CANFOR
CORPORATION

MD&A
2013

2013 MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the year ended December 31, 2013 relative to the year ended December 31, 2012, and the financial position of the Company at December 31, 2013. It should be read in conjunction with Canfor's Annual Information Form and its audited consolidated financial statements and accompanying notes for the years ended December 31, 2013 and 2012. The financial information contained in this MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which is the required reporting framework for Canadian publicly accountable enterprises.

Throughout this discussion, reference is made to Operating Income before Amortization which Canfor considers to be a relevant indicator for measuring trends in the performance of each of its operating segments and the Company's ability to generate funds to meet its debt repayment and capital expenditure requirements. Reference is also made to Adjusted Shareholder Net Income (Loss) (calculated as Shareholder Net income (loss) less specific items affecting comparability with prior periods – for the full calculation, see reconciliation included in the section "Analysis Overview of Consolidated Results – 2013 Compared to 2012") and Adjusted Shareholder Net Income (Loss) per Share (calculated as Adjusted Shareholder Net Income (Loss) divided by the weighted average number of shares outstanding during the period). Operating Income before Amortization and Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share are not generally accepted earnings measures and should not be considered as an alternative to net income or cash flows as determined in accordance with IFRS. As there is no standardized method of calculating these measures, Canfor's Operating Income before Amortization, Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of Operating Income before Amortization to Operating Income (Loss) and Adjusted Shareholder Net Income (Loss) to Net Income (Loss) reported in accordance with IFRS are included in this MD&A.

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

All financial references are in millions of Canadian dollars unless otherwise noted. The information in this report is as at February 5, 2014.

<u>Forward Looking Statements</u>

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

COMPANY OVERVIEW

Canfor is a leading Canadian integrated forest products company based in Vancouver, British Columbia ("BC"), involved primarily in the lumber business, with production facilities in BC, Alberta, Quebec and the United States. Canfor also has a 50.4% interest in the pulp and paper business of Canfor Pulp Products Inc. ("CPPI"), and owns a Bleached Chemi-Thermo Mechanical Pulp ("BCTMP") mill ("Taylor pulp Mill"), all located in BC.

In 2013, the Company completed the first phase of the purchase of the lumber business of Scotch & Gulf Lumber, LLC ("Scotch Gulf") located in Mobile, Alabama. The first phase represented an initial 25% interest in Scotch Gulf, which will increase over a 3 year period to 33% after twelve months, 50% after eighteen months and 100% at the end of the term in August 2016.

In 2013, the Company also completed the sale of its 50% share in Canfor-LP OSB Limited Partnership (renamed Louisiana LP OSB Limited Partnership) ("Peace Valley OSB"), which owns the Peace Valley OSB Mill, to Louisiana Pacific Corporation ("LP").

During 2012 Canfor acquired 50.2% of the outstanding common shares of CPPI in exchange for 50.2% of the outstanding units of Canfor Pulp Limited Partnership ("CPLP"). Further, on December 27, 2013, CPLP was wound up and all of the net assets were transferred to Canfor Pulp Holding Inc. Subsequent to the transfer, Canfor Pulp Holding Inc. was renamed Canfor Pulp Ltd.

During 2013, Canfor's ownership of CPPI increased to 50.4% as a result of share purchases in 2013 under a Normal Course Issuer Bid. Further discussion of the Normal Course Issuer Bid is provided in "Financial Requirements and Liquidity".

There were no other changes in percentage ownership in 2013 or 2012 for the entities listed above.

Canfor employs approximately 4,221 people in its wholly owned subsidiaries and 1,130 in jointly owned operations for a total of 5,351 employees.

Lumber

Canfor's lumber operations have a current annual production capacity of approximately 5.6 billion board feet of lumber, including 100% of the capacity of the Scotch Gulf sawmills adjusted for additional shifting at certain mills. Subsequent to the closure of the Company's Quesnel Sawmill in 2014, annual production capacity is projected to be approximately 5.4 billion board feet of lumber. The majority of lumber produced by Canfor from its facilities is construction and specialty grade dimension lumber that ranges in size from one by three inches to two by twelve inches and in lengths from six to twenty-four feet. A significant proportion of Canfor's lumber production is comprised of specialty products that command premium prices, including Square Edge lumber for the North American market, J-grade lumber for the Japanese market, and machine stress rated ("MSR") lumber used in engineered applications such as roof trusses and floor joists.

Canfor's lumber operations also include a finger-joint plant, two lumber treating plants, a whole-log chipping plant and a trucking division. The lumber business segment also includes a 60% interest in Houston Pellet Limited Partnership, which has an annual capacity of approximately 217,000 tonnes of wood pellets.

Canfor holds approximately 11 million cubic metres of annual harvesting rights for its solid wood operations under various forest tenures located in the interior region of BC and northern Alberta, and harvests logs from those tenures to supply its interior lumber operations. Any shortfalls in mill requirements are made up with wood purchased from those areas. Operations in Quebec, North and South Carolina and Alabama mostly purchase logs.

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

Pulp and Paper

Canfor's Pulp and Paper segment is comprised of the CPPI and Taylor pulp mill operations, all of which are located in BC. CPPI produces northern bleached softwood kraft ("NBSK") pulp and specialty paper. NBSK pulp is primarily a bleached product, although unbleached and semi-bleached grades are also produced at the Prince George Pulp and Paper Mill.

The CPPI mills have the capacity to produce over one million tonnes of pulp annually. Approximately 220,000 tonnes of BCTMP per year can be produced at the Taylor Pulp Mill. CPPI's paper machine, located at the Prince George Pulp and Paper mill, has an annual production capacity, at optimum product mix levels, of 140,000 tonnes of kraft paper.

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

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

Other Operations

In 2013, Canfor sold its 50% share in the Peace Valley OSB Mill, located in Fort St. John, British Columbia. Prior to the sale, the mill was jointly owned with LP and was the Company's only currently operating panels facility. Canfor also owns an OSB plant ("PolarBoard"), which is currently indefinitely idled, and a plywood plant ("Tackama") which was permanently closed in December 2011.

Business Strategy

Canfor's general business strategy is to be a lumber industry leader with top-quartile financial performance, accomplished through:

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

Canfor is focused on being the preferred supplier of lumber to the building industry around the world, with a particular focus on North America and Asia. The Company is committed to being a major supplier to the retail segment of lumber consumption and expanding its presence in key offshore markets, including China and Japan. This objective includes making higher value structural lumber and specialized products to cater to specific customer requirements.

CPPI's overall business strategy is to be a pulp and paper industry leader with strong financial performance accomplished through:

- Preserving its low-cost operating position,
- Maintaining the premium quality of its products,
- Growing its green energy business,
- Developing an enterprise-wide culture of safety, innovation and engagement where CPPI is recognized as the preferred employer in its operating regions, and
- Capitalizing on attractive growth opportunities.

OVERVIEW OF 2013

2013 saw a further strengthening of lumber markets in many of Canfor's key markets. Continued momentum in the U.S. housing market, as evidenced by an increase of 18% in housing starts, contributed to a 19% and 24% rise in North American benchmark Western Spruce/Pine/Fir ("SPF") 2X4 #2&Btr and Southern Yellow Pine ("SYP") 2X4 #2 prices, and strong increases were also seen for most other grades and dimensions. Demand from offshore markets continued to trend upwards, particularly for the Company's higher-value lumber products. In addition to stronger US prices, Canfor's lumber sales realizations also benefited from a higher-value product mix, reflecting the Company's improved fibre base and recent capital upgrades, a weaker Canadian dollar and lower export taxes on Canadian shipments to the U.S., all of which more than offset upward market-related log cost pressures in the year.

The Company continued to position itself to take advantage of the improving lumber markets, continuing its program of targeted capital spending at various facilities to improve product quality and value, improve operational efficiency and drive down operating costs. In response to the improving markets, shifts were added at various locations, including the Company's Southern Pine operations. For the 2013 year, lumber production and Canfor-produced lumber shipments were up approximately 9% and 8%, respectively, largely attributable to the positive impacts from additional shifting and various high-return capital projects.

Other positive developments for Canfor's lumber segment in 2013 included the purchase of Scotch & Gulf Lumber, LLC ("Scotch Gulf") of Mobile, Alabama in a phased purchase (over three years). The Scotch Gulf transaction closed in August 2013 and with planned near-term capital investments and additional shifting, this acquisition will add approximately 440 million board feet of annual production capacity, bringing Canfor's total Southern Pine production capacity to over a billion board feet.

Reflecting the continuing impact of the Mountain Pine Beetle infestation on fibre availability in BC, in late 2013 the Company entered into an agreement with West Fraser Mills Ltd. ("West Fraser") for an exchange in forest tenure rights in the Quesnel, Lakes and Morice Timber Supply Areas of the BC interior as well as a non-replaceable license and undercut volumes (the "Timber Exchange"). The Company also made the difficult decision to permanently close its Quesnel Sawmill in early 2014. The annual capacity of this operation is approximately 250 million board feet of Western SPF lumber.

In December 2013, the Company ratified new five year collective agreements with the USW (United Steelworkers) for most of its lumber operations in BC. This agreement provides Canfor with a stable labour environment for the next five years.

Global softwood pulp markets improved steadily through 2013 with increased demand from mature markets, specifically Europe and North America and stable demand from China. Annual softwood demand increased 2% in 2013 compared to 2012 and global softwood inventories held by producers declined through the year largely as a result of the stronger demand. The demand supported modest increases in NBSK list prices, with the benchmark North American pulp list price up 8% from 2012, although the gain was partly eroded by increased upward pressure on discounts.

The Company's pulp and paper operations faced several operational challenges through 2013 as management renewed its focus on operations coming out of a prolonged period of asset renewal highlighted by significant capital and maintenance projects. In 2013, CPPI continued to focus on growing its green energy business, with the completion and commencement of several capital projects focused on upgrades to Cogeneration assets targeting electrical load displacement and the sale of incremental power generation.

2013 also saw progress in the Company's divestiture of its non-core assets and operations, with the Company completing the sale of its 50% share in the Peace Valley OSB operation, which includes an earn-out over a three-year period contingent upon that operation's financial performance.

Total operating earnings were up $260.0 million to $331.3 million in 2013, principally reflecting both higher lumber and pulp shipments and sales realizations, and the Company recorded a consolidated return on invested capital of 17.8%, up almost five-fold from 2012.

The Company continued to preserve its strong financial position in 2013, retaining a strong focus on working capital management and delivering on its capital investment, both in terms of being on-time, on-budget and achieving targeted savings. The Company ended the year with cash and cash equivalents of $90 million, net debt to total capitalization of 8% and $378 million available under its operating loans.

A review of the more significant developments in 2013 follows.

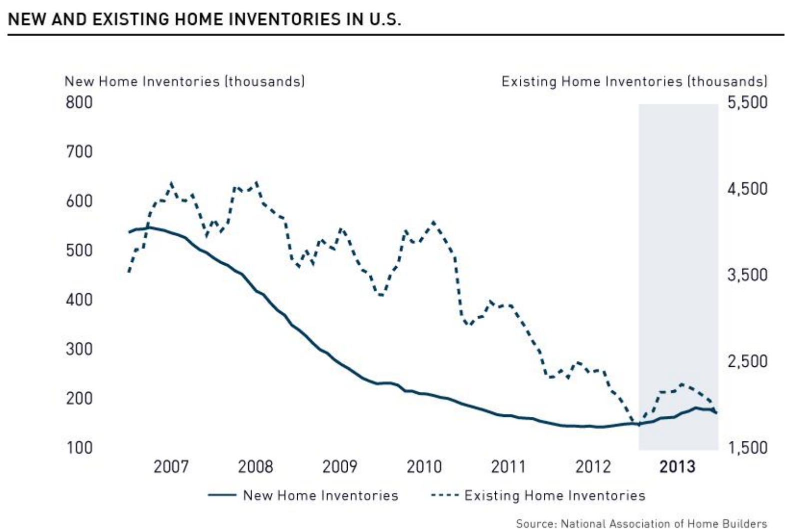
Markets and Pricing

(i) Solid Wood – Steady North American housing recovery and improved prices; Further opportunities arising in Asia as lumber demand continues to grow

Lumber demand in North America improved steadily throughout 2013, with the lumber market trending higher as a result of the moderate but steady U.S. housing recovery. The Company's offshore lumber shipments remained solid in 2013, buoyed by both strong shipments to China where the total BC softwood lumber industry set a new record high volume in during 2013, as well as increased demand for high-grade lumber from Japan. Benchmark lumber prices for both Western SPF and SYP products saw significant improvement, reflecting not only the steady North American housing market recovery but also overall growth in global demand for softwood lumber.

While new and existing home inventory levels rose early in 2013, both began to see levels decrease through the end of the 2013 as highlighted in Chart 1 below.

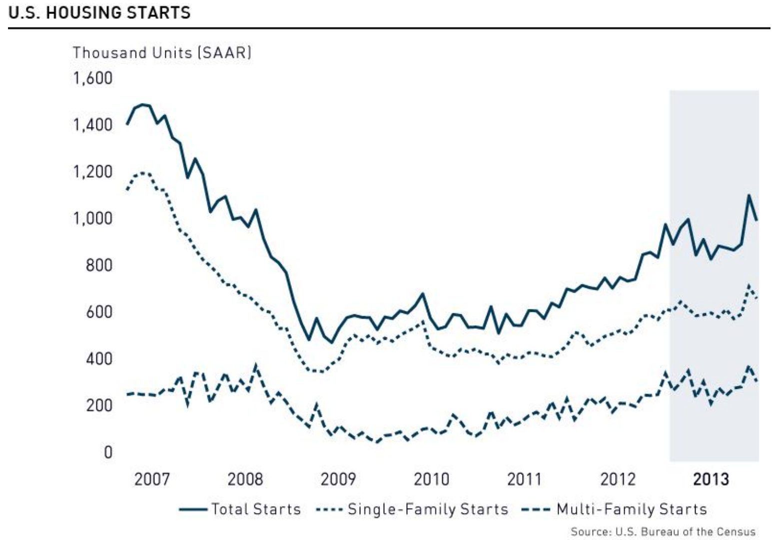
Chart 1



Total U.S. housing starts were up 18% in 2013 compared to 2012, averaging 923,000 starts[1] for the year compared to 783,000 in 2012, and reaching the highest levels since 2008 (Chart 2). Both single-family units and multi-family unit starts were up from 2012, as increases in single-family starts, which consume a higher proportion of lumber, experienced strong gains, with starts averaging 618,000 units, an increase of 15%.

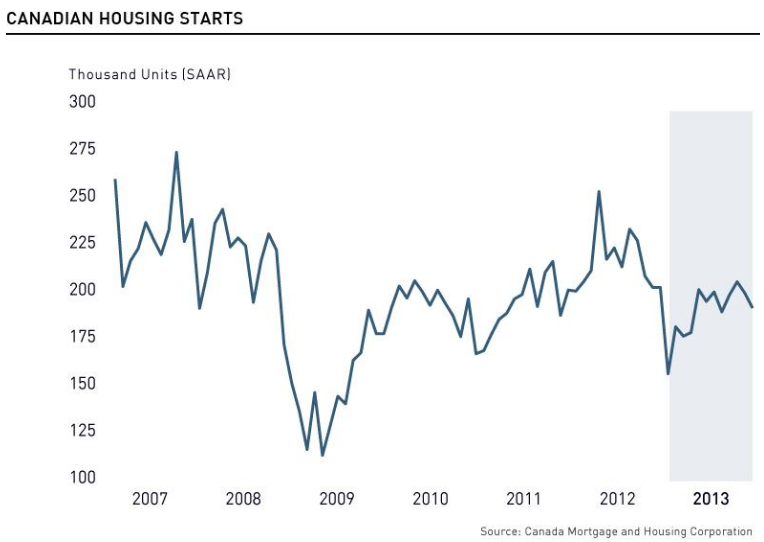
[1] Source: U.S. Bureau of the Census

Chart 2



In Canada, housing starts at 188,000 units[2] in 2013 were down 27,000 units, or 13%, compared to 215,000 units in 2012 (Chart 3), for the most part reflecting a sluggish first part of 2013 in response to a weaker housing market in various regions of the country. Housing activity picked up in the second half of the year.

