

# 2016

## CANFOR CORPORATION FINANCIAL STATEMENTS

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## MANAGEMENT'S RESPONSIBILITY

The information and representations in these consolidated financial statements are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements were prepared by management in accordance with International Financial Reporting Standards and, where necessary, reflect management's best estimates and judgments at this time. It is reasonably possible that circumstances may arise which cause actual results to differ. Management does not believe it is likely that any differences will be material.

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

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

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

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

February 8, 2017

*"Don B. Kayne"*

Don B. Kayne  
President and Chief Executive Officer

*"Alan Nicholl"*

Alan Nicholl  
Senior Vice-President, Finance and Chief Financial Officer



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## **INDEPENDENT AUDITORS' REPORT**

To the Shareholders of Canfor Corporation

We have audited the accompanying consolidated financial statements of Canfor Corporation, which comprise the consolidated balance sheets as at December 31, 2016 and December 31, 2015, the consolidated statements of income, other comprehensive income (loss), changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

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

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

### *Auditors' Responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.



*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Canfor Corporation as at December 31, 2016 and December 31, 2015, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP (signed)

Chartered Professional Accountants

February 8, 2017  
Vancouver, Canada

## Canfor Corporation Consolidated Balance Sheets

(millions of Canadian dollars)	As at December 31, 2016	As at December 31, 2015
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 156.6	\$ 97.5
Accounts receivable - Trade	164.2	191.8
- Other	66.5	61.1
Inventories (Note 5)	549.0	587.2
Prepaid expenses	50.6	53.2
<b>Total current assets</b>	<b>986.9</b>	990.8
<b>Property, plant and equipment</b> (Note 6)	<b>1,460.8</b>	1,445.1
<b>Timber licenses</b> (Note 7)	<b>532.7</b>	515.2
<b>Goodwill and other intangible assets</b> (Note 8)	<b>238.8</b>	241.0
<b>Long-term investments and other</b> (Note 9)	<b>50.7</b>	98.6
<b>Retirement benefit surplus</b> (Note 13)	<b>5.9</b>	2.7
<b>Deferred income taxes, net</b> (Note 21)	<b>1.3</b>	1.2
<b>Total assets</b>	<b>\$ 3,277.1</b>	\$ 3,294.6
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Operating loans (Note 11)	\$ 28.0	\$ 158.0
Accounts payable and accrued liabilities (Note 10)	384.1	350.3
Current portion of deferred reforestation obligations (Note 14)	48.5	50.7
Forward purchase liabilities (Note 31)	41.7	76.1
<b>Total current liabilities</b>	<b>502.3</b>	635.1
<b>Long-term debt</b> (Note 12)	<b>448.0</b>	456.2
<b>Retirement benefit obligations</b> (Note 13)	<b>302.2</b>	258.6
<b>Deferred reforestation obligations</b> (Note 14)	<b>56.9</b>	61.6
<b>Other long-term liabilities</b>	<b>23.7</b>	20.1
<b>Forward purchase liability</b> (Note 31)	<b>-</b>	43.0
<b>Deferred income taxes, net</b> (Note 21)	<b>205.5</b>	192.3
<b>Total liabilities</b>	<b>\$ 1,538.6</b>	\$ 1,666.9
<b>EQUITY</b>		
Share capital (Note 17)	\$ 1,047.7	\$ 1,047.7
Contributed surplus and other equity	(4.6)	(74.5)
Retained earnings	351.7	257.7
Accumulated other comprehensive income	88.9	100.0
<b>Total equity attributable to equity shareholders of the Company</b>	<b>1,483.7</b>	1,330.9
<b>Non-controlling interests</b> (Note 18)	<b>254.8</b>	296.8
<b>Total equity</b>	<b>\$ 1,738.5</b>	\$ 1,627.7
<b>Total liabilities and equity</b>	<b>\$ 3,277.1</b>	\$ 3,294.6

### Commitments (Note 25 and 31) & Subsequent Event (Note 31)

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

APPROVED BY THE BOARD

*"R.S. Smith"*

Director, R.S. Smith

*"M.J. Korenberg"*

Director, M.J. Korenberg

## Canfor Corporation Consolidated Statements of Income

(millions of Canadian dollars, except per share data)	Years ended December 31,	
	<b>2016</b>	2015
<b>Sales</b>	<b>\$ 4,234.9</b>	\$ 3,925.3
<b>Costs and expenses</b>		
Manufacturing and product costs	<b>2,947.2</b>	2,770.4
Freight and other distribution costs	<b>635.8</b>	646.9
Export taxes	-	28.1
Amortization	<b>242.3</b>	214.0
Selling and administration costs	<b>103.7</b>	100.2
Restructuring, mill closure and severance costs (Note 16)	<b>3.4</b>	24.7
	<b>3,932.4</b>	3,784.3
Equity income (Note 9)	<b>3.6</b>	0.6
<b>Operating income</b>	<b>306.1</b>	141.6
Finance expense, net (Note 20)	<b>(32.8)</b>	(24.9)
Foreign exchange gain (loss) on long-term debt	<b>4.1</b>	(5.9)
Gain (loss) on derivative financial instruments (Note 27)	<b>2.9</b>	(28.1)
Other income (expense), net (Note 30)	<b>(12.5)</b>	27.7
Net income before income taxes	<b>267.8</b>	110.4
Income tax expense (Note 21)	<b>(63.9)</b>	(18.5)
<b>Net income</b>	<b>\$ 203.9</b>	\$ 91.9
<b>Net income attributable to:</b>		
Equity shareholders of the Company	<b>\$ 150.9</b>	\$ 24.7
Non-controlling interests (Note 18)	<b>53.0</b>	67.2
<b>Net income</b>	<b>\$ 203.9</b>	\$ 91.9
<b>Net income per common share:</b> (in Canadian dollars)		
Attributable to equity shareholders of the Company		
- Basic and diluted (Note 17)	<b>\$ 1.14</b>	\$ 0.18

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

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

(millions of Canadian dollars)	Years ended December 31,	
	<b>2016</b>	2015
<b>Net income</b>	<b>\$ 203.9</b>	\$ 91.9
<b>Other comprehensive income (loss)</b>		
Items that will not be recycled through net income:		
Defined benefit plan actuarial gains (losses) (Note 13)	<b>(50.9)</b>	28.4
Income tax recovery (expense) on defined benefit plan actuarial gains (losses) (Note 21)	<b>13.2</b>	(7.3)
	<b>(37.7)</b>	21.1
Items that may be recycled through net income:		
Foreign exchange translation of foreign operations, net of tax	<b>(11.1)</b>	72.8
Other comprehensive income (loss), net of tax	<b>(48.8)</b>	93.9
<b>Total comprehensive income</b>	<b>\$ 155.1</b>	\$ 185.8
<b>Total comprehensive income attributable to:</b>		
Equity shareholders of the Company	<b>\$ 107.4</b>	\$ 115.9
Non-controlling interests (Note 18)	<b>47.7</b>	69.9
<b>Total comprehensive income</b>	<b>\$ 155.1</b>	\$ 185.8

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

## Canfor Corporation

### Consolidated Statements of Changes in Equity

(millions of Canadian dollars)	Years ended December 31,	
	2016	2015
<b>Share capital</b>		
Balance at beginning of year	\$ 1,047.7	\$ 1,068.0
Share purchases (Note 17)	-	(20.3)
Balance at end of year (Note 17)	\$ 1,047.7	\$ 1,047.7
<b>Contributed surplus and other equity</b>		
Balance at beginning of year	\$ (74.5)	\$ 31.9
Forward purchase liabilities related to acquisitions (Note 31)	69.9	(106.4)
Balance at end of year	\$ (4.6)	\$ (74.5)
<b>Retained earnings</b>		
Balance at beginning of year	\$ 257.7	\$ 260.1
Net income attributable to equity shareholders of the Company	150.9	24.7
Defined benefit plan actuarial gains (losses), net of tax	(32.4)	18.4
Share purchases (Note 17)	-	(38.9)
Elimination of non-controlling interests (Note 31)	(20.0)	-
Acquisition of non-controlling interests (Note 17)	(4.5)	(6.6)
Balance at end of year	\$ 351.7	\$ 257.7
<b>Accumulated other comprehensive income</b>		
Balance at beginning of year	\$ 100.0	\$ 27.2
Foreign exchange translation of foreign operations, net of tax	(11.1)	72.8
Balance at end of year	\$ 88.9	\$ 100.0
<b>Total equity attributable to equity shareholders of the Company</b>	<b>\$ 1,483.7</b>	<b>\$ 1,330.9</b>
<b>Non-controlling interests</b>		
Balance at beginning of year	\$ 296.8	\$ 250.4
Net income attributable to non-controlling interests	53.0	67.2
Defined benefit plan actuarial gains (losses) attributable to non-controlling interests, net of tax	(5.3)	2.7
Distributions to non-controlling interests	(30.1)	(56.8)
Elimination of non-controlling interests (Note 31)	(39.7)	-
Acquisition of non-controlling interests (Note 17)	(19.9)	(19.0)
Non-controlling interests arising on acquisitions (Note 31)	-	52.3
Balance at end of year (Note 18)	\$ 254.8	\$ 296.8
<b>Total equity</b>	<b>\$ 1,738.5</b>	<b>\$ 1,627.7</b>

