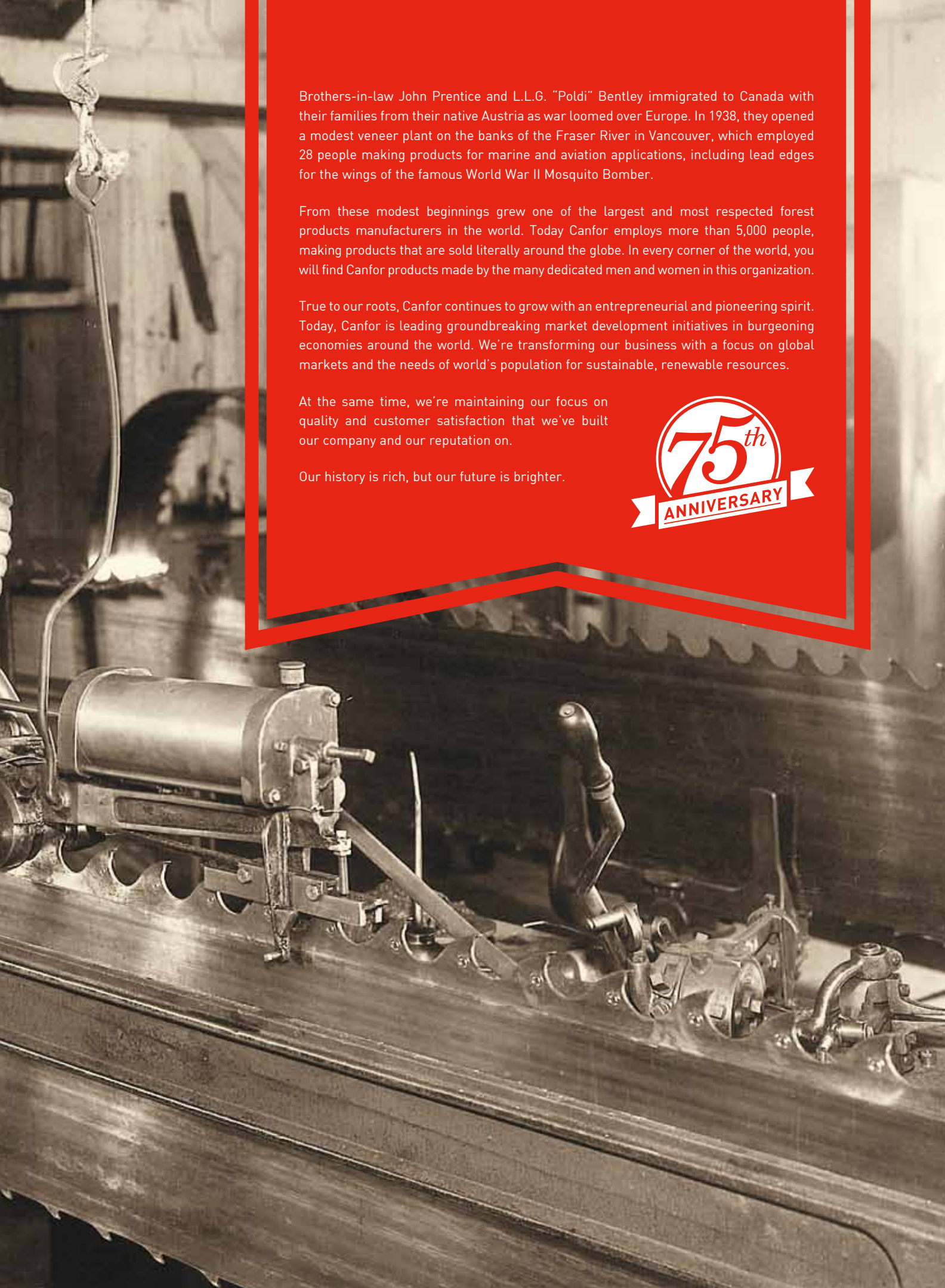


CANFOR
CORPORATION
ANNUAL
REPORT
2012







Brothers-in-law John Prentice and L.L.G. "Poldi" Bentley immigrated to Canada with their families from their native Austria as war loomed over Europe. In 1938, they opened a modest veneer plant on the banks of the Fraser River in Vancouver, which employed 28 people making products for marine and aviation applications, including lead edges for the wings of the famous World War II Mosquito Bomber.

From these modest beginnings grew one of the largest and most respected forest products manufacturers in the world. Today Canfor employs more than 5,000 people, making products that are sold literally around the globe. In every corner of the world, you will find Canfor products made by the many dedicated men and women in this organization.

True to our roots, Canfor continues to grow with an entrepreneurial and pioneering spirit. Today, Canfor is leading groundbreaking market development initiatives in burgeoning economies around the world. We're transforming our business with a focus on global markets and the needs of world's population for sustainable, renewable resources.

At the same time, we're maintaining our focus on quality and customer satisfaction that we've built our company and our reputation on.

Our history is rich, but our future is brighter.



MESSAGE TO SHAREHOLDERS

FROM THE PRESIDENT AND CEO

Canfor continued to make steady progress in 2012 toward our vision of becoming the world's most competitive forest products manufacturer. Our achievements were bolstered by the fact we are at last beginning to see signs of sustained improvement in lumber markets in the United States, the first since the start of the housing downturn in 2009.

Our lumber segment returned to profitability in 2012, and while the strengthening US markets and our advances in the China market are key factors, we owe much of our success to our decisions in the last few years to modernize our facilities and to secure a stable, high-quality fibre supply.

In 2012, we completed our acquisition of the Tembec Industries Ltd. sawmills and associated forestlands in southern British Columbia. This gives us access to some of the best fibre in the world, and meant we could introduce a new lumber product line – Canfor RED. Strategic expansion of our operations and diversification of our product offerings further solidifies our brand promise as a reliable supplier of top-quality products.

FROM THE CHAIRMAN

As we prepare to celebrate Canfor's 75th anniversary in 2013, we can pause to reflect on the leadership of those who shaped a company that has been able to withstand some truly challenging times.

And it is also an opportunity to look to the future – which looks brighter than it has for some time. I am cautiously optimistic that the US economy will continue to improve, and this will continue to be reflected in our financial results.

When John Prentice and L.L.G. (Poldi) Bentley opened their first small mill in 1938 on the Fraser River in New Westminster, they likely never imagined they were starting a company that would become one of the world's largest integrated forest products manufacturers with operations across North America serving global markets.

They built a company able to draw on its own internal strengths and talented workforce, and our success today is the direct result of the contributions of so many over the last 75 years.

The future has never been brighter for Canfor and for the modern forest industry. Our sustainable products are in demand worldwide, and we have both the secure source of

As we celebrate Canfor's 75th anniversary in 2013 and look back over the many accomplishments through our long history in the forest products business, it is my firm belief that the best is yet to come. Canfor is exceptionally well-positioned to be the supplier of choice to the many markets and customers we serve around the world. I'd like to thank Canfor's board of directors for their guidance and leadership in 2012, our customers and communities for their ongoing support, and most of all the employees of Canfor for their dedication to moving our company forward.



A handwritten signature in black ink, appearing to read 'D. Kayne'.

Donald B. Kayne
President and Chief Executive Officer

fibre and the modern facilities to meet this demand. We also have excellent employees and strong leadership to keep us headed in the right direction.

I would like to extend a warm welcome to Michael Korenberg, who was appointed to co-chair the Canfor Board of Directors with me in 2013, and my personal thanks to him and our board colleagues for their dedication and leadership. A special thanks is owed to Chairman Emeritus Peter Bentley, whose father was one of the company founders and who himself has contributed so much to this company. It is an honour to serve with you during this special year of Canfor's 75th anniversary.



A handwritten signature in black ink, appearing to read 'R. Cliff'.

Ron Cliff
Chairman of the Board

MESSAGE TO THE FOUNDERS

As we celebrate Canfor's 75th year in business, we reflect on the legacy of the two visionary entrepreneurs who founded this great company. The drive and determination of John Prentice and L.L.G. (Poldi) Bentley built what is now one of the world's largest and most respected forest products manufacturers. Canfor continues to grow and prosper on the foundation laid by these two remarkable men, and we move forward with appreciation of our rich history and our roots as a family company.



**THERE IS
NO SUBSTITUTE
FOR...**



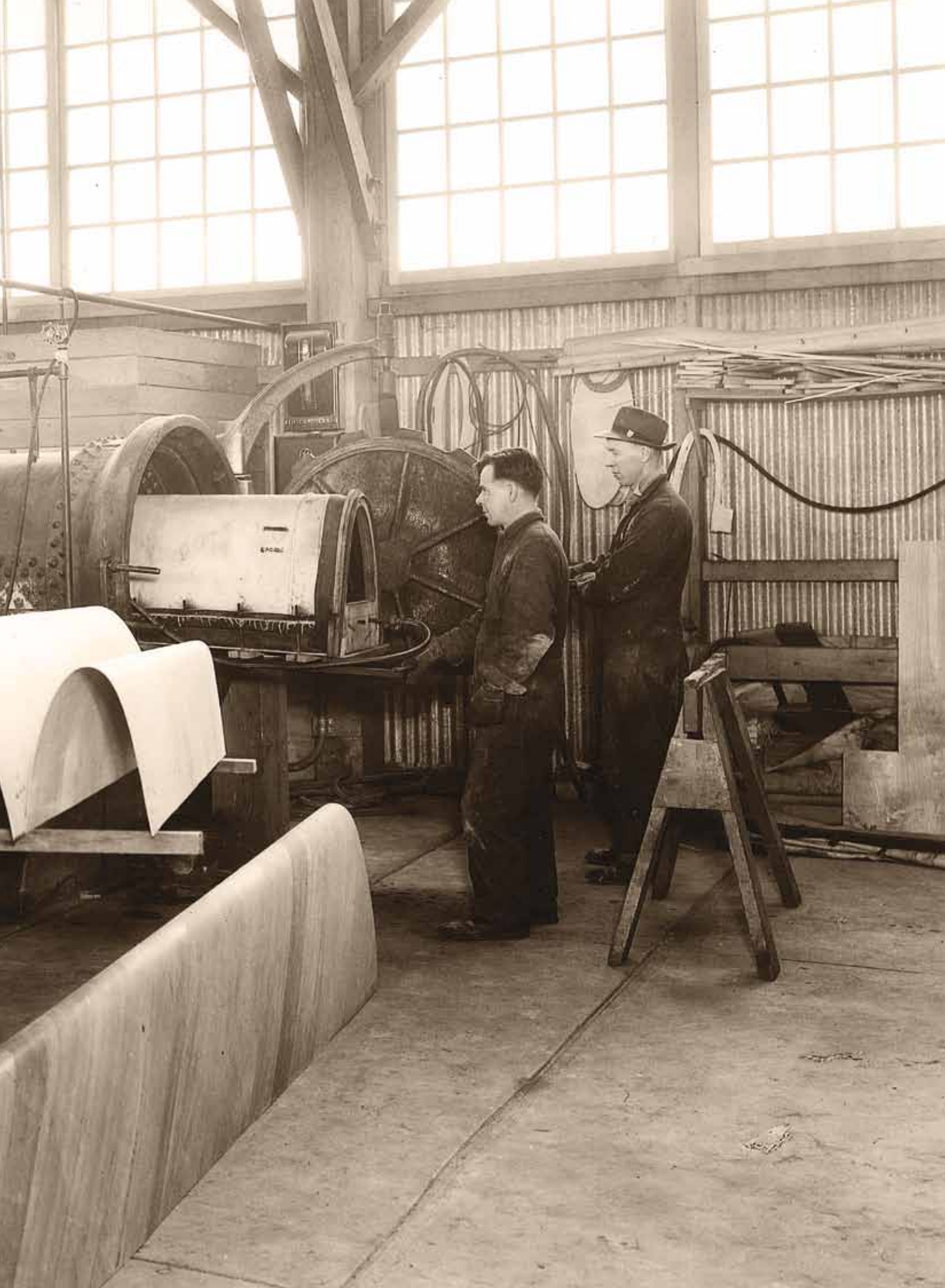
VISION

Canfor was built on the vision of two immigrants who had escaped a looming war in Europe. Their vision took Canfor from a small facility with 28 employees to one of the world's largest integrated forest products manufacturers with a 5,000 strong workforce. Our vision for the future sees us as the preferred supplier of sustainable wood and paper products in every market around the globe.

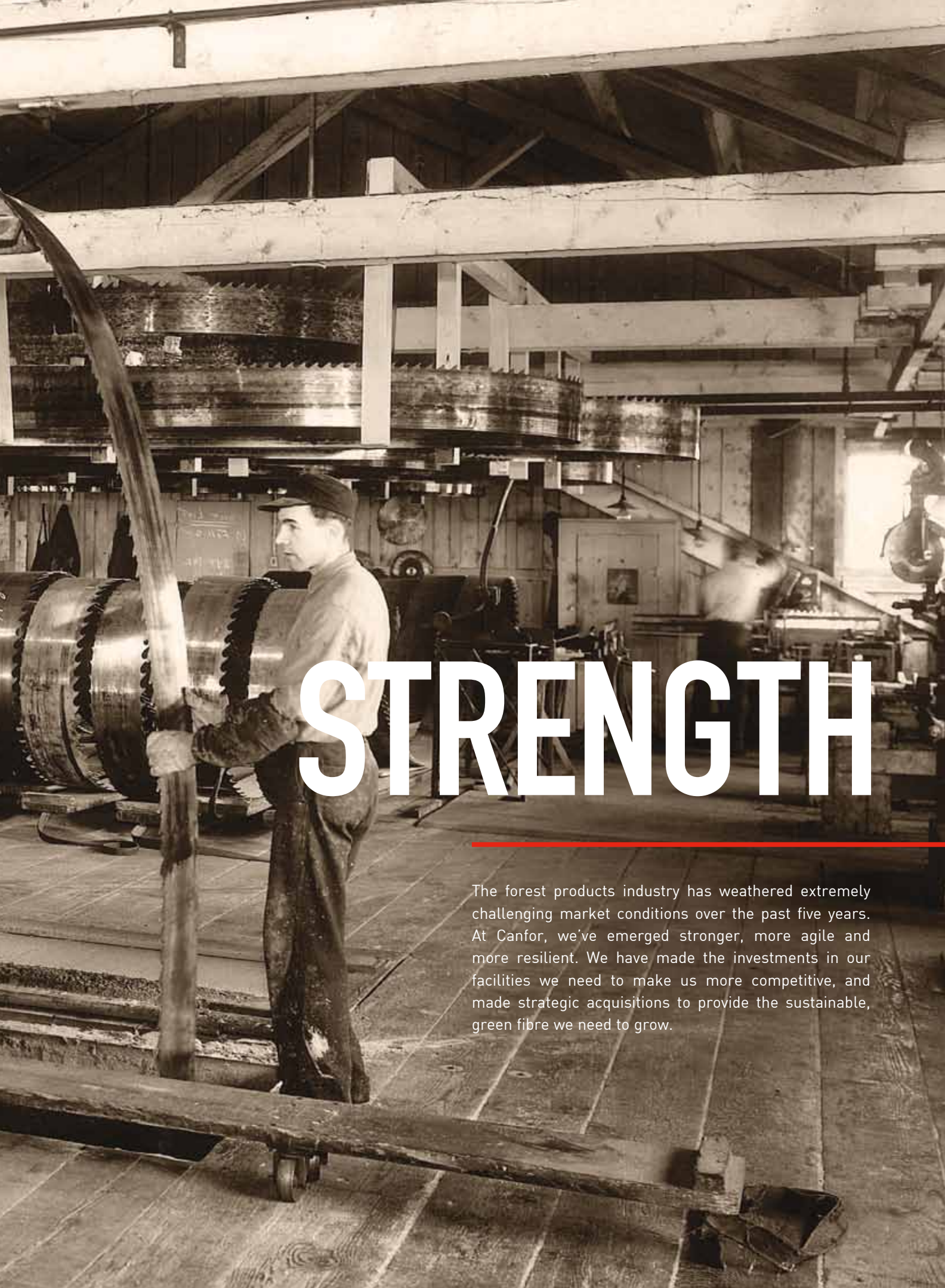


COMMITMENT

Our commitment – to our people, our shareholders, our customers, our stakeholders – drives our performance. We are committed to continually improving our processes, to delivering quality products and unmatched customer satisfaction, and to respecting the environment through every phase of our operations.





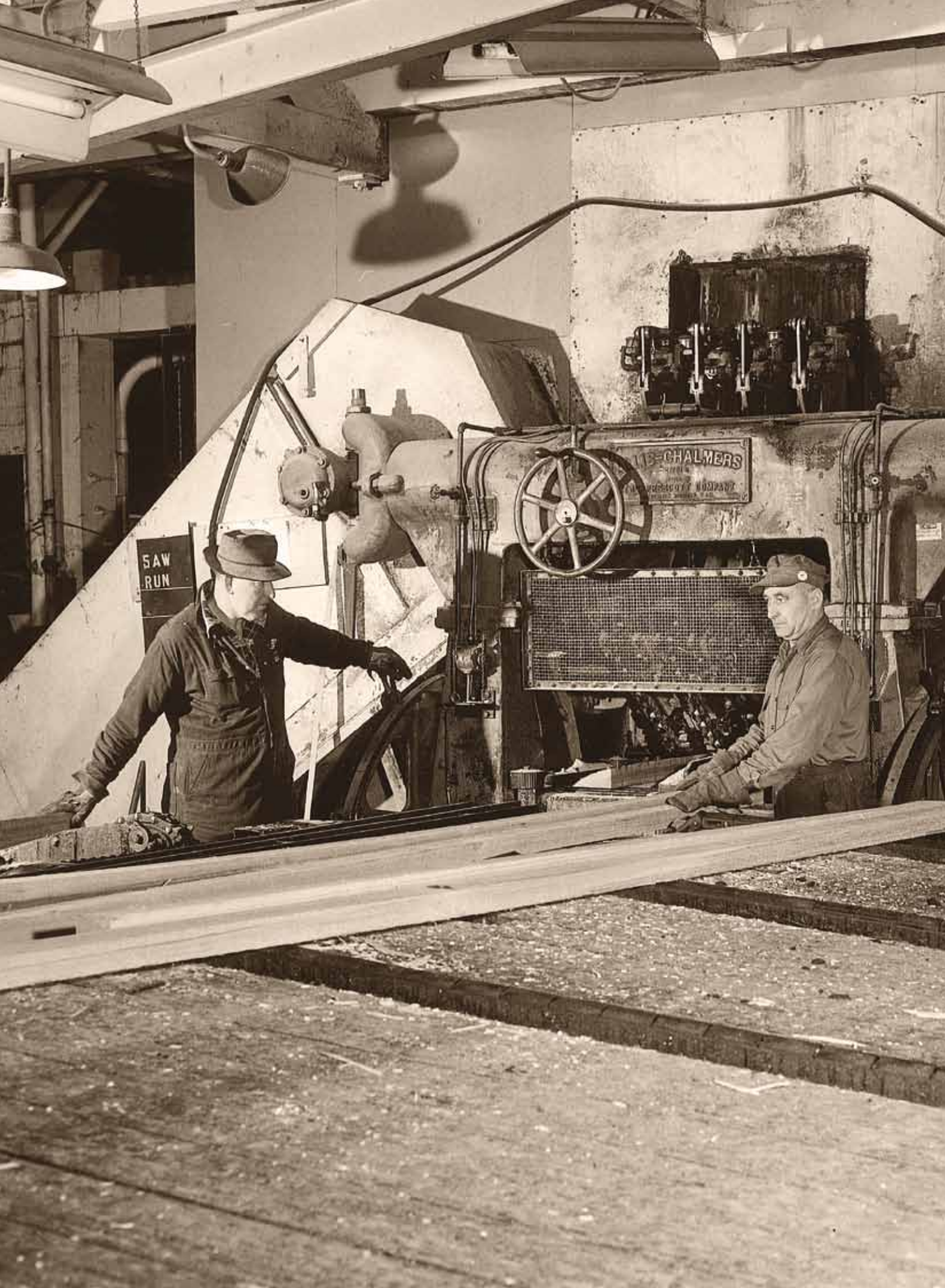


STRENGTH

The forest products industry has weathered extremely challenging market conditions over the past five years. At Canfor, we've emerged stronger, more agile and more resilient. We have made the investments in our facilities we need to make us more competitive, and made strategic acquisitions to provide the sustainable, green fibre we need to grow.

QUALITY

Our customers tell us that our reliability in product quality and top-notch customer service are what we're known for. We've expanded our operations and diversified our product lines to ensure Canfor continues to be the quality supplier of choice in every market we serve.



THERE IS NO SUBSTITUTE FOR CANFOR

We're proud of our history, but we have our sights set on the future. Canfor is building markets around the world for sustainable forest products. A secure, green fibre base that is second-to-none globally, modern and efficient facilities, a proven track record in sustainability performance and unmatched customer service and logistics support – it is what Canfor has built our reputation on, and what sets us apart.

There is no substitute for Canfor

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CANFOR.COM

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There is no substitute for Canfor

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FINANCIAL HIGHLIGHTS

| | 2012 | 2011 |
|--|------------|------------|
| Sales and income (millions of dollars) | | |
| Sales | \$ 2,714.1 | \$ 2,421.4 |
| Operating income | \$ 76.9 | \$ 11.9 |
| Net income | \$ 41.4 | \$ 10.8 |
| Net income (loss) attributable to equity shareholders of the Company | \$ 32.1 | \$ (56.6) |
| Per common share (dollars) | | |
| Net income (loss) attributable to equity shareholders of the Company | \$ 0.22 | \$ (0.40) |
| Book value | \$ 7.78 | \$ 7.90 |
| Share price | | |
| High | \$ 17.17 | \$ 15.48 |
| Low | \$ 10.14 | \$ 8.80 |
| Close – December 31 | \$ 16.58 | \$ 10.65 |
| Financial position (millions of dollars) | | |
| Working capital | \$ 166.1 | \$ 195.4 |
| Total assets | \$ 2,487.9 | \$ 2,401.6 |
| Net debt | \$ 325.8 | \$ 210.1 |
| Common shareholders' equity | \$ 1,110.9 | \$ 1,127.3 |
| Additional information ⁽¹⁾ | | |
| Return on invested capital | 3.7% | (3.4)% |
| Return on common shareholders' equity | 2.9% | (4.8)% |
| Ratio of current assets to current liabilities | 1.3 : 1 | 1.5 : 1 |
| Ratio of net debt to capitalization | 20% | 13% |
| Operating income before amortization (millions of dollars) | \$ 264.1 | \$ 181.2 |
| Operating income before amortization margin | 9.7% | 7.5% |
| Capital expenditures (millions of dollars) | \$ 199.8 | \$ 312.3 |

(1) See Definitions of Selected Financial Terms on page 88.

MANAGEMENT'S DISCUSSION & ANALYSIS

This Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the year ended December 31, 2012 relative to the year ended December 31, 2011, and the financial position of the Company at December 31, 2012. It should be read in conjunction with Canfor's Annual Information Form and its audited consolidated financial statements and accompanying notes for the years ended December 31, 2012 and 2011. The financial information contained in this MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which is the required reporting framework for Canadian publicly accountable enterprises.

Throughout this discussion, reference is made to Operating Income before Amortization which Canfor considers to be a relevant indicator for measuring trends in the performance of each of its operating segments and the Company's ability to generate funds to meet its debt repayment and capital expenditure requirements. Reference is also made to Adjusted Shareholder Net Income (Loss) (calculated as Shareholder Net income (loss) less specific items affecting comparability with prior periods – for the full calculation, see reconciliation included in the section "Analysis Overview of Consolidated Results – 2012 Compared to 2011") and Adjusted Shareholder Net Income (Loss) per Share (calculated as Adjusted Shareholder Net Income (Loss) divided by the weighted average number of shares outstanding during the period). Operating Income before Amortization and Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share are not generally accepted earnings measures and should not be considered as an alternative to net income or cash flows as determined in accordance with IFRS. As there is no standardized method of calculating these measures, Canfor's Operating Income before Amortization, Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of Operating Income before Amortization to operating income

(loss) and Adjusted Shareholder Net Income (Loss) to net income (loss) reported in accordance with IFRS are included in this MD&A.

