# 2018

CANFOR CORPORATION

# FINANCIAL STATEMENTS

**MANAGEMENT'S RESPONSIBILITY**

The information and representations in these consolidated financial statements are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements were prepared by management in accordance with International Financial Reporting Standards and, where necessary, reflect management's best estimates and judgments at this time. It is reasonably possible that circumstances may arise which cause actual results to differ.

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

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

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

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

February 21, 2019

| | |
|---|---|
| "*Don B. Kayne*" | "*Alan Nicholl*" |
| Don B. Kayne<br>President and Chief Executive Officer | Alan Nicholl<br>Chief Financial Officer |

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# INDEPENDENT AUDITORS' REPORT

To the Shareholders of Canfor Corporation

## *Opinion*

We have audited the consolidated financial statements of Canfor Corporation (the "Company"), which comprise:

- the consolidated balance sheets as at December 31, 2018 and December 31, 2017;
- the consolidated statements of income for the years then ended;
- the consolidated statements of comprehensive income for the years then ended;
- the consolidated statements of changes in equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and,
- notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2018 and December 31, 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

## *Basis for Opinion*

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the **"*Auditors' Responsibilities for the Audit of the Financial Statements*"** section of our auditors' report.

We are independent of the Company in accordance with the ethical requirements that are relevant to or audit of the financial statements in Canada and we have fulfilled our other responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## *Other Information*

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.
- the information, other than the financial statements and the auditors' report thereon, included in the "2018 Canfor Corporation Annual Report".

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

The 2018 Canfor Corporation Annual Report is expected to be made available to us after the date of this auditors' report. If, based on the work we will perform on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact to those charged with governance for the financial statements.

## *Responsibilities of Management and Those Charged with Governance for the Financial Statements*

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

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance for the financial statements are responsible for overseeing the Company's financial reporting process.

## *Auditors' Responsibilities for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Communicate with those charged with governance for the financial statements regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

- Provide those charged with governance for the financial statements with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company (which is the Group Entity) to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

KPMG LLP

Chartered Professional Accountants

The engagement partner on the audit resulting in this auditors' report is John Desjardins.

Vancouver, Canada
February 21, 2019

## Canfor Corporation
## Consolidated Balance Sheets

| (millions of Canadian dollars) | **As at December 31, 2018** | As at December 31, 2017 |
|---|---|---|
| **ASSETS** | | |
| **Current assets** | | |
| Cash and cash equivalents | **$ 252.7** | $ 288.2 |
| Accounts receivable - Trade | **182.1** | 193.0 |
| - Other | **52.4** | 42.7 |
| Income taxes receivable | **32.5** | - |
| Inventories (Note 6) | **762.5** | 628.9 |
| Prepaid expenses and other | **67.1** | 54.2 |
| Total current assets | **1,349.3** | 1,207.0 |
| **Property, plant and equipment** (Note 7) | **1,607.2** | 1,438.1 |
| **Timber licenses** (Note 8) | **504.1** | 518.3 |
| **Goodwill and other intangible assets** (Note 9) | **268.3** | 228.1 |
| **Long-term investments and other** (Note 10) | **110.4** | 83.3 |
| **Retirement benefit surplus** (Note 14) | **4.9** | 7.9 |
| **Deferred income taxes, net** (Note 21) | **0.9** | 5.6 |
| **Total assets** | **$ 3,845.1** | $ 3,488.3 |
| **LIABILITIES** | | |
| **Current liabilities** | | |
| Accounts payable and accrued liabilities (Note 11) | **$ 458.9** | $ 470.0 |
| Current portion of deferred reforestation obligations (Note 15) | **52.9** | 49.5 |
| Current portion of long-term debt (Note 13) | **0.4** | 0.3 |
| Total current liabilities | **512.2** | 519.8 |
| **Long-term debt** (Note 13) | **408.0** | 385.4 |
| **Retirement benefit obligations** (Note 14) | **254.7** | 272.0 |
| **Deferred reforestation obligations** (Note 15) | **63.9** | 63.0 |
| **Other long-term liabilities** | **24.6** | 23.7 |
| **Deferred income taxes, net** (Note 21) | **241.8** | 223.4 |
| **Total liabilities** | **$ 1,505.2** | $ 1,487.3 |
| **EQUITY** | | |
| Share capital (Note 17) | **$ 987.9** | $ 1,014.9 |
| Contributed surplus and other equity | **31.9** | 31.9 |
| Retained earnings | **931.1** | 629.5 |
| Accumulated other comprehensive income | **105.5** | 55.1 |
| Total equity attributable to equity shareholders of the Company | **2,056.4** | 1,731.4 |
| Non-controlling interests (Note 18) | **283.5** | 269.6 |
| **Total equity** | **$ 2,339.9** | $ 2,001.0 |
| **Total liabilities and equity** | **$ 3,845.1** | $ 3,488.3 |

**Commitments and Contingencies** (Note 25) and **Subsequent Event** (Note 26)

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

APPROVED BY THE BOARD

*"R.S. Smith"* *"C.A. Pinette"*

Director, R.S. Smith Director, C.A. Pinette

## Canfor Corporation
## Consolidated Statements of Income

| (millions of Canadian dollars, except per share data) | | Years ended December 31, **2018** | | 2017 |
|---|---|---|---|---|
| **Sales** | **$** | **5,044.4** | $ | 4,563.3 |
| **Costs and expenses** | | | | |
| Manufacturing and product costs | | **3,244.5** | | 2,959.9 |
| Freight and other distribution costs | | **643.7** | | 637.6 |
| Countervailing and anti-dumping duty expense, net of recovery (Note 30) | | **169.1** | | 44.3 |
| Amortization | | **270.5** | | 249.9 |
| Selling and administration costs | | **108.0** | | 114.2 |
| | | **4,435.8** | | 4,005.9 |
| **Operating income** | | **608.6** | | 557.4 |
| Finance expense, net (Note 20) | | **(26.0)** | | (30.8) |
| Foreign exchange gain (loss) on long-term debt | | **(10.9)** | | 8.8 |
| Foreign exchange gain on duties receivable | | **6.1** | | - |
| Gain (loss) on derivative financial instruments (Note 27) | | **1.1** | | (5.2) |
| Other income (expense), net | | **9.9** | | (3.8) |
| Net income before income taxes | | **588.8** | | 526.4 |
| Income tax expense (Note 21) | | **(149.8)** | | (132.8) |
| **Net income** | **$** | **439.0** | $ | 393.6 |
| **Net income attributable to:** | | | | |
| Equity shareholders of the Company | **$** | **354.9** | $ | 345.4 |
| Non-controlling interests (Note 18) | | **84.1** | | 48.2 |
| **Net income** | **$** | **439.0** | $ | 393.6 |
| **Net income per common share:** (in Canadian dollars) | | | | |
| Attributable to equity shareholders of the Company | | | | |
| - Basic and diluted (Note 17) | **$** | **2.78** | $ | 2.63 |

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

## Canfor Corporation
## Consolidated Statements of Other Comprehensive Income

| (millions of Canadian dollars) | | Years ended December 31, 2018 | | 2017 |
|---|---|---|---|---|
| **Net income** | **$** | **439.0** | $ | 393.6 |
| **Other comprehensive income** | | | | |
| Items that will not be recycled through net income: | | | | |
| Defined benefit plan actuarial gains (Note 14) | | **6.9** | | 24.1 |
| Income tax expense on defined benefit plan actuarial gains (Note 21) | | **(1.9)** | | (5.0) |
| | **$** | **5.0** | $ | 19.1 |
| Items that may be recycled through net income: | | | | |
| Foreign exchange translation of foreign operations, net of tax | | **50.4** | | (33.8) |
| Other comprehensive income (loss), net of tax | | **55.4** | | (14.7) |
| **Total comprehensive income** | **$** | **494.4** | $ | 378.9 |
| | | | | |
| **Total comprehensive income attributable to:** | | | | |
| Equity shareholders of the Company | **$** | **408.5** | $ | 322.2 |
| Non-controlling interests (Note 18) | | **85.9** | | 56.7 |
| **Total comprehensive income** | **$** | **494.4** | $ | 378.9 |

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

**Canfor Corporation**
**Consolidated Statements of Changes in Equity**

| (millions of Canadian dollars) | Years ended December 31, 2018 | 2017 |
|---|---|---|
| **Share capital** | | |
| Balance at beginning of year | **$ 1,014.9** | $ 1,047.7 |
| Share purchases (Note 17) | **(27.0)** | (32.8) |
| Balance at end of year (Note 17) | **$ 987.9** | $ 1,014.9 |
| **Contributed surplus and other equity** | | |
| Balance at beginning of year | **$ 31.9** | $ (4.6) |
| Forward purchase liability related to acquisitions (Note 29(a)) | **-** | 36.5 |
| Balance at end of year | **$ 31.9** | $ 31.9 |
| **Retained earnings** | | |
| Balance at beginning of year | **$ 629.5** | $ 351.7 |
| Net income attributable to equity shareholders of the Company | **354.9** | 345.4 |
| Defined benefit plan actuarial gains, net of tax | **3.2** | 10.6 |
| Share purchases (Note 17) | **(57.8)** | (57.9) |
| Elimination of non-controlling interests (Note 29(a)) | **-** | (16.6) |
| Acquisition of non-controlling interests (Note 17) | **-** | (3.7) |
| Non-controlling interests arising from change in partnership interest in pellet plants | **1.3** | - |
| Balance at end of year | **$ 931.1** | $ 629.5 |
| **Accumulated other comprehensive income** | | |
| Balance at beginning of year | **$ 55.1** | $ 88.9 |
| Foreign exchange translation of foreign operations, net of tax | **50.4** | (33.8) |
| Balance at end of year | **$ 105.5** | $ 55.1 |
| **Total equity attributable to equity shareholders of the Company** | **$ 2,056.4** | $ 1,731.4 |
| **Non-controlling interests** | | |
| Balance at beginning of year | **$ 269.6** | $ 254.8 |
| Net income attributable to non-controlling interests | **84.1** | 48.2 |
| Defined benefit plan actuarial gains attributable to non-controlling interests, net of tax | **1.8** | 8.5 |
| Distributions to non-controlling interests | **(74.5)** | (8.4) |
| Elimination of non-controlling interests (Note 29(a)) | **-** | (19.9) |
| Acquisition of non-controlling interests (Note 17) | **-** | (14.1) |
| Non-controlling interests arising from investment | **-** | 0.5 |
| Non-controlling interests arising from change in partnership interest in pellet plants | **2.5** | - |
| Balance at end of year (Note 18) | **$ 283.5** | $ 269.6 |
| **Total equity** | **$ 2,339.9** | $ 2,001.0 |

