still existing which may affect the ability of certain customers to pay amounts owed to the Company.

## **FUTURE CHANGES IN ACCOUNTING POLICIES**

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*, which will supersede IAS 18, *Revenue*, IAS 11, *Construction Contracts* and related interpretations. The new standard is effective for annual periods beginning on or after January 1, 2018. The Company has performed an assessment of the impact of the new standard, and has determined that adoption of this standard will have no significant impact on the Company's financial statements.

In July 2014, the IASB issued IFRS 9, *Financial Instruments*. The required adoption date for IFRS 9 is January 1, 2018. The Company has performed an assessment of the impact of the new standard, and has determined that adoption of this standard will have no significant impact on the Company's financial statements.

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 a depreciation expense for right-of-use assets and interest expense on lease liabilities.

It is expected that IFRS 16 will have an impact on the Company's financial statements with recognition of new assets and liabilities for its operating leases; however, the Company is still in the process of assessing the quantitative impact on its financial statements of this new standard. The Company's future minimum lease payments, on an undiscounted basis, under non-cancellable operating leases at December 31, 2017 are \$42.5 million.



## **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 Aboriginal 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.*

### **Aboriginal Issues**

Canadian judicial decisions have recognized the continued existence of Aboriginal rights and title to lands continuously and exclusively used or occupied by Aboriginal groups. In June 2014, the Supreme Court of Canada, for the first time, recognized Aboriginal 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 Aboriginal title lands.

While Aboriginal 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 Aboriginal title over a specific piece of land and, in so doing, affirmed a broader territorial use-based approach to Aboriginal title. The decision also further defines what Aboriginal title means and the types of land uses consistent with this form of collective ownership.

Presently, Aboriginal title has not been established by law in any areas overlapping Canfor's tenure areas; however, Aboriginal 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 First 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 First Nations that include timber rights. Canfor holds numerous agreements with individual First 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 Aboriginal rights and title develop and be resolved in Canadian courts, Canfor will continue to engage, cooperate and exchange information and views with First Nations and Government to foster good relationships and minimize risks to Canfor's tenures and operational plans.

### **Capital Requirements**

The lumber 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 2017 were \$252.1 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, 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 can be no guarantees 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, 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, 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; plant efficiencies; 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.

### **Cyclical 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, 2015. 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 by an estimated \$59.3 million and a one percentage point decrease in the discount rate would increase the accrued benefit obligation by an estimated \$59.8 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 and woodlands operations 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 tree to truck 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, and long-term investments. Cash and cash equivalents includes 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 receivables. As at December 31, 2017, approximately 40% of the outstanding trade receivables are covered by credit insurance. Canfor's trade receivable balance at December 31, 2017 is \$196.5 million before an allowance for doubtful accounts of \$3.5 million. At December 31, 2017, approximately 99% 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, 2017, Canfor had no amount drawn on its operating loans, and accounts payable and accrued liabilities of \$470.0 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, energy and commodity prices.

#### *(i) Interest Rate risk:*

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

At times, Canfor may utilize 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 collars 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).

#### *(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 exchange contracts and option contracts to hedge future movements of exchange rates and interest rates, and futures and forward contracts to hedge 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 2018 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 <sup>56, 57</sup>	\$ 47
SYP lumber – US\$10 change per Mfbm <sup>56, 57</sup>	\$ 18
Softwood Lumber Duties – 5% change	\$ 40
Pulp – US\$10 change per tonne <sup>58, 59</sup>	\$ 13
Canadian dollar – US\$0.01 change per Canadian dollar <sup>58, 59</sup>	\$ 21

<sup>56</sup> Based on sales of Canfor-produced product, before softwood lumber duties.

<sup>57</sup> Excluding impacts of exchange rate, freight, discounting, potential change in fibre costs and other deductions.

<sup>58</sup> Includes 100% of CPPI.

<sup>59</sup> 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 dominated the focus for Canfor harvesting activities in central and northern BC for more than a decade, but given the shelf-life expiry of the dead pine stands, that focus is now rapidly shifting to mixed coniferous species stands. To ensure that sufficient dead pine is being harvested to sustain the current allowable harvest rates and minimize impacts to the mid-term timber supply, the Chief Forester of British Columbia has 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 annual allowable 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 collective agreements with the USW (United Steelworkers) expire on June 30, 2018. The Company's collective agreement with the PPWC (Public and Private Workers of Canada) at its Mackenzie lumber operation expires June 30, 2019. Negotiating new collective agreements may result in increased operating costs because of higher wages or benefits paid to unionized workers. Any inability to negotiate acceptable contracts with the USW as they expire could result in a strike 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.

### **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 2017, Canfor provided approximately 62% 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 has completed the construction and is 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. The first period of review will be based on sales and cost data from April 2017 to December 2018, and is 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.

## **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 twelfth annual update to the MPS on July 1, 2018. 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. Additional regulatory initiatives up to and including stop work conditions within the industry have occurred, and remain a possibility.



## **OUTSTANDING SHARE DATA**

At February 22, 2018, based on trade date, there were 128,625,480 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, 2017, 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, 2017 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, 2017, the CEO and CFO have concluded that these controls are operating effectively.

Additional information about the Company, including its 2017 Annual Information Form, is available at <a href="http://www.sedar.com">www.sedar.com</a> or at <a href="http://www.canfor.com">www.canfor.com</a> .
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## CONSOLIDATED FINANCIAL STATEMENTS

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## 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. Management does not believe it is likely that any differences will be material.

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.

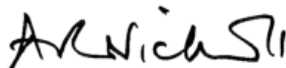
The Audit Committee is comprised of three Directors who are not employees of the Company. The Committee meets periodically throughout the year with management, external auditors and internal auditors to review their respective responsibilities, results of the reviews of internal controls over financial 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 22, 2018



Don B. Kayne  
President and Chief Executive Officer



Alan Nicholl  
Senior Vice-President, Finance and 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

We have audited the accompanying consolidated financial statements of Canfor Corporation, which comprise the consolidated balance sheets as at December 31, 2017 and December 31, 2016, the consolidated statements of income, other comprehensive income (loss), changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### *Management's Responsibility for the Consolidated Financial Statements*

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

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Canfor Corporation as at December 31, 2017 and December 31, 2016, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Chartered Professional Accountants

February 22, 2018  
Vancouver, Canada

KPMG LLP is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. KPMG Canada provides services to KPMG LLP.

## Canfor Corporation Consolidated Balance Sheets

(millions of Canadian dollars)	As at December 31, 2017	As at December 31, 2016
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 288.2	\$ 156.6
Accounts receivable - Trade	193.0	164.2
- Other	45.5	66.5
Inventories (Note 5)	628.9	549.0
Prepaid expenses and other	51.4	50.6
<b>Total current assets</b>	<b>1,207.0</b>	986.9
<b>Property, plant and equipment</b> (Note 6)	<b>1,438.1</b>	1,460.8
<b>Timber licenses</b> (Note 7)	<b>518.3</b>	532.7
<b>Goodwill and other intangible assets</b> (Note 8)	<b>228.1</b>	238.8
<b>Long-term investments and other</b> (Note 9)	<b>83.3</b>	50.7
<b>Retirement benefit surplus</b> (Note 13)	<b>7.9</b>	5.9
<b>Deferred income taxes, net</b> (Note 21)	<b>5.6</b>	1.3
<b>Total assets</b>	<b>\$ 3,488.3</b>	\$ 3,277.1
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Operating loans (Note 11)	\$ -	\$ 28.0
Accounts payable and accrued liabilities (Note 10)	470.0	384.1
Current portion of deferred reforestation obligations (Note 14)	49.5	48.5
Forward purchase liability (Note 30)	-	41.7
Current portion of long-term debt (Note 12)	0.3	-
<b>Total current liabilities</b>	<b>519.8</b>	502.3
<b>Long-term debt</b> (Note 12)	<b>385.4</b>	448.0
<b>Retirement benefit obligations</b> (Note 13)	<b>272.0</b>	302.2
<b>Deferred reforestation obligations</b> (Note 14)	<b>63.0</b>	56.9
<b>Other long-term liabilities</b>	<b>23.7</b>	23.7
<b>Deferred income taxes, net</b> (Note 21)	<b>223.4</b>	205.5
<b>Total liabilities</b>	<b>\$ 1,487.3</b>	\$ 1,538.6
<b>EQUITY</b>		
Share capital (Note 17)	\$ 1,014.9	\$ 1,047.7
Contributed surplus and other equity	31.9	(4.6)
Retained earnings	629.5	351.7
Accumulated other comprehensive income	55.1	88.9
<b>Total equity attributable to equity shareholders of the Company</b>	<b>1,731.4</b>	1,483.7
Non-controlling interests (Note 18)	269.6	254.8
<b>Total equity</b>	<b>\$ 2,001.0</b>	\$ 1,738.5
<b>Total liabilities and equity</b>	<b>\$ 3,488.3</b>	\$ 3,277.1

