

A background image of a dense forest with tall, thin trees. A bright sunburst effect is visible in the upper left quadrant, with rays of light filtering through the trees.

# 2016

## CANFOR PULP PRODUCTS INC. QUARTER FOUR INTERIM REPORT

FOR THE THREE MONTHS ENDED DEC 31, 2016

---

2	Message to Shareholders
4	Condensed Consolidated Balance Sheets
5	Condensed Consolidated Statements of Income
6	Condensed Consolidated Statements of Other Comprehensive Income (Loss) and Changes in Equity
7	Condensed Consolidated Statements of Cash Flows
8	Notes to the Condensed Consolidated Financial Statements

## To Our Shareholders

Canfor Pulp Products Inc. (“CPPI”) reported net income of \$10.1 million, or \$0.15 per share, for the fourth quarter of 2016, compared to \$22.4 million, or \$0.34 per share, for the third quarter of 2016 and \$29.7 million, or \$0.43 per share, for the fourth quarter of 2015. For the year ended December 31, 2016, the Company’s net income was \$57.8 million, or \$0.86 per share, compared to \$106.6 million, or \$1.52 per share, for 2015.

The following table summarizes selected financial information for the Company for the comparative periods:

(millions of Canadian dollars, except per share amounts)	Q4 2016	Q3 2016	YTD 2016	Q4 2015	YTD 2015
Sales	\$ 257.8	\$ 291.6	\$ 1,101.9	\$ 330.8	\$ 1,174.7
Operating income before amortization	\$ 42.1	\$ 50.0	\$ 172.0	\$ 56.2	\$ 208.4
Operating income	\$ 22.9	\$ 31.0	\$ 98.2	\$ 38.6	\$ 143.2
Net income	\$ 10.1	\$ 22.4	\$ 57.8	\$ 29.7	\$ 106.6
Net income per share, basic and diluted	\$ 0.15	\$ 0.34	\$ 0.86	\$ 0.43	\$ 1.52
Adjusted net income	\$ 10.1	\$ 22.4	\$ 57.8	\$ 29.0	\$ 111.8
Adjusted net income per share, basic and diluted	\$ 0.15	\$ 0.34	\$ 0.86	\$ 0.42	\$ 1.59

The Company had no items affecting comparability in the fourth quarter of 2016 or for the year ended December 31, 2016. Adjusted net income was \$29.0 million, or \$0.42 per share, for the fourth quarter of 2015, and \$111.8 million, or \$1.59 per share, for 2015.

The Company reported operating income of \$22.9 million for the fourth quarter of 2016, a decrease of \$8.1 million from \$31.0 million reported for the third quarter of 2016. The decrease in operating income was largely attributable to adverse weather conditions, which impacted both shipment logistics and operations through the period. Sales realizations for Northern Bleached Softwood Kraft (“NBSK”) pulp were largely unchanged quarter-over-quarter, while Bleached Chemi-Thermo Mechanical Pulp (“BCTMP”) sales realizations saw a marked improvement. The Company’s net income for the fourth quarter of 2016 included the pre-tax write-down of \$7.0 million of advances made in connection with the biofuels technology initiative with Licella Fibre Fuels Pty. Ltd. (“Licella”), a subsidiary of Ignite Energy Resources Ltd. Notwithstanding the future benefits that may result from this innovative effort, the write-down reflected the research and development nature of the advances.

Global softwood pulp markets were relatively stable through most of the fourth quarter of 2016 as evidenced by the average China US-dollar NBSK pulp list price, as published by RISI, remaining at US\$595 per tonne. NBSK pulp unit sales realizations were broadly in line with the third quarter of 2016, as a slightly weaker Canadian dollar was offset by increased pricing pressure in North America. BCTMP unit sales realizations increased significantly, reflecting the continued improvement in BCTMP markets. Energy revenues moderately increased during the current quarter, for the most part, reflecting increased power generation and seasonally higher energy prices.

Pulp shipments were down 14% from the previous quarter principally reflecting weather-related impacts on shipments, including a delayed vessel shipment over the year end. Pulp production was 3% lower than the previous quarter, primarily due to the severe weather conditions, which more than offset the impacts of scheduled maintenance outages in the previous quarter. Pulp unit manufacturing costs were up slightly from the previous quarter, reflecting higher energy usage combined with seasonally higher energy costs, as well as the unfavourable per unit impact of lower production volumes.

