2016

CANFOR CORPORATION MANAGEMENT'S DISCUSSION & ANALYSIS

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This Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the year ended December 31, 2016 relative to the year ended December 31, 2015, and the financial position of the Company at December 31, 2016. It should be read in conjunction with Canfor's Annual Information Form and its audited consolidated financial statements and accompanying notes for the years ended December 31, 2016 and 2015. The financial information contained in this MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which is the required reporting framework for Canadian publicly accountable enterprises.

Throughout this discussion, reference is made to Operating Income before Amortization and Adjusted Operating Income which Canfor considers to be a relevant indicator for measuring trends in the performance of each of its operating segments and the Company's ability to generate funds to meet its debt repayment and capital expenditure requirements. Reference is also made to Adjusted Shareholder Net Income (Loss) (calculated as Shareholder Net income (loss) less specific items affecting comparability with prior periods – for the full calculation, see reconciliation included in the section "Overview of Consolidated Results – 2016 Compared to 2015") and Adjusted Shareholder Net Income (Loss) per Share (calculated as Adjusted Shareholder Net Income (Loss) divided by the weighted average number of shares outstanding during the period). Operating Income before Amortization, Adjusted Operating Income, Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share are not generally accepted earnings measures and should not be considered as an alternative to net income or cash flows as determined in accordance with IFRS. As there is no standardized method of calculating these measures, Canfor's Operating Income before Amortization, Adjusted Operating Income, Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of Operating Income before Amortization to Operating Income (Loss) and Adjusted Shareholder Net Income (Loss) to Net Income (Loss) reported in accordance with IFRS are included in this MD&A.

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

All financial references are in millions of Canadian dollars unless otherwise noted. The information in this report is as at February 8, 2017.

Forward Looking Statements

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

COMPANY OVERVIEW

Canfor is a leading Canadian integrated forest products company based in Vancouver, British Columbia ("BC"), involved primarily in the lumber business, with production facilities in BC, Alberta, Ontario and the United States ("US"). Canfor also has a 53.6% interest in Canfor Pulp Products Inc. ("CPPI") which is involved in the Pulp and Paper business with production facilities located in BC.

Significant changes to the Company's business in 2016 include the following:

Lumber

- On July 29, 2016, the Company completed the final phase of the purchase of the lumber business of Scotch & Gulf Lumber, LLC ("Scotch Gulf") located in Mobile, Alabama increasing its ownership from 50% to 100%. The lumber business of Scotch Gulf comprises three sawmills located within an area of high-quality fibre supply, with a strong focus on value-added lumber and a combined annual capacity of 440 million board feet following capital upgrades and additional shifting. The aggregate purchase price for Scotch Gulf is $131.5 million, including working capital.
- On April 15, 2016, Canfor completed the acquisition of the assets of Wynndel Box and Lumber Ltd. ("Wynndel"), located in the Creston Valley of British Columbia for a purchase price of $40.3 million, including working capital. The acquisition is payable in three installments, of which $19.7 million was paid in 2016. Wynndel produces premium boards and customized specialty wood products, and has access to exceptionally high-quality fibre. The acquisition of assets includes a sawmill with annual production capacity of 80 million board feet, and approximately 65,000 cubic meters of annual harvesting rights in the Kootenay Lake Timber Supply Area.
- During 2015, the Company completed an investment agreement with Conifex Inc. ("Conifex"). As part of the agreement, Conifex issued a five-year senior secured note payable to Canfor in the amount of $30.0 million, secured by a forest license located in British Columbia with 200,000 cubic meters of annual allowable cut. On February 12, 2016, Canfor exercised its option to convert the loan into an ownership interest in the forest license.

Pulp

- During 2016, Canfor's ownership of CPPI increased to 53.6% as a result of share purchases from non-controlling shareholders under CPPI's Normal Course Issuer Bid. Further discussion of the Normal Course Issuer Bid is provided in the "Liquidity and Financial Requirements" section of this document.
- During 2016, CPPI and Licella Fibre Fuel Pty Ltd. ("Licella") agreed to form a joint venture under the name Licella Pulp Joint Venture to investigate opportunities to integrate Licella's Catalytic Hydrothermal Reactor platform into CPPI's pulp mills to economically convert biomass into next generation biofuels and biochemicals. Licella is a subsidiary of Ignite Energy Resources Ltd. ("IER") an Australian energy technology development company. This additional residue stream refining would allow the Company to further optimize pulp production capacity. This agreement follows a successful program of preliminary trials conducted on feedstock from the Company at Licella's pilot plants located in New South Wales, Australia, in which wood residue streams from CPPI's kraft process were successfully converted into a stable biocrude oil. In conjunction with the joint venture agreement, CPPI provided a $7.0 million convertible credit facility to IER, the parent company of Licella, which matures on June 21, 2019. In 2016, CPPI's net income included the pre-tax write-down of $7.0 million of advances made in connection with the biofuels initiative to Licella. Notwithstanding the future benefits that may result from this innovative effort, the write-down reflected the research and development nature of the advances.

Green Energy

- In late 2015 and early 2016, the Company completed the construction of two pellet plants located at the Chetwynd and Fort St. John sawmill sites, in the Northern British Columbia interior (the "pellet plants") in partnership with Pacific BioEnergy Corporation ("Pacific BioEnergy"). Canfor owns an approximate 95% interest in the pellet plants while Pacific BioEnergy owns the remaining 5% and has an option to increase its ownership interest in the pellet plants up to a total of 15% by January 1, 2018. The Chetwynd pellet plant commenced operations in the fourth quarter of 2015 and the Fort St. John pellet plant began production in early 2016.

Subsequent to year end, on January 2, 2017, Canfor completed the final phase of the purchase of Beadles Lumber Company and Balfour Lumber Company Inc. ("Beadles & Balfour") located in Georgia, increasing its ownership interest to 100%. The first phase of the transaction was completed on January 2, 2015, representing an initial 55% ownership interest. The aggregate purchase price for Beadles & Balfour is US$68.0 million, excluding working capital. Beadles and Balfour operate two sawmills in an area with high quality sustainable fibre supply, with one sawmill focused primarily on one-inch lumber products and the other sawmill producing structural lumber, with combined annual production capacity of 210 million board feet following capital upgrades and additional shifting.

As of December 31, 2016, Canfor employed 6,257 people, of which 1,266 are employed by CPPI.

Lumber

Canfor's lumber operations have a current annual production capacity of approximately 5.9 billion board feet of lumber, including 100% of the capacity of the Beadles & Balfour sawmills, reflecting near-term capital investments and additional operating shifts. The majority of lumber produced by Canfor from its facilities is construction and specialty grade dimension lumber that ranges in size from one by three inches to two by twelve inches and in lengths from six to twenty-six feet. A significant and increasing proportion of Canfor's lumber production is comprised of specialty products that command premium prices, including Square Edge lumber for the North American market, J-grade lumber for the Japanese market, and machine stress rated ("MSR") lumber used in engineered applications such as roof trusses and floor joists. As a result of its recent acquisitions, Canfor has also expanded its product offering to include high-value engineered wood products, higher-grade MSR lumber, as well as premium one-inch boards.

Canfor's lumber operations also include one finger-joint plant, two glulam plants, one whole-log chipping plant and a trucking division. As outlined above, the Company, in partnership with Pacific BioEnergy, operates pellet plants at the Chetwynd and Fort St. John Sawmill sites. Canfor's lumber business segment also includes a 60% interest in the Houston Pellet Limited Partnership, which has an annual capacity of approximately 225,000 tonnes of wood pellets, and a 50% interest in Anthony EACOM Inc., an I-joist producer located in Sault Ste. Marie, Ontario with annual capacity of approximately 54 million lineal feet.

Canfor holds approximately 11.8 million cubic metres of annual harvesting rights for its solid wood operations under various forest tenures located in the interior region of BC and northern Alberta, and harvests logs from those tenures to supply its interior lumber operations. Any shortfalls in mill requirements are made up with wood purchased from other tenure holders in those areas. The wood fibre requirements in the US are met through open market purchases from private timberland owners.

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

Pulp and Paper

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

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

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

All pulp produced by CPPI is sold by CPPI's sales offices in Vancouver, Canada, Tokyo, Japan, and Seoul, South Korea, to customers primarily in North America, Europe and Asia. The significant majority of product sold to North America is shipped by rail, while product sold overseas is transported by container or breakbulk vessels.

Business Strategy

One of Canfor's primary objectives is to be the preferred supplier of wood products to the building industry around the world, with particular focus on North America and Asia. Canfor is focused on increasing its building products business in global markets, including key offshore markets such as China and Japan, and on making higher value structural lumber and specialized products for specific customer needs. The Company is also committed to being a major supplier to the retail segment of the lumber market.

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

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

CPPI is focused on being a pulp and paper industry leader with a particular focus on end-use diversification, innovative sales agreements as well as expanding its strategic relationships.

OVERVIEW OF 2016

North American lumber demand was solid across all segments of the market through 2016, as the US housing market continued its slow but gradual recovery. US housing starts showed a modest improvement in 2016, with many key economic indicators such as employment rates, consumer confidence and US housing prices trending positively through the year, while Canadian housing starts saw a slight improvement compared to 2015. Lumber demand from China continued to increase in 2016, while demand from Japan and other markets was stable. While Russia supplied an increasing share of shipments to China, Canfor continued to see solid demand from China for its higher-value products, which represented an increasing percentage of its shipments to that region in 2016.

Increased lumber consumption resulted in higher average US-dollar benchmark lumber prices through the year. The North American benchmark Western Spruce/Pine/Fir ("SPF") 2x4 #2 & Better grade ("#2&Btr") lumber price was up US$27 per thousand board feet ("Mfbm"), or 10%, compared to 2015, while the Southern Yellow Pine ("SYP") East 2x4 #2 lumber prices was 11% higher on a US-dollar basis over the same period, with more modest increases seen for most-wider dimension SYP products. Lumber unit sales realizations in 2016 also benefitted from a 3 cent, or 4%, weaker Canadian dollar, a higher-value product mix and the absence of export taxes when compared to 2015.

In 2016, the Company continued to build on its solid reputation as a producer and seller of high-margin lumber products to global markets, supported by its most recent acquisition of Wynndel in April of 2016. Combined with the Company's recent acquisitions in the US South, these sawmills have expanded Canfor's lumber capacity by close to 1.0 billion board feet after near-term capital investments and additional shifting. As highlighted earlier, these acquisitions also expand the Company's overall product offering, provide access to new markets and increase exposure to higher-margin value-added products.

In 2016, the Company saw a solid improvement in productivity, reflecting the positive impact of capital upgrades and improved operational performance. Lumber production, excluding the impact of the previously announced closure of the Canal Flats sawmill in November of 2015 as well as the benefit from the recent acquisitions, showed slight gains compared to 2015. Capital spending in 2016 included upgrades at the Polar sawmill in British Columbia and Fulton sawmill in Alabama.

The Company's British Columbia lumber operations continued to experience log cost pressures in 2016, reflecting market-driven increases in purchased wood costs and stumpage, as well as a continued shift out of the Mountain Pine Beetle dominated log profile over the past several years, which has resulted in increases to logging and hauling and additional costs for road building and block development. Unfavourable weather conditions towards the end of 2016, which impacted log deliveries in Western Canada, also contributed to higher unit log costs in 2016. These increases were partly offset by disciplined cost management and lower diesel costs, which resulted in a modest year-over-year increase. Unit log costs for Canfor's operations in the US South region were stable, reflecting significant volumes of high-quality fibre in close proximity to its sawmills and resulting muted pressure on log costs.

Overall operating results for the lumber segment were well up in 2016 compared to 2015, reflecting improved unit sales realizations, increased productivity, and stable log costs in the US South, which more than offset modestly higher unit log costs in Western Canada.

Global pulp demand was relatively stable in 2016 while global inventory levels were on the high end of the balanced range, reflecting slowly increasing pulp capacity through 2016. NBSK pulp list prices to China averaged US$599 per tonne for the year, $45 per tonne lower than in 2015. BCTMP markets remained under significant pressure through the first half of 2016, but a price recovery in the third and fourth quarters of 2016 resulted in US-dollar prices being broadly in line with the previous year. The 4% weaker Canadian dollar offset part of the impact from the lower NBSK pulp US-dollar prices and to a lesser extent, higher NBSK pulp shipments in 2016 to lower-margin regions.

Operating results for the pulp and paper segment were lower than the previous year, mostly due to the aforementioned lower NBSK pulp unit sales realizations, and to a lesser extent, logistics challenges that impacted shipments around year end. Excluding weather-related disruptions, productivity was in line with the prior year, while fibre costs showed a small improvement, primarily due to lower prices for delivered sawmill residual chips and a lower proportion of higher-cost whole log chips. The favourable BCTMP pricing in the third and fourth quarters of 2016, combined with the weaker Canadian dollar, enabled the Taylor pulp mill to deliver improved operating results in 2016 compared to 2015.

CPPI's energy business and power generation continued to grow in 2016 with the turbines at all three NBSK pulp mills now operating and selling power. The last of these at the Intercontinental Pulp mill was completed in early 2015 and started selling power in April 2015. With all three turbines operating, CPPI is projecting further incremental benefits of these green energy projects into 2017.

CPPI's paper business performed well in 2016, continuing on from its strong operating performance in the prior year, as lower slush pulp costs more than offset a slight decrease in paper unit sales realizations. Reduced costs for slush pulp reflected lower global softwood pulp prices, while a moderate decrease in US-dollar kraft paper prices more than offset the favourable movement of the Canadian dollar.

Total consolidated operating income was $306.1 million, up $164.5 million from operating income of $141.6 million in 2015, as improved results in the lumber segment were offset by the lower operating earnings in the pulp and paper segment. The Company recorded a consolidated return on invested capital of 9.5% in 2016, up 7.2% from 2015, reflecting the higher lumber segment earnings.

The Company continued to preserve its strong financial position in 2016, applying a disciplined approach to cash allocation for internal investment and growth, and working capital management. The Company's focus on the latter resulted in significantly lower finished lumber and pulp inventory levels through the year, with supply chain management resulting in record on-time shipments in 2016. The Company ended the year with cash and cash equivalents of $156.6 million, consolidated net debt of $319.4 million and a net debt to capitalization ratio of 15.5%, a decrease of 8.6% compared to the prior year. The Company also purchased $216.1 million of annuities through its defined benefit pension plans in 2016 in order to mitigate its exposure to future volatility fluctuations in related pension obligations. Given the Company's focus on targeted capital spending and debt reduction, there were no shares repurchased in 2016. CPPI was active in repurchasing shares through 2016, purchasing approximately 2.2

million common shares from non-controlling shareholders under its Normal Course Issuer Bid for $24.4 million, which increased Canfor's ownership of CPPI from 51.9% at December 31, 2015 to 53.6% at December 31, 2016.

A review of the more significant developments in 2016 follows.

Markets and Pricing

(i) Solid Wood – North American housing recovery continues; increasing demand across all sectors

North American lumber demand improved across all segments of the market through 2016 as the US housing market continued its ongoing slow but gradual recovery coupled with continued strength in the repair and remodeling sector. The Canadian housing market recorded another solid year in 2016, while offshore lumber demand for Canfor's products increased, with steady shipment volumes to China and Japan, particularly for the Company's higher-value lumber products. Increased lumber consumption resulted in higher average US-dollar benchmark lumber prices through the year. The North American benchmark Western SPF 2x4 #2&Btr lumber price was up US$27 per Mfbm[1], or 10%, compared to 2015. The following table shows benchmark Random Lengths prices for selected key grades and widths of Western SPF lumber:

(Average Western SPF US$ price, per thousand board feet) [1]	**2016**	2015
2x4 #2&Btr	**$ 305**	$ 278
2x4 #3	**$ 240**	$ 209
2x6 #2&Btr	**$ 285**	$ 280
2x10 #2&Btr	**$ 322**	$ 329

The Random Length SYP East 2x4 #2 price was up US$43 per Mfbm, or 11%, compared to 2015, with slightly lower gains seen for wider dimension SYP products, as highlighted in the following table:

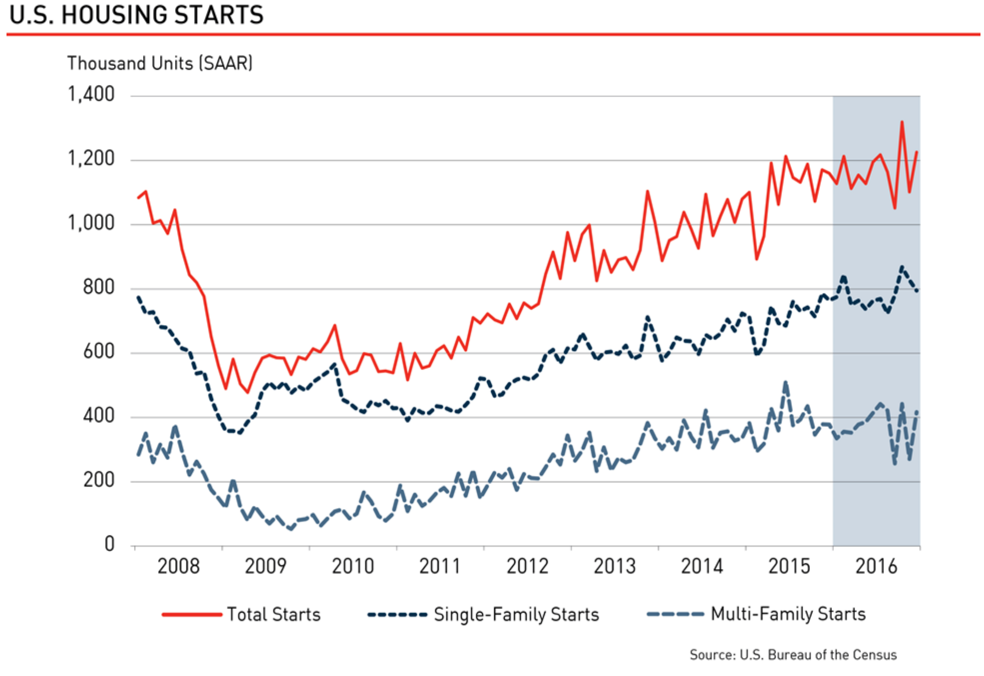
(Average SYP East US$ price, per thousand board feet) [1]	**2016**	2015
2x4 #2	**$ 425**	$ 382
2x6 #2	**$ 343**	$ 317
2x8 #2	**$ 337**	$ 298
2x10 #2	**$ 369**	$ 338
2x12 #2	**$ 467**	$ 444

US housing starts averaged 1,168,000 units[2] in 2016, an increase of 5% from 2015, and the highest annual average since 2007 (Chart 1). Single-family unit starts, which consume a higher proportion of lumber, were up 10% in 2016 while multi-family unit starts were slightly lower than 2015.