### Commitments and Contingencies (Note 25)

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,	
	<b>2017</b>	2016
<b>Sales</b>	<b>\$ 4,658.8</b>	\$ 4,234.9
<b>Costs and expenses</b>		
Manufacturing and product costs	<b>3,038.1</b>	2,947.2
Freight and other distribution costs	<b>656.2</b>	635.8
Countervailing and anti-dumping duty expense, net of recovery (Note 31)	<b>44.3</b>	-
Amortization	<b>249.9</b>	242.3
Selling and administration costs	<b>114.5</b>	103.7
Restructuring, mill closure and severance costs, net of recovery (Note 16)	<b>(1.0)</b>	3.4
	<b>4,102.0</b>	3,932.4
Equity income (Note 9)	<b>0.6</b>	3.6
<b>Operating income</b>	<b>557.4</b>	306.1
Finance expense, net (Note 20)	<b>(30.8)</b>	(32.8)
Foreign exchange gain on long-term debt	<b>8.8</b>	4.1
Gain (loss) on derivative financial instruments (Note 27)	<b>(5.2)</b>	2.9
Other expense, net	<b>(3.8)</b>	(12.5)
Net income before income taxes	<b>526.4</b>	267.8
Income tax expense (Note 21)	<b>(132.8)</b>	(63.9)
<b>Net income</b>	<b>\$ 393.6</b>	\$ 203.9
<b>Net income attributable to:</b>		
Equity shareholders of the Company	<b>\$ 345.4</b>	\$ 150.9
Non-controlling interests (Note 18)	<b>48.2</b>	53.0
<b>Net income</b>	<b>\$ 393.6</b>	\$ 203.9
<b>Net income per common share:</b> (in Canadian dollars)		
Attributable to equity shareholders of the Company		
- Basic and diluted (Note 17)	<b>\$ 2.63</b>	\$ 1.14

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

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

(millions of Canadian dollars)	Years ended December 31,	
	<b>2017</b>	2016
<b>Net income</b>	<b>\$ 393.6</b>	\$ 203.9
<b>Other comprehensive income (loss)</b>		
Items that will not be recycled through net income:		
Defined benefit plan actuarial gains (losses) (Note 13)	<b>24.1</b>	(50.9)
Income tax recovery (expense) on defined benefit plan actuarial losses/gains (Note 21)	<b>(5.0)</b>	13.2
	<b>19.1</b>	(37.7)
Items that may be recycled through net income:		
Foreign exchange translation of foreign operations, net of tax	<b>(33.8)</b>	(11.1)
Other comprehensive loss, net of tax	<b>(14.7)</b>	(48.8)
<b>Total comprehensive income</b>	<b>\$ 378.9</b>	\$ 155.1
<b>Total comprehensive income attributable to:</b>		
Equity shareholders of the Company	<b>\$ 322.2</b>	\$ 107.4
Non-controlling interests (Note 18)	<b>56.7</b>	47.7
<b>Total comprehensive income</b>	<b>\$ 378.9</b>	\$ 155.1

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,	
	<b>2017</b>	2016
<b>Share capital</b>		
Balance at beginning of year	\$ 1,047.7	\$ 1,047.7
Share purchases (Note 17)	<b>(32.8)</b>	-
Balance at end of year (Note 17)	<b>\$ 1,014.9</b>	\$ 1,047.7
<b>Contributed surplus and other equity</b>		
Balance at beginning of year	\$ (4.6)	\$ (74.5)
Forward purchase liability related to acquisitions (Note 30)	<b>36.5</b>	69.9
Balance at end of year	<b>\$ 31.9</b>	\$ (4.6)
<b>Retained earnings</b>		
Balance at beginning of year	\$ 351.7	\$ 257.7
Net income attributable to equity shareholders of the Company	<b>345.4</b>	150.9
Defined benefit plan actuarial gains (losses), net of tax	<b>10.6</b>	(32.4)
Share purchases (Note 17)	<b>(57.9)</b>	-
Elimination of non-controlling interests (Note 30)	<b>(16.6)</b>	(20.0)
Acquisition of non-controlling interests (Note 17)	<b>(3.7)</b>	(4.5)
Balance at end of year	<b>\$ 629.5</b>	\$ 351.7
<b>Accumulated other comprehensive income</b>		
Balance at beginning of year	\$ 88.9	\$ 100.0
Foreign exchange translation of foreign operations, net of tax	<b>(33.8)</b>	(11.1)
Balance at end of year	<b>\$ 55.1</b>	\$ 88.9
<b>Total equity attributable to equity shareholders of the Company</b>	<b>\$ 1,731.4</b>	\$ 1,483.7
<b>Non-controlling interests</b>		
Balance at beginning of year	\$ 254.8	\$ 296.8
Net income attributable to non-controlling interests	<b>48.2</b>	53.0
Defined benefit plan actuarial gains (losses) attributable to non-controlling interests, net of tax	<b>8.5</b>	(5.3)
Distributions to non-controlling interests	<b>(8.4)</b>	(30.1)
Elimination of non-controlling interests (Note 30)	<b>(19.9)</b>	(39.7)
Acquisition of non-controlling interests (Note 17)	<b>(14.1)</b>	(19.9)
Non-controlling interests arising from investment (Note 12)	<b>0.5</b>	-
Balance at end of year (Note 18)	<b>\$ 269.6</b>	\$ 254.8
<b>Total equity</b>	<b>\$ 2,001.0</b>	\$ 1,738.5

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



## Canfor Corporation

### Consolidated Statements of Cash Flows

	Years ended December 31,	
(millions of Canadian dollars)	<b>2017</b>	2016
<b>Cash generated from (used in):</b>		
<b>Operating activities</b>		
Net income	\$ 393.6	\$ 203.9
Items not affecting cash:		
Amortization	249.9	242.3
Income tax expense	132.8	63.9
Long-term portion of deferred reforestation obligations	5.4	(4.8)
Foreign exchange gain on long-term debt	(8.8)	(4.1)
Changes in mark-to-market value of derivative financial instruments	0.9	(4.9)
Employee future benefits	11.0	13.0
Finance expense, net	30.8	32.8
Adjustment to accrued duties (Note 31)	(44.9)	-
Gain on sale of Anthony EACOM Inc., net (Note 9)	(3.7)	-
Gain on legal settlement, net (Note 28)	-	(15.5)
Equity income	(0.6)	(3.6)
Recovery on operations closure provisions (Note 16)	(3.2)	(2.0)
Write-down of advances to Licella (Note 29)	-	7.0
Other, net	(8.3)	1.7
Defined benefit plan contributions, net	(28.8)	(33.3)
Cash received from legal settlement (Note 28)	-	16.3
Income taxes paid, net	(43.9)	(29.9)
	<b>682.2</b>	482.8
Net change in non-cash working capital (Note 22)	<b>(72.1)</b>	101.0
	<b>610.1</b>	583.8
<b>Financing activities</b>		
Change in operating bank loans (Note 11)	(28.0)	(130.0)
Proceeds from long-term debt, net (Note 12)	6.0	-
Repayment of long-term debt (Note 12)	(50.3)	-
Finance expenses paid	(21.1)	(22.0)
Share purchases (Note 17)	(87.0)	-
Acquisition of non-controlling interests (Note 17)	(17.7)	(24.7)
Cash distributions paid to non-controlling interests (Note 18)	(10.0)	(28.5)
Other, net	0.5	-
	<b>(207.6)</b>	(205.2)
<b>Investing activities</b>		
Additions to property, plant and equipment, timber and intangible assets, net	(252.1)	(233.8)
Proceeds on disposal of property, plant and equipment	11.4	3.9
Proceeds on sale of Anthony EACOM Inc., net (Note 9)	21.1	-
Proceeds on sale of Lakeland Winton (Note 9)	15.0	-
Acquisitions (Note 30)	(59.8)	(83.9)
Advances to Licella (Note 29)	-	(7.0)
Other, net	(2.0)	3.0
	<b>(266.4)</b>	(317.8)
Foreign exchange loss on cash and cash equivalents	(4.5)	(1.7)
<b>Increase in cash and cash equivalents*</b>	<b>131.6</b>	59.1
Cash and cash equivalents at beginning of year*	156.6	97.5
<b>Cash and cash equivalents at end of year*</b>	<b>\$ 288.2</b>	<b>\$ 156.6</b>

\*Cash and cash equivalents include cash on hand less unrepresented cheques.

