



Canfor Corporation

**Annual Information Form**

**Information in this Annual Information Form  
is as at February 14, 2013 unless otherwise indicated.**

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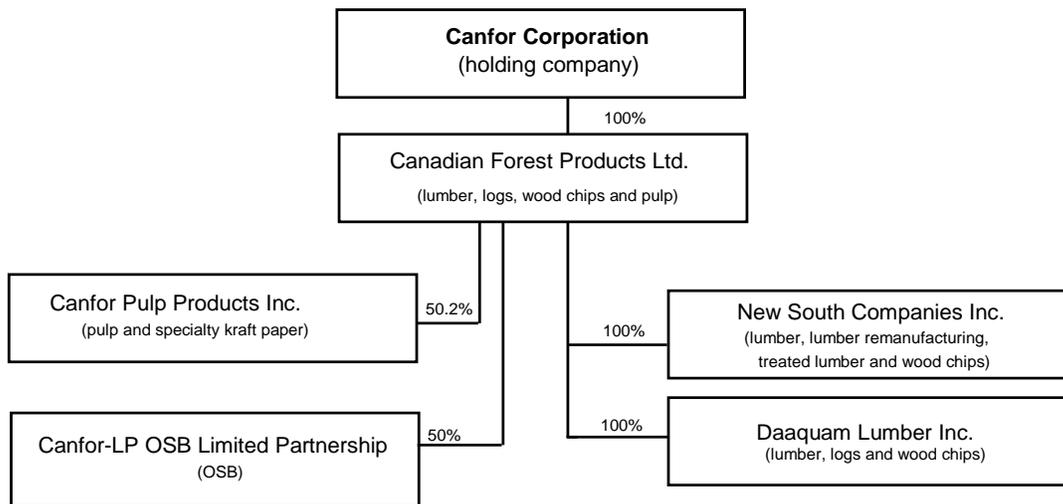
## INCORPORATION

The Company was incorporated on May 17, 1966, under the British Columbia *Company Act* as part of a reorganization of predecessors of the Canfor group of companies, the first of which commenced operations in 1938. The Company is now governed by the British Columbia *Business Corporations Act*. In July 1983, Canfor became a public Company and the Common Shares of the Company are listed and traded on the Toronto Stock Exchange ("TSX").

The registered and head office of the Company is located at 100-1700 West 75<sup>th</sup> Avenue, Vancouver, British Columbia. In this Annual Information Form, Canfor Corporation is referred to as the "Company" and, unless otherwise indicated by the context, "Canfor" refers to the Company, its subsidiaries and its interests in the limited partnerships as described under "Corporate Structure" below.

## CORPORATE STRUCTURE

The following chart shows, as at December 31, 2012, the Company's material subsidiaries and its direct or indirect interest in Canfor Pulp Products Inc. ("CPPI"), and Canfor-LP OSB Limited Partnership (renamed Louisiana Pacific OSB Limited Partnership) ("Peace Valley OSB"), their primary products or activities and the percentage of voting securities or ownership held. All of the companies listed below were incorporated or amalgamated under the laws of British Columbia and are now governed by the British Columbia *Business Corporations Act*, except Daaquam Lumber Inc. ("Daaquam"), which is constituted under the laws of Québec and New South Companies Inc. ("New South"), which is constituted under the laws of the State of South Carolina. Peace Valley OSB is a limited partnership constituted under the *Partnership Act* of British Columbia.



The Company completed the spin-out of its northern bleached softwood kraft pulp and paper business to Canfor Pulp Limited Partnership ("Canfor Pulp LP") in 2006. On March 2, 2012, Canadian Forest Products Ltd. ("CFP"), a wholly owned subsidiary of the Company, acquired 35,776,483 common shares of CPPI in exchange for its 35,776,483 Class B Exchangeable LP Units of Canfor Pulp LP and 35,776,483 common shares of Canfor Pulp Holding Inc., the general partner of Canfor Pulp LP, pursuant to the terms of an Exchange Agreement made as of January 1, 2011 among the parties. Subsequent to the exchange, the Company holds 50.2% of the voting securities of CPPI. Any reference to CPPI in this Annual Information Form, unless otherwise indicated by context, refers to Canfor Pulp Products Inc., its subsidiaries and its interest in the limited partnership described above.

The Company holds a 50% interest in Peace Valley OSB, in partnership with Louisiana-Pacific Canada Ltd. ("Louisiana-Pacific"). Peace Valley OSB owns and operates an oriented strand board ("OSB") plant in Fort St. John, British Columbia, which commenced operations in late 2005. Canfor has agreed to sell its interest in Peace Valley OSB to Louisiana-Pacific for a purchase price of \$70 million plus working capital, with the transactions currently scheduled to close by the end of the first half of 2013. In contemplation of the completion of the sale to Louisiana Pacific, Peace Valley OSB changed its name to "Louisiana-Pacific OSB Limited Partnership" on January 9, 2013.

The Company, through a wholly owned holding company, holds a one-third interest in each of Lakeland Mills Ltd. ("Lakeland") and Winton Global Lumber Ltd. ("Winton Global"). Lakeland and Winton Global, which have approximately 835,000 m<sup>3</sup> of tenure combined, own sawmills in the Prince George region of British Columbia, selling their wood chips to Canfor Pulp LP's Prince George pulp and paper operations. The Winton Global sawmill operation was permanently closed in 2011 and the Lakeland operation was destroyed by fire in April 2012.

On October 1, 2010, Howe Sound Pulp and Paper Limited Partnership (name changed to 6382 Pulp and Paper Limited Partnership on January 21, 2011) ("HSLP"), in which Canfor held a 49.99% interest, disposed of substantially all of its assets to a wholly owned subsidiary of Paper Excellence BV ("Paper Excellence"), a Netherlands subsidiary of Sinar Mas group of Indonesia. At the same time, Canfor disposed of all of its 50% interests in Coastal Fibre Limited Partnership ("CFLP") to Paper Excellence.

## **BUSINESS OF CANFOR**

Canfor is a Canadian integrated forest products company based in Vancouver, British Columbia, involved primarily in the lumber business, with production facilities in British Columbia, Alberta, Québec and the United States. Canfor also has a 50.2% interest in the pulp and paper business owned by CPPI, a 50% interest in the panels business of Peace Valley OSB, and owns the Taylor pulp mill. The capacity and production figures set out in this Annual Information Form are presented as at December 31, 2012.

As at December 31, 2012, Canfor employed approximately 3,970 persons in its wholly owned subsidiaries and approximately 1,340 in jointly owned operations for a total of approximately 5,310 employees. For a detailed breakdown of employees and related collective agreements, refer to segmented information, which starts from page 14.

Softwood lumber production facilities are located in British Columbia, Alberta, Québec and the United States with annual production capacity (including idled operations) at December 31, 2012 of approximately 5.2 billion board feet of lumber and 0.8 billion square feet of OSB (3/8 inch basis), including the Company's 50% share of Peace Valley OSB production capacity. Canfor's products also include remanufactured and finger-jointed lumber, treated lumber, wood chips, wood pellets and logs.

Canfor also holds a 50.2% interest in the pulp and paper business of CPPI with annual production capacity at December 31, 2012 of over one million tonnes of kraft pulp and 140,000 tonnes of kraft paper and a 100% interest in the Taylor pulp mill with an annual capacity of 210,000 tonnes of Bleached Chemi-Thermo-Mechanical Pulp ("BCTMP").

Canfor also holds approximately 16.4 million cubic metres of annual harvesting rights under its forest tenures and pulpwood agreements.

Canfor's products are exported primarily to the United States and Asia as well as shipped domestically in Canada. Canfor maintains wood products sales offices in Vancouver, Canada, Myrtle Beach, United States, Tokyo, Japan and Shanghai, China, and pulp sales offices in Vancouver, Canada, Brussels, Belgium, and Tokyo, Japan, and is represented by sales representatives serving various other markets around the world.

### **General Development**

One of Canfor's primary objectives is to be the preferred supplier of wood products to the building industry around the world with 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 lumber industry leader with strong financial performance, accomplished through:

- Expanding geographical markets and increasing market share of value-added products and building strong long-term partnerships with valued customers,
- Optimizing the extraction of high-margin products and value from its available fibre sources,
- Attaining world class supply chain performance,
- Achieving and maintaining a low cost structure,

- Maintaining a strong financial position,
- Fully engaging employees and utilizing their experience and expertise to maximize performance,
- Capitalizing on attractive growth opportunities, and
- Positioning the Company as a leading supplier of green, environmentally friendly building products.

CPPI, which on a day-to-day basis operates under the oversight of a separate Board of Directors, has the following business strategies:

- Preserving its low-cost operating position,
- Maintaining the premium quality of its products,
- Growing its green energy business, and
- Opportunistically acquiring high quality assets.

In support of these strategies, the Company, during the past three financial years, has made capital investments of over \$354 million at its lumber operations and over \$295 million at its pulp and paper operations (with \$122 million of the latter funded by the Canadian Federal Government's Green Transformation Program). Capital spending in the lumber segment includes expenditures as part of a \$300 million strategic capital investment program.

**Other significant events for Canfor over the past three fiscal years have been the following:**

*Peace Valley OSB Joint Venture Sale*

In November 2012, Canfor announced that it had entered into a Letter of Intent with Louisiana-Pacific to sell Canfor's 50% share in the Peace Valley OSB joint venture in Fort St. John, B.C for \$70 million plus working capital. On completion of this transaction, Louisiana-Pacific will become the sole owner of the Peace Valley OSB mill. As part of the sale, Canfor may receive additional annual consideration over a 3 year period based on Peace Valley OSB's annual earnings before interest, taxes, depreciation and amortization ("EBITDA"). The transaction is subject to customary closing conditions and is expected to occur in the first half of 2013.

*South Eastern British Columbia Acquisition*

On March 23, 2012, Canfor completed the acquisition of Tembec Industries Ltd.'s ("Tembec") southern British Columbia Interior wood products assets for cash consideration of \$65.9 million, including a payment on account of net working capital, which excluded certain liabilities retained by Tembec. The acquisition included Tembec's Elko and Canal Flats sawmills (the "Tembec Mills") and approximately 1.1 million cubic metres of combined Crown, private land and contract annual allowable cut. The transaction also included a long-term agreement to provide residual fibre supply for Tembec's Skookumchuck pulp mill. The assets acquired increase the Company's fibre availability, production capacity and ability to produce and sell premium dimension lumber products.

*Grande Prairie Ecopower Centre (GPEC) Acquisition*

In October 2011, Canfor completed the purchase of GPEC from TransAlta Corporation. The GPEC is a biomass energy generation facility that exclusively uses Canfor residual fibre to produce steam power and electricity. All of the steam and some of the electricity will fuel the Grande Prairie sawmill, eliminating the need to buy external power; the remainder of the electricity is sold externally at market prices.

*Sale of the Howe Sound Mill by Howe Sound Pulp & Paper Limited Partnership (HSLP)*

The Howe Sound Mill was a pulp and paper facility in Port Mellon, British Columbia, capable of producing 400,000 tonnes of NBSK pulp and 230,000 tonnes of thermo mechanical paper. This mill was owned and operated by HSLP, of which Canfor had a 49.99% interest. On October 1, 2010, HSLP completed the sale of substantially all of its assets including the Howe Sound Mill, and Canfor sold its 50% interest in CFLP to Paper Excellence, a Netherlands based unit of Sinar Mas group of Indonesia. As a result of the sale, Canfor recorded a gain on disposal of \$5.5 million.

### Union Agreements

In March 2010, Canfor reached an agreement with the United Steel Workers union (“USW”). The agreement, which expires in July 1, 2013, affects 13 operations in British Columbia, and applies to approximately 2,300 Canfor employees.

In 2011, the contract with the Communications, Energy and Paperworkers Union (“CEP”) was renewed and expires on September 30, 2014. The contract represents workers at Canfor’s Grande Prairie operation.

### Permanent Closures/Production Curtailments & Restarts

As a result of challenging markets for lumber, OSB, and plywood, as well as the lack of economic long term fibre supply in the areas of certain of its operations, the Company has adjusted its production volume significantly during the past three years. Some of the downtime took the form of shortened work weeks and/or reduced shifts in its operations in British Columbia, Québec, North Carolina and South Carolina; other adjustments were in the form of permanent & indefinite idling. The Company restarted several operations over this period, following capital investment at these locations.