Chart 3



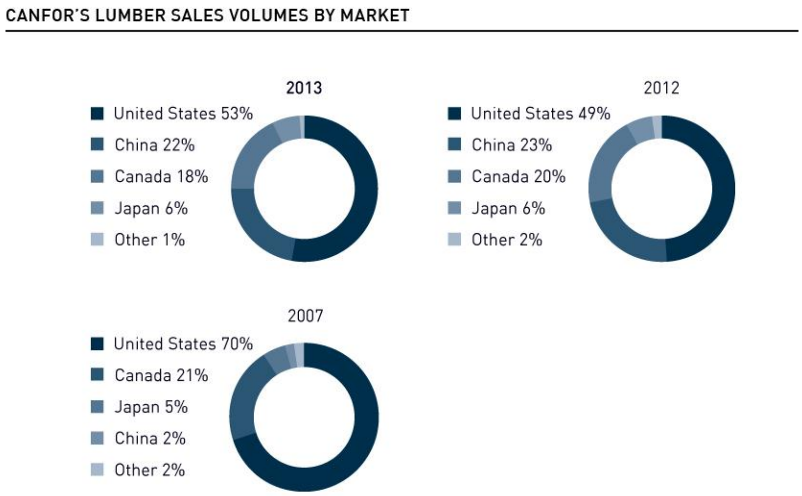
Lumber shipments to China remained solid in 2013 while shipments to Japan increased 8% compared to 2012 in response to increased demand. The Company saw a continued increase in value-added product shipments to China, which has historically been heavily weighted to more low-grade lumber.

In response to the increasing demand in Asia, the Company also entered a 50/50 joint venture agreement ("Caofeidan JV") with Tangshan Caofeidian Wood Industry Co. Ltd. of China to review the potential construction of a secondary manufacturing facility in Hebei Province, China.

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

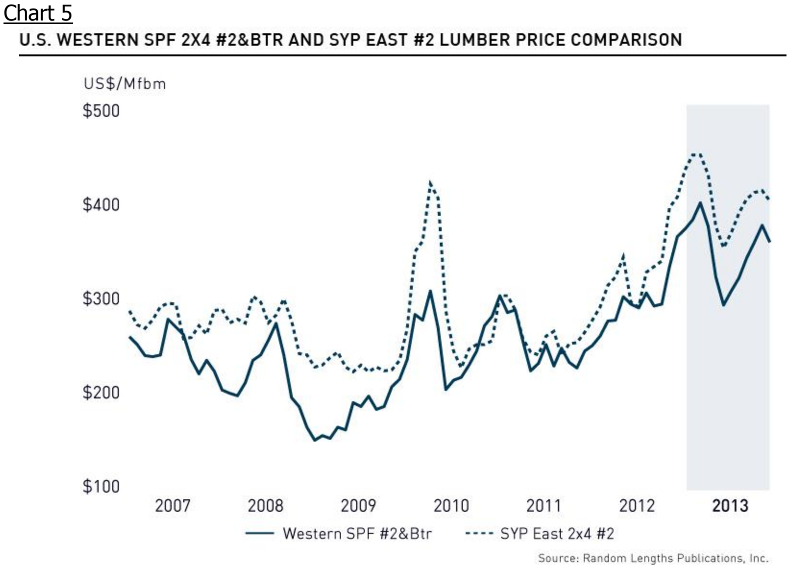
The shift in the Company's geographical sales mix over the past six years is highlighted in Chart 4, which shows the shift to a more globally balanced distribution of sales in support of strategic growth objectives.

Chart 4



The benchmark Western SPF 2x4 #2 & Better grade ("#2&Btr") price saw solid gains in 2013, averaging US$356 per thousand board feet ("Mfbm")[3], a 19% improvement over the US$299 per Mfbm average in 2012. Price levels for other dimensions and grades showed increases consistent with the benchmark level. The benchmark 2x4 #2 price for SYP lumber in 2013 averaged US$413 per Mfbm, up 24% compared to 2012 at US$333 per Mfbm, following a similar trend to the SPF prices. Prices for both Western SPF and SYP 2x4 #2&Btr products saw seasonal increases early in 2013 before dipping in the second quarter and then recovering steadily through the second half of the year (Chart 5).

Chart 5



The Canadian dollar weakened modestly against the US dollar in 2013, continuing the trend seen in the previous year. On average the Canadian dollar was at $0.971[4], 3 cents, or 3%, lower than in 2012, which had a moderate positive impact on sales realizations for all Canadian-produced exports.

[3] Random Lengths Publications, Inc.
[4] Bank of Canada

(ii) Pulp – Steady global demand and tightening producer inventory levels support modest price increases through 2013

Global softwood pulp markets improved gradually through 2013 driven by increased demand from mature markets, specifically Europe and North America, while demand from China was relatively flat year-over-year. Global softwood inventories held by producers declined through the year driven by the aforementioned stronger demand coupled with steady supply. Annual softwood demand increased 2% in 2013, compared to 2012.

The benchmark North American list price for NBSK pulp averaged US$941 per tonne[5] for 2013, up US$69, or 8%, from the prior year. Increases of US$51 per tonne and US$33 per tonne were seen for Europe and China, respectively. North American NBSK pulp list prices ended the year at US$990 per tonne, up US$120, or 14% from the end of 2012. List prices to all regions ended the year at their highest levels over the last two years, although increased upward pressure on discounts, particularly in North America, partly eroded some of these list price gains.

The following charts show the NBSK price movements in 2013 (Chart 6) and the global pulp inventory levels (Chart 7), and highlights the gradual rise in list prices through the year, as well as an overall decline in year-over-year inventories, fueled in part by increased demand as discussed above.

Chart 6

NBSK PULP LIST PRICE DELIVERED TO U.S. - IN US AND CANADIAN DOLLARS

Note: Canadian price is calculated as the US price multiplied by the average monthly exchange rate per the Bank of Canada

Source: Resource Information Systems Inc.

Chart 7

WORLD SOFTWOOD PULP INVENTORIES

Source: Pulp and Paper Products Council

[5] Resource Information Systems, Inc.

Further, towards the end of 2013, CPPI also entered into a strategic sales and marketing cooperation agreement with UPM-Kymmene Corporation. Beginning January 1, 2014, CPPI's sales network will represent and co-market UPM Pulp products in North America and Japan whereas UPM's Pulp sales network will represent and co-market CPPI's products in Europe and China. Customers will benefit from a broader product and technical offering.

Solid Wood Operations

(i) Company continuing to grow, "organically" and externally; Significant strategic capital spending in recent years positioning the Company to capitalize on improving markets

The Company's confidence in the longer-term prospects of the lumber industry has driven an investment strategy aimed at positioning itself as a top-quartile industry performer during the lumber market recovery. In support of this objective, in 2013 the Company continued with the final implementation of its $300 million strategic capital initiatives at its sawmills aimed at enhancing the quality and value offering of products to its customers from a top-tier productivity and cost position. At the end of 2013, the program was substantially complete. The Company is also nearing completion of its capital upgrade initiatives for its sawmills in the Kootenay region of BC subsequent to its Tembec acquisition in early 2012.

The Company's strategic capital investments are designed to capitalize on its strong fibre position in many regions of the BC Interior and the U.S. South. In particular, the investments in upgraded facilities in high-value fibre areas in Western Canada are helping to alleviate fibre cost pressures.

In addition to its strategic capital initiatives, the Company, in August 2013, completed the first phase of its purchase of Scotch Gulf, representing an initial 25% interest. The Scotch Gulf purchase includes three sawmills, a treating plant and a remanufacturing facility, favourably located within an area of high-quality fibre supply. Canfor's initial 25% interest will increase over a 3 year period to 33% after twelve months, 50% after eighteen months and 100% at the end of the term. The aggregate purchase price for Scotch Gulf is US$80.0 million, plus working capital. With planned near-term capital investments, this acquisition will add 440 million board feet of annual production capacity, bringing Canfor's total Southern Pine production to over a billion board feet.

Capital spending in the lumber segment for 2013 totaled $165 million and included a major planer rebuild at the Elko facility, a major sawmill rebuild at Mackenzie, installation of a new biomass thermal energy plant at Vavenby and commencement of a major planer rebuild at the Houston sawmill late in the year. The Company also completed various other smaller upgrades during the year and added kiln drying capacity in its U.S. South operations to support production growth.

(ii) Continued focus on strong operational performance

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

a. Product quality / value

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

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

b. Unit manufacturing costs

The Company continues to remain focused on ensuring a strong operational performance at all of its operations, with continuous improvement initiatives, complementing and maximizing the benefits from capital upgrades. Compared to the prior year, unit conversion costs were negatively impacted by a combination of factors, including industry-wide dust mitigation efforts, start-up curves associated with several large capital projects and a full year of operations from the higher-margin Kootenay area mills.

Continued lumber market improvement, increased upward pressures on non-quota timber, and a shift out of the Mountain Pine Beetle-dominated log profile of the past several years has resulted in increases to both stumpage and hauling costs in BC operations. Added costs for road building and block development in 2013 also resulted from the fibre profile shift. The Company's U.S. operations' log costs remained broadly in line with the prior year largely due to a strong supply of timber in the regions in which the Company operates and a relatively balanced demand and competition for log procurement.

c. Residual fibre revenue

Residual fibre revenue for the Company relates principally to the sale of sawmill residual chips to be used in the manufacture of pulp products. Prices for sawmill residual chips are typically based on a pricing formula with a number of inputs, predominantly driven by market prices for pulp products. Increased residual fibre revenue for 2013 reflected increased sawmill production as well as an increase in average chip prices related to pulp price increases.

Other residual fibre products also hold value, and the Company continued to focus on extracting maximum value from these sources in 2013, increasing its revenue stream from sawdust and shavings. In addition, the Company now has modern energy systems at the significant majority of its sawmills that make use of other residual fibre products, such as bark hog, which have resulted in significantly reduced energy costs and dependence on fossil fuels.

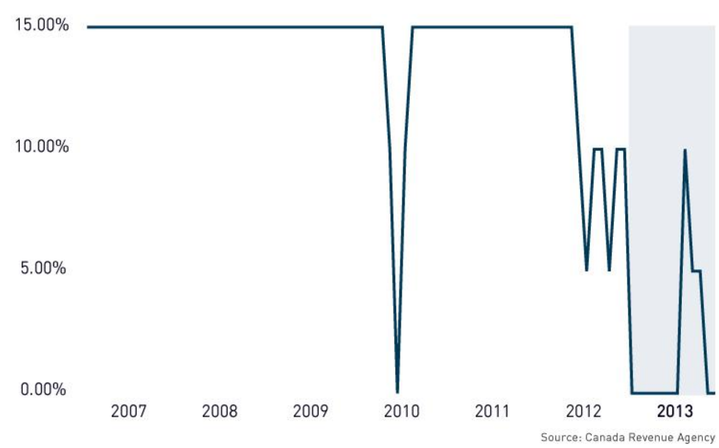
(ii) Softwood Lumber Agreement

Under the Softwood Lumber Agreement ("SLA") implemented by the federal governments of Canada and the U.S. in 2006, Canadian softwood lumber exporters pay an export tax on lumber shipped to the U.S. when the price of lumber is at or below US$355 per Mfbm, as determined by the Random Lengths Framing Lumber Composite Price. When the price is at or below US$355 per Mfbm, the export tax rate ranges between 5% and 15%. In January 2012, the governments of Canada and the U.S. exercised an option to extend the SLA from its original expiry date in 2013 to October 2015.

The export tax rate averaged 2% for the 2013 year, resulting in export tax payments of approximately $9 million by the Company for the year, compared to $46 million in 2012 when the export tax rate averaged 11%. The following chart shows the average SLA export tax rate in 2013 (Chart 8), with the rate fluctuating through the year in connection with the Random Lengths Framing Lumber Composite Price.

Chart 8

SLA EXPORT TAX



(iii) Impacts of Mountain Pine Beetle ("MPB") remain significant; Company continuing to mitigate impact

The MPB epidemic has killed a significant proportion of the available pine forest in the interior region of BC. Recent estimates indicate that pine mortality has reached approximately 55%. The infestation, however, has largely run its course throughout most of the interior and annual attack levels have declined significantly year-over-year since 2005. Current attack is generally restricted to the edges of the affected regions, such as the Houston, Mackenzie, and Peace Regions of Northern British Columbia, Northern Alberta and, to a lesser degree, the Kootenay region of Southeast British Columbia.

The industry has been aggressively salvaging attacked stands at accelerated harvest rates for more than a decade, and continues to do so. In the most heavily attacked areas, salvage harvesting continues but the harvest profile is gradually shifting from dead pine into green or mixed stands and will do so for another 5 to 10 years as the remaining dead stands are harvested or the quality deteriorates to the point that the stands are no longer viable for sawlog harvest. In these areas, declining timber quality, smaller piece size and blow down are resulting in increased operational costs. This will be offset in the short to medium-term, however, as the harvest moves into mixed species stands.

To ensure that sufficient dead pine is being harvested to sustain the current allowable harvest rates and minimize impacts to the mid-term timber supply, government has instituted "partitions" in a number of timber supply areas. These partitions cap the harvest of non-pine species in the short-term, and will be revisited as the availability of merchantable dead pine stands declines. The Company maintains a significant focus on salvage harvesting and achieving these partitions where applicable.

Recent forecasts have predicted that annual allowable harvest rates could be reduced by more than 30% from current levels. Some reductions have already occurred, such as for the Prince George (16%), Quesnel (24%) and Lakes (38%) Timber Supply Areas. In some areas with more recent attacks, e.g. Mackenzie and Chetwynd in Northern BC and Northern Alberta, it is anticipated that allowable harvest rates will be increased temporarily.

In anticipation of these impacts, the Company has taken a number of actions to ensure the viability and competitiveness of its operations. These include the acquisition of the Kootenay area sawmills in 2012, the announced permanent closure of its Quesnel Sawmill, and the exchange of timber rights with West Fraser in 2013. The Timber Exchange with West Fraser was completed in the fourth quarter of 2013 and Canfor exchanged 382,194 cubic metres of replaceable forest license allowable annual cut in the Quesnel Timber Supply Area and 53,627 cubic metres of replaceable forest license allowable annual cut in the Lakes Timber Supply Area with West Fraser for 324,500 cubic metres of replaceable forest license allowable annual cut in the Morice Timber Supply Area as well as a non-replaceable license and undercut volumes. The Timber Exchange will provide additional timber supply security to the Houston Sawmill. As a result of these transactions, the Company no longer has tenures in Timber Supply Areas that have been the most heavily impacted by the MPB, and the remaining operations are forecast to have sufficient fibre supply through the transition to lower provincial harvest levels and green or mixed species stands.