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

# **Canfor Corporation**

## **Notes to the Consolidated Financial Statements**

Years ended December 31, 2017 and December 31, 2016  
(millions of Canadian dollars unless otherwise noted)

### **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 75<sup>th</sup> Avenue, Vancouver, British Columbia, Canada, V6P 6G2. The consolidated financial statements of the Company as at and for the year ended December 31, 2017 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 22, 2018.

#### ***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 fair value through net income are measured at fair value;
- Financial instruments classified as available-for-sale are measured at fair value with gains or losses, other than impairment losses, recorded in other comprehensive income until realized;
- 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 6 – Property, Plant and Equipment;
- Note 7 – Timber Licenses;
- Note 8 – Goodwill and Other Intangible Assets;
- Note 9 – Long-Term Investments and Other;
- Note 13 – Employee Future Benefits;
- Note 14 – Deferred Reforestation Obligations;
- Note 15 – Asset Retirement Obligations;
- Note 16 – Restructuring, Mill Closure and Severance Costs;
- Note 21 – Income Taxes;
- Note 29 – Licella Pulp Joint Venture; and
- Note 30 – 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, 2017.

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. As part of the acquisition of Anthony Forest Products ("Anthony") in 2015, Canfor acquired a 50% interest in Anthony EACOM Inc., a joint venture that owns and operates an I-joist facility located in Sault St. Marie, Ontario. In March 2017, the Company sold its investment in Anthony EACOM Inc. (Note 9).

#### ***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 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 highly liquid money market instruments with original maturities, or redemption dates, of three months or less from the date of acquisition, and are valued at cost, which approximates market value. Cash is presented net of unrepresented cheques. When the amount of unrepresented 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***

#### *Non-derivative financial instruments*

Non-derivative financial instruments comprise investments in equity securities, trade and other receivables, cash and cash equivalents, loans and advances, and trade and other payables. Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through net income, any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured as described below:

- Financial assets at fair value through net income - An instrument is classified at fair value through net income if it is held for trading or is designated as such upon initial recognition. Financial instruments at fair value through net income are measured at fair value, and changes therein are recognized in the statements of income, with attributable transaction costs being recognized in net income when incurred.
- Available-for-sale financial assets - Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any other categories. These are measured at fair value through other comprehensive income, other than impairment losses.
- Loans and receivables - Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These are measured initially at fair value and subsequently at amortized cost using the effective interest method, less any impairment losses. The effective interest method spreads the total costs of or income from a financial instrument over the life of the instrument. Financial assets included within this category for Canfor are trade and other receivables, and cash and cash equivalents.
- Other liabilities - All of Canfor's financial liabilities are measured initially at fair value less transaction costs, and subsequently at amortized cost using the effective interest method.

#### *Derivative financial instruments*

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. Consequently, such derivatives for which hedge accounting is not applied are carried on the balance sheet at fair value, with changes in fair value (realized and unrealized) being recognized in the statement of income as 'gain (loss) on derivative financial instruments'.

The fair value of the derivatives is determined with reference to period end market trading prices for derivatives with comparable characteristics.

### ***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 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 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 not exceeding four to ten years.

#### *Tenure permitting and development costs*

The Company capitalizes development and permitting costs related to timber that is expected to be harvested beyond twelve months from the balance sheet date as an intangible asset, which is classified under 'long-term investments and other'. These costs are amortized to inventory as timber is harvested using estimated harvest volumes.

### ***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.

Financial assets are reviewed at each reporting date to determine whether there is evidence indicating they are impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative impact on estimated future cash flows from that asset. An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. All impairment losses are recognized in net income and are not reversed.

## ***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 provision 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.

#### *Restructuring*

A provision for restructuring is recognized when Canfor has approved a detailed and formal restructuring plan, which may include the indefinite or permanent closure of one of its operations, and the restructuring either has commenced or has been announced publicly. Provisions are not recognized for future operating costs.

#### ***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 compensation expense 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 at the fair value of the consideration received or receivable net of applicable sales taxes, returns, rebates and discounts and after eliminating sales within the Company. Revenue is recognized when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible returns of the goods can be estimated reliably, there is no continuing management involvement with the goods, and the amounts of revenue can be measured reliably.

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. Accounting Standards Issued and Not Applied**

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*, which will supersede IAS 18, *Revenue*, IAS 11, *Construction Contracts* and related interpretations. The new standard is effective for annual periods beginning on or after January 1, 2018. The Company has performed an assessment of the impact of the new standard, and has determined that adoption of this standard will have no significant impact on the Company's financial statements.

In July 2014, the IASB issued IFRS 9, *Financial Instruments*. The required adoption date for IFRS 9 is January 1, 2018. The Company has performed an assessment of the impact of the new standard, and has determined that adoption of this standard will have no significant impact on the Company's financial statements.

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 a depreciation expense for right-of-use assets and interest expense on lease liabilities.

It is expected that IFRS 16 will have an impact on the Company's financial statements with recognition of new assets and liabilities for its operating leases. The Company is still in the process of assessing the quantitative impact on its financial statements of this new standard. The Company's future minimum lease payments, on an undiscounted basis, under non-cancellable operating leases at December 31, 2017 is disclosed in Note 25, Commitments and Contingencies.



## 5. Inventories

(millions of Canadian dollars)	As at December 31, 2017	As at December 31, 2016
Logs	\$ 132.1	\$ 107.3
Finished products	354.6	310.6
Residual fibre	20.8	13.8
Materials and supplies	121.4	117.3
	<b>\$ 628.9</b>	<b>\$ 549.0</b>

There were no inventory write-downs at December 31, 2017 or December 31, 2016.

In 2017, total manufacturing and product costs were \$3,038.1 million (December 31, 2017 - \$2,947.2 million), of which \$1,328.7 million was related to the costs of raw materials, consumables and finished products (December 31, 2016 - \$1,591.3 million).

## 6. Property, Plant and Equipment

(millions of Canadian dollars)	Land	Pulp and kraft paper mills	Solid Wood operations <sup>2</sup>	Logging assets and other equipment	Total
<b>Cost</b>					
Balance at January 1, 2016	\$ 51.5	\$ 1,600.5	\$ 1,803.7	\$ 214.7	\$ 3,670.4
Additions <sup>1</sup>	-	63.7	150.9	12.8	227.4
Acquisitions (Note 30)	1.1	-	21.8	0.3	23.2
Disposals	-	(25.9)	(66.2)	(2.2)	(94.3)
Effect of movements in exchange rates	(0.7)	-	(11.8)	-	(12.5)
Balance at December 31, 2016	\$ 51.9	\$ 1,638.3	\$ 1,898.4	\$ 225.6	\$ 3,814.2
Additions <sup>1</sup>	1.1	77.5	140.0	19.3	237.9
Disposals	(1.8)	(64.1)	(25.2)	(7.4)	(98.5)
Effect of movements in exchange rates	(1.9)	-	(32.4)	(0.6)	(34.9)
Balance at December 31, 2017	\$ 49.3	\$ 1,651.7	\$ 1,980.8	\$ 236.9	\$ 3,918.7
<b>Amortization and impairment losses</b>					
Balance at January 1, 2016	\$ (2.5)	\$ (1,073.6)	\$ (987.6)	\$ (161.6)	\$ (2,225.3)
Amortization for the year	-	(73.8)	(136.1)	(10.1)	(220.0)
Disposals	-	22.4	63.2	1.9	87.5
Effect of movements in exchange rates	-	-	4.4	-	4.4
Balance at December 31, 2016	\$ (2.5)	\$ (1,125.0)	\$ (1,056.1)	\$ (169.8)	\$ (2,353.4)
Amortization for the year	-	(74.3)	(141.2)	(14.6)	(230.1)
Disposals	-	62.5	19.8	6.9	89.2
Effect 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)
<b>Carrying amounts</b>					
At January 1, 2016	\$ 49.0	\$ 526.9	\$ 816.1	\$ 53.1	\$ 1,445.1
At December 31, 2016	\$ 49.4	\$ 513.3	\$ 842.3	\$ 55.8	\$ 1,460.8
<b>At December 31, 2017</b>	<b>\$ 46.8</b>	<b>\$ 514.9</b>	<b>\$ 816.8</b>	<b>\$ 59.6</b>	<b>\$ 1,438.1</b>

<sup>1</sup>Net of capital expenditures by CPPI that are financed by government grants.