A summary of the adjustments in the form of permanent closures, indefinite idling and restarts of its operations in the last three years is summarized below:

Tackama Plywood Plant (Annual capacity 270 million square feet – 3/8” basis)	<ul style="list-style-type: none"><li>• Idled - October 2008 to January 2012</li><li>• Permanently closed January 2012</li></ul>
Rustad Sawmill (Annual capacity 295 million board feet of spruce, pine, fir (“SPF”) lumber)	<ul style="list-style-type: none"><li>• Idled - July 2009 to January 2012</li><li>• Permanently closed January 2012</li></ul>
Clear Lake Sawmill (Annual capacity 130 million board feet of SPF lumber)	<ul style="list-style-type: none"><li>• Permanently closed January 2011</li></ul>
Vavenby Sawmill (Annual capacity 260 million board feet of SPF lumber)	<ul style="list-style-type: none"><li>• Idled - July 2009 to September 2011</li><li>• Restarted operations on single shift in September 2011 and added a second shift in January 2012</li></ul>
Mackenzie Sawmill (Annual capacity 300 million board feet of SPF lumber)	<ul style="list-style-type: none"><li>• Idled - June 2008 to July 2009</li><li>• Restarted operations on single shift in July 2009 and added a second shift in February 2010</li></ul>
Chetwynd Sawmill (Annual capacity 240 million board feet of SPF lumber)	<ul style="list-style-type: none"><li>• Idled - March 2008 to May 2010</li><li>• Restarted operations on a single shift basis in May 2010 and added a second shift in October 2010</li></ul>
Radium Sawmill (Annual capacity 260 million board feet of SPF lumber)	<ul style="list-style-type: none"><li>• Idled - July 2009 to October 2012</li><li>• Restarted operations on single shift in October 2012 and added a second shift in December 2012</li></ul>
PolarBoard OSB Mill (Annual capacity 640 million square feet – 3/8” basis)	<ul style="list-style-type: none"><li>• Indefinitely idled - June 2008 to current</li></ul>

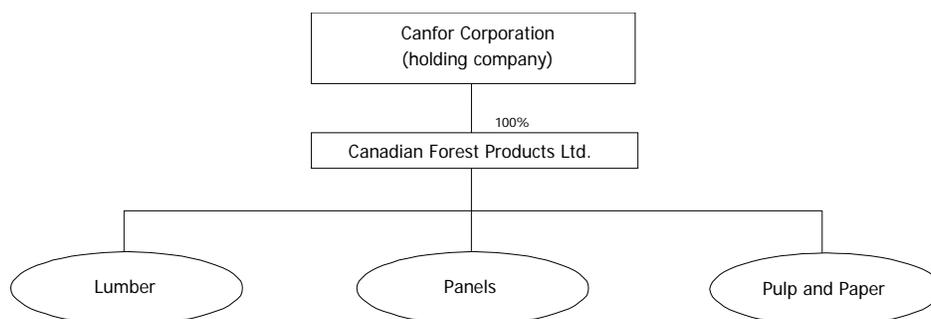
### Trends, Events, Risks and Uncertainties

For additional information regarding changes to Canfor’s business expected in 2013 and known trends, commitments, events or uncertainties, see Canfor’s “2012 Management’s Discussion and Analysis”, in particular, the “Outlook” and “Risks and Uncertainties” sections thereof, which are incorporated by reference herein.

## Business Segments

Canfor's business is in two reportable segments: "Lumber" and "Pulp and Paper". The Lumber segment includes Canfor's sawmilling and remanufacturing operations and the Pulp and Paper segment includes the kraft pulp and kraft paper business of CPPI, in which Canfor has a 50.2% interest, as well as 100% of the Taylor Pulp mill, which was excluded from the Canfor Pulp LP spin-out transaction. Canfor has not reported the Panels business (which included its plywood and OSB operations) as a separate reporting segment since 2008, given that all but one of the Company's panel operations are now either indefinitely idled or permanently closed and the business does not meet the required criteria for segment reporting under International Financial Reporting Standards ("IFRS").

The following chart and notes outline Canfor's business segments and the panels business and their respective principal operations as at December 31, 2012. Unless otherwise indicated in the diagram below, Canfor has a 100% interest in the operations referred to in each segment.



- 13 sawmills in British Columbia, one in Alberta and one in Québec, with annual production capacity of 4.6 billion board feet.
- Four sawmills in North and South Carolina with annual production capacity of 0.6 billion board feet, for a combined annual production capacity of 5.2 billion board feet.
- Other operations include one finger-jointing facility in North Carolina, two lumber treating plants in North Carolina and South Carolina and a whole-log chipping plant in British Columbia.
- Woodlands operations with an allowable annual cut of 16.4 million m<sup>3</sup>, of which 11.2 million m<sup>3</sup> relates to lumber operations.
- 60% interest in Houston Pellet Inc. in Houston, British Columbia.
- Lumber sales and marketing.
- 50% interest in Peace Valley OSB mill with annual production capacity of 820 million square feet (3/8" basis) of OSB.<sup>1</sup>
- An OSB mill (PolarBoard) with annual production capacity of 640 million square feet (3/8" basis), which was idled indefinitely, effective the second quarter of 2008.
- 50.2% interest in three pulp mills and one paper mill with annual production capacity of over one million tonnes of kraft pulp, 140,000 tonnes of kraft paper.
- Taylor pulp mill with annual production capacity of 210,000 tonnes of BCTMP.
- Pulp and paper marketing.

<sup>1</sup> For information regarding the Letter of Intent to sell Canfor's 50% share in the Peace Valley OSB mill see "Peace Valley OSB Joint Venture Sale" earlier in this document.

The following table sets out, by business segment, Canfor's total sales revenues in 2012 and 2011 (including the revenues from the operations acquired from Tembec (from March 23, 2013), 100% of the revenues of the pulp and paper business owned by CPPI and 50% of the revenues of the panels business of Peace Valley OSB):

	<u>Year ended</u> <u>December 31</u>	
	<u>2012</u>	<u>2011</u>
	(Millions of dollars)	
Lumber.....	\$1,711.8	\$ 1,317.1
Pulp and Paper.....	923.5	1,057.5
Other (Panels).....	<u>78.8</u>	<u>46.8</u>
<b>Total sales</b> .....	<b><u>\$2,714.1</u></b>	<b><u>\$2,421.4</u></b>

The following table indicates the percentage composition of Canfor's consolidated sales revenues by market for the last two years (including the revenues from the operations acquired from Tembec (from March 23, 2012), 100% of the revenues of the pulp and paper business owned by CPPI and 50% of the revenues of the panels business of Peace Valley OSB):

	<u>Year ended</u> <u>December 31</u>	
	<u>2012</u>	<u>2011</u>
United States.....	43%	39%
Asia.....	35%	40%
Canada.....	16%	12%
Europe.....	4%	7%
Other.....	<u>2%</u>	<u>2%</u>
<b>Total</b> .....	<b><u>100%</u></b>	<b><u>100%</u></b>

## WOOD SUPPLY

### Timber Resources

Canfor harvests timber under forest tenures held by it in British Columbia, northern Alberta and southern Québec, and has a total allowable annual cut ("AAC") of approximately 16.4 million cubic metres. The forest tenures consist of both area-based and volume-based replaceable tenures and volume-based non-replaceable tenures. Canfor's Canadian wood fibre requirements are also met by open market purchases and exchanges of logs on either a spot or contract basis. The wood fibre requirements of New South in the U.S. are met through open market purchases from private timberland owners in North and South Carolina and adjacent states.

The following table sets out Canfor's timber resources as at December 31, 2012:

	<b>Productive Area (Hectares)</b>	<b>Allowable Annual Cut (Cubic metres)</b>
<b>British Columbia</b>		
Tenures having regulated sustained yields <sup>(1)</sup>		
Area-based — Tree Farm Licenses <sup>(2)</sup> .....	970,199	1,446,970
Volume-based — Forest Licenses (replaceable) <sup>(3)</sup> .....	N/A	7,926,713
— Forest Licenses (non-replaceable) <sup>(4)</sup> .....	N/A	668,800
— Pulpwood Agreements (non-replaceable) <sup>(5)</sup> .....	N/A	5,171,000
<b>Alberta</b>		
Tenures having regulated sustained yields		
Forest Management Agreement <sup>(6)</sup> .....	475,446	715,000
Timber Quotas .....	N/A	215,081
<b>Québec</b>		
Tenures having regulated sustained yields		
Forest Management Agreement <sup>(7)</sup> .....	N/A	190,000
Timber Supply and Forest Management Agreement <sup>(8)</sup> .....	<u>N/A</u>	<u>35,100</u>
<b>Total</b> <sup>(9)</sup> .....	<u>1,445,645</u>	<u>16,368,664</u>

Notes:

- (1) For an explanation of "regulated sustained yields", see the section entitled "Forest Management" below.
- (2) Comprised of Tree Farm License ("TFL") 14 (Spillamacheen), TFL 18 (Clearwater), TFL 30 (Sinclair), and TFL 48 (Chetwynd). TFL 14 was acquired from Tembec in 2012.
- (3) Increased by 720,341 cubic metres ("m<sup>3</sup>") in 2012 due to addition of 3 replaceable Forest Licences acquired from Tembec.
- (4) Includes 250,000 m<sup>3</sup> held jointly with the West Moberly First Nation and 30,000 m<sup>3</sup> of 120,000 m<sup>3</sup> jointly held with West Fraser Timber Co. Ltd. ("West Fraser") in Quesnel. The total volume is up by approximately 150,000 m<sup>3</sup> from 2011 primarily due to the addition of two non-replaceable licenses in the Quesnel area, and two non-replaceable licenses in the East Kootenays.
- (5) Includes Pulpwood Agreements ("PA") 1, 3, 7, 12 and 14. In connection with the sale of its interest in Peace Valley OSB, it is proposed that Canfor will subdivide PA 12 and transfer an annual harvest volume of 330,000 m<sup>3</sup> to Peace Valley OSB.
- (6) Productive area increased by 1,253 hectares as a result of a new, more accurate inventory and reforestation of abandoned seismic lines.
- (7) This licence will expire on March 31, 2013.
- (8) This licence will be reduced to 31,550 cubic metres on March 31, 2013.
- (9) The Company's private timberlands in Maine, U.S. were sold in 2012.

Note: N/A denotes Not Applicable.

Canfor obtains additional wood fibre through contractual rights to purchase logs by way of business relationships with First Nations and other licensees.

## British Columbia

The Province of British Columbia owns approximately 95% of all timberlands in the province. Pursuant to the provisions of the *Forest Act* (British Columbia) ("Forest Act"), the Minister of Forests, Lands and Natural Resource Operations are empowered to grant various forms of tenure and to regulate forestry operations.

A TFL requires a licensee undertake the management of an area of Crown forest land, often in combination with other forest land held by the licensee, to yield an annual cut on a regulated sustained yield basis. TFLs are granted for 25-year terms and, subject to satisfactory levels of performance, may be replaced every five to ten years with new TFLs with 25-year terms. Canfor's TFL 18 (Clearwater) and TFL 30 (Sinclair) were replaced in 2001 for a 25-year term. Each of TFL 14 (Spillimacheen) and TFL 48 (Chetwynd) were replaced in 2009 for a 25-year term.

A Forest License is a volume-based tenure, which authorizes a right to harvest a specified volume of timber each year within a particular timber supply area ("TSA") and generally provides for 15-year terms. These licenses may be replaced every five to ten years for further 15-year terms, subject to satisfactory levels of performance. Canfor holds 14 replaceable Forest Licenses, under which it is continuing to harvest (in addition to three such licenses which have no remaining AAC as the result of reductions described below), all of which were replaced between 1998 and 2006. To date, the Government of British Columbia has offered, and Canfor has accepted, the replacement of all 14 Forest Licenses. Canfor holds six non-replaceable Forest Licenses, which expire between 2013 and 2017. Canfor also holds two non-replaceable Forest Licenses under joint venture agreements with West Moberly First Nations, which expire in 2023, and one with West Fraser in Quesnel, which was extended in 2012 and expires in 2013.