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

# Canfor Corporation
## Consolidated Statements of Cash Flows

| (millions of Canadian dollars) | Years ended December 31, 2018 | 2017 |
|---|---|---|
| **Cash generated from (used in):** | | |
| **Operating activities** | | |
| Net income | **$ 439.0** | $ 393.6 |
| Items not affecting cash: | | |
| Amortization | **270.5** | 249.9 |
| Income tax expense | **149.8** | 132.8 |
| Long-term portion of deferred reforestation obligations | **(0.3)** | 5.4 |
| Foreign exchange (gain) loss on long-term debt | **10.9** | (8.8) |
| Foreign exchange gain on duties receivable (Note 10) | **(6.1)** | - |
| Adjustment to accrued duties (Note 30) | **(25.8)** | (44.9) |
| Changes in mark-to-market value of derivative financial instruments | **(19.1)** | 0.9 |
| Employee future benefits expense | **11.7** | 11.0 |
| Finance expense, net | **26.0** | 30.8 |
| Other, net | **12.9** | (15.8) |
| Defined benefit plan contributions, net | **(28.2)** | (28.8) |
| Income taxes paid, net | **(222.4)** | (43.9) |
| | **618.9** | 682.2 |
| Net change in non-cash working capital (Note 22) | **(82.8)** | (72.1) |
| | **536.1** | 610.1 |
| **Financing activities** | | |
| Change in operating bank loans (Note 12) | **-** | (28.0) |
| Proceeds from long-term debt, net (Note 13) | **-** | 6.0 |
| Repayment of long-term debt (Note 13) | **(0.4)** | (50.3) |
| Finance expenses paid | **(23.3)** | (21.1) |
| Share purchases (Note 17) | **(88.5)** | (87.0) |
| Acquisition of non-controlling interests (Note 17) | **(0.1)** | (17.7) |
| Cash distributions paid to non-controlling interests (Note 18) | **(74.5)** | (10.0) |
| Other, net | **-** | 0.5 |
| | **(186.8)** | (207.6) |
| **Investing activities** | | |
| Additions to property, plant and equipment, timber and intangible assets, net | **(401.4)** | (252.1) |
| Proceeds on disposal of property, plant and equipment | **2.6** | 11.4 |
| Proceeds on sale of Anthony EACOM Inc., net (Note 10) | **-** | 21.1 |
| Proceeds on sale of Lakeland Winton (Note 10) | **-** | 15.0 |
| Acquisition of Beadles and Balfour and Wynndel (Notes 29(a) and (b)) | **-** | (59.8) |
| Other, net | **5.4** | (2.0) |
| | **(393.4)** | (266.4) |
| Foreign exchange gain (loss) on cash and cash equivalents | **8.6** | (4.5) |
| **Increase (decrease) in cash and cash equivalents*** | **(35.5)** | 131.6 |
| Cash and cash equivalents at beginning of year* | **288.2** | 156.6 |
| **Cash and cash equivalents at end of year*** | **$ 252.7** | $ 288.2 |

*Cash and cash equivalents include cash on hand less unpresented cheques.

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

## 1. Reporting Entity

Canfor Corporation is a company incorporated and domiciled in Canada and listed on The Toronto Stock Exchange. The address of the Company's registered office is 100-1700 West 75th Avenue, Vancouver, British Columbia, Canada, V6P 6G2. The consolidated financial statements of the Company as at and for the year ended December 31, 2018 comprise the Company and its subsidiaries (together referred to as "Canfor" or "the Company") and the Company's interests in associates and jointly controlled entities.

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

## 2. Basis of Preparation

### *Statement of compliance*

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

The consolidated financial statements were authorized for issue by the Board of Directors on February 21, 2019.

### *Basis of measurement*

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

- Financial instruments classified as measured at fair value;
- Equity investments are initially recognized at cost and subsequently increased or decreased to recognize the investor's share of the investee's equity;
- Asset retirement obligations and deferred reforestation obligations are measured at the discounted value of expected future cash flows; and
- The retirement benefit surplus and obligation related to the defined benefit pension plans are the net of the accrued benefit obligation and the fair value of the plan assets.

### *Use of estimates and judgments*

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

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

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

- Note 7 – Property, Plant and Equipment;
- Note 8 – Timber Licenses;
- Note 9 – Goodwill and Other Intangible Assets;
- Note 10 – Long-Term Investments and Other;
- Note 14 – Employee Future Benefits;
- Note 15 – Deferred Reforestation Obligations;
- Note 16 – Asset Retirement Obligations;
- Note 21 – Income Taxes;
- Note 28 – Licella Pulp Joint Venture; and
- Note 29 – Acquisitions.

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

## 3. Significant Accounting Policies

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

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

Subsidiaries are entities controlled by the Company. Control exists when Canfor is able to govern the financial and operating activities of those other entities to generate returns for the Company. Inter-company transactions, balances and unrealized gains and losses on transactions between different entities within the Company are eliminated. Significant subsidiaries include Canadian Forest Products Ltd. and Canfor Southern Pine, Inc. ("CSP"), which are wholly owned, and Canfor Pulp Products Inc. ("CPPI"), which was 54.8% owned at December 31, 2018.

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

### ***Business combinations***

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

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

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

### ***Financial Instruments***

Financial instruments comprise cash and cash equivalents, trade and other accounts receivables, investments in debt and equity securities, derivative instruments, accounts payable and accrued liabilities, operating loans and long-term debt. Canfor uses derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange, interest rate, lumber price, and energy price risk. Canfor's policy is not to utilize derivative financial instruments for trading or speculative purposes. Canfor's derivative financial instruments are not designated as hedges for accounting purposes.

Canfor's financial instruments are classified and measured as follows:

| | |
|---|---|
| Financial Assets: | |
| Cash and cash equivalents | Amortized cost |
| Trade and other accounts receivables | Amortized cost |
| Investments in debt and equity securities | FVTPL |
| Futures contracts (lumber and energy) | FVTPL |
| Foreign exchange forward contracts | FVTPL |
| Financial Liabilities: | |
| Accounts payable and accrued liabilities | Amortized cost |
| Operating loans | Amortized cost |
| Long-term debt | Amortized cost |

*Classification and measurement of financial assets*

Financial assets are classified as either measured at amortized cost, fair value through other comprehensive income ("FVOCI"), or fair value through net income ("FVTPL") based on the business model in which a financial asset is managed, its contractual cash flow characteristics and when certain conditions are met:

- Amortized cost – measured at amortized cost using the effective interest rate method. Where applicable, amortized cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognized in net income.
- FVOCI – measured at FVOCI if not designated as FVTPL. Interest income, foreign exchange gains and losses and impairment are recognized in net income. Other net gains and losses are recognized in other comprehensive income ("OCI"). On derecognition, gains and losses accumulated in OCI are reclassified to net income.
- FVTPL – measured at FVTPL if not classified as amortized cost or FVOCI with net gains and losses, including any interest or dividend income, recognized in net income.

Equity investments are required to be classified as measured at fair value. However, on initial recognition of an equity investment that is not held-for-trading, the Company may irrevocably elect to present subsequent changes in the investments fair value in OCI. This election is made on an investment by investment basis. The Company currently records gains and losses on its equity investments in net income.

*Classification and measurement of financial liabilities*

Financial liabilities are classified as either measured at amortized cost or FVTPL. A financial liability is classified as FVTPL if it is held-for-trading, a derivative or it is designated as such on initial recognition. Financial liabilities at FVTPL are measured at fair value with net gains and losses, including interest expense, recognized in net income. Other financial liabilities are subsequently measured at amortized cost using the effective interest rate method. Interest expense and foreign exchange gains and losses are recognized in net income. Any gains or losses on derecognition are also recognized in net income.

*Impairment*

The Company applies the simplified approach in determining expected credit losses ("ECLs"), which requires a probability-weighted estimate of expected lifetime credit losses to be recognized upon initial recognition of financial assets measured at amortized cost, contract assets and debt investments at FVOCI. Credit losses are measured as the present value of cash shortfalls from all possible default events, discounted at the effective interest rate of the financial asset. Loss allowances for financial assets at amortized cost are deducted from the gross carrying amount of the assets.

***Inventories***

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

***Property, plant and equipment***

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

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

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

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

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

| | |
|---|---|
| Buildings | 5 to 50 years |
| Pulp and kraft paper machinery and equipment | 8 to 20 years |
| Sawmill machinery and equipment | 5 to 15 years |
| Logging machinery and equipment | 4 to 20 years |
| Logging roads and bridges | 5 to 25 years |
| Mobile and other equipment | 5 to 10 years |

***Timber licenses***

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

***Other intangible assets***

*Goodwill*

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

*Computer software*

Software development costs relate to major software systems purchased or developed by the Company. These costs are amortized on a straight-line basis over periods of four to ten years.

***Government assistance***

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

***Asset impairment***

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

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

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

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

***Employee future benefits***

*Defined contribution plans*

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

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

*Defined benefit plans*

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

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

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

***Provisions***

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

*Asset retirement obligations*

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

*Deferred reforestation obligations*

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

***Share-based compensation***

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

***Revenue recognition***

Canfor's revenues are derived from the sale of lumber, engineered wood products, pulp, kraft paper, residual fibre, logs, wood pellets, and energy. Revenue is measured based on the consideration specified in a contract with a customer, net of applicable sales taxes, returns, rebates and discounts and after eliminating sales within the Company. Revenue is recognized when the Company transfers control of products to customers. The timing of transfer of control to customers varies depending on the individual terms of the contract of sale, but is typically as follows for Canfor's principal revenue generating activities:

- *Lumber* – At the time lumber is loaded onto a truck or rail carrier, upon vessel departure, or when lumber has been picked up by the buyer at a designated transfer point at the Company's mill or warehouse. The amount of revenue recognized is adjusted for volume rebates and discounts at the point in time control is transferred.
- *Pulp and Paper* – At the time pulp and paper is loaded onto a truck or rail carrier, upon vessel departure, or when pulp and kraft paper has been picked up by the buyer at a designated transfer point at the Company's mill or warehouse. The amount of revenue recognized is adjusted for commissions, volume rebates and discounts at the point in time control is transferred.

Amounts charged to customers for shipping and handling are recognized as revenue, and shipping and handling costs incurred by Canfor are reported as a component of freight and other distribution costs. Countervailing and anti-dumping duties are recorded as a component of operating income.

***Income taxes***

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

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

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

A deferred income tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred income tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized. Investment tax credits are credited to manufacturing and product costs in the period in which it becomes reasonably assured that the Company is entitled to them. Unused investment tax credits are recorded as other current or long- term assets in the Company's balance sheet, depending upon when the benefit is expected to be received.

***Foreign currency translation***

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

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

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

***Segment reporting***

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

## 4. Changes in significant accounting policies

*IFRS 9 – Financial Instruments*

Effective January 1, 2018, the Company adopted IFRS 9, *Financial Instruments* which supersedes IAS 39, *Financial Instruments: Recognition and Measurement,* and sets out requirements for the recognition, measurement, impairment and derecognition of financial assets and liabilities, as well as general hedge accounting.