In Alberta, the provincial government has implemented short-term actions and a long-term strategy to mitigate the risks associated with MPB. Included in these are comprehensive detection surveys and treatment of individual trees in newly infested stands, as well as a collaborative approach by government and the forest industry to achieve a 75% reduction in the amount of susceptible pine in Alberta by 2026. The latter has resulted in a 12% increase in the Annual Allowable Cut ("AAC") of the Company's Forest Management Agreement (FMA) for the next 15 years. Additionally, the province approved a 103% AAC increase for the Company's quota area North of Hines Creek, which will enable a shift of a significant portion of the harvest for the Grande Prairie Sawmill into the Northern area where the MPB infestation has been most severe. This shift, which is forecast to last for 5-7 years, will result in higher than normal log transportation costs but will mitigate potential impacts to long-term timber supply and ensure the timber is harvested before the quality deteriorates significantly.

Closed and indefinitely idled operations

As previously highlighted, in October 2013, the Company announced that it will permanently close its Quesnel Sawmill, currently anticipated to occur in March 2014. The closure was the result of timber availability in the Quesnel region following the MPB infestation and will remove approximately 250 million board feet of SPF lumber capacity. The Company recorded a provision related to the closure costs of $20.0 million in 2013.

In 2011 the Company closed, or announced the closing of, three of its operations in response to the continued difficult market conditions for solid wood products, and fibre supply challenges relating to the MPB impact. In January 2011 the Clear Lake lumber operation was permanently closed due to weak prices for stud lumber and a lack of economical long-term fibre available to that mill. In January 2012 the Rustad Sawmill and Tackama Plywood Plant were permanently closed due to a combination of MPB fibre challenges (Rustad), the difficult market conditions and the level of capital investment required to make both operations economically viable.

As mentioned above, the Radium Sawmill in British Columbia, which was idled in 2009, restarted in October 2012. The Company has no remaining lumber operations that are idled. Only the PolarBoard OSB Plant in Fort Nelson, which was indefinitely idled in mid-2008, remains idled.

Pulp and Paper Operations

The Company's pulp and paper operations faced several operational challenges through 2013 as management renewed its focus on operations coming out of a prolonged period of asset renewal highlighted by significant capital and maintenance projects. Increased production in 2013 resulted principally from an increase in operating days primarily reflecting the impact of a recovery boiler failure at the Northwood Pulp Mill in the prior year. Overall operating rates were down slightly in 2013 in part due to ramp-up challenges related to capital projects coupled with the impact of severe thunderstorms and related power outages at all facilities. However, after several quarters of such challenges, operating rates showed signs of improvement heading into 2014. Scheduled maintenance outages were completed at all facilities in 2013 including an outage at the Northwood Mill that was extended to complete upgrades to the recovery boiler.

Over the past few years, significant capital projects and extended maintenance outages have been completed at CPPI's facilities, largely targeted at renewal of aging recovery boilers. With the completion of this renewal initiative the Company's facilities are well positioned to have reduced maintenance and regulatory requirements over the next few years which will result in shorter planned outages.

CPPI's continued focus on growth in green energy was highlighted in 2013 by the completion and commencement of several green energy projects in 2013 including completion of a new precipitator at the Prince George Pulp Mill, substantial completion of upgrades to turbines at the Northwood Mill with the project targeted for commissioning by the end of the first quarter of 2014, and commencement of upgrades to the Intercontinental Mill turbine which are targeted for completion by the end of 2014. CPPI has secured agreements with a BC energy company for all of these projects, which provide for commitments to electrical load displacement and the sale of incremental power generation under energy purchase agreements.

Canfor and CPPI Integration

In mid-2012, the Company and CPPI announced leadership changes focused on integration and greater alignment in several key business areas including transportation and logistics, fibre management and procurement, and finance and administration. The companies have substantially completed the integration and both companies have seen the continued benefits, with total annual costs savings of approximately $12 million realized in 2013, well in excess of initial estimates.

OVERVIEW OF CONSOLIDATED RESULTS – 2013 COMPARED TO 2012

Selected Financial Information and Statistics[6]

(millions of Canadian dollars, except for per share amounts)		2013		2012
Sales	**$**	**3,194.9**	$	2,642.8
Operating income before amortization	**$**	**517.5**	$	248.4
Operating income	**$**	**331.3**	$	71.3
Foreign exchange gain (loss) on long-term debt and investments, net	**$**	**(8.9)**	$	4.7
Gain (loss) on derivative financial instruments[7]	**$**	**4.4**	$	(0.8)
Net income	**$**	**250.5**	$	35.6
Net income (loss) attributable to equity shareholders of Company	**$**	**228.6**	$	26.4
Net income (loss) per share attributable to equity shareholders of Company, basic and diluted	**$**	**1.61**	$	0.18
ROIC – Consolidated[8]		**17.8%**		3.7%
Average exchange rate (US$/CDN$)[9]	**$**	**0.971**	$	1.001

[6] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits* and IFRS 11, Joint Arrangements. Further details can be found in the "Changes in Accounting Policy" section in this document.
[7] Includes gains (losses) from energy, foreign exchange, lumber and interest rate derivatives (see "Unallocated and Other Items" section for more details).
[8] Consolidated Return on Invested Capital ("ROIC") is equal to operating income/loss, plus realized gains/losses on derivatives, equity income/loss from joint venture and other income/expense, all net of minority interest, divided by the average invested capital during the year. Invested capital is equal to capital assets, plus long-term investments and net non-cash working capital, all excluding minority interest components.
[9] Source – Bank of Canada (average noon rate for the period).

(millions of Canadian dollars)		2013		2012
Operating income (loss) by segment:				
Lumber	**$**	**285.1**	$	75.6
Pulp and Paper	**$**	**72.2**	$	27.6
Unallocated and Other	**$**	**(26.0)**	$	(31.9)
Total operating income	**$**	**331.3**	$	71.3
Add: Amortization	**$**	**186.2**	$	177.1
Total operating income before amortization	**$**	**517.5**	$	248.4
Add (deduct):				
Working capital movements	**$**	**(7.5)**	$	(71.3)
Defined benefit pension plan contributions	**$**	**(53.0)**	$	(54.9)
Other operating cash flows, net[10]	**$**	**33.3**	$	(4.8)
Cash from operating activities	**$**	**490.3**	$	117.4
Add (deduct):				
Finance expenses paid	**$**	**(17.4)**	$	(19.5)
Distributions paid to non-controlling interests	**$**	**(9.3)**	$	(15.9)
Capital additions, net[11]	**$**	**(237.3)**	$	(245.5)
Investment in Scotch & Gulf Lumber, LLC	**$**	**(29.5)**	$	-
Loan to Scotch & Gulf Lumber, LLC	**$**	**(31.9)**	$	-
Proceeds from sale of Canfor-LP OSB	**$**	**77.9**	$	-
Drawdown (repayment) of long-term debt	**$**	**(139.8)**	$	50.1
Other, net	**$**	**(44.0)**	$	42.7
Change in cash / operating loans	**$**	**59.0**	$	(70.7)

[10] Further information on operating cash flows can be found in the Company's annual consolidated financial statements.
[11] Additions to property, plant and equipment include the acquisition of assets from Tembec in the first quarter of 2012, and are shown net of amount received under Government funding initiatives in the pulp and paper segment.

Analysis of Specific Items Affecting Comparability of Shareholder Net Income[6]

After-tax impact, net of non-controlling interests

(millions of Canadian dollars, except for per share amounts)		2013		2012
Shareholder Net Income	**$**	**228.6**	$	26.4
Foreign exchange (gain) loss on long-term debt and investments, net	**$**	**4.6**	$	(3.1)
(Gain) loss on derivative financial instruments	**$**	**(3.3)**	$	1.2
Mill closure provisions	**$**	**14.8**	$	-
One-time costs associated with collective agreements for the lumber business	**$**	**0.8**	$	-
Canfor's 50% interest in Canfor-LP OSB's income, net of tax	**$**	**12.1**	$	-
(Gain) loss on sale of Canfor-LP OSB[12]	**$**	**(28.8)**	$	-
Change in substantively enacted tax rate	**$**	**4.2**	$	-
Net gain on post retirement and pension plan amendments	**$**	**-**	$	(8.7)
Restructuring charges for management changes	**$**	**-**	$	1.5
Increase in fair value of asset-backed commercial paper	**$**	**-**	$	(1.1)
Costs related to Tembec acquisition	**$**	**-**	$	2.8
Net impact of above items	**$**	**4.4**	$	(7.4)
Adjusted shareholder net income	**$**	**233.0**	$	19.0
Shareholder net income per share, as reported	**$**	**1.61**	$	0.18
Net impact of above items per share	**$**	**0.03**	$	(0.05)
Adjusted shareholder net income per share	**$**	**1.64**	$	0.13

[12] The Company completed the sale of its 50% share of the Canfor-LP OSB Limited Partnership ("Canfor-LP OSB") in 2013 and recorded a gain of $33.4 million (after tax). As part of the sale, Canfor may receive additional annual consideration over a 3 year period, starting June 1, 2013, based on Peace Valley OSB's annual adjusted earnings before interest, tax, depreciation and amortization. An asset was recorded based on the fair value of this additional consideration and will be adjusted to current estimated fair value each reporting period. Based on the estimated fair value at December 31, 2013, a loss of $4.6 million (after tax) was recorded in 2013.

The Company recorded net income attributable to equity shareholders of $228.6 million, or $1.61 per share, for the year ended December 31, 2013, a positive variance of $202.2 million, or $1.43 per share, from $26.4 million, or $0.18 per share, reported for the year ended December 31, 2012.

After taking account of specific items affecting comparability with prior periods, the Company's 2013 adjusted shareholder net income was $233.0 million, or $1.64 per share, a positive variance of $214.0 million, or $1.51 per share, compared to similarly adjusted shareholder net income of $19.0 million, or $0.13 per share, for 2012.

Reported operating income for 2013 was $331.3 million, up $260.0 million from operating income of $71.3 million for 2012. Included in operating income for the current year is an expense of $20.0 million related to the announced closure of the Quesnel sawmill and one-time costs of $1.1 million associated with the new five year collective labour agreements for its lumber business.

Operating income in 2012 included costs related to the Kootenay sawmills acquisition of $3.8 million, restructuring costs of $2.8 million related to changes in the Company's management group and the integration of CPPI, and positive inventory valuation adjustments of $15.5 million. Operating income for 2012 also included a pre-tax accounting gain of $14.2 million reflecting amendments to the Company's salaried post retirement benefit plans and net of settlement losses related to its Rustad pension plan. Excluding these items, operating income for 2013 was $352.4 million, up $304.2 million from similarly adjusted operating income of $48.2 million in 2012.

Operating results for 2013 compared to 2012 were favourably impacted by substantially improved average lumber sales realizations which was attributable to improved market prices, a higher-value product mix, partly resulting from the Company's improved fibre base, lower export taxes and a weaker Canadian dollar for its Western SPF operations. Overall results also reflected the favourable impacts of increased production and shipment volumes. These gains were partially offset by a moderate increase in unit manufacturing costs, resulting from higher log costs, mostly reflecting increased market-based stumpage, coupled with a modest increase in unit conversion costs.

A more detailed review of the Company's operational performance and results is provided in "Operating Results by Business Segment – 2013 compared to 2012", which follows this overview of consolidated results.

OPERATING RESULTS BY BUSINESS SEGMENT – 2013 COMPARED TO 2012

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

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

Lumber

Selected Financial Information and Statistics – Lumber[13]

Summarized results for the Lumber segment for 2013 and 2012 are as follows:

(millions of Canadian dollars, unless otherwise noted)		2013		2012
Sales	**$**	**2,192.2**	$	1,711.8
Operating income before amortization	**$**	**398.6**	$	177.4
Operating income	**$**	**285.1**	$	75.6
Positive impact of inventory valuation adjustments	**$**	**-**	$	(13.5)
Mill closure provisions	**$**	**20.0**	$	-
One-time costs associated with collective agreements	**$**	**1.1**	$	-
Costs related to Tembec acquisition	**$**	**-**	$	2.5
Operating income excluding impact of inventory valuation adjs and unusual items	**$**	**306.2**	$	64.6
Capital expenditures	**$**	**164.7**	$	110.9
Average SPF 2x4 #2&Btr lumber price in US$[14]	**$**	**356**	$	299
Average SPF price in Cdn$	**$**	**367**	$	299
Average SYP 2x4 #2 lumber price in US$[15]	**$**	**413**	$	333
Average SYP price in Cdn$	**$**	**425**	$	333
U.S. housing starts (thousand units) [16]		**923**		783
Production – SPF lumber (MMfbm)		**4,207.4**		3,857.5
Production – SYP lumber (MMfbm)		**539.9**		479.1
Shipments – Canfor-produced SPF lumber (MMfbm)[17]		**4,187.9**		3,867.5
Shipments – Canfor-produced SYP lumber (MMfbm)[17]		**548.6**		511.8
Shipments – wholesale lumber (MMfbm)		**24.8**		54.7

[13] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits* and IFRS 11, *Joint Arrangements*. Further details can be found in the "Changes in Accounting Policy" section in this document.
[14] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.).
[15] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.).
[16] Source – U.S. Census Bureau.
[17] Canfor-produced lumber, including lumber purchased for remanufacture.

Overview

The Lumber segment reported operating income of $285.1 million for 2013, up $209.5 million from $75.6 million in 2012. Results in the lumber segment in 2013 were impacted by various unusual items including an expense of $20.0 million related to the announced closure of the Quesnel Sawmill and one-time costs of $1.1 million associated with new five year collective agreements ratified in the quarter. Excluding the impact of these unusual items, operating income for 2013 was $306.2 million, compared to adjusted operating income of $64.6 million in 2012. Results in 2012 reflected positive inventory valuation adjustments and an accounting gain of $6.8 million related to certain amendments to the Company's salaried post-retirement benefit plans.

For the most part, the increase in lumber earnings was attributable to higher sales realizations, reflecting improved demand and market prices coupled with the favourable impact of lower average export taxes and a 3% weaker Canadian dollar compared to the US dollar. These increases were partially offset by higher unit manufacturing costs primarily due to market-driven increases in log costs.

Markets

Canfor-produced lumber sales volume for 2013 was approximately 4.7 billion board feet, up 400 million board feet, or 8%, from 4.4 billion for 2012, with SPF and SYP making up 88% and 12% of total 2013 sales volumes, respectively. In 2013, the North American lumber market trended higher resulting from moderate by steady U.S. housing recovery throughout the year and solid offshore demand. A healthy rise in U.S. home prices and a low new home inventory levels led to a solid increase in total housing starts, which averaged 923,000 units for 2013, an increase of 18% from 2012. Single-family starts, which consume a higher proportion of lumber compared to multi-family starts, added further impetus to softwood lumber consumption during the year, with starts averaging 618,000 units, up 15% from 2012, representing the highest levels since 2008.

In Canada, housing starts at 188,000 units, were down 27,000 units, or 13%, compared to 2012, although housing starts improved slightly through the second half of the year, after a sluggish start to 2013.

Sales volumes to offshore markets were steady, with key countries such as China maintaining strong shipment levels from 2012, and purchasing an increased proportion of higher value prime grade lumber. Japan experienced one of the most active markets in recent years, and 2013 saw the highest J-Grade prices on record. Another positive note was the growth in shipments seen in several emerging countries, pointing to the underlying strength in the overall global lumber market.