In addition, Canfor has five Pulpwood Agreements with the Province of British Columbia, which grant a holder the right to obtain licenses to harvest up to a specified volume of timber within a particular geographic area, subject to certain conditions. Canfor has the right, if necessary and subject to the terms of the Pulpwood Agreement, to supply the requirements of CPPI's three pulp mills at Prince George under Pulpwood Agreement No. 1, which expires in 2018, Pulpwood Agreement No. 3, which expires in 2020, and Pulpwood Agreement No. 7, which expires in 2022. None of these Pulpwood Agreements are replaceable under the *Forest Act* and Canfor has not needed to access timber under these or their predecessor agreements since 1976. Canfor also has the right under Pulpwood Agreement No. 12 to 500,000 cubic metres of deciduous timber per year in the Fort St. John TSA in connection with the Taylor Pulp Mill and the Peace Valley OSB mill in Fort St. John, and under Pulpwood Agreement No. 14 up to 610,000 cubic metres of deciduous timber per year in the Fort Nelson TSA in connection with the Company's PolarBoard OSB mill in Fort Nelson, which has been indefinitely idled.

For each Forest License and TFL, an AAC is determined. The actual cut in any one year may vary from year to year provided that the actual cut over a five-year period does not exceed 110% of the aggregate AAC for that period. As required by the *Forest Act*, the provincial Chief Forester determines the AAC for each TFL and the total AAC in each TSA (which affects the AAC of Forest Licenses in that TSA) in the Province. The Chief Forester is required to repeat such determination every five years, but has the option of postponing a redetermination for a period of up to ten years after the last determination if he concludes that the AAC will not change significantly from the previous determination. The AAC reflects harvesting practices in the previous five years, timber conditions, regional and local economic and social interests and environmental considerations for these licenses and areas.

## Alberta

In northern Alberta, Canfor has a Forest Management Agreement ("FMA") #9900037 under which it undertakes to manage a designated area of Crown forestland. This FMA was renewed in 1999 for a 20-year period.

The Province of Alberta also grants Timber Quotas having terms of 20 years and containing provisions for renewal. These quotas are intended to provide a continuous supply of timber in perpetuity. As a result of the amalgamation of forest management units by the Province of Alberta during 2010 and subsequent amalgamation of Timber Quotas in 2012, Canfor now has two Timber Quotas, one of which expires in 2024 and one which expires in 2030.

Canfor's regulated sustained yield tenures in Alberta specify an AAC and an aggregate allowable cut over a five-year period. The actual cut during each five-year period must be at least 60% of the aggregate specified for that period for the tenure to remain in good standing. Canfor would be subject to significant levies if its production were to exceed 110% of the aggregate allowable cut for that period.

## **Québec**

In the Province of Québec, the Minister of Natural Resources and Wildlife has a number of tools for allocating timber harvesting rights and associated forest resource management responsibility. They include Timber Supply and Forest Management Agreements (“TSFMA”) and Forest Management Agreements (“FMA”). Both require the agreement holder to fulfill management obligations similar to those in British Columbia with regard to planning, monitoring and reporting activities. A TSFMA is a volume-based agreement that authorizes an owner of a wood processing mill to harvest an annual amount of volume from a specified timber supply area. A license holder is evaluated based on the collective forest management and environmental performance of all operators within the timber supply area and on the effective utilization of the allocated volume by the individual mill owner. An FMA is a volume-based agreement by which a single licensee is responsible for the management of a forest reserve where no TSFMA or FMA have been granted.

Canfor acquired Daaquam and Produits Forestiers Anticosti Inc. (“Anticosti”), two lumber and timber harvesting companies based in Québec, in May 2003. Anticosti has woodlands and harvesting operations on Anticosti Island located in the Gulf of St. Lawrence and holds an FMA with an AAC of 190,000 cubic metres. The timber is sold on a market price basis with Daaquam having first right of refusal on 65,000 cubic metres. Daaquam maintains a TSFMA near Saint Just-de-Bretenières with an annual harvest allocation of 35,100 cubic metres. The Company secures an additional volume of wood for its Québec operations through procurement contracts with suppliers in Ontario, Québec and the U.S.

As of April 1, 2013, the government of Québec will be taking over the majority of the forest management activities from licensees. As a result, the Anticosti FMA will expire on March 31, 2013, and the Daaquam TSFMA will be reduced to an annual harvest allocation of 31,550 cubic metres. After that date, the Province will be responsible for completion of forest planning and will make timber volume available to each mill, and some volume will be put up for auction.

Canfor is in substantial compliance with the harvesting terms of all of its tenure agreements in British Columbia, Alberta and Québec.

## **Mountain Pine Beetle**

The infestation of the Mountain Pine Beetle has reached critical levels in many TSAs throughout the interior of British Columbia and western Alberta, including many of Canfor’s operating areas. The impact of this outbreak is expected to affect the long-term timber supply in the interior of British Columbia. Given the nature and extent of the infestation, its mid and long term operational and financial impact on Canfor is not quantifiable at this time, but could be significant. For additional information regarding the beetle infestation and its impact on Canfor and its operations, see the Company’s “2012 Management’s Discussion and Analysis”, in particular, the “Risks and Uncertainties – Mountain Pine Beetle” section thereof, which is incorporated by reference herein.

## **Aboriginal Issues**

The issues relating to Aboriginal rights and title and consultation continue to be heard, developed and resolved by Canadian courts at all levels. Canfor continues to cooperate, communicate and exchange information and views with Aboriginal groups in order to foster good relationships and minimize risks to its tenures, operations and operational plans, and will continue to participate with the Province in its consultations with Aboriginal groups. Due to their complexity, it is not expected that the issues regarding Aboriginal rights and title or consultation will be resolved in the short term and their impact, if any, on the timber supply from Crown lands and Canfor’s tenures and operations is unknown at this time. For additional information regarding the Aboriginal issues and their impact on Canfor and its operations, see the Company’s “2012 Management’s Discussion and Analysis”, in particular, the “Risks and Uncertainties - Aboriginal Issues” section thereof, which is incorporated by reference herein.

## **Forest Management**

Canfor is responsible for all aspects of forest management on the lands within its TFLs in British Columbia. In Alberta, Canfor is responsible for all aspects of forest management on the lands covered by its FMAs except forest fire protection, which is a responsibility of the Province of Alberta under terms of an agreement with the Company. In Québec, until April 1, 2013, Canfor is responsible for all aspects of forest management on lands specified within its FMA and TSFMA, after which date the Province will assume most of these responsibilities. The lands held under TFLs, FMAs, TSFMAs, Forest Licenses and Timber Quotas are managed on a “sustained yield” basis, whereby the volume of timber harvested is regulated according to the productive capacity of the land and the inventory of mature timber available for harvest. In British Columbia, Alberta and Québec, Canfor is responsible for reforestation of areas logged on all of its sustained yield

tenures. The overall management of forestlands held under Forest Licenses and Timber Quotas is the responsibility of the respective forest Ministries of British Columbia and Alberta.

Canfor carries out its forest management responsibilities through a full complement of registered professional foresters and technologists; as well as additional professional staff hired on a part-time and contract basis. This forestry staff is engaged in supervising all aspects of forest development including planning, road development, harvesting methods and forest protection, and in research and development programs to increase the yield of its forestlands and improve the quality of its timber resources. Canfor currently operates, directly or under contract, seed orchards for the genetic improvement of forest seed at Vernon, British Columbia, and at Grande Prairie, Alberta.

Canfor was a signatory to the Canadian Boreal Forest Agreement (CBFA) in May 2010. This is an agreement signifying a new era of joint leadership in the Boreal Forest. Nine environmental non-governmental organizations and twenty one forest sector companies signed this agreement. The signatories wish to demonstrate leadership in developing and implementing a globally significant model for conservation and resource management in Canada's Boreal Forests in a manner that sets the stage for joint action in relation to both Boreal Forest conservation and forest sector competitiveness.

Customers of forest products companies increasingly require assurances that products purchased are derived from well-managed forests. Canfor has responded by implementing a comprehensive third-party sustainable forest management ("SFM") certification strategy to verify the quality of its forest management practices.

Canfor retains an International Organization for Standardization ("ISO") 14001 certification of its environmental management system for its forest operations, first obtained in 1999 and re-certified as required for subsequent three-year terms. In addition, Canfor retains certification under the Canadian Standards Association ("CSA") standard for sustainable forest management (CAN/CSA Z809) for its FMA area at Grande Prairie, Alberta, for its TFLs at Chetwynd, Prince George and Vavenby, British Columbia, for its Forest Licenses at Fort St John, Houston, Prince George, Fort Nelson, Vanderhoof, Vavenby, Quesnel, Radium and Mackenzie, British Columbia and for its Pulpwood Agreements at Fort St John and Fort Nelson, British Columbia. At present, 96.7% of Canfor's AAC is certified to the ISO 14001 standards. Canfor received its continued registration under the (CAN/CSA Z809) standard and ISO 14001 corporately in November 2012, allowing Canfor to offer these trading certifications to its customers.

Canfor has seen an increased interest from customers worldwide in understanding the origin of the products they purchase. Canfor continues to make significant progress in implementing a certified Program for Endorsement of Forest Certification ("PEFC"), Chain of Custody system to provide this information. PEFC is a global, independent non-government organization for the assessment and mutual recognition of forest certification schemes. "Chain of Custody" is the process of tracking forest products from their place of origin (forest) through all stages of transfer and production to the final consumer as an end product. The PEFC Chain of Custody system that Canfor has put in place is able to track all of the Company's raw wood material and its certification status both from the Company's own managed forest tenures as well as those from outside suppliers.

On June 22, 2012, Canfor received a new Chain of Custody Certificate (PEFC-certified) based on third quarter 2012 audits by the accounting firm KPMG LLP, which covered the production of residual chips and whole log chips to the point of sale and the production of lumber to the point of sale from the following facilities: Chetwynd sawmill, Fort St. John sawmill, Grande Prairie sawmill, Houston sawmill, Polar sawmill, Prince George chip plant, Prince George sawmill, Plateau sawmill, Isle Pierre sawmill, Quesnel sawmill, Vavenby sawmill and Radium sawmill. Mackenzie sawmill received its Chain of Custody Certificate (PEFC-certified) in 2009.

Effective October 1, 2012, Canfor's Quota operations located in the FMA area held by Daishowa Marubeni International ("DMI") were registered to the Sustainable Forestry Initiative ("SFI") standard. Canfor's CSA Z809 Certification, held jointly with DMI, will also be maintained on this area until its expiry on May 30, 2013.

As a result of the acquisition of the Tembec Mills in 2012, Canfor also retains a Forest Stewardship Council ("FSC") certification under the FSC BC Standard, for the forests in the East Kootenay Defined Forest Area, including TFL 14 and three replaceable Forest Licences in the Invermere, Cranbrook and Kootenay Lake TSAs. The Radium operating area is not included at this time. Canfor received an FSC Multi-site Chain-of-Custody certificate for Canal Flats, Elko and Radium sawmills in 2012.

## Wood Fibre Supply

The wood fibre supply for Canfor's lumber, panels and pulp operations is obtained from logging of Canfor's forest tenures and purchasing logs and chips. Logs are also purchased from other tenure holders and from farmers, Aboriginal groups and other private landholders. Chips and waste materials are purchased from sawmills and other wood products producers.

As part of the spin-out of its kraft pulp and paper business in 2006 to Canfor Pulp LP, including its three pulp mills in the Prince George area, Canfor entered into residual wood chip, whole log chipping and hog fuel agreements with Canfor Pulp LP (see "Pulp and Paper").

The following table sets out the volume of wood fibre produced and purchased in Canfor's operations and the volume of wood fibre sold to other wood fibre consumers for the last two financial years:

	<u>Year ended</u> <u>December 31</u>	
	<u>2012</u>	<u>2011</u>
	(000 cubic metres)	
Wood Fibre Supply		
Log Production – Canfor tenure .....	13,410	10,511
Log Purchase .....	3,846	3,104
Net Sales/Trades/Transfers .....	(604)	(474)

During 2012, Canfor Pulp LP purchased 1,205,164 oven-dried tonnes (2011 – 1,166,620 oven-dried tonnes) of chips from Canfor pursuant to the fibre supply agreements between both entities, which are not included in the above table. See "Pulp and Paper".