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

# Canfor Corporation

## Consolidated Statements of Cash Flows

	Years ended December 31,	
(millions of Canadian dollars)	2016	2015
<b>Cash generated from (used in):</b>		
<b>Operating activities</b>		
Net income	\$ 203.9	\$ 91.9
Items not affecting cash:		
Amortization	242.3	214.0
Income tax expense	63.9	18.5
Long-term portion of deferred reforestation obligations	(4.8)	(2.0)
Foreign exchange loss (gain) on long-term debt	(4.1)	5.9
Changes in mark-to-market value of derivative financial instruments	(4.9)	(4.1)
Employee future benefits	13.0	16.8
Finance expense, net	32.8	24.9
Gain on legal settlement, net (Note 29)	(15.5)	-
Equity income	(3.6)	(0.6)
Operations closure provisions (Note 16)	(2.0)	19.4
Write-down of advances to Licella (Note 30)	7.0	-
Other, net	1.7	3.4
Defined benefit plan contributions, net	(33.3)	(5.9)
Cash received from legal settlement (Note 29)	16.3	-
Income taxes paid, net	(29.9)	(61.3)
	<b>482.8</b>	<b>320.9</b>
Net change in non-cash working capital (Note 22)	<b>101.0</b>	<b>(66.3)</b>
	<b>583.8</b>	<b>254.6</b>
<b>Financing activities</b>		
Change in operating bank loans (Note 11)	(130.0)	90.0
Proceeds from long-term debt (Note 12)	-	388.4
Repayment of long-term debt (Note 12)	-	(175.0)
Finance expenses paid	(22.0)	(12.7)
Share purchases (Note 17)	-	(59.2)
Acquisition of non-controlling interests (Note 17)	(24.7)	(25.3)
Cash distributions paid to non-controlling interests (Note 18)	(28.5)	(56.8)
	<b>(205.2)</b>	<b>149.4</b>
<b>Investing activities</b>		
Additions to property, plant and equipment, timber and intangible assets, net	(233.8)	(240.0)
Acquisitions (Note 31)	(83.9)	(263.4)
Advances to Licella (Note 30)	(7.0)	-
Change in restricted cash (Note 31)	-	50.2
Timber investment loan (Note 9)	-	(30.0)
Proceeds on sale of Lakeland Winton (Note 9)	-	15.0
Other, net	6.9	(9.8)
	<b>(317.8)</b>	<b>(478.0)</b>
Foreign exchange gain (loss) on cash and cash equivalents	(1.7)	13.2
<b>Increase (decrease) in cash and cash equivalents*</b>	<b>59.1</b>	<b>(60.8)</b>
Cash and cash equivalents at beginning of year*	97.5	158.3
<b>Cash and cash equivalents at end of year*</b>	<b>\$ 156.6</b>	<b>\$ 97.5</b>

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

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

# Canfor Corporation

## Notes to the Consolidated Financial Statements

Years ended December 31, 2016 and 2015  
(millions of Canadian dollars unless otherwise noted)

### 1. Reporting Entity

Canfor Corporation is a company incorporated and domiciled in Canada and listed on The Toronto Stock Exchange. The address of the Company's registered office is 100-1700 West 75<sup>th</sup> Avenue, Vancouver, British Columbia, Canada, V6P 6G2. The consolidated financial statements of the Company as at and for the year ended December 31, 2016 comprise the Company and its subsidiaries (together referred to as "Canfor" or "the Company") and the Company's interests in associates and jointly controlled entities.

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

### 2. Basis of Preparation

#### *Statement of compliance*

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

The consolidated financial statements were authorized for issue by the Board of Directors on February 8, 2017.

#### *Basis of measurement*

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

- Financial instruments classified as fair value through net income are measured at fair value;
- Financial instruments classified as available-for-sale are measured at fair value with gains or losses, other than impairment losses, recorded in other comprehensive income until realized;
- Equity investments are initially recognized at cost and subsequently increased or decreased to recognize the investor's share of the investee's equity;
- Asset retirement obligations and deferred reforestation obligations are measured at the discounted value of expected future cash flows; and
- The retirement benefit surplus and obligation related to the defined benefit pension plans are the net of the accrued benefit obligation and the fair value of the plan assets.

### ***Use of estimates and judgments***

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

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

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

- Note 6 – Property, Plant and Equipment;
- Note 7 – Timber Licenses;
- Note 8 – Goodwill and Other Intangible Assets;
- Note 9 – Long-Term Investments and Other;
- Note 13 – Employee Future Benefits;
- Note 14 – Deferred Reforestation Obligations;
- Note 15 – Asset Retirement Obligations;
- Note 16 – Restructuring, Mill Closure and Severance Costs;
- Note 21 – Income Taxes;
- Note 30 – Licella Pulp Joint Venture; and
- Note 31 – Acquisitions.

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

### **3. Significant Accounting Policies**

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

#### ***Basis of consolidation***

Subsidiaries are entities controlled by the Company. Control exists when Canfor is able to govern the financial and operating activities of those other entities to generate returns for the Company. Inter-company transactions, balances and unrealized gains and losses on transactions between different entities within the Company are eliminated. Significant subsidiaries include Canadian Forest Products Ltd. and Canfor Southern Pine, Inc. ("CSP"), formerly known as New South Companies, Inc., which are wholly owned, and Canfor Pulp Products Inc. ("CPPI"), which is 53.6% owned. During 2015, the Company completed the third phase of the purchase of the lumber business of Scotch & Gulf Lumber, LLC ("Scotch Gulf"), increasing its ownership to 50% and completed the first phase of the purchase of the lumber business of Beadles Lumber Company & Balfour Lumber Company Inc. ("Beadles & Balfour"), representing an initial 55% ownership interest. In 2015, Canfor also acquired Southern Lumber Company Inc. ("Southern Lumber") and Anthony Forest Products Company ("Anthony"), which are wholly owned. Canfor acquired the remaining 50% of Scotch Gulf in July 2016 and the remaining 45% of Beadles & Balfour in January 2017.

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

Joint ventures are accounted for using the equity method of accounting. As part of the acquisition of Anthony, Canfor acquired a 50% interest in Anthony EACOM Inc., a joint venture that owns and operates an I-joist facility located in Sault St. Marie, Ontario (Note 9).

### ***Business combinations***

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

### ***Cash and cash equivalents***

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

### ***Financial instruments***

#### *Non-derivative financial instruments*

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

Financial assets at fair value through net income - An instrument is classified at fair value through net income if it is held for trading or is designated as such upon initial recognition. Financial instruments at fair value through net income are measured at fair value, and changes therein are recognized in the statements of income, with attributable transaction costs being recognized in net income when incurred.

Available-for-sale financial assets - Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any other categories. These are measured at fair value through other comprehensive income, other than impairment losses.

Loans and receivables - Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These are measured at amortized cost using the effective interest method, less any impairment losses. The effective interest method is used to spread the total costs of or income from a financial instrument over the life of the instrument. Financial assets included within this category for Canfor are trade and other receivables, and cash and cash equivalents.

Other liabilities - All of Canfor's financial liabilities are measured at amortized cost using the effective interest method.

#### *Derivative financial instruments*

Canfor uses derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange, interest rate, lumber and pulp price and energy price risk. Canfor's policy is not to utilize derivative financial instruments for trading or speculative purposes.