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

All financial references are in millions of Canadian dollars unless otherwise noted. The information in this report is as at February 14, 2013.

FORWARD LOOKING STATEMENTS

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

COMPANY OVERVIEW

Canfor is a leading Canadian integrated forest products company based in Vancouver, British Columbia ("BC"), involved primarily in the lumber business, with production facilities in BC, Alberta, Quebec and the United States. Canfor also has a 50.2% interest in the pulp and paper business of Canfor Pulp Products Inc. ("CPPI"), a 50% interest in the oriented strand board ("OSB") business of Peace Valley OSB and owns a Bleached Chemi-Thermo Mechanical Pulp ("BCTMP") mill ("Taylor pulp mill"), all located in BC.

As described in note 33 to Canfor's 2012 consolidated financial statements, during 2012 Canfor acquired 50.2% of the outstanding common shares of CPPI in exchange for 50.2% of the outstanding units of Canfor Pulp Limited Partnership ("CPLP"). There were no other changes in percentage ownership in 2012 or 2011 for the entities listed above.

Canfor employs approximately 3,970 people in its wholly owned subsidiaries and 1,340 in jointly owned operations for a total of 5,310 employees.

LUMBER

Canfor's lumber operations have a current annual production capacity of approximately 5.2 billion board feet of lumber. The majority of lumber produced by Canfor from its facilities is construction and specialty grade dimension lumber that ranges in size from one by three inches to two by twelve inches and in lengths from six to twenty-four feet. A significant proportion of Canfor's lumber production is comprised of specialty products that command premium prices, including Square Edge lumber for the North American market, J-grade lumber for the Japanese market, and machine stress rated ("MSR") lumber used in engineered applications such as roof trusses and floor joists.

Canfor's lumber operations also include a finger-joint plant, two lumber treating plants, a whole-log chipping plant and a trucking division. The lumber business segment also includes a 60% interest in Houston Pellet Limited Partnership, which has an annual capacity of approximately 217,000 tonnes of wood pellets. In late 2012, the Company disposed of its remanufacturing facility in Bellingham, Washington and certain timber land in the U.S.

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

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

PULP AND PAPER

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

The CPPI mills have the capacity to produce over one million tonnes of pulp annually. Over 200,000 tonnes of BCTMP per year can be produced at the Taylor pulp mill. CPPI's paper machine, located at the Prince George Pulp and Paper mill, has an annual production capacity, at optimum product mix levels, of 140,000 tonnes of kraft paper.

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

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

OTHER OPERATIONS

The Company's only currently operating panels facility is the Peace Valley OSB plant in Fort St. John, BC, which is jointly owned with Louisiana-Pacific Canada Ltd. The Peace Valley OSB mill has an annual capacity of approximately 820 million square feet (3/8" basis). OSB production is primarily performance rated sheathing and flooring, which is used in wall, roof and flooring construction of new homes and in repair and remodeling projects. Canfor also owns an OSB plant ("PolarBoard"), which is currently indefinitely idled, and a plywood plant ("Tackama") which was permanently closed in December 2011.

In late 2012, the Company has entered into a Letter of Intent with Louisiana-Pacific Corporation to sell Canfor's 50% share in the Peace Valley OSB joint venture. Upon completion of the sale, Louisiana-Pacific Corporation will become the sole owner of the Peace Valley OSB mill. The transaction is subject to various customary closing conditions and is currently scheduled to close in the first half of 2013. Further discussion of the commitment is provided in "Financial Requirements and Liquidity - Commitments".

BUSINESS STRATEGY

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

- ▶ Expanding geographical markets, increasing market share of value-added products and building strong long-term partnerships with valued customers,
- ▶ Optimizing the extraction of high-margin products and value from its available fibre sources,
- ▶ Attaining world class supply chain performance,
- ▶ Achieving and maintaining a low cost structure,
- ▶ Maintaining a strong financial position,
- ▶ Fully engaging employees and utilizing their experience and expertise to maximize performance,
- ▶ Capitalizing on attractive growth opportunities, and
- ▶ Positioning the Company as a leading supplier of green, environmentally friendly building products.

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

CPPI, which on a day-to-day basis operates under a separate Board of Directors, has the following business strategies:

- ▶ Preserving its low-cost operating position,
- ▶ Maintaining the premium quality of its products,
- ▶ Growing its green energy business, and
- ▶ Capitalizing on attractive growth opportunities.

OVERVIEW OF 2012

On balance, 2012 represented a better year for lumber markets. After a slow start to the year, lumber markets showed a steady improvement through the balance of 2012 as the challenged housing sector finally show some encouraging signs of growth, while global demand for Western SPF (Spruce/Pine/Fir) lumber products, led by China, reached new record-highs. The combined strengthening demand resulted in a 17% rise in North American benchmark Western SPF 2x4 #2&Btr price over the previous year and was a key driver in improved overall lumber operating results. Results were further improved by stronger pricing for other grades and dimensions, a moderately weaker Canadian dollar and improved operational cost performance. These improvements were offset to some extent by upward log cost pressures in the year, which in part reflected higher market stumpage rates associated with improved sales realizations.

The Company continued to position itself to take advantage of the improving lumber markets, with continued targeted capital spending at many operations to improve product quality and value, improve operational efficiency and drive down operating costs. In 2012, these included capital upgrades at the Company's Radium mill in advance of its reopening in October 2012, after being idled for more than three years, as well as completion of planer upgrades at its Prince George and Grande Prairie sawmills. Results to date from these capital upgrades continue to be encouraging.

Another positive development in 2012 was the Company's acquisition and integration of sawmill and timber license assets in south-east BC from Tembec Industries Ltd. ("Tembec"). This acquisition closed in March 2012 and has further strengthened the Company's fibre position and its ability to capitalize on a very high quality product mix in the region.

Operating results for the pulp and paper segment declined from the previous year reflecting a challenging year for the global pulp markets as the ongoing financial crisis in Europe and slowing growth in China tempered global demand. As a result of the challenging markets, average NBSK pulp list prices dropped by over US\$100 per tonne from 2011. Also contributing to the weaker results were reduced pulp production and shipments and increased unit manufacturing costs, which primarily reflected a scheduled outage at the Prince George Pulp Mill that was extended to complete several major capital projects and an outage at the Northwood Pulp Mill due to the unscheduled shutdown of one of the facility's recovery boilers in the summer months.

CPPI also ratified new five year collective agreements with the CEP (Communications, Energy and Paperworkers Union) and PPWC (Pulp, Paper and Woodworkers of Canada) during 2012. Both agreements expire on April 30, 2017.

The Company continued to preserve its strong financial position in 2012, retaining a strong focus on working capital management and on delivering on its capital investment, both in terms of being on-time, on-budget and achieving targeted

savings. The Company ended the year with net debt to total capitalization of 19.9% and \$413 million available under its operating loans.

In mid-2012, the Company and CPPI announced leadership changes focused on integration and greater alignment in several key business areas. Integration-to-date has gone very well with both companies realizing benefits of a more collaborative, streamlined approach as well as leveraging the expertise of both companies. Total cost savings of approximately \$10 million are projected to be realized in 2013.

A review of the more significant developments in 2012 follows.

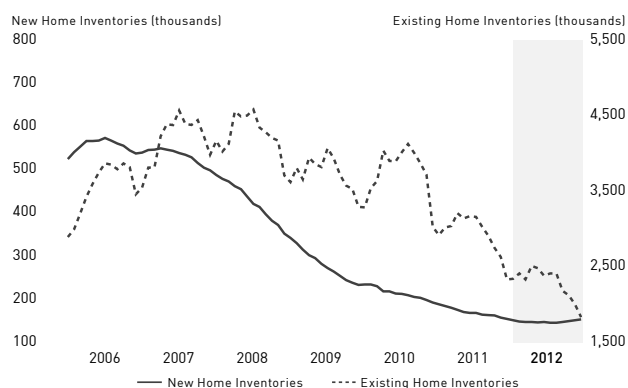
MARKETS AND PRICING

(i) SOLID WOOD - NORTH AMERICAN HOUSING SECTORS AND PRICES FLAT; ASIAN LUMBER DEMAND CONTINUES TO GROW

After a slow start to the year, lumber demand in North America improved steadily throughout 2012, with many leading indicators increasingly displaying signs of sustainable recovery. Demand from Asia remained solid with the Company's shipments to China reaching new record-highs. Benchmark lumber prices for both Western SPF and Southern Yellow Pine ("SYP") products saw substantial improvement, reflecting not only the improving fundamentals in the North American housing market but also overall growth in global demand for softwood lumber.

Sales of new and existing homes improved substantially in the second half of 2012, as job growth and reduced interest rates supported more home purchases. Levels of existing home inventories continued to drop through the year (as highlighted in Chart 1).

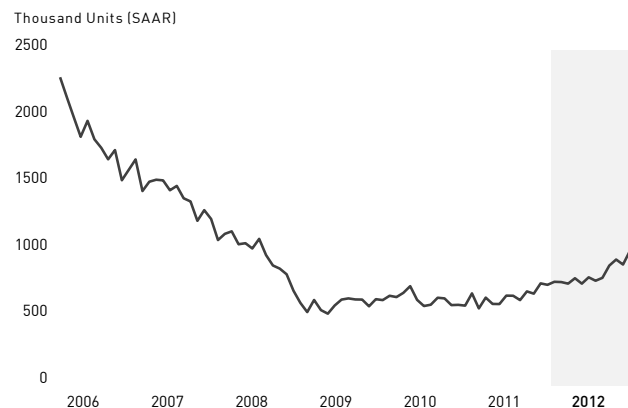
CHART 1 - NEW AND EXISTING HOME INVENTORIES IN U.S.



Source: National Association of Home Builders

Total U.S. housing starts were up substantially in 2012, with 780,000 starts¹ in the year compared to 609,000 in 2011, but remained approximately 25% below historical troughs in previous downturns and 20% below the average of the last six years (Chart 2). Both single family units and multifamily unit starts saw increases from 2011, with multifamily starts, which use a smaller proportion of lumber, leading the gains, increasing by 37% from last year versus single family starts, up 24%. A strong increase in starts in the fourth quarter, with starts averaging 954,000 units SAAR (seasonally adjusted annual rate) in December provided further evidence that a substantial housing recovery is now underway.

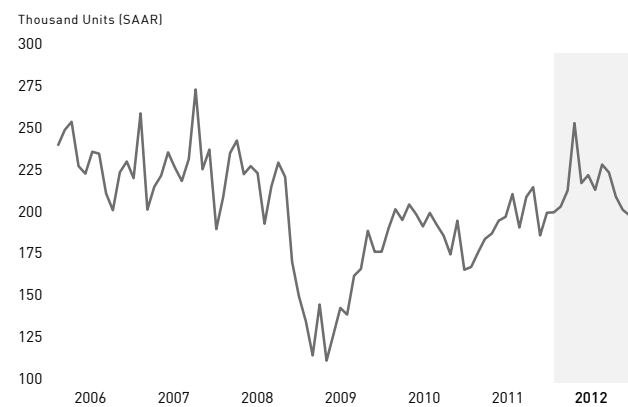
CHART 2 – U.S. HOUSING STARTS



Source: U.S. Bureau of the Census

The Canadian housing market remained strong through 2012, up 21,000 units² to 215,000 units compared to 194,000 in 2011 (Chart 3), although starts dipped late in the year partially in response to a recent tightening of Canadian mortgage rules.

CHART 3 – CANADIAN HOUSING STARTS



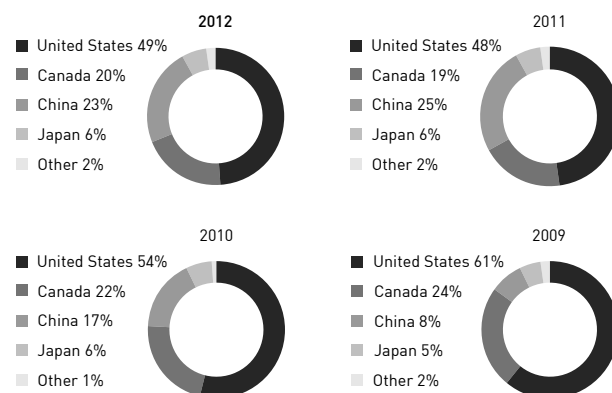
Source: Canada Mortgage and Housing Corporation

Accompanying the improvement in lumber demand in North America, which grew by 21% over 2011, was ongoing growth in Asian markets. Lumber shipments to China continued their strong growth trend, up 13% over the previous year, with shipments to Japan increasing 17% over the same period. Robust double-digit volume sales growth into China included greater consumption of prime grade products.

Complementary to the Company's strategy and adding to its continuing growth in total shipments to China was a continued increase in value-added product volume to a region which has historically been heavily weighted to more low grade lumber.

The shift in the Company's geographical sales mix is highlighted in Chart 4, which shows the progressive shift to a more globally balanced distribution of sales in support of strategic growth objectives in 2011 and 2012.

CHART 4 – CANFOR'S LUMBER SALES VOLUMES BY MARKET



The benchmark Western SPF 2x4 #2 & Better grade ("#2&Btr") price started the year at US\$254 per thousand board feet ("Mfbm")³, and trended steadily up throughout 2012, closing in December at a seven-year high of US\$370 per Mfbm. Benchmark pricing averaged US\$299 for 2012, a 17% improvement over the US\$255 per Mfbm average in 2011. Price levels for other dimensions and grades generally showed increases consistent with the benchmark level.

The Canadian dollar weakened marginally against the US dollar in 2012. On average the Canadian dollar was at \$1.001⁴, 1 cent, or 1%, lower than in 2011, which had a modest positive impact on sales realizations for all Canadian-produced exports.

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

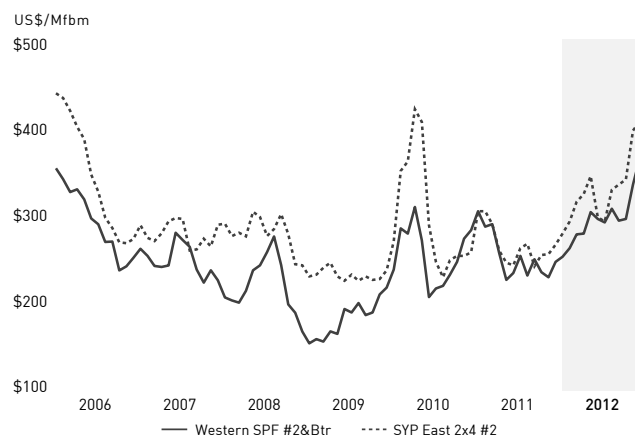
[2] Canada Mortgage and Housing Corporation ("CMHC")

[3] Random Lengths Publications, Inc.

[4] Bank of Canada

The benchmark 2x4 #2 price for SYP lumber in 2012 averaged US\$333 per Mfbm, up 24% compared to 2011 at US\$268 per Mfbm. After a steady increase in the first five months of 2012, SYP prices dipped for several months before rallying in the second half of 2012, (Chart 5), in contrast to 2011.

CHART 5 – U.S. WESTERN SPF 2X4 #2&BTR AND SYP EAST #2 LUMBER PRICE COMPARISON



Source: Random Lengths Publications, Inc.

Markets for OSB rallied in the latter part of 2012, with demand reflecting the housing upturn in the U.S. and to a lesser extent, the damage caused by Hurricane Sandy. Prices for OSB products averaged US\$270 per thousand square feet ("Msf")⁵ for the 2012 year, up US\$84 per Msf, or 45%, from the prior year, the relative increase reflecting both the increase in demand along with supply constraints as a result of long-term idled capacity.

(ii) PULP - CHALLENGING GLOBAL MARKETS CONTRIBUTE TO WEAKER PRICE ENVIRONMENT

2012 was a challenging year for global pulp markets as the ongoing financial crisis in Europe and slowing growth in China tempered global demand. Weak markets at the end of 2011 continued through the first quarter of 2012 before showing some signs of moderate improvement heading into the seasonally strong spring maintenance period. However, markets failed to gain any traction through the latter half of 2012, in spite of declines in inventories held by producers, largely due to weak demand in certain markets, notably Europe. In 2012, Pulp and Paper Products Council ("PPPC") reported annual softwood demand increased 3% from 2011. Bleached softwood shipments into China increased significantly, offsetting declines in Europe and North America and to some extent reflecting substitution of softwood pulp for hardwood pulp by Chinese buyers.

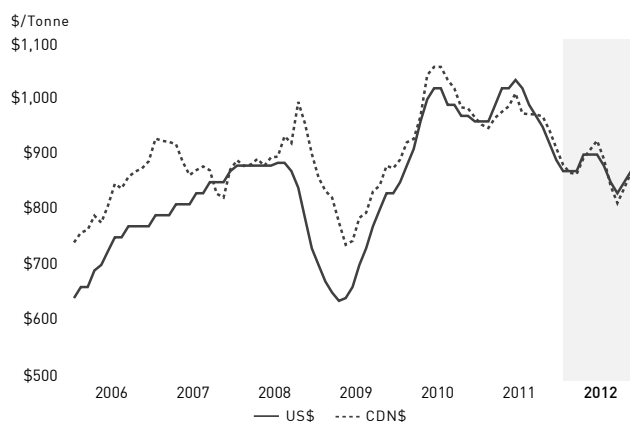
[5] Oriented Strand Board, North Central price, 7/16" [Source - Random Lengths Publications, Inc.]

[6] Resource Information Systems, Inc.

The benchmark North American list price for NBSK pulp averaged US\$872 per tonne⁶ for 2012, down US\$105, or 11%, from the prior year. More pronounced price decreases were seen for Europe and China of US\$140 to US\$170 per tonne, as a result of the weak European demand and strong competition for business in China. BCTMP prices averaged slightly higher in the beginning of 2012 compared to 2011, before declining in the second half of the year. The average price in 2012 was in line with 2011. Canadian dollar sales realizations for both NBSK and BCTMP products received a modest uplift from a weaker Canadian dollar.

The following charts show the NBSK price movements in 2012 (Chart 6) and the global pulp inventory levels (Chart 7), with prices and inventories trending down through most of the year.

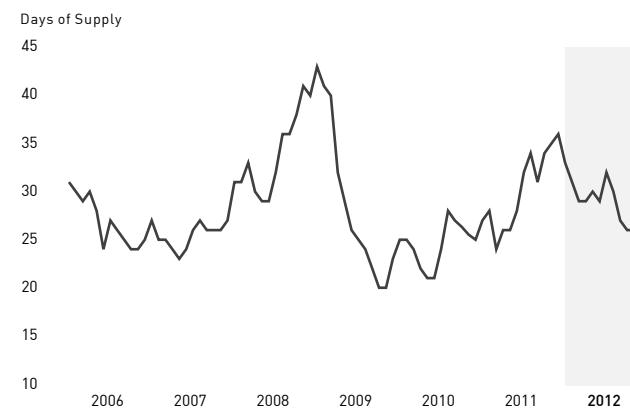
CHART 6 – NBSK PULP LIST PRICE DELIVERED TO U.S. - IN US AND CANADIAN DOLLARS



Source: Resource Information Systems Inc.

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

CHART 7 – WORLD SOFTWOOD PULP INVENTORIES



Source: Pulp and Paper Products Council

SOLID WOOD OPERATIONS

(i) COMPANY ACHIEVES “ORGANIC” AND EXTERNAL GROWTH; STRATEGIC CAPITAL SPENDING THROUGH 2012 DELIVERING ONGOING BENEFITS

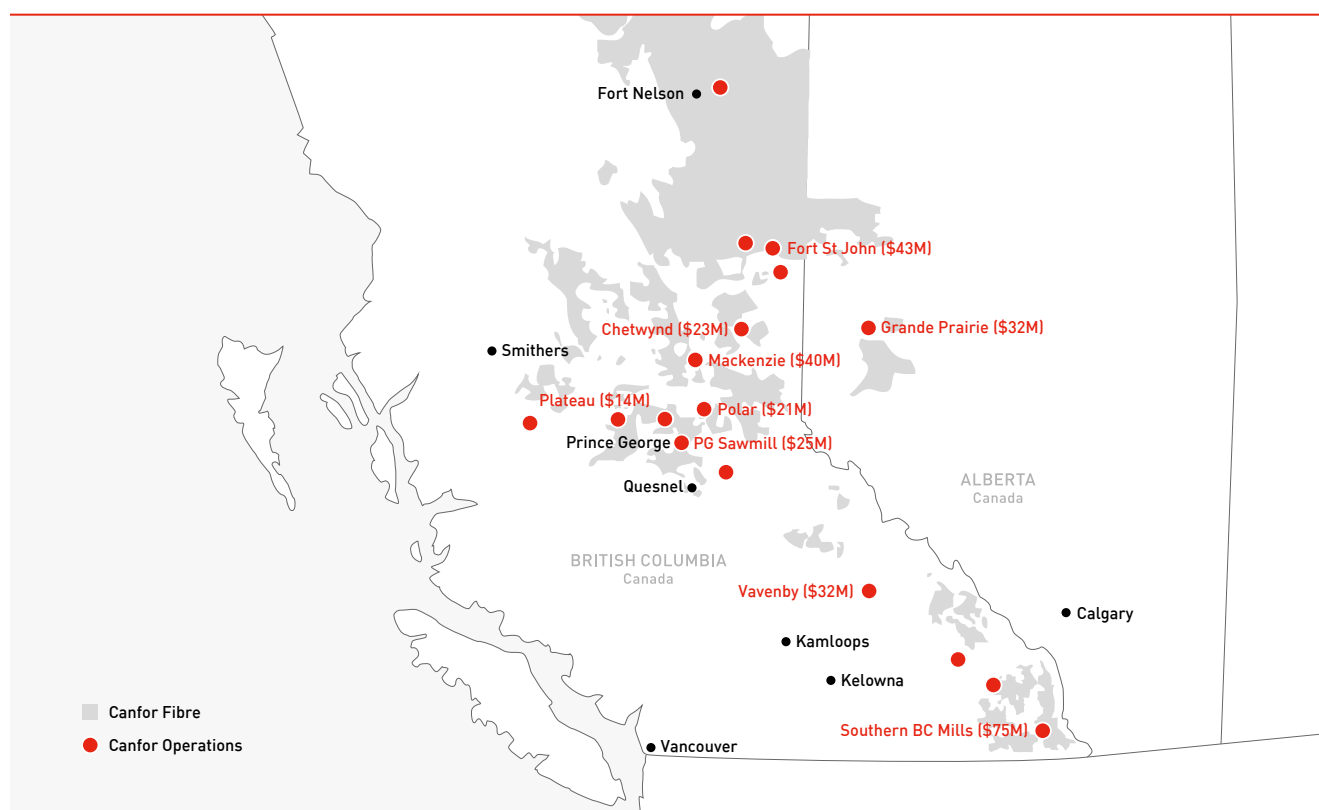
The Company’s confidence in the longer-term prospects of the lumber industry has driven an investment strategy in various facility upgrades to position itself as a top-quartile industry performer going into the lumber market recovery. In support of this objective, the Company continued with the implementation of its \$300 million strategic capital initiatives at its sawmills aimed at enhancing the quality and value offering of products to its customers from a top tier productivity and cost position. Including the recently announced \$40 million capital improvement project at the Company’s Mackenzie sawmill, the program is approximately 75% complete.

In addition to its strategic capital and continuous improvement initiatives, the Company in March 2012 successfully completed the acquisition and integration of Tembec’s southern BC Interior wood products assets (the “Kootenay sawmills acquisition”), for a purchase price of \$66 million, which included a payment on account of net working capital and excluded certain liabilities retained by Tembec. The purchase included Tembec’s Elko and Canal Flats sawmills, approximately 1.1 million cubic metres of combined Crown, private land and contract allowable cut, and a long-term agreement to provide residual fibre supply for Tembec’s Skookumchuck pulp mill.