Canfor has one whole-log chipping facility in the Prince George area, with available annual capacity of 480,000 oven-dried tonnes of chips, to supplement its supply of sawmill residual chips.

Historically, Canfor Pulp LP has competed successfully for residual chips which cannot be supplied by Canfor's sawmills and timber tenures. It does not expect that this situation will change in 2013.

With the acquisition of the former Tembec sawmills, whole-log chipping infrastructure and associated timber tenures in the East Kootenay region of British Columbia in March of 2012, Canfor entered into a chip supply and hog fuel supply agreement with Tembec for its Skookumchuck pulp mill. Under the agreement, supply commitments for chips and hog fuel are established annually.

## LUMBER

### Lumber Production Facilities

As at December 31, 2012, Canfor owned thirteen sawmills in the Interior of British Columbia, one in Alberta, one in Québec, three in South Carolina and one in North Carolina. At December 31, 2012 Canfor's sawmills had annual production capacity of approximately 5.2 billion board feet of lumber. 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-four feet. A portion of Canfor's lumber production is comprised of specialty products that command premium prices, including Square Edge lumber for the North American market, J-grade lumber for the Japanese market and machine stress rated ("MSR") lumber that is used in engineering applications such as roof trusses and floor joists. In 2012, the Company launched a new dimension lumber product line, Canfor RED. Canfor RED lumber comes from fibre regions with limited exposure to the mountain pine beetle. While having the same grades and structural performance as Canfor's classic product line, Canfor RED lumber provides appearance benefits preferred by some customers or for certain applications.

As a by-product of Canfor's lumber production facilities, wood chips are produced from the portion of each log not converted into lumber. These wood chips are sold to pulp mills for use as their raw material, including to the Taylor pulp mill and to Canfor Pulp LP pursuant to fibre supply agreements entered into between Canfor and Canfor Pulp LP in connection with Canfor's spin-out of its pulp and paper business in 2006 (see "Pulp and Paper"). In addition, Canfor

extracts pulpwood from its northern forestry operations and converts this wood to chips for Canfor Pulp LP's pulp and paper operations and its Taylor pulp mill.

Canfor's other operations include a whole-log chipping plant in British Columbia, and in the two Carolinas, two lumber treating plants, a finger joint plant, and a trucking division. The Lumber segment also includes Canfor's wood products sales and marketing division, located in Vancouver and Canfor's 60% interest in Houston Pellet Inc., a joint venture with Pinnacle Pellet Inc. and the Moricetown Indian Band, which has an annual capacity of 217,000 tonnes of wood pellets.

The following table sets out Canfor's lumber production and sales for the last two years:

	<u>Year ended</u> <u>December 31</u>	
	<u>2012</u>	<u>2011</u>
	(MMfbm) <sup>(1)</sup>	
British Columbia <sup>(2)</sup> .....	3,490.4	2,767.4
Alberta .....	245.9	244.7
Québec .....	121.2	122.2
United States .....	<u>479.1</u>	<u>431.3</u>
<b>Total Production</b> .....	<b><u>4,336.6</u></b>	<b><u>3,565.6</u></b>
<b>Sales<sup>(3)</sup></b> .....	<b><u>4,379.3</u></b>	<b><u>3,632.7</u></b>

Notes:

- (1) MMfbm denotes million foot board measure
- (2) Includes lumber production from the facilities acquired from Tembec from March 23, 2012.
- (3) Excludes lumber not produced by Canfor but sold under contract for third parties (55 MMfbm in 2012 and 141 MMfbm in 2011)

Canfor harvests logs from tenures located in the interior region of British Columbia and northern Alberta to supply its lumber operations, with any shortfall in mill requirements being made up with wood purchased from these areas (see "Wood Supply - Timber Resources" above). Operations in Québec and North and South Carolina rely mainly on purchased logs.

The following table sets out the log production, log purchases and wood chip production for the last two years (including log production, log purchases and wood chip production related to the acquired Tembec operations from March 23, 2012):

	<u>Year ended</u> <u>December 31</u>	
	<u>2012</u>	<u>2011</u>
	(000)	(000)
Log Production (m <sup>3</sup> ) .....	13,410	10,511
Log Purchases (m <sup>3</sup> ) .....	3,846	3,104
Wood Chip Production (oven-dried tonnes) .....	2,751	2,271
Wood Pellet Production (tonnes) .....	208	213

### Lumber Markets and Distribution

Canfor markets lumber products throughout North America and overseas. In addition to its own production, Canfor markets lumber produced from independent mills and offshore countries to complement its product line.

In 2012, approximately 49% of Canfor's lumber sales volumes were to United States markets (2011 – 48%) and 20% to Canadian markets (2011 – 20%). The total remaining 31% (2011 – 32%) was sold to offshore markets, predominantly to China and Japan. Other offshore markets consisted of Korea, Taiwan, Southeast Asia and the Middle East. In 2012, sales volumes of SPF were up 18% from the previous year and Southern Yellow Pine ("SYP") sales volumes were up 14%. Substantially all lumber destined for North America was shipped by truck or rail. For product transported offshore, over 99% was sent by container ship and the balance by breakbulk vessel.

For a detailed discussion of the markets for Canfor's lumber products see the Company's "2012 Management's Discussion

and Analysis," in particular, the "Lumber - Markets" and "2012 Outlook – Lumber Markets" sections, which is incorporated by reference herein.

### **Human Resources**

As at December 31, 2012, Canfor employed approximately 2,960 persons in its lumber operations in British Columbia, approximately 185 persons in Alberta, approximately 188 persons in Québec and approximately 629 persons in the United States. Of these, approximately 61% are covered by collective agreements with the USW, the PPWC and the CEP.

The collective agreement with the USW (which represents the majority of the workers in the British Columbia operations, except as noted below) was renewed in 2010 and expires on July 1, 2013. The contract with the CEP, which represents workers at Canfor's Grande Prairie operation in Alberta, was renewed in 2011 and expires on September 30, 2014. The contract with the PPWC, which represents workers at Canfor's Mackenzie operation, was renewed in 2009 and expires in June 2014. However, for Vavenby, Radium, Canal Flats, Elko and FMG Southern BC Interior operations, the Company has negotiated Memorandums of Agreement with the USW Local 1-401 to extend the current collective agreement beyond the expiry date. These Agreements ensure that the Company will not have any disruptions (strike or lockout) for these operations as a result of the upcoming negotiations. The Company has also negotiated a similar agreement with PPWC Local 18 for extension of the current Collective Agreement beyond the expiry of June 30, 2014 for the Mackenzie operation.

### **PULP AND PAPER**

On July 1, 2006, Canfor completed the separation of its pulp and paper business from its wood products business by transferring to Canfor Pulp LP its northern softwood kraft pulp and paper business, including its Northwood pulp mill, Intercontinental pulp mill and Prince George pulp and paper mill, together with associated management and employees. At that time, Canfor distributed a 20% indirect interest in Canfor Pulp LP to Canfor's shareholders and retained an 80% interest. On November 30, 2006, Canfor distributed a further 29.8% indirect interest in Canfor Pulp LP to its shareholders, retaining a 50.2% interest. In connection with the spin-out, Canfor entered into a number of significant agreements with Canfor Pulp LP relating to the transfer of the pulp and paper business assets to Canfor Pulp LP. Agreements still in effect include: an Acquisition Agreement providing for the transfer of assets to, and the assumption of liabilities by, Canfor Pulp LP; and a Shareholders Agreement relating to, among other things, the appointment of Directors and management of Canfor Pulp Holding Inc., the general partner of Canfor Pulp LP, the transfer of shares of the general partner and approval thresholds for certain corporate matters.

Under a plan of arrangement (the "2010 Arrangement") approved by unitholders of Canfor Pulp LP in April 2010, the fund converted into a dividend paying public corporation named Canfor Pulp Products Inc. ("CPPI"). The conversion was completed effective January 1, 2011. Under the 2010 Arrangement, unitholders of the Fund received, for each unit of the Fund held, one common share of CPPI. As a result of the 2010 Arrangement certain of the agreements listed above were amended to reflect the fact that CPPI then owned directly the 49.8% interest in Canfor Pulp LP previously indirectly held by the Fund. On March 2, 2012 Canfor exercised its right to exchange its 50.2% interest in Canfor Pulp LP for a 50.2% interest in CPPI (the "2012 Exchange"). As a result of this exchange, CPPI now holds a 100% interest in the Canfor Pulp LP, and Canfor owns 50.2% of CPPI. The full text of the amended agreements relating to the Fund, its successor CPPI, and the 2010 Arrangement and 2012 Exchange can be found on SEDAR (System for Electronic Document Analysis and Retrieval) at [www.sedar.com](http://www.sedar.com).

Canfor's Taylor pulp mill was not included in the spin-out of the pulp and paper business and remains 100% owned by the Company. See "Taylor Pulp Mill" below.

### **CPPI Production Facilities**

CPPI is a leading global supplier of pulp and paper products with operations based in Prince George, British Columbia. CPPI's strategy is to maximize cash flows and enhance the value of its assets by preserving its low cost operating position and maintaining the premium quality of its products.

CPPI owns and operates three mills with annual capacity to produce over one million tonnes of northern softwood market kraft pulp, 90% of which is bleached to become northern bleached softwood kraft ("NBSK") pulp for sale to the market, and approximately 140,000 tonnes of kraft paper.

In connection with the spin-out of the pulp and paper business to Canfor Pulp LP, Canfor entered into fibre supply agreements under which Canfor has agreed to supply Canfor Pulp LP with annual quantities of residual wood chips and hog fuel produced at certain of its specified sawmills in the Prince George region. Prices paid by Canfor Pulp LP for residual wood chips are based on a pricing formula that results in Canfor Pulp LP paying market prices for wood chips, subject to adjustment to the formula to reflect market conditions. Prices paid for hog fuel are based on market prices. Canfor Pulp LP is also entitled, upon giving three months notice to Canfor, to request Canfor to supply it with pulp logs or other pulpwood harvested from its woodlands operations, at market prices. These fibre supply agreements, together with supplemental agreements by Canfor Pulp LP with third parties for the supply of wood chips and hog fuel, are expected to satisfy all of the anticipated fibre requirements to operate CPPI's mills at their current capacity levels of operation.

Under arrangements entered into with the Company in connection with the spin-out, CPPI also purchases, at cost, a number of administrative, accounting, legal and management services from Canfor under a partnership services agreement, which can be terminated, in whole or in part, on twelve months notice by either party.

The following table sets out pulp production and sales volumes for CPPI pulp mills for the last two years:

	<u>Year ended</u> <u>December 31</u>	
	<u>2012</u>	<u>2011</u>
	(000 tonnes)	
Pulp production .....	956	997
Pulp sales.....	961	979

The following table sets out the kraft paper production and sales volumes for CPPI for the last two years:

	<u>Year ended</u> <u>December 31</u>	
	<u>2012</u>	<u>2011</u>
	(000 tonnes)	
Kraft paper production .....	130	136
Kraft paper sales.....	129	128

### **CPPI Markets and Distribution**

CPPI has a sales and marketing department staffed by full time marketing professionals who are responsible for global sales of all of the pulp produced by its mills through three regional offices. Canfor Pulp LP also sells the pulp produced by the Taylor pulp mill. Customers in the Americas are serviced through a Vancouver office. Asian customers (excluding Japanese customers) are generally serviced through long-term sales agents who have been granted exclusive territories. These sales agents generally realize a commission of between one and two percent of the net selling price of the pulp, with the fee varying depending on the selling price, services provided and the tonnage sold.

A wholly-owned subsidiary of Canfor Pulp LP, Canfor Pulp Japan Corporation, markets pulp in Japan, while another wholly-owned subsidiary, Canfor Pulp and Paper Europe SA, markets and administers pulp sales in Europe.

In 2012, the approximate geographic distribution of Canfor Pulp LP's mills' kraft pulp sales was 56% to Asia, 32% to the Americas and 12% to the European market (2011 - 52%, 32%, and 16% respectively).

Premium 1 Papers, a sales and marketing partnership owned equally by Canfor Pulp LP and Tolko Marketing and Sales Ltd. ("Tolko"), is responsible for marketing all bleached and unbleached kraft paper products produced by the Prince George Pulp and Paper operation in Prince George, British Columbia and Tolko's unbleached kraft paper mill in The Pas, Manitoba. Premium 1 Papers has approximately 15 full time marketing professionals.