[1] Random Lengths Publications, Inc.

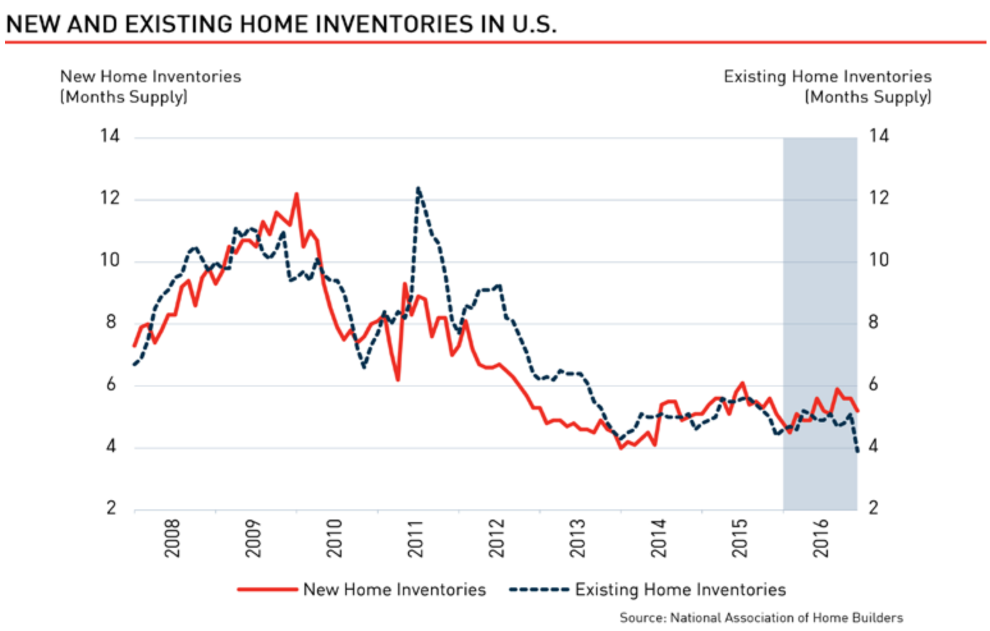
[2] Source: US Bureau of the Census

Chart 1



New home inventory levels show a modest upward trend through 2016, while existing home inventory levels decreased towards the end of the year as highlighted in Chart 2 below.

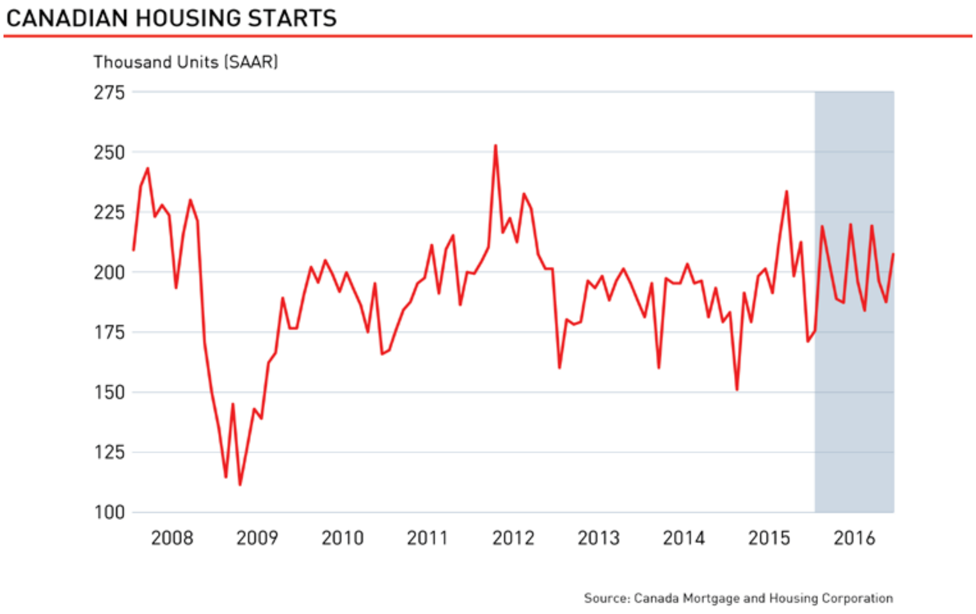
Chart 2



The Canadian housing market remained solid through 2016, with housing starts at 199,000 units[3] in 2016, slightly higher than 2015 (Chart 3), for the most part reflecting a stable housing market in most regions through the year.

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

Chart 3

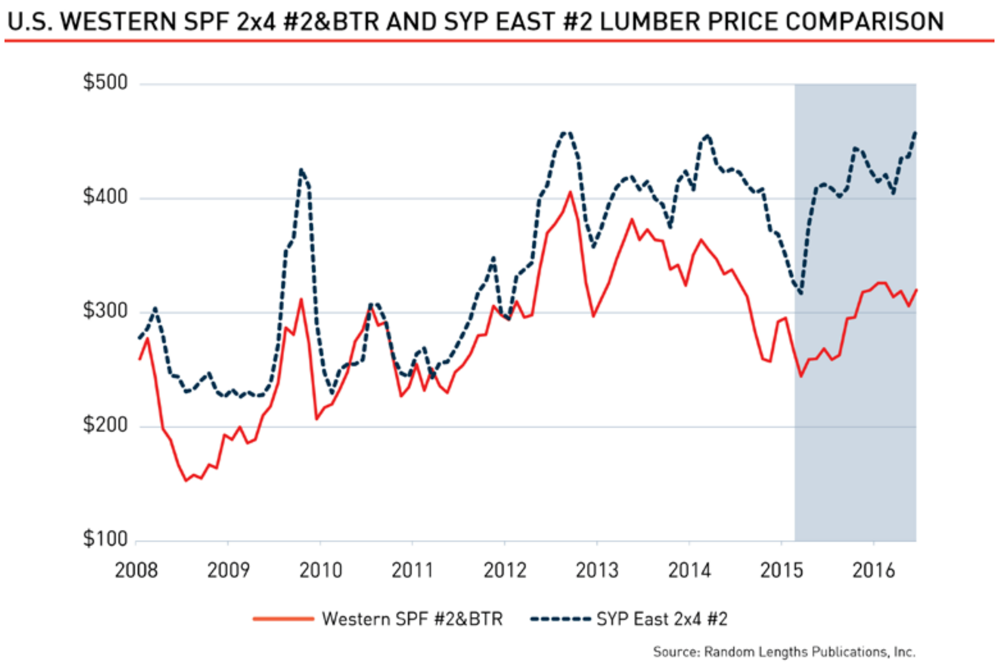


Canfor's lumber shipments to offshore markets were broadly in line with the prior year, with steady shipments to key offshore lumber markets, including China and Japan. As previously mentioned, offshore demand for the Company's higher-value lumber products improved in 2016, particularly in the second half of the year.

The change in the Company's geographical sales mix over the past nine years shows a shift to a more globally balanced distribution of sales in support of strategic growth objectives. The Company's recent growth in the US South has resulted in Canfor increasing its sales exposure to the US market. Notwithstanding strong US lumber demand in 2016 and the growth of the Company's US South lumber business in recent years, the Company's exposure to the US remained well below where it was in 2007, with Western SPF lumber sales to North America in 2016 down approximately 20% as a result of the Company's development of new markets for its lumber products, particularly in China.

As previously mentioned, prices for Western SPF and SYP products trended up during 2016 reflecting increased lumber consumption and solid demand, with a historically high spread between the prices of SYP East 2x4 #2 and Western SPF 2x4 #2&Btr lumber products (see Chart 4). More modest gains were seen in most-wider dimension SYP products.

Chart 4



The Canadian dollar continued to weaken against the US-dollar in 2016. On average the Canadian dollar was at $0.755[4] per US-dollar, 3 cents, or 4%, lower than in 2015, boosting unit sales realizations for all Canadian-produced exports.

(ii) Pulp – Global market supply pressures contribute to weaker price environment in 2016 despite favourable currency movements

Global softwood pulp markets saw moderate downward pressure on average NBSK pulp list prices to China throughout 2016, despite a slight rebound in prices in the second quarter of 2016. While overall global pulp demand was steady, additional hardwood pulp capacity was absorbed into global markets, particularly China, during the year. Global shipments of bleached softwood kraft pulp were up slightly in 2016 compared to 2015, primarily to China, where shipment levels were well above trend. Globally, softwood pulp producer inventories increased in the first quarter of 2016 with limited industry maintenance downtime, then fell through the spring maintenance period in the second quarter of 2016. Thereafter, inventories remained at, or slightly above, the high end of the balanced range through the second half of 2016.

The benchmark China NBSK pulp list price averaged US$599 per tonne[5] in 2016, down US$45 per tonne, or 7%, from the prior year. This was offset in part by a 4% weaker Canadian dollar, resulting in an overall decline in NBSK pulp sales realizations in Canadian dollar terms.

The following charts show the NBSK pulp list price movements in 2016 before taking account of customer discounts and rebates (Chart 5) and the global pulp inventory levels (Chart 6).

[4] Bank of Canada

[5] Resource Information Systems, Inc.

Chart 5

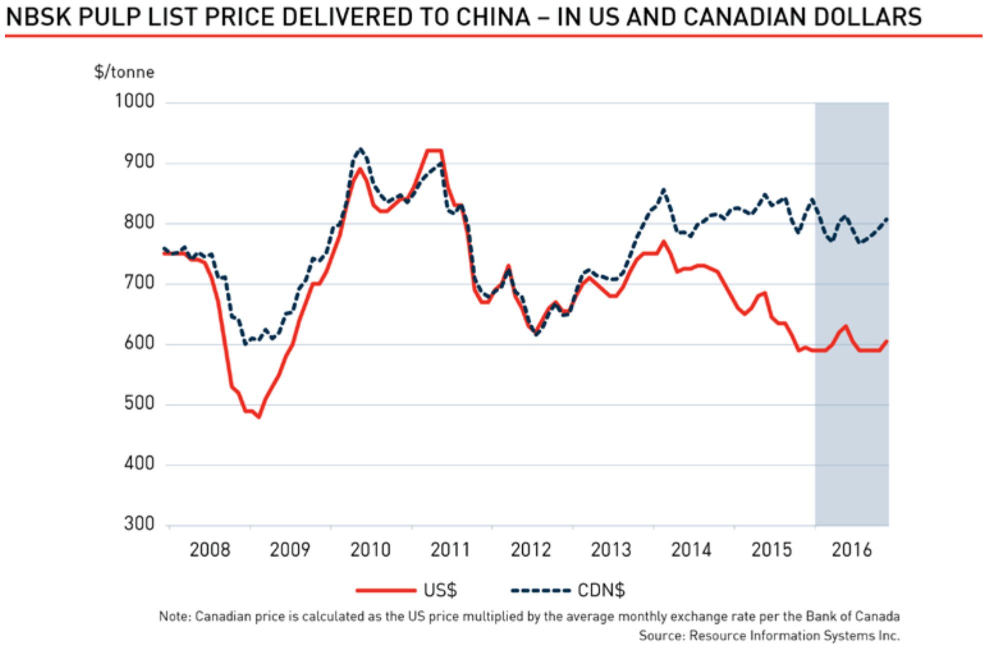
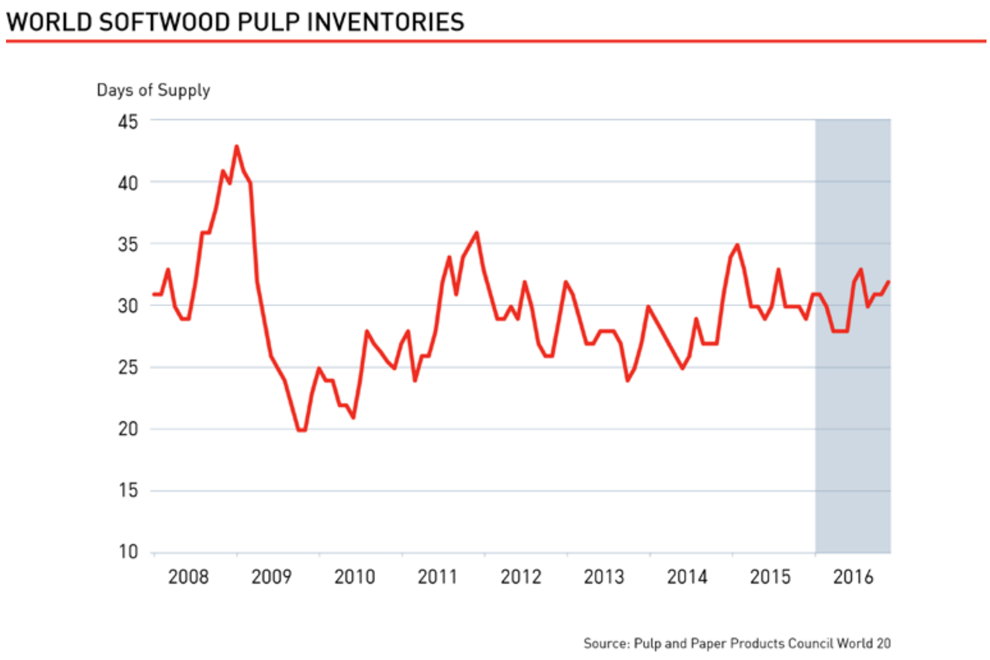


Chart 6



Since the beginning of 2014, CPPI's sales network has represented and co-marketed UPM-Kymmene ("UPM") pulp products in North America and Japan, while UPM's pulp sales network represented and co-marketed CPPI's products in Europe and China, as part of a strategic sales and marketing cooperation agreement with UPM. This arrangement has been working very well for both parties, allowing both CPPI and UPM to sell a broader offering of pulp products and offering enhanced technical service to customers.

Solid Wood Operations

(i) Company well positioned reflecting continued expansion and strategic capital spending in recent years

The Company's confidence in the longer-term prospects of the lumber industry has driven an investment strategy aimed at positioning itself as a top-quartile margin performer in the industry during the lumber market recovery. In support of this objective, the Company has completed several targeted strategic capital initiatives at its sawmills in the last six years, all aimed at enhancing the quality and value offering of products to its customers from a top-tier productivity and cost position. These strategic capital investments are designed to capitalize on the Company's strong fibre position in the BC Interior and the US South. In 2016, the Company completed several major upgrades, most notably at its Polar sawmill in British Columbia, and Fulton sawmill in Alabama, while productivity and the percentage of high-value products produced showed a solid improvement in 2016 compared to the previous year.

In addition to its strategic capital initiatives, the Company has acquired a number of operations in recent years, increasing Canfor's market share of value-added products, as highlighted by the acquisition of Wynndel and a number of operations located in the US South, including Scotch Gulf, Beadles & Balfour, Southern Lumber Company ("Southern") and Anthony Forest Products Company ("Anthony"). Wynndel, located in British Columbia, produces premium boards and customized specialty wood products, and has access to exceptionally high-quality fibre. Scotch Gulf includes three sawmills located in Alabama which produce primarily structural grade lumber. Beadles & Balfour includes two sawmills located in Georgia with one sawmill focused primarily on 1 inch lumber products and the other sawmill producing structural grade lumber. Southern owns a single sawmill in Mississippi that produces high-margin lumber in lengths up to 26 feet. Anthony operates four facilities including a sawmill and laminating plant in Arkansas, a laminating plant in Georgia and an I-joist plant through a joint venture in Sault Ste. Marie, Ontario. All of these sawmills are located in areas of high-quality fibre supply and, with near-term capital investments and shifting additions, will contribute approximately 970 million board feet of production capacity. The acquisitions of Scotch Gulf, Beadles & Balfour, Southern and Anthony increase Canfor's Southern Pine capacity to just over 1.6 billion board feet, or 27% of total lumber capacity. The Company's current US South lumber capacity represents an approximate three-fold increase since 2010.