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

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

### ***Inventories***

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

### ***Property, plant and equipment***

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

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

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

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

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

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

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### ***Timber licenses***

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

### ***Other intangible assets***

#### ***Goodwill***

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

#### ***Customer agreements***

Canfor's customer agreements were acquired as part of the purchase of CSP, and were recognized at fair value at the acquisition date. The customer agreements have a finite useful life and are carried at cost less accumulated amortization, which is recorded on a straight-line basis over 10 years.

#### ***Computer software***

Software development costs relate to major software systems purchased or developed by the Company. These costs are amortized on a straight-line basis over periods not exceeding five to ten years.

### ***Government assistance***

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

### ***Asset impairment***

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

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

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

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

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

### ***Employee future benefits***

#### ***Defined contribution plans***

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

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

#### ***Defined benefit plans***

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

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

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

### ***Provisions***

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

#### ***Asset retirement obligations***

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

#### ***Deferred reforestation obligations***

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

#### ***Restructuring***

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

### ***Share-based compensation***

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

### ***Revenue recognition***

Canfor's revenues are derived from the sale of lumber, engineered wood products, pulp, kraft paper, residual fibre, logs and energy. Revenue is measured at the fair value of the consideration received or receivable net of applicable sales taxes, returns, rebates and discounts and after eliminating sales within the Company. Revenue is recognized when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible returns of the goods can be estimated reliably, there is no continuing management involvement with the goods, and the amounts of revenue can be measured reliably.

Amounts charged to customers for shipping and handling are recognized as revenue, and shipping and handling costs incurred by Canfor are reported as a component of freight and other distribution costs. Lumber export taxes are recorded as a component of operating income.

### ***Income taxes***

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

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

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

A deferred income tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred income tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Investment tax credits are credited to manufacturing and product costs in the period in which it becomes reasonably assured that the Company is entitled to them. Unused investment tax credits are recorded as other current or long-term assets in the Company's balance sheet, depending upon when the benefit is expected to be received.

### ***Foreign currency translation***

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

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

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

### ***Segment reporting***

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

## **4. Accounting Standards Issued and Not Applied**

In May 2014, the 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.

## 5. Inventories

(millions of Canadian dollars)	As at December 31, 2016	As at December 31, 2015
Logs	\$ 107.3	\$ 169.1
Finished products	310.6	285.4
Residual fibre	13.8	20.8
Materials and supplies	117.3	111.9
	<b>\$ 549.0</b>	<b>\$ 587.2</b>

The above inventory balances are stated after inventory write-downs from cost to net realizable value. There were no write-downs at December 31, 2016 (2015 - \$0.5 million).

In 2016, of the total manufacturing and product costs of \$2,947.2 million, \$1,591.3 million related to the costs of raw materials, consumables and finished products (2015 - \$1,353.1 million).

## 6. Property, Plant and Equipment

(millions of Canadian dollars)	Land	Pulp and kraft paper mills	Solid Wood operations <sup>2</sup>	Logging assets and other equipment	Total
<b>Cost</b>					
Balance at January 1, 2015	\$ 45.1	\$ 1,557.9	\$ 1,537.7	\$ 223.3	\$ 3,364.0
Additions <sup>1</sup>	-	70.1	134.1	19.8	224.0
Acquisitions (Note 31)	4.1	-	165.9	0.7	170.7
Disposals	(1.7)	(42.7)	(88.6)	(14.1)	(147.1)
Effect of movements in exchange rates	4.0	-	54.6	0.2	58.8
Balance at December 31, 2015	\$ 51.5	\$ 1,585.3	\$ 1,803.7	\$ 229.9	\$ 3,670.4
Additions <sup>1</sup>	-	62.3	151.1	14.0	227.4
Acquisitions (Note 31)	1.1	-	21.8	0.3	23.2
Disposals	-	(25.7)	(66.4)	(2.2)	(94.3)
Effect of movements in exchange rates	(0.7)	-	(11.8)	-	(12.5)
Balance at December 31, 2016	\$ 51.9	\$ 1,621.9	\$ 1,898.4	\$ 242.0	\$ 3,814.2
<b>Amortization and impairment losses</b>					
Balance at January 1, 2015	\$ (4.0)	\$ (1,039.0)	\$ (925.9)	\$ (179.0)	\$ (2,147.9)
Amortization for the year	-	(64.8)	(118.5)	(7.6)	(190.9)
Disposals	1.5	42.0	86.0	13.2	142.7
Impairment losses	-	-	(4.6)	-	(4.6)
Effect of movements in exchange rates	-	-	(24.6)	-	(24.6)
Balance at December 31, 2015	\$ (2.5)	\$ (1,061.8)	\$ (987.6)	\$ (173.4)	\$ (2,225.3)
Amortization for the year	-	(73.2)	(136.1)	(10.7)	(220.0)
Disposals	-	22.3	63.2	2.0	87.5
Effect of movements in exchange rates	-	-	4.4	-	4.4
Balance at December 31, 2016	\$ (2.5)	\$ (1,112.7)	\$ (1,056.1)	\$ (182.1)	\$ (2,353.4)
<b>Carrying amounts</b>					
At January 1, 2015	\$ 41.1	\$ 518.9	\$ 611.8	\$ 44.3	\$ 1,216.1
At December 31, 2015	\$ 49.0	\$ 523.5	\$ 816.1	\$ 56.5	\$ 1,445.1
<b>At December 31, 2016</b>	<b>\$ 49.4</b>	<b>\$ 509.2</b>	<b>\$ 842.3</b>	<b>\$ 59.9</b>	<b>\$ 1,460.8</b>

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

<sup>2</sup>Solid Wood operations include those sawmills, pellet plants, engineered wood products plants, chip plants, plywood and oriented strand board plants that are consolidated on a line-by-line basis.

Included in the above are assets under construction in the amount of \$33.4 million (2015 - \$48.6 million), which have not been amortized as at December 31, 2016.

## 7. Timber Licenses

(millions of Canadian dollars)

<b>Cost</b>	
Balance at January 1, 2015	\$ 824.3
Additions	11.1
Balance at December 31, 2015	\$ 835.4
Additions (Note 9)	30.6
Acquisitions (Note 31)	9.7
Disposals	(6.9)
Balance at December 31, 2016	\$ 868.8
<b>Amortization</b>	
Balance at January 1, 2015	\$ (304.8)
Amortization for the year	(15.4)
Balance at December 31, 2015	\$ (320.2)
Amortization for the year	(15.9)
Balance at December 31, 2016	\$ (336.1)
<b>Carrying amounts</b>	
At January 1, 2015	\$ 519.5
At December 31, 2015	\$ 515.2
<b>At December 31, 2016</b>	<b>\$ 532.7</b>

## 8. Goodwill and Other Intangible Assets

(millions of Canadian dollars)	Goodwill	Other intangible assets	Total
<b>Cost</b>			
Balance at January 1, 2015	\$ 81.2	\$ 75.8	\$ 157.0
Additions	-	9.2	9.2
Acquisitions (Note 31)	108.2	0.3	108.5
Disposals	-	(0.8)	(0.8)
Effect of movement in exchange rates	26.1	6.3	32.4
Balance at December 31, 2015	\$ 215.5	\$ 90.8	\$ 306.3
Additions	-	10.7	10.7
Effect of movement in exchange rates	(6.4)	(1.2)	(7.6)
Balance at December 31, 2016	\$ 209.1	\$ 100.3	\$ 309.4
<b>Amortization</b>			
Balance at January 1, 2015	\$ -	\$ (52.0)	\$ (52.0)
Amortization for the year	-	(8.0)	(8.0)
Effect of movement in exchange rates	-	(5.3)	(5.3)
Balance at December 31, 2015	\$ -	\$ (65.3)	\$ (65.3)
Amortization for the year	-	(6.4)	(6.4)
Effect of movement in exchange rates	-	1.1	1.1
Balance at December 31, 2016	\$ -	\$ (70.6)	\$ (70.6)
<b>Carrying amounts</b>			
At January 1, 2015	\$ 81.2	\$ 23.8	\$ 105.0
At December 31, 2015	\$ 215.5	\$ 25.5	\$ 241.0
<b>At December 31, 2016</b>	<b>\$ 209.1</b>	<b>\$ 29.7</b>	<b>\$ 238.8</b>

Goodwill relates to Canfor's US subsidiaries (CSP, Scotch Gulf, Beadles & Balfour, Southern Lumber, and Anthony) and is denominated in US dollars. Goodwill is allocated separately to each acquired business and tested at that level for impairment purposes. The recoverable amount of the goodwill is determined for each past acquisition based on an assessment of the value in use that is estimated using a discounted cash flow model.