The approximate geographic distribution of kraft paper sales in 2012 was 69% in North America, 13% to Asia, and 18% to Europe/Middle East (2011 - 67%, 15%, 18%, respectively).

Canfor Pulp LP uses various modes of surface transportation to distribute its pulp and kraft paper products. In the case of pulp, substantially all product is shipped from the mills by rail and each of the mills is serviced by at least one dedicated rail spur. In the case of kraft paper, due to the smaller average order size, a much higher percentage is shipped by truck, with the balance being shipped by rail. Products destined for overseas customers are loaded at one of three terminals in

Vancouver and Montreal, and are then transported by breakbulk cargo vessel for European customers, and either breakbulk or container cargo vessels for Asian customers, depending on which mode is more cost-effective.

The cost of transportation over the past several years has risen due to increasing fuel costs and the reduction in breakbulk capacity. Canfor Pulp LP is working to minimize the effect of these cost increases by optimizing its geographic pulp distribution.

For a detailed discussion of the markets for CPPI's pulp and paper products, see the Company's "2012 Management's Discussion and Analysis", in particular, the "Pulp and Paper – Markets" and "2012 Outlook – Pulp and Paper Markets" sections thereof, which are incorporated by reference herein. Further information can be obtained from CPPI's 2012 annual information form, which can be obtained on SEDAR.

**CPPI Human Resources**

As at December 31, 2012, CPPI employed approximately 1,160 people in its operations and approximately 73% of these employees are hourly employees covered by collective agreements with the CEP and the PPWC. Negotiations with the CEP and PPWC for the renewal of the collective agreements were successfully concluded and ratified in 2012 for the term of five years expiring on April 30, 2017.

**Taylor Pulp Mill**

The Taylor pulp mill produces both hardwood and softwood BCTMP using wood chips from northern white spruce softwood and aspen hardwood species. The mill is located near Taylor, British Columbia. As highlighted earlier, the Taylor pulp mill was not included in the Canfor Pulp LP spin-out transaction.

**Taylor Production and Sales**

The Taylor pulp mill has an annual production capacity of 220,000 tonnes. The following table sets forth the pulp production and sales volumes for the Taylor pulp mill for the last two years:

	<u>Year ended</u>	
	<u>December 31</u>	
	<u>2012</u>	<u>2011</u>
	(000 tonnes)	
BCTMP production .....	214	203
BCTMP sales .....	215	210

**Taylor Pulp Markets and Distribution**

BCTMP is marketed to customers globally through CPPI's sales force. Similar to kraft pulp, the BCTMP market is global. Asia is the largest and fastest growing consumer of BCTMP and is Taylor pulp mill's largest market, accounting for virtually 100% of all sales made in 2012 (100% in 2011). China, India, Korea and Indonesia represent the top four markets in Asia.

The production of the Taylor pulp mill is loaded in rail cars for transport direct to terminals in Vancouver and Squamish, British Columbia, where the products are transferred to vessels to be sent overseas.

**Taylor Pulp Human Resources**

As at December 31, 2012, Canfor employed approximately 110 persons in the Taylor pulp mill operation, none of whom are part of any collective agreement.

**OTHER OPERATIONS**

**Panels**

The Panels business includes Canfor's 50% share of the Peace Valley OSB mill, located in Fort St. John, British Columbia, which is jointly owned with Louisiana-Pacific. The Peace Valley OSB mill has an annual capacity of 820 million square feet (3/8" basis). The Panels business also includes the PolarBoard OSB facility, with an annual production capacity of 640 million square feet (3/8" basis), which has been indefinitely idled since June 2008. OSB production from all facilities (including Peace Valley OSB) is primarily performance rated sheathing and flooring, which is used in wall, roof and flooring construction of new homes and in repair and remodeling projects.

The Tackama plywood plant, with an annual product capacity of 270 million square feet (3/8" basis), was permanently closed effective January 20, 2012, after being indefinitely idled since October 2008.

Canfor has not reported its Panels business as a separate reporting segment since 2008, given that it no longer meets the reporting criteria for separate reporting under IFRS.

## ENVIRONMENT

Canfor is committed to the responsible stewardship of the environment throughout its operations. Canfor meets this commitment by: practicing forest management that recognizes ecological processes and diversity and supports integrated use of the forest; designing and operating its facilities to comply with or surpass legal requirements; setting environmental objectives and targets to reduce the risk of pollution and continuing to achieve improvements in environmental performance; and promoting environmental awareness throughout Canfor's operations.

Canfor has a long-standing program of regular audits of its Environmental Management System ("EMS") at all operations and also audits compliance with regulatory requirements, principals of due diligence and good industry practices at all manufacturing facilities. Canfor's management believes it has sound environmental management programs established in all operations. These programs are continually being improved to help ensure that Canfor is exercising due diligence and is fulfilling its environmental commitments and responsibilities.

At present, 96.7% of Canfor's AAC is certified to the CSA sustainable forest management standard (CAN/CSA Z809) and the ISO 14001 standard.

CPPI's Prince George Pulp and Paper and Intercontinental Pulp mills were among the first mills in North America to achieve ISO 14001 registrations in early 1998. The Northwood Pulp mill achieved ISO 14001 registration in June 2001. These mills were all successful in retaining registration following audits by the registrar for these standards in 2003, 2006 and 2009. Canfor's wood products operations have been implementing an ISO 14001-based EMS, but are not seeking ISO 14001 registration at this time.

The B.C. government in early 2011 passed an amendment to the Wood Residue Burner and Incinerator Regulation requiring phase out of remaining Tier 2 beehive burners by December 31, 2016. In July 2011, Canfor shut its last operating Tier 2 wood residue burner at the Plateau sawmill and installed a bark fired heat energy system at that location.

In November, 2009, the British Columbia Ministry of Environment released the greenhouse gas ("GHG") reporting regulations under the Greenhouse Gas Reduction Act, requiring any facilities emitting more than 10,000 tonnes of carbon dioxide ("CO<sub>2</sub>") to report 2010 emissions in 2011. In 2012, two of Canfor's sawmills and all of the pulp mills (including CPPI's mills) registered and reported GHG emissions under the British Columbia GHG reporting regulation. GHG emission reporting has been required federally and in Alberta for several years. Canfor Pulp LP facilities have been reporting federally, however Canfor wood products facilities do not trigger federal or Alberta reporting thresholds. The Canfor Green Energy biomass cogeneration facility triggers the Alberta reporting threshold which includes biogenic Carbon Dioxide emissions. Canfor's New South facilities located in North and South Carolina are subject to state GHG reporting requirements.

Canfor is also a participant in the carbon offset market in Alberta and British Columbia, selling offset credits from Canfor Green Energy in Grande Prairie and from several biomass heat energy system projects recently completed in British Columbia.

The British Columbia government is in the process of assessing whether or not it will proceed with plans to participate in the Western Climate Initiative (WCI) regional GHG cap and trade system. Should cap and trade be implemented for British Columbia, the CPPI mills and Taylor Pulp would be subject to cap and trade legislation. The economic impact on pulp and paper mills will depend on factors such as cost to purchase carbon credits, and allocation allowance, which are currently undeterminable.

The Québec government in December 2011 announced adoption of GHG cap and trade legislation with capping and reduction of emissions starting January 1, 2013. Canfor's Daaquam facility in southeast Québec falls well under the 25,000 t CO<sub>2</sub>e annual emission threshold of that legislation, so is not subject to GHG capping and reduction requirements.

During 2012, Canfor's operations were in substantial compliance with environmental requirements, except for incidents, which have not had, nor are they expected to have, a material effect on Canfor or its operations. For additional

information regarding Canfor's environmental initiatives, see the Company's "2012 Management's Discussion and Analysis", in particular the section entitled "Environmental Issues", which is incorporated by reference herein.

#### **COMPETITIVE POSITION**

Each of the markets in which the Company sells lumber, panels, pulp and paper products is highly competitive with many major companies in each market. The Company's competitive position is influenced by the availability, quality and cost of its raw materials, energy and labour, and its plant efficiencies and productivity in relation to its competitors. Like the rest of the Canadian forest products industry, the Company (including CPPI and Peace Valley OSB) competes in an international market and is therefore subject to the impact of currency fluctuations and global business conditions. Many of the Company's lumber and panel products also compete with substitutes for wooden building materials of various kinds.

#### **RESEARCH AND DEVELOPMENT**

The Company conducts and is committed to research and development in the areas of fibre analysis, manufacturing processes, quality control and product and building systems development. The Company is an active member and participant in key industry research and development organizations and currently contracts out its research and development services. The Company maintains its connection to developments in industry research and technical information through its relationships with various associations, universities, research institutes, suppliers and customers.

## DIRECTORS AND OFFICERS

### Directors

The name and municipality, province, state and country of residence of the Directors of the Company, their principal occupations and the periods during which they have been Directors of the Company are as follows:

<u>Name and Municipality, Province and Country of Residence</u>	<u>Principal Occupation and Background</u>	<u>Director Since</u>
P. J. G. Bentley, O.C., LL.D. <sup>(2),(3),(4),(6)</sup> Vancouver, B.C. Canada	Chairman Emeritus of the Board of Directors of the Company  Background: Peter J. G. Bentley is Chairman Emeritus of the Board of the Company. Mr. Bentley was formerly the Chairman of the Board of the Company from 1983 to 2009. Mr. Bentley is a Director of CPPI. After working in various positions throughout the Company, Mr. Bentley became Executive Vice President in 1970, President in 1975, and Chairman and Chief Executive Officer ("CEO") in 1985, a position he held until April 24, 1995. Mr. Bentley was reappointed to the position of President and CEO of the Company on July 25, 1997 and relinquished the position of President and CEO on January 1, 1998. Mr. Bentley is Chairman and a Director of Sierra Mountain Minerals Inc., a member of the Board of the Canadian Institute for Advanced Research, a member of the Advisory Board of BuildDirect.com, and a Trustee and Chair Emeritus of the Vancouver General Hospital and University of British Columbia Hospital Foundation. He also served for many years as a Director of Bank of Montreal and Shell Canada Ltd. Mr. Bentley retired as Chancellor of the University of Northern British Columbia in May 2007. Mr. Bentley holds Honorary Doctorate of Laws degrees from the University of British Columbia and University of Northern British Columbia.	1966

**Name and Municipality, Province and Country of Residence**

**Principal Occupation and Background**

**Director Since**

G. D. Clark <sup>(4),(5)</sup>  
Vancouver, B.C.  
Canada

President and Director of The Jim Pattison Group

2009

Background: Mr. Clark is a member of the Board of Directors of Sun-Rype Products Ltd. In the capacity of President of the Jim Pattison Group, Mr. Clark has corporate responsibility for Pattison Sign, Canadian Fishing Company, Overwaitea Food Group, Ocean Brands, Jim Pattison Lease, Ripley Entertainment, Guinness World Book and News Group North America. Prior to 2001, Mr. Clark served as Premier of British Columbia from February 1996 to August 1999. He was Minister of Finance and Corporate Relations from November 1991 to September 1993 and Minister of Employment and Investment from September 1993 until February 1996. Mr. Clark was first elected to the Legislative Assembly of British Columbia in 1986 to represent the constituency of Vancouver-East. In the 1991 and 1996 general elections, he was re-elected to represent the constituency of Vancouver-Kingsway. Mr. Clark holds a Bachelor of Arts degree from Simon Fraser University and a Master's Degree in Community and Regional Planning from the University of British Columbia.

R. L. Cliff, C.M., F.C.A. <sup>(1),(3)</sup>  
West Vancouver, B.C.  
Canada

Co-Chairman of the Board of Directors of the Company, Chairman of the Board, Heathcliff Properties Ltd.

1983

Background: Mr. Cliff is Co-Chairman of the Board of Directors of the Company and of the Company's principal subsidiary, Canadian Forest Products Ltd. He is also a Director and Co-Chairman of CPPI. Mr. Cliff is Chairman of Heathcliff Properties Ltd. and President of the Heathcliff Foundation. Mr. Cliff was Chairman and a Director of BC Gas Inc. (now FortisBC) from 1972 to 2002. He also served as a Director of the Royal Bank of Canada and was a Director and Chairman of Southam Inc. Mr. Cliff is a Trustee and Chairman Emeritus of the Vancouver Police Foundation; a former Trustee of the Vancouver General Hospital and University of British Columbia Hospital Foundation and the Chairman of the Vancouver Symphony Foundation. Mr. Cliff received his Commerce Degree from the University of British Columbia and qualified as a Chartered Accountant in 1954 and was elected a Fellow of the Institute of Chartered Accountants of British Columbia in 1994.