Integration remains a key focus area for Canfor, supported by the implementation of its sales, transportation, supply chain and inventory management enterprise resource planning ("ERP") software system, which in 2014 was implemented across the Company's Canadian operations. In 2015, Canfor implemented its US South ERP platform in the Carolina's with the remaining, and recently acquired, US South lumber operations scheduled to come online in the first quarter of 2017. Excluding acquisitions, capital spending in the lumber segment for 2016 totaled $161.0 million and included costs related to major upgrades at the Company's Polar sawmill in British Columbia and Fulton sawmill in Alabama, a kiln replacement project at the Houston sawmill, final payments in connection of the construction of the pellet plants in Chetwynd and Fort St. John as well as various smaller high-returning capital projects at the Company's US South lumber operations.

(ii) Maximizing margins through strong focus on value added products and competitive cost structure in the face of log cost pressure in British Columbia

In order to achieve top-quartile margin performance, and maximize profitability, the Company continues to focus on the key areas of maximizing product quality and value, tightly controlling unit manufacturing costs and maximizing residual fibre revenues.

a. Product quality / value

Product quality and value are key parts of the Company's focus, with a view to ensuring that valued customers are provided with high quality products and service. Numerous initiatives have been undertaken to ensure continuous improvements in this area, including acquisitions of high-value operations across the US South and British Columbia, capital projects, which are resulting in a higher proportion of higher-value lumber products, and transitioning to harvesting non-Mountain Pine Beetle fibre for use in the BC Interior sawmills.

The Company also has in place, or takes part in, various initiatives designed to promote the benefits of the use of lumber products by developers and end users. This includes initiatives to promote the environmental benefits of using lumber, and also North American industry-wide programs, such as the Softwood Lumber Board, to promote wood as a building product.

b. Unit manufacturing costs

The Company remains focused on ensuring strong operational performance at all of its operations, with continuous improvement initiatives complementing and maximizing the benefits from capital upgrades. Compared to the prior year, unit cash conversion costs increased slightly as productivity improvements following several capital upgrades and shift configuration changes were offset in part by costs associated with the high-value products manufactured at the recent acquisitions. Excluding the recently acquired operations, unit cash conversion costs were broadly in line with the prior year reflecting the Company's emphasis on maintaining a competitive cost structure.

Increased upward pressures on non-quota timber and a continued shift out of the Mountain Pine Beetle dominated log profile over the past several years has resulted in increases to logging, hauling and purchased wood costs in BC operations. Added costs for road building and block development in 2016 have also resulted from this fibre profile shift. Despite modest log cost increases in British Columbia, greener fibre has supported the Company's value-added focus and enabled the Company to maximize margins in light of inflationary cost pressures. In contrast, the Company's US operations' log costs were broadly in line with the prior year, reflecting a strong supply of high-quality fibre in close proximity to its sawmills.

c. Residual fibre revenue

Residual fibre revenue for the Company relates principally to the sale of sawmill residual chips to be used in the manufacture of pulp products. Prices for sawmill residual chips are typically based on a pricing formula with a number of inputs, predominantly driven by market prices for pulp products. Total residual fibre revenue for 2016 was up from the prior year largely reflecting the recent acquisitions, offset in part by the closure of the Canal Flats Sawmill in 2015 and modestly lower pulp unit sales realizations in the current year.

In addition, the Company continued to focus on extracting maximum value from its other residual fibre sources in 2016, generating relatively stable revenues from the sale of sawdust, shavings and bark. Pellet sales revenues showed significant increases as the Fort St. John and Chetwynd pellet plants continued through their respective ramp ups through 2016. The pellet plants have enhanced the utilization of Canfor's sawmill residual fibre in northern BC and will provide stable long-term cash flow while contributing to the Company's sustainable value proposition.

In addition, as part of its strategic capital investment focus, the Company now has modern energy systems at the significant majority of its sawmills that make use of other residual fibre products, such as bark hog, which have resulted in lower energy costs and reduced dependence on fossil fuels.

The Company continues to build on the successful integration of Canfor and CPPI leadership teams and key business areas that commenced in 2012. Both companies continue to recognize sustainable benefits from further integration and alignment, specifically in the areas of residual fibre management.

(iii) Softwood Lumber Agreement

On October 12, 2015, the Softwood Lumber Agreement ("SLA") expired which resulted in a twelve month period in which no trade actions could be imposed for the importation of softwood lumber from Canada to the US (commonly referred to as a "stand-still period"). Under the previous SLA implemented by the federal governments of Canada and the US in 2006, Canadian softwood lumber exporters paid an export tax on lumber shipped to the US when the price of lumber was at or below US$355 per Mfbm, as determined by the Random Lengths Framing Lumber Composite Price. When the price was at or below US$355 per Mfbm, the export tax rate ranged between 5% and 15%.

On October 12, 2016 the stand-still period expired, and on November 25, 2016 a petition was filed by the US Lumber Coalition to the US Department of Commerce and the US International Trade Commission ("ITC") alleging certain subsidies and administered fees below the fair market value of timber that favour Canadian lumber producers. On January 6, 2017, the ITC ruled that there is a reasonable indication that US lumber producers are materially injured by reason of imports of softwood lumber products from Canada that are allegedly subsidized and sold in the United States at less than fair value. As a result, the US Department of Commerce will continue to conduct its antidumping and countervailing duty investigations on imports of these products from Canada, and is expected to announce its countervailing duty in the second quarter of 2017 and its preliminary antidumping duty determination approximately 60 days thereafter. Canfor continues to cooperate with the Provincial and Federal Governments of Canada who have indicated they will vigorously defend the interests of Canadian workers and producers. Further discussion of the SLA agreement may be found under "Softwood Lumber Agreement" in the "Risks and Uncertainties" section of this document.

(iv) Secure long term fibre supply as impacts of Mountain Pine Beetle ("MPB") run their course

For more than a decade, the Mountain Pine Beetle epidemic has been the primary focus for the majority of the Company's Western Canadian operations. The infestation has largely run its course with estimates indicating that pine mortality has peaked at approximately 55%. Northern Alberta and the Peace area are still experiencing MPB activity and the Company anticipates this trend will continue for the next 2 to 4 years. In the most heavily attacked areas in British Columbia, salvage harvesting continues but harvesting efforts are increasingly shifting from dead pine leading stands into green mixed species stands and will continue until any remaining viable dead stands are harvested. The MPB shelf life assumption of 15 years since time of attack has been a reliably predictive indicator of the economic viability of MPB stands, and in those areas where the shelf life has been reached (i.e. Morice, Lakes and Prince George Timber Supply Areas), the Company is increasingly shifting harvesting operations away from these now unviable stands into greener mixed species stands.

Recent forecasts have predicted that annual allowable harvest rates in the Interior regions of BC could be reduced by more than 30% from current levels. Some annual allowable cut ("AAC") reductions have already occurred, such as for the Kamloops (43%), Williams Lake (48%), Merritt (38%) and Lakes (18%) Timber Supply Areas ("TSA"). Additionally, Timber Supply Review ("TSR") processes are being completed in other areas and it is expected that further harvest reductions will occur in the Prince George and Quesnel TSA. In response to more recent MPB activity however, some management units have seen increases in the annual allowable harvest rates. This includes Tree Farm License 30 in the Prince George region (25% increase), Mackenzie TSA (48% increase for 10 years) and Tree Farm License 48 in the Chetwynd area (72% increase for 5 years). Some Northern Alberta harvest rates have been temporarily increased to deal with the rising MPB infestation and additional temporary increases could be made for the same reason in other areas of the province.

In anticipation of these impacts, the Company has taken a number of steps to ensure the viability and competitiveness of its operations. These include the acquisition of the Kootenay area tenure and sawmill operations purchased in 2012, the exchange of timber harvest rights with West Fraser Timber in 2013 and associated permanent closure of its Quesnel sawmill as a result of limited timber availability in the region following the MPB infestation, and an additional forest license acquired in the Kootenay region of BC in 2015. Also in 2016, the Company exercised an option as part of a timber investment loan to acquire a forest license in the Prince George TSA. In 2011 and 2012, the Company closed, or announced the closing of, three of its operations in response to the continued difficult market conditions for solid wood products, and fibre supply challenges relating to the MPB impact.

In British Columbia, the Company has been actively engaged with many First Nations to build and strengthen business relationships to provide the Company with an increased level of fibre security. As a result of these initiatives, the Company has reduced its fibre risk exposure in areas most heavily impacted by the MPB, and the remaining operations are forecast to have sufficient fibre supply through the transition to near-term lower provincial harvest levels. In Alberta, the Provincial Government has implemented short-term actions and a long-term strategy to mitigate the risks associated with the MPB. Included in these are comprehensive detection surveys and removal of individual trees from newly infested stands, as well as a collaborative approach by government and the forest industry to harvest up to 75% of the susceptible pine in Alberta by 2026. The latter has resulted in a 12% increase in the AAC of the Company's Forest Management Agreement ("FMA") area for a 15 year period. Additionally, the Province of Alberta approved a 103% AAC increase for the Company's quota area in northern Alberta which will enable a shift of a significant portion of the harvest for the Grande Prairie Sawmill into the northern area where the MPB infestation has been most severe. This shift, which is forecast to last for 5 years, will result in slightly higher log transportation costs but will mitigate potential impacts to long-term timber supply and ensure the timber is harvested before the quality deteriorates significantly.

Pulp and Paper Operations

Total pulp production in 2016 was broadly in line with 2015, as a modest improvement in BCTMP productivity through most of the year offset the impact to all pulp operations in late 2016 from inclement weather conditions in British Columbia. Kraft paper production in 2016 was also broadly in line with 2015, reflecting a slight increase in productivity offset by additional scheduled maintenance days in 2016. Scheduled maintenance outages were completed on time at all facilities in 2016.

The pulp and paper segment experienced its first full year of generating power at all three of its NBSK pulp mills, after the Intercontinental pulp mill turbine started selling power in April 2015 and following the ramp-up of the Northwood pulp mill turbines. As a result of these green energy projects, CPPI's energy business saw a modest increase in power generation in 2016, which was offset by weather-related operational challenges, particularly in the fourth quarter. The Company is projecting further incremental benefits of these green energy projects into 2017.

OVERVIEW OF CONSOLIDATED RESULTS – 2016 COMPARED TO 2015

Selected Financial Information and Statistics

(millions of Canadian dollars, except for per share amounts)		2016		2015
Sales	**$**	**4,234.9**	$	3,925.3
Operating income before amortization	**$**	**548.4**	$	355.6
Operating income	**$**	**306.1**	$	141.6
Foreign exchange gain (loss) on long-term debt	**$**	**4.1**	$	(5.9)
Gain (loss) on derivative financial instruments[6]	**$**	**2.9**	$	(28.1)
Net income	**$**	**203.9**	$	91.9
Net income attributable to equity shareholders of Company	**$**	**150.9**	$	24.7
Net income per share attributable to equity shareholders of Company, basic and diluted	**$**	**1.14**	$	0.18
ROIC – Consolidated[7]		**9.5%**		2.3%
Average exchange rate (US$/CDN$)[8]	**$**	**0.755**	$	0.783

[6] Includes gains (losses) from energy, foreign exchange, lumber and interest rate derivatives (see "Unallocated and Other Items" section for more details).
[7] Consolidated Return on Invested Capital ("ROIC") is equal to operating income/loss, plus realized gains/losses on derivatives, equity income/loss from joint venture and other income/expense, all net of minority interest, divided by the average invested capital during the year. Invested capital is equal to capital assets, plus long-term investments and net non-cash working capital, all excluding minority interest components.
[8] Source – Bank of Canada (average noon rate for the period).

(millions of Canadian dollars)		2016		2015
Operating income (loss) by segment:				
Lumber	**$**	**237.4**	$	30.2
Pulp and Paper	**$**	**98.2**	$	144.8
Unallocated and Other	**$**	**(29.5)**	$	(33.4)
Total operating income	**$**	**306.1**	$	141.6
Add: Amortization	**$**	**242.3**	$	214.0
Total operating income before amortization[9]	**$**	**548.4**	$	355.6
Add (deduct):				
Working capital movements	**$**	**101.0**	$	(66.3)
Defined benefit plan contributions	**$**	**(33.3)**	$	(5.9)
Income taxes paid, net	**$**	**(29.9)**	$	(61.3)
Other operating cash flows, net[10]	**$**	**(2.4)**	$	32.5
Cash from operating activities	**$**	**583.8**	$	254.6
Add (deduct):				
Finance expenses paid	**$**	**(22.0)**	$	(12.7)
Acquisitions of non-controlling interests	**$**	**(24.7)**	$	(25.3)
Distributions paid to non-controlling interests	**$**	**(28.5)**	$	(56.8)
Additions to property, plant and equipment, timber and intangible assets, net	**$**	**(233.8)**	$	(240.0)
Acquisitions	**$**	**(83.9)**	$	(263.4)
Advance to Licella	**$**	**(7.0)**	$	-
Proceeds from long-term debt	**$**	**-**	$	388.4
Repayment of long-term debt	**$**	**-**	$	(175.0)
Timber investment loan	**$**	**-**	$	(30.0)
Share purchases	**$**	**-**	$	(59.2)
Change in restricted cash[11]	**$**	**-**	$	50.2
Proceeds from sale of Lakeland Winton	**$**	**-**	$	15.0
Foreign exchange gain (loss) on cash and cash equivalents	**$**	**(1.7)**	$	13.2
Other, net	**$**	**6.9**	$	(9.8)
Change in cash / operating loans	**$**	**189.1**	$	(150.8)

[9] Amortization includes certain capitalized major maintenance costs.
[10] Further information on operating cash flows can be found in the Company's annual consolidated financial statements.
[11] Change in restricted cash relates to amounts transferred into an escrow bank account for the first phase of the Beadles & Balfour acquisition which closed on January 2, 2015.

Analysis of Specific Items Affecting Comparability of Shareholder Net Income

After-tax impact, net of non-controlling interests

(millions of Canadian dollars, except for per share amounts)		2016		2015
Shareholder Net Income, as reported	**$**	**150.9**	$	24.7
Gain on legal settlement[12]	**$**	**(6.9)**	$	-
Foreign exchange (gain) loss on long-term debt	**$**	**(3.6)**	$	5.1
(Gain) loss on derivative financial instruments	**$**	**(2.1)**	$	17.6
Mill closure provisions (recovery)[13]	**$**	**(1.5)**	$	14.4
Pension plan legislative changes	**$**	**-**	$	2.4
Mark-to-market adjustment on Taylor pulp contingent consideration, net[14]	**$**	**-**	$	0.7
Gain on investment in Lakeland Mills Ltd. and Winton Global Lumber Ltd. [15]	**$**	**-**	$	(6.1)
Net impact of above items	**$**	**(14.1)**	$	34.1
Adjusted shareholder net income	**$**	**136.8**	$	58.8
Shareholder net income per share (EPS), as reported	**$**	**1.14**	$	0.18
Net impact of above items per share		**(0.11)**		0.25
Adjusted shareholder net income per share	**$**	**1.03**	$	0.43

[12]Gain relates to a $16.3 million settlement of a legal claim with respect to logistics services, net of a $0.8 million impairment of related machinery and equipment and minority interest.
[13]In 2015, Canfor recorded one-time costs of $19.4 million (before tax) associated with the announced closure of the Canal Flats sawmill. A portion of the provision relating to the Canal Flats sawmill in the amount of $2.0 million was reversed in 2016, reflecting lower than estimated demolition costs.
[14] As part of the sale of the BCTMP Taylor pulp mill to CPPI on January 30, 2015, Canfor could receive contingent consideration based on the Taylor pulp mill's future earnings over a three year period. On the acquisition date, the contingent consideration was valued at $1.8 million (before-tax) and Canfor recorded an asset and CPPI recorded an offsetting liability for this amount. During the second quarter of 2015, the contingent consideration asset and liability were revalued to nil. The adjustment above reflects the impact to Canfor EPS net of non-controlling interest.
[15] On July 1, 2015, Canfor sold its 33.3% interest in Lakeland Mills Ltd. and Winton Global Lumber Ltd. for $30.0 million and recorded a $7.0 million gain before tax.

The Company recorded net income attributable to equity shareholders of $150.9 million, or $1.14 per share, for the year ended December 31, 2016, an increase of $126.2 million, or $0.96 per share, from $24.7 million, or $0.18 per share, reported for the year ended December 31, 2015. After taking account of specific items affecting comparability with prior periods, the Company's 2016 adjusted shareholder net income was $136.8 million, or $1.03 per share, up $78.0 million, or $0.60 per share, compared to similarly adjusted shareholder net income of $58.8 million, or $0.43 per share, for 2015.

Reported operating income for 2016 was $306.1 million, up $164.5 million from operating income of $141.6 million for 2015. Included in operating income in 2016 were one-time pre-tax gains of $17.5 million, while 2015 operating income included one-time pre-tax expenses of $22.6 million. Excluding these items, operating income was up $124.4 million from 2015, as much improved results in the lumber segment more than offset a decline in operating earnings for the pulp and paper segment.

A more detailed review of the Company's operational performance and results is provided in the "Operating Results by Business Segment – 2016 compared to 2015" section, which follows this overview of consolidated results.