Sales

Lumber segment revenues of $2.2 billion for 2013 were up $480 million, or 28%, compared to 2012, reflecting a combination of increased sales volumes and higher unit sales realizations. Total shipments of Canfor-produced lumber were approximately 4.7 billion board feet for the year, up 8% from approximately 4.4 billion board feet shipped in the previous year. The Western SPF lumber 2x4 #2&Btr Random Lengths price averaged US$356 per Mfbm, a US$57 per Mfbm or 19% increase over the previous year. Similar substantial increases were seen across the dimension and grade profile as can be seen from the following table which shows benchmark Random Lengths prices for selected key grades and widths of Western SPF lumber:

(Average Western SPF US$ price, per thousand board feet)	2013	2012
2x4 #2&Btr	**$ 356**	$ 299
2x4 #3	**$ 295**	$ 250
2x6	**$ 343**	$ 301
2x10	**$ 393**	$ 344

Offshore sales realizations also saw significant increases compared to 2012 combined with solid shipments in 2013. The 3% decrease in the average value of the Canadian dollar versus the US dollar for 2013 compared to 2012 also contributed to increased overall Canadian dollar sales realizations as did a lower average export tax rate for shipments to the U.S. Freight costs showed a modest increase compared to the prior year, resulting from increased shipment volume as well as increased rail rates.

Prices for SYP products experienced slightly larger gains in the year, with the benchmark 2x4 #2 price up US$80, or 24%, over 2012 to US$413 per Mfbm, following a similar trend from the previous year. Other dimensions of SYP products experienced comparable solid increases from 2012.

Total residual fibre revenue for 2013 was well up from the prior year, primarily due to increased sales volumes and to a lesser extent an increase in average chip prices related to pulp price increases.

Export Taxes

Under the Softwood Lumber Agreement ("SLA") implemented by the federal governments of Canada and the U.S. in 2006, Canadian softwood lumber exporters pay an export tax on lumber shipped to the U.S. when the price of lumber is at or below US$355 per Mfbm, as determined by the Random Lengths Framing Lumber Composite Price ("RLCP"). The export tax rate is determined monthly, with the monthly price calculated as the four week average of the weekly RLCP available 21 days before the beginning of the month to which it applies. The rate is applied based on the following trigger prices:

Trigger RLCP Price	Tax Rate
Over US$355	0 %
US$336-$355	5 %
US$316-$335	10 %
US$315 and under	15 %

The SLA also includes a "Surge Mechanism", which increases the export tax rate for the month by 50% when the monthly volume of exports from a region exceeds a "Trigger Volume" as defined in the SLA.

For 2013, the export tax rate on lumber shipments from BC to the U.S. averaged 2%. There was no surge tax on Alberta's shipments in 2013. In 2012, the BC export tax rate averaged 11% while shipments from Alberta attracted an average export tax rate of 12%, which included a surge rate of 2.5% for two months during that period. The average RLCP for 2013 was US$384 per Mfbm, up US$62, or 19%, from US$322 per Mfbm in 2012. At December 31, 2013, the RCLP was US$387 per Mfbm.

Total export tax paid by the Company in 2013 was $9.2 million, down $36.3 million from 2012 with the year-to-year change principally attributable to higher prices and the resulting impact on the average export tax rate.

Operations

Total lumber production for 2013 was 4.7 billion board feet, up over 400 million board feet, or 9% from 2012. Increased production predominantly resulted from additional shifting and increased operating hours as well as continued productivity improvements from various capital projects. Also contributing to the increase production, to a lesser degree, was a full year of production from the Company's Radium Sawmill, which was restarted late in 2012 and the Kootenay area mills, which were acquired early in 2012.

Total lumber unit manufacturing costs were up moderately from the previous year, driven largely by increases in unit log costs and to a lesser degree, modestly higher unit conversion costs. The increases in unit log costs were mainly due to market-driven increases in stumpage rates coupled with increased costs reflecting both the outfall from severe flooding in the southeast area of BC in the late spring of 2013 and increased hauling costs, the latter the result of both longer distances and higher diesel costs. Unit conversion costs in 2013 reflected a full year of operations from the higher-margin Kootenay area mills as well as continued efforts on dust control initiatives, all of which offset the favourable impacts of increased production.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[18,19]

Summarized results for the Pulp and Paper segment for 2013 and 2012 are as follows:

(millions of Canadian dollars, unless otherwise noted)	**2013**	**2012**
Sales	**$ 999.4**	$ 923.5
Operating income before amortization	**$ 144.0**	$ 96.6
Operating income	**$ 72.2**	$ 27.6
Capital expenditures	**$ 62.6**	$ 88.7
Average pulp price delivered to U.S. - in US$[20]	**$ 941**	$ 872
Average pulp price in Cdn$	**$ 969**	$ 871
Production – pulp (000 mt)	**1,192.9**	1,169.9
Production – paper (000 mt)	**134.7**	130.2
Shipments – Canfor-produced pulp (000 mt)	**1,213.0**	1,176.6
Shipments – paper (000 mt)	**138.8**	129.1

[18] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits*. Further details can be found in the "Changes in Accounting Policy" section in this document.
[19] Includes Taylor pulp mill and 100% of CPPI, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.
[20] Per tonne, NBSK pulp list price delivered to U.S. (Resource Information Systems, Inc., - "RISI").

Overview

The Pulp and Paper segment reported operating income of $72.2 million for 2013, up $44.6 million from $27.6 million in 2012. Results in the current year were significantly impacted by improved market pulp prices, and higher shipment and production volumes, while results in 2012 were impacted by lower sales realizations, lower shipment volumes and the impact of the Northwood unscheduled outage. Unit manufacturing costs were broadly in line with the previous year as a result of higher production volumes and lower maintenance expenditures offset by higher fibre and energy costs. Also included in the previous year's pulp and paper segment results were one-time costs of $3.2 million associated with new five year collective labour agreements and an accounting gain of $5.3 million related to the post retirement plan adjustments.

NBSK pulp list prices saw solid gains from the prior year, with list prices to North America up US$69 to US$941 per tonne. Increased discounts, particularly on sales to the U.S., eroded some of these gains Shipments in 2013 also reflected increased volumes to China, offset by reduced volumes to the U.S. Sales realizations were also positively impacted by the 3% weaker Canadian dollar compared to the previous year.

Markets

Global softwood pulp markets improved steadily through 2013 driven by increased demand from mature markets, specifically Europe and North America, while demand from China was relatively flat year-over-year. Global softwood inventories held by producers declined through the year driven by the aforementioned demand and steady supply.

Pulp and Paper Products Council ("PPPC") statistics reported an increase in shipments of bleached softwood kraft pulp of 2% in 2013, with increased shipments to North America and Europe.

At the end of December 2013, World 20[21] producers of bleached softwood pulp inventories were at 27 days of supply. By comparison, December 2012 inventories were at 29 days of supply. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

Sales

The Company's pulp shipments in 2013 were 1,213,000 tonnes, up approximately 37,000 tonnes, or 3%, from the prior year. The increased sales largely reflected higher production volumes and higher shipments into China, partially offset by reduced volume into the U.S.

As mentioned, NBSK pulp list prices experienced solid gains in all regions in 2013. North American NBSK pulp list prices averaged US$941 per tonne in 2013, up US$69, or 8%, from US$872 per tonne. North American NBSK pulp list prices ended the year at US$990 per tonne, up US$120, or 14%, from the end of 2012. NBSK pulp average list prices also increased in other regions with the Northern Europe benchmark price up over US$50 per tonne and China pricing up US$33 per tonne. The upward pressure on discounts in North American markets and shift in the regional sales mix partially offset the favourable impacts from the improved NBSK US dollar list prices and the 3% weaker Canadian dollar. BCTMP sales realizations were broadly in line with 2012, with a modest decrease in prices through the year offset by the weaker Canadian dollar.

Operations

Pulp production was 1,193,000 tonnes in 2013, up 23,000 tonnes, or 2%, compared to the prior year. The increase in production was mainly attributable to reduced unscheduled outages in 2013. 2013 results were impacted by outages at the Northwood and Intercontinental Pulp Mills, with the outages resulting in reductions in overall production of approximately 44,000 tonnes and 6,000 tonnes, respectively. In comparison, 2012 production was impacted by the scheduled outages at the Prince George and Intercontinental Mills and unscheduled outages at the Northwood Mill, which totalled 75,000 tonnes.

Unit manufacturing costs were broadly in line with the prior year with the favourable impact of higher production volumes and lower maintenance spending offset by higher fibre costs (mostly related to higher-cost sawmill residual chips, where prices are linked to NBSK sales realizations) and higher energy costs as well as a slight increase in the proportion of higher-cost whole log chips (18% of total consumption in 2013 compared to 17% in 2012). Unit manufacturing costs in 2012 were also impacted by one-time costs of $3.2 million associated with new five year collective labour agreements.

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

Unallocated and Other Items[22]

(millions of Canadian dollars)	2013	2012
Operating loss of Panels operations[23]	**$ (1.7)**	$ (5.0)
Corporate costs	**$ (24.3)**	$ (26.9)
Finance expense, net	**$ (27.9)**	$ (33.8)
Foreign exchange gain (loss) on long-term debt and investments, net	**$ (8.9)**	$ 4.7
Gain (loss) on derivative financial instruments	**$ 4.4**	$ (0.8)
Gain on sale of Canfor-LP OSB joint venture	**$ 38.3**	$ -
Other income (expense), net	**$ 1.5**	$ 6.6

[22] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits* and IFRS 11, *Joint Arrangements*. Further details can be found in the "Changes in Accounting Policy" section in this document.

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

Corporate Costs

Corporate costs, which comprise corporate, head office and general and administrative expenses, were $24.3 million in 2013, down $2.6 million from 2012. The decrease included costs savings related to the integration of Canfor and CPPI and other cost saving initiatives as well as costs related to the acquisition of the Kootenay area sawmills in 2012. 2012's corporate costs also reflected a portion of the accounting gain recorded due to amendments to the Company's salaried post-retirement benefit plans.

Finance Income and Expense

Net finance expense for 2013 was $27.9 million, down $5.9 million from 2012. The decrease was principally the result of lower debt levels following repayments made in 2012 and 2013 and the transition from fixed interest rate debt to lower floating interest rate debt. Included in finance expense for both periods is the expense related to the Company's retirement benefit obligations, with total interest expense of $12.0 million in 2013 compared to $13.6 million in 2012. The Company's net finance expense for the 2012 periods has been restated for adoption of amended IAS 19, *Employee Benefits*, as further discussed in the "Changes in Accounting Policies" section later in this document.

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

The Canadian dollar ended 2013 well below par compared to the US dollar, and down more than 6 cents, or 7%, from a year earlier. As a result, the Company recorded a foreign exchange translation loss on its US dollar denominated debt of $8.9 million in 2013 (2012 – gain of $4.7 million). The Company repaid all of its outstanding US dollar denominated debt in the fourth quarter of 2013.

Gain (Loss) on Derivative Financial Instruments

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

In 2013, the Company recorded a net gain of $4.2 million related to its derivative financial instruments, principally reflecting gains on lumber futures contracts during the year.

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

Gain (Loss) on Derivative Financial Instruments:

(millions of Canadian dollars)	2013	2012
Foreign exchange collars and forward contracts	**$ 0.2**	$ 3.2
Energy derivatives	**$ 0.2**	$ 0.6
Lumber futures	**$ 4.2**	$ (3.6)
Pulp futures	**$ (0.1)**	$ -
Interest rate swaps	**$ (0.1)**	$ (1.0)
	$ 4.4	$ (0.8)

Other Income and Expense, net

Other income, net in 2013 of $1.5 million included a gain of $5.9 million relating to foreign exchange movements on US dollar denominated cash, receivables and payables of Canadian operations, compared to a loss on foreign exchange in the prior year of $1.5 million. In 2013, the Company recorded gains of $1.1 million related to a royalty agreement associated with the sale of the operating assets of Howe Sound Pulp and Paper Limited Partnership in late 2010.

As part of the sale of the Company's interest in Canfor-LP OSB in 2013, Canfor may receive additional annual consideration over a 3 year period, based on Peace Valley OSB's annual adjusted earnings before interest, tax, depreciation and amortization. An asset was recorded based on the fair value of this additional consideration and will be adjusted to current estimated fair value each reporting period. In 2013, an unfavourable fair value adjustment of $6.2 million was recorded related to the Canfor-LP OSB contingent consideration asset, largely reflecting a decrease in OSB prices since the sale in May 2013 and weaker forecast OSB prices over the earn-out period.

In addition, the Company recognized an accounting loss of $4.2 million related to the Timber Exchange with West Fraser in the fourth quarter of 2013 (see further discussion in the "Solid Wood Operations" section earlier in this document).

Income Tax Expense

The Company recorded an income tax expense of $88.2 million in 2013, compared to $12.4 million in 2012, with an overall effective tax rate of 26% (2012 – 26%).

The reconciliation of income taxes calculated at the statutory rate to the actual income tax provision is as follows[24]:

(millions of Canadian dollars)	2013	2012
Net income before income taxes	**$ 338.7**	$ 48.0
Income tax expense at statutory rate 2013 – 25.75% (2012 – 25.0%)	**$ (87.2)**	$ (12.0)
Add (deduct):		
Non-taxable income related to non-controlling interests in limited partnerships	**0.3**	1.7
Entities with different income tax rates and other tax adjustments	**0.5**	(2.3)
Permanent difference from capital gains and losses and other non-deductible items	**3.6**	0.2
Change in substantively enacted tax rate[25]	**(5.4)**	-
Income tax expense	**$ (88.2)**	$ (12.4)

[24] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits* and IFRS 11, *Joint Arrangements*. Further details can be found in the "Changes in Accounting Policy" section in this document.

[25] Effective April 1, 2013, the British Columbia Provincial Government increased the corporate tax rate from 10% to 11%.

Other Comprehensive Income (Loss)[26]

(millions of Canadian dollars)	2013	2012
Foreign exchange translation differences for foreign operations	**$ 15.0**	$ (4.6)
Defined benefit actuarial gains (losses), net of tax	**91.7**	(42.4)
Other comprehensive income (loss), net of tax	**$ 106.7**	$ (47.0)

[26] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits*. Further details can be found in the "Changes in Accounting Policy" section in this document.

Canfor measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. Any actuarial gains or losses which arise are recognized immediately by means of a credit or charge through other comprehensive income. For 2013, an after-tax amount of $91.7 million was credited to other comprehensive income, which comprised gains on the defined benefit post-employment compensation plans and other non-pension post-employment benefits. The gain associated with the defined benefit post-employment compensation plans principally due to a higher return on plan assets coupled with a higher discount rate used to value the net defined benefit obligation, offset in part by adjustments to mortality rate assumptions. The gain related to the other non-pension post-employment benefits principally reflected a higher discount rate used to value the post-employment obligation and favourable experience adjustments, offset in part by adjustments to mortality rate assumptions. In 2012, the after-tax charge was $42.4 million, primarily reflecting a lower discount rate over that year offset in part by a slightly higher rate of return on plan assets. For more information, see the 'Employee Future Benefits' part of the 'Critical Accounting Estimates' section later in this report.

In addition, the Company recorded a gain of $15.0 million in 2013 for foreign exchange differences for foreign operations, resulting from the weakening of the US dollar relative to the Canadian dollar in 2013. This compared to a charge of $4.6 million in 2012 due to a strengthening of the US dollar relative to the Canadian dollar.

SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's financial position as at December 31, 2013 and 2012[27]:

(millions of Canadian dollars, except for ratios)	**2013**	**2012**
Cash and cash equivalents	**$ 89.5**	$ -
Operating working capital, excluding investment in joint venture held for sale	**266.5**	329.5
Investment in joint venture held for sale	**-**	75.1
Cheques issued in excess of cash on hand	**-**	(17.1)
Current portion of long-term debt	**-**	(184.1)
Current portion of deferred reforestation	**(44.1)**	(37.3)
Net working capital	**311.9**	166.1
Property, plant and equipment	**1,151.9**	1,081.7
Timber licenses	**534.6**	554.6
Goodwill and other intangible assets	**93.5**	80.4
Retirement benefit surplus	**42.2**	4.1
Long-term investments and other	**112.5**	43.2
Net assets	**$ 2,246.6**	$ 1,927.4
Long-term debt	**$ 153.1**	$ 100.0
Retirement benefit obligations	**200.5**	311.7
Deferred reforestation obligations	**69.8**	78.4
Other long-term liabilities	**14.9**	13.6
Deferred income taxes, net	**210.9**	111.8
Non-controlling interests	**223.1**	199.4
Equity attributable to shareholders of Company	**1,374.3**	1,112.5
	$ 2,246.6	$ 1,927.4
Ratio of current assets to current liabilities	**1.7 : 1**	1.3 : 1
Net debt to total capitalization	**8.0%**	20.0%

[27] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits* and IFRS 11, *Joint Arrangements*. Further details can be found in the "Changes in Accounting Policy" section in this document.

The ratio of current assets to current liabilities at the end of 2013 was 1.7:1 compared to 1.3:1 at the end of 2012, and reflected the Company's improved financial results and higher cash and cash equivalent balances net of amounts drawn on operating lines at December 31, 2013 compared to December 31, 2012. The improved ratio also reflected repayment of Canfor's US$75.0 million 5.42% term debt in the second quarter of 2013 and CPPI's US$110.0 million 6.41% term debt in the fourth quarter of 2013, both of which were presented as current liabilities at December 31, 2012.

The Company's net debt to capitalization was 8.0% at December 31, 2013 (December 31, 2012: 20.0%). The decrease principally reflects lower debt levels at December 31, 2013 compared to December 31, 2012. The Company's term debt repayments in 2013 coupled with higher cash and cash equivalents net of amounts drawn on operating lines and higher shareholders equity as a result of net income attributable to equity shareholders were the principal contributing factors.

CHANGES IN FINANCIAL POSITION

At the end of 2013, Canfor had $89.5 million of cash and cash equivalents[28].

(millions of Canadian dollars)	2013	2012
Cash generated from (used in)		
Operating activities	**$ 490.3**	$ 117.4
Financing activities	**(181.4)**	42.0
Investing activities	**(202.3)**	(203.1)
Increase (decrease) in cash and cash equivalents	**$ 106.6**	$ (43.7)

[28] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits* and IFRS 11, *Joint Arrangements*. Further details can be found in the "Changes in Accounting Policy" section in this document.

The changes in the components of these cash flows during 2013 are discussed in the following sections.

Operating Activities

For the 2013 year, Canfor generated cash from operations of $490.3 million, up $372.9 million from cash generated of $117.4 million in the previous year. Operating cash flows reflected an increase in cash earnings in the lumber and pulp and paper segments. Offsetting the net increase in consolidated cash earnings was an increase in non-cash working capital principally due to higher log inventory costs offset by higher accounts payable and accrued liability balances due to increases in contractor, stumpage and payroll liabilities compared to the previous year.

Financing Activities

Financing activities in 2013 used net cash of $181.4 million compared to net cash generated of $42.0 million in 2012. In 2013, the Company repaid its US$75.0 million 5.64% term debt and CPPI's US$110.0 million 6.41% term debt for a total of $192.9 million Canadian dollars. In the fourth quarter, CPPI completed new $50.0 million floating rate term debt financing, which is being used to finance its high-returning energy projects at the Northwood and Intercontinental Mills. In addition, the Company paid $17.4 million in finance expenses, down $2.1 million from the previous year reflecting lower total debt levels and the transition from fixed interest rate debt to lower floating interest rate debt. CPPI made dividend payments $9.3 million to non-controlling shareholders in 2013, down $6.6 million from 2012. At December 31, 2013, the Company had a consolidated amount of $74.6 million drawn on its operating loan facilities.

Cash used for financing activities also included share purchases under Canfor's and CPPI's Normal Course Issuer Bids. During 2013, Canfor purchased 2,847,838 common shares for $60.0 million and CPPI purchased 262,449 common shares from non-controlling shareholders for $2.4 million (see further discussion of the shares purchased under the Normal Course Issuer Bid in the following "Financial Requirements and Liquidity" section).

Investing Activities

In 2013, the Company used net cash for investing activities of $202.3 million, compared to $203.1 million in 2012. Additions to property, plant and equipment totaled $237.3 million, up $35.7 million from 2012. In the lumber segment, capital spending of $164.7 million included major capital projects at the Elko, Mackenzie, Houston, Conway and Darlington operations. In the pulp and paper segment, capital spending of $62.6 million included the Northwood Pulp Mill turbine upgrades. Upgrades to the Northwood Pulp Mill turbines was substantially completed in the fourth quarter of 2013 with the project targeted for commissioning by the end of the first quarter of 2014.

During 2013, Canfor completed the first phase of the purchase of Scotch Gulf which included payment of $29.5 million for an initial 25% equity investment plus transaction closing costs and a proportionate share of working capital and $34.0 million loaned to Scotch Gulf under a secured term loan agreement, of which $33.0 million was outstanding at December 31, 2013. Also during the year, Canfor completed the sale of its 50% interest in the Canfor-LP OSB joint venture for proceeds of $77.9 million. Prior to completion of the sale on May 31, 2013, Canfor received $16.5 million in partner distributions from Canfor-LP OSB.

FINANCIAL REQUIREMENTS AND LIQUIDITY

Operating Loans

On a consolidated basis, at December 31, 2013, the Company had $480.0 million of unsecured operating loan facilities, $74.6 million drawn on its operating loans, and an additional $27.0 million reserved for several standby letters of credit, leaving $378.4 million of available undrawn operating loans.

Excluding CPPI, the Company's bank operating loans at December 31, 2013 totaled $350.0 million, of which $64.0 million was drawn, and an additional $14.8 million reserved for several standby letters of credit, the majority of which related to unregistered pension plans. In 2013, Canfor extended the maturity on its operating loan to February 28, 2018. All other terms on the operating loan facility remain unchanged.

At December 31, 2013, CPPI had a $110.0 million bank loan facility, of which $10.6 million was drawn. In 2013, CPPI extended the maturity of this operating loan facility to January 31, 2018, with all other terms on the operating loan facility remaining unchanged. In the fourth quarter of 2013, CPPI replaced its facility for energy related letters of credit with a new $20.0 million facility maturing on June 30, 2015. At December 31, 2013, CPPI had $12.2 million in standby letters of credit related to energy sales covered under its operating loan facilities.

Debt Covenants

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

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

The debt held by CPPI is subject to the same debt covenants as Canfor.

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

Management reviews results and forecasts to monitor the Company's compliance with these covenant requirements. Canfor was in compliance with all its debt covenants for the year ended December 31, 2013.

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

Normal Course Issuer Bid

On March 5, 2013, the Company commenced a normal course issuer bid whereby it can purchase for cancellation up to 7,137,621 common shares or approximately 5% of its issued and outstanding common shares. The normal course issuer bid is set to expire on March 4, 2014. In 2013, Canfor purchased 2,847,838 common shares for $60.0 million, at an average price of $21.07 per share. Under a separate normal course issuer bid, CPPI purchased shares from non-controlling shareholders increasing Canfor's ownership of CPPI to 50.4% by year end.

2014 Projected Capital Spending and Debt Repayments

Based on its current outlook for 2014, assuming no deterioration in market conditions during the year, the Company anticipates that it may invest approximately $215 million in capital projects, which will consist primarily of various improvement projects as well as maintenance of business expenditures. There are no scheduled long-term debt payments in 2014. Canfor has sufficient liquidity in its cash reserves and operating loans to finance its planned capital expenditures as required during 2014.

Derivative Financial Instruments

As at December 31, 2013, the Company had the following derivatives:

a. Foreign exchange collars of US$210.0 million and forward contracts of US$3.5 million. There were unrealized gains of $0.3 million on the foreign exchange derivatives at the end of the year. The contracts in place at the end of 2013 were as follows:

	2013	
	Notional Amount	**Exchange Rates**
US dollar collars	(millions of US dollars)	(protection/topside, per dollar)
0-12 months	**$210.0**	**$1.04/$1.12**
US dollar forward contracts	(millions of US dollars)	(range of rates, per dollar)
0-12 months	**$3.5**	**$1.07**

b. Canfor partly uses Brent oil and Western Texas Intermediate ("WTI") oil contracts as a proxy to hedge its diesel purchases. At 2013 year end collars for 105 thousand barrels of WTI oil were in place, which will be settled in 2014, with weighted average protection of $84.14 per barrel and topside of $100.86 per barrel. There were unrealized gains of $0.1 million on these contracts at the end of the year.

c. Futures contracts for the sale of lumber with a total notional amount of 23.5 MMfbm. There were unrealized gains of $0.2 million at year end on these contracts.

	2013	
	Notional Amount	**Average Rate**
Lumber	(MMfbm)	(US dollars per Mfbm)
Futures sales contracts 0 – 12 months	**23.5**	**$376.14**

d. Futures contracts for the sale of pulp with a total notional amount of 12,000 tonnes. There were unrealized losses of $0.1 million at year end on these contracts.

	2013	
	Notional Amount	**Average Rate**
Pulp	(Tonnes)	(US dollars per Tonnes)
Futures sales contracts 0 – 12 months	**12,000**	**$945.00**

e. Canfor uses interest rate swaps to reduce its exposure to interest rate risk associated with financial obligations bearing variable interest rates. At December 31, 2013, the Company had $205.0 million in interest rate swaps with fixed interest rates from 1.55% to 1.75% and maturities between 2014 and 2017. There were unrealized losses of $0.2 million at year end on these swaps.

Commitments

The following table summarizes Canfor's financial contractual obligations at December 31, 2013 for each of the next five years and thereafter:

(millions of Canadian dollars)	2014	2015	2016	2017	2018	Thereafter	Total
Long-term debt obligations	$ -	$ -	$ -	$ 100.0	$ 50.0	$ 3.1	$ 153.1
Operating leases	$ 8.8	$ 6.2	$ 4.5	$ 3.2	$ 2.3	$ 9.1	$ 34.1
	$ 8.8	$ 6.2	$ 4.5	$ 103.2	$ 52.3	$ 12.2	$ 187.2

The interest payments associated with floating rate debt will depend on the lenders' Canadian prime rate or bankers' acceptance rate during the year of payment and have been excluded from the above commitments.

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

- Contractual commitments totaling $21.5 million, principally related to the construction of capital assets. This includes capital investments at the Company's Houston Sawmill, as well as a turbine project at CPPI's Intercontinental Pulp Mill.
- Purchase obligations and contractual obligations in the normal course of business. For example, purchase obligations of a more substantial dollar amount generally relate to the pulp business and are subject to "force majeure" clauses. In these instances, actual volumes purchased may vary significantly from contracted amounts depending on Canfor's requirements in any given year.
- Contractual commitments of US$60.0 million, excluding working capital, relating to the commitment to purchase the remaining 75% of Scotch Gulf.
- Deferred reforestation, for which a liability of $113.9 million has been recorded at December 31, 2013. The reforestation liability is a fluctuating obligation, based on the area harvested. The future cash outflows are a function of the actual costs of silviculture programs and of harvesting and are based on, among other things, the location of the harvesting and the activities necessary to adequately stock harvested areas and achieve a "free-to-grow" state.
- Obligations to pay pension and other post-employment benefits, for which the net liability for accounting purposes at December 31, 2013 was $158.3 million. As at December 31, 2013, Canfor estimated that it would make total contribution payments of $38.9 million to its defined benefit plans in 2014.
- CPPI has entered into three separate energy agreements with a BC energy company and electricity transmission provider (the "Energy Agreements") for all three of CPPI's mills, with commencement dates ranging from 2006 through 2013. These agreements are for the commitment of electrical load displacement and the sale of incremental power from CPPI's pulp and paper mills. These Energy Agreements include incentive grants from the BC energy company for capital investments to increase electrical generation capacity, and also call for performance guarantees to ensure minimum required amounts of electricity are generated, with penalty clauses if they are not met. As part of these commitments, CPPI has entered into standby letters of credit for these guarantees. The standby letters of credit have variable expiry dates, depending on the capital invested and the length of the Energy Agreement involved. As at December 31, 2013 CPPI had posted $12.2 million of standby letters of credit under these agreements, and had no repayment obligations under the terms of any of these agreements.

TRANSACTIONS WITH RELATED PARTIES

The Company undertakes transactions with various related entities. These transactions are in the normal course of business and are generally on the same terms as those accorded to unrelated third parties, except where noted otherwise. Related party transactions include the purchase of lumber, at market value, from Lakeland Mills Ltd. ("Lakeland") and Winton Global Lumber Ltd. ("Winton"), in which Canfor holds a one-third equity interest in both entities. In 2013, Canfor purchased $4.6 million in logs from Lakeland and Winton. No amounts were outstanding to Lakeland and Winton at December 31, 2013. Related party transactions in 2013 also included lease management services provided by Jim Pattison Lease. There were $1.5 million in transactions with the party during the year and no amounts were outstanding at December 31, 2013.

As previously noted, during 2013, Canfor completed the first phase of the purchase of Scotch Gulf. As part of the transaction, Scotch Gulf borrowed $34.0 million from Canfor in the form of a term loan, of which $33.0 million is outstanding at December 31, 2013.

Additional details on related party transactions are contained in note 23 to Canfor's 2013 consolidated financial statements.

SELECTED QUARTERLY FINANCIAL INFORMATION[29]

	Q4 2013	Q3 2013	Q2 2013	Q1 2013	Q4 2012	Q3 2012	Q2 2012	Q1 2012
Sales and income (millions of Canadian dollars)								
Sales	**$ 809.5**	**$ 755.9**	**$ 843.2**	**$ 786.3**	$ 700.3	$ 663.7	$ 685.0	$ 593.8
Operating income (loss)	**$ 53.8**	**$ 49.3**	**$ 128.2**	**$ 100.0**	$ 49.0	$ 18.1	$ 22.6	$ (18.4)
Net income (loss)	**$ 35.1**	**$ 33.6**	**$ 114.3**	**$ 67.5**	$ 24.7	$ 18.8	$ 5.0	$ (12.9)
Shareholder net income (loss)	**$ 28.0**	**$ 28.4**	**$ 110.3**	**$ 61.9**	$ 21.3	$ 20.5	$ 2.6	$ (18.0)
Per common share (dollars)								
Shareholder net income (loss) – basic and diluted	**$ 0.20**	**$ 0.20**	**$ 0.77**	**$ 0.43**	$ 0.15	$ 0.14	$ 0.02	$ (0.13)
Statistics								
Lumber shipments (MMfbm)	**1,148**	**1,211**	**1,268**	**1,135**	1,149	1,133	1,158	994
Pulp shipments (000 mt)	**330**	**268**	**308**	**308**	298	269	282	328
Average exchange rate – US$/Cdn$	**$ 0.953**	**$ 0.963**	**$ 0.977**	**$ 0.991**	$ 1.009	$ 1.005	$ 0.990	$ 0.999
Average Western SPF 2x4 #2&Btr lumber price (US$)	**$ 370**	**$ 328**	**$ 335**	**$ 391**	$ 335	$ 300	$ 295	$ 266
Average SYP (East) 2x4 #2 lumber price (US$)	**$ 415**	**$ 393**	**$ 392**	**$ 452**	$ 386	$ 322	$ 325	$ 298
Average OSB price – North Central (US$)	**$ 243**	**$ 252**	**$ 345**	**$ 418**	$ 332	$ 312	$ 235	$ 202
Average NBSK pulp list price delivered to U.S. (US$)	**$ 983**	**$ 947**	**$ 937**	**$ 897**	$ 863	$ 853	$ 900	$ 870

[29] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits* and IFRS 11, *Joint Arrangements*. Further details can be found in the "Changes in Accounting Policy" section in this document.