2012 also saw the restart of another previously idled sawmill operation, the Company’s Radium sawmill, which had been idle since mid-2009, was upgraded during 2012 and recommenced operations in October 2012. This restart followed successful restarts in 2009, 2010 and 2011 of the Company’s upgraded Mackenzie, Chetwynd and Vavenby sawmills. These three mills operated on two shifts through 2012 and delivered solid increases in financial performance through the year.

Capital spending in the lumber segment for 2012 totalled \$111 million and included the major sawmill and planer rebuild at Radium ahead of the mill’s restart, and major planer rebuilds at the Grande Prairie and Prince George sawmills. The Company also completed various other planer upgrades during the year and added kiln drying capacity at selected operations as production increased.

The Company’s strategic capital investments are designed to capitalize on its strong fibre position in many regions of the BC Interior. The Kootenay sawmills acquisition reinforces the Company’s strong fibre position, providing access to significant volumes of high quality fibre. The Company plans to continue its investment in its BC Southern Interior mill facilities with its recently announced \$40 million upgrade plans at the Elko facility. The following chart shows the location of the Company’s timber licenses in BC and the locations of the sawmills with significant recent and future planned capital upgrades.



(ii) CONTINUED FOCUS ON STRONG OPERATIONAL PERFORMANCE

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

A. PRODUCT QUALITY / VALUE

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

The Company also has in place, or takes part in, various initiatives designed to promote the benefits of the use of lumber products by developers and end users. This includes initiatives to promote the environmental qualities of the use of lumber, and also industry wide programs, such as the Blue Ribbon Commission for Softwood Lumber Check-Off program in the U.S., to promote wood as a building product.

B. UNIT MANUFACTURING COSTS

The Company continues to remain focused on ensuring a strong operational performance at all of its operations, with continuous improvement initiatives in place, complementing and maximizing the benefits from capital upgrades. Further improvements were seen in unit conversion costs in 2012 compared to the prior year. The positive impact of capital upgrades on the Company's cost structure, in the form of productivity gains, and lower energy costs were significant factors in the cost improvement realized in 2012.

This improved operational performance partially mitigated the impacts of ongoing upward pressure on log costs in the Company's BC operations in 2012. Continued lumber market improvement, increased upward pressures on non-quota timber, and a shift out of the Mountain Pine Beetle dominated log profile of the past several years has resulted in increases to both stumpage and hauling costs in BC operations. Added costs for road building and block development also resulted from the improving higher-value fibre profile shift. The company's U.S. operations realized log cost reductions reflecting a strong supply of timber in the regions in which the Company operates and declining pulp market conditions which eased competition for log procurement.

C. RESIDUAL FIBRE REVENUE

Residual fibre revenue for the Company relates principally to the sale of sawmill residual chips to be used in the manufacture of pulp products. Prices for sawmill residual chips are typically based on a pricing formula with a number of inputs, predominantly driven by market prices for pulp products. Increased sawmill residual chip revenues in 2012 reflected higher operating rates and the incremental volume associated with the Kootenay sawmills acquisition, but reduced prices in comparison to the prior year largely offset the volume-driven revenue gains.

Other residual fibre products also hold value, and the Company continued to focus on extracting maximum value from these sources in 2012, increasing its revenue stream from sawdust and shavings. In addition, the Company now

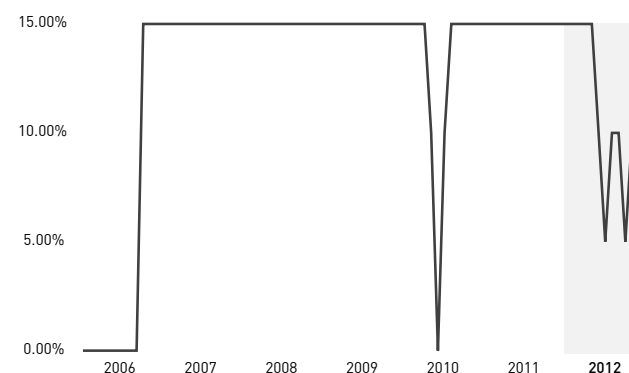
has modern energy systems at the significant majority of its sawmills that make use of other residual fibre products, such as bark hog, which have resulted in significantly reduced energy costs and dependence on fossil fuels. The Company's 2012 results included a full year of the Canfor Green Energy ("CGE") operation, a biomass energy generation facility, which provides "green" electricity to the Company's Grande Prairie sawmill and external customers and heat to the Grande Prairie sawmill kilns.

(iii) SOFTWOOD LUMBER AGREEMENT

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

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

CHART 8 – SLA EXPORT TAX



Source: Canada Revenue Agency

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

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

(iv) IMPACTS OF MOUNTAIN PINE BEETLE (“MPB”) REMAIN SIGNIFICANT; COMPANY CONTINUING TO MITIGATE IMPACT

The Company continued to process a large volume of dry MPB killed logs in 2012, and to minimize the impact on its operations through further application of new technology and best practices. The Company plans to continue salvaging dead fibre before the end of its commercial shelf life, which can vary between 3 and 15 years depending on soil moisture levels.

Once the salvage of dead pine is complete, it is anticipated that the current elevated Annual Allowable Cut (“AAC”) levels in certain BC Interior regions where the MPB presence is high will be adjusted downward. In some areas, this adjustment will be significant to reflect lower mature inventory levels of surviving pine, offset in part by higher inventories of unaffected non-pine species such as spruce, balsam fir and Douglas-fir stands, where strict harvesting limits are currently in force. In 2010, the Chief Forester for the Province of BC commenced AAC reviews for six timber supply areas (“TSAs”), with Canfor having operations in five of these. In January 2011, the Chief Forester released his determinations for the Prince George and Quesnel TSAs which resulted in AAC reductions of 16% and 24%, respectively, for these areas, with most of the reductions coming from the temporary MPB uplift in AAC. These AAC reductions did not have an impact on the Company’s licenses. In addition, the Chief Forester for the Province of BC reduced the AAC in the Lakes TSA by approximately 38%, which also had no impact on Canfor. The Company does not expect that determinations for the remaining TSAs will significantly impact the AAC at its other operations in the near term; however, it is anticipated that future determinations in the longer term will impact the Company’s licenses, although it is currently unclear as to how much this might be.

On July 1, 2010, the Ministry of Forests and Range implemented changes to the BC Interior market pricing system for timber. These changes dealt with issues raised by the MPB epidemic and included: the introduction of stand-as-a-whole pricing with cruise-based billing for MPB damaged timber; and, from a stumpage distribution perspective, the transition over two years to a system more sensitive to market forces. For stands with 35% or more MPB damaged timber, a single stumpage rate is established with billing based on a cruise measurement (estimate) rather than scaling. For these stands, determination of log grades is no longer necessary. An impact of these changes is to increase the overall market sensitivity of BC Interior timber pricing and to improve the utilization of low value material. These changes are consistent with the 2006 Softwood Lumber Agreement.

Compared to three years ago, largely as a result of the Company’s strategic capital initiative and the Kootenay acquisition, the Company is now processing a significantly lower volume of MPB infected fibre at its Western SPF operations.

(v) CLOSED AND INDEFINITELY IDLED OPERATIONS

In 2011 the Company closed, or announced the closing of, three of its operations in response to the continued difficult market conditions for solid wood products, and fibre supply challenges relating to the MPB impact. In January 2011 the Clear Lake lumber operation was permanently closed due to weak prices for stud lumber and a lack of economical long-term fibre available to that mill. In January 2012 the Rustad sawmill and Tackama plywood plant were permanently closed due to

a combination of MPB fibre challenges (Rustad), the difficult market conditions and the level of capital investment required to make both operations economically viable.

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

PULP AND PAPER OPERATIONS

The pulp operations were impacted significantly in 2012 as a result of the aforementioned outages at the Prince George Pulp Mill and Northwood Pulp Mill, which resulted in a reduction in pulp production and shipments in 2012. Both mills experienced slower-than-anticipated ramp ups in the period following the outages but operating rates saw a solid improvement in the fourth quarter of 2012. Unit manufacturing costs increased slightly in 2012 as the impact of lower production volumes and increased spending, including maintenance and one-time costs associated with the new five year collective labour agreements, more than offset lower fibre costs.

In October 2009, the Canadian federal government announced the introduction of a Pulp and Paper Green Transformation Program (the “Program”) designed to reimburse funds spent by Canadian kraft pulp producers on qualifying energy and environmental capital projects. CPPI was allocated \$122.2 million from this Program, most of which related to the installation of a recovery boiler and precipitator upgrade at the Northwood Pulp Mill. At the end of 2011, CPPI had spent its full allocation under the Program, and during 2012, CPPI received remaining outstanding reimbursements under the Program totaling \$19.7 million. The completion of these projects and other capital projects over the past three years has positioned the pulp operations to maintain its top quartile position in the industry and enabled the Company to continue with its near term strategy of growing the energy business. Looking forward, the capital spending focus will be on growing the energy side of the Company’s business. To that end, an Energy Purchase Agreement with BC Hydro was announced in December 2012 and is scheduled to commence upon completion of upgrades to the turbines at the Northwood Pulp Mill. The turbine upgrades are scheduled for completion by the end of 2013.

In 2012, CPPI spent an additional \$87.6 million on capital projects including upgrades to the boiler and feedwater treatment system and replacement of the recovery boiler lower furnace at the Prince George Pulp and Paper Mill, along with other maintenance capital.

CANFOR AND CPPI INTEGRATION

In mid-2012, the Company and CPPI announced leadership changes focused on integration and greater alignment in several key business areas including transportation and logistics, fibre management and procurement and finance and administration. Integration-to-date has gone very smoothly and both companies are seeing the benefits of a more collaborative and streamlined approach and from leveraging the expertise of both companies. Total cost savings of approximately \$10 million are projected to be realized in 2013.

OVERVIEW OF CONSOLIDATED RESULTS – 2012 COMPARED TO 2011

SELECTED FINANCIAL INFORMATION AND STATISTICS⁷

| (millions of dollars, except for per share amounts) | 2012 | 2011 |
|---|------------|------------|
| Sales | \$ 2,714.1 | \$ 2,421.4 |
| Operating income before amortization | \$ 264.1 | \$ 181.2 |
| Operating income | \$ 76.9 | \$ 11.9 |
| Foreign exchange gain (loss) on long-term debt and investments, net | \$ 4.7 | \$ (5.0) |
| Gain (loss) on derivative financial instruments ⁸ | \$ (0.8) | \$ 3.5 |
| Net income | \$ 41.4 | \$ 10.8 |
| Net income (loss) attributable to equity shareholders of Company | \$ 32.1 | \$ (56.6) |
| Net income (loss) per share attributable to equity shareholders of Company, basic and diluted | \$ 0.22 | \$ (0.40) |
| ROIC – Consolidated ⁹ | 3.7% | (3.4)% |
| Average exchange rate (US\$/CDN\$) ¹⁰ | \$ 1.001 | \$ 1.011 |

(7) Certain prior period amounts have been restated due to a change in accounting policy for treatment of net interest expense for defined benefit post-retirement plans. Further details can be found in the "Changes in Accounting Policy" section later in this document.

(8) Includes gains (losses) from energy, foreign exchange, lumber price and interest rate derivatives (see "Unallocated and Other Items" section for more details).

(9) Consolidated Return on Invested Capital ("ROIC") is equal to operating income/loss, plus realized gains/losses on derivatives and other income/expense, all net of minority interest, divided by the average invested capital during the year. Invested capital is equal to capital assets, plus long-term investments and net non-cash working capital, all excluding minority interest components.

(10) Source – Bank of Canada (average noon rate for the period).

| (millions of dollars) | 2012 | 2011 |
|--|------------|------------|
| Operating income (loss) by segment: | | |
| Lumber | \$ 75.4 | \$ (81.5) |
| Pulp and Paper | \$ 26.6 | \$ 152.9 |
| Unallocated and Other | \$ (25.1) | \$ (59.5) |
| Total operating income | \$ 76.9 | \$ 11.9 |
| Add: Amortization | \$ 187.2 | \$ 169.3 |
| Total operating income before amortization | \$ 264.1 | \$ 181.2 |
| Add (deduct): | | |
| Working capital movements | \$ (75.3) | \$ (5.6) |
| Salary pension plan contributions | \$ (35.7) | \$ (37.3) |
| Other operating cash flows, net ¹¹ | \$ (21.9) | \$ 24.7 |
| Cash from operating activities | \$ 131.2 | \$ 163.0 |
| Add (deduct): | | |
| Finance expenses paid | \$ (19.5) | \$ (18.9) |
| Distributions paid to non-controlling interests | \$ (15.9) | \$ (91.0) |
| Capital additions, net ¹² | \$ (245.7) | \$ (236.7) |
| Proceeds from sale of asset-backed commercial paper ("ABCP") | \$ 12.9 | \$ 29.8 |
| Drawdown (repayment) of long-term debt | \$ 50.1 | \$ (81.9) |
| Other, net | \$ 16.3 | \$ 4.3 |
| Change in cash / operating loans | \$ (70.6) | \$ (231.4) |

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

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

ANALYSIS OF SPECIFIC ITEMS AFFECTING COMPARABILITY OF SHAREHOLDER NET INCOME (LOSS)

| After-tax impact, net of non-controlling interests (millions of dollars, except for per share amounts) | 2012 | 2011 |
|---|-----------|-----------|
| Shareholder Net Income (Loss) | \$ 32.1 | \$ (56.6) |
| Foreign exchange (gain) loss on long-term debt and investments, net | \$ (3.1) | \$ 3.3 |
| (Gain) loss on derivative financial instruments | \$ 1.2 | \$ (3.3) |
| Restructuring charges for management changes | \$ 1.5 | \$ 2.6 |
| Increase in fair value of asset-backed commercial paper | \$ (1.1) | \$ (0.2) |
| Costs related to Tembec acquisition | \$ 2.8 | \$ - |
| Asset impairment charges | \$ 0.6 | \$ 5.5 |
| Net gain on post retirement and pension plan amendments | \$ (7.1) | \$ - |
| Mill closure provisions | \$ - | \$ 17.0 |
| Net impact of above items | \$ (5.2) | \$ 24.9 |
| Adjusted shareholder net income (loss) | \$ 26.9 | \$ (31.7) |
| Shareholder net income (loss) per share, as reported | \$ 0.22 | \$ (0.40) |
| Net impact of above items per share | \$ (0.04) | \$ 0.18 |
| Adjusted shareholder net income (loss) per share | \$ 0.18 | \$ (0.22) |

The Company recorded net income attributable to equity shareholders of \$32.1 million, or \$0.22 per share, for the year ended December 31, 2012, a positive variance of \$88.7 million, or \$0.62 per share, from a shareholder net loss of \$56.6 million, or \$0.40 per share, reported for the year ended December 31, 2011.

After taking account of specific items affecting comparability with prior periods, the Company's 2012 adjusted shareholder net income was \$26.9 million, or \$0.18 per share, a positive variance of \$58.6 million, or \$0.40 per share, compared to similarly adjusted shareholder net loss of \$31.7 million, or \$0.22 per share, for 2011.

Reported operating income for 2012 was \$76.9 million, up \$65.0 million from operating income of \$11.9 million for 2011. Included in operating income for the current year are costs related to the Kootenay sawmills acquisition of \$3.8 million, restructuring costs of \$2.8 million related to changes in the Company's management group and the integration of CPPI, asset impairment charges of \$0.8 million on certain damaged panel assets and positive inventory valuation adjustments of \$15.5 million. Operating income for 2012 also included a pre-tax accounting gain of \$11.4 million reflecting amendments to the Company's salaried post retirement benefit plans and net of settlement losses related to its Rustad pension plan.

Operating income in 2011 included restructuring costs of \$22.5 million related to the announced closures of the Rustad sawmill and Tackama Plywood plant, asset impairment charges of \$9.2 million on certain lumber and panel assets and negative inventory valuation adjustments of \$12.3 million. Excluding these items, operating income for 2012 was \$57.4 million, up \$1.5 million from similarly adjusted operating income of \$55.9 million in 2011.

Operating results were favourably impacted by improved average lumber sales realizations which reflected a 19% and 26% increase in 2x4 benchmark price levels for SPF and SYP, respectively. In addition to the improvement in the lumber market, overall results were further boosted by operational cost improvements in the year. These gains were partially offset by increased log costs corresponding to lumber market-related stumpage factors, and lower sawmill residual chips reflecting a 13% reduction in NBSK pulp benchmark pricing.

A more detailed review of the Company's operational performance and results is provided in "Operating Results by Business Segment – 2012 compared to 2011", which follows this overview of consolidated results.

OPERATING RESULTS BY BUSINESS SEGMENT – 2012 COMPARED TO 2011

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

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

LUMBER

SELECTED FINANCIAL INFORMATION AND STATISTICS – LUMBER

Summarized results for the Lumber segment for 2012 and 2011 are as follows:

(millions of dollars, unless otherwise noted)

| | 2012 | 2011 |
|---|------------|------------|
| Sales | \$ 1,711.8 | \$ 1,317.1 |
| Operating income before amortization | \$ 177.2 | \$ 2.4 |
| Operating income (loss) | \$ 75.4 | \$ (81.5) |
| Negative (positive) impact of inventory valuation adjustments | \$ (13.5) | \$ 12.4 |
| Costs related to Tembec acquisition | \$ 2.5 | \$ - |
| Mill closure provisions | \$ - | \$ 11.9 |
| Asset impairment charges | \$ - | \$ 7.2 |
| Operating income (loss) excluding impact of inventory valuation adjustments and unusual items | \$ 64.4 | \$ (50.0) |
| Capital expenditures | \$ 110.9 | \$ 155.3 |
| Average SPF 2x4 #2&Btr lumber price in US\$ ¹³ | \$ 299 | \$ 255 |
| Average SPF price in Cdn\$ | \$ 299 | \$ 252 |
| Average SYP 2x4 #2 lumber price in US\$ ¹⁴ | \$ 333 | \$ 268 |
| Average SYP price in Cdn\$ | \$ 333 | \$ 265 |
| U.S. housing starts (thousand units) ¹⁵ | 780 | 609 |
| Production – SPF lumber (MMfbm) | 3,857.5 | 3,134.3 |
| Production – SYP lumber (MMfbm) | 479.1 | 431.3 |
| Shipments – Canfor-produced SPF lumber (MMfbm) ¹⁶ | 3,867.5 | 3,182.8 |
| Shipments – Canfor-produced SYP lumber (MMfbm) ¹⁶ | 511.8 | 449.9 |
| Shipments – wholesale lumber (MMfbm) | 54.7 | 140.5 |

(13) Western Spruce/Pine/Fir, per thousand board feet [Source – Random Lengths Publications, Inc.]

(14) Southern Yellow Pine, Eastside, per thousand board feet [Source – Random Lengths Publications, Inc.]

(15) Source – U.S. Census Bureau

(16) Includes shipments of lumber purchased for remanufacture

OVERVIEW

The Lumber segment reported operating income of \$75.4 million for 2012, up \$156.9 million from an operating loss of \$81.5 million in 2011. Results for 2012 were favourably impacted by inventory valuation adjustment of \$13.5 million, compared to an adverse impact of \$12.4 million in 2011. This was partially offset by acquisition costs of \$2.5 million related to the Kootenay sawmills acquisition completed in the first quarter of 2012.

Excluding the above noted items, operating income was \$64.4 million, a \$114.4 million improvement from the prior year. For the most part, the increase was attributable to higher sales realizations, reflecting improved demand and market prices augmented by improved manufacturing costs and to some extent by the weaker Canadian dollar, but partially offset by higher delivered log costs. The 2012 results also reflected an accounting gain of \$5.6 million related to the aforementioned post retirement and pension plan adjustments.

MARKETS

Canfor's total lumber sales volume for 2012 was over 4.4 billion board feet, compared to almost 3.8 billion for 2011, with SPF and SYP making up 88% and 12% of total 2012 sales volumes, respectively. In 2012, the lumber market exhibited the first consistent signs of improvement since the U.S. housing downturn began. Throughout the year, the supply of new and existing homes dropped considerably while record-high home affordability and increasing customer confidence supported increased homebuilding activity, particularly in the second half of the year. U.S. housing starts finished the year strongly at 954,000 SAAR units and averaged 780,000 units for 2012, an increase of 28% from 2011. The strength of the housing starts was led primarily by multifamily starts, which consume a smaller proportion of lumber, gaining 37% from last year versus gains in single Family starts at 24%.

In Canada, lumber consumption was solid in 2012 with housing starts at 215,000 units, up 21,000 units, or 11%, compared to 2011, dipping late in the year partially in response to tightening of Canadian mortgage lending rules.

Offshore lumber markets demand continued to trend higher compared to the previous year. Canfor's total shipments were strong across all major offshore markets as volumes increased by 15% versus 2011. Robust double-digit volume sales growth into China included greater consumption of prime grade products.

SALES

Lumber segment revenues of \$1.7 billion for 2012 were up \$395 million, or 30%, compared to 2011, reflecting a combination of increased sales volumes and higher unit sales realizations. Total shipments were just over 4.4 billion board feet for the year, up 16% from 3.8 billion board feet shipped in the previous year. The Western SPF lumber 2x4 #2&Btr Random Lengths price averaged US\$299 per Mfbm, a US\$44 per Mfbm or 17% increase over the previous year. Similar increases were seen across the dimension and grade profile as can be seen from the following table which shows benchmark Random Lengths prices for selected key grades and widths of Western SPF Lumber:

(Average Western SPF US\$ price, per thousand board feet)

| | 2012 | 2011 |
|------------|--------|--------|
| 2x4 #2&Btr | \$ 299 | \$ 255 |
| 2x4 #3 | \$ 250 | \$ 217 |
| 2x6 | \$ 301 | \$ 255 |
| 2x10 | \$ 344 | \$ 286 |

The 1% decrease in the average value of the Canadian dollar versus the US dollar for 2012 compared to 2011 contributed marginally to increased overall Canadian dollar sales realizations. Freight costs showed a modest increase compared to the prior year, reflecting increased shipment volume as well as increased rail rates.

Prices for SYP products were also well up in the year, with the benchmark 2x4 #2 price up US\$65, or 24%, over 2011 to US\$333 per Mfbm.

Total residual fibre revenue for 2012 was up from the prior year, reflecting increased sales volumes with significant offsetting reduction in average chip prices related to pulp price reductions.

EXPORT TAXES

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

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

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

For 2012, the export tax rate on lumber shipments from BC to the U.S. averaged 11%. Alberta's shipments attracted an average export tax rate of 12%, which reflected a surge rate of 2.5% for two months during that period. In 2011, the BC export tax rate was 15% while shipments from Alberta attracted a surge rate of 22.5% for most of the year. The average RLCP for 2012 was US\$322 per Mfbm, up US\$50 from US\$272 per Mfbm in 2011. At December 31, 2012, the RLCP was US\$381 per Mfbm.

Total export tax paid by the Company in 2012 was \$45.5 million, up \$5.6 million from 2011 with the year-to-year change, principally reflecting higher prices and a 25% increase in sales volumes from Western Canadian operations in 2012, partly offset by the lower average export tax rate.

OPERATIONS

Total lumber production for 2012 was 4.3 billion board feet, up over 770 million board feet, or 22% from 2011. Increased production reflected the Kootenay sawmills acquisition, internal expansion and the restart of previously idled facilities. Production in 2012 reflected nine months of production from the acquired Canal Flats and Elko lumber operations. The positive impact of increased productivity, related to both capital upgrades and continuous improvement initiatives were also realized during the year. A full year of operations in 2012 for the Company's Vavenby facility along with production attributable to the restart of its Radium operations in the fourth quarter also contributed to production increases in 2012.

Total lumber unit manufacturing costs were up from the previous year, with lower unit conversion costs being more than offset by the impact of higher unit log costs at Western SPF operations. The improved unit conversion costs largely reflected the productivity gains in the current year and the increasingly positive impact on the Company's cost structure of capital upgrades through the last three years. Unit log costs in 2012 saw measured increases, consistent with market-price driven stumpage factors, increased road building activity, positive log profile changes and increased haul distances.