<u>Name and Municipality, Province and Country of Residence</u>	<u>Principal Occupation and Background</u>	<u>Director Since</u>
M. J. Korenberg <sup>(1),(5),(6)</sup> West Vancouver, B.C. Canada	Deputy Chairman and Managing Director of The Jim Pattison Group, a diversified group of companies, and Co-Chairman of the Board of Directors of the Company  Background: Mr. Korenberg was previously the Vice Chairman of the Jim Pattison Group. Mr. Korenberg is a Director of The Jim Pattison Group Inc. (and its affiliates), Sun-Rype Products Ltd., Westshore Terminals Investment Corporation and Westshore Terminals Ltd. Mr. Korenberg is also the Co-Chairman of the Board of Directors of the Company and of the Company's principal subsidiary, Canadian Forest Products Ltd. He is also a Director and Co-Chairman of CPPI. He is an adjunct professor, Faculty of Law, University of British Columbia, a member of the Dean's Advisory Committee for the National Centre for Business Law and a member of the Law Societies of Upper Canada (Ontario) and British Columbia.	2003
J. A. Pattison, O.C., O.B.C. <sup>(2), (3)</sup> West Vancouver, B.C. Canada	Managing Director, CEO and Chairman, The Jim Pattison Group, a diversified group of companies  Background: Mr. Pattison is a Director of Jim Pattison Group Inc. (and its affiliates), Brookfield Asset Management Inc. and Sun-Rype Products Ltd. and a Trustee of the Board of the Ronald Reagan Presidential Foundation.	2003
C. A. Pinette <sup>(2),(3),(4),(6)</sup> Vancouver, B.C. Canada	Former owner and President, Pinette & Therrien Mills Ltd.  Background: Mr. Pinette is also a Director of CPPI. Mr. Pinette's work in the Canadian forest industry began 40 years ago as an owner and President of a family lumber business, Pinette & Therrien Mills Ltd. Mr. Pinette has also served as Executive Vice President, Tolko Industries Ltd. (2005), Executive Vice President, Riverside Forest Products Limited (2004) and served as President and Chief Operating Officer of Lignum Limited from January 1990 to April 2004. Mr. Pinette is the former Chairman of Finning International Inc. and a former Director of TimberWest Forest Corp, Northgate Minerals Corporation, A&W Revenue Royalties Income Fund, Finning International Inc. and the British Columbia Business Council. Mr. Pinette is currently a member of the Vancouver General Hospital and University of British Columbia Prostate Advisory Board and Chairman and a Director of Gold Canyon Resources.	2008

**Name and Municipality, Province and Country of Residence**

**Principal Occupation and Background**

**Director Since**

J. M. Singleton, BA <sup>(4),(6)</sup>  
Myrtle Beach, SC  
USA

Former CEO of New South Companies Inc., headquartered in Myrtle Beach, South Carolina, a wholly owned subsidiary of the Company

2007

Background: Mr. Singleton has 38 years of experience in the wood products industry, all with New South or its predecessor companies and has been the CEO of New South since 1985. Mr. Singleton retired as the CEO of New South in September 2009. He has served on the boards of numerous industry associations and committees and is past Chairman of the US Coalition for Fair Lumber Imports and the Southern Forest Products Association. Mr. Singleton received a BA degree from Presbyterian College, a J.D. degree from the University of South Carolina School of Law, and completed the PMD Program at Harvard Business School. He is currently a member of the Board of Trustees of Presbyterian College.

R. S. Smith <sup>(1),(2),(5)</sup>  
West Vancouver, B.C.  
Canada

Mr. Smith is a member of the Board of Directors of Kal Tire Ltd. and Rotherham Holdings Ltd. He is also a member of the Advisory Board of Marsh Canada Limited and is Chairman of the Board of Directors for K-Bro Linen Inc and Kal Tire Holdings Ltd. Mr. Smith is a former member of the Board of Directors of HSBC Bank Canada

2009

Background: Mr. Smith had a successful 35 year career at KPMG LLP where he held various roles, including Managing Partner for British Columbia region and served for 13 years on the National Management Committee prior to his retirement in 1998. While in public practice, Mr. Smith served major public and private companies, many of which were in the forest industry, from an audit and securities perspective. Mr. Smith has served on many charitable and community boards in past years and is a past member of the Board of Governors of the University of British Columbia. Mr. Smith qualified as a Chartered Accountant in 1962 and was elected a Fellow of the Institute of Chartered Accountants of British Columbia ("ICABC") in 1990 and in 2010 was awarded a lifetime achievement award by the ICABC.

<u>Name and Municipality, Province and Country of Residence</u>	<u>Principal Occupation and Background</u>	<u>Director Since</u>
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W. W. Stinson <sup>(2),(6)</sup>  
Vancouver, B.C.  
Canada

Mr. Stinson is the Chairman and CEO of Westshore Terminals Investment Corporation

2011

Background: Mr. Stinson is a Director of CPPI. Mr. Stinson spent the majority of his business career with Canadian Pacific Ltd., retiring as Chairman and CEO in 1996 after 11 years in that position. He has served on a wide variety of boards and has held the positions of Chairman of Sun Life Financial, Chairman of the Executive Committee of United Dominion Industries and Lead Director of CHC Helicopter Corporation.

Notes:

- (1) Member of the Audit Committee.
- (2) Member of the Management Resources and Compensation Committee.
- (3) Member of the Corporate Governance Committee.
- (4) Member of the Environmental, Health and Safety Committee.
- (5) Member of the Pension Committee.
- (6) Member of the Joint Capital Expenditure Committee.

The term of office of each Director expires on the date of the next Annual General Meeting of the Company to be held on May 1, 2013.

## Officers

The names and municipality, province and country of residence of the executive officers of the Company and the offices held by them are as follows:

<u>Name</u>	<u>Municipality of Residence</u>	<u>Office</u>
P. J. G. Bentley	Vancouver, B.C., Canada	Chairman Emeritus
R. L. Cliff	West Vancouver, B.C., Canada	Chairman
D. B. Kayne	Tsawwassen, B.C., Canada	President and CEO
A. R. Nicholl	West Vancouver, B.C., Canada	Senior Vice President, Finance and Chief Financial Officer
D. M. Calabrigo, Q.C.	Vancouver, B.C., Canada	Senior Vice President, Corporate Development, Legal Affairs and Human Resources and Corporate Secretary
A. L. W. Cook	Surrey, B.C., Canada	Senior Vice President, Operations Canada
M. Feldinger	Surrey, B.C., Canada	Senior Vice President, Energy, Environment, Transportation and Sourcing
W. R. Guthrie	White Rock, B.C., Canada	Senior Vice President, Sales and Marketing
D. Warstler	Myrtle Beach, SC, United States	President, US Operations
O. Athwal	Delta, B.C., Canada	Vice President, Human Resources (Commencing January 1, 2013)
P. A. J. Elliott	Vancouver, B.C., Canada	Vice President and Treasurer
B. Hayes	Delta, B.C., Canada	Vice President, Transportation Procurement and Distribution
C. Kennedy	Vancouver, B.C., Canada	Vice President, Brand and External Relations
T. Lewis	Prince George, B.C., Canada	Vice President, Woodlands

All of the above Directors and Officers have had the same or similar principal occupations with the organizations indicated for the last five years except that: prior to April 2009, Mr. Bentley was Chairman of the Company and Mr. Cliff was appointed Chairman in April 2009; prior to May 2011, Mr. Kayne was Vice President, Wood Products Marketing and Sales, Mr. Nicholl was Corporate Controller, Mr. Calabrigo was Vice President, Corporate Development, General Counsel and Corporate Secretary, Mr. Cook was Vice President, Capital Projects, Mr. Feldinger was Vice President, Manufacturing, Mr. Guthrie was Vice President Sales and Marketing at Tembec Inc., and Mr. Elliott was Treasurer; prior to July 1, 2012, Mr. Hayes was General Manager, Global Supply Chain, Ms. Kennedy was Director, Public Affairs and Corporate Communications and Mr. Lewis was Regional Manager, Forest Management Group; prior to January 1, 2013, Mr. Athwal was Vice President, Human Resources at CPPI.

## INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

To the knowledge of the Company, no Director or Executive Officer of the Company, or any of their associates, has or had any material interest, directly or indirectly, in any transaction of the Company within the three most recently completed financial years of the Company that has materially affected or will materially affect the Company.

## CONFLICTS OF INTEREST

To the knowledge of the Company, no Director or Executive Officer of the Company has an existing or potential conflict of interest with the Company.

## DESCRIPTION OF CAPITAL STRUCTURE

The authorized share capital of the Company consists of 1,010,000,000 shares divided into 1,000,000,000 Common Shares without par value and 10,000,000 Preferred Shares with a par value of \$25 each. At December 31, 2012 there were 142,752,431 Common Shares issued and outstanding and no Preferred Shares issued and outstanding.

Holders of the Common Shares are entitled to vote at all meetings of shareholders of the Company, except meetings at which only the 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.

Holders of Preferred shares are not generally entitled as such 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 the payment of dividends and upon any distribution of assets in the event of liquidation, dissolution and winding-up of the Company.

On July 1, 2006, under the plan of arrangement (the "2006 Arrangement") in connection with the spin-out of the Company's pulp and paper business to Canfor Pulp LP, the previously existing "Common Shares" of the Company were redesignated as "Class A Common Shares", the authorized capital of the Company was increased to authorize the issuance of up to 1,000,000,000 new Common Shares and special rights and restrictions were added to the redesignated Class A Common Shares. As part of the 2006 Arrangement, each Company shareholder received one Common Share and 0.1 units of the Fund in exchange for each Class A Common Share held by them and all of the outstanding Class A Common Shares were then cancelled by the Company. Upon completion of the spin-out, the Company's shareholders owned all of the issued and outstanding Common Shares and all of the issued and outstanding units of the Fund and the authorized capital of the Company was subsequently reduced to delete the 1,000,000,000 Class A Common Shares, none of which were then issued and outstanding.

On April 27, 2010, under the 2010 Arrangement approved by unitholders of Canfor Pulp LP, the Fund converted into a dividend paying public corporation named CPPI. The conversion was completed effective January 1, 2011. Under the 2010 Arrangement, unitholders of the Fund received, for each unit of the Fund held, one common share of CPPI.

## RATINGS

The credit rating agency listed below has assigned the following unsolicited rating to the senior notes issued by Canfor under the April Note Agreement (see "Material Contracts"):

DBRS Ltd. ("DBRS")	BB (high)	(the fifth ranking category out of ten granted by DBRS for long-term debt)
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A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the rating organization. The foregoing DBRS rating was not requested by Canfor and is based, as specified by DBRS in its rating report, on publicly available information about the Company. Canfor did not participate with or provide information to DBRS in connection with this rating. Accordingly, Canfor cannot comment on the accuracy of the rating or of the appropriateness of the factors considered by DBRS in preparing the rating.

The following information about DBRS credit ratings is taken from publicly available information provided by DBRS on its website. DBRS credit ratings are on a long-term debt rating scale that ranges from AAA to D, which represents the range from highest to lowest quality of such securities rated and is meant to give an indication of the risk that a borrower will not fulfill its obligations in a timely manner. Every DBRS rating is based on quantitative and qualitative considerations relevant to the borrower. According to the DBRS rating system, an obligation rated BB is defined to be speculative and

non-investment grade, where the degree of protection afforded interest and principal is uncertain, particularly during periods of economic recession. Entities in the BB range typically have limited access to capital markets and additional liquidity support. In many cases, deficiencies in critical mass, diversification, and competitive strength are additional negative considerations.

The ratings from AA to CCC may be modified by the addition of a high or low modifier to show relative standing within the major rating categories. The lack of one of these designations indicates a rating, which is essentially in the “middle” of the category.

#### **DIVIDENDS**

The declaration and payment of dividends is at the discretion of the Company's Board of Directors. There were no dividends paid on its Common Shares from 2008 to 2012.