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

(millions of Canadian dollars)	Q4 2013	Q3 2013	Q2 2013	Q1 2013	Q4 2012	Q3 2012	Q2 2012	Q1 2012
Operating income (loss) by segment:								
Lumber	**$ 37.4**	**$ 43.8**	**$ 115.5**	**$ 88.4**	$ 42.5	$ 34.8	$ 18.6	$ (20.3)
Pulp and Paper	**$ 23.2**	**$ 11.5**	**$ 18.6**	**$ 18.9**	$ 12.0	$ (7.3)	$ 11.6	$ 11.3
Unallocated and Other	**$ (6.8)**	**$ (6.0)**	**$ (5.9)**	**$ (7.3)**	$ (5.5)	$ (9.4)	$ (7.6)	$ (9.4)
Total operating income (loss)	**$ 53.8**	**$ 49.3**	**$ 128.2**	**$ 100.0**	$ 49.0	$ 18.1	$ 22.6	$ (18.4)
Add: Amortization	**$ 44.9**	**$ 44.8**	**$ 49.6**	**$ 46.9**	$ 47.8	$ 43.2	$ 43.5	$ 42.6
Total operating income before amortization	**$ 98.7**	**$ 94.1**	**$ 177.8**	**$ 146.9**	$ 96.8	$ 61.3	$ 66.1	$ 24.2
Add (deduct):								
Working capital movements	**$ (14.5)**	**$ 4.6**	**$ 96.9**	**$ (94.5)**	$ (49.4)	$ (17.2)	$ 72.1	$ (76.8)
Defined benefit pension plan contributions	**$ (14.0)**	**$ (12.9)**	**$ (12.6)**	**$ (13.5)**	$ (13.4)	$ (14.8)	$ (12.7)	$ (14.0)
Other operating cash flows, net[30]	**$ 28.6**	**$ (10.5)**	**$ (1.9)**	**$ 17.1**	$ (6.4)	$ (4.9)	$ (8.3)	$ 14.8
Cash from operating activities	**$ 98.8**	**$ 75.3**	**$ 260.2**	**$ 56.0**	$ 27.6	$ 24.4	$ 117.2	$ (51.8)
Add (deduct):								
Finance expenses paid	**$ (5.9)**	**$ (1.5)**	**$ (7.5)**	**$ (2.5)**	$ (7.6)	$ (1.4)	$ (7.4)	$ (3.1)
Distributions paid to non-controlling interests	**$ (2.4)**	**$ (2.4)**	**$ (2.1)**	**$ (2.4)**	$ (0.4)	$ (3.0)	$ (8.2)	$ (4.3)
Capital additions, net[31]	**$ (67.5)**	**$ (74.6)**	**$ (48.8)**	**$ (46.4)**	$ (48.8)	$ (44.1)	$ (44.0)	$ (110.6)
Investment in Scotch & Gulf Lumber, LLC	**$ (0.5)**	**$ (29.0)**	**$ -**	**$ -**	$ -	$ -	$ -	$ -
Loan to Scotch & Gulf Lumber, LLC	**$ 2.1**	**$ (34.0)**	**$ -**	**$ -**	$ -	$ -	$ -	$ -
Proceeds from sale of Canfor-LP OSB	**$ -**	**$ 1.3**	**$ 76.6**	**$ -**	$ -	$ -	$ -	$ -
Drawdown (repayment) of long-term debt	**$ (66.6)**	**$ -**	**$ (73.2)**	**$ -**	$ -	$ -	$ -	$ 50.1
Other, net	**$ (33.0)**	**$ (16.9)**	**$ 0.3**	**$ 5.6**	$ 12.0	$ 10.0	$ 16.8	$ 5.9
Change in cash / operating loans	**$ (75.0)**	**$ (81.8)**	**$ 205.5**	**$ 10.3**	$ (17.2)	$ (14.1)	$ 74.4	$ (113.8)

30 Further information on operating cash flows can be found in the Company's annual consolidated financial statements.

31 Additions to property, plant and equipment include the acquisition of assets from Tembec Industries Ltd. ("Tembec") in the first quarter of 2012, and are shown net of amount received under Government funding initiatives in the pulp and paper segment.

THREE-YEAR COMPARATIVE REVIEW[32]

(millions of Canadian dollars, except per share amounts)	2013	2012	2011
Sales	**$ 3,194.9**	$ 2,642.8	$ 2,421.4
Net income	**$ 250.5**	$ 35.6	$ 10.8
Shareholder net income (loss)	**$ 228.6**	$ 26.4	$ (56.6)
Total assets	**$ 2,693.3**	$ 2,490.6	$ 2,401.6
Total long-term financial liabilities	**$ 153.1**	$ 100.0	$ 188.1
Shareholder net income (loss) per share, basic and diluted	**$ 1.61**	$ 0.18	$ (0.40)

32 Certain 2012 amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits* and IFRS 11, *Joint Arrangements*. Further details can be found in the "Changes in Accounting Policy" section in this document.

QUARTER ENDED DECEMBER 31, 2013 VS. QUARTER ENDED DECEMBER 31, 2012

Overview of Operating Results

The Company recorded operating income of $53.8 million and a shareholder net income of $28.0 million for the fourth quarter of 2013, compared to $49.0 million and shareholder net income of $21.3 million in the fourth quarter of 2012. The shareholder net income per share was $0.20 for the fourth quarter of 2013, compared to $0.15 per share in the fourth quarter of 2012. Included in the fourth quarter of 2013 were restructuring costs of $20.0 million related to the announced closure of the Company's Quesnel Sawmill and one-time costs of $1.1 million associated with new five year collective labour agreements for the lumber business ratified in December 2013, while the fourth quarter of 2012 included an accounting gain of $14.2 million related to certain amendments to the Company's salaried post retirement benefit plans. Adjusted for these one-time items, operating income in the fourth quarter was $74.9 million, an increase of $40.1 million compared to adjusted operating income of $34.8 million in the fourth quarter of 2012.

An overview of the results by business segment for the fourth quarter of 2013 compared to the last quarter of 2012 follows.

Lumber

Selected Financial Information and Statistics – Lumber[33]

Summarized results for the Lumber segment for the fourth quarter of 2013 and 2012 were as follows:

(millions of Canadian dollars, unless otherwise noted)		**Q4 2013**		**Q4 2012**
Sales	**$**	**533.7**	$	469.9
Operating income before amortization	**$**	**66.1**	$	69.1
Operating income	**$**	**37.4**	$	42.5
Positive impact of inventory valuation adjustments	**$**	**-**	$	(0.4)
Mill closure provisions	**$**	**20.0**	$	-
One-time costs associated with collective agreements	**$**	**1.1**	$	-
Operating income excluding impact of inventory valuation adjustments and unusual items	**$**	**58.5**	$	42.1
Average SPF 2x4 #2 & Btr lumber price in US$[34]	**$**	**370**	$	335
Average SPF price in Cdn$	**$**	**388**	$	332
Average SYP 2x4 #2 lumber price in US$[35]	**$**	**415**	$	386
Average SYP price in Cdn$	**$**	**436**	$	383
U.S. housing starts (thousand units SAAR)[36]		**1,002**		898
Production – SPF lumber (MMfbm)		**979.7**		985.5
Production – SYP lumber (MMfbm)		**138.7**		121.8
Shipments – Canfor-produced SPF lumber (MMfbm)[37]		**999.1**		1,007.9
Shipments – Canfor-produced SYP lumber (MMfbm)[37]		**143.2**		133.5
Shipments – wholesale lumber (MMfbm)		**5.7**		8.0

[33] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits* and IFRS 11, *Joint Arrangements*. Further details can be found in the "Changes in Accounting Policy" section in this document.
[34] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.).
[35] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.).
[36] Source – U.S. Census Bureau, seasonally adjusted annual rate ("SAAR").
[37] Canfor-produced lumber, including lumber purchased for remanufacture.

Overview

Operating income for the lumber segment was $37.4 million for the fourth quarter of 2013, a decrease of $5.1 million from operating income of $42.5 million reported for the fourth quarter of 2012. Results in the lumber segment for the fourth quarter of 2013 were impacted by various unusual items including an expense of $20.0 million related to the announced closure of the Quesnel Sawmill and, to a lesser extent, one-time costs of $1.1 million associated with new five year collective agreements ratified in the quarter. Excluding the impact of these unusual items, operating income for the fourth quarter of 2013 was $58.5 million, compared to $42.1 million in the fourth quarter of 2012.

Results in the fourth quarter of 2012 also included an accounting gain of $6.8 million related to certain amendments to the Company's salaried post retirement benefit plans.

The improved adjusted operating income compared to the fourth quarter of 2012 resulted principally from higher sales realizations, due to stronger market prices, lower export taxes and a weaker Canadian dollar. These gains more than offset higher unit manufacturing costs, which were largely log cost driven. Total shipments and production were in line with the fourth quarter of 2012, with an increase in productivity following various capital projects undertaken in 2013 offset by reduced overtime shifts in the current quarter. Higher unit manufacturing costs were driven by significant market-price related increases in stumpage and to a lesser extent, continued dust control efforts and additional shifts at the Company's southern pine operations.

Markets

The North American lumber market saw strong gains in prices during the fourth quarter of 2013, driven mostly by solid demand from the U.S. residential construction market. The U.S. housing market recovery continued to gain momentum with total housing starts averaging 1,002,000 units SAAR, reaching the highest level since the first quarter of 2008, and up 11% compared to the same period in 2012. Single-family starts, which consume a larger proportion of lumber compared to multi-family starts, were also up 11% compared to the fourth quarter of 2012.

In Canada, lumber consumption was lower than the fourth quarter of 2012, as Canadian housing starts averaged 200,000 units SAAR for the fourth quarter of 2013, down 4,000 units, or 2%, compared to the same quarter in 2012, attributable to a more moderate pace of construction activity in most parts of the country.

Canfor's offshore lumber shipments remained solid in the fourth quarter of 2013, buoyed by strong shipments to China where the total BC softwood lumber industry set a new record high volume in the month of October.

Sales

Sales for the lumber segment for the fourth quarter of 2013 were $533.7 million, compared to $469.9 million in the fourth quarter of 2012. The increase from the comparable period principally reflected overall higher sales realizations in the current quarter as total shipments, at just over 1.1 billion board feet, were in line with the fourth quarter of 2012. Compared to the fourth quarter of 2012, log sales were up, largely as a result of higher log costs.

Sales realizations showed a modest improvement reflecting stronger overall prices, lower export taxes and a favourable foreign exchange impact. The benchmark North American Random Lengths Western SPF 2x4 #2&Btr price was up US$35 per Mfbm, or 10%, compared to the fourth quarter of 2012, while most other grades and dimensions also saw increases, but to a lesser degree. Offshore pricing also showed solid increases compared to the fourth quarter of 2012. SYP products experienced similar gains, with the benchmark SYP 2X4 #2 price up US$29 per Mfbm, or 8%. Sales realizations for Canadian operations benefited from a 6 cent, or 6%, weaker Canadian dollar. Likewise, export taxes on Canadian shipments to the U.S. were lower, averaging 2% in the current period (5% in October) compared to the fourth quarter of 2012, when the export tax averaged 8% (5% in October and 10% in November and December).

Total residual fibre revenue was down compared to the fourth quarter of 2012, with lower shipments of sawmill residual chips more than offsetting a market-driven increase in sawmill residual chip prices.

Operations

Lumber production, at just over 1.1 billion board feet, was broadly in line with the fourth quarter of 2012, with continued productivity improvements from various capital projects undertaken in 2013 and a full quarter of production from the Company's Radium Sawmill, which was restarted in the comparative period of 2012, offset by the impact of capital project ramp-ups, industry-wide dust control efforts and a reduction in overtime shifts in the fourth quarter of 2013.

Unit manufacturing costs were up compared to the fourth quarter of 2012 largely attributable to market-related stumpage increases and higher logging and hauling costs, and to a lesser degree, the aforementioned continuing dust control efforts and additional shifts at the Company's southern pine operations.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[38,39]

Summarized results for the Pulp and Paper segment for the fourth quarter of 2013 and 2012 were as follows:

(millions of Canadian dollars, unless otherwise noted)		Q4 2013		Q4 2012
Sales	**$**	**275.8**	$	228.4
Operating income before amortization	**$**	**39.2**	$	32.5
Operating income	**$**	**23.2**	$	12.0
Average pulp price delivered to U.S. – US$[40]	**$**	**983**	$	863
Average price in Cdn$	**$**	**1,032**	$	855
Production – pulp (000 mt)		**299.5**		314.1
Production – paper (000 mt)		**30.8**		35.4
Shipments – Canfor-produced pulp (000 mt)		**329.5**		297.8
Shipments – paper (000 mt)		**31.1**		32.1

[38] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits*. Further details can be found in the "Changes in Accounting Policy" section in this document.
[39] Includes the Taylor pulp mill and 100% of CPPI, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.
[40] Per tonne, NBSK pulp price delivered to U.S. (RISI)

Overview

Operating income for the pulp and paper segment was $23.2 million for the fourth quarter of 2013, up $11.2 million from the fourth quarter of 2012.

Improved results for the pulp segment compared to the fourth quarter of 2012 principally reflected higher sales realizations, resulting from a 14% increase in pulp list prices, a 6% weaker Canadian dollar and higher shipments in the current quarter, the latter driven by higher shipments to China, partially offset by reduced volume into the U.S. This shift in the regional sales mix as well as upward pressure on discounts in North American markets partially offset the improved NBSK list prices and favourable exchange rates. Unit manufacturing costs increased moderately quarter-over-quarter, as a result of higher sawmill residual chip fibre costs (linked to NBSK market pulp sales realizations), and lower production levels, offset in part by reduced chemical and maintenance spend. The fourth quarter of 2012 results included an accounting gain of $4.5 million related to post retirement plan adjustments.

Markets

Global softwood pulp markets strengthened in the fourth quarter of 2013, with increased demand and solid increases in list prices through the quarter. Global softwood pulp producer inventory levels were balanced during the quarter, at 27 days' supply in December 2013, in line with September 2013. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

According to the World 20 report, global shipments of bleached softwood kraft pulp increased 2% in 2013 compared to 2012. The increase in softwood pulp shipments in the year was primarily due to increased shipments to North America and Europe, while shipments to China were relatively flat. Global shipments to China were up 11% in the fourth quarter of 2013 compared to the same period in 2012.

Sales

The Company's pulp shipments in the fourth quarter of 2013 were 330,000 tonnes, an increase of 32,000 tonnes, or 11%, from the fourth quarter of 2012 due largely to increased shipments to China, partially offset by reduced volumes to the U.S.

Pulp sales realizations saw increases compared to the same period in 2012, resulting from significant improvements in average pulp prices in all regions and the 6% weakening of the Canadian dollar. The North American NBSK list pulp price increased US$120 per tonne, or 14%. List prices to Europe and China experienced similar increases, up 12% and 11%, respectively, compared to the fourth quarter of 2012. The improved NBSK list prices more than offset the impact of increased volume to lower-margin regions, principally China, and the impact of increased discounts in North American markets in 2013. BCTMP sales realizations experienced moderate increases compared to the fourth quarter of 2012, reflecting higher market pricing and the weaker Canadian dollar.

Operations

Pulp production in the current quarter was 300,000 tonnes, a decrease of 15,000 tonnes, or 5%, compared to the fourth quarter of 2012, reflecting slightly lower scheduled outages, which were more than offset by lower overall operating rates.