Operating income in the Company’s paper segment at \$8.1 million for the fourth quarter of 2016 was up \$0.9 million from the third quarter of 2016, largely reflecting slightly higher paper unit sales realizations in the current quarter, principally due to a 2% weaker Canadian dollar and lower manufacturing unit costs resulting from higher production volumes during the current quarter.

For the month of January 2017, the Company announced an increase of US\$20 per tonne for NBSK pulp list price to China, equating to US\$630 per tonne, and an increase of US\$10 per tonne for BCTMP. For the month of February 2017, the Company announced a further US\$20 per tonne increase to both its NBSK pulp and BCTMP list prices to China. Global softwood markets are currently seeing positive pricing momentum, for both NBSK pulp and BCTMP, and this is anticipated to continue into the second quarter of 2017.

On February 8, 2017, the Board of Directors declared a quarterly dividend of \$0.0625 per share, payable on February 28, 2017 to the shareholders of record on February 21, 2017.

Refer to the Company's annual Management's Discussion and Analysis for further discussion on the Company's results for the fourth quarter of 2016 on page 19.



**Michael J. Korenberg**  
Chairman



**Don B. Kayne**  
Chief Executive Officer

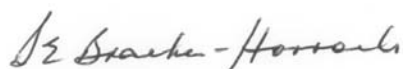
**Canfor Pulp Products Inc.**  
**Condensed Consolidated Balance Sheets**

(millions of Canadian dollars, unaudited)	As at December 31, 2016	As at December 31, 2015
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 51.9	\$ 17.5
Accounts receivable - Trade	75.9	101.8
- Other	16.8	17.5
Inventories	166.5	163.8
Prepaid expenses	5.1	7.5
<b>Total current assets</b>	<b>316.2</b>	<b>308.1</b>
Property, plant and equipment	518.7	532.3
<b>Other long-term assets</b>	<b>2.2</b>	<b>0.9</b>
<b>Total assets</b>	<b>\$ 837.1</b>	<b>\$ 841.3</b>
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 125.4	\$ 144.2
<b>Total current liabilities</b>	<b>125.4</b>	<b>144.2</b>
<b>Long-term debt</b>	<b>50.0</b>	<b>50.0</b>
<b>Retirement benefit obligations</b>	<b>109.1</b>	<b>93.0</b>
<b>Other long-term provisions</b>	<b>6.2</b>	<b>6.2</b>
<b>Deferred income taxes, net</b>	<b>61.7</b>	<b>68.2</b>
<b>Total liabilities</b>	<b>\$ 352.4</b>	<b>\$ 361.6</b>
<b>EQUITY</b>		
Share capital	\$ 491.6	\$ 508.2
Retained earnings (deficit)	(6.9)	(28.5)
<b>Total equity</b>	<b>\$ 484.7</b>	<b>\$ 479.7</b>
<b>Total liabilities and equity</b>	<b>\$ 837.1</b>	<b>\$ 841.3</b>

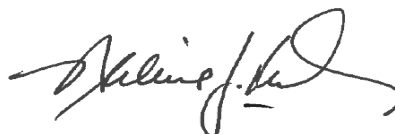
**Subsequent Event** (Note 7)

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

APPROVED BY THE BOARD



Director, S.E. Bracken-Horrocks



Director, M.J. Korenberg

**Canfor Pulp Products Inc.**  
**Condensed Consolidated Statements of Income**

(millions of Canadian dollars, except per share data, unaudited)	3 months ended December 31,		12 months ended December 31,	
	<b>2016</b>	2015	<b>2016</b>	2015
Sales	\$ 257.8	\$ 330.8	\$ 1,101.9	\$ 1,174.7
Costs and expenses				
Manufacturing and product costs	173.4	220.5	746.8	769.3
Freight and other distribution costs	35.1	47.0	155.5	169.0
Amortization	19.2	17.6	73.8	65.2
Selling and administration costs	7.2	7.1	27.6	28.0
	<b>234.9</b>	292.2	<b>1,003.7</b>	1,031.5
<b>Operating income</b>	<b>22.9</b>	38.6	<b>98.2</b>	143.2
Finance expense, net	(1.9)	(1.7)	(6.6)	(6.0)
Gain (loss) on derivative financial instruments	-	0.9	-	(8.8)
Other income (expense), net (Note 6)	(5.1)	1.9	(10.4)	14.5
Net income before income taxes	15.9	39.7	81.2	142.9
Income tax expense (Note 2)	(5.8)	(10.0)	(23.4)	(36.3)
<b>Net income</b>	<b>\$ 10.1</b>	\$ 29.7	<b>\$ 57.8</b>	\$ 106.6
 <b>Net income per common share:</b> (in Canadian dollars)				
Attributable to equity shareholders of the Company				
- Basic and diluted (Note 3)	\$ 0.15	\$ 0.43	\$ 0.86	\$ 1.52