While the existing requirements for the classification and measurement of financial liabilities are largely retained under IFRS 9, financial assets are required to be classified as measured at amortized cost, FVOCI or FVTPL. The table below outlines the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Company's financial instruments at January 1, 2018:

| | Original Classification Under IAS 39 | New Classification Under IFRS 9 |
|---|---|---|
| Financial Assets: | | |
| Cash and cash equivalents | Loans and receivables | Amortized cost |
| Trade and other accounts receivables | Loans and receivables | Amortized cost |
| Investments in debt securities | FVTPL | FVTPL |
| Investments in equity securities | Available-for-sale | FVTPL |
| Futures contracts (lumber and energy) | FVTPL | FVTPL |
| Foreign exchange forward contracts | FVTPL | FVTPL |
| Financial Liabilities: | | |
| Accounts payable and accrued liabilities | Other liabilities | Amortized cost |
| Operating loans | Other liabilities | Amortized cost |
| Long-term debt | Other liabilities | Amortized cost |

There have been no changes to the carrying values of our financial instruments at January 1, 2018, or to previously reported figures as a result of the classification changes outlined above. There was no impact of the new hedging requirements, as Canfor's derivative instruments are not designated as hedges for accounting purposes.

IFRS 9 also replaces the incurred loss impairment model under IAS 39 with an ECL model. The Company has elected to apply the simplified approach in determining expected credit losses ECLs, which requires a probability-weighted estimate of expected lifetime credit losses to be recognized upon initial recognition of financial assets measured at amortized cost, contract assets and debt investments at FVOCI. Credit losses are measured as the present value of cash shortfalls from all possible default events, discounted at the effective interest rate of the financial asset. Loss allowances for financial assets at amortized cost are deducted from the gross carrying amount of the assets. At January 1, 2018, the identified impairment losses were not significant or material and therefore no changes in loss allowances were recognized.

*IFRS 15 – Revenue from Contracts with Customers*

Effective January 1, 2018, the Company adopted IFRS 15, *Revenue from Contracts with Customers,* which supersedes IAS 18, *Revenue*, IAS 11, *Construction Contracts* and related interpretations, and establishes a comprehensive framework for determining whether, how much and when revenue is recognized.

In the comparative period, revenue was measured at the fair value of consideration received or receivable, net of applicable sales tax, rebates and discounts and after eliminating sales within the Company. Revenue was previously recognized when the significant risks and rewards of ownership had been transferred to the buyer, recovery of consideration was probable, the associated costs and possible returns of the goods could be reliably estimated, there was no continuing management involvement with the goods, and the amount of revenue could be reliably measured.

Under the new standard, however, revenue from the sale of goods is measured based on the consideration specified in a contract with a customer and is recognized when a customer obtains control of the goods or services.

The Company has applied the full retrospective method upon transition to IFRS 15, with no resulting quantitative impact to the consolidated financial statements.

## 5. Accounting Standards Issued and Not Applied

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. IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognizes a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. In addition, the nature of expenses related to those leases will change as IFRS 16 replaces straight-line operating lease expense with an amortization expense for right-of-use assets and interest expense on lease liabilities.

IFRS 16 may be applied retrospectively to each prior period presented (full retrospective approach), or with the cumulative effect of adoption recognized at initial application (modified retrospective approach). The Company has elected to apply the modified retrospective approach upon adoption at January 1, 2019, measuring the right-of-use asset at its carrying amount had the standard been applied at commencement of the lease. The short-term and low-value recognition exemptions available under the standard will be utilized, along with certain practical expedients.

Based on lease data as at December 31, 2018, IFRS 16 is estimated to have the following financial statement impact on the Company's consolidated balance sheet at transition on January 1, 2019, with no material impact to 2019 net income:

| (millions of Canadian dollars) | | | As at January 1, 2019 |
|---|---|---|---|
| Right-of-use asset, net of accumulated amortization | Increase in assets | $ | 42.2 |
| Lease obligation | Increase in liabilities | | 44.3 |
| Deferred income tax | Decrease in liabilities | | 0.5 |
| Retained earnings | Decrease in equity | | 1.6 |

The full quantification of the new standard will be disclosed in the condensed consolidated interim financial statements for the first quarter of 2019.

## 6. Inventories

| (millions of Canadian dollars) | | **As at December 31, 2018** | | As at December 31, 2017 |
|---|---|---|---|---|
| Logs | **$** | **199.5** | $ | 132.1 |
| Finished products | | **389.3** | | 354.6 |
| Residual fibre | | **44.8** | | 20.8 |
| Materials and supplies | | **128.9** | | 121.4 |
| | **$** | **762.5** | $ | 628.9 |

The above inventory balances are stated after inventory write-downs from cost to net realizable value, which mostly reflect significant declines in prices for solid wood products at the end of 2018.

The write-downs for the various components of inventory at December 31 were:

| (millions of Canadian dollars) | | **2018** | | 2017 |
|---|---|---|---|---|
| Logs | **$** | **11.1** | $ | - |
| Finished products | | **25.6** | | - |
| | **$** | **36.7** | $ | - |

Inventory expensed in 2018 includes manufacturing and product costs and amortization.

## 7. Property, Plant and Equipment

| (millions of Canadian dollars) | | Land | | Pulp and kraft paper mills | | Solid wood operations[2] | | Logging assets and other equipment | | Construction in progress | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | | | | | |
| Balance at January 1, 2017 | $ | 51.9 | $ | 1,620.0 | $ | 1,884.2 | $ | 224.7 | $ | 33.4 | $ | 3,814.2 |
| Additions[1] | | 0.1 | | - | | 19.4 | | 0.2 | | 218.2 | | 237.9 |
| Disposals | | (1.8) | | (64.1) | | (25.2) | | (7.4) | | - | | (98.5) |
| Transfers | | 1.0 | | 52.1 | | 87.4 | | 17.6 | | (158.1) | | - |
| Effect of movements in exchange rates | | (1.9) | | - | | (30.7) | | (0.6) | | (1.7) | | (34.9) |
| Balance at December 31, 2017 | $ | 49.3 | $ | 1,608.0 | $ | 1,935.1 | $ | 234.5 | $ | 91.8 | $ | 3,918.7 |
| Additions[1] | | - | | 0.4 | | 1.1 | | 0.8 | | 395.1 | | 397.4 |
| Disposals | | (0.1) | | (54.7) | | (29.5) | | (5.7) | | - | | (90.0) |
| Transfers | | 1.4 | | 139.2 | | 214.4 | | 17.1 | | (372.1) | | - |
| Effect of movements in exchange rates | | 2.3 | | - | | 43.5 | | 0.7 | | 5.6 | | 52.1 |
| Balance at December 31, 2018 | $ | 52.9 | $ | 1,692.9 | $ | 2,164.6 | $ | 247.4 | $ | 120.4 | $ | 4,278.2 |
| **Amortization** | | | | | | | | | | | | |
| Balance at January 1, 2017 | $ | (2.5) | $ | (1,125.0) | $ | (1,056.1) | $ | (169.8) | $ | - | $ | (2,353.4) |
| Amortization for the year | | - | | (74.3) | | (143.2) | | (12.6) | | - | | (230.1) |
| Disposals | | - | | 62.5 | | 19.8 | | 6.9 | | - | | 89.2 |
| Transfers | | - | | - | | 2.0 | | (2.0) | | - | | - |
| Effects of movements in exchange rates | | - | | - | | 13.5 | | 0.2 | | - | | 13.7 |
| Balance at December 31, 2017 | $ | (2.5) | $ | (1,136.8) | $ | (1,164.0) | $ | (177.3) | $ | - | $ | (2,480.6) |
| Amortization for the year | | - | | (79.1) | | (157.6) | | (12.2) | | - | | (248.9) |
| Disposals | | - | | 53.4 | | 23.9 | | 2.2 | | - | | 79.5 |
| Transfers | | - | | - | | (2.0) | | 2.0 | | - | | - |
| Effect of movements in exchange rates | | - | | - | | (20.6) | | (0.4) | | - | | (21.0) |
| Balance at December 31, 2018 | $ | (2.5) | $ | (1,162.5) | $ | (1,320.3) | $ | (185.7) | $ | - | $ | (2,671.0) |
| **Carrying Amounts** | | | | | | | | | | | | |
| At January 1, 2017 | $ | 49.4 | $ | 495.0 | $ | 828.1 | $ | 54.9 | $ | 33.4 | $ | 1,460.8 |
| At December 31, 2017 | $ | 46.8 | $ | 471.2 | $ | 771.1 | $ | 57.2 | $ | 91.8 | $ | 1,438.1 |
| **At December 31, 2018** | **$** | **50.4** | **$** | **530.4** | **$** | **844.3** | **$** | **61.7** | **$** | **120.4** | **$** | **1,607.2** |

[1]Net of capital expenditures by CPPI that are financed by government grants.
[2]Solid Wood operations include those sawmills, pellet plants, engineered wood products plants, plywood and oriented strand board plants that are consolidated on a line-by-line basis.

## 8. Timber Licenses

| (millions of Canadian dollars) | | |
|---|---|---|
| **Cost** | | |
| Balance at January 1, 2017 | $ | 868.8 |
| Additions | | 1.2 |
| Balance at December 31, 2017 | $ | 870.0 |
| Additions | | 1.4 |
| Balance at December 31, 2018 | $ | 871.4 |
| **Amortization** | | |
| Balance at January 1, 2017 | $ | (336.1) |
| Amortization for the year | | (15.6) |
| Balance at December 31, 2017 | $ | (351.7) |
| Amortization for the year | | (15.6) |
| Balance at December 31, 2018 | $ | (367.3) |
| **Carrying amounts** | | |
| At January 1, 2017 | $ | 532.7 |
| At December 31, 2017 | $ | 518.3 |
| **At December 31, 2018** | **$** | **504.1** |

## 9. Goodwill and Other Intangible Assets

| (millions of Canadian dollars) | | Goodwill | | Other intangible assets | | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| Balance at January 1, 2017 | $ | 209.1 | $ | 100.3 | $ | 309.4 |
| Additions | | - | | 8.2 | | 8.2 |
| Disposals and transfers | | - | | (1.8) | | (1.8) |
| Effect of movement in exchange rates | | (13.7) | | (3.4) | | (17.1) |
| Balance at December 31, 2017 | $ | 195.4 | $ | 103.3 | $ | 298.7 |
| Additions and transfers | | - | | 29.1 | | 29.1 |
| Disposals | | - | | (39.8) | | (39.8) |
| Effect of movement in exchange rates | | 17.0 | | 4.1 | | 21.1 |
| Balance at December 31, 2018 | $ | 212.4 | $ | 96.7 | $ | 309.1 |
| **Amortization** | | | | | | |
| Balance at January 1, 2017 | $ | - | $ | (70.6) | $ | (70.6) |
| Amortization for the year | | - | | (4.2) | | (4.2) |
| Disposal and transfers | | - | | 1.8 | | 1.8 |
| Effect of movement in exchange rates | | - | | 2.4 | | 2.4 |
| Balance at December 31, 2017 | $ | - | $ | (70.6) | $ | (70.6) |
| Amortization for the year | | - | | (6.0) | | (6.0) |
| Disposals and transfers | | - | | 39.0 | | 39.0 |
| Effect of movement in exchange rates | | - | | (3.2) | | (3.2) |
| Balance at December 31, 2018 | $ | - | $ | (40.8) | $ | (40.8) |
| **Carrying amounts** | | | | | | |
| At January 1, 2017 | $ | 209.1 | $ | 29.7 | $ | 238.8 |
| At December 31, 2017 | $ | 195.4 | $ | 32.7 | $ | 228.1 |
| **At December 31, 2018** | **$** | **212.4** | **$** | **55.9** | **$** | **268.3** |

Goodwill relates to Canfor's US subsidiaries and is denominated in US dollars. Goodwill is allocated separately to each acquired business and tested at that level for impairment purposes. The recoverable amount of the goodwill is determined based on an assessment of the value in use, which is estimated using a discounted cash flow model.