As part of the goodwill impairment assessment, assumptions are made in relation to forecast prices and exchange rates. Key assumptions used in the cash flow models include forecast prices and foreign exchange rates which the Company's management determined with reference to external publications. A pre-tax discount rate of 11.0% and cost inflation rate of 2.0% were used for the purpose of the calculation in 2016 consistent with the calculation in 2015. The net present value of the future expected cash flows is compared to the carrying value of the Company's investment in these assets, including goodwill, at year end.

Based upon management's analysis, no impairment of goodwill was required in 2016 or 2015.

## 9. Long-Term Investments and Other

(millions of Canadian dollars)	<b>As at December 31, 2016</b>	As at December 31, 2015
Investments	\$ 14.7	\$ 17.7
Timber investment loan	-	30.5
Equity investment in Anthony EACOM Inc.	16.8	16.2
Lakeland Winton receivable	-	15.0
Other deposits, loans and advances	19.2	19.2
	<b>\$ 50.7</b>	<b>\$ 98.6</b>

On July 1, 2015, the Company sold its 33.3% investment in Lakeland Mills Ltd. and Winton Global Lumber Ltd. ("Lakeland Winton") for consideration of \$30.0 million and recorded a gain of \$7.0 million in other income. The first installment of \$15.0 million was received on July 1, 2015 and the second installment for \$15.0 million is scheduled to be received on July 1, 2017, and as such, has been reclassified to other accounts receivable in 2016.

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

As part of the acquisition of Anthony Forest Products Company (Note 31), Canfor acquired a 50% interest in Anthony EACOM Inc., which owns an I-joist facility located in Sault St. Marie, Ontario. Canfor's investment in Anthony EACOM Inc. is classified as a joint venture and is accounted for using the equity method of accounting. For the year ended December 31, 2016, the Company's share of the joint venture's sales was \$25.5 million (2015 - \$3.8 million) and net income was \$3.6 million (2015 - \$0.6 million). At December 31, 2016, the carrying value of the equity investment is \$16.8 million (2015 - \$16.2 million).

## 10. Accounts Payable and Accrued Liabilities

(millions of Canadian dollars)	<b>As at December 31, 2016</b>	As at December 31, 2015
Trade payables and accrued liabilities	\$ 226.8	\$ 201.1
Accrued payroll and related liabilities	104.1	103.9
Restructuring, mill closure and severance costs	7.6	11.5
Other	45.6	33.8
	<b>\$ 384.1</b>	<b>\$ 350.3</b>

## 11. Operating Loans

(millions of Canadian dollars)	As at December 31, 2016	As at December 31, 2015
<b>Canfor (excluding CPPI)</b>		
Available operating loans:		
Operating loan facility	\$ 350.0	\$ 350.0
Facility for letters of credit	50.0	39.7
Total operating loan facility	400.0	389.7
Operating loan drawn	(28.0)	(158.0)
Letters of credit	(41.6)	(39.7)
Total available operating loan facility - Canfor	\$ 330.4	\$ 192.0
<b>CPPI</b>		
Available operating loans:		
Operating loan facility	\$ 110.0	\$ 110.0
Facility for letters of credit	-	20.0
Total operating loan facility	110.0	130.0
Letters of credit	(9.3)	(13.0)
Total available operating loan facility - CPPI	\$ 100.7	\$ 117.0
<b>Consolidated:</b>		
<b>Total operating loan facilities</b>	<b>\$ 510.0</b>	<b>\$ 519.7</b>
<b>Total available operating loan facilities</b>	<b>\$ 431.1</b>	<b>\$ 309.0</b>

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.

CPPI extended the maturity date on its operating loan facility in 2015 to January 31, 2019 and also removed certain financial covenants at that time. In 2016, the maturity date of this facility was further extended to January 31, 2020. The terms of CPPI's operating loan facility include interest payable at floating rates that vary depending on the ratio of debt to total capitalization and is based on lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin.

Both Canfor's and CPPI's operating loan facilities have certain financial covenants, including maximum debt to total capitalization ratios. In 2015, with the extension of both operating facilities, the financial covenants were modified to exclude minimum net worth covenants based on shareholders' equity.

Canfor (excluding CPPI) has a separate facility to cover letters of credit. In 2016, the Company increased the separate facility to \$50.0 million. At December 31, 2016, \$39.0 million of letters of credit outstanding are covered under this facility with the balance of \$2.6 million covered under Canfor's general operating loan facility.

CPPI had a separate facility to cover letters of credit, which expired in 2016. At December 31, 2016, \$9.3 million of letters of credit outstanding are covered under the general operating loan facility.

As at December 31, 2016, the Company and CPPI are in compliance with all covenants relating to their operating loans. Substantially all borrowings of CPPI are non-recourse to other entities within the Company.

## 12. Long-Term Debt

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

### *Summary of long-term debt*

(millions of Canadian dollars)	As at December 31, 2016	As at December 31, 2015
Privately placed senior notes		
Canfor Corporation		
CAD\$125.0 million, floating interest, repayable September 28, 2020	\$ 125.0	\$ 125.0
US\$100.0 million, floating interest, repayable September 28, 2023	134.3	138.4
US\$100.0 million, fixed interest of 4.4%, repayable in three tranches on October 2, 2023, 2024 and 2025	134.3	138.4
Other <sup>3</sup>	4.4	4.4
Canfor Pulp Products Inc.		
CAD\$50.0 million, floating interest, repayable January 31, 2020	50.0	50.0
	<b>\$ 448.0</b>	<b>\$ 456.2</b>

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

During the year, CPPI extended the maturity date on its term loan from November 5, 2018 to January 31, 2020.

In 2015, 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 financing with the same syndicate of lenders with a maturity of September 28, 2020. The term debt financing was completed to rebalance the Company's debt levels prior to the completion of the US-dollar financings described below. Consistent with the Company's principal operating loan facility, interest is payable on the \$125.0 million term debt 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.

On October 2, 2015, the Company issued US\$100.0 million of senior unsecured notes, bearing interest at 4.4% per annum. The notes mature in three tranches with US\$33.3 million due on each of October 2, 2023 and October 2, 2024 with the balance due on October 2, 2025.

On September 28, 2015, the Company entered into a new eight-year floating interest rate term loan for US\$100.0 million to further support its growth in the US. The debt is repayable on September 28, 2023 with interest payable based on LIBOR plus a margin.

All borrowings of the Company feature similar financial covenants, including a maximum debt to total capitalization ratio.

As at December 31, 2016, the Company and CPPI are in compliance with all covenants relating to their long-term debt.

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

At December 31, 2016, the fair value of the Company's long-term debt is \$447.2 million (2015 - \$448.1 million). The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

## 13. Employee Future Benefits

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

Total cash payments for employee future benefits, net of withdrawals, for 2016 were \$65.8 million (2015 - \$37.1 million), consisting of cash contributed by Canfor to its funded pension plans, cash payments directly to beneficiaries for its unfunded other non-pension post-retirement benefit plans, cash contributed to its defined contribution plans, and cash contributed to forest industry union benefit plans.

### Defined benefit plans

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

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

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

Fair market value of plan assets	2016		2015	
	Defined Benefit Pension Plans	Other Benefit Plans	Defined Benefit Pension Plans	Other Benefit Plans
(millions of Canadian dollars)				
Beginning of year	\$ 705.9	\$ -	\$ 721.4	\$ -
Interest income on plan assets	28.4	-	27.7	-
Return on plan assets greater (less) than discount rate	(20.0)	-	1.2	-
Employer contributions	27.4	5.9	18.3	5.2
Employee contributions	0.5	-	0.5	-
Benefit payments	(44.3)	(5.9)	(46.7)	(5.2)
Withdrawals	-	-	(18.6)	-
Administration expense	(0.5)	-	(0.7)	-
Other	(0.4)	-	2.8	-
End of year	\$ 697.0	\$ -	\$ 705.9	\$ -

Plan assets consist of the following:	As at	As at
	December 31, 2016	December 31, 2015
	Percentage of Plan Assets	
Asset category		
Equity securities	15%	22%
Debt securities	46%	68%
Annuities	38%	9%
Cash and cash equivalents and other	1%	1%
	100%	100%

Accrued benefit obligations	2016		2015	
	Defined Benefit Pension Plans	Other Benefit Plans	Defined Benefit Pension Plans	Other Benefit Plans
(millions of Canadian dollars)				
Beginning of year	\$ 795.1	\$ 165.2	\$ 805.4	\$ 177.5
Current service cost	9.0	2.9	9.5	3.5
Interest cost	31.8	6.5	30.8	6.7
Employee contributions	0.5	-	0.5	-
Benefit payments	(44.3)	(5.9)	(46.7)	(5.2)
Plan amendments	-	-	3.2	-
Actuarial loss (gain)	20.9	10.2	(11.0)	(16.2)
Other	(0.6)	0.4	3.4	(1.1)
End of year	\$ 812.4	\$ 179.3	\$ 795.1	\$ 165.2

Of the defined benefit pension plan obligation of \$812.4 million (2015 - \$795.1 million), \$739.7 million (2015 - \$723.2 million) relates to plans that are wholly or partly funded and \$72.7 million (2015 - \$71.9 million) relates to plans that are wholly unfunded. At December 31, 2016, certain liabilities for pension benefit plans were secured by letters of credit in the amount of \$38.5 million (2015 - \$36.9 million).