<sup>2</sup>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.

Included in the above are assets under construction in the amount of \$91.8 million (December 31, 2016 - \$33.4 million), which have not been amortized as at December 31, 2017.

## 7. Timber Licenses

(millions of Canadian dollars)

<b>Cost</b>	
Balance at January 1, 2016	\$ 835.4
Additions	30.6
Acquisitions (Note 30)	9.7
Disposals	(6.9)
Balance at December 31, 2016	\$ 868.8
Additions	1.2
Balance at December 31, 2017	\$ 870.0
<b>Amortization</b>	
Balance at January 1, 2016	\$ (320.2)
Amortization for the year	(15.9)
Balance at December 31, 2016	\$ (336.1)
Amortization for the year	(15.6)
Balance at December 31, 2017	\$ (351.7)
<b>Carrying amounts</b>	
At January 1, 2016	\$ 515.2
At December 31, 2016	\$ 532.7
<b>At December 31, 2017</b>	<b>\$ 518.3</b>

During 2015, the Company completed an investment agreement with Conifex Inc. ("Conifex"), a subsidiary of Conifex Timber Inc. As part of the agreement, Conifex issued a five-year senior secured note payable to Canfor in the amount of \$30.0 million, secured by a forest license located in British Columbia with 200,000 cubic meters of annual allowable cut. On February 12, 2016, Canfor exercised its option to convert the loan into an ownership interest in the forest license. Upon exercising of the option, the timber investment loan was derecognized and timber additions of \$30.6 million were recorded under timber licenses.

## 8. Goodwill and Other Intangible Assets

(millions of Canadian dollars)	Goodwill	Other intangible assets	Total
<b>Cost</b>			
Balance at January 1, 2016	\$ 215.5	\$ 90.8	\$ 306.3
Additions	-	10.7	10.7
Effect of movement in exchange rates	(6.4)	(1.2)	(7.6)
Balance at December 31, 2016	\$ 209.1	\$ 100.3	\$ 309.4
Additions	-	8.2	8.2
Disposals	-	(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
<b>Amortization</b>			
Balance at January 1, 2016	\$ -	\$ (65.3)	\$ (65.3)
Amortization for the year	-	(6.4)	(6.4)
Effect of movement in exchange rates	-	1.1	1.1
Balance at December 31, 2016	\$ -	\$ (70.6)	\$ (70.6)
Amortization for the year	-	(4.2)	(4.2)
Disposals	-	1.8	1.8
Effect of movement in exchange rates	-	2.4	2.4
Balance at December 31, 2017	\$ -	\$ (70.6)	\$ (70.6)
<b>Carrying amounts</b>			
At January 1, 2016	\$ 215.5	\$ 25.5	\$ 241.0
At December 31, 2016	\$ 209.1	\$ 29.7	\$ 238.8
<b>At December 31, 2017</b>	<b>\$ 195.4</b>	<b>\$ 32.7</b>	<b>\$ 228.1</b>

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 for each past acquisition based on an assessment of the value in use that 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 external publications. A pre-tax discount rate of 11.0% and cost inflation rate of 2.0% were used for the purpose of the calculation in 2017 consistent with the calculation in 2016. 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 2017 or 2016.

## 9. Long-Term Investments and Other

(millions of Canadian dollars)	<b>As at December 31, 2017</b>	As at December 31, 2016
Investments	\$ 22.5	\$ 14.7
Anti-dumping duties receivable (Note 31)	44.9	-
Equity investment in Anthony EACOM Inc.	-	16.8
Other deposits, loans, advances and long-term assets	15.9	19.2
	<b>\$ 83.3</b>	<b>\$ 50.7</b>

Included in other accounts receivable at December 31, 2016 was \$15.0 million related to the final instalment for the July 1, 2015 sale of the Company's 33.3% investment in Lakeland Mills Ltd. and Winton Global Lumber Ltd. ("Lakeland Winton") for consideration of \$30.0 million. The balance was received on June 30, 2017.

The anti-dumping duties receivable balance represents anti-dumping cash deposits paid in excess of the calculated expense accrued at December 31, 2017 (Note 31).

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 (before-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.

## 10. Accounts Payable and Accrued Liabilities

(millions of Canadian dollars)	<b>As at December 31, 2017</b>	As at December 31, 2016
Trade payables and accrued liabilities	\$ 289.1	\$ 272.4
Accrued payroll and related liabilities	117.6	104.1
Income tax payable	60.5	-
Restructuring, mill closure and severance costs	2.8	7.6
	<b>\$ 470.0</b>	<b>\$ 384.1</b>

## 11. Operating Loans

(millions of Canadian dollars)	<b>As at December 31, 2017</b>	As at December 31, 2016
<b>Canfor (excluding CPPI)</b>		
Available operating loans:		
Operating loan facility	\$ 350.0	\$ 350.0
Facility for letters of credit	50.0	50.0
Total operating loan facility	400.0	400.0
Operating loan drawn	-	(28.0)
Letters of credit	(44.0)	(41.6)
Total available operating loan facility - Canfor	\$ 356.0	\$ 330.4
<b>CPPI</b>		
Available operating loans:		
Operating loan facility	\$ 110.0	\$ 110.0
Letters of credit	(9.2)	(9.3)
Total available operating loan facility - CPPI	\$ 100.8	\$ 100.7
<b>Consolidated:</b>		
<b>Total operating loan facilities</b>	<b>\$ 510.0</b>	<b>\$ 510.0</b>
<b>Total available operating loan facilities</b>	<b>\$ 456.8</b>	<b>\$ 431.1</b>

Interest is payable on Canfor's 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.

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.

Both Canfor's and CPPI's operating loan facilities have certain financial covenants, including maximum debt to total capitalization ratios.

In 2017, the Company's principal operating loans, excluding those of CPPI, were extended to September 28, 2022.

Canfor (excluding CPPI) has a separate facility to cover letters of credit. At December 31, 2017, \$41.5 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.

As at December 31, 2017, the Company and CPPI are in compliance with all covenants relating to their operating loans. Substantially all borrowings of CPPI are non-recourse to other entities within the Company.

## 12. Long-Term Debt

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

### **Summary of long-term debt**

(millions of Canadian dollars)	<b>As at December 31, 2017</b>	As at December 31, 2016
Canfor Corporation		
CAD\$125.0 million, floating interest, repayable September 28, 2022	\$ 125.0	\$ 125.0
US\$100.0 million, floating interest, repayable September 28, 2025	125.5	134.3
US\$100.0 million, fixed interest of 4.4%, repayable in three equal tranches on October 2, 2023, 2024 and 2025	125.5	134.3
Other (US\$7.7 million) <sup>3</sup>	9.7	4.4
Canfor Pulp Products Inc.		
CAD\$50.0 million, floating interest	-	50.0
Long-term debt at end of year	\$ 385.7	\$ 448.0
Less: Current portion	(0.3)	-
Long-term portion	\$ 385.4	\$ 448.0

<sup>3</sup> Amount relates to net financing for specific capital projects at Canfor's U.S. sawmills.

In 2017, the Company extended the maturity date on its Canadian dollar denominated \$125.0 million term loan from September 28, 2020 to September 28, 2022, and extended the maturity date on its US dollar denominated \$100.0 million floating rate term loan from September 28, 2023 to September 28, 2025.

In 2017, the Company obtained \$4.3 million (US\$3.4 million) in net financing at an interest rate of 1.3% to fund certain capital projects at its U.S. sawmills. The structure of the financing arrangement included a 95% investment in a new subsidiary, resulting in the recognition of \$0.5 million (US\$0.4 million) in non-controlling interests.

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, 2017, the Company is in compliance with all covenants relating to its long-term debt.

### **Fair value of total long-term debt**

At December 31, 2017, the fair value of the Company's long-term debt is \$389.1 million (December 31, 2016 - \$447.2 million). The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

## 13. 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 2017 were \$61.1 million (December 31, 2016 - \$65.8 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, 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, 2017, Canfor has three registered defined benefit pension plans for which actuarial valuations are performed every three years. The largest pension plan underwent an actuarial valuation for funding purposes as of December 31, 2015, which was completed in 2016. In addition, Canfor has other non-contributory benefit plans that provide certain non-pension post-retirement benefits to its members. The other non-contributory plans also underwent a valuation as of December 31, 2015, which was completed in 2016.