PULP AND PAPER

SELECTED FINANCIAL INFORMATION AND STATISTICS – PULP AND PAPER¹⁷

Summarized results for the Pulp and Paper segment for 2012 and 2011 are as follows:

(millions of dollars, unless otherwise noted)

| | 2012 | 2011 |
|--|----------|------------|
| Sales | \$ 923.5 | \$ 1,057.5 |
| Operating income before amortization | \$ 95.6 | \$ 220.9 |
| Operating income | \$ 26.6 | \$ 152.9 |
| Capital expenditures | \$ 88.7 | \$ 156.2 |
| Average pulp price delivered to U.S. - in US\$ ¹⁸ | \$ 872 | \$ 977 |
| Average pulp price in Cdn\$ | \$ 871 | \$ 966 |
| Production – pulp (000 mt) | 1,169.9 | 1,200.0 |
| Production – paper (000 mt) | 130.2 | 136.5 |
| Shipments – Canfor-produced pulp (000 mt) | 1,176.6 | 1,188.7 |
| Shipments – paper (000 mt) | 129.1 | 127.6 |

[17] Includes Taylor pulp mill and 100% of CPPI, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.

[18] Per tonne, NBSK pulp list price delivered to U.S. [Resource Information Systems, Inc. - "RISI"].

OVERVIEW

Operating income for the pulp and paper segment for 2012 was \$26.6 million, down \$126.3 million from \$152.9 million in 2011. Results in the current year were significantly impacted by lower market pulp prices, lower shipment volumes, and the impact of the extended maintenance outage at the Prince George Pulp Mill and the unscheduled outage at the Northwood Pulp Mill, while results in 2011 were impacted by an extended maintenance outage at the Northwood Pulp Mill. Unit manufacturing costs were also up slightly reflecting lower production volumes, higher maintenance expenditures and one-time costs of \$3.2 million associated with new five year collective labour agreements in 2012, partially offset by lower fibre costs. Also included in 2012's pulp and paper segment results was \$4.0 million of the accounting gain related to the post retirement plan adjustments.

NBSK pulp list prices decreased significantly from the prior year, with prices to North America down US\$105 to US\$872 per tonne. Sales realizations were positively impacted by the 1% weaker Canadian dollar compared to the previous year.

MARKETS

Global softwood pulp markets entered 2012 with pulp inventories held by producers and customers at elevated levels. Inventory levels decreased through the first quarter of 2012 driven by stronger demand from China and constrained supply heading into the annual spring maintenance period allowing pricing to gain traction, particularly in China. Through the latter half of 2012 inventory levels increased through the seasonally slow summer period, returning to normal or balanced levels through the fourth quarter and down overall compared to the end of 2011; however markets remained under pressure due to weak global demand, particularly in Europe. Global softwood pulp pricing closed as it had opened the year, relatively unchanged.

Pulp and Paper Products Council ("PPPC") statistics reported decreased global demand for printing and writing papers of 2% in 2012 compared to 2011. PPPC also reported an increase in shipments of bleached softwood sulphate pulp of 3% in 2012, with increased shipments to China offset by reduced shipments to Europe and North America.

At the end of December 2012, World 20¹⁹ producers of bleached softwood pulp inventories were at 29 days of supply. By comparison, December 2011 inventories were at 36 days of supply.

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

SALES

Shipments of Canfor-produced pulp were 1.2 million tonnes for 2012, down approximately 12,000 tonnes, or 1%, from the prior year. For the most part, the decrease reflected a reduction in market pulp available for sale due to the impact of the extended maintenance outage at the Prince George Pulp Mill and the unscheduled outage at the Northwood Pulp Mill.

North American NBSK pulp list prices averaged US\$872 per tonne in 2012, down over US\$100, or 11%, from the 2011 average of US\$977 per tonne. NBSK pulp list prices saw even larger decreases in other regions with the Northern Europe benchmark price down over US\$140 per tonne and China pricing falling US\$166 per tonne. North American NBSK pulp list prices ended the year at US\$870 per tonne, down US\$20, or 2% from the end of 2011. A positive impact on sales realizations from a 1% weaker Canadian dollar was more than outweighed by increased shipments to lower-margin regions. BCTMP prices were largely unchanged year-over-year with a slight improvement in prices early in 2012 offset by declining prices later in the year.

Results for paper operations were improved from the prior year, due in part to lower slush pulp costs, reflecting lower market pulp prices, partially offset by lower paper sales realizations. Further contributing to the positive results was a slight increase in paper shipments to 129,000 tonnes.

UNALLOCATED AND OTHER ITEMS

(millions of dollars)

| | 2012 | 2011 |
|---|-----------|-----------|
| Operating income (loss) of Panels operations ²⁰ | \$ 2.0 | \$ (33.8) |
| Corporate costs | \$ (27.1) | \$ (25.7) |
| Finance expense, net | \$ (24.7) | \$ (26.0) |
| Foreign exchange gain (loss) on long-term debt and investments, net | \$ 4.7 | \$ (5.0) |
| Gain (loss) on derivative financial instruments | \$ (0.8) | \$ 3.5 |
| Other income (expense), net | \$ (0.4) | \$ 5.9 |

[20] The Panels operations include the Peace Valley OSB (Oriented Strand Board) joint venture, the only facility currently operating, and the Company's Tackama plywood plant, which was closed in January 2012, and its PolarBoard OSB plant, which is currently indefinitely idled.

OPERATING INCOME (LOSS) OF PANELS OPERATIONS

The panels operations reported operating income of \$2.0 million for 2012, compared to a loss of \$33.8 million for the previous year. Results for 2012 included \$0.8 million in impairment charges related to damage to an asset held by the operation and inventory valuation adjustments of positive \$2.0 million. Results for 2011 included an expense of \$10.6 million relating to the announced closure of the Tackama plywood plant, as well as an asset impairment charge of \$2.0 million relating to other idled panels assets. Excluding the impact of these items, the operating income of panels operations was \$0.8 million for 2012, a positive variance of \$22.0 million from a similarly adjusted operating loss in 2011 of \$21.2 million.

The increase in operating results from 2011 reflects a significant uptick in OSB markets, as evidenced by a US\$84 per thousand square foot ("msf"), or 45%, increase in the average benchmark OSB North Central 7/16" price to US\$270 per msf. The improved markets supported strong price increases in 2012. Prices rose sharply at the end of the fourth quarter of 2012, due to the improving housing market and the damage caused by Hurricane Sandy, closing the year at a peak of US\$355 per msf. In contrast, prices in 2011 generally remained in the range of US\$170 to US\$200 per msf. Unit manufacturing costs saw an 8% increase from the prior year as a result of increases to unit log and cash conversion costs, the latter

OPERATIONS

Pulp production was just under 1.2 million tonnes in 2012, down 30,000 tonnes, or 2.5%, compared to the prior year. The lower production was mainly attributable to the extended maintenance outage at the Prince George Pulp Mill and the unscheduled outage at the Northwood Pulp Mill, partially offset by an increase in BCTMP production. The maintenance outage at the Prince George Pulp Mill was extended to complete several major maintenance and capital projects including the final project partially funded under the Canadian Federal Government's Green Transformation Program. The unscheduled shutdown of a recovery boiler at the Northwood Pulp Mill in the second quarter of 2012 and subsequent repairs resulted in a reduction in overall production of approximately 31,000 tonnes.

Unit manufacturing costs increased marginally compared to the prior year due primarily to lower production volumes related to the aforementioned outages, as well as the one-time costs associated with the new five year collective labour agreements and higher chemical prices. These increased costs were partially offset by lower fibre costs mostly related to lower-cost sawmill residual chips, where prices are linked to NBSK pulp sales realizations.

reflecting rising wax and resin costs coupled with increased maintenance spending.

CORPORATE COSTS

Corporate costs, which comprise corporate, head office and certain information technology costs, were \$27.1 million in 2012, up \$1.4 million from 2011. The increase for the most part reflected higher share-based compensation expense and costs related to the acquisition of the Kootenay area sawmills in the current year, partially offset by lower severance and restructuring costs following changes in the management group in 2011. 2012's corporate costs also reflected a portion of the accounting gain recorded due to amendments to the Company's salaried post retirement benefit plans.

FINANCE INCOME AND EXPENSE

Net finance expense for 2012 was \$24.7 million, down \$1.3 million from 2011. The decrease was in part the result of lower long-term debt levels following repayments made in 2011 and 2012 and costs recorded in 2011 in connection with an extension of the Company's main operating loan. These reductions were offset in part by costs associated with the Company's new \$100 million term debt and CPPI's new operating loan facility as well as reduced interest income as a result of lower cash balances.

FOREIGN EXCHANGE GAIN (LOSS) ON TRANSLATION OF LONG-TERM DEBT AND INVESTMENTS

The Canadian dollar ended 2012 slightly above par compared to the US dollar, and up more than 2 cents, or 2%, from a year earlier. As a result, the Company recorded a foreign exchange translation gain on its US dollar denominated debt less investments of \$4.7 million in 2012 (2011 – loss of \$5.0 million).

GAIN (LOSS) ON DERIVATIVE FINANCIAL INSTRUMENTS

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

For 2012, the Company recorded a net loss of \$0.8 million related to its derivative financial instruments, principally reflecting losses on lumber futures and interest rate swaps in the period, offset by gains on foreign exchange forward contracts and collars.

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

Gain (Loss) on Derivative Financial Instruments:

| (millions of dollars) | 2012 | 2011 |
|--|----------|----------|
| Foreign exchange collars and forward contracts | \$ 3.2 | \$ (2.7) |
| Energy derivatives | \$ 0.6 | \$ 0.6 |
| Lumber futures | \$ (3.6) | \$ 5.6 |
| Interest rate swaps | \$ (1.0) | \$ - |
| | \$ (0.8) | \$ 3.5 |

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

| (millions of dollars) | 2012 | 2011 |
|---|-----------|----------|
| Net income (loss) before income taxes | \$ 55.7 | \$ (9.7) |
| Income tax recovery (expense) at statutory rate 2012 – 25.0% (2011 – 26.5%) | \$ (13.9) | \$ 2.6 |
| Add (deduct): | | |
| Non-taxable income related to non-controlling interests in limited partnerships | 1.7 | 17.9 |
| Entities with different income tax rates and other tax adjustments | (2.4) | 1.0 |
| Tax recovery (expense) at rates other than statutory rate | 0.1 | (0.9) |
| Permanent difference from capital gains and losses and other non-deductible items | 0.2 | (0.1) |
| Income tax recovery (expense) | \$ (14.3) | \$ 20.5 |

OTHER COMPREHENSIVE INCOME (LOSS)

| (millions of dollars) | 2012 | 2011 |
|---|-----------|-----------|
| Foreign exchange translation differences for foreign operations | \$ (4.6) | \$ 4.4 |
| Defined benefit actuarial losses, net of tax | (50.4) | (50.3) |
| Other comprehensive income (loss), net of tax | \$ (55.0) | \$ (45.9) |

Canfor measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. Any actuarial gains or losses which arise are recognized immediately by means of a credit or charge through other comprehensive income. For 2012, an after-tax amount of \$50.4 million was charged to other comprehensive income, principally reflecting a decrease in the discount rate over the year, which fell 0.80% for defined benefit pension plans and 0.90% for other post-retirement benefit plans, offset in part by a slightly higher than expected rate of return on plan assets. In

OTHER INCOME AND EXPENSE, NET

Other expense, net in 2012 of \$0.4 million included a loss of \$1.5 million relating to foreign exchange movements on US dollar denominated cash, receivables and payables of Canadian operations, compared to a gain on foreign exchange in the prior year of \$2.0 million.

Also included in other expense, net in 2012 was a \$0.5 million positive fair value adjustment related to a royalty agreement associated with the sale in late 2010 of the operating assets of Howe Sound Pulp and Paper Limited Partnership, compared to a positive fair value adjustment of \$2.2 million in 2011.

Other expense, net in 2012 further reflected a \$1.1 million gain relating to the change in fair value of the Company's investment in asset-backed commercial paper (“ABCP”), compared to a gain of \$0.2 million in 2011. The Company sold its investment in ABCP in the second quarter of 2012. A \$0.6 million loss recorded on the sale of land and timber was included in other expense, net in 2012.

INCOME TAX (EXPENSE) RECOVERY

The Company recorded an income tax expense of \$14.3 million in 2012, compared to recovery of \$20.5 million in 2011, with an overall effective tax rate of 26% (2011 – 211%). The most significant factor accounting for the 2012 tax rate differing from the Canadian statutory tax rate of 25% is entities with different tax rates and other tax adjustments primarily related to the Company's U.S. subsidiaries and the non-taxable income attributable to non-controlling interests of Houston Pellet Limited Partnership.

2011, the after-tax charge was \$50.3 million, also reflecting a lower discount rate over that year. For more information, see the ‘Employee Future Benefits’ part of the ‘Critical Accounting Estimates’ section later in this report.

In addition, the Company recorded a charge of \$4.6 million to other comprehensive income in 2012 for foreign exchange differences for foreign operations, reflecting the 2% strengthening of the Canadian dollar over the year. This compared to a \$4.4 million credit in 2011 due to a 2% weakening of the Canadian dollar over that year.

SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's financial position as at the end of the years 2012 and 2011:

(millions of dollars, except for ratios)

| | 2012 | 2011 |
|---|------------|------------|
| Cash and cash equivalents | \$ - | \$ 28.9 |
| Operating working capital, excluding assets held for sale | 326.9 | 249.0 |
| Assets held for sale, net of liabilities held for sale | 75.3 | - |
| Cheques issued in excess of cash on hand | (14.7) | - |
| Current portion of long-term debt | (184.1) | (50.9) |
| Current portion of deferred reforestation | (37.3) | (31.6) |
| Net working capital | 166.1 | 195.4 |
| Property, plant and equipment | 1,081.7 | 1,139.2 |
| Timber licenses | 554.6 | 530.1 |
| Goodwill and other intangible assets | 80.4 | 83.0 |
| Long-term investments and other | 44.6 | 62.8 |
| Net assets | \$ 1,927.4 | \$ 2,010.5 |
| Long-term debt | \$ 100.0 | \$ 188.1 |
| Retirement benefit obligations | 314.5 | 298.3 |
| Deferred reforestation obligations | 78.4 | 65.0 |
| Other long-term liabilities | 13.6 | 13.8 |
| Future income taxes, net | 111.1 | 85.2 |
| Non-controlling interests | 198.9 | 232.8 |
| Equity attributable to shareholders of Company | 1,110.9 | 1,127.3 |
| | \$ 1,927.4 | \$ 2,010.5 |
| Ratio of current assets to current liabilities | 1.3 : 1 | 1.5 : 1 |
| Net debt to total capitalization | 19.9% | 13.4% |

The ratio of current assets to current liabilities at the end of 2012 was 1.3:1 compared to 1.5:1 at the end of 2011. The reduction principally reflects the classification of CPPI's US\$110 million debt as current at the end of 2012 as this matures in November 2013. In anticipation of the maturation of the debt in 2013, CPPI obtained a new \$110.0 million operating loan facility in the fourth quarter of 2012. The maturity date of the new facility is November 30, 2016 and no amounts were drawn on the facility at December 31, 2012. This decrease was offset in part by the classification of the assets and liabilities of Peace Valley OSB as current due to its pending sale. See further discussion in "Financial Requirements and Liquidity" section.

The Company's net debt to capitalization was 19.9% at December 31, 2012 (December 31, 2011: 13.4%). The increase is explained principally by the new \$100 million term debt obtained in early 2012, coupled with reduced cash balances and reduced equity balances for the most part reflecting the CPPI share exchange transaction and overall comprehensive losses relating to pension plan.

CHANGES IN FINANCIAL POSITION

At the end of 2012, Canfor had \$14.7 million of cheques issued in excess of cash on hand.

| (millions of dollars) | 2012 | 2011 |
|---------------------------------------|-----------|------------|
| Cash generated from (used in) | | |
| Operating activities | \$ 131.2 | \$ 163.0 |
| Financing activities | 42.0 | (191.4) |
| Investing activities | (216.8) | (203.0) |
| Decrease in cash and cash equivalents | \$ (43.6) | \$ (231.4) |

The changes in the components of these cash flows during 2012 are discussed in the following sections.

OPERATING ACTIVITIES

During 2012, Canfor generated cash from operations of \$131.2 million, down \$31.8 million from cash generated of \$163.0 million in the previous year. Operating cash flows reflected an increase in cash earnings in the lumber segment offset in part by a decline in cash earnings in the pulp and paper business segment. More than offsetting the net increase in consolidated cash earnings was a volume and cost related increase in log and lumber inventories and a reduction in payables, the latter reflecting less restructuring costs, lower capital spending as well as the timing of certain payables.

FINANCING ACTIVITIES

Financing activities in 2012 generated net cash of \$42.0 million compared to net cash used of \$191.4 in 2011. The current year's cash flows included \$100.0 million of new term debt and \$27.0 million drawn on the Company's operating loans. The new term debt is in the form of an unsecured non-revolving term loan, with a maturity date of February 13, 2017. Interest rates are floating based on the lenders' Canadian prime rate or bankers acceptances. The increase also reflected lower long-term debt repayments of \$49.9 million in 2012 compared to \$81.9 million repaid in the prior year. In addition, cash distributions of \$15.9 million were paid in 2012, down \$75.1 million from the prior year. Finance expenses paid of \$19.5 million were in line with the prior year.

INVESTING ACTIVITIES

Net cash used for investing activities in 2012 amounted to \$216.8 million, compared to \$203.0 million used in 2011. Property, plant and equipment additions for 2012 totaled \$180.1 million, net of proceeds from the federal government's green transformation program of \$19.7 million. Investing activities in the current year also included \$65.6 million spent on the acquisition of Kootenay sawmill assets in the first quarter of 2012.

Capital spending in the current year included amounts spent as part of the Company's \$300 million, three-year strategic capital investment program at its lumber operations. Capital spending in the lumber segment for 2012 was \$110.9 million for the most part reflecting costs incurred on the previously highlighted capital projects at the Radium, Grande Prairie and Prince George Sawmills.

In the pulp and paper segment, capital spending of \$88.7 million for 2012 included upgrades to the boiler and feedwater treatment system and replacement of the recovery boiler lower furnace at the Prince George Pulp and Paper Mill, along with maintenance capital related to outages at the Company's mills throughout the year.

Cash of \$12.9 million was received from the sale of the Company's ABCP assets in the second quarter of 2012, compared to \$29.8 million received from the partial redemption of ABCP in 2011.

FINANCIAL REQUIREMENTS AND LIQUIDITY

OPERATING LOANS

On a consolidated basis, at December 31, 2012, the Company had \$467.5 million of unsecured operating loan facilities, \$27.0 million drawn on its operating loans, and an additional \$27.2 million reserved for several standby letters of credit.

Excluding CPPI, the Company's bank operating loans at December 31, 2012 totalled \$350.0 million, of which \$27.0 million was drawn, and an additional \$18.0 million reserved for several standby letters of credit, the majority of which related to unregistered pension plans. The Company's other operating loan facility in the amount of US\$12.7 million expired in January 2012. For Canfor, excluding CPPI, the principal operating loans mature on October 31, 2015.

At December 31, 2012, CPPI had a \$110.0 million bank loan facility of which \$1.7 million was utilized for a standby letter of credit issued for general business purposes. In the fourth quarter of 2012, CPPI obtained a new \$110.0 million operating loan facility replacing its previous \$40.0 million operating loan facility. The new facility has certain financial covenants that stipulate maximum net debt to total capitalization ratios and minimum net worth amounts based on shareholders' equity. In addition, CPPI had a separate facility with a maturity date of November 30, 2013 to cover a \$7.5 million standby letter of credit issued to BC Hydro. During 2012, CPPI terminated its \$30.0 million bridge loan credit facility in conjunction with the completion of the Canadian Federal Government Green Transformation Program ("Program"). The facility was used to fund timing differences between expenditures and reimbursements for projects funded by the Program.

DEBT COVENANTS

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

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

In addition, CPPI has leverage and interest coverage ratios calculated by reference to earnings before interest, taxes, depreciation and amortization and other non-cash items.

Provisions contained in Canfor's long-term borrowing agreements also limit the amount of indebtedness that the Company may incur and the amount of dividends it may pay on its common shares. The amount of dividends the Company is permitted to pay under its long-term borrowing agreements

is determined by reference to consolidated net earnings less certain restricted payments.

Management reviews results and forecasts to monitor the Company's compliance with these covenant requirements. Canfor was in compliance with all its debt covenants for the year ended December 31, 2012.

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

2013 PROJECTED CAPITAL SPENDING AND DEBT REPAYMENTS

Based on its current outlook for 2013, assuming no deterioration in market conditions during the year, the Company anticipates that it may invest approximately \$150 million in capital projects, which will consist primarily of various improvement projects as well as maintenance of business expenditures. Scheduled long-term debt repayments in 2013 consist of a US\$75.0 million payment on Canfor's long-term debt on April 1, 2013 and the US\$110.0 million payment on maturity of CPPI's term debt due on November 30, 2013. Canfor has sufficient liquidity in its cash reserves and operating loans to finance its planned capital expenditures and scheduled debt repayments as required during 2013.

DERIVATIVE FINANCIAL INSTRUMENTS

As at December 31, 2012, the Company had the following derivatives:

a. Foreign exchange collars of US\$12.0 million and forward contracts of US\$40.8 million. There were unrealized gains of \$0.3 million on the foreign exchange derivatives at the end of the year. The contracts in place at the end of 2012 were as follows:

| 2012 | | |
|------------------------------------|--------------------------|----------------------------------|
| | Notional Amount | Exchange Rates |
| US dollar collars | (millions of US dollars) | (protection/topside, per dollar) |
| 0 – 12 months | \$ 12.0 | \$ 1.0000 / \$ 1.1000 |
| US dollar forward contracts | (millions of US dollars) | (range of rates, per dollar) |
| 0 – 12 months | \$ 40.8 | \$ 0.9926 - \$ 1.0043 |

b. Canfor partly uses heating oil, Brent oil and Western Texas Intermediate ("WTI") oil contracts as a proxy to hedge its diesel purchases. At 2012 year end collars for 210 thousand barrels of Brent and WTI oil collars were in place, which will be settled in 2013, with weighted average protection of \$90.36 per barrel and topside of \$111.78 per barrel. There were unrealized gains of \$0.3 million on these contracts at the end of the year. The Company had no heating oil collars outstanding at December 31, 2012.

c. Futures contracts for the sale of lumber with a total notional amount of 115.9 MMfbm. There were unrealized losses of \$4.1 million at year end on these contracts.

| 2012 | | |
|-------------------|-----------------|-----------------------|
| | Notional Amount | Average Rate |
| Lumber | (MMfbm) | (US dollars per Mfbm) |
| Futures Contracts | | |
| 0 – 12 months | 115.9 | \$ 338.45 |

d. During 2012 Canfor put in place interest rate swaps to reduce its exposure to interest rate risk associated with financial obligations bearing variable interest rates. At December 31, 2012, the Company had \$205.0 million in interest rate swaps with fixed interest rates from 1.55% to 2.59% and maturities between 2014 and 2017. There were unrealized losses of \$0.6 million at year end on these swaps.