Pulp unit manufacturing costs increased moderately compared to the fourth quarter of 2012, primarily driven by higher fibre costs, lower production levels and higher energy costs, offset in part by reduced chemical costs and reduced maintenance spending. The higher fibre costs in the current quarter resulted from market-related increases in prices for sawmill residual chips coupled with increased prices for higher-cost whole log chips, in part related to pressure on stumpage rates.

Unallocated and Other Items[41]

(millions of Canadian dollars)	Q4 2013	Q4 2012
Operating loss of Panels operations[42]	**$ (0.5)**	$ (0.7)
Corporate costs	**$ (6.3)**	$ (4.8)
Finance expense, net	**$ (6.4)**	$ (8.7)
Foreign exchange loss on long-term debt and investments, net	**$ (3.4)**	$ (2.0)
Loss on derivative financial instruments	**$ (0.2)**	$ (8.7)
Other income (expense), net	**$ (3.1)**	$ 3.2

[41] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits* and IFRS 11, *Joint Arrangements*. Further details can be found in the "Changes in Accounting Policy" section in this document.

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

Corporate costs were $6.3 million for the fourth quarter of 2013, up $1.5 million compared to the fourth quarter of 2012, principally due to the fact that the fourth quarter of 2012 corporate costs included a portion of the gain due to amendments to the Company's salaried post retirement benefit plans.

Net finance expense for the fourth quarter of 2013 was $6.4 million, down $2.3 million compared to the fourth quarter of 2012, principally resulting from lower debt and higher cash balances through the current quarter. Net finance expense for the 2012 periods has been restated for adoption of amended IAS 19, Employee Benefits, as further discussed in the "Changes in Accounting Policies" section later in this document.

The Company recorded a foreign exchange translation loss on its US dollar denominated debt of $3.4 million for the fourth quarter of 2013, as a result of a weakening of the Canadian dollar against the US dollar through the fourth quarter of 2013. In the fourth quarter of 2012 the Company showed a loss of $2.0 million due to a weakening of the Canadian dollar against the US dollar at the respective quarter ends.

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs, lumber prices, pulp prices and interest rates. In the fourth quarter of 2013, the Company recorded a net loss $0.2 million related to its derivative instruments due to realized and unrealized losses on its interest rate swaps as a result of lower interest rates, largely offset by realized and unrealized gains on US dollar forward contracts and collars.

The following table summarizes the gains (losses) on derivative financial instruments for the comparable periods:

(millions of Canadian dollars)	Q4 2013	Q4 2012
Foreign exchange collars and forward contracts	**$ 0.3**	$ (1.0)
Energy derivatives	**$ 0.1**	$ (0.3)
Lumber futures	**$ 0.2**	$ (7.5)
Pulp futures	**$ (0.1)**	$ -
Interest rate swaps	**$ (0.7)**	$ 0.1
	$ (0.2)	$ (8.7)

Other expense, net for the fourth quarter of 2013 included a $4.8 million negative fair value adjustment to the Canfor-LP OSB contingent consideration asset, largely reflecting weaker forecast OSB prices over the contingent consideration period. On completion of the Canfor-LP OSB sale in the second quarter of 2013, the initial fair value estimate for the contingent consideration arrangement was included in the gain on sale of the Canfor-LP OSB joint venture. The Company also recognized a net accounting loss of $4.2 million related to the Timber Exchange with West Fraser. Partially offsetting these factors in the fourth quarter of 2013 were foreign exchange gains on US dollar denominated working capital of $4.0 million resulting from the weakening of the Canadian dollar relative to the US dollar over the course of the quarter.

SPECIFIC ITEMS AFFECTING COMPARABILITY

Specific Items Affecting Comparability of Shareholder Net Income (Loss)

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

After-tax impact, net of non-controlling interests[43]

(millions of Canadian dollars, except for per share amounts)	**Q4 2013**	**Q3 2013**	**Q2 2013**	**Q1 2013**	**Q4 2012**	**Q3 2012**	**Q2 2012**	**Q1 2012**
Shareholder net income (loss), as reported	**$ 28.0**	$ 28.4	**$ 110.3**	**$ 61.9**	$ 21.3	$ 20.5	$ 2.6	$ (18.0)
Foreign exchange (gain) loss on long-term debt and investments, net	**$ 1.5**	$ (1.0)	**$ 1.8**	**$ 2.3**	$ 1.2	$ (4.0)	$ 2.4	$ (2.7)
(Gain) loss on derivative financial instruments	**$ 0.1**	$ (2.2)	**$ 1.0**	**$ (2.2)**	$ 6.5	$ (4.4)	$ 4.2	$ (5.1)
Mill closure provisions	**$ 14.8**	$ -	**$ -**	**$ -**	$ -	$ -	$ -	$ -
One-time costs associated with collective agreements for the lumber business	**$ 0.8**	$ -	**$ -**	**$ -**	$ -	$ -	$ -	$ -
Canfor's 50% interest in Canfor-LP OSB's income, net of tax	**$ -**	$ -	**$ 3.8**	**$ 8.3**	$ -	$ -	$ -	$ -
(Gain) loss on sale of Canfor-LP OSB	**$ 3.6**	$ 1.0	**$ (33.4)**	**$ -**	$ -	$ -	$ -	$ -
Change in substantively enacted tax rate	**$ -**	$ -	**$ 4.2**	**$ -**	$ -	$ -	$ -	$ -
Net gain on post retirement and pension plan amendments	**$ -**	$ -	**$ -**	**$ -**	$ (8.7)	$ -	$ -	$ -
Restructuring charges for management changes	**$ -**	$ -	**$ -**	**$ -**	$ -	$ 1.5	$ -	$ -
Increase in fair value of asset-backed commercial paper	**$ -**	$ -	**$ -**	**$ -**	$ -	$ -	$ -	$ (1.1)
Costs recorded in relation to Tembec acquisition	**$ -**	$ -	**$ -**	**$ -**	$ -	$ -	$ -	$ 2.8
Net impact of above items	**$ 20.8**	$ (2.2)	**$ (22.6)**	**$ 8.4**	$ (1.0)	$ (6.9)	$ 6.6	$ (6.1)
Adjusted shareholder net income (loss)	**$ 48.8**	$ 26.2	**$ 87.7**	**$ 70.3**	$ 20.3	$ 13.6	$ 9.2	$ (24.1)
Shareholder net income (loss) per share (EPS), as reported	**$ 0.20**	$ 0.20	**$ 0.77**	**$ 0.43**	$ 0.15	$ 0.14	$ 0.02	$ (0.13)
Net impact of above items per share	**$ 0.15**	$ (0.02)	**$ (0.16)**	**$ 0.06**	$ (0.01)	$ (0.05)	$ 0.05	$ (0.05)
Adjusted net income (loss) per share	**$ 0.35**	$ 0.18	**$ 0.61**	**$ 0.49**	$ 0.14	$ 0.09	$ 0.07	$ (0.18)

[43] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits* and IFRS 11, *Joint Arrangements*. Further details can be found in the "Changes in Accounting Policy" section in this document.

OUTLOOK

Lumber Markets

For 2014, North American lumber consumption is forecast to improve as the U.S. housing market continues to recover and more existing homeowners are forecast to undertake home improvement projects this year. Offshore markets are projected to remain solid supported by continued demand from China, Japan and other emerging markets.

Pulp and Paper Markets

For the month of January 2014, CPPI announced an increase in the NBSK pulp list price of US$20 per tonne in North America with list prices to China and Europe remaining unchanged. There are no maintenance outages planned for the first quarter of 2014. NBSK pulp markets are projected to remain stable through the first quarter of 2014 and producer inventories are balanced with steady demand from North America and Europe. Demand from China is projected to soften before the end of the first quarter of 2014 following strong buying in the fourth quarter of 2013 and the traditional Chinese Lunar New Year's holiday in January 2014.

With significant new hardwood pulp capacity projected to come online in the coming months, there continues to be a risk that pulp prices may come under pressure in 2014.

CRITICAL ACCOUNTING ESTIMATES

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

Employee Future Benefits

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

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

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

	December 31, 2013		December 31, 2012	
	Pension Benefit Plans	**Other Benefit Plans**	Pension Benefit Plans	Other Benefit Plans
Discount rate	**4.80%**	**4.90%**	4.20%	4.40%
Rate of compensation increases	**3.00%**	**n/a**	3.00%	n/a
Future salary increases	**3.00%**	**n/a**	3.00%	n/a
Initial medical cost trend rate	**n/a**	**7.00%**	n/a	10.00%
Ultimate medical cost trend rate	**n/a**	**4.50%**	n/a	4.50%
Year ultimate rate is reached	**n/a**	**2021**	n/a	2029

In addition to the significant assumptions listed in the table above, the average life expectancy of a 65 year old at December 31, 2013 is between 19.8 years and 23.0 years (2012 – 19.8 years and 22.0 years). As at December 31, 2013, the weighted average duration of the defined benefit obligation is 11.4 years (2012 – 11.2 years). The weighted average duration of the other benefit plans is 13.7 years (2012 – 15.9 years).

Assumed discount rates and medical cost trend rates have a significant effect on the accrued benefit obligation. A one percentage point change in these assumptions would have the following effects on the accrued benefit obligation for 2013:

(millions of Canadian dollars)		1% Increase		1% Decrease
Pension benefit plans				
Discount rate	$	(78.1)	$	88.0
Other benefit plans				
Discount rate	$	(18.8)	$	23.2
Initial medical cost trend rate	$	15.9	$	(13.5)

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

Deferred Reforestation

Canfor accrues an estimate of its future liability to perform forestry activities, defined to mean those silviculture treatments or activities that are carried out to ensure the establishment of a free-growing stand of young trees, including logging road rehabilitation on its forestry tenures in BC, Alberta and Quebec. An estimate is recorded in the financial statements based on the number of hectares of timber harvested in the period and the estimated costs of fulfilling Canfor's obligation. Payments in relation to reforestation are expected to occur over periods of up to 15 years (the significant majority occurring in the first seven years) and have been discounted accordingly at risk-free rates ranging from 1.0% to 3.1%. The actual costs that will be incurred in the future may vary based on, among other things, the actual costs at the time of silviculture activities.

Deferred Taxes

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

Asset Retirement Obligations

Canfor records the estimated fair value of a liability for asset retirement obligations, such as landfill closures, in the period when it is incurred. For CPPI's landfill closure costs, the fair value is determined using estimated closure costs discounted over the estimated useful life. Payments relating to landfill closure costs are expected to occur at periods ranging from 5 to 38 years and have been discounted at risk-free rates ranging from 1.9% to 3.2%. The actual closure costs and periods of payment may differ from the estimates used in determining the year end liability. On initial recognition, the fair value of the liability is added to the carrying amount of the associated asset and amortized over its useful life. The liability is accreted over time through charges to earnings and reduced by actual costs of settlement.

Environmental Remediation Costs

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

Impairment of Goodwill

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

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

Based upon the analysis performed in 2013 the net present value of the estimated future discounted cash flows exceeded the value of the investment, and therefore no impairments to goodwill were required. However, if the U.S. and global economic recovery were to be longer than anticipated in the forecast assumptions, there is a possibility that an impairment of goodwill may be required in future periods.

Asset Impairments

Canfor reviews the carrying values of its long-lived assets, including property, plant and equipment and timber licenses, on a regular basis as events or changes in circumstances may warrant. An impairment loss is recognized in net income at the amount that 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. A review of the carrying values of Canfor's sawmill and panel operations and various other assets was undertaken in 2012 and 2013 as a result of the ongoing difficult market conditions and global economic uncertainty.

Discounted future cash flow models were used to estimate the fair value of the majority of Canfor's long-lived assets. Key assumptions used related to forecast product prices and exchange rates, which were determined in a similar manner to tests for impairment of goodwill, as above. Other significant assumptions are the estimated useful life of the long-lived assets, the discount rate used and the impact of the Mountain Pine Beetle epidemic. No impairments were recorded in 2013 or 2012.

Valuation of Log and Finished Product Inventories

Log and finished product inventories are recorded at the lower of cost and net realizable value. For inventories of solid wood products, the net realizable value is determined by taking into account forecast prices and exchange rates for the period over which the inventories are expected to be sold. Forecast prices are determined using RISI forecasts and management's estimates as at the year end, and may differ from the actual prices at which the inventories are sold. At the end of December 2013, there were no write-downs against inventory balances.

Allowance for Doubtful Accounts

An allowance for doubtful accounts of $2.7 million has been recorded at December 31, 2013 which reflects management's assessment of risks attached to the collection of receivable balances. While significant bad debts have not been experienced in prior years, the provision is considered appropriate due to several risks still existing with respect to the U.S. housing market which may affect the ability of certain customers to pay amounts owed to the Company.

CHANGES IN ACCOUNTING POLICY

The Company has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2013. These changes were made in accordance with the applicable transitional provisions.

- The Company adopted IFRS 11, *Joint Arrangements*, which redefines joint operations and joint ventures with a focus on the rights and obligations of an arrangement, rather than its legal form. Under the new Standard, joint ventures are accounted for using the equity method accounting as set out in IAS 28, *Investments in Associates and Joint Ventures*, whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operations. Canfor's 50% interest in the Canfor-LP OSB was classified as a joint venture and accounted for using the equity method. The Company has restated its comparative period results for adoption of IFRS 11. Further details are contained in note 33 to Canfor's 2013 consolidated financial statements. Canfor sold its 50% interest in the Canfor-LP OSB to Louisiana Pacific Corporation ("LP") on May 31, 2013.
- The Company adopted the amended IAS 19, *Employee Benefits,* which changes the recognition and measurement of defined benefit pension expense and termination benefits and enhances the disclosure of all employee benefits. Pension benefit cost is split between (i) the cost of benefits accrued in the current period (service cost) and benefit changes (past-service costs (including plan amendments, settlements and curtailments)); and (ii) finance expense or income. Interest cost and expected return on plan assets, which previously reflected different rates, has been replaced with a net interest amount that is calculated by applying one discount rate to the net defined benefit liability (asset). The Company has restated its comparative period results for adoption of amended IAS 19. Further details are contained in note 33 to Canfor's 2013 consolidated financial statements.
- The Company also adopted IFRS 10, *Consolidated Financial Statements,* IFRS 13, *Fair Value Measurement,* and IAS 1, *Presentation of Financial Statements,* effective January 1, 2013. These Standards did not result in material impacts on the amounts recorded in the financial statements of Canfor.

FUTURE CHANGES IN ACCOUNTING POLICIES

In May 2011, the International Accounting Standards Board ("IASB") issued IFRS 9, *Financial Instruments.* The new Standard limits the number of categories for classification of financial assets to two: amortized cost and fair value through profit or loss. IFRS 9 also replaces models for measuring equity instruments and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. The required adoption date for IFRS 9 has been deferred and is not expected until January 1, 2017, with early adoption permitted. IFRS 9 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.

RISKS AND UNCERTAINTIES

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

Aboriginal Issues

Canadian judicial decisions have recognized the continued existence in the country of Aboriginal rights, including title, to lands continuously used or occupied by Aboriginal groups. Although Aboriginal groups have claimed Aboriginal rights over substantial portions of BC no Aboriginal right or title has yet been determined in areas overlapping with Canfor's forest tenures and other operations that aren't currently subject to treaties. While uncertainty regarding property rights in Canada (including forest tenure and other resource rights) continues to exist, particularly in those areas where treaties have not been concluded with Aboriginal groups, the Government of BC has provided greater certainty for the forest industry by reaching agreements on forest resources with many bands. As a means of protecting treaty and aboriginal rights, as well as undetermined Aboriginal rights, Canadian courts continue to confirm a duty to consult with Aboriginal groups when the Crown has knowledge of existing rights or the potential existence of an Aboriginal right, such as title, and contemplates conduct that might adversely impact them. The courts have not extended this duty to third parties, such as forest companies.