As part of the goodwill impairment assessment, assumptions are made in relation to forecast prices and exchange rates. Key assumptions used in the cash flow models include forecast prices and foreign exchange rates, which the Company's management determined with reference to internal and external publications, respectively.

A pre-tax discount rate of 8.0% (2017 – 11.0%), based on the Company's current weighted average cost of capital and US denominated risk-adjusted internal borrowing rate, and a cost inflation rate of 2.0% (2017 – 2.0%) was used for the purpose of the 2018 calculation. The net present value of the future expected cash flows is compared to the carrying value of the Company's investment in these assets, including goodwill, at year end. Based upon management's analysis, no impairment of goodwill was required in 2018 or 2017.

## 10. Long-Term Investments and Other

| (millions of Canadian dollars) | | **As at December 31, 2018** | | As at December 31, 2017 |
|---|---|---|---|---|
| Investments | **$** | **21.0** | $ | 22.5 |
| Anti-dumping duties receivable (Note 30) | | **76.6** | | 44.9 |
| Other deposits, loans, advances and long-term assets | | **12.8** | | 15.9 |
| | **$** | **110.4** | $ | 83.3 |

The anti-dumping duties receivable balance represents anti-dumping cash deposits paid in excess of the calculated expense accrued, and interest, at December 31, 2018 (Note 30).

In 2017, the Company received the final instalment of $15.0 million related to the July 1, 2015 sale of the Company's 33.3% investment in Lakeland Mills Ltd. And Winton Global Lumber Ltd. ("Lakeland Winton") for aggregate consideration of $30.0 million.

In 2017, the Company sold its 50% investment in Anthony EACOM Inc. to EACOM Timber Corporation for net proceeds of $21.1 million and recognized a $3.7 million gain (pre-tax), with the cash proceeds paid by EACOM Timber Corporation to the Company in 2017. Prior to the sale, the Company's interest in Anthony EACOM Inc. was classified as a joint venture and accounted for using the equity method of accounting.

### 11. Accounts Payable and Accrued Liabilities

| (millions of Canadian dollars) | | **As at December 31, 2018** | | As at December 31, 2017 |
|---|---|---|---|---|
| Trade payables and accrued liabilities | **$** | **328.8** | $ | 291.9 |
| Accrued payroll and related liabilities | | **130.1** | | 117.6 |
| Income tax payable | | **-** | | 60.5 |
| | **$** | **458.9** | $ | 470.0 |

### 12. Operating Loans

| (millions of Canadian dollars) | | **As at December 31, 2018** | | As at December 31, 2017 |
|---|---|---|---|---|
| **Canfor (excluding CPPI)** | | | | |
| Available operating loans: | | | | |
| Operating loan facility | **$** | **450.0** | $ | 350.0 |
| Facility for letters of credit | | **60.0** | | 50.0 |
| Total operating loan facility | | **510.0** | | 400.0 |
| Letters of credit | | **(57.4)** | | (44.0) |
| Total available operating loan facility - Canfor | **$** | **452.6** | $ | 356.0 |
| **CPPI** | | | | |
| Available operating loans: | | | | |
| Operating loan facility | **$** | **110.0** | $ | 110.0 |
| Letters of credit | | **(11.1)** | | (9.2) |
| Total available operating loan facility - CPPI | **$** | **98.9** | $ | 100.8 |
| **Consolidated:** | | | | |
| **Total operating loan facilities** | **$** | **620.0** | $ | 510.0 |
| **Total available operating loan facilities** | **$** | **551.5** | $ | 456.8 |

Interest is payable on Canfor's operating loan facility at floating rates based on the lenders' Canadian prime rate, bankers' acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin that varies with the Company's debt to total capitalization ratio.

In 2017, Canfor's principal operating loan (excluding CPPI) was extended to September 28, 2022. On December 14, 2018, the operating loan was further extended to January 2, 2024, with the principal increased by $100.0 million to $450.0 million at December 31, 2018. At December 31, 2018, the Company had total available undrawn operating loans of $551.5 million, including undrawn facilities for letters of credit.

Canfor (excluding CPPI) has a separate facility to cover letters of credit. On February 28, 2018, the Company increased its facility by $10.0 million, which can be drawn in either Canadian or US dollars. At December 31, 2018, $54.9 million of letters of credit outstanding are covered under this facility with the balance of $2.5 million covered under Canfor's general operating loan facility.

The terms of CPPI's operating loan facility include interest payable at floating rates that vary depending on the ratio of debt to total capitalization and is based on lenders' Canadian prime rate, bankers' acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin. On April 6, 2018, the maturity date of CPPI's principal operating loan facility was extended from January 31, 2020 to April 6, 2022.

Both Canfor's and CPPI's operating loan facilities have certain financial covenants, including maximum debt to total capitalization ratios. As at December 31, 2018, the Company and CPPI are in compliance with all covenants relating to their operating loan facilities. Substantially all borrowings of CPPI are non-recourse to other entities within the Company.

## 13. Long-Term Debt

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

| (millions of Canadian dollars) | | **As at December 31, 2018** | | As at December 31, 2017 |
|---|---|---|---|---|
| Canfor Corporation | | | | |
| CAD$225.0 million (CAD$125.0 million drawn), floating interest, repayable January 2, 2024 | **$** | **125.0** | $ | 125.0 |
| US$200.0 million (US$100.0 million drawn), floating interest, repayable January 2, 2027 | | **136.4** | | 125.5 |
| US$100.0 million, fixed interest of 4.4%, repayable in three equal tranches on October 2, 2023, 2024 and 2025 | | **136.4** | | 125.5 |
| Other (US$7.7 million)[3] | | **10.6** | | 9.7 |
| Long-term debt at end of year | **$** | **408.4** | $ | 385.7 |
| Less: Current portion | | **(0.4)** | | (0.3) |
| Long-term portion | **$** | **408.0** | $ | 385.4 |

[3] Amount relates to net financing for specific capital projects at Canfor's U.S. sawmills.

On December 14, 2018, the Company increased its Canadian dollar denominated floating interest rate term debt facility to $225.0 million (2017 - $125.0 million) and extended its maturity date from September 28, 2022 to January 2, 2024. The Company also increased its US-dollar denominated floating rate term debt facility to $200.0 million (2017 - $100.0 million) and extended its maturity date from September 28, 2025 to January 2, 2027. As at December 31, 2018, the incremental borrowing capacity available under both the Canadian dollar and US-dollar floating rate term debt was undrawn.

On December 29, 2017, the Company's subsidiary CPPI repaid the full principal balance of its term debt of $50.0 million.

All borrowings of the Company feature similar financial covenants, including a maximum debt to total capitalization ratio. As at December 31, 2018, the Company is in compliance with all covenants relating to its long-term debt.

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

At December 31, 2018, the fair value of the Company's long-term debt is $402.9 million (December 31, 2017 - $389.1 million). The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

## 14. Employee Future Benefits

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

Total cash payments for employee future benefits for 2018 were $64.0 million (December 31, 2017 - $61.1 million), consisting of cash contributed by Canfor to its funded pension plans, cash payments directly to beneficiaries for its unfunded other non-pension post-retirement benefit plans, and cash contributed to its defined contribution and other plans.

### *Defined benefit plans*

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

As at December 31, 2018, Canfor has four registered defined benefit pension plans for which actuarial valuations are performed at least every three years. The largest pension plan underwent an actuarial valuation for funding purposes as of December 31, 2017, which was completed in 2018. The next actuarial valuation for funding purposes is currently scheduled for December 31, 2020, to be completed in 2021. In addition, Canfor has other non-contributory benefit plans that provide certain non-pension post-retirement benefits to its members. The majority of the other non-contributory plans underwent actuarial valuations as of December 31, 2018, to be completed in 2019.

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

| **Fair market value of plan assets** | **2018** | | 2017 | |
|---|---|---|---|---|
| (millions of Canadian dollars) | **Defined Benefit Pension Plans** | **Other Benefit Plans** | Defined Benefit Pension Plans | Other Benefit Plans |
| Beginning of year | **$ 717.5** | **$ -** | $ 697.0 | $ - |
| Interest income on plan assets | **24.1** | **-** | 26.7 | - |
| Return on plan assets greater (less) than discount rate | **(31.1)** | **-** | 19.9 | - |
| Employer contributions | **23.8** | **4.4** | 19.3 | 9.5 |
| Employee contributions | **0.6** | **-** | 0.4 | - |
| Benefit payments | **(45.5)** | **(4.4)** | (43.8) | (9.5) |
| Administration expense | **(0.6)** | **-** | (1.0) | - |
| Other | **1.6** | **-** | (1.0) | - |
| End of year | **$ 690.4** | **$ -** | $ 717.5 | $ - |

| Plan assets consist of the following: | **As at December 31, 2018** | As at December 31, 2017 |
|---|---|---|
| | Percentage of Plan Assets | |
| Asset category | | |
| Equity securities | **23%** | 31% |
| Debt securities | **13%** | 12% |
| Annuities | **63%** | 56% |
| Cash and cash equivalents | **1%** | 1% |
| | **100%** | 100% |

| **Accrued benefit obligations** | **2018** | | 2017 | |
|---|---|---|---|---|
| (millions of Canadian dollars) | **Defined Benefit Pension Plans** | **Other Benefit Plans** | Defined Benefit Pension Plans | Other Benefit Plans |
| Beginning of year | **$ 853.6** | **$ 126.0** | $ 812.4 | $ 179.3 |
| Current service cost | **9.1** | **2.2** | 8.8 | 3.3 |
| Settlement adjustment | **-** | **-** | - | (3.0) |
| Plan amendment | **-** | **-** | 1.1 | - |
| Interest cost | **28.4** | **4.0** | 30.9 | 6.8 |
| Employee contributions | **0.6** | **-** | 0.4 | - |
| Benefit payments | **(45.5)** | **(4.4)** | (43.8) | (9.5) |
| Actuarial loss (gain) | **(20.4)** | **(17.4)** | 45.3 | (50.0) |
| Other | **1.9** | **(0.4)** | (1.5) | (0.9) |
| End of year | **$ 827.7** | **$ 110.0** | $ 853.6 | $ 126.0 |

Of the defined benefit pension plan obligation of $827.7 million (December 31, 2017 - $853.6 million), $749.3 million (December 31, 2017 - $773.2 million) relates to plans that are wholly or partly funded and $78.4 million (December 31, 2017 - $80.4 million) relates to plans that are wholly unfunded, with letters of credit securing $48.3 million (December 31, 2017 - $41.3 million) of the unfunded liability.