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

**Canfor Pulp Products Inc.**  
**Condensed Consolidated Statements of Other Comprehensive Income (Loss)**

(millions of Canadian dollars, unaudited)	3 months ended December 31,		12 months ended December 31,	
	<b>2016</b>	2015	<b>2016</b>	2015
<b>Net income</b>	\$ 10.1	\$ 29.7	\$ 57.8	\$ 106.6
<b>Other comprehensive income (loss)</b>				
Items that will not be recycled through net income:				
Defined benefit plan actuarial gains (losses)	3.5	0.7	(15.5)	7.6
Income tax recovery (expense) on defined benefit plan actuarial gains (losses) (Note 2)	(1.0)	(0.2)	4.0	(2.0)
	<b>2.5</b>	<b>0.5</b>	<b>(11.5)</b>	<b>5.6</b>
Items that may be recycled through net income:				
Change in fair value of available-for-sale financial instruments, net of tax	(0.2)	-	-	-
Other comprehensive income (loss), net of tax	<b>2.3</b>	<b>0.5</b>	<b>(11.5)</b>	<b>5.6</b>
<b>Total comprehensive income</b>	<b>\$ 12.4</b>	<b>\$ 30.2</b>	<b>\$ 46.3</b>	<b>\$ 112.2</b>

**Condensed Consolidated Statements of Changes in Equity**

(millions of Canadian dollars, unaudited)	3 months ended December 31,		12 months ended December 31,	
	<b>2016</b>	2015	<b>2016</b>	2015
<b>Share capital</b>				
Balance at beginning of period	\$ 491.6	\$ 513.4	\$ 508.2	\$ 522.1
Share purchases (Note 3)	-	(5.2)	(16.6)	(13.9)
Balance at end of period	<b>\$ 491.6</b>	<b>\$ 508.2</b>	<b>\$ 491.6</b>	<b>\$ 508.2</b>
<b>Retained earnings (deficit)</b>				
Balance at beginning of period	\$ (15.3)	\$ (49.8)	\$ (28.5)	\$ (32.5)
Net income	10.1	29.7	57.8	106.6
Defined benefit plan actuarial gains (losses), net of tax	2.5	0.5	(11.5)	5.6
Dividends declared	(4.2)	(4.4)	(16.9)	(96.5)
Share purchases (Note 3)	-	(4.5)	(7.8)	(11.7)
Balance at end of period	<b>\$ (6.9)</b>	<b>\$ (28.5)</b>	<b>\$ (6.9)</b>	<b>\$ (28.5)</b>
<b>Accumulated other comprehensive income</b>				
Balance at beginning of period	\$ 0.2	\$ -	\$ -	\$ -
Change in fair value of available-for-sale financial instruments, net of tax	(0.2)	-	-	-
Balance at end of period	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Total equity</b>	<b>\$ 484.7</b>	<b>\$ 479.7</b>	<b>\$ 484.7</b>	<b>\$ 479.7</b>