The amount of dividends the Company is permitted to pay under its term loan agreements is determined by reference to consolidated net earnings less certain restricted payments. As at September 30, 2012, the Company would be permitted under these agreements to pay up to \$122 million or \$0.85 per share in dividends on its Common Shares. The agreements do not restrict payment of dividends on Preferred Shares or dividends paid in Common Shares of the Company.

#### **SHAREHOLDINGS OF DIRECTORS AND EXECUTIVE OFFICERS**

At February 14, 2013, the Directors and Executive Officers of the Company, as a group, beneficially owned, directly or indirectly, or exercised control or direction over, 59,407,389 Common Shares representing approximately 41.6% of the outstanding Common Shares.

At February 14, 2013, James A. Pattison beneficially owned 58,705,000 Common Shares, which are held by companies wholly owned by Mr. Pattison, and represent approximately 41.1% of the outstanding Common Shares of the Company. This amount is included in the calculation of the Directors and Executive Officers holdings above.

#### **MARKETS FOR SECURITIES**

The Common Shares are listed and traded on the TSX under the symbol CFP. The main operating Company is Canadian Forest Products Ltd., from which the name Canfor is derived.

#### **TRADING PRICE AND VOLUME**

The following table presents the high and low prices for the Company's Common Shares and the average daily trading volume of those shares, on a monthly basis, on the TSX for 2012.

<b>Month of 2012</b>	<b>High</b>	<b>Low</b>	<b>Average Daily Trading Volume</b>
January	12.30	10.69	312,895
February	12.30	10.71	286,396
March	12.90	11.00	273,408
April	11.95	10.14	216,456
May	11.69	10.27	166,777
June	12.25	10.84	221,022
July	12.38	11.53	343,927
August	13.07	11.51	274,411
September	13.76	12.61	171,508
October	14.63	12.34	188,722
November	15.00	13.80	227,215
December	17.17	14.40	426,899

#### **SECURITY**

The Company's operating lines of credit and term indebtedness are unsecured.

## MATERIAL CONTRACTS

The Company entered into a revolving credit agreement dated for reference July 30, 2010 with Canadian lenders to amend and restate its previous credit facilities. This credit agreement provides for an unsecured and committed \$350 million revolving credit facility to replace the previous credit facility of \$355 million. This facility was originally for a term of 3.25 years (terminating on October 31, 2013) and it provided for floating rates of interest. In August 2011, the Company extended the maturity of this facility from October 31, 2013 to October 31, 2015. The general terms and conditions of the new facility are similar to the previous facility. The facility may be increased by up to \$150 million with existing or new lenders.

On January 30, 2009, the Company entered into two new operating loan facilities with a Canadian bank (the "2009 Facilities") in the amounts of US \$16.7 million ("Facility A") and US\$43.7 million ("Facility B"). Facility B expired in January 2011, and was non-recourse to the Company under normal circumstances. For Facility A, the asset backed commercial paper (ABCP) assets of the Company were pledged as security to support the credit facility and expired in January 2012.

The Company entered into a note purchase agreement dated February 2, 2004 with The Prudential Investment Management, Inc. and other purchasers providing financing of up to US \$160 million (the "February Note Agreement"). The Company also entered into a note purchase agreement on April 1, 2004 with John Hancock Life Insurance Company, Investors Partner Life Insurance Company, John Hancock Insurance Company of Vermont and The Maritime Life Assurance Company provided financing of up to US \$75 million (the "April Note Agreement").

On February 4, 2004, the Company issued US \$50 million of senior notes under the February Note Agreement for general operating purposes and capital expenditures. On April 1, 2004, the Company issued US \$110 million of senior notes under the February Note Agreement and US \$75 million under the April Note Agreement for the repayment of \$160 million of long-term debt existing at the time of acquisition of Slocan Forest Products Ltd. ("Slocan"). Certain of the funds under the February Note Agreement and the April Note Agreement were also used to pay a make-whole payment on Slocan's outstanding indebtedness at the time of acquisition and for general corporate purposes.

The senior notes issued under the February Note Agreement and the April Note Agreement have the following interest rates and maturities: US \$50 million at 6.33% was paid on February 2, 2012 and US \$75 million at 5.42% to be paid on April 1, 2013.

In February, 2012, the Company issued new term debt totaling \$100 million. The new debt is in the form of an unsecured non-revolving term loan, with a maturity date of February 13, 2017. Interest rates are floating based on the lender's Canadian prime rate or bankers' acceptances.

Other than the security under the 2009 Facilities (now expired), all of the foregoing note agreements and credit facilities are unsecured but require compliance with certain covenants that could in certain circumstances restrict the ability of the Company or its subsidiaries to incur additional indebtedness, to encumber or dispose of their assets, or to make certain payments or distributions.

The Company and Canfor Pulp LP each entered into a number of material contracts in connection with the spin-out of the NBSK pulp and paper business by the Company to Canfor Pulp LP on July 1, 2006, including an Acquisition Agreement, an Exchange Agreement and a Shareholders Agreement. Pursuant to the 2010 Arrangement, these arrangements have been amended to reflect the fact that CPPI now holds directly the 49.8% interest in Canfor Pulp LP previously held directly by the Fund. In addition, the Shareholders' Agreement has been amended to provide the Company with more flexibility in appointing persons who are not independent of the Company as Directors of the general partner of Canfor Pulp LP. For a description of the 2006 Arrangement and these contracts see "Pulp and Paper" and the section entitled "The Spin-out – Transfer of the Pulp Business and Related Agreements" of the Company's Information Circular dated April 28, 2006, which is incorporated by reference herein and also the Canfor Pulp LP Information Circular dated March 16, 2010 and both of which are available on SEDAR at [www.sedar.com](http://www.sedar.com).

On November 28, 2011, the Company and Tembec Industries Inc. ("Tembec") entered into an asset purchase agreement ("APA") pursuant to which the Company proposed to acquire (the "Tembec Transaction") Tembec's southern British Columbia interior wood products assets, including the Canal Flats and Elko sawmills (the "Acquired Mills") and approximately 1.1 million cubic metres of combined Crown, private land and contract harvesting rights. The Tembec Transaction included a long-term agreement to provide residual fibre supply for Tembec's Skookumchuck mill.

The purchase price, including payment on account of net working capital, was valued at approximately \$65.6 million. The

Acquired Mills will provide an additional 420 million board feet to the Company's annual production capacity, taking the Company's total production capacity in North America to over 5 billion board feet. On March 23, 2012, the Company completed the Tembec Transaction and now has three sawmills in the British Columbia Southern Interior (including the recently idled sawmill at Radium, B.C.).

On November 28, 2012, Canfor entered into a letter of intent with Louisiana-Pacific to sell Canfor's 50% in Peace Valley OSB joint venture. The purchase price is estimated at \$70 million plus working capital. Canfor may receive additional annual consideration over a three year period based on Peace Valley OSB's annual EBITDA. The transaction is expected to close in the first half of 2013.

#### **CEASE TRADE ORDERS, BANKRUPTCIES, PENALTIES, SANCTIONS**

To the knowledge of the Company, no Director or Executive Officer of the Company is at the date hereof or was within the last 10 years of the date of this Annual Information Form, a Director, CEO or Chief Financial Officer of a Company that, (i) while acting in that capacity, was subject to a cease trade or similar order or an order that denied the Company access to any exemption under securities legislation for a period of 30 consecutive days; (ii) was subject to an event that resulted, after ceasing to act in such capacity, in a cease trade or similar order or an order that denied the Company access to any exemption under securities legislation for a period of 30 consecutive days. To the knowledge of the Company, no Director or Executive Officer of the Company or a shareholder holding a sufficient number of securities of the Company to materially affect the control of the Company is at the date hereof, or has been within the 10 years before the date of this Annual Information Form, a Director or Executive Officer of a Company that, while acting in that capacity, or within a year of ceasing to act in such capacity became bankrupt, made a proposal under legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver or trustee appointed to hold its assets, other than Messrs. Bentley, Calabrigo and Elliott, each of whom were Directors or Officers of HSPP General Partner Ltd. ("HSPP"), general partner of HSLP during the period of January 29 to February 1, 2008 when HSLP completed a restructuring under the Companies' Creditors Arrangement Act (Canada), and on January 27, 2011, when HSLP renamed 6382 Pulp and Paper Limited Partnership voluntarily filed for bankruptcy under the Bankruptcy and Insolvency Act (Canada) (the "BIA") after the sale of substantially all of its assets to a third party effective October 1, 2010. HSLP filed a proposal under BIA which was subsequently approved by its creditors and finally by the British Columbia Supreme Court on July 18, 2011. To the knowledge of the Company, no Director or Executive Officer of the Company or a shareholder holding a sufficient number of securities of the Company to materially affect the control of the Company has, within the ten years before the date of this Annual Information Form, become bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency, or become subject to or instituted any proceeding, arrangement or compromise with creditors, or had a receiver, receiver manager or trustee appointed to hold his assets.

#### **EXPERTS**

PricewaterhouseCoopers LLP, Chartered Accountants, of Vancouver, British Columbia are the auditors of the Company. PricewaterhouseCoopers LLP, Chartered Accountants, have reported that they are independent of the Company in accordance with the auditor's rules of professional conduct in British Columbia, Canada.

#### **TRANSFER AGENT AND REGISTRAR**

Canadian Stock Transfer Company Inc. is the Company's transfer agent and registrar with registers of transfer in Vancouver and Toronto.

## AUDIT COMMITTEE INFORMATION

### Audit Committee Terms of Reference – See APPENDIX A

#### Composition of Audit Committee

The Audit Committee is composed entirely of independent Directors, all of whom are financially literate as defined in Multilateral Instrument form 52-110F1. Mr. Smith, the Chairman of the Committee, is a Chartered Accountant and was a partner in a national accounting firm for over 20 years. Mr. Cliff is a Chartered Accountant and received a commerce degree from the University of British Columbia. Mr. Korenberg is the Vice Chairman of the Jim Pattison Group and an adjunct professor of the Faculty of Law, University of British Columbia.

The Audit Committee has adopted a policy for the engagement of non-audit services whereby the external auditor of the Company is not entitled to provide any non-audit services to the Company exceeding \$50,000 in value without the Audit Committee Chairman's prior approval and any such services exceeding \$100,000 are to be approved by the Audit Committee. All such engagements are reported to the Audit Committee.

#### External Auditor Service Fees (By Category)

The aggregate fees billed by PricewaterhouseCoopers LLP, the auditor of the Company for the last two years, was \$2,118,649. This entire amount was for audit, tax and financial services.

External Auditor Service Fees (000s)	2012	2011
Audit <sup>(1)</sup>	\$709	\$734
Audit Related Fees <sup>(2)</sup>	124	109
Tax Fees <sup>(3)</sup>	234	88
Other Fees <sup>(4)</sup>	15	105
<b>Total Fees <sup>(5)</sup></b>	<b>\$1,082</b>	<b>\$1,036</b>

Notes:

- (1) For the audit of the Company's annual financial statements and services normally provided by the principal auditor in connection with the Company's statutory and regulatory filings.
- (2) For assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements and are not reported in (1), including accounting consultations and various agreed upon procedures.
- (3) For tax compliance and tax consulting services.
- (4) For consulting services other than the fees reported in (1) to (3).
- (5) In addition to the above fees, total fees of \$618,927 were billed to the Company's subsidiary, CPPI in 2012 (In 2011, \$641,790 was billed to Canfor Pulp LP).

## ADDITIONAL INFORMATION

Additional financial information regarding the Company is provided in the Company's "2012 Management's Discussion and Analysis" and "Consolidated Financial Statements" for the year ended December 31, 2012, which is incorporated by reference herein. Additional information, including Directors' and Officers' remuneration and indebtedness, principal holders of the Company's securities, options to purchase securities and interests of insiders in material transactions, where applicable, and securities authorized for issuance under equity compensation plans, is contained in the Information Circular for the Annual General Meeting of the Company held on April 24, 2012 and in the Information Circular for the Annual General Meeting of the Company to be held on May 1, 2013.