The total obligation for the non-pension post-retirement benefit plans of $110.0 million (December 31, 2017 - $126.0 million) is unfunded.

**Annuity contracts**

The Company purchased $58.9 million (December 31, 2017 - $136.3 million) of buy-in annuities through its defined benefit pension plans during the year, increasing total annuities purchased to $481.8 million at December 31, 2018 (December 31, 2017 - $422.9 million). Future cash flows from the annuities will match the amount and timing of benefits payable under the plans, substantially mitigating the exposure to future volatility in the related pension obligations. Transaction costs of $3.6 million (December 31, 2017 - $4.9 million) related to the purchase were recognized in other comprehensive income (loss), principally reflecting the difference between the annuity rate compared to the discount rate used to value the obligations on a going concern basis.

**Voluntary Retiree Buyout Program**

In October 2017, certain non-pension post-retirement benefit plan members of Canfor and CPPI were given an offer to receive lump-sum payment in exchange for settlement of their future non-pension post-retirement benefit obligations under the Voluntary Retiree Buyout Program ("the Program"). Acceptance of the offer constitutes an irrevocable election to terminate future benefit obligations by plan members, and as such, settlement was recorded at the time of election by members. The deadline for elections made under the Program was October 31, 2017, and the resulting payments were made from November 2017 through January 2018. Under the program, $7.4 million of non-pension post-retirement benefit obligations were settled and derecognized in 2017, resulting in a settlement adjustment of $3.0 million, which was included in operating income. For the year ended December 31, 2018, $1.1 million was paid out under the Program (December 31, 2017 - $3.3 million).

**Medical Services Plan changes**

On November 2, 2017, the Legislative Assembly of British Columbia enacted the *Budget Measures Implementation Act, 2017,* which included a 50% reduction in Medical Services Plan ("MSP") premiums effective January 1, 2018. This change in legislation was recognized in actuarial financial assumptions in 2017 and resulted in a $49.0 million pre-tax reduction of the non-pension post-retirement benefit obligation and a corresponding gain recognized through other comprehensive income.

In addition, in measuring the accrued benefit obligation at December 31, 2017, the MSP growth trend rate actuarial financial assumption was reduced from 4.5% to 2.0% resulting in an additional $14.7 million pre-tax gain recognized through other comprehensive income in 2017.

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

| (millions of Canadian dollars) | **December 31, 2018** Defined Benefit Pension Plans | **December 31, 2018** Other Benefit Plans | December 31, 2017 Defined Benefit Pension Plans | December 31, 2017 Other Benefit Plans |
|---|---|---|---|---|
| Fair market value of plan assets | **$ 690.4** | **$ -** | $ 717.5 | $ - |
| Accrued benefit obligations | **(827.7)** | **(110.0)** | (853.6) | (126.0) |
| Funded status of plans – deficit | **$ (137.3)** | **$ (110.0)** | $ (136.1) | $ (126.0) |
| Other pension plans | **(2.5)** | **-** | (2.0) | - |
| Total accrued benefit liability, net | **$ (139.8)** | **$ (110.0)** | $ (138.1) | $ (126.0) |

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

| (millions of Canadian dollars) | **December 31, 2018** Defined Benefit Pension Plans | **December 31, 2018** Other Benefit Plans | December 31, 2017 Defined Benefit Pension Plans | December 31, 2017 Other Benefit Plans |
|---|---|---|---|---|
| Retirement benefit surplus | **$ 4.9** | **$ -** | $ 7.9 | $ - |
| Retirement benefit obligations | **(144.7)** | **(110.0)** | (146.0) | (126.0) |
| Total accrued benefit liability, net | **$ (139.8)** | **$ (110.0)** | $ (138.1) | $ (126.0) |

At December 31, 2018 and December 31, 2017, certain defined benefit pension plans are in a surplus position reflecting the return on plan assets, actuarial gains and employer contributions to the pension plans during 2018 and 2017. The plans with a net retirement surplus have been classified as non-current assets on the balance sheet.

### Components of pension cost

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

| | **2018** | | 2017 | |
|---|---|---|---|---|
| (millions of Canadian dollars) | **Defined Benefit Pension Plans** | **Other Benefit Plans** | Defined Benefit Pension Plans | Other Benefit Plans |
| **Recognized in net income** | | | | |
| Current service cost | **$ 9.1** | **$ 2.2** | $ 8.8 | $ 3.3 |
| Settlement adjustment | **-** | **-** | - | (3.0) |
| Plan amendment | **-** | **-** | 1.1 | - |
| Administration expense | **0.8** | **-** | 0.5 | - |
| Interest cost | **4.3** | **4.0** | 4.2 | 6.8 |
| Other | **-** | **(0.4)** | - | 0.3 |
| Total expense included in net income | **$ 14.2** | **$ 5.8** | $ 14.6 | $ 7.4 |
| **Recognized in other comprehensive income** | | | | |
| Actuarial loss (gain) – experience | **$ 1.0** | **$ (8.5)** | $ (6.0) | $ (0.4) |
| Actuarial gain – demographic assumptions | **(0.1)** | **-** | (0.1) | - |
| Actuarial loss (gain) – financial assumptions | **(21.3)** | **(8.9)** | 51.4 | (49.6) |
| Return on plan assets less (greater) than discount rate | **31.1** | **-** | (19.9) | - |
| Administrative costs greater (less) than expected | **(0.2)** | **-** | 0.5 | - |
| Total loss (gain) in other comprehensive income | **$ 10.5** | **$ (17.4)** | $ 25.9 | $ (50.0) |

### Significant assumptions

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

| | **December 31, 2018** | | December 31, 2017 | |
|---|---|---|---|---|
| | **Defined Benefit Pension Plans** | **Other Benefit Plans** | Defined Benefit Pension Plans | Other Benefit Plans |
| Discount rate | **3.6%** | **3.6%** | 3.4% | 3.4% |
| Rate of compensation increases | **3.0%** | **n/a** | 3.0% | n/a |
| Initial medical cost trend rate | **n/a** | **5.5%** | n/a | 6.5% |
| Ultimate medical cost trend rate | **n/a** | **4.5%** | n/a | 4.5% |
| Year ultimate rate is reached | **n/a** | **2022** | n/a | 2022 |

In addition to the significant assumptions listed in the table above, the average life expectancy of a 65-year-old at December 31, 2018 is between 21.1 years and 24.2 years (December 31, 2017 – 21.0 years and 24.1 years). As at December 31, 2018, the weighted average duration of the defined benefit obligation, which reflects the average age of the plan members, is 12.0 years (December 31, 2017 - 12.3 years). The weighted average duration of the other benefit plans is 13.3 years (December 31, 2017 - 14.2 years).

### Sensitivity analysis

Assumed discount rates and medical cost trend rates have a significant effect on the accrued retirement benefit obligation and related plan assets. A one percentage point change in these assumptions would have the following effects on the accrued retirement benefit obligation, including the hedging impact of plan annuity assets, for 2018:

| (millions of Canadian dollars) | 1% Increase | 1% Decrease |
|---|---|---|
| Defined benefit pension plan liabilities, net of annuity assets | | |
| Discount rate | $ (48.0) | $ 59.0 |
| Other benefit plan liabilities | | |
| Discount rate | $ (13.1) | $ 16.1 |
| Initial medical cost trend rate | $ 8.5 | $ (7.6) |

When taking into account the impact of hedging, 52% (December 31, 2017 – 46%) of the change to the defined benefit pension plans is fully hedged against changes in discount rates and longevity risk (potential increases in life expectancy of plan members) through buy-in annuities, and a further 12% (December 31, 2017 - 10%) is partially hedged through the plan's investment in debt securities.

As at December 31, 2018, contribution payments of $19.0 million are estimated to be made to the Company's defined benefit pension plans in 2019 based on the last actuarial valuation for funding purposes.

***Defined contribution and other plans***

The total expense recognized in 2018 for Canfor's defined contribution plans was $12.8 million (December 31, 2017 - $9.5 million). Canfor contributes to various forest industry union benefit plans providing both pension and other retirement benefits. These plans are accounted for as defined contribution plans. Contributions to these plans, not included in the expense for defined contribution plans above, amounted to $23.0 million in 2018 (December 31, 2017 - $22.8 million).

## 15. Deferred Reforestation Obligations

The following table provides a reconciliation of the deferred reforestation obligations as at December 31, 2018 and December 31, 2017:

| (millions of Canadian dollars) | | **2018** | | 2017 |
|---|---|---|---|---|
| Reforestation obligations at beginning of year | **$** | **112.5** | $ | 105.4 |
| Expense for year | | **50.3** | | 49.9 |
| Accretion expense | | **1.2** | | 0.7 |
| Changes in estimates | | **(0.7)** | | (1.6) |
| Paid during the year, net | | **(46.5)** | | (41.9) |
| Reforestation obligations at end of year | **$** | **116.8** | $ | 112.5 |
| Less: Current portion | | **(52.9)** | | (49.5) |
| Long-term portion | **$** | **63.9** | $ | 63.0 |

The total undiscounted amount of the estimated cash flows required to settle the obligations at December 31, 2018 is $121.8 million (December 31, 2017 - $117.8 million) with payments expected to occur over 15 years. Due to the general long-term nature of the liability, the most significant area of uncertainty in estimating the provision is the future costs that will be incurred. The estimated cash flows have been adjusted for inflation and discounted using risk-free rates ranging from 1.9% to 2.1% at December 31, 2018 (December 31, 2017 – 1.5% to 2.1%).

## 16. Asset Retirement Obligations

The following table provides a reconciliation of the asset retirement obligations as at December 31, 2018 and December 31, 2017:

| (millions of Canadian dollars) | | **2018** | | 2017 |
|---|---|---|---|---|
| Asset retirement obligations at beginning of year | **$** | **10.3** | $ | 9.9 |
| Accretion expense | | **0.2** | | 0.2 |
| Changes in estimates | | **0.5** | | 0.2 |
| Asset retirement obligations at end of year | **$** | **11.0** | $ | 10.3 |
| Less: Current portion | | **(0.3)** | | - |
| Long-term portion | **$** | **10.7** | $ | 10.3 |

Canfor's asset retirement obligations include $6.0 million in relation to landfill closure costs of CPPI. CPPI's obligations represent estimated undiscounted future payments of $9.3 million to remediate landfills at the operations at the end of their useful lives. The payments are expected to occur over periods ranging from 1 to 33 years and have been discounted at risk-free rates ranging from 1.9% to 2.2% (December 31, 2017 – 1.9% to 2.3%).

Canfor's asset retirement obligations, excluding CPPI's, represent estimated undiscounted future payments of $7.9 million to remediate landfills at the operations at the end of their useful lives. The payments are expected to occur over periods ranging from 3 to 52 years and have been discounted at risk-free rates ranging from 1.9% to 2.2% (December 31, 2017 – 1.8% to 2.3%).