OPERATING RESULTS BY BUSINESS SEGMENT – 2016 COMPARED TO 2015

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

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

Lumber

Selected Financial Information and Statistics – Lumber

Summarized results for the Lumber segment for 2016 and 2015 are as follows:

(millions of Canadian dollars, unless otherwise noted)		2016		2015
Sales	$	3,133.2	$	2,740.1
Operating income before amortization	$	401.8	$	174.3
Operating income	$	237.4	$	30.2
Gain on legal settlement, net	$	(15.5)	$	-
Mill closure provisions (recovery)	$	(2.0)	$	19.4
One-time costs associated with pension legislative changes	$	-	$	3.2
Adjusted operating income	$	219.9	$	52.8
Capital expenditures	$	161.0	$	161.7
Average SPF 2x4 #2&Btr lumber price in US$[16]	$	305	$	278
Average SPF price in Cdn$	$	404	$	356
Average SYP 2x4 #2 lumber price in US$[17]	$	425	$	382
US housing starts (thousand units SAAR) [18]		1,168		1,108
Production – SPF lumber (MMfbm)[19]		3,786.8		3,829.6
Production – SYP lumber (MMfbm)[19]		1,335.6		1,161.9
Shipments – SPF lumber (MMfbm)[20]		3,932.0		4,016.1
Shipments – SYP lumber (MMfbm)[20]		1,377.4		1,196.6

[16] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.).
[17] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.).
[18] Source – US Census Bureau, seasonally adjusted annual rate ("SAAR").
[19] Excluding production of trim blocks.
[20] Canfor-produced lumber, including lumber purchased for remanufacture and excluding trim blocks, excludes shipments of wholesale lumber.

Overview

The lumber segment reported operating income of $237.4 million for 2016, up $207.2 million from operating income of $30.2 million for 2015. Excluding the impact of the aforementioned one-time items, operating income was $219.9 million in 2016, up $167.1 million compared to adjusted operating income of $52.8 million in 2015.

The increase in adjusted operating income for the lumber segment was largely attributable to higher lumber unit sales realizations, reflecting the combination of higher Western SPF and SYP benchmark lumber prices, a 3 cent, or 4%, weaker Canadian dollar and the absence of export taxes in 2016. In addition, lumber segment earnings benefitted from the high-value product mix of the recent acquisitions of Wynndel on April 15, 2016, and Anthony on October 30, 2015. These factors were partially offset by modest log cost increases in Western Canada largely reflecting increased purchased wood costs, market stumpage and haul costs as well as challenging weather conditions later in the year, partly offset by disciplined cost management and lower diesel costs. Total lumber shipments and production were slightly higher than the prior year as increased productivity following several capital upgrades and the incremental contribution from the recent acquisitions was offset in part by the closure of the Canal Flats sawmill in November of 2015, and additional shifts in the prior year.

Markets

North American lumber demand improved across all segments of the market through 2016 as the US housing market continued its slow but gradual recovery. US housing starts averaged 1,168,000 units in 2016, an increase of 5% from 2015, and the highest annual average since 2007. Canadian housing starts were slightly higher than 2015, at an average of 199,000 units on a seasonally adjusted basis. Offshore lumber demand was stable through 2016, with steady shipment volumes to China and Japan, reflecting an increased proportion of the Company's higher-value lumber products.

Increased lumber consumption resulted in higher average US-dollar benchmark lumber prices through 2016. The North American benchmark Western SPF 2x4 #2&Btr lumber price was up US$27 per Mfbm, or 10%, compared to 2015 while Southern Yellow Pine lumber prices moved significantly higher on a US-dollar basis over the same period, as evidenced by a US$43 per Mfbm, or 11%, increase in the SYP East 2x4 #2 price.

Sales

Lumber segment revenues of approximately $3.1 billion for 2016 were up 14% compared to 2015, largely reflecting increased lumber unit sales realizations, the incremental contribution from the recent acquisitions, and to a lesser extent, higher pellet revenue reflecting the ramp-up of the Chetwynd and Fort St. John pellet plants through 2016.

Total lumber shipments were approximately 5.3 billion board feet for the year, up 2% from 5.2 billion board feet shipped in the previous year. Excluding the benefit of the recent acquisitions and impact of the closure of the Canal Flats sawmill in 2015, lumber shipments were in line with the prior year.

Western SPF lumber unit sales realizations showed a solid improvement compared to the prior year as a result of the aforementioned higher average benchmark lumber prices, weaker Canadian dollar, and the absence of export taxes in the current year. A focus on high-value products and a continued gradual shift to greener fibre resulted in the Company producing a lower proportion of low grade products in 2016. Offshore sales realizations were broadly in line with 2015 reflecting a period of weaker prices in the first part of the year, offset by the benefit of the weaker Canadian dollar and a higher-value sales mix in China. Prices to China showed a gradual improvement in the back half of 2016, while prices to Japan were stable through most of the year.

Total residual fibre revenue for 2016 was up from the prior year largely reflecting the Company's recent acquisitions, offset in part by the closure of the Canal Flats Sawmill and modestly lower pulp unit sales realizations. Increased pellet sales revenues reflected the ramp ups through 2016 of the Fort St. John and Chetwynd pellet plants.

Operations

Total lumber production for 2016 was 5.1 billion board feet, up 3%, from 2015. Excluding the impact of the Canal Flats sawmill as well as the benefit from the recent acquisitions, lumber production showed slight gains compared to 2015, as a solid improvement in productivity following several major capital upgrades in recent years was offset in part by additional shifts in the prior year.

Lumber unit manufacturing costs in 2016 compared to 2015 reflected a modest increase in unit log costs in Western Canada reflecting the aforementioned market-driven increases in purchased wood costs and stumpage, and the gradual shift out of the Mountain Pine Beetle dominated log profile over the past several years which has resulted in increases to logging and hauling, as well as additional costs for road building and block development. Also contributing to higher unit log costs in 2016 were unfavourable weather conditions towards the end of the year which materially impacted log deliveries in Western Canada, offset in part by disciplined cost management and lower diesel costs in 2016. Unit log costs in the US South were broadly in line with the prior year, with logs continuing to be in ample supply. Unit cash conversion costs, after taking account of costs associated with the high-value products manufactured at the recent acquisitions, were broadly in line with 2015, with productivity improvements following several capital upgrades and shift configuration changes offsetting the impact of capital related downtime and the challenges presented by severe winter weather in the current year.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[21]

Summarized results for the Pulp and Paper segment for 2016 and 2015 are as follows:

(millions of Canadian dollars, unless otherwise noted)	2016	2015
Sales	$ 1,101.7	$ 1,185.2
Operating income before amortization[22]	$ 172.0	$ 210.2
Operating income	$ 98.2	$ 144.8
Capital expenditures	$ 64.0	$ 68.3
Average NBSK pulp price delivered to China - in US$[23]	$ 599	$ 644
Average NBSK pulp price delivered to China - Cdn$	$ 794	$ 824
Production – pulp (000 mt)	1,217.9	1,235.8
Production – paper (000 mt)	135.8	136.8
Shipments – pulp (000 mt)	1,201.5	1,242.8
Shipments – paper (000 mt)	142.5	133.4

[21] Includes 100% of CPPI, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.
[22] Amortization includes certain capitalized major maintenance costs.
[23] Per tonne, NBSK pulp list price delivered to China (Resource Information Systems, Inc.).

Overview

The Pulp and Paper segment reported operating income of $98.2 million for 2016, down $46.6 million from $144.8 million in 2015. The decrease in operating income compared to 2015 was mostly due to lower NBSK pulp unit sales realizations, and to a lesser extent logistics challenges that impacted shipments around the 2016 year end. Excluding weather-related disruptions, productivity was in line with the prior year, while unit fibre costs showed a small improvement, primarily due to lower prices for delivered sawmill residual chips and a lower proportion of higher-cost whole log chips.

Markets

Global softwood pulp markets saw moderate downward pressure on average NBSK pulp list prices to China throughout 2016, despite a slight rebound in prices in the second quarter of 2016. While overall global pulp demand was steady, additional hardwood pulp capacity was absorbed into global markets, particularly China, during the year. Global shipments of bleached softwood kraft pulp were up slightly in 2016 compared to 2015, primarily to China, where shipment levels were well above trend. Globally, softwood pulp producer inventories increased in the first quarter of 2016 with limited industry maintenance downtime, then fell through the spring maintenance period in the second quarter of 2016. Thereafter, inventories remained at, or slightly above, the high end of the balanced range through the second half of 2016.

At the end of December 2016, World 20[24] producers of bleached softwood pulp inventories were at 32 days' supply, just above the balanced range. By comparison, December 2015 inventories were at 29 days' supply. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

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

Sales

Pulp shipments in 2016 were 1,201,500 tonnes, down 41,300 tonnes, or 3%, from the prior year. Lower pulp shipments, reflected the slippage of a vessel shipment to Asia into January 2017, combined with an overall decrease in NBSK pulp shipments to North America throughout the 2016 year. BCTMP shipments made up approximately 18% of total pulp shipments for 2016, up 2% from 2015.

As mentioned, China NBSK pulp list prices averaged US$599 per tonne in 2016, down US$45 per tonne, or 7%. Average NBSK pulp unit sale realizations were moderately lower in 2016 largely reflecting the lower list price to China and a lower-value regional sales mix, which outweighed the benefit of the weaker Canadian dollar in 2016. Average BCTMP unit sales realizations were broadly in line with 2015, reflecting a challenging BCTMP market in the first half of the year, which was offset by favourable improvements in BCTMP markets towards the latter part of the year, combined with the benefit of the weaker Canadian dollar.

During 2016, CPPI experienced its first full year of generating power at all three of its NBSK pulp mills, after the Intercontinental pulp mill turbine started selling power in April 2015 and following the ramp-up of the Northwood pulp mill turbines in the previous year. As a result of these green energy projects, CPPI's energy business saw a modest increase in power generation in 2016, which was offset by weather-related operational challenges, particularly in the fourth quarter. CPPI is projecting further incremental benefits of these green energy projects into 2017.

Paper shipments in 2016 were 142,500 tonnes, an increase of 9,100 tonnes, or 7%, from 2015, principally the result of higher volumes sold to North America. Prime bleached paper shipments, which attract higher prices, represented 86% of prime sales volumes in 2016, up 1% from 2015. Paper unit sales realizations decreased slightly in 2016, reflecting the decline in US-dollar kraft paper prices, offset in part by the favourable impact of the weaker Canadian dollar as well as the proportionately higher prime bleached shipments.

Operations

Pulp production in 2016, at 1,217,900 tonnes, was down approximately 17,900 tonnes compared to 2015, primarily due to lower operating rates, particularly in the fourth quarter of 2016 as a result of severe cold weather challenges. Paper production in 2016 was 135,800 tonnes, broadly in line with 2015. This reflects a slight increase in operating rates offset by additional scheduled maintenance days in 2016.

Pulp unit manufacturing costs were slightly lower compared to 2015 principally due to moderately lower fibre costs, as pulp unit conversion costs were broadly in line with the prior year. The decrease in fibre costs compared to 2015 reflected lower market prices for delivered sawmill residual chips (linked to Canadian dollar NBSK pulp unit sales realizations) combined with a significant increase in the proportion of lower-cost sawmill residual chips.

Paper unit manufacturing costs were modestly lower compared to 2015, reflecting a moderate decrease in slush pulp costs (linked to lower Canadian dollar market pulp prices) offset, in part, by higher maintenance and increased cost of chemicals in 2016.

Unallocated and Other Items

(millions of Canadian dollars)		**2016**		2015
Operating loss of Panels operations[25]	**$**	**(2.0)**	$	(3.4)
Corporate costs	**$**	**(27.5)**	$	(30.0)
Finance expense, net	**$**	**(32.8)**	$	(24.9)
Foreign exchange gain (loss) on long-term debt	**$**	**4.1**	$	(5.9)
Gain (loss) on derivative financial instruments	**$**	**2.9**	$	(28.1)
Other income (expense), net	**$**	**(12.5)**	$	27.7

[25] The Panels operations include the Company's PolarBoard OSB plant, which is currently indefinitely idled and its Tackama plywood plant, which was closed in January 2012.

Corporate Costs

Corporate costs, which comprise corporate, head office and general and administrative expenses, were $27.5 million in 2016, down $2.5 million from 2015, largely reflecting higher legal costs in the previous year, including those related to acquisitions, as well as targeted cost reductions in the current year.

Finance Income and Expense

Net finance expense for 2016 was $32.8 million, up $7.9 million from 2015. The increase reflected higher net interest expense associated with the US-dollar term debt financings completed in the fourth quarter of 2015 (associated with the Company's 2015 US South acquisitions), offset in part by lower amounts drawn on the Company's operating loans in 2016. See the "Liquidity and Financial Requirements" section for further discussion on the term debt financing.

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

In 2016, the Company recognized a foreign exchange gain on its US-dollar term debt held by Canadian entities due to the stronger Canadian dollar at the close of 2016 relative to the exchange rate at the close of 2015 (see further discussion on the term debt financing in the "Liquidity and Financial Requirements" section).

Gain (Loss) on Derivative Financial Instruments

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

In 2016, the Company recorded a net gain of $2.9 million related to its derivative financial instruments, largely reflecting unrealized and realized gains on lumber future contracts. In 2015, the net loss of $28.1 million principally reflected unrealized losses on foreign exchange collars as a result of the weakening of the Canadian dollar at the close of 2015 relative to the exchange rate at the close of 2014, and in part, net losses on crude oil collars stemming from a sharp decline in oil prices at the end of 2015.

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

(millions of Canadian dollars)		2016		2015
Lumber Futures	**$**	**3.5**	$	(0.8)
Energy derivatives	**$**	**(0.8)**	$	(5.4)
Interest rate swaps	**$**	**0.2**	$	(1.3)
Foreign exchange collars and forward contracts	**$**	**-**	$	(20.6)
Gain (loss) on derivative financial instruments	**$**	**2.9**	$	(28.1)

Other Income (Expense), net

Other expense, net in 2016 of $12.5 million principally reflected CPPI's write-down of research and development related advances to Licella and a loss of $6.8 million relating to foreign exchange movements on US-dollar denominated cash, receivables and payables of Canadian operations, compared to a gain on foreign exchange in the prior year of $20.9 million.

Income Tax Expense

The Company recorded an income tax expense of $63.9 million in 2016, compared to $18.5 million in 2015, with an overall effective tax rate of 24% (2015 - 17%).

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

(millions of Canadian dollars)		2016		2015
Net income before income taxes	**$**	**267.8**	$	110.4
Income tax expense at statutory rate of 26%	**$**	**(69.6)**	$	(28.7)
Add (deduct):				
Non-taxable income related to non-controlling interests		**6.7**		3.9
Entities with different income tax rates and other tax adjustments		**(0.4)**		6.6
Permanent difference from capital gains and losses and other non-deductible items		**(0.6)**		(0.3)
Income tax expense	**$**	**(63.9)**	$	(18.5)

Other Comprehensive Income (Loss)

(millions of Canadian dollars)	2016	2015
Foreign exchange translation differences for foreign operations, net of tax	$ (11.1)	$ 72.8
Defined benefit plan actuarial gains (losses), net of tax	(37.7)	21.1
Other comprehensive income (loss), net of tax	$ (48.8)	$ 93.9

Canfor measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. Any actuarial gains or losses which arise are recognized immediately by means of a credit or charge through other comprehensive income. For 2016, an after-tax loss of $37.7 million was recorded to other comprehensive income, which comprised losses on the defined benefit post-employment compensation plans and other non-pension post-employment benefits. The loss associated with the defined benefit post-employment compensation plans reflected in part a lower discount rate used to value the net defined benefit obligation. The losses related to the other non-pension post-employment benefits substantially reflected a lower discount rate used to value the obligation.

In addition, in 2016, the Company purchased $216.1 million of annuities through its defined benefit plans to mitigate its exposure to the future volatility in the related pension obligations, taking total annuities purchased by the Company in the last three years to approximately $286.6 million. As at December 31, 2016, 33% of the defined benefit pension plan obligations were fully hedged against changes in future discount rates and longevity risk (potential increases in life expectancy of plan members). A further 32% was partially hedged against changes in future discount rates through the plan's investment in debt securities. At purchase of these annuities, transaction costs of $19.5 million were recognized in Other Comprehensive Income principally reflecting the difference in the annuity rate (which is comparable to solvency rates) as compared to the discount rate used to value the pension obligations on a going concern basis.

In 2015, an after-tax gain of $21.1 million was recorded to other comprehensive income, primarily reflecting a higher discount rate used to value the net defined benefit obligation offset in part by unfavourable actuarial experience adjustments. For more information, see the "Employee Future Benefits" part of the "Critical Accounting Estimates" section later in this report.

In addition, the Company recorded a loss after-tax of $11.1 million to Other Comprehensive Income in 2016 related to foreign exchange differences for foreign operations, resulting from the strengthening of the Canadian dollar at the end of 2016 compared to one-year earlier. This compared to an after-tax gain of $72.8 million in 2015 due to a weakening of the Canadian dollar relative to its US counterpart.

SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's financial position as at December 31, 2016 and 2015:

(millions of Canadian dollars, except for ratios)	2016	2015
Cash and cash equivalents	$ 156.6	$ 97.5
Operating working capital	418.2	385.0
Current portion of deferred reforestation	(48.5)	(50.7)
Net working capital	526.3	431.8
Property, plant and equipment	1,460.8	1,445.1
Timber licenses	532.7	515.2
Goodwill and other intangible assets	238.8	241.0
Retirement benefit surplus	5.9	2.7
Long-term investments and other	50.7	98.6
Forward purchase liability	(41.7)	(76.1)
	$ 2,773.5	$ 2,658.3
Long-term debt	$ 448.0	$ 456.2
Retirement benefit obligations	302.2	258.6
Deferred reforestation obligations (long-term portion)	56.9	61.6
Other long-term liabilities	23.7	20.1
Deferred income taxes, net	204.2	191.1
Forward purchase liability (long-term portion)	-	43.0
Non-controlling interests	254.8	296.8
Equity attributable to shareholders of Company	1,483.7	1,330.9
	$ 2,773.5	$ 2,658.3
Ratio of current assets to current liabilities	2.0 : 1	1.6 : 1
Net debt to total capitalization	15.5%	24.1%

The ratio of current assets to current liabilities at the end of 2016 was 2.0:1 compared to 1.6:1 at the end of 2015, and largely reflected the Company's improved cash, net of amounts drawn on operating loans, at December 31, 2016 compared to December 31, 2015.