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

<b>Fair market value of plan assets</b>	<b>2017</b>		<b>2016</b>	
	<b>Defined Benefit Pension Plans</b>	<b>Other Benefit Plans</b>	<b>Defined Benefit Pension Plans</b>	<b>Other Benefit Plans</b>
(millions of Canadian dollars)				
Beginning of year	\$ 697.0	\$ -	\$ 705.9	\$ -
Interest income on plan assets	26.7	-	28.4	-
Return on plan assets greater (less) than discount rate	19.9	-	(20.0)	-
Employer contributions	19.3	9.5	27.4	5.9
Employee contributions	0.4	-	0.5	-
Benefit payments	(43.8)	(9.5)	(44.3)	(5.9)
Administration expense	(1.0)	-	(0.5)	-
Other	(1.0)	-	(0.4)	-
End of year	\$ 717.5	\$ -	\$ 697.0	\$ -

Plan assets consist of the following:	<b>As at December 31, 2017</b>	<b>As at December 31, 2016</b>
	Percentage of Plan Assets	
Asset category		
Equity securities	31%	15%
Debt securities	12%	46%
Annuities	56%	38%
Cash and cash equivalents and other	1%	1%
	100%	100%

<b>Accrued benefit obligations</b>	<b>2017</b>		<b>2016</b>	
	<b>Defined Benefit Pension Plans</b>	<b>Other Benefit Plans</b>	<b>Defined Benefit Pension Plans</b>	<b>Other Benefit Plans</b>
(millions of Canadian dollars)				
Beginning of year	\$ 812.4	\$ 179.3	\$ 795.1	\$ 165.2
Current service cost	8.8	3.3	9.0	2.9
Settlement adjustment	-	(3.0)	-	-
Plan amendment	1.1	-	-	-
Interest cost	30.9	6.8	31.8	6.5
Employee contributions	0.4	-	0.5	-
Benefit payments	(43.8)	(9.5)	(44.3)	(5.9)
Actuarial loss (gain)	45.3	(50.0)	20.9	10.2
Other	(1.5)	(0.9)	(0.6)	0.4
End of year	\$ 853.6	\$ 126.0	\$ 812.4	\$ 179.3

Of the defined benefit pension plan obligation of \$853.6 million (December 31, 2016 - \$812.4 million), \$773.2 million (December 31, 2016 - \$739.7 million) relates to plans that are wholly or partly funded and \$80.4 million (December 31, 2016 - \$72.7 million) relates to plans that are wholly unfunded, with letters of credit securing \$41.3 million (December 31, 2016 - \$38.5 million) of the unfunded liability.

The total obligation for the non-pension post-retirement benefit plans of \$126.0 million (December 31, 2016 - \$179.3 million) is unfunded.

## Annuity contracts

In 2017, the Company purchased \$136.3 million (December 31, 2016 - \$216.1 million) of buy-in annuities through its defined benefit pension plans, increasing total annuities purchased to \$422.9 million (December 31, 2016 - \$286.6 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 \$4.9 million (December 31, 2016 - \$19.5 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, 2017, \$3.3 million was paid out under the Program, with an additional \$1.1 million paid in January 2018.

## 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 (loss).

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 (loss) in 2017.

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

	December 31, 2017		December 31, 2016	
	Defined Benefit Pension Plans	Other Benefit Plans	Defined Benefit Pension Plans	Other Benefit Plans
(millions of Canadian dollars)				
Fair market value of plan assets	\$ 717.5	\$ -	\$ 697.0	\$ -
Accrued benefit obligations	(853.6)	(126.0)	(812.4)	(179.3)
Funded status of plans – deficit	\$ (136.1)	\$ (126.0)	\$ (115.4)	\$ (179.3)
Other pension plans	(2.0)	-	(1.6)	-
Total accrued benefit liability, net	\$ (138.1)	\$ (126.0)	\$ (117.0)	\$ (179.3)

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

	December 31, 2017		December 31, 2016	
	Defined Benefit Pension Plans	Other Benefit Plans	Defined Benefit Pension Plans	Other Benefit Plans
(millions of Canadian dollars)				
Retirement benefit surplus	\$ 7.9	\$ -	\$ 5.9	\$ -
Retirement benefit obligations	(146.0)	(126.0)	(122.9)	(179.3)
Total accrued benefit liability, net	\$ (138.1)	\$ (126.0)	\$ (117.0)	\$ (179.3)

At December 31, 2017 and December 31, 2016, 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 2017 and 2016. 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:

	2017		2016	
	Defined Benefit Pension Plans	Other Benefit Plans	Defined Benefit Pension Plans	Other Benefit Plans
(millions of Canadian dollars)				
<b>Recognized in net income</b>				
Current service cost	\$ 8.8	\$ 3.3	\$ 9.0	\$ 2.9
Settlement adjustment	-	(3.0)	-	-
Plan amendment	1.1	-	-	-
Administration expense	0.5	-	0.7	-
Interest cost	4.2	6.8	3.4	6.5
Other	-	0.3	-	0.4
Total charge included in net income	\$ 14.6	\$ 7.4	\$ 13.1	\$ 9.8
<b>Recognized in other comprehensive income (loss)</b>				
Actuarial loss (gain) – experience	\$ (6.0)	\$ (0.4)	\$ 2.2	\$ (0.3)
Actuarial gain – demographic assumptions	(0.1)	-	(0.5)	-
Actuarial loss (gain) – financial assumptions	51.4	(49.6)	19.2	10.5
Return on plan assets less (greater) than discount rate	(19.9)	-	20.0	-
Administration expense greater (less) than expected	0.5	-	(0.2)	-
Total charge (credit) included in other comprehensive income (loss)	\$ 25.9	\$ (50.0)	\$ 40.7	\$ 10.2

## Significant assumptions

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

	December 31, 2017		December 31, 2016	
	Defined Benefit Pension Plans	Other Benefit Plans	Defined Benefit Pension Plans	Other Benefit Plans
Discount rate	3.4%	3.4%	3.9%	3.9%
Rate of compensation increases	3.0%	n/a	3.0%	n/a
Initial medical cost trend rate	n/a	6.5%	n/a	7.0%
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, 2017 is between 21.0 years and 24.1 years (December 31, 2016 - 20.9 years and 24.1 years). As at December 31, 2017, the weighted average duration of the defined benefit obligation, which reflects the average age of the plan members, is 12.3 years (December 31, 2016 - 12.1 years). The weighted average duration of the other benefit plans is 14.2 years (December 31, 2016 - 14.6 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, taking into account the hedging impact of plan annuity assets, for 2017:

(millions of Canadian dollars)	1% Increase		1% Decrease	
Defined benefit pension plan liabilities, net of annuity assets				
Discount rate	\$	(59.3)	\$	59.8
Other benefit plan liabilities				
Discount rate	\$	(15.9)	\$	19.9
Initial medical cost trend rate	\$	13.9	\$	(11.7)

When taking into account the impact of hedging, 46% (December 31, 2016 - 33%) 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 10% (December 31, 2016 - 32%) is partially hedged through the plan's investment in debt securities.

As at December 31, 2017, Canfor estimates that it will make contribution payments of \$24.2 million to its defined benefit pension plans in 2018 based on the last actuarial valuation for funding purposes.

### ***Defined contribution and other plans***

The total expense recognized in 2017 for Canfor's defined contribution plans was \$9.5 million (December 31, 2016 - \$9.9 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 \$22.8 million in 2017 (December 31, 2016 - \$22.6 million).

## 14. Deferred Reforestation Obligations

The following table provides a reconciliation of the deferred reforestation obligations as at December 31, 2017 and December 31, 2016:

(millions of Canadian dollars)	<b>2017</b>		2016	
Reforestation obligations at beginning of year	\$	<b>105.4</b>	\$	112.3
Expense for year		<b>49.9</b>		40.0
Accretion expense		<b>0.7</b>		0.5
Additions		-		2.8
Disposals		-		(3.8)
Changes in estimates		<b>(1.6)</b>		(0.8)
Paid during the year		<b>(41.9)</b>		(45.6)
Reforestation obligations at end of year	\$	<b>112.5</b>	\$	105.4
Less: Current portion		<b>(49.5)</b>		(48.5)
Long-term portion	\$	<b>63.0</b>	\$	56.9

The total undiscounted amount of the estimated cash flows required to settle the obligations at December 31, 2017 is \$117.8 million (December 31, 2016 - \$109.0 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 1.5% to 2.1% at December 31, 2017 (December 31, 2016 - 0.7% to 2.0%).