The total obligation for the other benefit plans of \$179.3 million (2015 - \$165.2 million) is unfunded.

### Annuity contracts

In 2016, the Company purchased \$216.1 million of buy-in annuities through its defined benefit pension plans, increasing total annuities purchased to \$286.6 million. Future cash flows from the annuities will match the amount and timing of benefits payable under the plans, substantially mitigating the exposure to future volatility in the related pension obligations. Transaction costs of \$19.5 million related to the purchase were recognized in other comprehensive income (loss), principally reflecting the difference between the annuity rate (which is comparable to solvency rates) compared to the discount rate used to value the obligations on a going concern basis.

At December 31, 2016, reflecting the buy-in annuities, 33% (2015 - 8%) 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 (2015 - 58%).

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

	December 31, 2016		December 31, 2015	
	Defined Benefit Pension Plans	Other Benefit Plans	Defined Benefit Pension Plans	Other Benefit Plans
(millions of Canadian dollars)				
Fair market value of plan assets	\$ 697.0	\$ -	\$ 705.9	\$ -
Accrued benefit obligations	(812.4)	(179.3)	(795.1)	(165.2)
Funded status of plans – deficit	\$ (115.4)	\$ (179.3)	\$ (89.2)	\$ (165.2)
Other pension plans	(1.6)	-	(1.5)	-
Total accrued benefit liability, net	\$ (117.0)	\$ (179.3)	\$ (90.7)	\$ (165.2)

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

	December 31, 2016		December 31, 2015	
	Defined Benefit Pension Plans	Other Benefit Plans	Defined Benefit Pension Plans	Other Benefit Plans
(millions of Canadian dollars)				
Retirement benefit surplus	\$ 5.9	\$ -	\$ 2.7	\$ -
Retirement benefit obligations	(122.9)	(179.3)	(93.4)	(165.2)
Total accrued benefit liability, net	\$ (117.0)	\$ (179.3)	\$ (90.7)	\$ (165.2)

At December 31, 2016 and 2015, certain defined benefit pension plans are in a surplus position reflecting the return on plan assets, actuarial gains and employer contributions to the pension plans during 2016 and 2015. The plans with a net retirement surplus have been classified as non-current assets on the balance sheet.

## Components of pension cost

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

	2016		2015	
	Defined Benefit Pension Plans	Other Benefit Plans	Defined Benefit Pension Plans	Other Benefit Plans
(millions of Canadian dollars)				
<b>Recognized in net income</b>				
Current service cost	\$ 9.0	\$ 2.9	\$ 9.5	\$ 3.5
Administration expense	0.7	-	1.4	-
Interest cost	3.4	6.5	3.1	6.7
Plan amendments	-	-	3.2	-
Other	-	0.4	-	(1.1)
<b>Total charge included in net income</b>	<b>\$ 13.1</b>	<b>\$ 9.8</b>	<b>\$ 17.2</b>	<b>\$ 9.1</b>
<b>Recognized in other comprehensive income (loss)</b>				
Actuarial loss (gain) – experience	\$ 2.2	\$ (0.3)	\$ 6.4	\$ 5.0
Actuarial loss (gain) – demographic assumptions	(0.5)	-	1.3	-
Actuarial loss (gain) – financial assumptions	19.2	10.5	(18.7)	(21.2)
Return on plan assets less (greater) than discount rate	20.0	-	(1.2)	-
Administration expense less than expected	(0.2)	-	(0.7)	-
Other	-	-	-	0.7
<b>Total charge (credit) included in other comprehensive income (loss)</b>	<b>\$ 40.7</b>	<b>\$ 10.2</b>	<b>\$ (12.9)</b>	<b>\$ (15.5)</b>

## Significant assumptions

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).

## Sensitivity analysis

Assumed discount rates and medical cost trend rates have a significant effect on the accrued retirement benefit obligation and related plan assets. A one percentage point change in these assumptions would have the following effects on the accrued retirement benefit obligation, 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)

As at December 31, 2016, Canfor estimates that it will make contribution payments of \$19.4 million to its defined benefit pension plans in 2017 based on the last actuarial valuation for funding purposes.

### *Defined contribution and other plans*

The total expense recognized in 2016 for Canfor's defined contribution plans was \$9.9 million (2015 - \$10.2 million).

Canfor contributes to various forest industry union benefit plans providing both pension and other retirement benefits. These plans are accounted for as defined contribution plans. Contributions to these plans, not included in the expense for defined contribution plans above, amounted to \$22.6 million in 2016 (2015 - \$21.9 million).

## 14. Deferred Reforestation Obligations

The following table provides a reconciliation of the deferred reforestation obligations as at December 31, 2016 and 2015:

(millions of Canadian dollars)	2016	2015
Reforestation obligations at beginning of year	\$ 112.3	\$ 112.1
Expense for year	40.0	44.1
Accretion expense	0.5	0.8
Additions	2.8	3.8
Disposals	(3.8)	-
Changes in estimates	(0.8)	0.3
Paid during the year	(45.6)	(48.8)
Reforestation obligations at end of year	\$ 105.4	\$ 112.3
Less: Current portion	(48.5)	(50.7)
Long-term portion	\$ 56.9	\$ 61.6

The total undiscounted amount of the estimated cash flows required to settle the obligations at December 31, 2016 is \$109.0 million (2015 - \$115.1 million) with payments spread over 15 years. Due to the general long-term nature of the liability, the most significant area of uncertainty in estimating the provision is the future costs that will be incurred. The estimated cash flows have been adjusted for inflation and discounted using risk-free rates ranging from 0.7% to 2.0% at December 31, 2016.

Additions of \$2.8 million during 2016 related to the deferred reforestation obligations assumed by Canfor on the acquisition of Wynndel Box and Lumber Ltd. ("Wynndel") (Note 31). Disposals of \$3.8 million during 2016 related to the sale of a forest license in the Kootenays.

## 15. Asset Retirement Obligations

The following table provides a reconciliation of the asset retirement obligations as at December 31, 2016 and 2015:

(millions of Canadian dollars)	2016	2015
Asset retirement obligations at beginning of year	\$ 8.0	\$ 7.4
Accretion expense	0.1	0.1
Changes in estimates	1.8	0.5
Asset retirement obligations at end of year	\$ 9.9	\$ 8.0

Canfor's asset retirement obligations include \$5.4 million in relation to landfill closure costs at CPPI. CPPI's obligations represent estimated undiscounted future payments of \$9.3 million to remediate landfills at the operations at the end of their useful lives. The payments are expected to occur at periods ranging from 6 to 35 years and have been discounted at risk-free rates ranging from 1.3% to 2.3% (2015 - 1.0% to 2.2%).

Canfor's asset retirement obligations, excluding CPPI's, represent estimated undiscounted future payments of \$7.7 million to remediate landfills at the operations at the end of their useful lives. The payments 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% (2015 - 1.1% to 2.1%).

The \$1.8 million of changes in estimates associated with the asset retirement obligations principally reflect revised costs of the obligations offset in part by higher discount rates used in the valuation of the obligations.