The Company's net debt to capitalization was 15.5% at December 31, 2016 (December 31, 2015: 24.1%). The improvement primarily reflected the Company's cash flow from operations, particularly from cash earnings and working capital management.

CHANGES IN FINANCIAL POSITION

At the end of 2016, Canfor had $156.6 million of cash and cash equivalents.

(millions of Canadian dollars)	2016	2015
Cash generated from (used in)		
Operating activities	$ 583.8	$ 254.6
Financing activities	(205.2)	149.4
Investing activities	(317.8)	(478.0)
Increase (decrease) in cash and cash equivalents[26]	$ 60.8	$ (74.0)

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

The changes in the components of these cash flows during 2016 are discussed in the following sections.

Operating Activities

For the 2016 year, Canfor generated cash from operations of $583.8 million, up $329.2 million from cash generated of $254.6 million in the previous year. The increase in operating cash flows largely reflected an increase in cash earnings, a favourable change in non-cash working capital balances compared to the previous year and lower income tax payments during 2016, offset in part by increased pension plan contributions in 2016.

Financing Activities

Financing activities in 2016 used net cash of $205.2 million compared to net cash provided of $149.4 million in 2015. The Company had $28.0 million outstanding on its Canadian operating loan facility at the end of 2016, a decrease of $130.0 million from the end of 2015. The Company made cash distributions of $28.5 million to non-controlling shareholders in 2016, down $28.3 million from the previous year reflecting the special dividend of $1.125 per share made to the non-controlling shareholders of CPPI in 2015. In 2015, the Company repaid $175.0 million of its floating interest rate term debt, completed a new $125.0 million floating interest rate term debt financing, issued US$100.0 million of senior unsecured notes concurrent with the acquisition of Anthony, and also completed an eight-year floating interest rate term loan for US$100.0 million to further support the Company's growth in the US South (see "Liquidity and Financial Requirements" section for more details).

Cash used for financing activities also included share purchases under Canfor's and CPPI's Normal Course Issuer Bids. In 2016, Canfor did not purchase any common shares. Under a separate normal course issuer bid, CPPI purchased 2,252,504 common shares from non-controlling shareholders for $24.4 million. During 2015, Canfor purchased 2,572,420 common shares for $59.2 million and CPPI purchased 1,877,951 common shares from non-controlling shareholders for $25.6 million. See further discussion of the shares purchased under the Normal Course Issuer Bid in the following "Liquidity and Financial Requirements" section.

Investing Activities

In 2016, the Company used net cash for investing activities of $317.8 million, compared to $478.0 million in 2015. Additions to property, plant and equipment totaled $233.8 million, down $6.2 million from 2015. In the lumber segment, capital spending of $161.0 million included costs related to major upgrades at the Company's Polar sawmill in British Columbia and Fulton sawmill in Alabama, a kiln replacement project at the Houston sawmill, final construction payments in regard to the pellet pants in Chetwynd and Fort St. John as well as various smaller high-returning capital projects at the Company's US South lumber operations. In the pulp and paper segment, capital spending of $64.0 million associated with several capital projects including energy, maintenance of business and improvement projects, as well as, to a lesser extent, the acquisition of mobile equipment.

As previously highlighted, during 2016 the Company completed the final phase of the acquisition of Scotch Gulf, increasing its ownership interest to 100%, and completed the acquisition of Wynndel, with the first installment paid during the year. Also included in cash used for investing activities is $7.0 million in advances to Licella. In 2015, Canfor completed the third phase of the purchase of Scotch Gulf, the first phase of the purchase of Beadles & Balfour, as well as the acquisition of Southern and Anthony. Investing activities in 2015 also included cash consideration paid of $30.0 million related to the timber investment loan made to Conifex, and $15.0 million received for the first payment related to the sale of the Company's investment in Lakeland Mills Ltd. and Winton Global Lumber Ltd.

LIQUIDITY AND FINANCIAL REQUIREMENTS

Operating Loans

At December 31, 2016, the Company on a consolidated basis had cash of $156.6 million, $28.0 million drawn on its operating loans, and an additional $50.9 million reserved for several standby letters of credit. Total available undrawn operating loans at year end were $431.1 million.

Excluding CPPI, the Company's available bank operating loans at December 31, 2016 totaled $350.0 million, of which $28.0 million was drawn, and an additional $41.6 million reserved for several standby letters of credit, the majority of which related to unregistered pension plans. In 2015, Canfor's principal operating loans, excluding CPPI, were extended to September 28, 2020 and certain financial covenants were removed. Interest is payable on the operating loans at floating rates based on the lenders' Canadian prime rate, bankers acceptances, US-dollar base rate or US-dollar LIBOR rate, plus a margin that varies with the Company's debt to total capitalization ratio.

At December 31, 2016, CPPI had an undrawn $110.0 million bank loan facility with a maturity date of January 31, 2020 and $9.3 million in letters of credit outstanding under the operating loan facility.

Term Debt

During 2015, as outlined above, the Company repaid $175.0 million of its floating interest rate term debt and completed a new $125.0 million floating interest rate term debt with the same syndicate of lenders with a maturity of September 28, 2020. In conjunction with the acquisition of Anthony, the Company completed a US$100.0 million financing, repayable in three equal tranches on October 2, 2023, October 2, 2024 and the balance due on October 2, 2025. Also in 2015, the Company entered into a new eight-year floating interest rate term loan for an additional US$100.0 million to further support growth in the US. Separately, CPPI has $50.0 million of floating interest rate term debt. In 2016, CPPI extended the maturity of its term debt from November 5, 2018 to January 31, 2020.

Debt Covenants

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

In circumstances when debt to total capitalization exceeds a certain threshold, Canfor (excluding CPPI) is subject to an interest coverage ratio that requires a minimum amount of earnings before interest, taxes, depreciation and amortization relative to net interest expense. Canfor is not currently subject to this test. The debt held by CPPI is subject to the same debt covenants as Canfor.

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

Management reviews results and forecasts in monitoring the Company's compliance with these covenant requirements. Canfor was in compliance with all its debt covenants for the year ended December 31, 2016.

Substantially all borrowings of CPPI (operating loans and long-term debt) are non-recourse to other entities within the Company.

Normal Course Issuer Bid

On March 7, 2016, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 6,640,227 common shares or approximately 5% of its issued and outstanding common shares as of March 1, 2016. The renewed normal course issuer bid is set to expire on March 6, 2017. In 2016, Canfor did not purchase any common shares. In 2015, Canfor purchased 2,572,420 common shares for $59.2 million, of which $20.3 million was charged to share capital and $38.9 million charged to retained earnings. Under a separate normal course issuer bid, in 2016, CPPI purchased 2,252,504 common shares from non-controlling shareholders for $24.4 million increasing Canfor's ownership of CPPI from 51.9% at December 31, 2015 to 53.6% at December 31, 2016.

2017 Projected Capital Spending and Debt Repayments

Based on its current outlook for 2017, assuming no deterioration in market conditions during the year, the Company anticipates it will invest approximately $240.0 million in capital projects which will consist primarily of various improvement projects and maintenance of business expenditures, with proportionately more capital being allocated to the Company's growth in its US South lumber business. There are no scheduled long-term debt payments in 2017. Canfor has sufficient liquidity in its cash reserves and operating loans to finance its planned capital expenditures as required during 2017.

Derivative Financial Instruments

As at December 31, 2016, the Company had the following derivatives:

a. Canfor partly uses Brent oil and Western Texas Intermediate ("WTI") oil contracts as a proxy to hedge its diesel purchases. At December 31, 2016, collars for 21 thousand barrels of WTI oil were in place, which will be settled in 2017, with weighted average protection of US$47.27 per barrel and topside of US$72.86 per barrel. There were unrealized gains of $3.8 million on these contracts at the end of the year.

b. Futures contracts for the sale of lumber with a total notional amount of 74.3 MMfbm. There were unrealized gains of $0.2 million at year end on these contracts.

	As at December 31, 2016	
	Notional Amount	**Average Rate**
Lumber	(MMfbm)	(US-dollars per Mfbm)
Futures sales contracts 0 – 12 months	**74.3**	**$326.35**

c. Canfor uses interest rate swaps to reduce its exposure to interest rate risk associated with financial obligations bearing variable interest rates. At December 31, 2016, the Company had $100.0 million in interest rate swaps with fixed interest rates ranging from 1.55% to 1.75% maturing in 2017. There were unrealized gains of $0.9 million at year end on these swaps.

Commitments and Subsequent Events

The following table summarizes Canfor's financial contractual obligations at December 31, 2016 for each of the next five years and thereafter:

(millions of Canadian dollars)	2017	2018	2019	2020	2021	Thereafter	Total
Long-term debt obligations	$ -	$ -	$ -	$ 179.4	$ -	$ 268.6	$ 448.0
Operating leases	11.9	9.0	6.1	4.1	2.8	6.2	40.1
	$ 11.9	$ 9.0	$ 6.1	$ 183.5	$ 2.8	$ 274.8	$ 488.1

Interest payments include interest of 4.4% on the Company's US$100.0 million term loan and interest on floating rate debt, which will depend on the lenders' Canadian prime rate or bankers' acceptance rate during the year of payment. Interest payments have been excluded from the above commitments.

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

- Contractual commitments totaling $41.4 million, which includes commitments for the construction of property, plant and equipment at the Company's sawmills.
- Purchase obligations and contractual obligations in the normal course of business. For example, purchase obligations of a more substantial dollar amount generally relate to the pulp business and are subject to "force majeure" clauses. In these instances, actual volumes purchased may vary significantly from contracted amounts depending on Canfor's requirements in any given year.
- Contractual commitment of US$31.1 million, excluding working capital and various lease arrangements, relating to the commitment to purchase the remaining 45% of Beadles & Balfour remains outstanding at December 31, 2016. On January 2, 2017 the Company acquired the remaining 45% of Beadles & Balfour, increasing its ownership interest to 100%.
- Deferred reforestation, for which a liability of $105.4 million has been recorded at December 31, 2016. The reforestation liability is a fluctuating obligation, based on the area harvested. The future cash outflows are a function of the actual costs of silviculture programs and of harvesting and are based on, among other things, the location of the harvesting and the activities necessary to adequately stock harvested areas and achieve a "free-to-grow" state.

- Obligations to pay pension and other post-employment benefits, for which the net liability for accounting purposes at December 31, 2016 was $296.3 million. As at December 31, 2016, Canfor estimated that it would make total contribution payments of $19.4 million to its defined benefit plans in 2017.
- CPPI has energy agreements with a BC energy company (the "Energy Agreements") for three of CPPI's mills. These agreements are for the commitment of electrical load displacement and the sale of incremental power from the CPPI's pulp and paper mills. These Energy Agreements include incentive grants from the BC energy company for capital investments to increase electrical generation capacity, and also call for performance guarantees to ensure minimum required amounts of electricity are generated, with penalty clauses if they are not met. As part of these commitments, CPPI has entered into standby letters of credit for these guarantees. The standby letters of credit have variable expiry dates, depending on the capital invested and the length of the Energy Agreement involved. As at December 31, 2016 the Company had posted $7.7 million of standby letters of credit under these agreements, and had no repayment obligations under the terms of any of these agreements.

TRANSACTIONS WITH RELATED PARTIES

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

The Jim Pattison Group is Canfor's largest shareholder. During 2016, subsidiaries owned by the Jim Pattison Group provided lease, insurance and other services to Canfor at market rates totalling $5.2 million. An outstanding balance of $0.6 million is due to the Jim Pattison Group and its subsidiaries at December 31, 2016.

Related party transactions in 2016 also included I-joist purchases from Anthony EACOM Inc., as part of a marketing supply and distribution agreement, in the amount of $58.7 million with no amounts owing at December 31, 2016.

Additional details on related party transactions are contained in Note 23 to Canfor's 2016 consolidated financial statements

Sale of Taylor Pulp Mill to Canfor Pulp Products Inc.

On January 30, 2015, Canfor completed the sale of its BCTMP Taylor pulp mill to CPPI for cash proceeds of $12.6 million including working capital. The transaction also includes a long-term fibre supply agreement under which Canfor will supply the Taylor pulp mill with fibre at prices that approximate fair market value. In addition to the cash consideration paid on the acquisition date, Canfor may also receive contingent consideration from CPPI, based on the Taylor pulp mill's annual adjusted operating income before amortization over a three-year period, starting January 31, 2015. The fair value of the contingent consideration was nil at December 31, 2016 reflecting lower forecast BCTMP prices over the contingent consideration period.

SELECTED QUARTERLY FINANCIAL INFORMATION

	Q4 2016	Q3 2016	Q2 2016	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015
Sales and income (millions of Canadian dollars)								
Sales	**$ 1,043.5**	**$ 1,101.2**	**$ 1,022.3**	**$ 1,067.9**	$ 1,053.0	$ 989.9	$ 952.4	$ 930.0
Operating income	**$ 74.0**	**$ 97.4**	**$ 69.6**	**$ 65.1**	$ 31.8	$ 8.5	$ 17.6	$ 83.7
Net income	**$ 44.2**	**$ 66.4**	**$ 51.0**	**$ 42.3**	$ 19.6	$ 1.4	$ 23.9	$ 47.0
Shareholder net income (loss)	**$ 38.0**	**$ 50.9**	**$ 36.0**	**$ 26.0**	$ 1.6	$ (17.3)	$ 11.1	$ 29.3
Per common share (Canadian dollars)								
Shareholder net income (loss) – basic and diluted	**$ 0.29**	**$ 0.38**	**$ 0.27**	**$ 0.20**	$ 0.01	$ (0.13)	$ 0.08	$ 0.22
Book value[27]	**$ 11.17**	**$ 10.70**	**$ 9.92**	**$ 9.91**	$ 10.02	$ 10.00	$ 9.86	$ 9.76
Statistics								
Lumber shipments (MMfbm)	**1,278**	**1,343**	**1,351**	**1,362**	1,355	1,343	1,367	1,172
Pulp shipments (000 mt)	**275**	**320**	**287**	**319**	356	307	292	287
Average exchange rate – US$/Cdn$	**$ 0.750**	**$ 0.766**	**$ 0.776**	**$ 0.728**	$ 0.749	$ 0.764	$ 0.813	$ 0.806
Average Western SPF 2x4 #2&Btr lumber price (US$)	**$ 315**	**$ 322**	**$ 311**	**$ 272**	$ 263	$ 269	$ 270	$ 308
Average SYP (East) 2x4 #2 lumber price (US$)	**$ 445**	**$ 414**	**$ 437**	**$ 407**	$ 400	$ 331	$ 383	$ 413
Average NBSK pulp list price delivered to China (US$)	**$ 595**	**$ 595**	**$ 617**	**$ 590**	$ 600	$ 638	$ 675	$ 663