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

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

## 17. Share Capital

***Authorized***

10,000,000 preferred shares, with a par value of $25 each.
1,000,000,000 common shares without par value.

***Issued and fully paid***

| | **2018** | | 2017 | |
|---|---|---|---|---|
| (millions of Canadian dollars, except number of shares) | **Number of Shares** | **Amount** | Number of Shares | Amount |
| Common shares at beginning of year | **128,644,980** | **$ 1,014.9** | 132,804,573 | $ 1,047.7 |
| Common shares purchased | **(3,425,580)** | **(27.0)** | (4,159,593) | (32.8) |
| Common shares at end of year[4] | **125,219,400** | **$ 987.9** | 128,644,980 | $ 1,014.9 |

[4]Based on trade date.

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

Basic net income per share is calculated by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the period. The weighted average number of common shares outstanding for 2018 was 127,742,297 (December 31, 2017 – 131,449,999), and reflects common shares purchased under the Company's normal course issuer bid.

***Normal course issuer bid***

On March 5, 2018, the Company renewed its normal course issuer bid whereby up to 6,439,764 common shares or approximately 5% of its issued and outstanding common shares as of March 1, 2018 could be purchased for cancellation. The renewed normal course issuer bid is set to expire on March 6, 2019.

In 2018, Canfor purchased 3,425,580 common shares for $84.8 million (an average of $24.76 per common share), of which $27.0 million was charged to share capital and $57.8 million was charged to retained earnings. Cash payments for shares purchased during the year totaled $84.8 million. The Company paid an additional $3.7 million of cash in relation to shares purchased in the prior year.

In 2017, under a previous normal course issuer bid, the Company purchased 4,159,593 common shares for $90.7 million (an average of $21.81 per common share), of which $32.8 million was charged to share capital and $57.9 million was charged to retained earnings.

As at February 21, 2019 there were 125,219,400 common shares of the Company outstanding.

Under a separate normal course issuer bid, during the year ended December 31, 2018, CPPI purchased 500 common shares at an average of $13.01 per common share from non-controlling shareholders, and paid an additional $0.1 million in relation to shares purchased in the prior year. During the year ended December 31, 2017, CPPI purchased 1,448,109 common shares at an average of $12.29 per common share from non-controlling shareholders.

As at December 31, 2018 and February 21, 2019, Canfor's ownership interest in CPPI was 54.8% (December 31, 2017 – 54.8%).

## 18. Non-Controlling Interests

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

Summarized Balance Sheets:

| Amounts presented below represent non-controlling % (millions of Canadian dollars) | **As at December 31, 2018** | | | As at December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Lumber[5] | CPPI[6] | **Total** | Lumber[5] | CPPI[6] | Total |
| Current assets | $ 9.5 | $ 158.3 | **$ 167.8** | $ 7.8 | $ 165.0 | $ 172.8 |
| Non-current assets | 10.9 | 263.0 | **273.9** | 6.7 | 238.3 | 245.0 |
| Total assets | $ 20.4 | $ 421.3 | **$ 441.7** | $ 14.5 | $ 403.3 | $ 417.8 |
| Current liabilities | $ 3.0 | $ 82.3 | **$ 85.3** | $ 1.9 | $ 73.0 | $ 74.9 |
| Non-current liabilities | 3.6 | 69.3 | **72.9** | 1.3 | 72.0 | 73.3 |
| Total liabilities | $ 6.6 | $ 151.6 | **$ 158.2** | $ 3.2 | $ 145.0 | $ 148.2 |
| Total equity | $ 13.8 | $ 269.7 | **$ 283.5** | $ 11.3 | $ 258.3 | $ 269.6 |
| Total liabilities and equity | $ 20.4 | $ 421.3 | **$ 441.7** | $ 14.5 | $ 403.3 | $ 417.8 |

Summarized Statements of Income and Other Comprehensive Income:

| Amounts presented below represent non-controlling % (millions of Canadian dollars) | **Year ended December 31, 2018** | | | Year ended December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Lumber[5] | CPPI[6] | **Total** | Lumber[5] | CPPI[6] | Total |
| Sales | $ 18.3 | $ 621.2 | **$ 639.5** | $ 13.6 | $ 546.8 | $ 560.4 |
| Net income | 0.8 | 83.3 | **84.1** | 1.7 | 46.5 | 48.2 |
| Other comprehensive income | - | 1.8 | **1.8** | - | 8.5 | 8.5 |
| Total comprehensive income | $ 0.8 | $ 85.1 | **$ 85.9** | $ 1.7 | $ 55.0 | $ 56.7 |
| Dividends paid to non-controlling interests | $ 0.7 | $ 73.8 | **$ 74.5** | $ 2.4 | $ 7.6 | $ 10.0 |

Summarized Statements of Cash Flows:

| Amounts presented below represent non-controlling % (millions of Canadian dollars) | **Year ended December 31, 2018** | | | Year ended December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Lumber[5] | CPPI[6] | **Total** | Lumber[5] | CPPI[6] | Total |
| Cash flows from operating activities | $ 2.7 | $ 97.3 | **$ 100.0** | $ 3.1 | $ 88.9 | $ 92.0 |
| Cash flows from financing activities | $ (0.4) | $ (53.5) | **$ (53.9)** | $ (0.4) | $ (39.9) | $ (40.3) |
| Cash flows from investing activities | $ (0.7) | $ (75.3) | **$ (76.0)** | $ (1.1) | $ (37.6) | $ (38.7) |

[5]Lumber non-controlling interest includes non-controlling interest related to Houston Pellet Limited Partnership (40%), CSP Moultrie Investment, LLC (5%), and Canfor Energy North Limited Partnership (15%) (December 31, 2017 – 5%).
[6]CPPI purchased shares from non-controlling CPPI shareholders under a normal course issuer bid. However, due to the small number purchased, Canfor's ownership interest of 54.8% at December 31, 2018 remained unchanged from December 31, 2017 (Note 17).

On January 1, 2018, Pacific BioEnergy Corporation ("PBEC") exercised its option to purchase from Canfor an additional 10% of the outstanding shares of Canfor Energy North Limited Partnership ("CENLP") for consideration of $3.5 million, which was received in December 2017, thereby increasing their ownership from approximately 5% to 15%.

Accordingly, the non-controlling interest of CENLP was increased by $2.5 million to reflect PBEC's 15% total ownership from January 1, 2018 onwards. A net gain of $1.3 million was recorded as a credit to equity in the first quarter of 2018 representing the difference between the adjustment to Canfor's investment in CENLP and the consideration paid, and the associated tax effects.

## 19. Share-Based Compensation

The value of the Company's DSUs, when redeemed, is equal to the market value of the shares on the redemption date, including the value of dividends paid on the Company's common shares, if any, as if they had been reinvested in additional DSUs on each payment date. The DSUs may only be redeemed upon a director's retirement from the Company, its subsidiaries or any affiliated entity. Effective July 27, 2011, the Board ceased the issuance of DSUs for non-employee directors. The total recovery recorded in relation to the DSUs for 2018 was $0.6 million due to the revaluation of existing units (December 31, 2017 - expense of $1.1 million). The value of outstanding DSUs at December 31, 2018 is $1.0 million (December 31, 2017 - $2.8 million).

## 20. Finance Expense, Net

| (millions of Canadian dollars) | **2018** | 2017 |
|---|---|---|
| Interest expense on borrowings | **$ (25.0)** | $ (21.5) |
| Interest expense on retirement benefit obligations, net | **(8.3)** | (11.0) |
| Interest income | **8.8** | 2.7 |
| Other | **(1.5)** | (1.0) |
| Finance expense, net | **$ (26.0)** | $ (30.8) |

## 21. Income Taxes

The components of income tax expense are as follows:

| (millions of Canadian dollars) | **2018** | 2017 |
|---|---|---|
| Current | **$ (132.9)** | $ (120.7) |
| Deferred | **(16.9)** | (12.1) |
| Income tax expense | **$ (149.8)** | $ (132.8) |

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

| (millions of Canadian dollars) | **2018** | 2017 |
|---|---|---|
| Income tax expense at statutory rate of 27.0% (2017 – 26.0%) | **$ (159.0)** | $ (136.9) |
| Add (deduct): | | |
| Non-taxable income related to non-controlling interests | **0.2** | 0.4 |
| Entities with different income tax rates and other tax adjustments | **8.3** | (1.9) |
| Permanent difference from capital gains and losses and other non-deductible items | **0.7** | 1.8 |
| Change in substantively enacted tax legislation | **-** | 3.8 |
| Income tax expense | **$ (149.8)** | $ (132.8) |

In 2017, the Provincial Government of British Columbia passed legislation increasing the provincial corporate tax rate from 11% to 12% effective January 1, 2018. In addition, the Federal Government of the United States passed tax reform legislation, which included a reduction of the federal corporate income tax rate from 35% to 21% effective January 1, 2018. Accordingly, a $3.8 million net tax recovery was recorded in net income in 2017 to reflect the impact of these rate changes on deferred taxes, with an additional $1.1 million being recorded in other comprehensive income as an income tax recovery on defined benefit plan actuarial losses.

In addition, a tax expense of $1.9 million in relation to actuarial gains on the defined benefit plans (December 31, 2017 - expense of $6.1 million, before the tax rate adjustment) was recorded in other comprehensive income for the year ended December 31, 2018.

Also included in other comprehensive income for the 2018 year is a tax expense of $3.2 million related to foreign exchange differences on translation of investments in foreign operations (December 31, 2017 - recovery of $2.3 million).

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

| (millions of Canadian dollars) | | **As at December 31, 2018** | | As at December 31, 2017 |
|---|---|---|---|---|
| Deferred income tax assets | | | | |
| Accruals not currently deductible | **$** | **44.3** | $ | 44.4 |
| Loss carryforwards | | **3.4** | | 3.3 |
| Retirement benefit obligations | | **66.0** | | 69.9 |
| Goodwill and other intangible assets, net | | **9.4** | | 11.3 |
| Other | | **6.3** | | 8.0 |
| | **$** | **129.4** | $ | 136.9 |
| Deferred income tax liabilities | | | | |
| Depreciable capital assets | **$** | **(335.2)** | $ | (332.7) |
| Other | | **(35.1)** | | (22.0) |
| | **$** | **(370.3)** | $ | (354.7) |
| Total deferred income taxes, net | **$** | **(240.9)** | $ | (217.8) |
| Less: Entities in a net deferred income tax asset position | | **0.9** | | 5.6 |
| Deferred income tax liability, net | **$** | **(241.8)** | $ | (223.4) |

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

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

| (millions of Canadian dollars) | | **2018** | | 2017 |
|---|---|---|---|---|
| Accounts receivable | **$** | **25.5** | $ | (28.3) |
| Inventories | | **(126.5)** | | (85.7) |
| Prepaid expenses | | **(11.0)** | | 0.2 |
| Accounts payable, accrued liabilities and current portion of deferred reforestation obligations | | **29.2** | | 41.7 |
| Net increase in non-cash working capital | **$** | **(82.8)** | $ | (72.1) |

## 23. Related Party Transactions

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

The Jim Pattison Group is Canfor's largest shareholder. In August of 2018, The Jim Pattison Group's ownership interest of Canfor increased above 50%, ending the year at 50.9%. During 2018, subsidiaries owned by The Jim Pattison Group provided lease, insurance and other services to Canfor totalling $5.1 million (December 31, 2017 - $5.3 million) with no amounts outstanding at December 31, 2018 (December 31, 2017 - $0.5 million).