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

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

## 16. Restructuring, Mill Closure and Severance Costs

Restructuring, mill closure and severance costs represent costs associated with the indefinite or permanent closures of facilities and staff reductions. The expense for the year ended December 31, 2016 amounted to \$3.4 million (2015 - \$24.7 million). The 2015 expense in the lumber segment principally related to closure costs at the Canal Flats sawmill, which was permanently closed in November 2015. A portion of the provision relating to the Canal Flats sawmill in the amount of \$2.0 million was reversed in 2016, reflecting lower current estimates of demolition costs.

The following table provides a breakdown of the restructuring, mill closure and severance costs by business segment:

(millions of Canadian dollars)	2016	2015
Lumber, net	\$ 0.7	\$ 21.4
Pulp & Paper	-	-
Unallocated and Other	2.7	3.3
	\$ 3.4	\$ 24.7

The following table provides a reconciliation of the restructuring, mill closure and severance liability for the years ended December 31, 2016 and 2015:

(millions of Canadian dollars)	2016	2015
Accrued liability at beginning of year	\$ 13.7	\$ 8.7
Costs accrued in the year, net of reversals	-	19.8
Paid during the year	(3.1)	(14.8)
Accrued liability at end of year	\$ 10.6	\$ 13.7

At December 31, 2016, \$3.0 million of the restructuring, mill closure and severance liability is non-current (2015 - \$2.2 million).

## 17. Share Capital

### *Authorized*

10,000,000 preferred shares, with a par value of \$25 each.

1,000,000,000 common shares without par value.

### *Issued and fully paid*

	2016		2015	
(millions of Canadian dollars, except number of shares)	Number of Shares	Amount	Number of Shares	Amount
Common shares at beginning of year	132,804,573	\$ 1,047.7	135,376,993	\$ 1,068.0
Common shares purchased	-	-	(2,572,420)	(20.3)
Common shares at end of year	132,804,573	\$ 1,047.7	132,804,573	\$ 1,047.7

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

Basic net income per share is calculated by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the period. The weighted average number of common shares outstanding for 2016 was 132,804,573 (2015 - 134,068,255).

### *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. Under a separate normal course issuer bid, CPPI purchased common shares from non-controlling shareholders increasing Canfor's ownership of CPPI from 51.9% at December 31, 2015 to 53.6% at December 31, 2016.

In 2015, under a previous normal course issuer bid, Canfor purchased 2,572,420 common shares for \$59.2 million (an average price of \$23.01 per common share), of which \$20.3 million was charged to share capital and \$38.9 million charged to retained earnings.

## 18. Non-Controlling Interests

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

### Summarized Balance Sheets:

Amounts presented below represent non-controlling %  
(millions of Canadian dollars)

	As at December 31, 2016			As at December 31, 2015		
	Lumber <sup>4</sup>	CPPI <sup>5</sup>	Total	Lumber <sup>4</sup>	CPPI <sup>5</sup>	Total
Current assets	\$ 13.0	\$ 146.7	\$ 159.7	\$ 31.7	\$ 148.3	\$ 180.0
Non-current assets	26.6	241.7	268.3	57.7	256.5	314.2
<b>Total assets</b>	<b>\$ 39.6</b>	<b>\$ 388.4</b>	<b>\$ 428.0</b>	<b>\$ 89.4</b>	<b>\$ 404.8</b>	<b>\$ 494.2</b>
Current liabilities	\$ 8.4	\$ 58.2	\$ 66.6	\$ 20.8	\$ 69.4	\$ 90.2
Non-current liabilities	1.3	105.3	106.6	2.6	104.6	107.2
<b>Total liabilities</b>	<b>\$ 9.7</b>	<b>\$ 163.5</b>	<b>\$ 173.2</b>	<b>\$ 23.4</b>	<b>\$ 174.0</b>	<b>\$ 197.4</b>
<b>Total equity</b>	<b>\$ 29.9</b>	<b>\$ 224.9</b>	<b>\$ 254.8</b>	<b>\$ 66.0</b>	<b>\$ 230.8</b>	<b>\$ 296.8</b>
<b>Total liabilities and equity</b>	<b>\$ 39.6</b>	<b>\$ 388.4</b>	<b>\$ 428.0</b>	<b>\$ 89.4</b>	<b>\$ 404.8</b>	<b>\$ 494.2</b>

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

Amounts presented below represent non-controlling %  
(millions of Canadian dollars)

	Year ended December 31, 2016			Year ended December 31, 2015		
	Lumber <sup>4</sup>	CPPI <sup>5</sup>	Total	Lumber <sup>4</sup>	CPPI <sup>5</sup>	Total
Sales	\$ 130.6	\$ 519.0	\$ 649.6	\$ 154.7	\$ 574.5	\$ 729.2
Net income	25.8	27.2	53.0	15.1	52.1	67.2
Other comprehensive income (loss)	-	(5.3)	(5.3)	-	2.7	2.7
<b>Total comprehensive income</b>	<b>\$ 25.8</b>	<b>\$ 21.9</b>	<b>\$ 47.7</b>	<b>\$ 15.1</b>	<b>\$ 54.8</b>	<b>\$ 69.9</b>
Dividends paid to non-controlling interests	\$ 20.5	\$ 8.0	\$ 28.5	\$ 9.6	\$ 47.2	\$ 56.8

### Summarized Statements of Cash Flows:

Amounts presented below represent non-controlling %  
(millions of Canadian dollars)

	Year ended December 31, 2016			Year ended December 31, 2015		
	Lumber <sup>4</sup>	CPPI <sup>5</sup>	Total	Lumber <sup>4</sup>	CPPI <sup>5</sup>	Total
Cash flows from operating activities	\$ 36.2	\$ 70.6	\$ 106.8	\$ 22.1	\$ 70.0	\$ 92.1
Cash flows from financing activities	\$ (25.9)	\$ (21.1)	\$ (47.0)	\$ (7.8)	\$ (59.9)	\$ (67.7)
Cash flows from investing activities	\$ (12.0)	\$ (33.3)	\$ (45.3)	\$ (9.3)	\$ (38.6)	\$ (47.9)

<sup>4</sup>Lumber non-controlling interest includes non-controlling interest related to Beadles & Balfour (45%), Houston Pellet Limited Partnership (40%), and the Fort St. John and Chetwynd pellet plants (5%) as well as non-controlling interest related to Scotch Gulf (50%) up to the completion of the final phase of the acquisition in July 2016, which increased Canfor's ownership in Scotch Gulf to 100% (Note 31).

<sup>5</sup>CPPI purchased shares from non-controlling CPPI shareholders under a normal course issuer bid increasing Canfor's ownership of CPPI from 51.9% at December 31, 2015 to 53.6% at December 31, 2016 with CPPI's non-controlling interest decreasing by a corresponding amount throughout 2016.

## 19. Share-Based Compensation

The value of the Company's DSUs, when redeemed, is equal to the market value of the shares on the redemption date, including the value of dividends paid on the Company's common shares, if any, as if they had been reinvested in additional DSUs on each payment date. The DSUs may only be redeemed upon a director's retirement from the Company, its subsidiaries or any affiliated entity. Effective July 27, 2011, the Board ceased the issuance of DSUs for non-employee directors. The total recovery recorded in relation to the DSUs for 2016 was \$0.5 million due to the revaluation of existing units (2015 - recovery of \$1.0 million). The value of outstanding DSUs at December 31, 2016 is \$1.7 million (2015 - \$2.2 million).

## 20. Finance Expense, Net

(millions of Canadian dollars)	2016	2015
Interest expense on borrowings	\$ (23.1)	\$ (15.4)
Interest expense on retirement benefit obligations, net	(9.9)	(9.8)
Interest income	1.0	1.3
Other	(0.8)	(1.0)
Finance expense, net	\$ (32.8)	\$ (24.9)

## 21. Income Taxes

The components of income tax expense are as follows:

(millions of Canadian dollars)	2016	2015
Current	\$ (37.9)	\$ (32.6)
Deferred	(26.0)	14.1
Income tax expense	\$ (63.9)	\$ (18.5)

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
Income tax expense at statutory rate of 26.0%	\$ (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)

In addition to the amounts recorded to net income, a tax recovery of \$13.2 million was recorded in other comprehensive income (loss) for the year ended December 31, 2016 (2015 - expense of \$7.3 million) in relation to actuarial gains/losses on the defined benefit plans. Also included in other comprehensive income (loss) for the 2016 year is a tax recovery of \$1.2 million related to foreign exchange differences on translation of investments in foreign operations (2015 - expense of \$6.0 million).