As issues relating to Aboriginal and treaty rights and consultation continue to be heard, developed and resolved in Canadian courts, Canfor will continue to cooperate, communicate and exchange information and views with Aboriginal groups and government, and participate with the Crown in its consultation processes with Aboriginal groups in order to foster good relationships and minimize risks to its tenures and operational plans. Due to their complexity, it is not expected that the issues regarding Aboriginal and treaty rights or consultation will be finally resolved in the short-term and, accordingly, the impact of these issues on the timber supply from Crown lands and Canfor's tenures and on Canfor's operations is unknown at this time.

Canfor believes in building mutually beneficial and lasting relationships with local First Nations whose treaty rights or potential Aboriginal rights overlap with Canfor's areas of operations. The Company continues to communicate frequently with Aboriginal groups in the areas that Canfor operates in and, where appropriate, to develop business relationships and evolve strategy, especially in the areas of timber harvesting and silviculture.

Combustible Dust Management

Following two sawmill explosions in the BC Interior, the wood products industry and government regulators have been actively addressing the risks posed by wood dust in manufacturing facilities. Specifically, Canfor has taken extensive steps to mitigate the risks of a combustible dust incident in our facilities. Regulatory agencies across the province, including WorkSafeBC, BC Safety Authority, and the Office of the Fire Commissioner have implemented various regulatory initiatives in response to these explosions. In the event of another catastrophic incident, additional regulatory initiatives, up to and including stop work conditions within the industry, may be a possibility.

Employee Future Benefits

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

Cash payments required to fund the pension plan are determined by actuarial valuation completed at least once every three years, with the most recent actuarial valuation for the largest plan completed as of December 31, 2010. In 2014, this plan will undergo an actuarial valuation for funding purposes as of December 31, 2013. Other post-retirement benefit plans are unfunded, and the Company makes payments as required to cover liabilities as they arise.

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

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

In 2012, following a review of the defined benefit plans, the Company made certain amendments to the salaried post retirement plans to mitigate some of the risks discussed above.

For Canfor's pension benefit plans, a one percentage point increase in the discount rate used in calculating the actuarial estimate of future liabilities would reduce the accrued benefit obligation by an estimated $78.1 million and a one percentage point decrease in the discount rate would increase the accrued benefit obligation by an estimated $88.0 million. These changes would only impact the Company's funding requirements in years where a new actuarial funding valuation was performed and regulatory approval for a change in funding contributions was obtained.

Environmental Issues

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

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

Canfor has in place internal policies and procedures under which all its forestry and manufacturing operations are regularly audited for compliance with laws and accepted standards and with its management system requirements. Canfor's woodlands operations employ environmental management systems following the ISO 14001 Environmental Management System Standard. Further, approximately 97% of Canfor's forest tenures in Canada are third-party certified to the Canadian Standards Association ("CSA"), the Forest Stewardship Council ("FSC") or the Sustainable Forestry Initiative ("SFI") sustainable forest management standards. Canfor's operations and its ability to sell its products could be adversely affected if those operations did not, or were perceived by the public as failing to, comply with applicable laws and standards, including responsible environmental and sustainable forestry standards.

On November 25, 2009, the BC Ministry of Environment released the greenhouse gas ("GHG") reporting regulations under the Greenhouse Gas Reduction Act, requiring any facilities emitting more than 10,000 tonnes of CO_2 to report 2010 emissions in 2011. In 2013, three of Canfor's sawmills and all of the pulp mills (including CPPI's pulp mills) reported GHG emissions under the BC GHG reporting regulation. GHG emission reporting has been required federally and in Alberta for several years with CPPI's facilities meeting the requirements for federal reporting, though Canfor's wood products facilities have not triggered federal or Alberta reporting thresholds. Canfor's New South facilities located in North and South Carolina are subject to state GHG reporting requirements.

At this point carbon policy in BC, apart from the existing carbon tax, is uncertain. Should cap and trade be implemented for BC at some time in the future, the CPPI mills and Taylor pulp would likely be subject to cap and trade legislation. The economic impact on pulp and paper mills will depend on factors such as cost to purchase carbon credits and allocation allowance, which are currently undeterminable.

The Quebec government in December 2011 announced adoption of GHG cap and trade legislation with capping and reduction of emissions starting January 1, 2013. Canfor's Daaquam facility in Quebec falls well under the 25,000 tonnes CO_2e annual emission threshold so is not subject to capping and reduction requirements.

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

Fibre Cost and Availability

The Company's fibre costs are affected by a number of different factors which could have a significant impact on operating results. Lumber market fluctuations and log market speculative bidding can also have a significant impact on both fibre supply and costs. In the interior of BC, the Company's tenure harvesting continues to advance north and east in an effort to maximize the salvage of pine impacted by the Mountain Pine Beetle epidemic. While this has the added benefit of improving the quality of fibre, it also increases transportation, road construction and reforestation costs. These factors also contribute to higher log costs and are anticipated to provide upward pressure on the Company's log costs for the foreseeable future. In addition, the Company's ability to harvest fibre for use in its operations could be adversely impacted by natural events such as forest fires, severe weather conditions or insect infestations. In the event that sufficient volumes of economically viable fibre cannot be provided to an operation, it may be necessary to close that operation for a period of time, or even permanently. Such closures could result in significant costs to the Company. The Company is not insured for loss of standing timber. Canfor has secured its fibre position in Western Canada relative to its existing sawmills and no shortage of supply is anticipated at this time.

Financial Risk Management and Earnings Sensitivities

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

Financial Risk Management

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

Canfor's 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.

(a) Credit risk:

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

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

Canfor utilizes a combination of credit insurance to manage the risk associated with trade receivables. Approximately 67% of the outstanding trade receivables are covered by credit insurance. Canfor's trade receivable balance at December 31, 2013 is $112.6 million, net of an allowance for doubtful accounts of $2.7 million. At December 31, 2013, approximately 98% of the trade accounts receivable balance was within Canfor's established credit terms.

(b) Liquidity risk:

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

At December 31, 2013, Canfor had $74.6 million drawn on its operating loans, accounts payable and accrued liabilities of $321.8 million, all of which fall due for payment within twelve months of the balance sheet date.

(c) Market risk:

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

(i) *Interest Rate risk*:

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

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

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

(ii) *Currency risk:*

Canfor is exposed to foreign exchange risk primarily related to the US dollar, as Canfor's products are sold principally in US dollars. In addition, Canfor holds financial assets and liabilities primarily related to New South Companies Inc. based in South Carolina, in US dollars.

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

(iii) *Commodity price risk:*

Canfor is exposed to commodity price risk related to the sale of lumber, pulp and paper. From time to time, Canfor enters into futures contracts on the Chicago Mercantile Exchange for lumber and forward contracts direct with customers for pulp. Under the Price Risk Management Controls Policy, up to 15% of lumber sales and 5% of pulp sales may be sold in this way.

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

Derivative Financial Instruments

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

Earnings Sensitivities

Estimates of the sensitivity of Canfor's pre-tax results to currency fluctuations and prices for its principal products, based on 2014 Business Plan forecast production and year end foreign exchange rates, are set out in the following table:

(millions of Canadian dollars)	Impact on annual pre-tax earnings
SPF lumber – US$10 change per Mfbm[44, 45]	$ 40
SYP lumber – US$10 change per Mfbm[44 ,45]	$ 6
Pulp – US$10 change per tonne [44, 45, 46]	$ 9
Canadian dollar – US$0.01 change per Canadian dollar [46,47]	$ 21

[44] Based on sales of Canfor-produced product.
[45] Excluding impacts of exchange rate, freight, discounting, potential change in fibre costs and other deductions.
[46] Includes 100% of CPPI.
[47] Represents impact on operating income as no outstanding US dollar denominated debt at December 31, 2013. Decrease of US$0.01 per Canadian dollar results in an increase to pre-tax annual earnings and an increase of US$0.01 per Canadian dollar results in a decrease to pre-tax annual earnings.

Government and Other Regulations

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

Labour Agreements and Competition for Professional Skilled Labour

Canfor ratified new five year collective agreements with the USW (United Steelworkers) in late 2013, with terms expiring on June 30, 2018. The Company's collective agreement with the PPWC (Pulp, Paper and Woodworkers of Canada) expires in June 2014 for its Mackenzie lumber operation but will be automatically extended for five years on the same terms as the USW collective agreement ratified in 2013. Canfor's collective agreement with the CEP (Communications, Energy and Paperworkers Union) for its Grande Prairie lumber operation expires September 30, 2014. In addition, CPPI's collective agreements with the CEP and PPWC have terms expiring on April 30, 2017. Any inability to negotiate acceptable contracts with the unions as they expire could result in a strike or work stoppage by the affected workers and increased operating costs as a result of higher wages or benefits paid to unionized workers.

Market conditions may cause shortages of both professional and skilled labour, which could have an adverse impact on the operation and management of Canfor's facilities.

Maintenance Obligations and Facility Disruptions

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

Mountain Pine Beetle

As noted earlier in this document (Section (iv) of the Overview of 2014), timber affected by the Mountain Pine Beetle remained the focus for Canfor harvesting activities in BC in 2013 and will continue to be in 2014. The focus on salvage harvesting and achievement of required harvest partitions will have an upward pressure on harvesting costs, as a result of smaller piece sizes, lower volumes per hectare and increasing haul distances. These will be offset somewhat by the transition to green or mixed stands (lower cost and/or higher quality) in some areas and by uplifted harvest levels in others. The impact of the infestation on Canfor's operations continues to be manageable in the short term and the Company has taken steps to minimize its exposure to reductions in annual allowable harvests and to ensure a sufficient supply for its existing operations.

In Alberta, the Mountain Pine Beetle infestation is still significantly less wide-spread than in the BC Interior, however, population forecast surveys in 2013 indicated that overall winter survival rates have increased. The largest and most successful beetle populations are found in the West Central and Northwestern parts of the Province but an accelerated harvest of susceptible pine on the Canfor FMA area since 2009 has helped contain the spread there. Pine mortality in areas North of the Peace River, including the Canfor quota area, on the other hand, has been extensive and harvesting objectives are now focused on salvage rather than spread prevention. The approval of a significant AAC increase for the quota area will maximize the opportunity to harvest infected pine stands before significant reduction in log quality occurs.

Residual Fibre Revenues

Wood chips are a residual product of Canfor's lumber manufacturing process and are primarily sold to CPPI. These chips are the principal raw material utilized by CPPI in its pulp manufacturing operations. Canfor has a Chip Supply Agreement with CPPI, which contains a pricing formula that currently results in CPPI paying Canfor a price for wood chips based on pulp markets and CPPI's product mix. Canfor currently provides approximately 61% of CPPI's chip requirements. If market conditions caused CPPI to cease pulp operations for an extended period of time, Canfor would have a limited market for its chip supply and this could affect its ability to run its sawmills economically. Similarly, if lumber market conditions were such that Canfor is unable to provide the current volume of chips to CPPI as a result of sawmill closures, whether temporary or permanent, CPPI's financial results could be materially affected.

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

Sales of sawdust and shavings are made primarily to other customers and the demand is increasing and robust.

Softwood Lumber Agreement

The SLA, in effect from October 2006, provides both Canada and the U.S. with rights to terminate the agreement. The SLA term was extended and expires in October 2015. In order to terminate under all circumstances except one, the U.S. must provide a six month notice period, and cannot launch a new countervailing duty ("CVD") or anti-dumping duty ("ADD") investigation for 12 months after termination. The exception is that the U.S. may terminate immediately and launch new CVD or ADD cases without the 12 month standstill if Canada is accused of an egregious breach of the SLA. Canada may terminate at any time with six months notice.

Any early termination of the SLA would likely result in the U.S. initiating a new CVD and ADD investigation, potentially leading to duties imposed on the Canadian lumber producers, including the Company.

In addition to the above, the SLA includes a "Surge Mechanism", which increases the export tax rate for the month by 50% when the monthly volume of exports from a region exceeds a certain "Trigger Volume" as defined in the SLA. In 2013, the Company did not pay any surge tax on shipments from Alberta. The Company has attempted to minimize the impact of the surge tax by directing shipments from the Company's Alberta operation to domestic or offshore markets where possible.

On January 18, 2011, the U.S. triggered the arbitration provision of the SLA by delivering a Request for Arbitration. The U.S. claimed that the province of British Columbia had not properly applied the timber pricing system grandparented in the SLA. The U.S. also claimed that subsequent to 2006, BC made additional changes to the timber pricing system which had the effect of reducing timber prices. The claim focused on substantial increases in Grade 4 (non sawlog or low grade) volumes commencing in 2007. It was alleged that timber was scaled and graded as Grade 4 that did not meet the criteria for that grade, and was accordingly priced too low.

As the arbitration is a state-to-state international dispute under the SLA, Canada prepared a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. After numerous representations from both sides, a hearing was held before the arbitration panel in the first quarter of 2012. On July 18, 2012 the arbitration panel ruled in favour of Canada and dismissed the claims of the U.S. in their entirety.

Stumpage Rates

The BC government introduced a Market Pricing System ("MPS") for the BC Interior on July 1, 2006. On July 1, 2010 the Ministry of Forests and Range (the "Ministry") implemented changes to the interior market pricing system for timber. These changes dealt with issues raised by the MPB epidemic. These changes included the introduction of "stand-as-a-whole" pricing with cruise-based billing for MPB damaged timber and, from a stumpage distribution perspective, transition over two years to a system more sensitive to market forces such as lumber market pricing and competition for supply of logs through the BC Timber Sales program, both of which could have a material impact on stumpage rates and Canfor's business. For stands with 35% or more MPB damaged timber a single stumpage rate is established with billing based on the cruise rather than scaling. For these stands, determination of log grades is no longer necessary. An impact of these changes is to increase the overall market sensitivity of interior timber pricing and to improve the utilization of low value material. These changes are consistent with the 2006 SLA.

Canfor is actively participating in discussions on MPS with the Ministry, which is scheduled for its eighth annual update on July 1, 2014. Canfor will continue to seek to manage and reduce the stumpage costs for its Interior operations under the stumpage appraisal system. The near-term imperative is to ensure that the stumpage system accurately reflects the market value of timber and is responsive to the deteriorating quality of the beetle-impacted fibre. The inability of BC Timber Sales to advertise and sell its full annual allowable cut may have an impact on BC Timber Sales volume and Canfor's quota volume pricing through MPS. Further changes to the BC Interior market driven stumpage system and resultant stumpage rates could have a material impact on Canfor's business.

Transportation Services

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

OUTSTANDING SHARE DATA

At February 5, 2014, there were 139,904,593 common shares issued and outstanding.

DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Board of Directors and the Audit Committee. The Company's chief executive officer ("CEO") and chief financial officer ("CFO") have evaluated the effectiveness of these disclosure controls and procedures for the year ending December 31, 2013, and have concluded that they are effective.

The CEO and CFO acknowledge responsibility for the design of internal controls over financial reporting ("ICFR"), and confirm that there were no changes in these controls that occurred during the year ended December 31, 2013 which materially affected, or are reasonably likely to materially affect, the Company's ICFR. Based upon their evaluation of these controls for the year ended December 31, 2013, the CEO and CFO have concluded that these controls are operating effectively.

Additional information about the Company, including its 2013 Annual Information Form, is available at www.sedar.com or at www.canfor.com.