During 2018, CPPI sold paper to subsidiaries owned by The Jim Pattison Group totalling $3.0 million (December 31, 2017 - $3.5 million). No amounts related to these sales were outstanding as at December 31, 2018 or December 31, 2017.

During 2018, Canfor also made contributions to certain post-employment benefit plans for the benefit of Canfor employees and CPPI provided services to its joint venture with Licella Fibre Fuel Pty. Ltd. See Note 14, Employee Future Benefits, and Note 28, Licella Pulp Joint Venture, for further details.

***Key management personnel***

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

| (millions of Canadian dollars) | | 2018 | | 2017 |
|---|---|---|---|---|
| Short-term benefits | $ | **8.7** | $ | 8.3 |
| Post-employment benefits | | **0.2** | | 0.1 |
| Share-based payments | | **(0.6)** | | 1.1 |
| | $ | **8.3** | $ | 9.5 |

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

## 24. Segment Information

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

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

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

In accordance with the new revenue standard, IFRS 15, described in Note 4, sales from contracts with customers have been disaggregated by segment. Sales between segments are accounted for at prices that approximate fair value. These include sales of residual fibre from the lumber segment to the pulp and paper segment for use in the pulp production process. There was no quantitative financial statement impact as a result of the adoption of IFRS 15.

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

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

| (millions of Canadian dollars) | | Lumber | | Pulp & Paper | | Unallocated & Other | | Elimination Adjustment | | Consolidated |
|---|---|---|---|---|---|---|---|---|---|---|
| **Year ended December 31, 2018** | | | | | | | | | | |
| **Sales from contracts with customers** | **$** | **3,670.4** | **$** | **1,374.0** | **$** | **-** | **$** | **-** | **$** | **5,044.4** |
| **Sales to other segments** | | **249.5** | | **0.3** | | **-** | | **(249.8)** | | **-** |
| **Operating income (loss)** | | **390.5** | | **246.6** | | **(28.5)** | | **-** | | **608.6** |
| **Amortization** | | **190.8** | | **79.6** | | **0.1** | | **-** | | **270.5** |
| **Capital expenditures[7]** | | **272.3** | | **120.5** | | **8.6** | | **-** | | **401.4** |
| **Identifiable assets** | | **2,499.4** | | **919.3** | | **426.4** | | **-** | | **3,845.1** |
| Year ended December 31, 2017 | | | | | | | | | | |
| Sales from contracts with customers | $ | 3,365.6 | $ | 1,197.7 | $ | - | $ | - | $ | 4,563.3 |
| Sales to other segments | | 173.1 | | 0.2 | | - | | (173.3) | | - |
| Operating income (loss) | | 441.9 | | 154.6 | | (39.1) | | - | | 557.4 |
| Amortization | | 175.5 | | 74.4 | | - | | - | | 249.9 |
| Capital expenditures[7] | | 163.6 | | 83.1 | | 5.4 | | - | | 252.1 |
| Identifiable assets | | 2,285.1 | | 815.6 | | 387.6 | | - | | 3,488.3 |

[7]Capital expenditures represent cash paid for capital assets during the periods. Pulp & Paper includes capital expenditures by CPPI that were partially financed by government grants.

### Geographic information

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

| (millions of Canadian dollars) | | **2018** | | 2017 |
|---|---|---|---|---|
| Sales by location of customer | | | | |
| Canada | **$** | **592.6** | $ | 551.0 |
| Asia | | **1,514.4** | | 1,346.3 |
| United States | | **2,734.8** | | 2,503.9 |
| Europe | | **95.9** | | 74.7 |
| Other | | **106.7** | | 87.4 |
| | **$** | **5,044.4** | $ | 4,563.3 |

| (millions of Canadian dollars) | | **As at December 31, 2018** | | As at December 31, 2017 |
|---|---|---|---|---|
| Property, plant and equipment, timber licenses, and goodwill and other intangible assets by location | | | | |
| Canada | **$** | **1,719.4** | $ | 1,650.6 |
| United States | | **660.1** | | 533.8 |
| Asia and other | | **0.1** | | 0.1 |
| | **$** | **2,379.6** | $ | 2,184.5 |

## 25. Commitments and Contingencies

At the end of the year, Canfor had contractual commitments for $137.9 million (December 31, 2017 - $54.1 million). The majority of these commitments are expected to be settled over the following year.

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

| (millions of Canadian dollars) | | **As at December 31, 2018** | | As at December 31, 2017 |
|---|---|---|---|---|
| Within one year | **$** | **14.7** | $ | 12.2 |
| Between one and five years | | **30.9** | | 23.7 |
| Beyond five years | | **6.5** | | 6.6 |
| Total | **$** | **52.1** | $ | 42.5 |

During the year ended December 31, 2018, $22.5 million (December 31, 2017 - $20.4 million) was recognized as an expense for operating leases.

In the ordinary course of its business activities, the Company may be subject to, or enter into, legal actions and claims with customers, unions, suppliers or others.

In circumstances where the Company is not able to determine the outcome of a legal action and claim, no amount is recognized in the consolidated financial statements, with an amount accrued only when a reliable estimate of the obligation can be made. Although there can be no assurance as to the disposition of a legal action and claim, it is the opinion of the Company's management, based upon the information available at this time, that the expected outcome of a legal action and claim, individually or in aggregate, is unlikely to have a material adverse effect on the operating results and financial condition of the Company as a whole.

## 26. Financial Risk and Capital Management

***Financial risk management***

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

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

*Credit risk:*

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

Financial instruments that are subject to credit risk include cash and cash equivalents, accounts receivable, contract assets and certain investments in debt securities. Cash and cash equivalents include cash held through major Canadian and international financial institutions as well as temporary investments with an original maturity date, or redemption date, of three months or less. The cash and cash equivalents balance at December 31, 2018 is $252.7 million (December 31, 2017 - $288.2 million).

Canfor utilizes credit insurance to mitigate the risk associated with some of its trade accounts receivables. As at December 31, 2018, approximately 46% (December 31, 2017 - 40%) of the outstanding trade accounts receivables are covered by credit insurance. Canfor's trade accounts receivable balance at December 31, 2018 is $186.5 million, before a loss allowance of $4.4 million (December 31, 2017 - $196.5 million and $3.5 million, respectively).

At December 31, 2018, approximately 98% (December 31, 2017 - 99%) of the trade accounts receivable balance are within Canfor's established credit terms.

*Liquidity risk:*

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

At December 31, 2018, Canfor had no amount drawn on its operating loan facility (December 31, 2017 – nil), and accounts payable and accrued liabilities of $458.9 million (December 31, 2017 - $470.0 million), all of which are due within twelve months of the balance sheet date.

*Market risk:*

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

*(i) Interest rate risk:*

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

Canfor may use interest rate swaps to reduce its exposure to interest rate risk associated with financial obligations bearing variable interest rates. At December 31, 2018, and December 31, 2017, Canfor had no fixed interest rate swaps outstanding.

*(ii) Currency risk:*

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

An increase (decrease) in the value of the Canadian dollar by US$0.01 would result in a pre-tax: (i) loss (gain) of approximately $1.4 million in relation to working capital balances denominated in US dollars at year end (including cash, accounts receivable and accounts payable); and a (ii) gain (loss) of approximately $1.8 million in relation to long-term debt denominated in US dollars at year end.

A portion of the currency risk associated with US dollar denominated sales is naturally offset by US dollar denominated expenses. A portion of the remaining exposure is sometimes reduced by foreign exchange collar contracts that effectively limit the minimum and maximum Canadian dollar recovery related to the sale of those US dollars. At December 31, 2018 and December 31, 2017, the Company had no foreign exchange collar contracts outstanding.

Canfor is also subject to Swedish Krona ("SEK") foreign exchange risk associated with the commitment to purchase the VIDA Group (Note 29(d)). In order to reduce its exposure to fluctuations in the Swedish Krona versus the Canadian and US dollar, Canfor entered into forward foreign exchange contracts in the fourth quarter of 2018.

At December 31, 2018, Canfor had the following forward foreign exchange contracts outstanding:

| | As at December 31, 2018 | | |
|---|---|---|---|
| | **Notional Amount Currency** | **Notional Amount** | **Exchange Rates** |
| **Swedish Krona Forward Contracts** | | (millions of dollars) | (rate of SEK to notional dollar) |
| *January 15 - February 28, 2019* | USD | **$100.0** | **9.07** |
| *January 15 - February 28, 2019* | CAD | **$292.6** | **6.84** |

No forward foreign exchange contracts were outstanding at December 31, 2017.

Subsequent to year end, the Company continued to reduce its exposure to fluctuations in the Swedish Krona by entering into additional US and Canadian dollar forward foreign exchange contracts. Canadian dollar contracts were entered into with a total notional amount of $125.0 million, exchange rates ranging from 6.86 to 6.90 and settlement dates of February 28, 2019. US dollar contracts were also entered into with a total notional amount of US$25.0 million, an exchange rate of 9.06 and a settlement date of February 28, 2019.

*(iii) Commodity price risk:*

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

Canfor had the following lumber futures contracts at December 31, 2018 and December 31, 2017:

| | **As at December 31, 2018** | | As at December 31, 2017 | |
|---|---|---|---|---|
| | **Notional Amount** | **Average Rate** | Notional Amount | Average Rate |
| **Lumber** | (MMfbm) | (US dollars per Mfbm) | (MMfbm) | (US dollars per Mfbm) |
| Future sales contracts | | | | |
| *0-12 months* | **42.7** | **$343.14** | 24.3 | $436.41 |

An increase (decrease) in the futures market price of lumber of US$10 per Mfbm would result in a pre-tax gain (loss) of approximately $0.6 million in relation to the lumber futures held at year end.

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*(iv) Energy price risk:*

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

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

At December 31, 2018, and December 31, 2017, the Company had no oil collars outstanding.

Canfor is also exposed to energy price risk on the sale of electricity in Canada. Prices are set by third-party regulatory bodies. In 2017, Canfor entered into a commodity swap transaction to transfer 61,320 megawatt hours ("MWh") at a rate of $46.25 per MWh, effective January 1, 2018 through December 31, 2018.

***Capital management***

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

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

| (millions of Canadian dollars) | | **As at December 31, 2018** | | As at December 31, 2017 |
|---|---|---|---|---|
| Total debt (including operating loans) | **$** | **408.4** | $ | 385.7 |
| Less: Cash and cash equivalents | | **(252.7)** | | (288.2) |
| Net debt | **$** | **155.7** | $ | 97.5 |
| Total equity | | **2,339.9** | | 2,001.0 |
| | **$** | **2,495.6** | $ | 2,098.5 |

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

Canfor's strategy is to ensure it remains in compliance with all of its existing debt covenants, so as to ensure continuous access to capital. Canfor was in compliance with all its debt covenants for the years ended December 31, 2018 and December 31, 2017.