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

(millions of Canadian dollars)	As at December 31, 2016	As at December 31, 2015
Deferred income tax assets		
Accruals not currently deductible	\$ 40.5	\$ 42.9
Loss carryforwards	9.6	18.0
Retirement benefit obligations	72.6	61.8
Goodwill and other intangible assets, net	25.6	28.8
Other	4.0	6.3
	\$ 152.3	\$ 157.8
Deferred income tax liabilities		
Depreciable capital assets	\$ (341.4)	\$ (332.3)
Other	(15.1)	(16.6)
	\$ (356.5)	\$ (348.9)
Total deferred income taxes, net	\$ (204.2)	\$ (191.1)
Less: Entities in a net deferred income tax asset position	1.3	1.2
Deferred income tax liability, net	\$ (205.5)	\$ (192.3)

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

## 22. Net Change in Non-Cash Working Capital

(millions of Canadian dollars)	2016	2015
Accounts receivable	\$ 32.5	\$ (76.7)
Inventories	45.7	(22.9)
Prepaid expenses	4.2	10.6
Accounts payable, accrued liabilities and current portion of deferred reforestation obligations	18.6	22.7
Net decrease (increase) in non-cash working capital	\$ 101.0	\$ (66.3)

## 23. Related Party Transactions

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

The Jim Pattison Group is Canfor's largest shareholder. During 2016, subsidiaries owned by the Jim Pattison Group provided lease, insurance and other services to Canfor at market rates totalling \$5.2 million (2015 - \$4.8 million) with \$0.6 million outstanding at December 31, 2016 (2015 - \$0.5 million).

The Company has a marketing, supply and distribution agreement with its joint venture Anthony EACOM Inc. In 2016, the Company purchased I-joists from Anthony EACOM Inc. in the amount of \$58.7 million (2015 - \$7.3 million) with no amounts owing at December 31, 2016 (2015 - \$0.9 million).

During 2016, Canfor also made contributions to certain post-employment benefit plans for the benefit of Canfor employees and CPPI provided services to its joint venture with Licella Fibre Fuel Pty Ltd. See Note 13, Employee Future Benefits, and Note 30, Licella Pulp Joint Venture, for further details.

### *Key management personnel*

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

(millions of Canadian dollars)	2016	2015
Short-term benefits	\$ 7.2	\$ 7.3
Post-employment benefits	0.2	0.2
Termination benefits	0.3	0.7
Share-based payments	(0.5)	(1.0)
	\$ 7.2	\$ 7.2

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

## 24. Segment Information

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

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

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

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

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

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

(millions of Canadian dollars)	Lumber	Pulp & Paper	Unallocated & Other	Elimination Adjustment	Consolidated
<b>Year ended December 31, 2016</b>					
<b>Sales to external customers</b>	\$ 3,133.2	\$ 1,101.7	\$ -	\$ -	\$ 4,234.9
<b>Sales to other segments</b>	147.1	0.2	-	(147.3)	-
<b>Operating income (loss)</b>	237.4	98.2	(29.5)	-	306.1
<b>Amortization</b>	164.4	73.8	4.1	-	242.3
<b>Capital expenditures<sup>6</sup></b>	161.0	64.0	8.8	-	233.8
<b>Identifiable assets</b>	2,257.3	785.2	234.6	-	3,277.1
Year ended December 31, 2015					
Sales to external customers	\$ 2,740.1	\$ 1,185.2	\$ -	\$ -	\$ 3,925.3
Sales to other segments	168.2	-	-	(168.2)	-
Operating income (loss)	30.2	144.8	(33.4)	-	141.6
Amortization	144.1	65.4	4.5	-	214.0
Capital expenditures <sup>6</sup>	161.7	68.3	10.0	-	240.0
Identifiable assets	2,259.9	823.9	210.8	-	3,294.6

<sup>6</sup>Capital expenditures represent cash paid for capital assets during the periods. Pulp & Paper includes capital expenditures by CPPI that were partially financed by government grants. Capital expenditures exclude the assets purchased as part of the acquisitions of Scotch Gulf, Beadles & Balfour, Southern Lumber and Anthony in 2015, and Wynndel in 2016 (Note 31).

### Geographic information

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

(millions of Canadian dollars)	2016	2015
Sales by location of customer		
Canada	\$ 505.8	\$ 468.3
Asia	1,095.2	1,222.8
United States	2,459.4	2,076.9
Europe	82.3	97.0
Other	92.2	60.3
	\$ 4,234.9	\$ 3,925.3

(millions of Canadian dollars)	As at December 31, 2016	As at December 31, 2015
Property, plant and equipment, timber licenses and goodwill and other intangible assets by location		
Canada	\$ 1,693.8	\$ 1,682.3
United States	538.4	518.9
Asia and other	0.1	0.1
	\$ 2,232.3	\$ 2,201.3

## 25. Commitments

At the end of the year, Canfor had contractual commitments for \$41.4 million (2015 - \$40.6 million). The majority of these commitments are expected to be settled over the following year. At December 31, 2016, Canfor also has a commitment to purchase the remaining 45% of Beadles & Balfour on January 2, 2017 for a cumulative amount of US\$31.1 million, excluding working capital and various lease arrangements (Note 31).

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

(millions of Canadian dollars)	<b>As at December 31, 2016</b>	As at December 31, 2015
Within one year	\$ 11.9	\$ 11.4
Between one and five years	22.0	22.3
After five years	6.2	8.2
<b>Total</b>	<b>\$ 40.1</b>	<b>\$ 41.9</b>

During the year ended December 31, 2016, \$18.4 million (2015 - \$16.3 million) was recognized as an expense for operating leases.

## 26. Financial Risk and Capital Management

### *Financial risk management*

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

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

#### *Credit risk:*

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

Financial instruments that are subject to credit risk include cash and cash equivalents, accounts receivable, and certain long-term investments. Cash and cash equivalents includes cash held through major Canadian and international financial institutions as well as temporary investments with an original maturity date of three months or less. The cash and cash equivalents balance at December 31, 2016 is \$156.6 million (2015 - \$97.5 million).

Canfor utilizes credit insurance to mitigate the risk associated with some of its trade receivables. As at December 31, 2016, approximately 38% (2015 - 43%) 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 (2015 - \$196.3 million and \$4.5 million, respectively). At December 31, 2016, approximately 99% (2015 - 94%) of the trade accounts receivable balance are within Canfor's established credit terms.

#### *Liquidity risk:*

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

At December 31, 2016, Canfor has \$28.0 million drawn on its operating loans (2015 - \$158.0 million), and accounts payable and accrued liabilities of \$384.1 million (2015 - \$350.3 million), all of which are due within twelve months of the balance sheet date.

*Market risk:*

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates, foreign currency, 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 may use interest rate swaps to reduce its exposure to interest rate risk associated with financial obligations bearing variable interest rates. At December 31, 2016, Canfor has \$100.0 million (2015 - \$100.0 million) in fixed interest rate swaps with interest ranging from 1.55% to 1.75% and maturing in 2017.

*(ii) Currency risk:*

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

An increase (decrease) in the value of the Canadian dollar by US\$0.01 would result in a pre-tax: (i) loss (gain) of approximately \$2.0 million in relation to working capital balances denominated in US dollars at year end (including cash, accounts receivable and accounts payable); and a (ii) gain (loss) of approximately \$1.8 million in relation to long-term debt denominated in US dollars at year end.

A portion of the currency risk associated with US dollar denominated sales is naturally offset by US dollar denominated expenses. A portion of the remaining exposure is sometimes reduced by foreign exchange collar contracts that effectively limit the minimum and maximum Canadian dollar recovery related to the sale of those US dollars.

Canfor had no foreign exchange derivatives outstanding at December 31, 2016 and 2015.

*(iii) Commodity price risk:*

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

Canfor had the following lumber futures contracts at December 31, 2016 and 2015:

	<b>As at December 31, 2016</b>		As at December 31, 2015	
	<b>Notional Amount</b>	<b>Average Rate</b>	Notional Amount	Average Rate
<b>Lumber</b>	(MMfbm)	(US dollars per Mfbm)	(MMfbm)	(US dollars per Mfbm)
Future sales contracts				
<i>0-12 months</i>	<b>74.3</b>	<b>\$326.35</b>	8.8	\$264.73

An increase (decrease) in the futures market price of lumber of US\$10 per Mfbm would result in a pre-tax gain (loss) of approximately \$1.0 million in relation to the lumber futures held at year end.