Additions of \$2.8 million during 2016 related to the deferred reforestation obligations assumed by Canfor on the acquisition of Wynndel Box and Lumber Ltd. ("Wynndel") (Note 30). Disposals of \$3.8 million during 2016 related to the sale of a forest license in the Kootenays.

## 15. Asset Retirement Obligations

The following table provides a reconciliation of the asset retirement obligations as at December 31, 2017 and December 31, 2016:

(millions of Canadian dollars)	<b>2017</b>	2016
Asset retirement obligations at beginning of year	\$ <b>9.9</b>	\$ 8.0
Accretion expense	<b>0.2</b>	0.1
Changes in estimates	<b>0.2</b>	1.8
Asset retirement obligations at end of year	\$ <b>10.3</b>	\$ 9.9

Canfor's asset retirement obligations include \$5.5 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 5 to 34 years and have been discounted at risk-free rates ranging from 1.9% to 2.3% (December 31, 2016 - 1.3% 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 4 to 53 years and have been discounted at risk-free rates ranging from 1.8% to 2.3% (December 31, 2016 - 1.2% to 2.4%).

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.

## 16. Restructuring, Mill Closure and Severance Costs

Restructuring, mill closure and severance amounts represent those associated with the indefinite or permanent closures of facilities and staff reductions. Reducing these costs in 2017 was the reversal of a portion of the provision relating to the Canal Flats sawmill in the amount of \$3.2 million (before tax), reflecting lower current estimates of demolition costs as a result of the sale of the closed facility. In 2016, \$2.0 million of the Canal Flats provision was reversed also reflecting lower estimates of demolition costs.

The following table provides a breakdown of the net restructuring, mill closure and severance expense (recovery) by business segment:

(millions of Canadian dollars)	<b>2017</b>	2016
Lumber	\$ <b>(2.7)</b>	\$ 0.7
Pulp & Paper	-	-
Unallocated and Other	<b>1.7</b>	2.7
	\$ <b>(1.0)</b>	\$ 3.4

The following table provides a reconciliation of the restructuring, mill closure and severance liability for the years ended December 31, 2017 and December 31, 2016:

(millions of Canadian dollars)	<b>2017</b>	2016
Accrued liability at beginning of year	\$ <b>10.6</b>	\$ 13.7
Costs (recovery) accrued in the year, net	<b>(4.1)</b>	-
Paid during the year	<b>(1.8)</b>	(3.1)
Accrued liability at end of year	\$ <b>4.7</b>	\$ 10.6

At December 31, 2017, \$1.9 million of the restructuring, mill closure and severance liability is non-current (December 31, 2016 - \$3.0 million).

## 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*

	2017		2016	
(millions of Canadian dollars, except number of shares)	Number of Shares	Amount	Number of Shares	Amount
Common shares at beginning of year	<b>132,804,573</b>	<b>\$ 1,047.7</b>	132,804,573	\$ 1,047.7
Common shares purchased	<b>(4,159,593)</b>	<b>(32.8)</b>	-	-
Common shares at end of year <sup>4</sup>	<b>128,644,980</b>	<b>\$ 1,014.9</b>	132,804,573	\$ 1,047.7

<sup>4</sup>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 2017 was 131,449,999 (December 31, 2016 - 132,804,573), and reflects common shares purchased under the Company's normal course issuer bid.

### *Normal course issuer bid*

On March 7, 2017, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 6,640,227 common shares or approximately 5% of its issued and outstanding common shares as of March 1, 2017. The renewed normal course issuer bid is set to expire on March 6, 2018. In 2017, Canfor 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. Cash payments for share purchases totaled \$87.0 million during the year. In 2016, Canfor did not purchase any common shares.

Subsequent to year end, the Company purchased 19,500 shares for \$0.5 million (an average of \$25.64 per common share). As at February 22, 2018, based on trade date, there were 128,625,480 common shares of the Company outstanding.

Under a separate normal course issuer bid, CPPI purchased common shares from non-controlling shareholders increasing Canfor's ownership of CPPI from 53.6% at December 31, 2016 to 54.8% at December 31, 2017, and February 22, 2018.

## 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, 2017			As at December 31, 2016		
	Lumber <sup>5</sup>	CPPI <sup>6</sup>	Total	Lumber <sup>5</sup>	CPPI <sup>6</sup>	Total
Current assets	\$ 7.8	\$ 165.0	\$ 172.8	\$ 13.0	\$ 146.7	\$ 159.7
Non-current assets	6.7	238.3	245.0	26.6	241.7	268.3
Total assets	\$ 14.5	\$ 403.3	\$ 417.8	\$ 39.6	\$ 388.4	\$ 428.0
Current liabilities	\$ 1.9	\$ 73.0	\$ 74.9	\$ 8.4	\$ 58.2	\$ 66.6
Non-current liabilities	1.3	72.0	73.3	1.3	105.3	106.6
Total liabilities	\$ 3.2	\$ 145.0	\$ 148.2	\$ 9.7	\$ 163.5	\$ 173.2
Total equity	\$ 11.3	\$ 258.3	\$ 269.6	\$ 29.9	\$ 224.9	\$ 254.8
Total liabilities and equity	\$ 14.5	\$ 403.3	\$ 417.8	\$ 39.6	\$ 388.4	\$ 428.0

### Summarized Statements of Income and Other Comprehensive Income (Loss):

Amounts presented below represent non-controlling %

(millions of Canadian dollars)

	Year ended December 31, 2017			Year ended December 31, 2016		
	Lumber <sup>5</sup>	CPPI <sup>6</sup>	Total	Lumber <sup>5</sup>	CPPI <sup>6</sup>	Total
Sales	\$ 13.6	\$ 546.8	\$ 560.4	\$ 130.6	\$ 519.0	\$ 649.6
Net income	1.7	46.5	48.2	25.8	27.2	53.0
Other comprehensive income (loss)	-	8.5	8.5	-	(5.3)	(5.3)
Total comprehensive income	\$ 1.7	\$ 55.0	\$ 56.7	\$ 25.8	\$ 21.9	\$ 47.7
Dividends paid to non-controlling interests	\$ 2.4	\$ 7.6	\$ 10.0	\$ 20.5	\$ 8.0	\$ 28.5

### Summarized Statements of Cash Flows:

Amounts presented below represent non-controlling %

(millions of Canadian dollars)

	Year ended December 31, 2017			Year ended December 31, 2016		
	Lumber <sup>5</sup>	CPPI <sup>6</sup>	Total	Lumber <sup>5</sup>	CPPI <sup>6</sup>	Total
Cash flows from operating activities	\$ 3.1	\$ 88.9	\$ 92.0	\$ 36.2	\$ 70.6	\$ 106.8
Cash flows from financing activities	\$ (0.4)	\$ (39.9)	\$ (40.3)	\$ (25.9)	\$ (21.1)	\$ (47.0)
Cash flows from investing activities	\$ (1.1)	\$ (37.6)	\$ (38.7)	\$ (12.0)	\$ (33.3)	\$ (45.3)

<sup>5</sup>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 (5%), as well as non-controlling interest related to Scotch & Gulf Lumber, LLC (50%) and Beadles & Balfour Lumber Company (45%) up to the completion of the final phase of the acquisitions in July 2016 and January 2017, respectively, which increased Canfor's ownership 100% (Note 30).

<sup>6</sup>CPPI purchased shares from non-controlling CPPI shareholders under a normal course issuer bid increasing Canfor's ownership of CPPI from 53.6% at December 31, 2016 to 54.8% at December 31, 2017 with CPPI's non-controlling interest decreasing by a corresponding amount throughout 2017 (Note 17).

Subsequent to year end, on January 1, 2018, Pacific BioEnergy Corporation exercised its option to increase its ownership of Canfor Energy North Limited Partnership from 5% to 15%.

## 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 expense recorded in relation to the DSUs for 2017 was \$1.1 million due to the revaluation of existing units (December 31, 2016 - recovery of \$0.5 million). The value of outstanding DSUs at December 31, 2017 is \$2.8 million (December 31, 2016 - \$1.7 million).