The Company will provide upon request to the Corporate Secretary of the Company, 100-1700 West 75<sup>th</sup> Avenue, Vancouver, British Columbia V6P 6G2:

- a) at no cost when the securities of the Company are in the course of a distribution under a short form prospectus or a preliminary short form prospectus,
  - (i) one copy of this Annual Information Form, together with one copy of any document, or the pertinent pages of any document, incorporated by reference in this Annual Information Form;
  - (ii) one copy of the comparative financial statements of the Company for its most recently completed financial year together with the accompanying report of the auditor and one copy of any interim financial statements of the Company that have been filed, if any, for every period subsequent to the financial statements for its most recently completed financial year;
  - (iii) one copy of the Information Circular of the Company in respect of its most recent annual meeting of shareholders that involved the election of Directors or one copy of any annual filing prepared in lieu of that Information Circular, as appropriate, and;
  - (iv) one copy of any other documents that are incorporated by reference into the preliminary short form prospectus or the short form prospectus and are not required to be provided under (i) to (iii) above; or
- b) at any other time, one copy of any other documents referred to in (a) (i), (ii) and (iii) above, provided the Company may require the payment of a reasonable charge if the request is made by a person who is not a security holder of the Company.

Additional information about the company is available on SEDAR (System for Electronic Document Analysis and Retrieval) at [www.sedar.com](http://www.sedar.com). In addition, all documents identified in this Annual Information Form as being incorporated by reference herein are available on SEDAR at [www.sedar.com](http://www.sedar.com).

## APPENDIX A – AUDIT COMMITTEE TERMS OF REFERENCE

### 1. Purpose

The Audit Committee is appointed by the Board to assist the Board in fulfilling its oversight responsibilities. The Audit Committee will:

- (a) Review the financial reports and other financial information provided by the Company to its shareholders;
- (b) Monitor the integrity of the financial reporting process and the system of internal controls that management and the Board have established;
- (c) Monitor the management of the principal risks that could impact the financial performance of the Company;
- (d) Review and receive the Audit Plan, process, results and performance of the Company's independent external auditors and the Internal Audit department while providing an open avenue of communication between the external auditors, the internal auditors, management and the Board; and
- (e) Monitor the management of risk by the Company generally.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities and it has direct access to the external auditors as well as anyone in the organization. The Audit Committee has the authority to retain, at the Company's expense, special legal, accounting and other consultants or experts it deems necessary in the performance of its duties.

### 2. Audit Committee Composition and Meetings

All members of the Audit Committee must be Independent Directors.

All Audit Committee members must be financially literate with the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements. At least one Audit Committee member should have accounting or related financial expertise, including:

- (a) An understanding of financial statements and accounting principles used by the Company to prepare its financial statements;
- (b) The ability to assess the general application of such accounting principles in connection with accounting for estimates, accruals and reserves;
- (c) Experience preparing, auditing, analyzing or evaluating financial statements, or experience supervising the preparation, audit, analysis or evaluation of financial statements, that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements;
- (d) An understanding of internal controls and procedures for financial reporting; and
- (e) An understanding of audit committee functions.

A Chair shall be appointed by the Board annually from among the members of the Audit Committee.

The Audit Committee shall schedule regular meetings and shall meet at least four times annually, or more frequently as deemed necessary by the Chair. The Chair shall prepare and/or approve an agenda in advance of each meeting. The Audit Committee shall meet privately at least annually with management, the Director of the Internal Audit department and the external auditors to discuss any matters that the Audit Committee or each of these groups believe should be discussed.

The Chief Executive Officer, the Chief Financial Officer, the Director, Internal Audit (“the Internal Auditor”) and the external auditors shall be given notice of, and have the right to appear before and to be heard at, every meeting of the Audit Committee, and shall appear before the Audit Committee when requested to do so by the Committee.

### **3. Primary Duties and Responsibilities**

To fulfill its primary duties and responsibilities, the Audit Committee shall adhere to the following terms:

#### **(a) Review and Reporting Procedures**

- (i) The Audit Committee is authorized to review and/or investigate any financial, internal control, or risk management related issue or activity of the Company. The Audit Committee shall report to the Board at its next regular meeting all such action it has taken since the previous report.
- (ii) The Audit Committee is authorized to request the presence, at any meeting, of a representative from the external auditors, senior management, internal audit, legal counsel or anyone else who could contribute to the subject of a meeting.
- (iii) The Audit Committee will review and reassess these Terms of Reference at least annually to determine whether revisions are necessary. The Audit Committee shall periodically self-assess its performance and effectiveness in fulfilling its role.
- (iv) Supporting schedules and information reviewed by the Committee will be available for examination by any Director of the Audit Committee upon request to the Secretary of the Audit Committee.

#### **(b) Internal Controls and Risk Management Processes**

- (i) To assure itself that the Company has appropriate controls in place to achieve the following objectives:
  - Effectiveness and efficiency of operations (including safeguarding of assets);
  - Reliability of internal and external reporting;
  - Compliance with applicable laws and regulations and internal policies.
- (ii) To ensure the Company has appropriate processes in place to manage the principal risks of its businesses, the Audit Committee shall:
  - Consider and review internal processes for managing the principal risks of the Company's businesses, including a review of insurance coverage.
  - Obtain assurance from both management and the Internal Auditor regarding the adequacy of the risk management processes.
  - Review with management, the Internal Auditor and the external auditor:
    - The adequacy of the Company's internal controls including computerized information systems, controls and security.
    - Any related significant internal control findings and recommendations of the external auditor and/or Internal Auditor together with management's responses thereto.
    - The Company's compliance or adherence to debt covenants, terms or conditions.

(c) **Financial Reporting**

In order to satisfy itself that the Company's annual financial statements are fairly presented in accordance with generally accepted accounting principles ("GAAP") and in a form sufficient for the Audit Committee's recommendation for approval by the Board, and that the financial information contained in the Company's financial statements, Annual Report to Shareholders, Annual Information Form and other financial disclosure documents such as Management's Discussion and Analysis, is complete and accurate in all material respects, the Audit Committee shall:

(i) General

- Review significant accounting and reporting issues, including recent professional and regulatory pronouncements, and understand their impact on the financial statements.

(ii) Interim Financial Statements

- Review the Company's interim financial statements with management prior to their release or distribution. This review will include a detailed reporting of quarterly and year-to-date results, variance against budget and prior year and a discussion with the external auditor. Upon satisfactory completion of the review, the Audit Committee shall recommend to the Board approval of the financial statement release.
- Review any significant proposed changes to the Company's accounting principles or policies, or financial reporting practices.
- Review the financial statement impact of any significant, unusual event or transaction.
- Review news releases containing financial information disclosure and Management's Discussion and Analysis.

(iii) Annual Financial Statements and Other Financial Information

- Obtain draft annual financial statements in advance of the Committee meeting and assess, on a preliminary basis, the reasonableness of the financial statements in light of the analyses provided by management.
- Review any material changes in accounting policies, GAAP, or financial reporting requirements that may affect the current year's financial statements.
- Obtain and review summaries of significant or unusual transactions, and other potentially complex matters whose treatment in the annual financial statements merits advance consideration.
- Review a summary provided by the Company's legal counsel of the status of any material pending or threatened litigation, claims and assessments.
- Review and discuss the annual financial statements and the external auditor's report thereon in detail with management and the external auditors.
- Through discussion with management, the Internal Auditor and the external auditors, obtain assurance that the risk of material misstatement of the financial statements is acceptably low.
- Review the financial information included in the Management's Discussion and Analysis, and consider whether the information is adequate and consistent with the Audit Committee members' knowledge of the Company.
- Review the tax status of the Company and understand the status of any related tax reserves, potential reassessments or other matters which could affect the annual financial statements.
- Review and assess the quality and appropriateness of the Company's accounting and reporting principles and policies.
- Provide to the Board a recommendation as to whether the annual financial statements should be approved.

- Review the news release announcing the annual financial results of the Company.
  - Review the annual financial disclosure contained in the Annual Information Form.
- (iv) Prospectus and Information Circulars
- Review the financial information included in any prospectus or information circular prior to their release and, as appropriate, recommend to the Board whether such prospectus or information circular should be approved by the Board.

(d) **External Audit**

The external auditors are accountable to the Audit Committee and the Board as representatives of the shareholders.

In order to assure itself that the external audit function has been effectively carried out and that any matters that the external auditors consider appropriate to bring to the attention of the Board have been addressed, the Audit Committee shall:

- (i) Recommend to the Board the selection (retention or replacement) of the external auditors, considering independence and effectiveness, and approve the fees and other compensation to be paid to the external auditors. On an annual basis, the Audit Committee should review and discuss with the external auditors all significant relationships its accountants have with the Company to confirm their independence. If there is a recommendation to change auditors, review all the issues to change and the steps planned for an orderly transition.
- (ii) Review the external auditor's Audit Plan and engagement letter with management and the external auditors, including audit scope and approach.
- (iii) Meet with the external auditor and management in separate private sessions to discuss any matters that the Audit Committee or these groups believe should be discussed privately with the Audit Committee.
- (iv) Review any non-audit services that have been rendered by the external auditor.
- (v) Review and assess the performance of the external auditor, including consideration of demonstrated external audit judgment and application and adherence to accounting policy and standards.
- (vi) Review the external auditor's policy on partner rotation.

(e) **Internal Audit**

In order to assure itself that the internal audit function has been effectively carried out and that any matter that the Internal Auditor considers appropriate to bring to the attention of the Board has been addressed, the Audit Committee shall:

- (i) Be advised of and concur with the appointment, replacement, reassignment or dismissal of the Internal Auditor and consider resource requirements.
- (ii) Review and approve Internal Audit Terms of Reference, including scope, organization structure and mandate.
- (iii) Confirm and assure the independence of the Internal Auditor.
- (iv) Review jointly with the Internal Auditor and the external auditor the coordination of audit effort to assure completeness of coverage, reduction of redundant efforts, and the effective use of audit resources.
- (v) Review with management and the Internal Auditor the annual Audit Plan and monitor any changes required in the scope of the plan.
- (vi) Meet with the Internal Auditor and management in separate private sessions to discuss any matters that the Audit Committee or these groups believe should be discussed privately with the Audit Committee.

- (vii) Review significant internal audit reports together with management's response and follow-up actions, including any problems or issues encountered in the course of an audit.
- (viii) Review and assess the performance of the Internal Auditor; and
- (ix) Ensure that the Internal Auditor reports directly to the Chair of the Audit Committee with a dotted line reporting responsibility to either the CEO or CFO of the Company.

(f) **Finance**

The Audit Committee is authorized to review and approve for recommendation to the Board:

- (i) the Company's annual financing plan and any amendments thereto from time to time;
- (ii) any proposed financings;
- (iii) the method by which the Company measures financial results or performance.

**4. Other Duties**

(a) **Legal and Regulatory Compliance**

To provide assurance of Company compliance with all legal and regulatory requirements, the Audit Committee shall:

- (i) In areas in which it has oversight responsibility, monitor the Company's compliance and obtain management's assurance of compliance with applicable laws, regulations and internal policies in all jurisdictions where the Company does business. The Audit Committee will consider the financial statement implications of applicable laws and regulations, including the laws and regulations overseen by other Committees of the Board.
- (ii) Receive and review copies of legal letters provided to the external auditors by in-house and outside counsel regarding claims and possible claims against the Company.
- (iii) Make inquiries of management, the external auditors and Internal Auditor, to ensure that all material legal matters have been brought to the attention of the Audit Committee.
- (iv) On at least an annual basis, review with the Company's counsel any legal matters that could have a significant impact on the organization's financial statements or risk profile, the Company's compliance with applicable laws and regulations, and inquiries received from regulators or governmental agencies.
- (v) Ensure that all annual and interim financial statement filings are personally certified by the Chief Executive Officer and the Chief Financial Officer if and as required by applicable law.

(b) **Officer Expenses**

Review policies and procedures with respect to the Chairman of the Board and President and Chief Executive Officer's expense accounts and perquisites, including the use of corporate assets.

Periodically review major expenses incurred by the office of the Chairman of the Board and President and Chief Executive Officer.

(c) **Other Duties**

- (i) The Audit Committee will perform such other functions as assigned by law or regulation or as required by the Board.
- (ii) The Audit Committee will receive reports from the Canfor Pulp Holding Inc. audit committee at such times that the Chairman considers appropriate, detailing such matters, issues and circumstances of a financial nature that may impact the Company or be of interest to the Audit Committee.