(iv) *Energy price risk:*

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

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

At December 31, 2016, the Company has 21 thousand barrels of WTI oil collars, which will be settled in 2017, with weighted average protection of US\$47.27 per barrel and topside of US\$72.86 per barrel.

At December 31, 2015, the Company had 141 thousand barrels of WTI oil collars, with weighted average protection of US\$60.18 per barrel and topside of US\$82.98 per barrel.

***Capital management***

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

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

(millions of Canadian dollars)	<b>As at December 31, 2016</b>	As at December 31, 2015
Total debt (including operating loans)	\$ 476.0	\$ 614.2
Less: Cash and cash equivalents	156.6	97.5
Net debt	\$ 319.4	\$ 516.7
Total equity	1,738.5	1,627.7
	<b>\$ 2,057.9</b>	<b>\$ 2,144.4</b>

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

Canfor’s strategy is to ensure it remains in compliance with all of its existing debt covenants, so as to ensure continuous access to capital. Canfor was in compliance with all its debt covenants for the years ended December 31, 2016 and 2015.

The Company manages its capital structure through rigorous planning, budgeting and forecasting processes, and ongoing management of operations, investments and capital expenditures. In 2016, to meet Canfor’s operating, growth and return on invested capital objectives, the Company’s management of capital comprised strategic acquisitions, investment in the Company’s operations, development of energy and residual fibre-related assets and sustainable working capital reduction initiatives. Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

## 27. Financial Instruments

Canfor's cash and cash equivalents, accounts receivable, other deposits, loans and advances, operating loans, accounts payable and accrued liabilities, and long-term debt are measured at amortized cost subsequent to initial measurement.

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

The three levels of the fair value hierarchy are:

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

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

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

The following table summarizes Canfor's financial instruments measured at fair value at December 31, 2016 and 2015, and shows the level within the fair value hierarchy in which they have been classified:

(millions of Canadian dollars)	Fair Value Hierarchy Level	<b>As at December 31, 2016</b>	As at December 31, 2015
<b>Financial assets measured at fair value</b>			
Investments - held for trading	Level 1	\$ 14.3	\$ 17.2
Derivative financial instruments - held for trading	Level 2	0.2	-
Royalty receivable - available-for-sale	Level 3	-	0.2
		<b>\$ 14.5</b>	<b>\$ 17.4</b>
<b>Financial liabilities measured at fair value</b>			
Derivative financial instruments - held for trading	Level 2	\$ 0.1	\$ 4.8
		<b>\$ 0.1</b>	<b>\$ 4.8</b>

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

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

At December 31, 2016, the fair value of derivative financial instruments is a net asset of \$0.1 million (2015 - net liability of \$4.8 million). The fair value of these financial instruments was determined based on prevailing market rates for instruments with similar characteristics.

The following table summarizes the gain (loss) on derivative financial instruments for the years ended December 31, 2016 and 2015:

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

The following table summarizes the fair value of the derivative financial instruments included in the balance sheets at December 31, 2016 and 2015:

(millions of Canadian dollars)	As at December 31, 2016	As at December 31, 2015
Energy derivatives	\$ -	\$ (3.8)
Lumber futures	0.2	-
Interest rate swaps	(0.1)	(1.0)
Total asset (liability), net	0.1	(4.8)
Less: Current portion asset (liability), net	0.1	(3.6)
Long-term liability, net	\$ -	\$ (1.2)

There were no transfers between fair value hierarchy levels in 2016 or 2015.

## 28. Sale of Taylor Pulp Mill

On January 30, 2015, Canfor completed the sale of its BCTMP Taylor pulp mill to CPPI for cash proceeds of \$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. CPPI recognized long-term assets acquired net of liabilities assumed at a fair value of \$2.8 million and net working capital of \$11.6 million. From CPPI's perspective, the acquisition has been accounted for in accordance with IFRS 3, *Business Combinations*.

## 29. Houston Pellet Limited Partnership Settlement

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

## 30. Licella Pulp Joint Venture

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

Under IFRS 11, *Joint Arrangements*, the joint venture is classified as a joint operation and CPPI will recognize its assets, liabilities and transactions, including its share of those incurred jointly, in its consolidated financial statements. For the year ended December 31, 2016, CPPI's share of the joint venture's expenses was \$1.6 million, which has been recognized in manufacturing and product costs. CPPI is required to contribute the first \$20.0 million of any funding requirements, including cash and non-cash contributions, to the joint venture.

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

With regards to the convertible credit facility, during 2016, CPPI advanced \$7.0 million to Licella and exercised its option to convert \$3.5 million of the amount advanced into common shares of IER. Due to the inherent nature of this type of innovation and technology development, CPPI considers these advances to be substantially research and development in nature. As a result, at December 31, 2016, CPPI has recognized losses of \$7.0 million in other income (expense). This reflects CPPI's consideration of the intrinsic risk associated with these advances.

## 31. Acquisitions

### (a) US South

During 2015, Canfor acquired four forest product companies located in the Southern US. Below is a summary of the acquisitions and the consideration paid:

(millions of Canadian dollars)	Ownership as at December 31, 2016	Acquisition Date	Consideration paid as at December 31, 2016
<b>Company</b>			
Scotch & Gulf Lumber, LLC	100%	January 30, 2015	\$ 131.5
Beadles Lumber Company & Balfour Lumber Company Inc.	55%	January 2, 2015	51.6
Southern Lumber Company Inc.	100%	April 1, 2015	65.6
Anthony Forest Products Company	100%	October 30, 2015	126.8
Total consideration paid to date			<b>\$ 375.5</b>

As a result of these acquisitions, Canfor acquired seven sawmills and two laminating facilities located in the US South with operations in Georgia, Alabama, Mississippi, and Arkansas. In addition, Canfor acquired a 50% interest in an I-joist facility located in Ontario, Canada. The acquisitions of Scotch Gulf and Beadles & Balfour were phased acquisitions.

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

Canfor has recorded a forward purchase liability of \$41.7 million for the final step of the Beadles & Balfour phased acquisition. The Company accounted for the non-controlling interest related to Beadles & Balfour as the non-controlling share of the fair value of the net identifiable assets at the acquisition date. Subsequent to year end, on January 2, 2017, the Company completed the final phase of the acquisition of Beadles & Balfour for \$41.8 million (US\$31.1 million) bringing Canfor's interest in Beadles & Balfour to 100%.

All of the acquisitions were accounted for in accordance with IFRS 3, *Business Combinations*.

**(b) Wynndel Box and Lumber Ltd.**

On April 15, 2016, the Company completed the acquisition of the assets of Wynndel Box and Lumber Ltd. for \$40.3 million, including working capital. At the acquisition date, the Company paid \$19.7 million, and a working capital true-up payment of \$2.6 million was paid in early July. The remaining consideration of \$18.0 million will be paid in two installments and is included in accounts payable and accrued liabilities. The first installment of \$14.4 million is scheduled to be paid on April 15, 2017 and the second installment of \$3.6 million is scheduled to be paid on October 15, 2017. The acquisition has been accounted for in accordance with IFRS 3, *Business Combinations*.

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

The following summarizes the consideration paid for Wynndel and amounts of assets acquired and liabilities assumed recognized at the acquisition date:

(millions of Canadian dollars)	As at April 15, 2016
<b>Total consideration</b>	
Cash consideration paid	\$ 19.7
Consideration payable	20.6
<b>Total consideration</b>	<b>\$ 40.3</b>

(millions of Canadian dollars)	As at April 15, 2016
<b>Recognized amounts of identifiable assets acquired and liabilities assumed</b>	
Land	\$ 1.1
Buildings and equipment	22.1
Timber	9.7
Non-cash working capital, net	8.7
<b>Total net identifiable assets</b>	<b>\$ 41.6</b>
Deferred tax liability, net	(1.3)
<b>Total consideration</b>	<b>\$ 40.3</b>

If the acquisition of Wynndel had occurred on January 1, 2016, management estimates that the acquired assets would have increased total sales by \$9.0 million and net income by \$1.3 million for the year ended December 31, 2016. Acquisition-related costs of \$1.3 million, principally relating to external legal fees and due diligence costs, have been included in selling and administration costs when incurred. Wynndel's results are recorded in the lumber segment.

### **32. 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 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. The Company does not anticipate that this would give rise to a liability as at December 31, 2016.