## 20. Finance Expense, Net

(millions of Canadian dollars)	2017	2016
Interest expense on borrowings	\$ (21.5)	\$ (23.1)
Interest expense on retirement benefit obligations, net	(11.0)	(9.9)
Interest income	2.7	1.0
Other	(1.0)	(0.8)
Finance expense, net	\$ (30.8)	\$ (32.8)

## 21. Income Taxes

The components of income tax expense are as follows:

(millions of Canadian dollars)	2017	2016
Current	\$ (120.7)	\$ (37.9)
Deferred	(12.1)	(26.0)
Income tax expense	\$ (132.8)	\$ (63.9)

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

(millions of Canadian dollars)	2017	2016
Income tax expense at statutory rate of 26.0%	\$ (136.9)	\$ (69.6)
Add (deduct):		
Non-taxable income related to non-controlling interests	0.4	6.7
Entities with different income tax rates and other tax adjustments	(1.9)	(0.4)
Permanent difference from capital gains and losses and other non-deductible items	1.8	(0.6)
Change in substantively enacted tax legislation	3.8	-
Income tax expense	\$ (132.8)	\$ (63.9)

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 (loss) as an income tax recovery on defined benefit plan actuarial losses.

In addition, a tax expense of \$6.1 million, before the tax rate adjustment, in relation to actuarial gains on the defined benefit plans (December 31, 2016 - recovery of \$13.2 million on actuarial losses) was recorded in other comprehensive income (loss) for the year ended December 31, 2017.

Also included in other comprehensive income (loss) for the 2017 year is a tax recovery of \$2.3 million related to foreign exchange differences on translation of investments in foreign operations (December 31, 2016 - recovery of \$1.2 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)	<b>As at December 31, 2017</b>	As at December 31, 2016
Deferred income tax assets		
Accruals not currently deductible	\$ 44.4	\$ 40.5
Loss carryforwards	3.3	9.6
Retirement benefit obligations	69.9	72.6
Goodwill and other intangible assets, net	11.3	25.6
Other	8.0	4.0
	<b>\$ 136.9</b>	<b>\$ 152.3</b>
Deferred income tax liabilities		
Depreciable capital assets	\$ (332.7)	\$ (341.4)
Other	(22.0)	(15.1)
	<b>\$ (354.7)</b>	<b>\$ (356.5)</b>
Total deferred income taxes, net	\$ (217.8)	\$ (204.2)
Less: Entities in a net deferred income tax asset position	5.6	1.3
Deferred income tax liability, net	<b>\$ (223.4)</b>	<b>\$ (205.5)</b>

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)	<b>2017</b>	2016
Accounts receivable	\$ (24.3)	\$ 32.5
Inventories	(85.7)	45.7
Prepaid expenses	(3.8)	4.2
Accounts payable, accrued liabilities and current portion of deferred reforestation obligations	41.7	18.6
Net decrease (increase) in non-cash working capital	<b>\$ (72.1)</b>	<b>\$ 101.0</b>

## 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. During 2017, subsidiaries owned by The Jim Pattison Group provided lease, insurance and other services to Canfor totalling \$5.3 million (December 31, 2016 - \$5.2 million) with \$0.5 million outstanding at December 31, 2017 (December 31, 2016 - \$0.6 million).

During 2017, CPPI sold paper to subsidiaries owned by The Jim Pattison Group totalling \$3.5 million (December 31, 2016 - \$4.3 million). No amounts related to these sales were outstanding as at December 31, 2017 or December 31, 2016.

During 2017, 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 13, Employee Future Benefits, and Note 29, 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)	<b>2017</b>	2016
Short-term benefits	\$ <b>8.3</b>	\$ 7.2
Post-employment benefits	<b>0.1</b>	0.2
Termination benefits	-	0.3
Share-based payments	<b>1.1</b>	(0.5)
	<b>\$ 9.5</b>	\$ 7.2

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.

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.

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.

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	
<b>Year ended December 31, 2017</b>										
<b>Sales to external customers</b>	\$	<b>3,461.1</b>	\$	<b>1,197.7</b>	\$	-	\$	-	\$	<b>4,658.8</b>
<b>Sales to other segments</b>		<b>173.1</b>		<b>0.2</b>		-		<b>(173.3)</b>		-
<b>Operating income (loss)</b>		<b>441.9</b>		<b>154.6</b>		<b>(39.1)</b>		-		<b>557.4</b>
<b>Amortization</b>		<b>175.5</b>		<b>74.4</b>		-		-		<b>249.9</b>
<b>Capital expenditures<sup>7</sup></b>		<b>163.6</b>		<b>83.1</b>		<b>5.4</b>		-		<b>252.1</b>
<b>Identifiable assets</b>		<b>2,285.1</b>		<b>815.6</b>		<b>387.6</b>		-		<b>3,488.3</b>
Year ended December 31, 2016										
Sales to external customers	\$	3,133.2	\$	1,101.7	\$	-	\$	-	\$	4,234.9
Sales to other segments		147.1		0.2		-		(147.3)		-
Operating income (loss)		237.4		98.2		(29.5)		-		306.1
Amortization		164.4		73.8		4.1		-		242.3
Capital expenditures <sup>7</sup>		168.8		64.0		1.0		-		233.8
Identifiable assets		2,268.9		785.2		223.0		-		3,277.1

<sup>7</sup>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. Capital expenditures exclude the assets purchased as part of the acquisition of Wynndel Box and Lumber Ltd. in 2016 (Note 30).

## 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)	<b>2017</b>		2016
Sales by location of customer			
Canada	\$	<b>552.2</b>	\$ 505.8
Asia		<b>1,346.3</b>	1,095.2
United States		<b>2,598.2</b>	2,459.4
Europe		<b>74.7</b>	82.3
Other		<b>87.4</b>	92.2
	\$	<b>4,658.8</b>	\$ 4,234.9

(millions of Canadian dollars)	<b>As at December 31, 2017</b>		As at December 31, 2016
Property, plant and equipment, timber licenses, and goodwill and other intangible assets by location			
Canada	\$	<b>1,650.6</b>	\$ 1,693.8
United States		<b>533.8</b>	538.4
Asia and other		<b>0.1</b>	0.1
	\$	<b>2,184.5</b>	\$ 2,232.3

## 25. Commitments and Contingencies

At the end of the year, Canfor had contractual commitments for \$54.1 million (December 31, 2016 - \$41.4 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)	<b>As at December 31, 2017</b>		As at December 31, 2016
Within one year	\$	<b>12.2</b>	\$ 11.9
Between one and five years		<b>23.7</b>	22.0
Beyond five years		<b>6.6</b>	6.2
Total	\$	<b>42.5</b>	\$ 40.1

During the year ended December 31, 2017, \$20.4 million (December 31, 2016 - \$18.4 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 with certainty, no amount is recognized or accrued in the consolidated financial statements. 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, and certain long-term investments. Cash and cash equivalents includes 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, 2017 is \$288.2 million (December 31, 2016 - \$156.6 million).

Canfor utilizes credit insurance to mitigate the risk associated with some of its trade receivables. As at December 31, 2017, approximately 40% (December 31, 2016 - 38%) of the outstanding trade receivables are covered by credit insurance. Canfor's trade receivable balance at December 31, 2017 is \$196.5 million, before an allowance for doubtful accounts of \$3.5 million (December 31, 2016 - \$168.6 million and \$4.4 million, respectively). At December 31, 2017, approximately 99% (December 31, 2016 - 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, 2017, Canfor had no amount drawn on its operating loans (December 31, 2016 - \$28.0 million), and accounts payable and accrued liabilities of \$470.0 million (December 31, 2016 - \$384.1 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, 2016, Canfor had \$100.0 million in fixed interest rate swaps with interest ranging from 1.55% to 1.75%, which matured in 2017. As at 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 \$1.6 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 \$1.6 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.

Canfor had no foreign exchange derivatives outstanding at December 31, 2017 and December 31, 2016.

(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, 2017 and December 31, 2016:

	As at December 31, 2017		As at December 31, 2016	
	Notional Amount	Average Rate	Notional Amount	Average Rate
<b>Lumber</b>	(MMfbm)	(US dollars per Mfbm)	(MMfbm)	(US dollars per Mfbm)
Future sales contracts				
<i>0-12 months</i>	<b>24.3</b>	<b>\$436.41</b>	74.3	\$326.35

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 \$0.3 million in relation to the lumber futures held at year end.

(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, 2016, the Company had 21 thousand barrels of WTI oil collars, with weighted average protection of US\$47.27 per barrel and topside of US\$72.86 per barrel, which were settled in 2017.

At 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, 2017	As at December 31, 2016
Total debt (including operating loans)	\$ 385.7	\$ 476.0
Less: Cash and cash equivalents	288.2	156.6
Net debt	\$ 97.5	\$ 319.4
Total equity	2,001.0	1,738.5
	<b>\$ 2,098.5</b>	<b>\$ 2,057.9</b>

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, 2017 and December 31, 2016.