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

**Canfor Pulp Products Inc.**  
**Condensed Consolidated Statements of Cash Flows**

	3 months ended December 31,		12 months ended December 31,	
(millions of Canadian dollars, unaudited)	2016	2015	2016	2015
<b>Cash generated from (used in):</b>				
<b>Operating activities</b>				
Net income	\$ 10.1	\$ 29.7	\$ 57.8	\$ 106.6
Items not affecting cash:				
Amortization	19.2	17.6	73.8	65.2
Income tax expense	5.8	10.0	23.4	36.3
Changes in mark-to-market value of derivative financial instruments	-	(2.3)	-	(1.0)
Employee future benefits	1.4	1.3	5.1	5.5
Finance expense, net	1.9	1.7	6.6	6.0
Write-down of advances to Licella (Note 6)	7.0	-	7.0	-
Other, net	0.8	0.6	(0.8)	(0.4)
Defined benefit plan contributions, net	(2.1)	(1.7)	(8.3)	(3.9)
Income taxes paid, net	(0.8)	(2.0)	(33.6)	(36.0)
	<b>43.3</b>	<b>54.9</b>	<b>131.0</b>	<b>178.3</b>
Net change in non-cash working capital (Note 4)	3.8	(11.8)	19.0	(32.9)
	<b>47.1</b>	<b>43.1</b>	<b>150.0</b>	<b>145.4</b>
<b>Financing activities</b>				
Finance expenses paid	(1.1)	(0.7)	(3.2)	(2.7)
Dividends paid	(4.2)	(4.4)	(16.9)	(96.5)
Share purchases (Note 3)	-	(9.6)	(24.7)	(25.3)
	<b>(5.3)</b>	<b>(14.7)</b>	<b>(44.8)</b>	<b>(124.5)</b>
<b>Investing activities</b>				
Additions to property, plant and equipment, net	(18.3)	(27.6)	(64.0)	(68.3)
Advances to Licella (Note 6)	(3.5)	-	(7.0)	-
Acquisition of Taylor pulp mill	-	-	-	(12.6)
Other, net	-	0.1	0.2	0.7
	<b>(21.8)</b>	<b>(27.5)</b>	<b>(70.8)</b>	<b>(80.2)</b>
<b>Increase (decrease) in cash and cash equivalents*</b>	<b>20.0</b>	<b>0.9</b>	<b>34.4</b>	<b>(59.3)</b>
<b>Cash and cash equivalents at beginning of period*</b>	<b>31.9</b>	<b>16.6</b>	<b>17.5</b>	<b>76.8</b>
<b>Cash and cash equivalents at end of period*</b>	<b>\$ 51.9</b>	<b>\$ 17.5</b>	<b>\$ 51.9</b>	<b>\$ 17.5</b>

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

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



## Canfor Pulp Products Inc. Notes to the Condensed Consolidated Financial Statements

Three months and twelve months ended December 31, 2016 and 2015  
(unaudited, millions of Canadian dollars unless otherwise noted)

### 1. Basis of Preparation

These condensed consolidated interim financial statements (the "financial statements") include the accounts of Canfor Pulp Products Inc. ("CPPI") and its subsidiary entities, hereinafter referred to as "CPPI" or "the Company." At December 31, 2016, Canfor Corporation ("Canfor") held a 53.6% interest in CPPI, an increase of 1.7% from December 31, 2015 as a result of share purchases in 2016 (Note 3).

These financial statements do not include all of the disclosures required by International Financial Reporting Standards ("IFRS") for interim and annual financial statements. Additional disclosures relevant to the understanding of these financial statements, including the accounting policies applied, can be found in the Company's Annual Report for the year ended December 31, 2016, available at [www.canforpulp.com](http://www.canforpulp.com) or [www.sedar.com](http://www.sedar.com).

These financial statements were authorized for issue by the Company's Board of Directors on February 8, 2017.

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

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

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

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

### 2. Income Taxes

(millions of Canadian dollars, unaudited)	3 months ended December 31,		12 months ended December 31,	
	2016	2015	2016	2015
Current	\$ (8.1)	\$ (7.5)	\$ (25.9)	\$ (35.6)
Deferred	2.3	(2.5)	2.5	(0.7)
Income tax expense	\$ (5.8)	\$ (10.0)	\$ (23.4)	\$ (36.3)

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

(millions of Canadian dollars, unaudited)	3 months ended December 31,		12 months ended December 31,	
	2016	2015	2016	2015
Income tax expense at statutory rate of 26.0%	\$ (4.1)	\$ (10.4)	\$ (21.1)	\$ (37.2)
Add (deduct):				
Permanent difference from capital gains and other non-deductible items	(1.8)	(0.1)	(1.8)	(0.1)
Entities with different income tax rates and other tax adjustments	0.1	0.5	(0.5)	1.0
Income tax expense	\$ (5.8)	\$ (10.0)	\$ (23.4)	\$ (36.3)

In addition to the amounts recorded to net income, a tax expense of \$1.0 million was recorded in other comprehensive income (loss) for the three months ended December 31, 2016 (three months ended December 31, 2015 - expense of \$0.2 million) in relation to actuarial gains/losses on the defined benefit plans. For the twelve months ended December 31, 2016, a tax recovery of \$4.0 was recorded in other comprehensive income (loss) (twelve months ended December 31, 2015 - expense of \$2.0 million).