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

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

(millions of Canadian dollars)	Q4 2016	Q3 2016	Q2 2016	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015
Operating income (loss) by segment:								
Lumber	**$ 57.4**	**$ 75.1**	**$ 71.5**	**$ 33.4**	$ 3.7	$ (26.9)	$ 5.1	$ 48.3
Pulp and Paper	**$ 22.9**	**$ 31.0**	**$ 5.2**	**$ 39.1**	$ 38.6	$ 42.3	$ 20.9	$ 43.0
Unallocated and Other	**$ (6.3)**	**$ (8.7)**	**$ (7.1)**	**$ (7.4)**	$ (10.5)	$ (6.9)	$ (8.4)	$ (7.6)
Total operating income	**$ 74.0**	**$ 97.4**	**$ 69.6**	**$ 65.1**	$ 31.8	$ 8.5	$ 17.6	$ 83.7
Add: Amortization	**$ 63.6**	**$ 60.6**	**$ 57.5**	**$ 60.6**	$ 59.9	$ 52.6	$ 52.2	$ 49.3
Total operating income before amortization[28]	**$ 137.6**	**$ 158.0**	**$ 127.1**	**$ 125.7**	$ 91.7	$ 61.1	$ 69.8	$ 133.0
Add (deduct):								
Working capital movements	**$ 28.1**	**$ 2.1**	**$ 128.8**	**$ (58.0)**	$ (58.5)	$ 7.1	$ 86.3	$ (101.2)
Defined benefit pension plan contributions	**$ (7.7)**	**$ (15.2)**	**$ (5.2)**	**$ (5.2)**	$ (6.1)	$ 2.7	$ (5.5)	$ 3.0
Income taxes received (paid), net	**$ 0.2**	**$ (13.5)**	**$ (3.0)**	**$ (13.6)**	$ (2.1)	$ (25.1)	$ (12.1)	$ (22.0)
Cash received from legal settlement[29]	**$ -**	**$ 16.3**	**$ -**	**$ -**	$ -	$ -	$ -	$ -
Gain on legal settlement, net[29]	**$ -**	**$ -**	**$ (15.5)**	**$ -**	$ -	$ -	$ -	$ -
Other operating cash flows, net[30]	**$ 2.8**	**$ 0.9**	**$ (8.9)**	**$ 2.0**	$ 9.8	$ 14.1	$ (12.0)	$ 20.6
Cash from (used in) operating activities	**$ 161.0**	**$ 148.6**	**$ 223.3**	**$ 50.9**	$ 34.8	$ 59.9	$ 126.5	$ 33.4
Add (deduct):								
Finance expenses paid	**$ (7.5)**	**$ (3.5)**	**$ (6.9)**	**$ (4.1)**	$ (3.3)	$ (3.8)	$ (3.0)	$ (2.6)
Distributions paid to non-controlling Interests	**$ (5.4)**	**$ (11.6)**	**$ (7.3)**	**$ (4.2)**	$ (4.0)	$ (43.1)	$ (6.7)	$ (3.0)
Capital additions, net	**$ (63.4)**	**$ (57.1)**	**$ (66.2)**	**$ (47.1)**	$ (83.7)	$ (61.1)	$ (49.4)	$ (45.8)
Advances to Licella	**$ (3.5)**	**$ -**	**$ (3.5)**	**$ -**	$ -	$ -	$ -	$ -
Acquisitions	**$ -**	**$ (64.2)**	**$ (19.7)**	**$ -**	$ (123.9)	$ -	$ (66.4)	$ (73.1)
Proceeds from long-term debt, net	**$ -**	**$ -**	**$ -**	**$ -**	$ 263.4	$ (50.0)	$ -	$ -
Share purchases	**$ -**	**$ -**	**$ -**	**$ -**	$ (20.0)	$ -	$ (13.2)	$ (26.0)
Proceeds received from sale of Lakeland Winton	**$ -**	**$ -**	**$ -**	**$ -**	$ -	$ 15.0	$ -	$ -
Timber investment loan	**$ -**	**$ -**	**$ -**	**$ -**	$ -	$ (30.0)	$ -	$ -
Change in restricted cash[31]	**$ -**	**$ -**	**$ -**	**$ -**	$ -	$ -	$ -	$ 50.2
Foreign exchange gain on cash and cash equivalents	**$ 1.8**	**$ 0.7**	**$ (0.3)**	**$ (3.9)**	$ 3.2	$ 2.1	$ (0.5)	$ 8.4
Other, net	**$ (0.2)**	**$ 4.4**	**$ (18.6)**	**$ (3.4)**	$ (12.7)	$ (5.2)	$ (16.6)	$ (0.6)
Change in cash / operating loans	**$ 82.8**	**$ 17.3**	**$ 100.8**	**$ (11.8)**	$ 53.8	$ (116.2)	$ (29.3)	$ (59.1)

[28] Amortization includes certain capitalized major maintenance costs.
[29] Gain relates to a $16.3 million settlement of a legal claim with respect to logistics services, net of a $0.8 million impairment of related machinery and equipment and minority interest.
[30] Further information on operating cash flows can be found in the Company's annual consolidated financial statements.
[31] Change in restricted cash relates to amounts transferred into an escrow bank account for the first phase of the Beadles & Balfour acquisition which closed on January 2, 2015.

THREE-YEAR COMPARATIVE REVIEW

(millions of Canadian dollars, except per share amounts)	2016	2015	2014
Sales	**$ 4,234.9**	$ 3,925.3	$ 3,347.6
Net income	**$ 203.9**	$ 91.9	$ 221.8
Shareholder net income	**$ 150.9**	$ 24.7	$ 175.2
Total assets	**$ 3,277.1**	$ 3,294.6	$ 2,846.8
Term debt	**$ 448.0**	$ 456.2	$ 228.6
Shareholder net income per share, basic and diluted	**$ 1.14**	$ 0.18	$ 1.28

FOURTH QUARTER RESULTS

Overview of Operating Results

The Company shareholder net income for the fourth quarter of 2016 was $38.0 million, or $0.29 per share, compared to a shareholder net income of $50.9 million, or $0.38 per share, in the third quarter of 2016 and shareholder net income of $1.6 million, or $0.01 per share, in the fourth quarter of 2015.

The Company reported adjusted operating income of $72.0 million for the fourth quarter of 2016, down $25.4 million from operating income of $97.4 million in the third quarter of 2016 and up $43.2 million from adjusted operating income of $28.8 million in the fourth quarter of 2015. Adjusted operating income in the fourth quarter of 2016 excluded a pre-tax recovery of $2.0 million of the Canal Flats closure provision recorded in the third quarter of 2015 due to lower current estimated demolition costs. Adjusted operating income in the fourth quarter of 2015 excluded one-time costs before tax of $3.2 million associated with pension plan legislative changes, and a recovery of $6.2 million related to Western SPF inventory valuation adjustments that were recorded in the third quarter of 2015.

An overview of the results by business segment for the fourth quarter of 2016 compared to the third quarter of 2016 and fourth quarter of 2015 follows.

Lumber

Selected Financial Information and Statistics – Lumber

Summarized results for the Lumber segment for the fourth quarter of 2016, third quarter of 2016 and fourth quarter of 2015 were as follows:

(millions of Canadian dollars, unless otherwise noted)		Q4 2016		Q3 2016		Q4 2015
Sales	$	**785.7**	$	809.6	$	721.8
Operating income before amortization	$	**101.0**	$	115.7	$	44.8
Operating income	$	**57.4**	$	75.1	$	3.7
Mill closure provision recovery	$	**(2.0)**	$	-	$	-
One-time costs association with pension plan legislative changes	$	**-**	$	-	$	3.2
Inventory valuation adjustments	$	**-**	$	-	$	(6.2)
Adjusted operating income	$	**55.4**	$	75.1	$	0.7
Average SPF 2x4 #2 & Btr lumber price in US$[32]	$	**315**	$	322	$	263
Average SPF price in Cdn$	$	**420**	$	420	$	351
Average SYP 2x4 #2 lumber price in US$[33]	$	**445**	$	414	$	400
US housing starts (thousand units SAAR) [34]		**1,216**		1,145		1,133
Production – SPF lumber (MMfbm)[35]		**912.2**		953.0		976.0
Production – SYP lumber (MMfbm)[35]		**323.9**		341.2		320.7
Shipments – SPF lumber (MMfbm) [36]		**939.7**		990.4		1,025.1
Shipments – SYP lumber (MMfbm) [36]		**332.1**		348.1		321.9

[32] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.).
[33] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.).
[34] Source – US Census Bureau, seasonally adjusted annual rate.
[35] Excluding production of trim blocks.
[36] Canfor-produced lumber, including lumber purchased for remanufacture and excluding trim blocks. Shipments include volume from the Company's Glulam facilities acquired on October 30, 2015, and excludes shipments of wholesale lumber.

Overview

Operating income for the lumber segment was $57.4 million for the fourth quarter of 2016, down $17.7 million compared to operating income of $75.1 million in the previous quarter, and up $53.7 million compared to operating income of $3.7 million in the same quarter of 2015. Excluding the aforementioned one-time items, the lumber segment's operating income was $55.4 million in the fourth quarter of 2016, down $19.7 million from the third quarter of 2016 and up $54.7 million from the same quarter in 2015.

The decrease in adjusted operating income for the lumber segment compared to the immediately preceding quarter largely reflected slightly lower SYP unit sales realizations coupled with weather-related challenges, which impacted log harvesting activity (resulting in higher unit log costs), productivity and shipment volumes in Western Canada. These factors outweighed improved Western SPF unit sales realizations reflecting the benefit of a 2 cent, or 2%, weaker

Canadian dollar, a higher-value product mix, and higher US-dollar lumber prices in certain low grades, which offset a slight decline in the Western SPF 2x4 #2 & Btr benchmark lumber price in the current quarter. Total lumber shipments and production showed modest declines compared to the prior quarter, largely reflecting the aforementioned weather-related challenges in Western Canada as well as additional statutory holidays in the current quarter.

Compared to the fourth quarter of 2015, the increase in operating income in the current quarter was largely attributable to higher lumber unit sales realizations as a result of higher US-dollar benchmark lumber prices and a higher-value sales mix that included the incremental contribution from the Company's acquisition of Anthony on October 30, 2015 and Wynndel on April 15, 2016. Total lumber shipments and production were down from the same quarter in 2015 as the additional volume from the acquisitions of Anthony and Wynndel were more than offset by additional shifts in the comparative quarter.

The Company's Fort St. John and Chetwynd pellet plants continue through their respective capital ramp-ups during the fourth quarter of 2016, and operated above target production levels.

Markets

North American lumber demand remained steady in the fourth quarter of 2016, with US housing starts, on a seasonally adjusted basis, moderately higher than the prior quarter, averaging 1,216,000 units, and up 7% from the same period in 2015. Canadian housing starts were in line with both comparative quarters, at an average of 201,000 units on a seasonally adjusted basis. The benchmark North American Random Lengths Western SPF 2x4 #2&Btr lumber price decreased slightly compared to the prior quarter, while SYP lumber prices movements reflected solid gains for SYP 2x4 #2 product, but declines for wide-width SYP products, the latter reflecting seasonally slower activity in North America during the fourth quarter. Offshore lumber shipments showed a modest increase in the fourth quarter of 2016 reflecting steadily improving demand in key offshore lumber markets, primarily China and Japan.

Sales

Sales for the lumber segment for the fourth quarter of 2016 were $785.7 million, compared to $809.6 million in the previous quarter and $721.8 for the fourth quarter of 2015. Compared to the third quarter of 2016, the positive impact of improved Western SPF unit sales realizations, reflecting a 2 cent, or 2%, weaker Canadian dollar and higher average US-dollar benchmark lumber prices for certain low grades and dimensions, largely offset lower SYP unit sales realizations and a decrease in shipment volumes, mostly stemming from additional statutory holidays in the current quarter and weather-related impacts on production. Compared to the fourth quarter of 2015, the increase of $63.9 million, or 9%, in sales revenue was primarily due to higher Western SPF and SYP benchmark lumber prices and in part, the recent acquisitions.

Total lumber shipments in the fourth quarter of 2016, at over 1.27 billion board feet, were modestly lower than both comparative quarters principally reflecting additional statutory holidays and the weather-related challenges in Western Canada in the fourth quarter of 2016.

Western SPF lumber unit sales realizations showed a slight improvement compared to the prior quarter of 2016 as the benefit of a weaker Canadian dollar, a higher-value product mix and higher average prices for low grade product more than offset a slight decline in the benchmark Western SPF 2x4 #2&Btr lumber price, which was down US$7 per Mfbm, or 2%. SYP lumber unit sales realizations were down slightly compared to the prior quarter as a price increase of US$31 per Mfbm, or 7%, in the SYP East 2x4 #2 price was offset by more pronounced price decreases in SYP 2x6, 2x10 and 2x12 #2 products.

Compared to the fourth quarter of 2015, Western SPF and SYP lumber unit sales realizations in the current quarter were up, principally reflecting higher market prices and a higher-value sales mix, due in part to the recent acquisitions. The average North American Random Lengths Western SPF 2x4 #2&Btr price was up US$52 per Mfbm, or 20%, to US$315 per Mfbm compared to the fourth quarter of 2015, with more pronounced increases seen for low grade products. The SYP East 2x4 #2 price was up US$45 per Mfbm, or 11%, to US$445, with larger increases seen for several wider dimensions.

Total residual fibre revenue in the current quarter was broadly in line with both comparable periods, while log sales were slightly lower as a result of reduced logging and hauling activity in Western Canada due to adverse weather.

Pellet sales revenues showed moderate increases compared to both comparable quarters as the Fort St. John and Chetwynd pellet plants continued through their respective ramp ups.

Operations

Lumber production, at 1.24 billion board feet, was down 5% from the previous quarter principally reflecting the aforementioned additional statutory holidays and weather-related challenges in the current quarter which impacted log deliveries and productivity in Western Canada. Compared to the fourth quarter of 2015, total lumber production was down 5%, as the incremental production from the Anthony and Wynndel acquisitions were more than offset by additional shifts in the comparative quarter.

Unit manufacturing costs in the fourth quarter of 2016 were moderately higher than the previous quarter largely reflecting seasonally higher energy costs and the unfavourable impact of lower productivity and lower log deliveries on unit log and cash conversion costs in Western Canada as a result of the aforementioned weather-related challenges. Log costs in the US South were broadly in line with the prior quarter. Compared to the fourth quarter of 2015, unit manufacturing costs were moderately higher, as slightly improved productivity following several capital upgrades and slightly lower log costs in the US South were more than offset by costs associated with a higher proportion of higher-value products (associated with recent acquisitions), as well as higher market-based stumpage and weather-related log hauling cost increases in Western Canada.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[37]

Summarized results for the Pulp and Paper segment for the fourth quarter of 2016, third quarter of 2016 and fourth quarter of 2015 were as follows:

(millions of Canadian dollars, unless otherwise noted)	Q4 2016	Q3 2016	Q4 2015
Sales	**$ 257.8**	$ 291.6	$ 331.2
Operating income before amortization[38]	**$ 42.1**	$ 50.0	$ 56.2
Operating income	**$ 22.9**	$ 31.0	$ 38.6
Average NBSK pulp price delivered to China – US$[39]	**$ 595**	$ 595	$ 600
Average NBSK pulp price delivered to China – Cdn$	**$ 794**	$ 777	$ 801
Production – pulp (000 mt)	**304.0**	312.5	322.5
Production – paper (000 mt)	**36.0**	32.4	35.8
Shipments – pulp (000 mt)	**275.4**	319.8	356.2
Shipments – paper (000 mt)	**33.6**	35.5	35.4

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

Overview

Operating income for the pulp and paper segment was $22.9 million for the fourth quarter of 2016, down $8.1 million from the third quarter of 2016 and down $15.7 million from the fourth quarter of 2015. Results in the fourth quarter of 2016 reflected the disruption to operations and logistics caused by challenging weather conditions in British Columbia, which impacted productivity and pulp unit manufacturing costs, as well as shipments around year end. These impacts were partially offset by the improvement in average BCTMP unit sales realizations in the current quarter, reflecting higher market prices combined with the benefit of the weaker Canadian dollar. NBSK pulp unit sales realizations were broadly in line with the previous quarter, as a slightly weaker Canadian dollar was offset by increased pricing pressure from customers.

Compared to the fourth quarter of 2015, the impact of inclement weather conditions in British Columbia on pulp production and shipment volumes, as well as a modest decrease in NBSK pulp US-dollar prices, which more than offset an increase in BCTMP prices, were the primary factors accounting for the lower quarter-over-quarter operating income. Pulp unit manufacturing costs were relatively in line with the fourth quarter of 2015, with the weather-related disruption to operating performance and resulting higher unit conversion costs offset by lower fibre costs in the current quarter.

Markets

Global softwood pulp markets were relatively stable through most of the fourth quarter of 2016 with average NBSK pulp list prices to China, North America and Europe in line with the third quarter of 2016. Global softwood pulp producer inventory levels saw a slight increase through the quarter and finished at 32 days of supply at the end of December 2016, up 2 days from the end of September 2016[40]. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

Global shipments of bleached softwood kraft pulp decreased slightly in October before rebounding in November and December, primarily driven by increased shipments to Asia[41].

Sales

The Company's pulp shipments in the fourth quarter of 2016 totalled 275,400 tonnes, down 44,400 tonnes, or 14%, from the third quarter of 2016 and down 80,800 tonnes, or 23%, from the fourth quarter of 2015. Lower pulp shipments in the current quarter reflected both the slippage of a vessel shipment to Asia into early January 2017, combined with an overall decrease in NBSK pulp production. BCTMP shipments made up approximately 19% of the current quarter's total pulp shipments, representing a 3% increase from the previous quarter. Compared to the fourth quarter of 2015, the decrease in pulp shipments was mostly attributable to a significant drawdown of inventories in late 2015, as well as the lower NBSK pulp production and delayed shipment in the current quarter.

The average China US-dollar NBSK pulp list price, as published by RISI, was unchanged from the third quarter of 2016 and average NBSK pulp unit sales realizations were broadly in line with the previous quarter reflecting the benefit of the weaker Canadian dollar offset by increased pricing pressure from customers. Average BCTMP unit sales realizations showed a healthy increase when compared to the previous quarter, reflecting improved BCTMP markets combined with the benefit of the weaker Canadian dollar.

Compared to the fourth quarter of 2015, the average China US-dollar NBSK pulp list price was down $5 per tonne, or 1%. The Company's NBSK pulp unit sales realizations saw a modest decrease when compared to the fourth quarter of 2015 primarily reflecting lower US-dollar prices. BCTMP unit sales realizations increased significantly when compared to the fourth quarter of 2015, primarily reflecting the improvement in BCTMP markets compared to the end of 2015.

Energy revenues moderately increased during the fourth quarter of 2016 compared to the previous quarter, primarily reflecting increased power generation and seasonally higher energy prices. Compared to the fourth quarter of 2015, energy revenue was down primarily due to decreased power generation as a result of the weather-related operational challenges in the current quarter.

Paper shipments in the fourth quarter of 2016 were 33,600 tonnes, down 1,900 tonnes, or 5%, from the previous quarter and down 1,800 tonnes, or 5% from the same quarter in 2015, principally reflecting lower volumes sold to Asia and Europe. Prime bleached shipments, which attract higher prices, were in line with both the third quarter of 2016 and the same quarter of 2015. Paper unit sales realizations in the fourth quarter of 2016 were up slightly compared to the previous quarter, reflecting the weaker Canadian dollar, which more than offset a small decline in market prices, and in line with paper unit sales realizations when compared to the fourth quarter of 2015.