The Company manages its capital structure through rigorous planning, budgeting and forecasting processes, and ongoing management of operations, investments and capital expenditures. In 2017, 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, accounts receivable, other deposits, loans and advances, operating loans, accounts payable and accrued liabilities, and long-term debt are measured at amortized cost subsequent to initial measurement.

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

The three levels of the fair value hierarchy are:

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

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

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

The following table summarizes Canfor's financial instruments measured at fair value at December 31, 2017 and December 31, 2016, and shows the level within the fair value hierarchy in which they have been classified:

(millions of Canadian dollars)	Fair Value Hierarchy Level	<b>As at December 31, 2017</b>	As at December 31, 2016
<b>Financial assets measured at fair value</b>			
Investments - held for trading	Level 1	\$ 21.8	\$ 14.3
Derivative financial instruments - held for trading	Level 2	-	0.2
		<b>\$ 21.8</b>	<b>\$ 14.5</b>
<b>Financial liabilities measured at fair value</b>			
Derivative financial instruments - held for trading	Level 2	\$ 0.8	\$ 0.1
		<b>\$ 0.8</b>	<b>\$ 0.1</b>

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 comprehensive 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, 2017, the fair value of derivative financial instruments is a net liability of \$0.8 million (December 31, 2016 - net asset of \$0.1 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, 2017 and December 31, 2016:

(millions of Canadian dollars)	<b>2017</b>	2016
Lumber futures	\$ (4.7)	\$ 3.5
Energy derivatives	(0.5)	(0.8)
Interest rate swaps	-	0.2
Gain (loss) on derivative financial instruments	\$ (5.2)	\$ 2.9

The following table summarizes the fair value of the derivative financial instruments included in the balance sheets at December 31, 2017 and December 31, 2016:

(millions of Canadian dollars)	<b>As at December 31, 2017</b>	As at December 31, 2016
Lumber futures	\$ (0.3)	\$ 0.2
Energy derivatives	(0.5)	-
Interest rate swaps	-	(0.1)
Total asset (liability), net	(0.8)	0.1
Less: Current portion asset (liability), net	(0.8)	0.1
Long-term asset (liability), net	\$ -	\$ -

There were no transfers between fair value hierarchy levels in 2017 or 2016.

## **28. Houston Pellet Limited Partnership Settlement**

On June 28, 2016, Houston Pellet Limited Partnership ("HPLP") settled various legal claims with a logistics terminal located in Northern British Columbia related to unloading, storage, handling and shipping services for wood pellets manufactured by HPLP. Settlement funds of \$16.3 million were paid to HPLP in 2016. Certain machinery and equipment involved in the settlement were impaired resulting in approximately \$0.8 million in impairment charges being recorded by HPLP. The net gain of \$15.5 million was recorded in operating income net of manufacturing and product costs in 2016. Canfor owns a 60% interest in HPLP.

## **29. 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, 2017, CPPI's share of the joint venture's expenses was \$1.1 million (December 31, 2016 - \$0.6 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 \$1.7 million has been contributed as at December 31, 2017.

In conjunction with the joint venture agreement and CPPI's commitment to innovation and the development of potentially transforming technology, CPPI provided a convertible credit facility to IER, the parent company of Licella, which matures on June 21, 2019. The advances on this credit facility are convertible, at CPPI's option, into common shares of IER.

With regards to the convertible credit facility, during 2016, CPPI advanced \$7.0 million to Licella and exercised its option to convert \$3.5 million of the amount advanced into common shares of IER. Due to the inherent nature of this type of innovation and technology development, CPPI considers these advances to be substantially research and development in nature. As a result, in 2016, CPPI recognized losses of \$7.0 million in other income (expense). This reflects CPPI's consideration of the intrinsic risk associated with these advances. No advances were made by CPPI in 2017.

### **30. Acquisitions**

#### ***(a) US South***

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.

On July 29, 2016, Canfor completed the final phase of the acquisition of Scotch & Gulf Lumber, LLC ("Scotch Gulf") for \$61.6 million (US\$54.9 million) bringing Canfor's interest in Scotch Gulf to 100%. Upon completion of the final phase of the acquisition, the forward purchase liability of \$71.8 million and non-controlling interest of \$39.7 million were derecognized, and \$69.9 million was credited to other equity. In addition, \$20.0 million was charged to retained earnings reflecting Canfor's election to account for the non-controlling interest related to Scotch Gulf as the non-controlling share of the fair value of the net identifiable assets at the acquisition date.

All of the acquisitions were 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*.

The acquisition of Wynndel included a sawmill located in the Creston Valley of British Columbia, which produces premium boards and customized specialty wood products with an annual production capacity of 80 million board feet. Canfor acquired the assets of Wynndel, including approximately 65,000 cubic meters of annual harvesting rights in the Kootenay Lake Timber Supply Area.

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.

### **31. 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% (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. The first period of review will be based on sales and cost data from April 2017 to December 2018, and is currently anticipated to be completed in 2020.

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 are posted at the final published ADD rate of 7.28% as determined by the DOC, however for accounting purposes, the expense is being 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. Canfor will reassess its estimate of the anti-dumping duty rate at the end of each quarter in 2018 by applying the DOC's methodology to updated sales and cost data as this becomes available. These estimates may result in a material adjustment to the Income Statement on a quarterly basis during the first period of review. 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.

The cumulative countervailing and anti-dumping duty cash deposits in excess of the calculated expense accrued at December 31, 2017 is \$14.0 million and \$30.9 million, respectively. These balances are being carried as receivables under 'long-term investments and other'.

In 2017 the Company has recorded a net countervailing and anti-dumping duty expense of \$44.3 million.

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.

## ADDITIONAL INFORMATION

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# 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, 2017 are as below. For more information visit [www.canfor.com](http://www.canfor.com).

**John Baird**<sup>(3)(1)(4)(5)</sup>  
Corporate Director  
Toronto, Ontario, Canada

**Ross Smith, FCPA, FCA**<sup>(1)(2)</sup>  
Corporate Director  
West Vancouver, British Columbia, Canada

**J. Mack Singleton, BA**<sup>(4)(5)</sup>  
Corporate Director  
Myrtle Beach, South Carolina, United States

**Ryan Barrington-Foote**<sup>(1)(2)(3)</sup>  
Managing Director, Accounting  
The Jim Pattison Group  
Vancouver, British Columbia, Canada

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

**Conrad Pinette**<sup>(2)(3)(4)(5)</sup>  
Chairman  
Canfor Corporation  
Vancouver, British Columbia, Canada

**Peter Bentley, O.C., O.B.C., LL.D.**<sup>(2)(3)(4)(5)</sup>  
Chairman Emeritus  
Canfor Corporation  
Vancouver, British Columbia, Canada

**Michael Korenberg**  
Chairman  
The Wreath Group  
West Vancouver, British Columbia, Canada

**Glen Clark**<sup>(3)(4)(5)</sup>  
President and Chief Operating Officer  
The Jim Pattison Group  
Vancouver, British Columbia, Canada

**William Stinson**<sup>(1)(2)(4)(5)</sup>  
Chairman and Chief Executive Officer  
Westshore Terminals Investment Corporation  
Vancouver, 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, 2017 are as below. For more information visit [www.canfor.com](http://www.canfor.com).

**Peter Bentley**  
Chairman Emeritus  
Vancouver, British Columbia, Canada

**Kevin Pankratz**<sup>(6)</sup>  
Senior Vice President, Sales and Marketing  
North Vancouver, British Columbia, Canada

**Conrad Pinette**  
Chairman  
Vancouver, British Columbia, Canada

**Mark Feldinger**  
Senior Vice President, Energy, Environment,  
Transportation and Sourcing  
Surrey, British Columbia, Canada

**Bob Hayes**  
Vice President, Transportation  
Procurement and Distribution  
Delta, British Columbia, Canada

**Alan Nicholl**  
Senior Vice President, Finance and  
Chief Financial Officer  
West Vancouver, British Columbia, Canada

**Patrick Elliott**  
Vice President and Treasurer  
Vancouver, British Columbia, Canada

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

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

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

**Stephen Mackie**  
Senior Vice President, Operations 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.
- (6) Wayne Guthrie, former Senior Vice President, Sales and Marketing, retired at the end of 2017.

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



## **CORPORATE AND SHAREHOLDER INFORMATION**

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### **Annual General Meeting**

The Annual General Meeting of Canfor Corporation will be held at the Terminal City Club at 837 West Hastings Street, Vancouver, BC, on Wednesday, April 25, 2018 at 12:00 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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