COMMITMENTS

The following table summarizes Canfor's financial contractual obligations at December 31, 2012 for each of the next five years and thereafter:

| (millions of dollars) | 2013 | 2014 | 2015 | 2016 | 2017 | Thereafter | Total |
|--|----------|--------|--------|--------|----------|------------|----------|
| Long-term debt obligations | \$ 184.1 | \$ - | \$ - | \$ - | \$ 100.0 | \$ - | \$ 284.1 |
| Interest payments on long-term fixed rate debt | \$ 9.1 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 9.1 |
| Operating leases | \$ 9.1 | \$ 5.6 | \$ 2.7 | \$ 1.8 | \$ 1.1 | \$ 0.6 | \$ 20.9 |
| | \$ 202.3 | \$ 5.6 | \$ 2.7 | \$ 1.8 | \$ 101.1 | \$ 0.6 | \$ 314.1 |

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

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

- ▶ In November 2012, the Company entered into a Letter of Intent with Louisiana-Pacific Corporation to sell Canfor's 50% share in the Peace Valley OSB joint venture in Fort St. John, B.C. By completing this sale, Louisiana-Pacific Corporation will become the sole owner of the Peace Valley OSB mill. As at December 31, 2012, the assets and liabilities related to the sale are classified as held for sale in the Company's consolidated balance sheet. Further details are contained in note 6 to Canfor's 2012 consolidated financial statements. As part of the sale, Canfor may receive additional annual consideration over a 3 year period based on Peace Valley OSB's annual adjusted earnings before interest, tax, depreciation and amortization. The transaction is subject to various customary closing conditions and is currently scheduled to close in the first half of 2013.
- ▶ Contractual commitments totaling \$55.8 million, principally related to the construction of capital assets. This relates mostly to capital investments at the Company's Elko sawmill in BC and its Conway sawmill in the U.S., as well as the turbine project at Canfor Pulp's Northwood mill.
- ▶ Purchase obligations and contractual obligations in the normal course of business. For example, purchase obligations of a more substantial dollar amount generally relate to the pulp business and are subject to "force majeure" clauses. In these instances, actual volumes purchased may vary significantly from contracted amounts depending on Canfor's requirements in any given year.
- ▶ Deferred reforestation, for which a liability of \$115.7 million has been recorded at December 31, 2012 (2011 - \$96.6 million). The acquisition of the Kootenay mills in 2012 accounted for approximately \$16.5 million of the increase in the liability from 2011. The reforestation liability is a fluctuating obligation, based on the area harvested. The future cash outflows are a function of the actual costs of silviculture programs and of harvesting and are based on, among other things, the location of the harvesting and the activities necessary to adequately stock harvested areas and achieve a "free-to-grow" state.
- ▶ Obligations to pay pension and other post-employment benefits, for which the liability for accounting purposes at December 31, 2012 was \$314.5 million (2011 - \$298.3 million). As at December 31, 2012, Canfor estimated that it would make total contribution payments of \$49.3 million to its defined benefit plans in 2013.
- ▶ CPPI has an energy agreement with BC Hydro which provides for the sale of electrical power production that exceeds a committed amount from the cogeneration project at the Prince George Pulp and Paper Mill. Under the agreement, CPPI is required to post a standby letter of credit as security in annually decreasing amounts as the minimum required amount of electricity is generated. At December 31, 2012, CPPI had no repayment obligation under the terms of the agreement and a standby letter of credit in the amount of \$7.5 million had been issued to BC Hydro as security for future power generation commitments.
- ▶ On December 6, 2012, CPPI secured both a Load Displacement Agreement (LDA) and an Electricity Purchase Agreement (EPA) with BC Hydro as part of the Integrated Power Offer program, which provides for the commitment to electrical load displacement and the sale of incremental power production at the Northwood Pulp Mill commencing April 1, 2014. Under the LDA, CPPI receives a facilitated government grant called the Transmission Service Rate Incentive upon completion of the project and is provided in exchange for the standby letter of credit as performance security in annually decreasing amounts as the minimum required amount of electricity is generated. Under the EPA, CPPI is required to post a separate standby letter of credit as performance security for the term of the agreement. The total outstanding performance security for both agreements is the greater of the required performance security under the EPA or LDA until the performance security for the LDA is completely eliminated on the fifth anniversary of the project. As of December 31, 2012, CPPI had no repayment obligations under the terms of both agreements and two standby letters of credit in the amounts of \$0.8 million for the EPA and \$0.1 million for the LDA were issued to BC Hydro as performance security for future power generation commitments.

TRANSACTIONS WITH RELATED PARTIES

The Company undertakes transactions with various related entities. These transactions are in the normal course of business and are generally on the same terms as those accorded to unrelated third parties, except where noted otherwise. Related party transactions include the purchase of pulp chips and lumber, at market value, from Lakeland Mills Ltd. ("Lakeland") and Winton Global Lumber Ltd. ("Winton"), in which Canfor holds a one-third equity interest in both entities. In 2012, Canfor purchased \$2.6 million in chips and \$4.9 million in

logs from Lakeland and Winton. The balance owed to Lakeland and Winton outstanding at December 31, 2012 was \$0.2 million. Lakeland's sawmill operation was destroyed by fire in April 2012. Related party transaction in 2012 also included lease management services provided by Jim Pattison Lease. There were \$0.7 million in transactions with the party during the year and no amounts were outstanding at December 31, 2012.

Additional details on related party transactions are contained in note 25 to Canfor's 2012 consolidated financial statements.

SELECTED QUARTERLY FINANCIAL INFORMATION²¹

| | 2012 | | | | 2011 | | | |
|--|----------|----------|----------|-----------|-----------|-----------|----------|----------|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Sales and income (millions of dollars) | | | | | | | | |
| Sales | \$ 721.8 | \$ 683.8 | \$ 700.9 | \$ 607.6 | \$ 576.2 | \$ 602.1 | \$ 619.1 | \$ 624.0 |
| Operating income (loss) | \$ 50.1 | \$ 22.3 | \$ 26.0 | \$ (21.5) | \$ (63.1) | \$ 15.4 | \$ 27.4 | \$ 32.3 |
| Net income (loss) | \$ 24.6 | \$ 20.7 | \$ 7.0 | \$ (10.9) | \$ (38.1) | \$ (9.6) | \$ 26.2 | \$ 32.3 |
| Shareholder net income (loss) | \$ 21.6 | \$ 22.2 | \$ 4.5 | \$ (16.2) | \$ (44.1) | \$ (21.6) | \$ 2.1 | \$ 7.0 |
| Per common share (dollars) | | | | | | | | |
| Shareholder net income (loss) – basic and diluted | \$ 0.15 | \$ 0.16 | \$ 0.03 | \$ (0.11) | \$ (0.31) | \$ (0.15) | \$ 0.01 | \$ 0.05 |
| Statistics | | | | | | | | |
| Lumber shipments (MMfbm) | 1,149 | 1,133 | 1,158 | 994 | 974 | 969 | 973 | 857 |
| OSB shipments (MMsf 3/8") | 73 | 75 | 72 | 65 | 75 | 62 | 69 | 63 |
| Pulp shipments (000 mt) | 298 | 269 | 282 | 328 | 275 | 291 | 303 | 318 |
| Average exchange rate – US\$/Cdn\$ | \$ 1.009 | \$ 1.005 | \$ 0.990 | \$ 0.999 | \$ 0.977 | \$ 1.020 | \$ 1.033 | \$ 1.014 |
| Average Western SPF 2x4 #2&Btr lumber price (US\$) | \$ 335 | \$ 300 | \$ 295 | \$ 266 | \$ 238 | \$ 246 | \$ 240 | \$ 296 |
| Average SYP (East) 2x4 #2 lumber price (US\$) | \$ 386 | \$ 322 | \$ 325 | \$ 298 | \$ 260 | \$ 259 | \$ 251 | \$ 302 |
| Average OSB price – North Central (US\$) | \$ 332 | \$ 312 | \$ 235 | \$ 202 | \$ 190 | \$ 184 | \$ 172 | \$ 199 |
| Average NBSK pulp list price delivered to U.S. (US\$) | \$ 863 | \$ 853 | \$ 900 | \$ 870 | \$ 920 | \$ 993 | \$ 1,025 | \$ 970 |

[21] Certain prior period amounts have been restated due to a change in accounting policy for treatment of net interest expense for defined benefit post-retirement plans. Further details can be found in the "Changes in Accounting Policy" section in this document.

In addition to exposure to changes in product prices and foreign exchange, the Company's financial results are impacted by seasonal factors such as weather and building activity. Adverse weather conditions can cause logging curtailments, which can affect the supply of raw materials to manufacturing facilities. Market demand also varies seasonally to some degree.

For example, building activity and repair and renovation work, which affects demand for lumber products, is generally stronger in the spring and summer months. These factors, along with global supply and demand conditions, affect the Company's shipment volumes.

| (millions of dollars) | 2012 | | | | 2011 | | | |
|--|------------------|------------------|-----------------|-------------------|------------------|------------------|------------------|------------------|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Operating income (loss) by segment: | | | | | | | | |
| Lumber | \$ 41.7 | \$ 34.9 | \$ 18.9 | \$ (20.1) | \$ (55.8) | \$ (11.9) | \$ (11.3) | \$ (2.5) |
| Pulp and Paper | \$ 10.8 | \$ (7.2) | \$ 11.7 | \$ 11.3 | \$ 18.2 | \$ 38.0 | \$ 48.8 | \$ 47.9 |
| Unallocated and Other | \$ (2.4) | \$ (5.4) | \$ (4.6) | \$ (12.7) | \$ (25.6) | \$ (10.7) | \$ (10.1) | \$ (13.1) |
| Total operating income (loss) | \$ 50.1 | \$ 22.3 | \$ 26.0 | \$ (21.5) | \$ (63.2) | \$ 15.4 | \$ 27.4 | \$ 32.3 |
| Add: Amortization | \$ 50.4 | \$ 45.7 | \$ 46.0 | \$ 45.1 | \$ 47.6 | \$ 39.9 | \$ 40.3 | \$ 41.5 |
| Total operating income (loss) before amortization | \$ 100.5 | \$ 68.0 | \$ 72.0 | \$ 23.6 | \$ (15.6) | \$ 55.3 | \$ 67.7 | \$ 73.8 |
| Add (deduct): | | | | | | | | |
| Working capital movements | \$ (50.5) | \$ (14.0) | \$ 68.4 | \$ (79.2) | \$ 30.4 | \$ 19.2 | \$ 24.0 | \$ (79.2) |
| Salary pension plan contributions | \$ (8.7) | \$ (9.0) | \$ (9.0) | \$ (9.0) | \$ (8.1) | \$ (9.6) | \$ (9.9) | \$ (9.7) |
| Other operating cash flows, net ²² | \$ (7.9) | \$ (11.1) | \$ (12.3) | \$ 9.4 | \$ 31.6 | \$ (4.0) | \$ (12.0) | \$ 9.1 |
| Cash from operating activities | \$ 33.4 | \$ 33.9 | \$ 119.1 | \$ (55.2) | \$ 38.3 | \$ 60.9 | \$ 69.8 | \$ (6.0) |
| Add (deduct): | | | | | | | | |
| Finance expenses paid | \$ (7.6) | \$ (1.4) | \$ (7.4) | \$ (3.1) | \$ (6.2) | \$ (3.1) | \$ (6.1) | \$ (3.5) |
| Distributions paid to non-controlling interests | \$ (0.4) | \$ (3.0) | \$ (8.2) | \$ (4.3) | \$ (11.4) | \$ (15.7) | \$ (25.9) | \$ (38.0) |
| Capital additions, net ²³ | \$ (47.0) | \$ (44.1) | \$ (44.0) | \$ (110.6) | \$ (91.0) | \$ (60.2) | \$ (34.0) | \$ (39.3) |
| Proceeds from sale of asset-backed commercial paper ("ABCP") | \$ - | \$ - | \$ 12.9 | \$ - | \$ - | \$ - | \$ 0.1 | \$ 29.7 |
| Drawdown (repayment) of long-term debt | \$ - | \$ - | \$ - | \$ 50.1 | \$ - | \$ - | \$ (48.1) | \$ (33.8) |
| Other, net | \$ 4.0 | \$ 1.5 | \$ 1.9 | \$ 8.9 | \$ (2.1) | \$ (10.6) | \$ 1.7 | \$ 3.1 |
| Change in cash / operating loans | \$ (17.6) | \$ (13.1) | \$ 74.3 | \$ (114.2) | \$ (72.4) | \$ (28.7) | \$ (42.5) | \$ (87.8) |

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

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

THREE-YEAR COMPARATIVE REVIEW

| (millions of dollars, except per share amounts) | 2012 | 2011 | 2010 |
|--|------------|------------|------------|
| Sales | \$ 2,714.1 | \$ 2,421.4 | \$ 2,430.4 |
| Net income (loss) | \$ 41.4 | \$ 10.8 | \$ 173.3 |
| Shareholder net income (loss) | \$ 32.1 | \$ (56.6) | \$ 81.4 |
| Total assets | \$ 2,487.9 | \$ 2,401.6 | \$ 2,594.1 |
| Total long-term financial liabilities | \$ 100.0 | \$ 188.1 | \$ 235.6 |
| Shareholder net income (loss) per share, basic and diluted | \$ 0.22 | \$ (0.40) | \$ 0.57 |

QUARTER ENDED DECEMBER 31, 2012 VS. QUARTER ENDED DECEMBER 31, 2011

OVERVIEW OF OPERATING RESULTS

The Company recorded operating income of \$50.1 million and a shareholder net income of \$21.6 million for the fourth quarter of 2012, compared to an operating loss of \$63.2 million and shareholder net loss of \$44.1 million in the fourth quarter of 2011. The shareholder net income per share (basic and

diluted) was \$0.15 for the fourth quarter of 2012, compared to shareholder net loss per share of \$0.31 in the fourth quarter of 2011.

An overview of the results by business segment for the fourth quarter of 2012 compared to the last quarter of 2011 follows.

LUMBER

SELECTED FINANCIAL INFORMATION AND STATISTICS – LUMBER

Summarized results for the Lumber segment for the fourth quarter of 2012 and 2011 were as follows:

| (millions of dollars, unless otherwise noted) | Q4 2012 | Q4 2011 |
|---|------------|------------|
| Sales | \$ 469.9 | \$ 325.9 |
| Operating income (loss) before amortization | \$ 68.3 | \$ (34.3) |
| Operating income (loss) | \$ 41.7 | \$ (55.8) |
| Negative (positive) impact of inventory valuation adjustments | \$ (0.4) | \$ 9.7 |
| Mill closure provisions | \$ - | \$ 11.9 |
| Asset impairment charges | \$ - | \$ 7.2 |
| Operating income (loss) excluding impact of inventory valuation adjustments and unusual items | \$ 41.3 | \$ (27.0) |
| Average SPF 2x4 #2 & Btr lumber price in US\$ ²⁴ | \$ 335 | \$ 238 |
| Average SPF price in Cdn\$ | \$ 332 | \$ 244 |
| Average SYP 2x4 #2 lumber price in US\$ ²⁵ | \$ 386 | \$ 260 |
| Average SYP price in Cdn\$ | \$ 383 | \$ 266 |
| U.S. housing starts (thousand units SAAR) ²⁶ | 898 | 678 |
| Production – SPF lumber (MMfbm) | 985.5 | 760.8 |
| Production – SYP lumber (MMfbm) | 121.8 | 106.4 |
| Shipments – Canfor-produced SPF lumber (MMfbm) ²⁷ | 1,007.9 | 833.9 |
| Shipments – Canfor-produced SYP lumber (MMfbm) ²⁷ | 133.5 | 112.7 |
| Shipments – wholesale lumber (MMfbm) | 8.0 | 27.4 |

(24) Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)

(25) Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)

(26) Source – U.S. Census Bureau

(27) Includes shipments of lumber purchased for remanufacture.

OVERVIEW

Operating income for the lumber segment was \$41.7 million for the fourth quarter of 2012, an increase of \$97.5 million from the operating loss reported for the fourth quarter of 2011 of \$55.8 million. Results in the lumber segment for the fourth quarter of 2012 were favourably impacted by inventory valuation adjustment of \$0.4 million, compared to an adverse impact of \$9.7 million in the fourth quarter of 2011.

Excluding the above noted items, operating income was \$41.3 million for the fourth quarter of 2012, a \$68.3 million improvement from the fourth quarter of 2011, which also included certain mill closure provisions and asset impairment charges. For the most part, the improvement in operating income compared to the fourth quarter of 2011 reflected improved market prices, lower export taxes, and increased lumber shipments as a result of both production improvement and the integration of the two south-east Kootenay region operations acquired at the end of the first quarter of 2012. Partially offsetting these gains was a 3% stronger Canadian dollar, an increase in unit log costs, largely attributable to market-price related stumpage increases and a small increase in average unit production costs related to the restart of the Company's Radium sawmill and the acquired Kootenay mills. Other contributing factors included sawmill residual chip prices which were well down compared to the same quarter of 2011, consistent with the decline in NBSK pulp sales realizations over

the period, as well as the aforementioned amendments to the Company's salaried post retirement plans.

MARKETS

During the fourth quarter of 2012, the lumber market experienced one of the strongest price rallies in recent years, primarily due to improved housing activity and low lumber inventories throughout North America. Furthermore, solid offshore shipments to all markets aided this lumber price appreciation. Total U.S. housing starts averaged 898,000 units SAAR, an increase of 16% from the previous quarter and up 32% from the fourth quarter of 2011. Single-family starts, which consume a larger proportion of lumber, were 592,000 units SAAR in the fourth quarter of 2012, the highest level since late 2008. Repair and remodeling activity was steady and also trended higher than a year ago.

In Canada, lumber consumption was steady while housing demand trended lower on a seasonal basis. Canadian housing starts were 204,000 units SAAR for the quarter, up 1% from the same quarter in 2011 when starts were at 202,000 units SAAR, reflecting the dip in Canadian housing starts late in 2012.

Canfor's offshore lumber shipments continued an overall growth trend, up 11% over the fourth quarter of 2011. The rise in shipments was due to solid demand in key markets, particularly China and Japan.

SALES

Lumber sales for the fourth quarter of 2012 were \$469.9 million, up \$144.0 million compared to \$325.9 million in the fourth quarter of 2011. The increases from the comparative period reflected the impact of improved pricing and increased shipments. Total shipments in the fourth quarter of 2012 at just over 1.1 billion board feet were up 18% from the fourth quarter of 2011 reflecting higher production following various capital upgrades and other efficiency improvements, as well as additional production from the Kootenay mill operations.

Overall sales realizations saw positive gains in all markets in the fourth quarter of 2012, with North American sales realizations benefiting from the continued upward trend in pricing and lower export taxes. Compared to the fourth quarter of 2011, the benchmark North American Random Lengths Western SPF 2x4 #2&Btr price was up US\$97 per Mfbm, or 41%, with strong gains seen in all widths and dimensions. SYP products followed a similar trend, with the benchmark SYP 2x4 #2 price up 48%. Solid increases were also seen for offshore sales realizations for similar products. Sales realizations also reflected the positive impact of the higher proportion of high-value prime product produced at the Kootenay operations and

lower export taxes. Compared to the fourth quarter of 2011, realizations were negatively impacted from a 3.2 cent, or 3%, weaker average Canadian dollar over the quarter. The RLCP averaged US\$347 per Mfbm for the fourth quarter of 2012, resulting in an average 8% export tax rate on all U.S. bound shipments. This compared to a 15% rate in the fourth quarter of 2011.

Total residual fibre revenue was well up compared to the fourth quarter of 2011, with higher shipments of sawmill residual chips offsetting lower prices resulting from weaker NBSK market pulp prices.

OPERATIONS

Lumber production, at just over 1.1 billion board feet, was up 28% from the fourth quarter of 2011, again largely reflecting the recent Kootenay mills acquisition, the Radium start-up and increased productivity following various capital improvement projects in 2011 and early 2012. Compared to the fourth quarter of 2011, unit manufacturing costs showed an increase, reflecting higher unit log costs (mostly market-stumpage related) and slightly higher unit cash conversion costs largely attributable to the Radium start-up and the acquired Kootenay sawmills.

PULP AND PAPER

SELECTED FINANCIAL INFORMATION AND STATISTICS – PULP AND PAPER²⁸

Summarized results for the Pulp and Paper segment for the fourth quarter of 2012 and 2011 were as follows:

| | Q4 2012 | Q4 2011 |
|---|------------|------------|
| <i>(millions of dollars, unless otherwise noted)</i> | | |
| Sales | \$ 228.4 | \$ 237.0 |
| Operating income before amortization | \$ 31.3 | \$ 39.9 |
| Operating income | \$ 10.8 | \$ 18.2 |
| Average pulp price delivered to U.S. – US\$ ²⁹ | \$ 863 | \$ 920 |
| Average price in Cdn\$ | \$ 855 | \$ 942 |
| Production – pulp (000 mt) | 314.1 | 294.5 |
| Production – paper (000 mt) | 35.4 | 33.5 |
| Shipments – Canfor-produced pulp (000 mt) | 297.8 | 275.4 |
| Shipments – paper (000 mt) | 32.1 | 30.2 |

⁽²⁸⁾ Includes the Taylor pulp mill and 100% of Canfor Pulp, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.

⁽²⁹⁾ Per tonne, NBSK pulp price delivered to U.S. (RISI)

OVERVIEW

Operating income for the pulp and paper segment was \$10.8 million for the fourth quarter of 2012, down \$7.4 million from operating income of \$18.2 million in the fourth quarter of 2011. Results in the fourth quarter of 2012 were impacted by lower market pulp prices, partially offset by higher shipment volumes and lower unit manufacturing costs.

Compared to the fourth quarter of 2011, NBSK pulp list prices were down in all regions, with prices to North America declining US\$57 to US\$863 per tonne. Sales realizations were also negatively impacted by a 3% stronger Canadian dollar compared to the fourth quarter of 2011. Unit manufacturing costs decreased 5% compared to the fourth quarter of 2011, principally related to lower fibre costs and the impact of higher production volumes, in part reflecting more operations days in the current period. The fourth quarter of 2012 pulp and paper segment results also reflected a pre-tax accounting gain of \$4.0 million related to the post retirement plan adjustments.

MARKETS

According to the latest World 20 report, global softwood pulp demand increased 7% over the fourth quarter of 2012 compared to the same period in 2011. The increase in softwood shipments was primarily due to increased purchasing from China, partially offset by reductions in shipments to North America and Europe, particularly the latter region. Softwood pulp producer inventories increased 2 days to 29 days of supply, but were down 7 days compared to December 2011 inventories. PPPC statistics reported global demand for printing and writing papers decreased 2% in 2012 as compared to 2011.

SALES

The Company's pulp shipments in the fourth quarter of 2012 were 298,000 tonnes, an increase of approximately 22,000 tonnes from the fourth quarter of 2011. For the most part, this reflected higher production volumes coupled with higher levels of purchases by Chinese consumers. Compared to the fourth quarter of 2011, pulp sales realizations decreased 12% reflecting lower NBSK pulp list pricing in all regions and a 3% strengthening of the Canadian dollar. The North America NBSK pulp list prices averaged US\$863 per tonne for the quarter, down US\$57, or 6%, from the fourth quarter of 2011. NBSK pulp list prices to China and Europe also decreased compared to the same period in 2011, with the average price down US\$51 and US\$65, respectively. Also contributing to the lower sales realizations in the fourth quarter of 2012 were a higher proportion of shipments to China.

Global softwood pulp pricing saw a small increase through the fourth quarter of 2012. The North America NBSK pulp list price increased US\$40 in the fourth quarter of 2012, ending the year at US\$870 per tonne, as compared to US\$830 per tonne at the end of the third quarter of 2012. NBSK pulp list prices to Europe also increased US\$40 in the quarter, ending the year at

US\$810 per tonne, while the Company's price to China increased US\$30 in the quarter, to close 2012 at US\$680 per tonne. The BCTMP market weakened slightly through the fourth quarter of 2012, with the average sales realization down compared to the previous quarter; Compared to the fourth quarter of 2011, BCTMP sales realizations were down, reflecting the declining prices in the latter half of 2012 and the stronger Canadian dollar.

OPERATIONS

Pulp production in the fourth quarter of 2012 was 314,000 tonnes, up almost 20,000 tonnes, from the fourth quarter of 2011. The increase in production reflected a reduction in outages and improved operating rates in the fourth quarter of 2012.

Pulp unit manufacturing costs decreased 5% compared to the fourth quarter of 2011, principally reflecting the favourable impact of higher production volumes, reduced chemical usage, and lower fibre costs, partially offset by timing of maintenance spending. Lower fibre costs in the fourth quarter of 2012 reflected lower-cost sawmill residual chips, where prices are linked to NBSK pulp sales realizations, as well as a reduction in higher-cost whole log chips.