### 3. Earnings per Share and Normal Course Issuer Bid

Basic net income per share is calculated by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the period.

	3 months ended December 31,		12 months ended December 31,	
	2016	2015	2016	2015
Weighted average number of common shares	<b>66,699,368</b>	69,428,956	<b>67,519,888</b>	70,105,543

On March 7, 2016, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 3,446,139 common shares or approximately 5% of its issued and outstanding common shares as of March 1, 2016. The renewed normal course issuer bid is set to expire on March 6, 2017. During the fourth quarter of 2016, CPPI did not purchase any common shares. As at December 31, 2016 and February 8, 2017, there were 66,699,368 common shares of the Company outstanding and Canfor's ownership interest in CPPI was 53.6%.

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

(millions of Canadian dollars, unaudited)	3 months ended December 31,		12 months ended December 31,	
	2016	2015	2016	2015
Accounts receivable	\$ 8.8	\$ (40.2)	\$ 24.2	\$ (49.7)
Inventories	(12.6)	14.0	(2.9)	(4.8)
Prepaid expenses	6.2	3.5	2.5	4.4
Accounts payable and accrued liabilities	1.4	10.9	(4.8)	17.2
Net decrease (increase) in non-cash working capital	\$ 3.8	\$ (11.8)	\$ 19.0	\$ (32.9)

## 5. Segment Information

The Company has two reportable segments, which operate as separate business units and represent separate product lines.

Sales between the pulp and paper segments are accounted for at prices that approximate fair value. These include sales of slush pulp from the pulp segment to the paper segment.

Information regarding the operations of each reportable segment is included in the following table.

(millions of Canadian dollars, unaudited)	Pulp	Paper	Unallocated	Elimination Adjustment	Consolidated
<b>3 months ended December 31, 2016</b>					
<b>Sales to external customers</b>	\$ 215.9	\$ 41.8	\$ 0.1	\$ -	\$ 257.8
<b>Sales to other segments</b>	22.8	-	-	(22.8)	-
<b>Operating income (loss)</b>	18.1	8.1	(3.3)	-	22.9
<b>Amortization</b>	18.1	1.0	0.1	-	19.2
<b>Capital expenditures<sup>1</sup></b>	16.9	0.4	1.0	-	18.3
3 months ended December 31, 2015					
Sales to external customers	\$ 286.9	\$ 43.6	\$ 0.3	\$ -	\$ 330.8
Sales to other segments	23.6	-	-	(23.6)	-
Operating income (loss)	34.4	6.9	(2.7)	-	38.6
Amortization	16.5	1.0	0.1	-	17.6
Capital expenditures <sup>1</sup>	27.2	0.4	-	-	27.6
<b>12 months ended December 31, 2016</b>					
<b>Sales to external customers</b>	\$ 924.2	\$ 176.1	\$ 1.6	\$ -	\$ 1,101.9
<b>Sales to other segments</b>	85.9	-	-	(85.9)	-
<b>Operating income (loss)</b>	79.6	29.7	(11.1)	-	98.2
<b>Amortization</b>	69.9	3.8	0.1	-	73.8
<b>Capital expenditures<sup>1</sup></b>	60.9	1.7	1.4	-	64.0
<b>Identifiable assets</b>	719.9	55.6	61.6	-	837.1
12 months ended December 31, 2015					
Sales to external customers	\$ 1,006.1	\$ 166.7	\$ 1.9	\$ -	\$ 1,174.7
Sales to other segments	93.4	-	-	(93.4)	-
Operating income (loss)	127.0	27.6	(11.4)	-	143.2
Amortization	61.5	3.6	0.1	-	65.2
Capital expenditures <sup>1</sup>	62.5	5.8	-	-	68.3
Identifiable assets	746.4	64.0	30.9	-	841.3

<sup>1</sup>Capital expenditures represent cash paid for capital assets during the periods and include capital expenditures that were partially financed by government grants. Capital expenditures for the twelve months ended December 31, 2015 exclude the assets purchased as part of the acquisition of the Taylor pulp mill.

## 6. Licella Pulp Joint Venture

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

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

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

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

#### **7. Subsequent Event**

On February 8, 2017, the Board of Directors declared a quarterly dividend of \$0.0625 per share, payable on February 28, 2017, to shareholders of record on February 21, 2017.