The Company manages its capital structure through rigorous planning, budgeting and forecasting processes, and ongoing management of operations, investments and capital expenditures. In 2018, to meet Canfor's operating, growth and return on invested capital objectives, the Company's management of capital comprised investment in the Company's operations, development of energy and sustainable working capital and cost management initiatives. Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

## 27. Financial Instruments

Canfor's cash and cash equivalents, trade and other accounts receivables, investments in debt and equity securities, derivative instruments, accounts payable and accrued liabilities, operating loans, and long-term debt are classified as measured at amortized cost in accordance with IFRS 9, adopted by the Company on January 1, 2018 (Note 4). The carrying amounts of these instruments at December 31, 2018, approximate fair value.

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

The three levels of the fair value hierarchy are:

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

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

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

The following table summarizes Canfor's financial instruments measured at fair value at December 31, 2018 and December 31, 2017, and shows the level within the fair value hierarchy in which they have been classified:

| (millions of Canadian dollars) | Fair Value Hierarchy Level | | **As at December 31, 2018** | | As at December 31, 2017 |
|---|---|---|---|---|---|
| **Financial assets measured at fair value** | | | | | |
| Investments | Level 1 | **$** | **20.1** | $ | 21.8 |
| Derivative financial instruments | Level 2 | | **18.8** | | - |
| | | **$** | **38.9** | $ | 21.8 |
| **Financial liabilities measured at fair value** | | | | | |
| Derivative financial instruments | Level 2 | **$** | **0.6** | $ | 0.8 |
| | | **$** | **0.6** | $ | 0.8 |

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

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

At December 31, 2018, the fair value of derivative financial instruments is a net asset of $18.2 million (December 31, 2017 - net liability of $0.8 million). The fair value of these financial instruments was determined based on prevailing market rates for instruments with similar characteristics.

The following table summarizes the gain (loss) on derivative financial instruments for the years ended December 31, 2018 and December 31, 2017:

| (millions of Canadian dollars) | | **2018** | | 2017 |
|---|---|---|---|---|
| Lumber futures | **$** | **(17.9)** | $ | (4.7) |
| Energy derivatives | | **0.2** | | (0.5) |
| Foreign exchange forward contracts | | **18.8** | | - |
| Gain (loss) on derivative financial instruments | **$** | **1.1** | $ | (5.2) |

The following table summarizes the fair value of the derivative financial instruments included in the balance sheets at December 31, 2018 and December 31, 2017:

| (millions of Canadian dollars) | | **As at December 31, 2018** | | As at December 31, 2017 |
|---|---|---|---|---|
| Lumber futures | **$** | **(0.6)** | $ | (0.3) |
| Energy derivatives | | **-** | | (0.5) |
| Foreign exchange forward contracts | | **18.8** | | - |
| Total asset (liability), net | | **18.2** | | (0.8) |
| Less: Current portion asset (liability), net | | **18.2** | | (0.8) |
| Long-term asset (liability), net | **$** | **-** | $ | - |

There were no transfers between fair value hierarchy levels in 2018 or 2017.

## 28. Licella Pulp Joint Venture

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

Under IFRS 11, *Joint Arrangements*, the joint venture is classified as a joint operation and CPPI will recognize its assets, liabilities and transactions, including its share of those incurred jointly, in its consolidated financial statements. For the year ended December 31, 2018, CPPI's share of the joint venture's expenses was $2.1 million (December 31, 2017 - $1.1 million), which have been recognized in manufacturing and product costs. CPPI is required to contribute the first $20.0 million of any funding requirements, including cash and non-cash contributions, to the joint venture, of which $3.8 million has been contributed as at December 31, 2018.

In March 2017, the Canadian Federal Government through its Sustainable Development Technology Canada program announced the funding over several years of approximately $13.2 million, contingent on future spending. Advance funding of $1.9 million was received in April 2018 for the period October 1, 2017 through to the time at which the terms of funding have been met, which is currently estimated as March 31, 2019. Of this amount, $0.7 million has been recognized as an offset to costs within manufacturing and product costs during the year ended December 31, 2018.

## 29. Acquisitions

### *(a) Beadles Lumber Company & Balfour Lumber Company Inc.*

On January 2, 2015, the Company completed the first phase of the acquisition of Beadles Lumber Company & Balfour Lumber Company Inc. ("Beadles & Balfour") for total consideration of $51.6 million (US$44.0 million), representing an initial 55% interest.

On January 2, 2017, the Company completed the final phase of the acquisition of Beadles & Balfour for $41.8 million (US$31.1 million) bringing Canfor's interest in Beadles & Balfour to 100%. Upon completion of the final phase of the acquisition, the forward purchase liability of $41.8 million and non-controlling interest of $19.9 million were derecognized, and $36.5 million was recorded in other equity. In addition, $16.6 million was charged to retained earnings reflecting Canfor's election to account for the non-controlling interest related to Beadles & Balfour as the non-controlling share of the fair value of the net identifiable assets at the acquisition date.

The acquisition was accounted for in accordance with IFRS 3, *Business Combinations*.

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

On April 15, 2016, the Company completed the acquisition of the assets of Wynndel Box and Lumber Ltd. ("Wynndel") for total consideration of $40.3 million. The acquisition has been accounted for in accordance with IFRS 3, *Business Combinations*.

At the acquisition date, the Company paid $19.7 million, and a working capital true-up payment of $2.6 million was paid in early July 2016. On April 5, 2017, the Company paid an instalment of $14.4 million. The final instalment of $3.6 million was paid on October 13, 2017.

### *(c) Elliott Sawmilling Co., Inc.*

On November 9, 2018, the Company announced that it had entered into an agreement to purchase Elliott Sawmilling Co., Inc., ("Elliott") located in Estill, South Carolina for total consideration of $150.0 million (US$110.0 million). The transaction will be completed in two phases, with 49% acquired upon closing, and the remaining 51% being acquired one year later. Elliott has an annual production capacity in excess of 210 million board feet, with the sawmill consisting of both large and small log lines.

The transaction is anticipated to close during Q2 2019, following the completion of due diligence, completion of certain transaction documents and other customary closing conditions.

### *(d) VIDA Group of Sweden*

On November 15, 2018, the Company announced that it had entered into an agreement to purchase 70% of the VIDA Group ("VIDA") for total consideration of $580.0 million (3,990 million Swedish Krona). VIDA is Sweden's largest privately-owned sawmill company, operating nine sawmills in southern Sweden and producing up to 1.1 billion board feet of high-quality spruce and pine products annually. In addition, VIDA operates nine value added facilities that include premium packaging, modular housing, industrial products and energy.

The transaction is anticipated to close during Q1 2019 following the completion of due diligence, completion of certain transaction documents and other customary closing conditions.

## 30. Countervailing and Anti-Dumping Duties

On November 25, 2016, a petition was filed by the US Lumber Coalition to the US Department of Commerce ("DOC") and the US International Trade Commission ("ITC") alleging certain subsidies and administered fees below the fair market value of timber that favour Canadian lumber producers, an assertion the Canadian industry and Provincial and Federal Governments strongly deny and have successfully disproven in international courts in the past. Canfor was selected by the DOC as a "mandatory respondent" to the countervailing and anti-dumping investigations and is subject to company specific countervailing and anti-dumping duties.

On April 24, 2017, the DOC announced its preliminary countervailing duty ("CVD") of 20.26% specific to Canfor, to be posted by cash deposits or bonds on the exports of softwood lumber to the US effective April 28, 2017 to August 25, 2017. Following this period, CVD duties were not applicable on lumber shipments destined to the US from August 26, 2017 to December 27, 2017. On June 23, 2017, the DOC announced its preliminary anti-dumping duty determination ("ADD") of 7.72% specific to Canfor, to be posted by cash deposits or bonds on the exports of softwood lumber to the US effective June 30, 2017.

Final countervailing and anti-dumping duty determinations were announced by the DOC on November 2, 2017, while the ITC issued an affirmative determination of injury on December 7, 2017. As a result, Canfor was issued a final ADD rate of 7.28% effective November 8, 2017 and was subject to countervailing duties on Canadian lumber exports destined to the US at a reduced rate of 13.24%, effective December 28, 2017. Notwithstanding the final rates established in the DOC's investigation, the final liability for the assessment of CVD and ADD will not be determined until an official administrative review of the respective period is complete. For the CVD rate, the first Administrative Review is anticipated to be based on sales and cost data through 2017 and 2018, with the ADD rate expected to be based off data from July 2017 to December 2018. These two CVD and ADD Administrative Reviews are currently anticipated to be completed in 2020.

In 2017, the Company reduced its countervailing expense accrual by $14.0 million reflecting the difference in the DOC's preliminary and final countervailing duty rates. In the case of the ADD, cash deposits were posted at the final published ADD rate of 7.28% as determined by the DOC, however for accounting purposes, the expense was accrued at 1.1% reflecting Canfor's best estimate of the rate applicable to its product shipment profile, as determined by applying the DOC's methodology to current sales and cost data. As Canfor is unable to determine a current CVD accrual rate for accounting purposes, an expense was recorded at the CVD deposit rate. Accordingly, the Company reduced its anti-dumping duty accrual by $30.9 million reflecting the difference in the DOC's preliminary rate of 7.72%, and the Company's estimated accrual rate of 1.1% for the applicable period in 2017.

In 2018, cash deposits were posted reflecting the final published ADD rate of 7.28% and CVD rate of 13.24%, with ADD expense accrued at 2.9% for the applicable 2017 and 2018 combined period. Cumulative cash duties paid to December 31, 2018 were $284.0 million. The estimated ADD rate at December 31, 2018, increased by 1.8% from 2017 as a result of applying the DOC's methodology to current period sales and cost data included in the first period of review. In 2019, Canfor will move into a new period of review, with the estimated ADD rate based on 2019 sales and cost data. Canfor will continue to reassess the ADD accrual estimate at each quarter-end, applying the DOC's methodology to updated sales and cost data as this becomes available. Quarterly revisions to the ADD rate may result in a material adjustment to the Income Statement while the Administrative Reviews are taking place. Changes to the DOC's existing CVD and ADD rates during the course of each Administrative Review may also result in material adjustments to the Income Statement. At December 31, 2018, Canfor has recorded a receivable of $76.6 million (Note 10) reflecting the difference over the eighteen-month period of review between the current combined cash deposit rate of 20.52% and the current combined accrual rate for accounting purposes of 16.14%.

Canfor and other Canadian forest product companies, the Federal Government and Canadian Provincial Governments categorically deny the US allegations and strongly disagree with the current countervailing and anti-dumping determinations made by the DOC. Canada has proceeded with legal challenges under NAFTA and through the World Trade Organization, where Canadian litigation has proven successful in the past.