UNALLOCATED AND OTHER ITEMS

(millions of dollars)

| | Q4 2012 | Q4 2011 |
|---|------------|------------|
| Operating income (loss) of Panels operations ³⁰ | \$ 2.7 | \$ (19.0) |
| Corporate costs | \$ (5.1) | \$ (6.6) |
| Finance expense, net | \$ (6.5) | \$ (5.1) |
| Foreign exchange gain (loss) on long-term debt and investments, net | \$ (2.0) | \$ 4.9 |
| Gain (loss) on derivative financial instruments | \$ (8.7) | \$ 9.6 |
| Other income (expense), net | \$ (0.2) | \$ 1.3 |

(30) The Panels operations include the Peace Valley OSB joint venture, the only facility currently operating, and the Company's Tackama plywood and PolarBoard OSB plants, both of which are currently indefinitely idled.

The panels operations reported operating income of \$2.7 million for the fourth quarter of 2012, compared to an operating loss of \$19.0 million for the fourth quarter of 2011. Operating results for the fourth quarter of 2012 included \$0.8 million in impairment charges related to damage to some operating equipment. Results for the fourth quarter of 2011 included an expense of \$10.6 million relating to the announced closure of the Tackama plywood plant, as well as an asset impairment charge of \$2.0 million relating to other idled panels assets. Excluding the impact of these items and inventory valuation adjustments, quarter-over-quarter operating results for the panel operations improved by \$8.7 million, largely reflecting considerably stronger market prices, with the benchmark OSB price up by US\$142 per msf, or 75% due to the improving U.S. housing market and the damage caused by Hurricane Sandy, which more than offset increased log cost and seasonally higher unit cash conversion costs.

Corporate costs were \$5.1 million for the fourth quarter of 2012, down \$1.5 million compared to the fourth quarter of 2011. Corporate costs in the fourth quarter of 2011 reflected restructuring costs, and costs related to the acquisition of the Kootenay sawmills and tenure. The decrease also reflected a portion of the aforementioned gain due to amendments to the Company's salaried post retirement benefit plans offset in part by higher share-based compensation expense in the fourth quarter of 2012.

Net finance expense for the fourth quarter of 2012 was \$6.5 million, up \$1.4 million from the fourth quarter of 2011, primarily reflecting costs associated with the new operating loan facility entered into by CPPI in the fourth quarter of 2012 coupled with the effect of a positive present value accretion adjustment related to the Company reforestation obligation recorded in the fourth quarter of 2011.

The Company recorded a foreign exchange translation loss on its US dollar denominated debt of \$2.0 million for the fourth quarter of 2012, as a result of the weakening of the Canadian dollar against the US dollar, which fell just over 1% between the respective quarter ends. The \$4.9 million gain in the fourth quarter of 2011 resulted from a strengthening of the Canadian dollar by over 2% in the comparative period.

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs, lumber prices and interest rates. For the fourth quarter of 2012, the Company recorded a net loss of \$8.7 million related to its derivative financial instruments, largely reflecting realized and unrealized losses on lumber futures as a result of rising lumber prices, as well as realized and unrealized losses on the US dollar forward contracts and collars, related to the weakening of the Canadian dollar.

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

| (millions of dollars) | Q4 2012 | Q4 2011 |
|--|------------|------------|
| Foreign exchange collars and forward contracts | \$ (1.0) | \$ 9.3 |
| Energy derivatives | \$ (0.3) | \$ 0.9 |
| Lumber futures | \$ (7.5) | \$ (0.6) |
| Interest rate swaps | \$ 0.1 | \$ - |
| | \$ (8.7) | \$ 9.6 |

Other expense, net of \$0.2 million in 2012 reflected a \$0.4 million negative fair value adjustment related to a royalty agreement associated with the sale in late 2010 of the operating assets of Howe Sound Pulp and Paper Limited Partnership compared to a positive fair value adjustment of \$2.2 million in the fourth quarter of 2011. Further contributing to the other expense was a \$0.6 million loss recorded on the sale of land and

timber in the fourth quarter of 2012. Partially offsetting these charges in the fourth quarter of 2012 were favourable exchange movements on US dollar denominated cash, receivables and payables of Canadian operations of \$0.7 million, compared to a loss of \$2.1 million in the fourth quarter of 2011 resulting from the effect of the strengthening of the Canadian dollar.

SPECIFIC ITEMS AFFECTING COMPARABILITY

SPECIFIC ITEMS AFFECTING COMPARABILITY OF SHAREHOLDER NET INCOME (LOSS)

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

After-tax impact, net of non-controlling interests³¹
(millions of dollars, except for per share amounts)

| | 2012 | | | | 2011 | | | |
|---|----------|-----------|---------|-----------|-----------|-----------|----------|-----------|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Shareholder net income (loss), as reported | \$ 21.6 | \$ 22.2 | \$ 4.5 | \$ (16.2) | \$ (44.1) | \$ (21.6) | \$ 2.1 | \$ 7.0 |
| Foreign exchange (gain) loss on long-term debt and investments, net | \$ 1.2 | \$ (4.0) | \$ 2.4 | \$ (2.7) | \$ (3.3) | \$ 11.0 | \$ (1.4) | \$ (3.0) |
| (Gain) loss on derivative financial instruments | \$ 6.5 | \$ (4.4) | \$ 4.2 | \$ (5.1) | \$ (6.7) | \$ 7.0 | \$ (0.7) | \$ (2.9) |
| Asset impairment charges | \$ 0.6 | \$ - | \$ - | \$ - | \$ 5.5 | \$ - | \$ - | \$ - |
| Net gain on post retirement and pension plan changes | \$ (7.1) | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Restructuring costs related to changes in management group | \$ - | \$ 1.5 | \$ - | \$ - | \$ - | \$ - | \$ 2.6 | \$ - |
| Decrease (increase) in fair value asset-backed commercial paper | \$ - | \$ - | \$ - | \$ (1.1) | \$ (0.5) | \$ 1.8 | \$ (0.5) | \$ (1.0) |
| Costs recorded in relation to Tembec acquisition | \$ - | \$ - | \$ - | \$ 2.8 | \$ - | \$ - | \$ - | \$ - |
| Mill closure provisions | \$ - | \$ - | \$ - | \$ - | \$ 17.0 | \$ - | \$ - | \$ - |
| Net impact of above items | \$ 1.2 | \$ (6.9) | \$ 6.6 | \$ (6.1) | \$ 12.0 | \$ 19.8 | \$ - | \$ (6.9) |
| Adjusted shareholder net income (loss) | \$ 22.8 | \$ 15.3 | \$ 11.1 | \$ (22.3) | \$ (32.1) | \$ (1.8) | \$ 2.1 | \$ 0.1 |
| Shareholder net income (loss) per share (EPS), as reported | \$ 0.15 | \$ 0.16 | \$ 0.03 | \$ (0.11) | \$ (0.31) | \$ (0.15) | \$ 0.01 | \$ 0.05 |
| Net impact of above items per share | \$ 0.01 | \$ (0.05) | \$ 0.05 | \$ (0.05) | \$ 0.09 | \$ 0.14 | \$ 0.00 | \$ (0.05) |
| Adjusted net income (loss) per share | \$ 0.16 | \$ 0.11 | \$ 0.08 | \$ (0.16) | \$ (0.22) | \$ (0.01) | \$ 0.01 | \$ 0.00 |

(31) Certain prior period amounts have been restated due to a change in accounting policy for treatment of net interest expense for defined benefit post-retirement plans. Further details can be found in the "Changes in Accounting Policy" section in this document.

OUTLOOK

LUMBER MARKETS

For 2013, the U.S. market is projected to continue its gradual recovery. Rising housing prices, an improved job market, and an increase in household formations will support an improved housing market. Repair and remodel markets will also be significantly impacted by the same fundamentals. Canadian markets are anticipated to be flat through 2013, with softness projected in multi-family urban markets, but stable demand from other sectors. Offshore markets are forecast to also improve in 2013. After a slight slowdown in 2013, exports to China are anticipated to rise. Demand in Japan will be buoyant for 2013, in advance of an increase in the value-added tax in 2014.

PULP AND PAPER MARKETS

NBSK pulp prices are projected to show a modest improvement through the first half of 2013, but the outlook for the balance of the year is more uncertain given the economic challenges in Europe and new hardwood and softwood pulp capacity currently projected to come online the second half of 2013. For the month of January, CPPI announced an increase in the North American NBSK pulp list price of US\$30 per tonne to US\$900 per tonne.

CRITICAL ACCOUNTING ESTIMATES

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

eligible retired employees. The costs and related obligations of the pension and other retirement benefit plans are accrued in accordance with the requirements of IFRS.

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

EMPLOYEE FUTURE BENEFITS

Canfor has various defined benefit and defined contribution plans providing both pension and other retirement benefits to most of its salaried employees and certain hourly employees not covered by forest industry union plans. Canfor also provides certain health care benefits and pension bridging benefits to

The actuarial assumptions used in measuring Canfor's defined benefit plan are as follows:

| | 2012 | | 2011 | |
|--|-----------------------|---------------------|-----------------------|---------------------|
| | Pension Benefit Plans | Other Benefit Plans | Pension Benefit Plans | Other Benefit Plans |
| <i>(weighted average assumptions)</i> | | | | |
| Accrued benefit obligation as of December 31: | | | | |
| Discount rate | 4.20% | 4.40% | 5.00% | 5.30% |
| Rate of compensation increase | 3.00% | n/a | 3.00% | n/a |
| Benefit costs for year ended December 31: | | | | |
| Discount rate | 5.00% | 5.30% | 5.50% | 5.75% |
| Expected long-term rate of return on plan assets | 7.00% | n/a | 7.00% | n/a |
| Rate of compensation increase | 3.00% | n/a | 3.00% | n/a |

Assumed health care cost trend rates used in the accrued benefit obligation were as follows:

| (weighted average assumptions) | 2012 | 2011 |
|-------------------------------------|-------|-------|
| Initial health care cost trend rate | 6.28% | 6.33% |
| Ultimate health care trend rate | 4.50% | 4.50% |
| Year ultimate rate reached | 2029 | 2029 |

Assumed health care cost trend rates have a significant effect on the amounts reported for the other post-retirement benefit plans. A one percentage point change in assumed health care cost trend rates in each year would have had the following impact on the amounts recorded in 2012:

| (millions of dollars) | 1% Increase | 1% Decrease |
|---------------------------------|-------------|-------------|
| Accrued benefit obligation | \$ 28.6 | \$ 22.9 |
| Total service and interest cost | \$ 2.4 | \$ 1.9 |

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

DEFERRED REFORESTATION

Canfor accrues an estimate of its future liability to perform forestry activities, defined to mean those silviculture treatments or activities that are carried out to ensure the establishment of a free-growing stand of young trees, including logging road rehabilitation on its forestry tenures in BC, Alberta and Quebec. An estimate is recorded in the financial statements based on the number of hectares of timber harvested in the period and the estimated costs of fulfilling Canfor's obligation. Payments in relation to reforestation are expected to occur over periods of up to 15 years (the significant majority occurring in the first seven years) and have been discounted accordingly at risk-free rates ranging from 1.1% to 2.3%. The actual costs that will be incurred in the future may vary based on, among other things, the actual costs at the time of silviculture activities.

DEFERRED TAXES

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

ASSET RETIREMENT OBLIGATIONS

Canfor records the estimated fair value of a liability for asset retirement obligations, such as landfill closures, in the period when it is incurred. For CPPI's landfill closure costs, the fair value is determined using estimated closure costs discounted over the estimated useful life. Payments relating to landfill closure costs are expected to occur at periods ranging from 6 to 39 years and have been discounted at risk-free rates ranging from 1.6% to 2.4%. The actual closure costs and periods of payment may differ from the estimates used in determining the year end liability. On initial recognition, the fair value of the liability is added to the carrying amount of the associated asset and amortized over its useful life. The liability is accreted over time through charges to earnings and reduced by actual costs of settlement.

ENVIRONMENTAL REMEDIATION COSTS

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

IMPAIRMENT OF GOODWILL

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

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

Based upon the analysis performed in 2012 the net present value of the estimated future discounted cash flows exceeded the value of the investment, and therefore no impairments to goodwill were required. However, if the U.S. and global economic downturn were to be longer or more severe than anticipated in the forecast assumptions, there is a possibility that an impairment of goodwill may be required in future periods.

ASSET IMPAIRMENTS

Canfor reviews the carrying values of its long-lived assets, including property, plant and equipment and timber licenses, on a regular basis as events or changes in circumstances may warrant. An impairment loss is recognized in net income at the amount that the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. A review of the carrying values of Canfor's sawmill and panel operations and various other assets was undertaken in 2011 and 2012 as a result of the ongoing difficult market conditions and global economic uncertainty.

Discounted future cash flow models were used to estimate the fair value of the majority of Canfor's long-lived assets. Key assumptions used related to forecast product prices and exchange rates, which were determined in a similar manner to tests for impairment of goodwill, as above. Other significant assumptions are the estimated useful life of the long-lived assets, the discount rate used and the impact of the Mountain Pine Beetle epidemic.

As a result of its review, no impairments were recorded in 2012 other than \$0.8 million related to damage to certain panel assets. Impairment charges totaling \$9.2 million were recorded in 2011 relating to certain of the Company's sawmill and panel assets.

CHANGES IN ACCOUNTING POLICY

Effective January 1, 2012, the Company retroactively changed its accounting policy for the presentation of interest expense and expected rate of return on assets of defined benefit post-retirement plans. The net expense has been reclassified from operating income, where it was included in manufacturing and product costs and in selling and administration costs, to net finance expense. Management considers the classification of net

VALUATION OF LOG AND FINISHED PRODUCT INVENTORIES

Log and finished product inventories are recorded at the lower of cost and net realizable value. For inventories of solid wood products, where valuation adjustments were recorded in 2012, the net realizable value is determined by taking into account forecast prices and exchange rates for the period over which the inventories are expected to be sold. Forecast prices are determined using RISI forecasts and management's estimates as at the year end, and may differ from the actual prices at which the inventories are sold. At the end of December 2012, there were no write-downs against inventory balances.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

An allowance for doubtful accounts of \$2.6 million has been recorded at December 31, 2012 which reflects management's assessment of risks attached to the collection of receivable balances. While significant bad debts have not been experienced in prior years, the provision is considered appropriate due to several risks still existing with respect to the U.S. housing market which may affect the ability of certain customers to pay amounts owed to the Company.

pension interest expense as a finance expense more accurately reflects the nature of this cost. The effect on the financial statements for the year ended December 31, 2012 is an increase in operating income and an increase in net finance expense of \$3.5 million. There is no impact on amounts recorded in the consolidated balance sheet or opening equity as at January 1, 2012.

FUTURE CHANGES IN ACCOUNTING POLICIES

A number of new or revised accounting standards have recently been issued by the International Accounting Standards Board ("IASB"). These are mostly effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. These new and revised accounting standards have not yet been adopted by Canfor and the Company does not plan to early adopt any of the standards.

CONSOLIDATION AND INTERESTS IN OTHER ENTITIES

In May 2011, as part of its consolidation project, the IASB issued the following new suite of consolidation and related standards. The suite is intended to cover all aspects of interests in other entities from determination of how to account for interests in other entities to required disclosure of the interest in those entities. Early adoption is permitted provided that the entire suite of consolidation standards is adopted at the same time.

- ▶ IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvements with the investee and has the ability to affect those returns through its power over the investee.

IFRS 10 replaces SIC-12, *Consolidation – Special Purpose Entities*, and parts of IAS 27, *Consolidated and Separate Financial Statements*. IFRS 10 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.

- ▶ IFRS 11, *Joint Arrangements*, redefines joint operations and joint ventures with a focus on the rights and obligations of an arrangement, rather than its legal form. The new Standard requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting, whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities – Non-monetary Contributions by Venturers*.

Under IFRS 11, Canfor's 50% interest in Canfor-LP OSB is classified as a joint venture and will be accounted for using the equity method of accounting until completion of the sale. The Company currently proportionately consolidates Canfor-LP OSB in accordance with IAS 31.

- ▶ IFRS 12, *Disclosure of Interests in Other Entities*, carries forward existing disclosure requirements and introduces additional disclosures that address the nature of, and risks associated with, an entity's interests in other entities. IFRS 12 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- ▶ There have been amendments to existing standards, including IAS 27 (2011), *Separate Financial Statements*, and IAS 28 (2011), *Investments in Associates and Joint Ventures*. IAS 27 (2011) addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 (2011) sets out the equity accounting for joint ventures and associates, once the assessment of the arrangement has been made under IFRS 11. Canfor's interest in Canfor-LP OSB will be accounted for in accordance with IAS 28 (2011). The amendments to IAS 27 are not expected to have a material impact on amounts recorded in the financial statements of the Company. Canfor is in the process of assessing the full impact of the amendments to IAS 28, which is dependent upon the assessment of the Company's joint arrangements under IFRS 11.

EMPLOYEE BENEFITS

- ▶ IAS 19, *Employee Benefits*, has been amended to make changes to the recognition and measurement of defined benefit pension expense and termination benefits and to enhance the disclosure of all employee benefits. Pension benefit cost will be split between (i) the cost of benefits accrued in the current period (service cost) and benefit changes (past-service costs (including plan amendments, settlements and curtailments)); and (ii) finance expense or income. Interest cost and expected return on plan assets, which currently reflect different rates, will be replaced with a net interest amount that is calculated by applying one discount rate to the net defined benefit liability (asset). The principal impact on the Company of this portion of the amended standard is expected to be an increase in net finance cost as the Company's return on plan assets will effectively be estimated at a lower rate.

RISKS AND UNCERTAINTIES

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

The amended standard also requires immediate recognition of actuarial gains and losses in other comprehensive income as they arise, without subsequent recycling to net income. This is consistent with the Company's current accounting policy.

In addition, under the amended standard, the impact of plan amendments related to past service will no longer be recognized over a vesting period but instead will be recognized immediately in the period of a plan amendment.

The amended standard will result in an increase in operating income of approximately \$1.5 million offset by an increase in finance expense of approximately \$9.2 million in the 2012 comparative financial statements.

OTHER STANDARDS AND AMENDMENTS

- ▶ IFRS 9, *Financial Instruments*, addresses classification and measurement of financial assets and financial liabilities, and is effective January 1, 2015, with earlier adoption permitted. The new Standard limits the number of categories for classification of financial assets to two: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Equity instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. IFRS 9 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- ▶ IFRS 13, *Fair Value Measurement*, clarifies that fair value is the price that would be received on sale of an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. IFRS 13 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- ▶ IAS 1, *Presentation of Financial Statements*, has been amended to require entities to separate items presented in other comprehensive income ("OCI") into two groups, based on whether or not items may be recycled to net income in the future. The amendment is effective for annual periods beginning on or after July 1, 2012, with earlier application permitted. IAS 1 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.

ABORIGINAL ISSUES

Canadian judicial decisions have recognized the continued existence in the country of Aboriginal rights, including title, to lands continuously used or occupied by Aboriginal groups. Although Aboriginal groups have claimed Aboriginal rights over substantial portions of BC no Aboriginal right or title has yet been determined in areas overlapping with Canfor's forest tenures and other operations that aren't currently subject to treaties. While uncertainty regarding property rights in Canada (including forest tenure and other resource rights) continues to exist, particularly in those areas where treaties have not been concluded with Aboriginal groups, the Government of BC has provided greater certainty for the forest industry by reaching agreements on forest resources with many bands. As a means of protecting treaty and aboriginal rights, as well

as undetermined Aboriginal rights, Canadian courts continue to confirm a duty to consult with Aboriginal groups when the Crown has knowledge of existing rights or the potential existence of an Aboriginal right, such as title, and contemplates conduct that might adversely impact them. The courts have not extended this duty to third parties, such as forest companies.

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

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

EMPLOYEE FUTURE BENEFITS

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

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

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

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

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

For Canfor's main Salaried Pension Plan, a one percentage point increase in the rate of return on plan assets over one year would reduce the funded deficit by an estimated \$4.1 million. A one percent increase in the discount rate used in calculating the actuarial estimate of future liabilities would reduce the funded deficit by an estimated \$58.3 million. These changes would only impact the Company's funding requirements in years where a new actuarial funding valuation was performed and regulator approval for a change in funding contributions was obtained.

ENVIRONMENTAL ISSUES

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

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

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

On November 25, 2009, the BC Ministry of Environment released the greenhouse gas ("GHG") reporting regulations under the Greenhouse Gas Reduction Act, requiring any facilities emitting more than 10,000 tonnes of CO₂ to report 2010 emissions in 2011. In 2011, two of Canfor's sawmills and all of the pulp mills (including Canfor Pulp's pulp mills) registered and reported GHG emissions under the BC GHG reporting regulation. GHG emission reporting has been required federally and in Alberta for several years with Canfor Pulp's facilities meeting the requirements for federal reporting, though Canfor's wood products facilities have not triggered federal or Alberta reporting thresholds. Canfor's New South facilities located in North and South Carolina are subject to state GHG reporting requirements.

The BC government is in the process of assessing whether or not it will proceed with plans to participate in the Western Climate Initiative regional GHG cap and trade system. Should cap and trade be implemented for BC, the Canfor Pulp mills and Taylor pulp would likely be subject to cap and trade legislation. The economic impact on pulp and paper mills will depend on factors such as cost to purchase carbon credits and allocation allowance, which are currently undeterminable.

The Quebec government in December 2011 announced adoption of GHG cap and trade legislation with capping and reduction of emissions starting January 1, 2013. Canfor's Daaquam facility in Quebec falls well under the 25,000 tonnes CO₂e annual emission threshold so is not subject to capping and reduction requirements.

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

FIBRE COST AND AVAILABILITY

The Company's fibre costs are affected by a number of different factors which could have a significant impact on operating results. These include logging and hauling costs, stumpage and road and reforestation costs. Lumber market fluctuations and log market speculative bidding can also have a significant impact on both fibre supply and costs. These factors contribute to higher log costs and are anticipated to provide upward pressure on the Company's log costs for the foreseeable future. In addition, the Company's ability to harvest fibre for use in its operations could be adversely impacted by natural events such as forest fires, severe weather conditions or insect infestations. In the event that sufficient volumes of economically viable fibre cannot be provided to an operation, it may be necessary to close that operation for a period of time, or even permanently. Such closures could result in significant costs to the Company. The Company is not insured for loss of standing timber.

FINANCIAL RISK MANAGEMENT AND EARNINGS SENSITIVITIES

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

FINANCIAL RISK MANAGEMENT

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

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

(A) CREDIT RISK:

Credit risk is the risk of financial loss to Canfor if a customer or third party to a derivative instrument fails to meet its contractual obligations.

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

Canfor utilizes a combination of credit insurance, letters of credit and self-insurance to manage the risk associated with trade receivables. Approximately 50% of the outstanding trade receivables are covered by credit insurance. Canfor's trade receivable balance at December 31, 2012 is \$106.6 million, net of an allowance for doubtful accounts of \$2.6 million. Of the total trade receivables balance, \$3.9 million was reclassified to assets held for sale. At December 31, 2012, approximately 97% of the trade accounts receivable balance was within Canfor's established credit terms.

(B) LIQUIDITY RISK:

Liquidity risk is the risk that Canfor will be unable to meet its financial obligations on a current basis. Canfor manages liquidity risk through regular cash-flow forecasting in conjunction with maintaining in good standing adequate committed operating bank loan facilities.

At December 31, 2012, Canfor had \$27.0 million drawn on its operating loans, accounts payable and accrued liabilities of \$257.7 million and current debt obligations of \$184.1 million, all of which fall due for payment within one year of the balance sheet date. Of the total accounts payable and accrued liabilities, an amount of \$2.0 million was reclassified from accounts payable and accrued liabilities to liabilities held for sale.

In the fourth quarter of 2012, in anticipation of the debt maturity in 2013, CPPI obtained a new \$110.0 million operating loan facility replacing its previous \$40.0 million operating loan facility. The new facility has certain financial covenants that stipulate maximum net debt to total capitalization ratios and minimum net worth amounts based on shareholders' equity. The maturity date of the new facility is November 13, 2016.