Operations

Pulp production in the fourth quarter at 304,000 tonnes was down 8,500 tonnes, or 3%, from the third quarter of 2016, and down 18,500 tonnes, or 6%, compared to the fourth quarter of 2015. Production in the current quarter reflected a lower operating rate, primarily due to the cold weather challenges, which more than offset the quarter-over quarter impact of the scheduled maintenance outages in both comparative quarters. In the third quarter of 2016, the Company completed the scheduled maintenance outages at the Prince George NBSK pulp mill and the Taylor BCTMP mill, which reduced pulp production by 3,700 tonnes of NBSK pulp and 3,100 tonnes of BCTMP, respectively. In the comparative fourth quarter of 2015, the Company completed a scheduled maintenance outage at the Northwood pulp mill which reduced NBSK pulp production by approximately 20,000 tonnes.

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

Pulp unit manufacturing costs saw a slight increase from the previous quarter, reflecting higher energy usage combined with seasonally higher energy costs, as well as the unfavourable impact of the lower production volumes during the current quarter. Fibre costs were relatively flat compared to the third quarter of 2016 reflecting slightly lower market prices for delivered sawmill residual chips (linked to Canadian dollar NBSK pulp sales realizations), offset by a marginal increase in the proportion of higher-cost whole log chips in the current quarter. Pulp unit manufacturing costs were broadly in line with the fourth quarter of 2015 as lower productivity combined with higher energy usage and seasonally higher energy costs, was offset by slightly lower fibre costs in the current quarter reflecting lower market prices for delivered sawmill residual chips as well as a decrease in the proportion of higher-cost whole log chips.

Paper production for the fourth quarter of 2016 was 36,000 tonnes, up 3,600 tonnes, or 11%, from the previous quarter, principally reflecting the previous quarter's nine-day scheduled maintenance outage which reduced paper production by approximately 3,300 tonnes. Paper production in the current quarter was broadly in line with the fourth quarter of 2015. Paper unit manufacturing costs were modestly lower than the previous quarter, for the most part reflecting the scheduled maintenance outage in the previous quarter, and moderately lower than the fourth quarter of 2015 reflecting lower slush pulp costs due to slightly lower overall pulp sales realizations in the current quarter along with the timing of spend on maintenance and operating supplies in the current quarter.

Unallocated and Other Items

(millions of Canadian dollars)	**Q4 2016**	Q3 2016	Q4 2015
Operating loss of Panels operations[42]	**$ (0.6)**	$ (0.4)	$ (0.6)
Corporate costs	**$ (5.7)**	$ (8.3)	$ (9.9)
Finance expense, net	**$ (8.0)**	$ (8.2)	$ (7.6)
Foreign exchange loss on long-term debt	**$ (3.1)**	$ (1.1)	$ (5.9)
Gain on derivative financial instruments	**$ 2.1**	$ 0.1	$ 2.1
Other income (expense), net	**$ (4.1)**	$ 1.3	$ 3.5

[42] The Panels operations include the Company's PolarBoard OSB plant, which is currently indefinitely idled and its Tackama plywood plant, which was closed in January 2012.

Corporate costs were $5.7 million for the fourth quarter of 2016, down $2.6 million from the previous quarter in part reflecting overall lower cost spend. Compared to the same quarter of the previous year, corporate costs decreased $4.2 million partly reflecting legal costs recorded in the fourth quarter of 2015 associated with the Company's acquisition of Anthony and Wynndel.

Net finance expense at $8.0 million was broadly in line with the previous quarter and up $0.4 million from the fourth quarter of 2015. The increase reflected higher net interest expense associated with the US-dollar term debt financings completed in the fourth quarter of 2015 (associated with the Company's 2015 US South acquisitions). In the fourth quarter of 2016, the Company recognized a foreign exchange loss on its US-dollar term debt held by Canadian entities due to the weaker Canadian dollar at the end of the quarter (see further discussion on the term debt financing in the "Liquidity and Financial Requirements" section).

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs, lumber prices and interest rates. In the fourth quarter of 2016, the Company recorded a net gain of $2.1 million related to its derivatives instruments, principally reflecting realized and unrealized gains on lumber future contracts and crude oil collars settled during the quarter.

Other expense, net of $4.1 million in the fourth quarter of 2016 principally reflected the write-down of research and development related advances to Licella offset in part by foreign exchange gains on US-dollar denominated working capital resulting from the weakening of the Canadian dollar relative to the US-dollar over the course of the quarter.

Other Comprehensive Income (Loss)

(millions of Canadian dollars)		Q4 2016		Q3 2016		Q4 2015
Foreign exchange translation differences for foreign operations, net of tax	**$**	**10.4**	$	3.8	$	15.5
Defined benefit actuarial gains (losses), net of tax		**15.0**		(1.5)		(2.0)
Change in fair value of available-for-sale financial assets, net of tax		**(0.2)**		0.2		-
Other comprehensive income (loss), net of tax	**$**	**25.2**	$	2.5	$	(13.5)

In the fourth quarter of 2016, the Company recorded an after-tax gain of $15.0 million related to changes in the valuation of the Company's employee future benefit plans. The gain reflected a 0.5% increase in the discount rate used to value the employee future benefit plans partially offset by the return generated on plan assets. During the fourth quarter of 2016, the Company purchased $216.1 million of annuities through its defined benefit plans in order to mitigate its exposure to the future volatility fluctuations in the related pension obligations. At purchase of these annuities, transaction costs of $19.5 million were recognized in Other Comprehensive Income principally reflecting the difference in the annuity rate (which is comparable to solvency rates) as compared to the discount rate used to value the pension obligations on a going concern basis. This compared to an after-tax loss of $1.5 million in the previous quarter and loss of $2.0 million in the fourth quarter of 2015. For more information, see the "Employee Future Benefits" part of the "Critical Accounting Estimates" section later in this report.

In addition, the Company recorded an after-tax gain of $10.4 million in the fourth quarter of 2016 related to foreign exchange differences for foreign operations, resulting from the weakening of the Canadian dollar relative to the US-dollar in the quarter. This compared to an after-tax gain of $3.8 million in the previous quarter and an after-tax gain of $15.5 million in the fourth quarter of 2015 also due to a weakening of the Canadian dollar relative to the US counterpart during those respective periods.

CHANGES IN FINANCIAL POSITION

At the end of 2016, Canfor had $156.6 million of cash and cash equivalents.

(millions of Canadian dollars)		Q4 2016		Q3 2016		Q4 2015
Cash generated from (used in)						
Operating activities	**$**	**161.0**	$	148.6	$	34.8
Financing activities		**(80.9)**		(48.4)		183.5
Investing activities		**(67.1)**		(116.6)		(210.7)
Increase (decrease) in cash and cash equivalents[43]	**$**	**13.0**	$	(16.4)	$	7.6

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

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

Operating Activities

Canfor generated cash from operations of $161.0 million in the fourth quarter of 2016, up $12.4 million compared to the previous quarter as a favourable change in non-cash working capital balances was offset in part by lower quarter-over-quarter cash earnings in the current quarter as well as higher income tax payments and increased pension plan contributions in the previous quarter.

Compared to the fourth quarter of 2015, operating cash flows were up $126.2 million largely reflecting an increase in cash earnings and a favourable change in non-cash working capital balances that in part reflected lower log deliveries attributable to adverse weather conditions in Western Canada in the current quarter.

Financing Activities

Cash used in financing activities was $80.9 million in the current quarter, compared to cash used of $48.4 million in the previous quarter. The Company had $28.0 million outstanding on its Canadian operating loan facility at the end of the fourth quarter of 2016, a decrease of $68.0 million from the prior quarter, and a decrease of $130.0 million from the end of 2015. During the current quarter, the Company made cash distributions of $5.4 million to non-controlling shareholders, down $6.2 million from the previous quarter.

Financing activities in the fourth quarter of 2015 provided net cash of $183.5 million as a result of the US-dollar term debt financings completed in that quarter (see "Liquidity and Financial Requirements" section for more details). In the fourth quarter of 2015 Canfor purchased 1,050,120 common shares for $20.0 million and CPPI purchased 692,985 common shares from non-controlling shareholders for $9.7 million, while no common shares were repurchased in the third or fourth quarter of 2016. See further discussion of the shares purchased under the Normal Course Issuer Bid in the following "Liquidity and Financial Requirements" section.

Investing Activities

Cash used for investing activities was $67.1 million in the current quarter, compared to $116.6 million in the previous quarter and $210.7 million in the same quarter of 2015. In the fourth quarter of 2016, cash used for capital additions was $63.4 million, up $6.3 million from the previous quarter and down $20.3 million compared to the fourth quarter of 2015. Current quarter capital expenditures included costs related to various smaller high-returning capital projects at the Company's US South lumber operations and costs associated with the Company's major rebuild of the Polar sawmill in British Columbia which was substantially completed in the prior quarter. In the pulp and paper segment, capital expenditures primarily related to capital expenditures associated with several capital projects including energy, maintenance of business and improvement projects, as well as, to a lesser extent, the acquisition of mobile equipment.

SPECIFIC ITEMS AFFECTING COMPARABILITY

Specific Items Affecting Comparability of Shareholder Net Income (Loss)

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

After-tax impact, net of non-controlling interests

(millions of Canadian dollars, except for per share amounts)	Q4 2016	Q3 2016	Q2 2016	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015
Shareholder net income (loss), as reported	**$ 38.0**	**$ 50.9**	**$ 36.0**	**$ 26.0**	$ 1.6	$ (17.3)	$ 11.1	$ 29.3
Foreign exchange (gain) loss on long-term debt	**$ 2.7**	**$ 0.9**	**$ (0.3)**	**$ (6.9)**	$ 5.1	$ -	$ -	$ -
(Gain) loss on derivative financial instruments	**$ (1.5)**	**$ (0.1)**	**$ (2.3)**	**$ 1.8**	$ (1.2)	$ 9.3	$ (7.7)	$ 17.2
Mill closure provisions (recovery) [44]	**$ (1.5)**	**$ -**	**$ -**	**$ -**	$ -	$ 14.4	$ -	$ -
Gain on legal settlement, net[45]	**$ -**	**$ -**	**$ (6.9)**	**$ -**	$ -	$ -	$ -	$ -
One-time costs associated with pension plan legislation changes	**$ -**	**$ -**	**$ -**	**$ -**	$ 2.4	$ -	$ -	$ -
Gain on investment in Lakeland Mills Ltd. and Winton Global Lumber Ltd. [46]	**$ -**	**$ -**	**$ -**	**$ -**	$ -	$ -	$ (6.1)	$ -
Mark-to-market loss on Taylor pulp contingent consideration, net[47]	**$ -**	**$ -**	**$ -**	**$ -**	$ -	$ -	$ 0.7	$ -
Net impact of above items	**$ (0.3)**	**$ 0.8**	**$ (9.5)**	**$ (5.1)**	$ 6.3	$ 23.7	$ (13.1)	$ 17.2
Adjusted shareholder net income (loss)	**$ 37.7**	**$ 51.7**	**$ 26.5**	**$ 20.9**	$ 7.9	$ 6.4	$ (2.0)	$ 46.5
Shareholder net income (loss) per share (EPS), as reported	**$ 0.29**	**$ 0.38**	**$ 0.27**	**$ 0.20**	$ 0.01	$ (0.13)	$ 0.08	$ 0.22
Net impact of above items per share[48]	**$ -**	**$ 0.01**	**$ (0.07)**	**$ (0.04)**	$ 0.05	$ 0.18	$ (0.10)	$ 0.13
Adjusted net income (loss) per share[48]	**$ 0.29**	**$ 0.39**	**$ 0.20**	**$ 0.16**	$ 0.06	$ 0.05	$ (0.02)	$ 0.35

[44] During the third quarter of 2015, the Company recorded one-time costs of $19.4 million (before-tax) associated with the announced closure of the Canal Flats sawmill. In the fourth quarter of 2016, $2.0 million (before-tax) of the closure provision was reversed as a result of lower estimated demolition costs.

[45] Gain relates to a $16.3 million settlement of a legal claim with respect to logistics services, net of a $0.8 million impairment of related machinery and equipment and minority interest.

[46] On July 1, 2015, Canfor sold its 33.3% interest in Lakeland Mills Ltd. and Winton Global Lumber Ltd. for $30.0 million and recognized a $7.0 million gain (before-tax).

[47] As part of the sale of the BCTMP Taylor pulp mill to CPPI on January 30, 2015, Canfor could receive contingent consideration based on the Taylor pulp mill's future earnings over a three year period. On the acquisition date, the contingent consideration was valued at $1.8 million (before-tax) and Canfor recorded an asset and CPPI recorded an offsetting liability for this amount. During the second quarter of 2015, the contingent consideration asset and liability were revalued to nil. The adjustment above reflects the impact to Canfor EPS net of non-controlling interest.

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

OUTLOOK

Lumber Markets

Looking ahead, the US housing market is forecast to continue its gradual recovery through 2017. North American lumber consumption is projected to improve reflecting steady demand in the residential construction market and continued strength from the repair and remodelling sector. There remains a risk of material antidumping and countervailing duties being imposed on Canadian lumber shipments destined to the US absent a new Softwood Lumber Agreement. The Company anticipates marketplace volatility as investigations progress and determinations are made. For the Company's key offshore lumber markets, demand is anticipated to remain solid.

Pulp and Paper Markets

For the month of January 2017, CPPI announced an increase of US$20 per tonne for NBSK pulp list price to China, equating to US$630 per tonne, and an increase of $US10 per tonne for BCTMP. For the month of February 2017, CPPI announced a further US$20 per tonne increase to both its NBSK pulp and BCTMP list prices to China. Global softwood markets are currently seeing positive pricing momentum, for both NBSK pulp and BCTMP, and this is anticipated to continue into the second quarter of 2017, when many pulp producers have their major maintenance shutdowns.

CPPI has no maintenance outages planned for the first quarter of 2017. Maintenance outages are currently planned at the Northwood pulp mill in the second quarter of 2017 with a projected 25,000 tonnes of reduced production and at the Intercontinental pulp mill in the third quarter of 2017 with a projected 8,000 tonnes of reduced production. A maintenance outage at the Taylor pulp mill is scheduled for the second quarter of 2017 with a projected 3,000 tonnes of reduced production.

Kraft paper markets are projected to remain stable through the first quarter of 2017 and into the second quarter of 2017, with steady demand in the North American market continuing to lead the way globally.

CRITICAL ACCOUNTING ESTIMATES

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

Employee Future Benefits

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

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

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

	December 31, 2016		December 31, 2015	
	Defined Benefit Pension Plans	**Other Benefit Plans**	Defined Benefit Pension Plans	Other Benefit Plans
Discount rate	**3.9%**	**3.9%**	4.1%	4.1%
Rate of compensation increases	**3.0%**	**n/a**	3.0%	n/a
Initial medical cost trend rate	**n/a**	**7.0%**	n/a	7.0%
Ultimate medical cost trend rate	**n/a**	**4.5%**	n/a	4.5%
Year ultimate rate is reached	**n/a**	**2022**	n/a	2021

In addition to the significant assumptions listed in the table above, the average life expectancy of a 65 year old at December 31, 2016 is between 20.9 years and 24.1 years (2015 - 20.9 years and 24.0 years). As at December 31, 2016, the weighted average duration of the defined benefit obligation, which reflects the average age of the plan members, is 12.1 years (2015 - 12.0 years). The weighted average duration of the other benefit plans is 14.6 years (2015 - 14.3 years).

Assumed discount rates and medical cost trend rates have a significant effect on the accrued benefit obligation and related plan assets. A one percentage point change in these assumptions would have the following effects on the accrued retirement benefit obligation, before taking into account the impact of hedging, and related plan annuity assets for 2016:

(millions of Canadian dollars)	1% Increase	1% Decrease
Defined benefit pension plan liabilities		
Discount rate	$ (89.8)	$ 95.9
Defined benefit pension plan annuity assets		
Discount rate	$ (23.5)	$ 27.8
Other benefit plan liabilities		
Discount rate	$ (22.9)	$ 28.7
Initial medical cost trend rate	$ 19.8	$ (16.7)

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

Deferred Reforestation

Canfor accrues an estimate of its future liability to perform forestry activities, defined to mean those silviculture treatments or activities that are carried out to ensure the establishment of a free-growing stand of young trees, including logging road rehabilitation on its forestry tenures in BC and Alberta. An estimate is recorded in the financial statements based on the number of hectares of timber harvested in the period and the estimated costs of fulfilling Canfor's obligation. Payments in relation to reforestation are expected to occur over periods of up to 15 years (the significant majority occurring in the first seven years) and have been discounted accordingly at risk-free rates ranging from 0.7% to 2.0%. The actual costs that will be incurred in the future may vary based on, among other things, the actual costs at the time of silviculture activities.

Deferred Taxes

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

Asset Retirement Obligations

Canfor records the estimated fair value of a liability for asset retirement obligations, such as landfill closures, in the period when it is incurred. For landfill closure costs, the fair value is determined using estimated closure costs discounted over the estimated useful life. Payments relating to landfill closure costs are expected to occur at periods ranging from 5 to 54 years and have been discounted at risk-free rates ranging from 1.2% to 2.4%. The actual closure costs and periods of payment may differ from the estimates used in determining the year end liability. On initial recognition, the fair value of the liability is added to the carrying amount of the associated asset and amortized over its useful life. The liability is accreted over time through charges to earnings and reduced by actual costs of settlement.