(C) MARKET RISK:

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

(i) Interest rate risk:

Canfor is exposed to interest rate risk through its current financial assets and financial obligations bearing variable interest rates. Canfor's cash and cash equivalents include term deposits with original maturity dates of three months or less.

Changes in the market interest rates do not have a significant impact on Canfor's results of operations due to the short-term nature of the respective financial assets and obligations. Canfor utilizes interest rate swaps to reduce its exposure to interest rate risk associated with financial obligations bearing variable interest rates (See "Derivative Financial Instruments" section later in this document).

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

(ii) Currency risk:

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

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

(iii) Energy price risk:

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

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

(iv) Commodity price risk:

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

DERIVATIVE FINANCIAL INSTRUMENTS

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

EARNINGS SENSITIVITIES

Estimates of the sensitivity of Canfor's pre-tax results to currency fluctuations and prices for its principal products, based on 2013 Business Plan forecast production and year end foreign exchange rates, are set out in the following table:

| (millions of dollars) | Impact on annual pre-tax earnings |
|--|-----------------------------------|
| SPF lumber – US\$10 change per Mfbm ^{32,33} | \$ 38 |
| SYP lumber – US\$10 change per Mfbm ^{32,33} | \$ 5 |
| Pulp – US\$10 change per tonne ^{32,33,34} | \$ 12 |
| Canadian dollar – US\$0.01 change per Canadian dollar: | |
| Operations ³⁴ | \$ 17 |
| US dollar denominated debt ³⁴ | \$ 2 |

⁽³²⁾ Based on sales of Canfor-produced product.

⁽³³⁾ Excluding impacts of exchange rate, freight, discounting, potential change in fibre costs and other deductions.

⁽³⁴⁾ Includes 100% of Canfor Pulp.

GOVERNMENT AND OTHER REGULATIONS

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

LABOUR AGREEMENTS AND COMPETITION FOR PROFESSIONAL SKILLED LABOUR

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

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

MAINTENANCE OBLIGATIONS AND FACILITY DISRUPTIONS

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

MOUNTAIN PINE BEETLE

As noted earlier in this document (Section (iv) of the Overview of 2012), timber affected by the Mountain Pine Beetle continued to be a focus for Canfor harvesting activities in BC in 2012. The impact of the infestation on Canfor's operations continues to be manageable in the short term and the Company plans to continue harvesting MPB infected fibre. However, given the nature and extent of the infestation, the longer term operational and financial impact on Canfor could be significant.

In the long term, the volume of fibre available to Canfor is impacted by the length of time that the dead pine remains of sufficient quality to produce commercially viable sawlogs. Current indications are that this period can vary from 3 to 15 years, depending on soil moisture levels. One approach taken to increase utilization of MPB infected fibre has been to adjust harvesting processes to allocate more of this timber to pulping operations.

In Alberta, the Mountain Pine Beetle outbreak, which is significantly less wide-spread than in the BC Interior, also continues to impact the quality of fibre but to a lesser degree. Monitoring of MPB populations in 2012 indicated that mortality from winter weather continued to reduce the spread of the beetle in all except the northern portion of Alberta. Licensees continue to focus harvest activities in Alberta on "green" attacked and susceptible timber types. Canfor has received approval of a modest increase in allowable annual cut in order to accelerate the harvest of pine stands that are most susceptible to attack. The Alberta government continues to fund MPB programs, focusing on monitoring, which helps with forest planning, and some single tree removal in isolated areas.

RESIDUAL FIBRE REVENUES

Wood chips are a residual product of Canfor's lumber manufacturing process and are primarily sold to Canfor Pulp. These chips are the principal raw material utilized by Canfor Pulp in its pulp manufacturing operations. Canfor has a Fibre Supply Agreement with Canfor Pulp, which contains a pricing formula that currently results in Canfor Pulp paying Canfor a price for wood chips based on pulp markets and Canfor Pulp's product mix. Canfor currently provides approximately 59% of Canfor Pulp's chip requirements. If market conditions caused Canfor Pulp to cease pulp operations for an extended period of time, Canfor would have a limited market for its chip supply and this could affect its ability to run its sawmills economically. Similarly, if lumber market conditions were such that Canfor is unable to provide the current volume of chips to Canfor Pulp as a result of sawmill closures, whether temporary or permanent, Canfor Pulp's financial results could be materially affected.

Bark hog is a residual product of Canfor's lumber manufacturing process. Bark hog has increasing value to Canfor, for internal use in bark-fueled thermal oil energy systems used to dry lumber, as well as for sales externally or, in the Prince George region, to Canfor Pulp to be used in the generation of steam to manufacture power and heat.

Sales of sawdust and shavings are made primarily to other users and the demand is varied and robust.

SOFTWOOD LUMBER AGREEMENT

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

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

In addition to the above, the SLA includes a "Surge Mechanism", which increases the export tax rate for the month by 50% when the monthly volume of exports from a region exceeds a certain "Trigger Volume" as defined in the SLA. In 2012, the Company paid surge tax of \$0.1 million on shipments from Alberta. The Company has attempted to minimize the impact of the surge tax by directing shipments from the Company's Alberta operation to domestic or offshore markets where possible.

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

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

STUMPAGE RATES

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

Canfor is actively participating in discussions on MPS with the Ministry, which is scheduled for its seventh annual update on July 1, 2013. Canfor will continue to seek to manage and reduce the stumpage costs for its Interior operations under the stumpage appraisal system. The near-term imperative is to ensure that the stumpage system accurately reflects the market value of timber and is responsive to the deteriorating quality of the beetle-impacted fibre. Further changes to the BC Interior market driven stumpage system and resultant stumpage rates could have a material impact on Canfor's business.

The Alberta government is currently reviewing their provincial stumpage rates. The outcome from this review is uncertain at this time and could adversely impact stumpage rates in 2013 and beyond.

For the Company's operations in North and South Carolina, the Company does not directly own timberlands or have any lease rights to timber. There is therefore a risk that traditional sellers of timber may discontinue selling logs to our mills.

TRANSPORTATION SERVICES

Canfor relies primarily on third parties for transportation of its products, as well as delivery of raw materials, a significant portion of which are transported by railroad, trucks and ships. If any of Canfor's third party transportation providers were to fail to deliver the raw materials or products or distribute them in a timely manner, Canfor may be unable to sell those products at full value, or at all, or unable to manufacture its products in response to customer demand, which could have a material adverse effect on Canfor's financial condition and operating results. In addition, if any of these third parties were to cease operations, suffer labour-related disruptions, or cease doing business with Canfor, the Company's operations or cost structure may be adversely impacted. The protracted downturn in the U.S. economy has adversely affected the availability of trucks throughout North America over the past several years. If market conditions in the trucking industry continue to worsen, competition for trucking assets could affect Canfor's ability to move its logs, lumber and wood chips at market competitive prices.

OUTSTANDING SHARE DATA

At February 14, 2013, there were 142,752,431 common shares issued and outstanding.

DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Board of Directors and the Audit Committee. The Company's chief executive officer ("CEO") and chief financial officer ("CFO") have evaluated the effectiveness of these disclosure controls and procedures for the year ending December 31, 2012, and have concluded that they are effective.

The CEO and CFO acknowledge responsibility for the design of internal controls over financial reporting ("ICFR"), and confirm that there were no changes in these controls that occurred during the year ended December 31, 2012 which materially affected, or are reasonably likely to materially affect, the Company's ICFR. Based upon their evaluation of these controls for the year ended December 31, 2012, the CEO and CFO have concluded that these controls are operating effectively.

Additional information about the Company, including its 2012 Annual Information Form, is available at www.sedar.com or at www.canfor.com.

MANAGEMENT'S RESPONSIBILITY

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

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

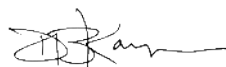
The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out these activities primarily through its Audit Committee.

The Audit Committee is comprised of three Directors who are not employees of the Company. The Committee meets

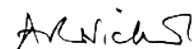
periodically throughout the year with management, external auditors and internal auditors to review their respective responsibilities, results of the reviews of internal accounting controls, policies and procedures and financial reporting matters. The external and internal auditors meet separately with the Audit Committee.

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

February 14, 2013



Don B. Kayne
President and
Chief Executive Officer



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

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF CANFOR CORPORATION

We have audited the accompanying consolidated financial statements of Canfor Corporation and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2012 and December 31, 2011 and the consolidated statements of income, the consolidated statements of other comprehensive income (loss), the consolidated statements of changes in equity and the consolidated statements of cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

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

AUDITOR'S RESPONSIBILITY

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the

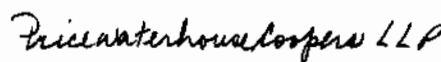
risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Canfor Corporation and its subsidiaries as at December 31, 2012 and December 31, 2011 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

February 14, 2013



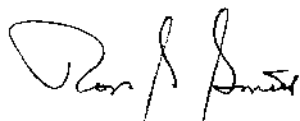
PricewaterhouseCoopers LLP
Chartered Accountants
Vancouver, British Columbia

CONSOLIDATED BALANCE SHEETS

| (millions of Canadian dollars) | As at December 31, 2012 | As at December 31, 2011 |
|---|-------------------------------|-------------------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ - | \$ 28.9 |
| Accounts receivable | | |
| Trade | 102.7 | 105.1 |
| Other | 52.2 | 65.7 |
| Inventories (Note 5) | 431.3 | 348.3 |
| Prepaid expenses | 23.4 | 20.4 |
| Assets held for sale (Note 6) | 77.3 | - |
| Total current assets | 686.9 | 568.4 |
| Property, plant and equipment (Note 7) | 1,081.7 | 1,139.2 |
| Timber licenses (Note 8) | 554.6 | 530.1 |
| Goodwill and other intangible assets (Note 9) | 80.4 | 83.0 |
| Long-term investments and other (Note 10) | 44.6 | 62.8 |
| Deferred income taxes, net (Note 22) | 39.7 | 18.1 |
| Total assets | \$ 2,487.9 | \$ 2,401.6 |
| LIABILITIES | | |
| Current Liabilities | | |
| Cheques issued in excess of cash on hand | \$ 14.7 | \$ - |
| Operating loans (Note 12) | 27.0 | - |
| Accounts payable and accrued liabilities (Note 11) | 255.7 | 290.5 |
| Current portion of long-term debt (Note 13) | 184.1 | 50.9 |
| Current portion of deferred reforestation obligations (Note 15) | 37.3 | 31.6 |
| Liabilities held for sale (Note 6) | 2.0 | - |
| Total current liabilities | 520.8 | 373.0 |
| Long-term debt (Note 13) | 100.0 | 188.1 |
| Retirement benefit obligations (Note 14) | 314.5 | 298.3 |
| Deferred reforestation obligations (Note 15) | 78.4 | 65.0 |
| Other long-term liabilities | 13.6 | 13.8 |
| Deferred income taxes, net (Note 22) | 150.8 | 103.3 |
| Total liabilities | \$ 1,178.1 | \$ 1,041.5 |
| EQUITY | | |
| Share capital (Note 18) | \$ 1,126.2 | \$ 1,125.9 |
| Contributed surplus | 31.9 | 31.9 |
| Retained earnings (deficit) | (36.7) | (24.6) |
| Accumulated foreign exchange translation differences | (10.5) | (5.9) |
| Total equity attributable to equity holders of the Company | 1,110.9 | 1,127.3 |
| Non-controlling interests | 198.9 | 232.8 |
| Total equity | \$ 1,309.8 | \$ 1,360.1 |
| Total liabilities and equity | \$ 2,487.9 | \$ 2,401.6 |

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

APPROVED BY THE BOARD



Director, R.S. Smith



Director, R.L. Cliff

CONSOLIDATED STATEMENTS OF INCOME

| Year ended December 31 (millions of Canadian dollars, except per share data) | 2012 | 2011 |
|--|----------------|----------------|
| Sales | \$ 2,714.1 | \$ 2,421.4 |
| Costs and expenses | | |
| Manufacturing and product costs | 1,820.2 | 1,627.5 |
| Freight and other distribution costs | 503.7 | 467.9 |
| Export taxes | 45.5 | 39.9 |
| Amortization | 187.2 | 169.3 |
| Selling and administration costs | 61.3 | 57.4 |
| Asset impairments (Note 7) | 0.8 | 9.2 |
| Restructuring, mill closure and severance costs (Note 17) | 18.5 | 38.3 |
| | 2,637.2 | 2,409.5 |
| Operating income | 76.9 | 11.9 |
| Finance expense, net (Note 20) | (24.7) | (26.0) |
| Foreign exchange gain (loss) on long-term debt and investments, net | 4.7 | (5.0) |
| Gain (loss) on derivative financial instruments (Note 31) | (0.8) | 3.5 |
| Other income (expense), net (Note 21) | (0.4) | 5.9 |
| Net income (loss) before income taxes | 55.7 | (9.7) |
| Income tax recovery (expense) (Note 22) | (14.3) | 20.5 |
| Net income | \$ 41.4 | \$ 10.8 |
| Net income (loss) attributable to: | | |
| Equity shareholders of the Company | \$ 32.1 | \$ (56.6) |
| Non-controlling interests | 9.3 | 67.4 |
| Net income | \$ 41.4 | \$ 10.8 |
| Net income (loss) per common share: (in dollars) | | |
| Attributable to equity shareholders of the Company | | |
| Basic and diluted (Note 23) | \$ 0.22 | \$ (0.40) |

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

CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE INCOME (LOSS) AND CHANGES IN EQUITY

| Year ended December 31 (millions of Canadian dollars) | 2012 | 2011 |
|---|-------------------|-------------------|
| CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE INCOME (LOSS) | | |
| Net income | \$ 41.4 | \$ 10.8 |
| Other comprehensive income (loss) | | |
| Foreign exchange translation differences for foreign operations | (4.6) | 4.4 |
| Defined benefit plan actuarial losses | (67.4) | (64.5) |
| Income tax recovery on defined benefit plan actuarial losses | 17.0 | 14.2 |
| Other comprehensive income (loss), net of tax | (55.0) | (45.9) |
| Total comprehensive income (loss) | \$ (13.6) | \$ (35.1) |
| Total comprehensive income (loss) attributable to: | | |
| Equity shareholders of the Company | \$ (16.7) | \$ (93.7) |
| Non-controlling interests | 3.1 | 58.6 |
| Total comprehensive income (loss) | \$ (13.6) | \$ (35.1) |
| CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY | | |
| Share capital | | |
| Balance at beginning of year | \$ 1,125.9 | \$ 1,125.4 |
| Common shares issued on exercise of stock options | 0.3 | 0.5 |
| Balance at end of year (Note 18) | \$ 1,126.2 | \$ 1,125.9 |
| Contributed surplus | | |
| Balance at beginning and end of year | \$ 31.9 | \$ 31.9 |
| Retained earnings (deficit) | | |
| Balance at beginning of year | \$ (24.6) | \$ 73.5 |
| Net income (loss) attributable to equity shareholders of the Company | 32.1 | (56.6) |
| Defined benefit plan actuarial losses, net of tax | (44.2) | (41.5) |
| Balance at end of year | \$ (36.7) | \$ (24.6) |
| Accumulated foreign exchange translation differences | | |
| Balance at beginning of year | \$ (5.9) | \$ (10.3) |
| Foreign exchange translation differences for foreign operations | (4.6) | 4.4 |
| Balance at end of year | \$ (10.5) | \$ (5.9) |
| Total equity attributable to equity holders of the Company | \$ 1,110.9 | \$ 1,127.3 |
| Non-controlling interests | | |
| Balance at beginning of year | \$ 232.8 | \$ 249.5 |
| Net income attributable to non-controlling interests | 9.3 | 67.4 |
| Defined benefit plan actuarial losses attributable to non-controlling interests | (6.2) | (8.8) |
| Distributions to non-controlling interests | (12.0) | (75.3) |
| Share exchange (Note 33) | (25.0) | - |
| Balance at end of year | \$ 198.9 | \$ 232.8 |
| Total equity | \$ 1,309.8 | \$ 1,360.1 |

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

| Year ended December 31 (millions of Canadian dollars) | 2012 | 2011 |
|--|-----------|---------|
| Cash generated from (used in): | | |
| Operating activities | | |
| Net income | \$ 41.4 | \$ 10.8 |
| Items not affecting cash: | | |
| Amortization | 187.2 | 169.3 |
| Income tax (recovery) expense (Note 22) | 14.3 | (20.5) |
| Long-term portion of deferred reforestation obligations | 2.5 | 3.1 |
| Change in fair value of long-term investment (Note 10) | (1.3) | (0.2) |
| Foreign exchange (gain) loss on long-term debt and investments, net | (4.7) | 5.0 |
| Changes in mark-to-market value of derivative financial instruments | 3.9 | (3.9) |
| Employee future benefits | (18.5) | (5.4) |
| Net finance expense (Note 20) | 24.7 | 26.0 |
| Asset impairments (Note 7) | 0.8 | 9.2 |
| Mill closure provisions (Note 17) | - | 22.5 |
| Other, net | - | (9.7) |
| Salary pension plan contributions | (35.7) | (37.3) |
| Income taxes paid, net | (8.1) | (0.3) |
| Net change in non-cash working capital (Note 23) | (75.3) | (5.6) |
| | 131.2 | 163.0 |
| Financing activities | | |
| Change in operating bank loans (Note 12) | 27.0 | - |
| Proceeds from long-term debt (Note 13) | 100.0 | - |
| Repayment of long-term debt (Note 13) | (49.9) | (81.9) |
| Finance expenses paid | (19.5) | (18.9) |
| Cash distributions paid to non-controlling interests | (15.9) | (91.0) |
| Other, net | 0.3 | 0.4 |
| | 42.0 | (191.4) |
| Investing activities | | |
| Additions to property, plant and equipment | (199.8) | (312.3) |
| Reimbursements from Federal Government under Green Transformation Program (Note 7) | 19.7 | 75.6 |
| Proceeds from disposal of property, plant and equipment | 6.1 | 1.4 |
| Acquisition of Tembec assets (Note 32) | (65.6) | - |
| Share exchange (Note 33) | 6.8 | - |
| Proceeds from redemption of asset-backed commercial paper (Note 10) | 12.9 | 29.8 |
| Other, net | 3.1 | 2.5 |
| | (216.8) | (203.0) |
| Decrease in cash and cash equivalents* | (43.6) | (231.4) |
| Cash and cash equivalents at beginning of year* | 28.9 | 260.3 |
| Cash and cash equivalents at end of year* | \$ (14.7) | \$ 28.9 |

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

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

NOTES TO THE 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, 2012 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. The Company produces softwood lumber, pulp and paper products, oriented strand board, remanufactured lumber products and specialized wood products.

2. BASIS OF PREPARATION

STATEMENT OF COMPLIANCE

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRSs" or "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 14, 2013.

BASIS OF MEASUREMENT

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

- ▶ Derivative financial instruments are measured at fair value;
- ▶ Financial instruments classified as fair value through profit and loss are measured at fair value;
- ▶ Asset retirement obligations and deferred reforestation obligations are measured at the discounted value of expected future cash flows; and
- ▶ The retirement benefit 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.

USE OF ESTIMATES AND JUDGMENTS

The preparation of the consolidated financial statements in accordance with IFRSs requires management to make judgments, estimates and assumptions that effect 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 cause actual results to differ from management estimates, and these differences could be material. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about the significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant affect 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 14 – Employee Future Benefits;
- ▶ Note 15 – Deferred Reforestation Obligations;
- ▶ Note 16 – Asset Retirement Obligations;
- ▶ Note 22 – Income Taxes; and
- ▶ Note 32 – Acquisition of Tembec Assets.

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 New South Companies Inc. ("New South"), which are wholly owned, and Canfor Pulp Products Inc. ("CPPI"), which is 50.2% owned. As described in note 33, during 2012, Canfor acquired 50.2% of the outstanding common shares of CPPI in exchange for 50.2% of the outstanding units of Canfor Pulp Limited Partnership ("CPLP"). There were no other changes in percentage ownership in 2012 or 2011 for the entities listed above.

Joint ventures are those entities over whose activities Canfor has joint control, established by contractual agreement and requiring unanimous consent for strategic financial and operating decisions. Joint ventures are proportionately consolidated. Canfor's joint ventures include a 50% interest in Canfor-LP OSB Limited Partnership ("Canfor-LP OSB"). As described in note 6, Canfor has entered into a Letter of Intent to sell its 50% interest in Canfor-LP OSB to Louisiana-Pacific Corporation ("Louisiana-Pacific").

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.

BUSINESS COMBINATIONS

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

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash in bank accounts and highly liquid money market instruments with maturities of three months or less from the date of acquisition, and are valued at cost, which approximates market value. Cash is presented net of unrepresented cheques. When the amount of unrepresented 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 amount, credit quality and term.

FINANCIAL INSTRUMENTS

NON-DERIVATIVE FINANCIAL INSTRUMENTS

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

Financial assets at fair value through net income - An instrument is classified at fair value through net income if it is held for trading or is designated as such upon initial recognition. Financial instruments at fair value through net income are measured at fair value, and changes therein are recognized in the statement of income, with attributable transaction costs being recognized in net income when incurred. Included within this category is asset-backed commercial paper ("ABCP") in 2011. The Company sold all remaining ABCP assets in 2012.

Available-for-sale financial assets - Canfor's investments in equity securities are classified as available-for-sale financial assets where it does not have control or significant influence over the investee. These instruments do not have a quoted market price in an active market. Any impairment loss on these investments is recorded through net income.

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

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

DERIVATIVE FINANCIAL INSTRUMENTS

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

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

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

INVENTORIES

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

PROPERTY, PLANT AND EQUIPMENT

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

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

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

Amortization is recognized in net income on a straight-line basis over the estimated useful lives of each component of an item of property, plant and equipment, as set out in the table below. Land is not amortized. The significant 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 | 20 years |
| Sawmill machinery and equipment | 5 to 15 years |
| Oriented strand board machinery and equipment | 10 to 20 years |
| Logging machinery and equipment | 4 to 20 years |
| Logging roads and bridges | 5 to 25 years |
| Mobile and other equipment | 5 years |

TIMBER LICENSES

Timber licenses include tree farm licenses, forest licenses and timber licenses that are renewable with the Provinces of British Columbia, Alberta and Quebec when the relevant conditions are met. 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 an acquisition over the fair value of Canfor's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill

is tested annually for impairment and carried at cost less any accumulated impairment losses.

CUSTOMER AGREEMENTS

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

COMPUTER SOFTWARE

Software development costs relate to major software systems purchased or developed by the Company. These costs are amortized on a straight-line basis over periods not exceeding five 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 assistance related to non-capital projects is recorded as a reduction of the related expenses.

ASSET IMPAIRMENT

Canfor's property, plant and equipment, timber licenses and 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, except for goodwill which is reviewed annually.

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 units or "CGU").

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

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

Financial assets are reviewed at each reporting date to determine whether there is evidence indicating they are impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative impact on estimated future cash flows from that asset. An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. All impairment losses are recognized in net income.

EMPLOYEE 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 pension plans are recognized as an employee benefit expense in net income when they are earned.

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 retirement benefits to most of its salaried employees and certain hourly employees not covered by forest industry union plans. Canfor also provides certain health care benefits and pension bridging benefits to eligible retired employees.

The liability 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 is calculated separately for each plan by estimating the amount of future benefit earned by employees in respect of their service in the current and prior periods; that benefit is discounted to determine its present value. The discount rate used to determine the present value of the obligation is the yield at the reporting date on high quality corporate bonds that have maturity dates approximating the terms of Canfor's obligations. The calculation is performed annually by a qualified actuary using the projected unit credit method and a measurement date of December 31. The pension deficit or surplus is adjusted on a quarterly basis for any material changes in underlying assumptions.