Environmental Remediation Costs

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

Impairment of Goodwill

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

An impairment loss is recognized in net income at the amount that the carrying value, including goodwill, of the relevant operating division exceeds its recoverable amount. The recoverable amount is the higher of the unit's fair value less costs to sell and value in use. For Canfor's goodwill (which is allocated to the lumber segment), the recoverable amount of the relevant assets is determined by estimating the future expected discounted cash flows of the unit as a whole on an annual basis, and more often if required. As part of this process, assumptions are made in relation to forecast product prices and exchange rates. Price forecasts are determined with reference to Forest Economic Advisors ("FEA") publications and management estimates. Other significant assumptions include the discount rate. The net present value of the future expected cash flows is compared to the carrying value of the Company's investment in these assets, including goodwill, at year end.

Based upon the analysis performed in 2016, the net present value of the estimated discounted future cash flows exceeded the carrying value of each of the cash generating units tested for impairment, and therefore no impairments to goodwill were required. If actual results were materially lower than the forecast assumptions, there is a possibility that an impairment of goodwill may be required in future periods.

Valuation of Log and Finished Product Inventories

Log and finished product inventories are recorded at the lower of cost and net realizable value. For inventories of solid wood products, the net realizable value is determined by taking into account forecast prices and exchange rates for the period over which the inventories are expected to be sold. Forecast prices are determined using management's estimates as at the year end, and may differ from the actual prices at which the inventories are sold. There were no inventory write-downs at December 31, 2016.

Allowance for Doubtful Accounts

An allowance for doubtful accounts of $4.4 million has been recorded at December 31, 2016 which reflects management's assessment of risks attached to the collection of receivable balances. While significant bad debts have not been experienced in prior years, the provision is considered appropriate due to several risks still existing which may affect the ability of certain customers to pay amounts owed to the Company.

FUTURE CHANGES IN ACCOUNTING POLICIES

In May 2014, the International Accounting Standards Board ("IASB") issued IFRS 15, *Revenue from Contracts with Customers*, which will supersede IAS 18, *Revenue*, IAS 11, *Construction Contracts* and related interpretations. The new standard is effective for annual periods beginning on or after January 1, 2018. The Company has performed a preliminary assessment of the impact of the new standard, and currently anticipates no significant impact on its financial statements.

In July 2014, the IASB issued IFRS 9, *Financial Instruments*. The required adoption date for IFRS 9 is January 1, 2018 and the Company does not anticipate the new standard to have a significant impact on its financial statements.

In January 2016, the IASB issued IFRS 16, *Leases*, which will supersede IAS 17, *Leases* and related interpretations. The required adoption date for IFRS 16 is January 1, 2019 and the Company is in the process of assessing the impact on the financial statements of this new standard.

RISKS AND UNCERTAINTIES

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

Aboriginal Issues

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

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

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

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

Capital Requirements

The lumber products industry is capital intensive, and the Company regularly incurs capital expenditures to expand its operations, maintain its equipment, increase its operating efficiency and comply with environmental laws. The Company's total capital expenditures during 2016 were $233.8 million. The Company anticipates available cash resources and cash generated from operations will be sufficient to fund its operating needs and capital expenditures.

Competitive Markets

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

Currency Exchange Risk

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

Cyclicality of Product Prices

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

Employee Future Benefits

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

Cash payments required to fund the pension plans are determined by actuarial valuations completed at least once every three years, with the most recent actuarial valuation for the largest plan completed as of December 31, 2015. Other non-pension post-retirement benefit plans are unfunded, and the Company makes payments as required to cover liabilities as they arise.

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

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

For Canfor's defined benefit pension plans, a one percentage point increase in the discount rate used in calculating the actuarial estimate of future liabilities would reduce the accrued benefit obligation by an estimated $89.8 million and a one percentage point decrease in the discount rate would increase the accrued benefit obligation by an estimated $95.9 million. These changes would only impact the Company's funding requirements in years where a new actuarial funding valuation was performed and regulatory approval for a change in funding contributions was obtained.

Environmental Issues

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

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

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

For 2017, all of the CPPI pulp mills will report Green House Gas ("GHG) emissions under the BC GHG reporting requirements which have been in place since 2009, and have a reporting threshold of 10,000 tonnes ("t") CO2e. GHG emission reporting has also been required federally and in Alberta for several years with CPPI's facilities meeting the requirements for federal reporting, though Canfor's wood products facilities have not triggered federal or Alberta reporting thresholds. Environment and Climate Change Canada ("ECCC") is considering an expansion to the federal GHG reporting requirements including lowering the federal reporting threshold from 50,000 tonnes to 10,000 tonnes and reporting of additional data. These new requirements will be gradually phased-in by sector following consultation planned for 2017. Under the US Environmental Protection Agency ("EPA") Federal GHG Reporting Rule, facilities emitting more than 25,000 tonnes of CO2e are required to report on their GHG emissions. Canfor's US facility direct GHG emissions are sufficiently low that they do not trigger this EPA reporting requirement.

Carbon policy at federal and provincial levels has been under active review and development following the December 2015 COP21 conference in Paris. The Canadian Federal Government is committed to a 30% reduction in 2005 levels by 2030 and support the 1.5 degree Celsius global temperature increase threshold. British Columbia introduced a carbon tax in 2008 and it now stands at $30 per tonne, adding an extra 6.67 cents to each litre of gasoline and 7.67 cents to each litre of diesel. In August, 2016 British Columbia said it would stick to that price until other jurisdictions catch up. In October, 2016, the Canadian Federal Government announced a national "floor price" on carbon of $10 per tonne beginning in 2018 rising $10 per tonne annually to $50 per tonne in 2022 and a requirement that all provinces and territories to have some form of carbon pricing by 2018. Alberta has developed a new strategy on climate change based on November 2015 recommendations put forward by the Alberta Climate Change Advisory Panel. The Alberta Climate Leadership Plan includes phase out of coal based power generation by 2030 and a broad based carbon tax. Alberta announced in November 2016 that it will implement a $20 per tonne carbon levy in 2017, rising to $30 per tonne in 2018. Similar to BC, the levy applies to gasoline, diesel, natural gas and propane. While Canfor's BC and Alberta sawmill and biomass cogeneration facility GHG emissions are all well below any foreseeable Regulation thresholds, all of our BC operations are subject to the BC carbon tax and going forward, all of our Alberta operations to the Alberta carbon levy.

At the federal level ECCC continues to indicate that the pulp and paper sector will be included in its GHG Regulatory system, currently under development. Canfor Pulp's three Prince George pulp mills are well positioned having already substantially reduced GHG emissions through energy efficiency measures and switching from fossil to carbon dioxide emission neutral biomass fuels.

In the United States, carbon policy at the federal and state levels is also uncertain, particularly with the recent federal election, however, direct GHG emissions from Canfor's US operations are very low, due to the use of biomass fuels for heat energy. The mills are exposed to potential pass through of future electrical utility GHG emission reduction requirements related to electricity purchases.

Canfor is a participant in the carbon offset market in Alberta and British Columbia, selling offset credits tied to its biomass cogeneration facility in Grande Prairie and from biomass heat energy projects recently completed at several mills in BC.

Fibre Cost and Availability

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

Financial Risk Management and Earnings Sensitivities

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

Financial Risk Management

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

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

(a) Credit risk:

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

Financial instruments that are subject to credit risk include cash and cash equivalents, accounts receivable, and long-term investments. Cash and cash equivalents includes cash held through major Canadian and international financial institutions as well as temporary investments with an original maturity date of three months or less.

Canfor utilizes credit insurance to mitigate the risk associated with some of its trade receivables. As at December 31, 2016, approximately 38% of the outstanding trade receivables are covered by credit insurance. Canfor's trade receivable balance at December 31, 2016 is $168.6 million before an allowance for doubtful accounts of $4.4 million.

At December 31, 2016, approximately 99% of the trade accounts receivable balance was within Canfor's established credit terms.

(b) Liquidity risk:

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

At December 31, 2016, Canfor had $28.0 million drawn on its operating loans, and accounts payable and accrued liabilities of $384.1 million, all of which are due within twelve months of the balance sheet date.

(c) Market risk:

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

(i) *Interest Rate risk*:

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

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

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

(ii) *Currency risk:*

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

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

(iii) *Commodity price risk:*

Canfor is exposed to commodity price risk related to the sale of lumber, pulp and paper. From time to time, Canfor enters into futures contracts on the Chicago Mercantile Exchange for lumber and forward contracts direct with customers or on commodity exchanges for pulp. Under the Price Risk Management Controls Policy, up to 15% of lumber sales and 1% of pulp sales may be sold in this way (See "Derivative Financial Instruments" section later in this document).

(iv) *Energy price risk:*

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

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

Derivative Financial Instruments

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

Earnings Sensitivities

Estimates of the sensitivity of Canfor's pre-tax results to currency fluctuations and prices for its principal products, based on 2017 forecast production and year end foreign exchange rates, are set out in the following table:

(millions of Canadian dollars)	Impact on annual pre-tax earnings
SPF lumber – US$10 change per Mfbm[49, 50]	$ 51
SYP lumber – US$10 change per Mfbm[49, 50]	$ 18
Pulp – US$10 change per tonne[50, 51]	$ 17
Canadian dollar – US$0.01 change per Canadian dollar [51, 52]	$ 18

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

Forest Health

As noted earlier in this document (Section (iv) of the Overview of 2016), timber affected by the Mountain Pine Beetle has dominated the focus for Canfor harvesting activities in central and northern BC for more than a decade, but given the shelf-life expiry of the dead pine stands, that focus is now shifting to mixed wood stands. To ensure that sufficient dead pine is being harvested to sustain the current allowable harvest rates and minimize impacts to the mid-term timber supply, the Chief Forester of British Columbia has established “AAC partitions” in a number of TSAs. These partitions cap or restrict the harvest of non-pine species and will be revisited during upcoming TSRs as the viability of the merchantable dead pine stands declines. Now however, upon reaching the end of shelf-life for the most severely impacted stands, the Chief Forester has begun reducing the AACs of the MPB impacted TSAs and we anticipate this trend to continue over the next five years.

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

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

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

In Alberta, detection surveys in 2015 have indicated a declining rate of spread in many areas. The largest active beetle populations are found in the West Central and Northwestern parts of the Province, particularly within the Jasper National Park boundary. An accelerated harvest of susceptible pine on the Canfor FMA area since 2009 in conjunction with government control efforts, has helped contain the spread in this area. On the other hand, pine mortality in areas north of the Peace River, including the Canfor quota area, has been extensive and harvesting objectives are now focused on salvage rather than spread prevention. The significant AAC increase approved for the quota area has maximized the opportunity to harvest infected pine stands before significant reduction in log quality occurs. In addition, the Alberta Government has committed funds for the rehabilitation of dead pine stands that have not been harvested due to merchantability limitations.

Government and Other Regulations

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

Information Technology Security

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

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

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

Labour Agreements and Competition for Professional Skilled Labour

Canfor collective agreements with the USW (United Steelworkers) expire on June 30, 2018. Canfor's collective agreement with UNIFOR at its Grande Prairie lumber operation expires September 30, 2017. The Company's collective agreement with the PPWC (Public and Private Workers of Canada) at its' Mackenzie lumber operation expires June 2019. CPPI's collective agreements with UNIFOR and PPWC at its Prince George operations expire on April 30, 2017. CPPI has received Notice to Bargain from the UNIFOR and the PPWC, and bargaining will commence on May 1, 2017. Negotiating new collective agreements may result in increased operating costs as a result of higher wages or benefits paid to unionized workers. Any inability to negotiate acceptable contracts with the unions as they expire could result in a strike or work stoppage by the affected workers. Regional labour market conditions may cause shortages of both professional and skilled labour, which could have an adverse impact on the operation and management of Canfor's facilities.

Maintenance Obligations and Facility Disruptions

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

Residual Fibre Revenues

Wood chips are a residual product of Canfor's lumber manufacturing process and are primarily sold to CPPI. These chips are the principal raw material utilized by CPPI in its pulp manufacturing operations. Canfor has two Chip Supply Agreements with CPPI, which contain pricing formulas that currently result in CPPI paying Canfor a price for wood chips based on pulp markets and CPPI's product mix. In 2016, Canfor provided approximately 63% of CPPI's chip requirements. If market conditions caused CPPI to cease pulp operations for an extended period of time, Canfor would have a limited market for its chip supply and this could affect its ability to run its sawmills economically. Similarly, if lumber market conditions were such that Canfor is unable to provide the current volume of chips to CPPI as a result of sawmill closures, whether temporary or permanent, CPPI's financial results could be materially affected.

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

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

Softwood Lumber Agreement

On October 12, 2015, the Softwood Lumber Agreement expired which resulted in a twelve month period in which no trade actions could be imposed for the importation of softwood lumber from Canada to the US (commonly referred to as a "stand-still period"). On October 12, 2016 the stand-still period expired, and on November 25, 2016 a petition was filed by the US Lumber Coalition to the US Department of Commerce and the US International Trade Commission alleging certain subsidies and administered fees below the fair market value of timber that favour Canadian lumber producers. On January 6, 2017, the US International Trade Commission ruled that there is a reasonable indication that US lumber producers are materially injured by reason of imports of softwood lumber products from Canada that are allegedly subsidized and sold in the United States at less than fair value. As a result, the US Department of Commerce will continue to conduct its antidumping and countervailing duty investigations on imports of these products from Canada, and is expected to announce its countervailing duty in the second quarter of 2017 and its preliminary antidumping duty determination approximately 60 days thereafter. The preliminary determinations could result in material countervailing and antidumping duties being imposed on Canadian exports of softwood lumber to the US. Canfor has been selected by the US Department of Commerce as a "mandatory respondent" to the countervailing and antidumping investigations and is subject to company specific countervailing and antidumping duties. If the US Department of Commerce determines that "critical circumstances" apply, duties could be applied retroactively up to 90 days prior to the preliminary determination. Canfor continues to cooperate with the Provincial and Federal Governments of Canada who have indicated they will vigorously defend the interests of Canadian workers and producers.

Stumpage Rates

The BC Government introduced a Market Pricing System ("MPS") for the BC Interior on July 1, 2006. On July 1, 2010 the Ministry of Forests and Range (the "Ministry") implemented changes to the interior market pricing system for timber, and from a stumpage distribution perspective, transitioned over two years to a system more sensitive to market forces such as lumber market pricing and competition for supply of logs through the BC Timber Sales ("BCTS") program, both of which could have a material impact on stumpage rates and Canfor's business. These changes dealt with issues raised by the MPB epidemic and included the introduction of "stand-as-a-whole" pricing with cruise-based billing for MPB damaged timber. For stands with 35% or more MPB damaged timber a single stumpage rate is established with billing based on the cruise rather than scaling. For these stands, determination of log grades is not necessary. Intended impacts of these changes is increased overall market sensitivity of interior timber pricing and improved utilization of low value material.

The Ministry is scheduled for its eleventh annual update of the MPS on July 1, 2017. Further changes to the BC Interior market driven stumpage system and resultant stumpage rates could have a material impact on Canfor's business. The Alberta Government will be reviewing their provincial stumpage rates (timber dues), however the Company is not aware of any planned changes at this point in time.

Transportation Services

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

Wood Dust Management

The wood products industry and government regulators continue to make the management of combustible wood dust within sawmill manufacturing facilities a high priority. Specifically, Canfor continues to take extensive steps to mitigate the risks of a combustible dust incident in our facilities, including significant capital investment, a formalized wood dust control program, and extensive employee training. Regulatory agencies across the Province of British Columbia, including WorkSafeBC, BC Safety Authority, and the Office of the Fire Commissioner have implemented various regulatory and inspection initiatives related to wood dust management. Additional regulatory initiatives up to and including stop work conditions within the industry have occurred, and continue to be a possibility.

OUTSTANDING SHARE DATA

At December 31, 2016 and February 8, 2017, there were 132,804,573 common shares issued and outstanding.

DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Board of Directors and the Audit Committee. The Company's chief executive officer ("CEO") and chief financial officer ("CFO") have evaluated the effectiveness of these disclosure controls and procedures for the year ended December 31, 2016, and have concluded that they are effective. As of December 31, 2016, the scope of the Company's design of disclosure controls and procedures ("DC&P") and internal controls over financial reporting ("ICFR") has been limited to exclude controls, policies and procedures of the Wynndel business acquired during 2016, as we have not yet completed an evaluation of these controls and procedures nor designed and implemented any necessary changes. The Company intends to include such controls, policies and procedures within the design of DC&P and ICFR during 2017. The acquisition accounted for approximately 0.4% and 2.6%, respectively, of the Company's total consolidated sales and net assets in 2016. Additional information about the acquisition is provided in Note 31 of Canfor's consolidated financial statements as at and for the year ended December 31, 2016.

The CEO and CFO acknowledge responsibility for the design of ICFR, and confirm that there were no changes in these controls that occurred during the year ended December 31, 2016 which materially affected, or are reasonably likely to materially affect, the Company's ICFR. Based upon their evaluation of these controls for the year ended December 31, 2016, the CEO and CFO have concluded that these controls are operating effectively.

Additional information about the Company, including its 2016 Annual Information Form, is available at www.sedar.com or at www.canfor.com.