Canfor recognizes all actuarial gains and losses arising from defined benefit plans in other comprehensive income in the year 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 cost. The main classes of provision recognized by Canfor are as follows:

ASSET RETIREMENT OBLIGATIONS

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

DEFERRED REFORESTATION OBLIGATIONS

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

RESTRUCTURING

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

SHARE-BASED COMPENSATION

Canfor has two share-based compensation plans, as described in note 19.

Compensation expense is recognized for Canfor's Deferred Share Unit ("DSU") Plans when the DSUs are granted, with a corresponding increase to liabilities. The liability is remeasured at each reporting date and at settlement date, with any changes in the fair value of the liability recognized as compensation expense in net income. The fair value of the DSUs is determined with reference to the market price of Canfor's shares as at the date of valuation. Cash consideration received from employees when they exercise the options is credited to share capital.

REVENUE RECOGNITION

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

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

INCOME TAXES

Income tax expense comprises current and deferred tax. Current and deferred tax 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 and long-term debt is denominated in foreign currencies, principally the US dollar. Transactions in foreign currencies are translated to the functional currencies of the respective entities at exchange rates at 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 at the reporting date. The income and expenses of foreign operations are translated to the Canadian dollar at exchange rates at 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 New South, which is a wholly-owned subsidiary based in the U.S.

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 ACCOUNTING POLICY

Effective January 1, 2012, the Company retroactively changed its accounting policy for the presentation of interest expense and expected rate of return on assets of defined benefit post-retirement plans. The net expense has been reclassified from operating income, where it was included in manufacturing and product costs and in selling and administration costs, to net finance expense. Management considers the classification of net pension interest expense as a finance expense more accurately reflects the nature of this cost. The effect on the financial statements for the year ended December 31, 2011 is an increase in operating income, and an increase in net finance expense, of \$3.5 million. There is no impact on amounts recorded in the consolidated balance sheet or opening equity as at January 1, 2012.

ACCOUNTING STANDARDS ISSUED AND NOT APPLIED

Unless otherwise noted, the following new or revised standards and amendments as adopted by the IASB are effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. These new and revised accounting standards have not yet been adopted by Canfor and the Company does not plan to early adopt any of the standards.

CONSOLIDATION AND INTERESTS IN OTHER ENTITIES

In May 2011, as part of its consolidation project, the IASB issued the following new suite of consolidation and related standards. The suite is intended to cover all aspects of interests in other entities from determination of how to account for interests in other entities to required disclosure of the interest in those entities. Early adoption is permitted provided that the entire suite of consolidation standards is adopted at the same time.

- ▶ IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvements with the investee and has the ability to affect those returns through its power over the investee. IFRS 10 replaces SIC-12, *Consolidation – Special Purpose Entities*, and parts of IAS 27, *Consolidated and Separate Financial Statements*. IFRS 10 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- ▶ IFRS 11, *Joint Arrangements*, redefines joint operations and joint ventures with a focus on the rights and obligations of an arrangement, rather than its legal form. The new Standard requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting, whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities – Non-monetary Contributions by Venturers*.

Under IFRS 11, Canfor's 50% interest in Canfor-LP OSB is classified as a joint venture and will be accounted for using the equity method of accounting until completion of the sale (Note 6). The Company currently proportionately consolidates Canfor-LP OSB in accordance with IAS 31.

- ▶ IFRS 12, *Disclosure of Interests in Other Entities*, carries forward existing disclosure requirements and introduces additional disclosures that address the nature of, and risks associated with, an entity's interests in other entities. IFRS 12 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- ▶ There have been amendments to existing standards, including IAS 27 (2011), *Separate Financial Statements*, and IAS 28 (2011), *Investments in Associates and Joint Ventures*. IAS 27 (2011) addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 (2011) sets out the equity accounting for joint ventures and associates, once the assessment of the arrangement has been made under IFRS 11. Canfor's interest in Canfor-LP OSB will be accounted for in accordance with IAS 28 (2011). The amendments to IAS 27 are not expected to have a material impact on amounts recorded in the financial statements of the Company.

EMPLOYEE BENEFITS

- ▶ IAS 19, *Employee Benefits*, has been amended to make changes to the recognition and measurement of defined benefit pension expense and termination benefits and to enhance the disclosure of all employee benefits. Pension benefit cost will be split between (i) the cost of benefits accrued in the current period (service cost) and benefit

changes (past-service costs (including plan amendments, settlements and curtailments)); and (ii) finance expense or income. Interest cost and expected return on plan assets, which currently reflect different rates, will be replaced with a net interest amount that is calculated by applying one discount rate to the net defined benefit liability (asset). The principal impact on the Company of this portion of the amended Standard is expected to be an increase in net finance cost as the Company's return on plan assets will effectively be estimated at a lower rate.

The amended Standard also requires immediate recognition of actuarial gains and losses in other comprehensive income as they arise, without subsequent recycling to net income. This is consistent with the Company's current accounting policy.

In addition, under the amended Standard, the impact of plan amendments related to past service will no longer be recognized over a vesting period but instead will be recognized immediately in the period of a plan amendment.

The amended Standard will result in an increase in operating income of approximately \$1.5 million offset by an increase in finance expense of approximately \$9.2 million in the 2012 comparative financial statements.

OTHER STANDARDS AND AMENDMENTS

- ▶ IFRS 9, *Financial Instruments*, addresses classification and measurement of financial assets and financial liabilities, and is effective January 1, 2015, with earlier adoption permitted. The new Standard limits the number of categories for classification of financial assets to two: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Equity instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. IFRS 9 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- ▶ IFRS 13, *Fair Value Measurement*, clarifies that fair value is the price that would be received on sale of an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. IFRS 13 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- ▶ IAS 1, *Presentation of Financial Statements*, has been amended to require entities to separate items presented in other comprehensive income ("OCI") into two groups, based on whether or not items may be recycled to net income in the future. The amendment is effective for annual periods beginning on or after July 1, 2012, with earlier application permitted. IAS 1 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.

5. INVENTORIES

| (millions of Canadian dollars) | As at December 31, 2012 | As at December 31, 2011 |
|--------------------------------|-------------------------------|-------------------------------|
| Finished products | \$ 205.8 | \$ 186.3 |
| Logs | 119.4 | 55.9 |
| Residual fibre | 11.5 | 17.3 |
| Materials and supplies | 94.6 | 88.8 |
| | \$ 431.3 | \$ 348.3 |

In 2012, costs of raw materials, consumables and changes in finished products recognized as manufacturing and product costs amounted to \$786.2 million (2011 - \$766.0 million). The above inventory balances are stated after inventory write-downs from cost to net realizable value. No write-downs were included in inventory at December 31, 2012 (2011 - \$15.5 million). At December 31, 2012, an amount of \$4.3 million was reclassified from inventories to assets held for sale (Note 6).

6. ASSETS AND LIABILITIES HELD FOR SALE

On November 28, 2012, the Company entered into a Letter of Intent with Louisiana-Pacific to sell its 50% share in Canfor-LP OSB for a price of \$70.0 million plus working capital. As part of the sale, Canfor may receive additional annual consideration over a 3 year period based on Peace Valley OSB's annual adjusted earnings before interest, tax, depreciation and amortization. On completion of the sale, Louisiana-Pacific will become the sole owner of the Peace Valley OSB mill. At

December 31, 2012, the assets and liabilities to be sold have been reclassified as held for sale and the non-current assets have been measured at the lower of the carrying amount and the fair value less cost to sell. No impairment was recorded on reclassification as the fair value less cost to sell exceeded the carrying amount. The transaction is currently scheduled to close in the first half of 2013.

At December 31, 2012, the following assets and liabilities are classified as held for sale:

| (millions of Canadian dollars) | As at December 31, 2012 |
|--|-------------------------------|
| Accounts receivable | \$ 3.9 |
| Inventories | 4.3 |
| Prepaid expenses | 0.3 |
| Property, plant and equipment | 68.8 |
| Assets held for sale | \$ 77.3 |
| Accounts payable and accrued liabilities | \$ 2.0 |
| Liabilities held for sale | \$ 2.0 |

There are no cumulative income or expenses included in other comprehensive income (loss) relating to the assets and liabilities held for sale.

7. PROPERTY, PLANT AND EQUIPMENT

| (millions of Canadian dollars) | Land | Pulp and kraft paper mills | Sawmills, plywood and OSB plants | Logging assets and other equipment | Total |
|---|----------|----------------------------|----------------------------------|------------------------------------|--------------|
| Cost | | | | | |
| Balance at January 1, 2011 | \$ 44.7 | \$ 1,399.1 | \$ 1,336.4 | \$ 189.3 | \$ 2,969.5 |
| Additions ¹ | 2.0 | 85.8 | 155.5 | 6.7 | 250.0 |
| Disposals | - | (42.6) | (31.5) | (1.6) | (75.7) |
| Effect of movements in exchange rates | 0.4 | - | 2.6 | - | 3.0 |
| Balance at December 31, 2011 | \$ 47.1 | \$ 1,442.3 | \$ 1,463.0 | \$ 194.4 | \$ 3,146.8 |
| Additions ¹ | 0.3 | 65.7 | 102.1 | 8.2 | 176.3 |
| Additions due to acquisition (Note 32) | 3.0 | - | 6.5 | - | 9.5 |
| Disposals | (2.7) | (25.0) | (83.2) | (1.5) | (112.4) |
| Reclassified to held for sale (Note 6) | (1.6) | - | (132.4) | (0.4) | (134.4) |
| Effect of movements in exchange rates | (0.4) | - | (2.9) | - | (3.3) |
| Balance at December 31, 2012 | \$ 45.7 | \$ 1,483.0 | \$ 1,353.1 | \$ 200.7 | \$ 3,082.5 |
| Amortization and impairment losses | | | | | |
| Balance at January 1, 2011 | \$ (7.0) | \$ (885.7) | \$ (857.6) | \$ (170.1) | \$ (1,920.4) |
| Amortization for the year | - | (67.3) | (77.6) | (4.3) | (149.2) |
| Impairment losses | - | - | (7.9) | (0.8) | (8.7) |
| Disposals | - | 41.6 | 29.5 | 1.3 | 72.4 |
| Effect of movements in exchange rates | - | - | (1.7) | - | (1.7) |
| Balance at December 31, 2011 | \$ (7.0) | \$ (911.4) | \$ (915.3) | \$ (173.9) | \$ (2,007.6) |
| Amortization for the year | - | (68.3) | (94.3) | (4.4) | (167.0) |
| Impairment losses | - | - | (0.8) | - | (0.8) |
| Disposals | - | 24.6 | 81.6 | 1.2 | 107.4 |
| Reclassified to held for sale (Note 6) | - | - | 65.2 | 0.4 | 65.6 |
| Effect of movements in exchange rates | - | - | 1.6 | - | 1.6 |
| Balance at December 31, 2012 | \$ (7.0) | \$ (955.1) | \$ (862.0) | \$ (176.7) | \$ (2,000.8) |
| Carrying amounts | | | | | |
| At January 1, 2011 | \$ 37.7 | \$ 513.4 | \$ 478.8 | \$ 19.2 | \$ 1,049.1 |
| At December 31, 2011 | \$ 40.1 | \$ 530.9 | \$ 547.7 | \$ 20.5 | \$ 1,139.2 |
| At December 31, 2012 | \$ 38.7 | \$ 527.9 | \$ 491.1 | \$ 24.0 | \$ 1,081.7 |

(1) Net of capital expenditures by CPPI that are financed by the federal government-funded Green Transformation Program and other government grants.

Included in the above are assets under construction in the amount of \$28.9 million (2011 - \$33.3 million), which as at December 31, 2012 have not been amortized.

In October 2009, the Canadian federal government announced the introduction of a Pulp and Paper Green Transformation Program (the "Program") designed to reimburse funds spent by Canadian kraft pulp producers on qualifying energy and environmental capital projects. CPPI was allocated \$122.2 million from this Program, most of which related to the installation of a recovery boiler and precipitator upgrade at the Northwood pulp mill. As of December 31, 2012, CPPI has spent its full allocation under the Program. During 2012, CPPI received reimbursements totaling \$19.7 million (2011 - \$75.6 million), and no amounts (2011 - \$19.7 million) were receivable at year end. These projects are expected to provide economic and environmental benefits to CPPI's operations.

IMPAIRMENT LOSS

The Company reviews the carrying values of its long-lived assets, including property, plant and equipment and timber licenses, on a regular basis as events or changes in circumstances may warrant. A review of the carrying values of the Company's sawmill and panel operations and various other assets was undertaken in 2011 and 2012. Recoverable amounts were determined at all CGU's with indicators of impairment in 2012.

The recoverable amounts of property, plant and equipment, and timber licenses for impairment assessment purposes were determined using a discounted cash flow calculation to estimate their value in use, using cash flows forecast for periods consistent with the CGU's useful life. Key assumptions used in

these cash flow forecasts included forecast prices and foreign exchange rates which the Company's management determined with reference to external publications including Resource Information Systems, Inc. ("RISI") and Forest Economic Advisors ("FEA") publications. A pre-tax discount rate of 11.0% and inflation rate of 2.0% were used for the purposes of the calculations in 2012 and 2011.

Impairment charges of \$0.8 million were recorded in 2012 on certain damaged panel assets. In 2011, the Company recorded impairment charges totaling \$9.2 million, with \$7.2 million relating to lumber assets and \$2.0 million relating to panel assets. Of the total, \$8.7 million of this impairment was recorded against property, plant and equipment, with the remaining \$0.5 million recorded against other inventory.

8. TIMBER LICENSES

(millions of Canadian dollars)

| | |
|--|------------|
| Cost | |
| Balance at January 1, 2011 and December 31, 2011 | \$ 840.2 |
| Additions due to acquisition (Note 32) | 43.5 |
| Disposals | (2.0) |
| Balance at December 31, 2012 | 881.7 |
| Amortization and impairment losses | |
| Balance at January 1, 2011 | \$ (293.5) |
| Amortization for the year | (16.6) |
| Balance at December 31, 2011 | \$ (310.1) |
| Amortization for the year | (17.1) |
| Disposal | 0.1 |
| Balance at December 31, 2012 | \$ (327.1) |
| Carrying amounts | |
| At January 1, 2011 | \$ 546.7 |
| At December 31, 2011 | \$ 530.1 |
| At December 31, 2012 | \$ 554.6 |

As described in note 32, additions to timber licenses during 2012 related to the acquisition of Tembec Industries Ltd.'s ("Tembec") Southern British Columbia Interior wood product assets, which included approximately 1.1 million cubic meters of combined crown, private land and contract annual allowable cut. In late 2012, the Company disposed of certain timberlands in the United States.

9. GOODWILL AND OTHER INTANGIBLE ASSETS

(millions of Canadian dollars)

| | Goodwill | Customer Agreements | Other | Total |
|--------------------------------------|----------|------------------------|-----------|-----------|
| Cost | | | | |
| Balance at January 1, 2011 | \$ 69.6 | \$ 26.0 | \$ 23.4 | \$ 119.0 |
| Additions | - | - | 0.2 | 0.2 |
| Effect of movement in exchange rates | 1.6 | 0.5 | - | 2.1 |
| Balance at December 31, 2011 | \$ 71.2 | \$ 26.5 | \$ 23.6 | \$ 121.3 |
| Additions | - | - | 2.2 | 2.2 |
| Effect of movement in exchange rates | (1.5) | (0.6) | - | (2.1) |
| Balance at December 31, 2012 | \$ 69.7 | \$ 25.9 | \$ 25.8 | \$ 121.4 |
| Amortization | | | | |
| Balance at January 1, 2011 | \$ - | \$ (12.6) | \$ (21.9) | \$ (34.5) |
| Amortization for the year | - | (2.6) | (0.9) | (3.5) |
| Effect of movement in exchange rates | - | (0.3) | - | (0.3) |
| Balance at December 31, 2011 | \$ - | \$ (15.5) | \$ (22.8) | \$ (38.3) |
| Amortization for the year | - | (2.6) | (0.5) | (3.1) |
| Effect of movement in exchange rates | - | 0.4 | - | 0.4 |
| Balance at December 31, 2012 | \$ - | \$ (17.7) | \$ (23.3) | \$ (41.0) |
| Carrying amounts | | | | |
| At January 1, 2011 | \$ 69.6 | \$ 13.4 | \$ 1.5 | \$ 84.5 |
| At December 31, 2011 | \$ 71.2 | \$ 11.0 | \$ 0.8 | \$ 83.0 |
| At December 31, 2012 | \$ 69.7 | \$ 8.2 | \$ 2.5 | \$ 80.4 |

Goodwill relates to Canfor's U.S. subsidiary, New South Companies Inc., and is denominated in US dollars. Goodwill is not allocated any level lower than the New South company and therefore this is considered to be the CGU for the purposes of the review of goodwill for impairment. The recoverable amount of the goodwill is determined based on an assessment of the value in use of the CGU. This is estimated using a discounted cash flow model to value the New South company.

As part of this process, assumptions are made in relation to forecast prices and exchange rates. Key assumptions used in the cash flow model included forecast prices and foreign

exchange rates which the Company's management determined with reference to external publications including RISI and FEA publications. A pre-tax discount rate of 11.0% and inflation rate of 2.0% were used for the purposes of the calculations in 2012 and 2011. 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 2012 or 2011.

10. LONG-TERM INVESTMENTS AND OTHER

| (millions of Canadian dollars) | As at December 31, 2012 | As at December 31, 2011 |
|--|-------------------------------|-------------------------------|
| Asset-backed commercial paper ("ABCP") | \$ - | \$ 11.8 |
| Other investments | 23.7 | 24.3 |
| Investment tax credits | 8.6 | 8.6 |
| Defined benefit plan assets (Note 14) | 1.4 | 3.0 |
| Other deposits, loans and advances | 10.9 | 15.1 |
| | \$ 44.6 | \$ 62.8 |

In 2012, the Company recorded a gain of \$1.3 million (2011 - \$0.2 million) arising from a change in the fair value of its US dollar denominated investment in ABCP. In addition, net proceeds of \$12.9 million were received from the redemption of the Company's remaining investment in ABCP in 2012 (2011 - \$29.8 million).

Other investments include the Company's 33.3% investment in Lakeland Mills Ltd. and Winton Global Lumber Ltd. The Company does not exercise significant influence with respect to this investment. At December 31, 2012, indicators of impairment exist at Lakeland Mills Ltd. as a result of a fire which destroyed the Company's sawmill earlier in 2012. The fair value less cost to sell of Canfor's 33.3% interest was estimated and no impairment charges were required as a result of Management's review.

11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

| (millions of Canadian dollars) | As at December 31, 2012 | As at December 31, 2011 |
|---|-------------------------------|-------------------------------|
| Trade payables and accrued liabilities | \$ 145.6 | \$ 159.7 |
| Accrued payroll and related liabilities | 77.7 | 73.2 |
| Derivative financial instruments | 4.2 | 1.8 |
| Restructuring, mill closure and severance costs | 7.4 | 27.1 |
| Interest and distributions payable | 1.8 | 6.9 |
| Other | 19.0 | 21.8 |
| | \$ 255.7 | \$ 290.5 |

At December 31, 2012, an amount of \$2.0 million was reclassified from trade payables and accrued liabilities to liabilities held for sale.

12. OPERATING LOANS

| (millions of Canadian dollars) | As at December 31, 2012 | As at December 31, 2011 |
|--|-------------------------------|-------------------------------|
| Canfor (excluding CPLP) | | |
| Principal operating loans | \$ 350.0 | \$ 350.0 |
| Facility A | - | 12.9 |
| Total operating loans - Canfor (excluding CPLP) | 350.0 | 362.9 |
| Drawn | (27.0) | - |
| Letters of credit (principally unregistered pension plans) | (18.0) | (17.2) |
| Total available operating loans - Canfor (excluding CPLP) | \$ 305.0 | \$ 345.7 |
| CPLP | | |
| Operating loan facility | \$ 110.0 | \$ 40.0 |
| Bridge loan credit facility (maximum \$30.0 million) | - | 19.7 |
| Facility for BC Hydro letter of credit | 7.5 | 10.4 |
| Total operating loans - CPLP | 117.5 | 70.1 |
| Drawn | - | - |
| Letters of credit (for general business purposes) | (1.7) | (0.5) |
| BC Hydro letter of credit | (7.5) | (10.4) |
| Total available operating loans - CPLP | \$ 108.3 | \$ 59.2 |
| Consolidated: | | |
| Total operating loans | \$ 467.5 | \$ 433.0 |
| Total available operating loans | \$ 413.3 | \$ 404.9 |

Canfor's, excluding CPLP, principal operating loans mature on October 31, 2015. Interest is payable at floating rates based on lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin that varies with the Company's net debt to total capitalization ratio.

Facility A, which was for US\$12.7 million at December 31, 2011, expired in January 2012, and was non-recourse to the Company under normal circumstances, except for an amount of US\$6.7 million. The ABCP assets of the Company had been pledged as security to support this credit facility which had similar terms to the other operating loans, except that the interest rate was plus or minus a margin.

The terms of CPLP's principal bank loan facility include interest payable at floating rates that vary depending on the ratio of net debt to operating earnings before interest, taxes, amortization and certain other non-cash items, and is based on lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin. In the fourth quarter of 2012, CPLP entered into a new \$110.0

million operating loan facility replacing its previous \$40.0 million operating loan facility. The new facility has certain financial covenants that stipulate maximum net debt to total capitalization ratios and minimum net worth amounts based on shareholders' equity. The maturity date of the new facility is November 13, 2016.

During 2012, CPLP terminated its \$30.0 million bridge loan credit facility in conjunction with the completion of the Canadian Federal Government Green Transformation Program ("Program"). The facility was used to fund timing differences between expenditures and reimbursements for projects funded by the Program. The Company has a separate facility with a maturity date of November 30, 2013 to cover a \$7.5 million standby letter of credit issued to BC Hydro.

As at December 31, 2012, the Company and CPLP were in compliance with all covenants relating to their operating loans.

Substantially all borrowings of CPLP (operating loans and long-term debt) 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:

SUMMARY OF LONG-TERM DEBT

| (millions of Canadian dollars) | As at December 31, 2012 | As at December 31, 2011 |
|--|-------------------------------|-------------------------------|
| Privately placed senior notes | | |
| Canfor Corporation | | |
| US\$50 million, interest at 6.33%, repaid February 2, 2012 | \$ - | \$ 50.9 |
| US\$75 million, interest at 5.42%, repayable April 1, 2013 | 74.7 | 76.2 |
| CAD\$100 million, floating interest, repayable February 13, 2017 | 100.0 | - |
| Canfor Pulp Limited Partnership | | |
| US\$110 million, interest at 6.41%, repayable November 30, 2013 | 109.4 | 111.9 |
| | \$ 284.1 | \$ 239.0 |
| Less: current portion | (184.1) | (50.9) |
| Long-term portion | \$ 100.0 | \$ 188.1 |

In 2012, the Company repaid \$49.9 million (US\$50.0 million) of 6.33% interest rate privately placed senior notes. The Company also issued new term debt totaling \$100.0 million which was used to fund the above debt repayment and the acquisition of assets from Tembec (Note 32). The new debt is in the form of an unsecured non-revolving term loan, with a maturity date of February 13, 2017. Interest rates are floating based on the lenders' Canadian prime rate or bankers acceptances.

FAIR VALUE OF TOTAL LONG-TERM DEBT

The fair value of total long-term debt at December 31, 2012 was \$288.8 million (2011 - \$246.6 million). The fair value was determined using prevailing market rates for long-term debt with similar characteristics and risk profiles.

SCHEDULED LONG-TERM DEBT REPAYMENTS AND INTEREST PAYMENTS

Long-term debt repayments and interest payments on the Company's fixed rate debt for the next five years are as follows:

| (millions of Canadian dollars) | Debt Repayments | Interest Payments |
|--------------------------------|--------------------|----------------------|
| 2013 | \$ 184.1 | \$ 9.1 |
| 2014 | - | - |
| 2015 | - | - |
| 2016 | - | - |
| 2017 | 100.0 | - |
| | \$ 284.1 | \$ 9.1 |

The interest payments associated with the floating rate debt will depend on the lenders' Canadian prime rate or bankers acceptance rate during the year of payment.

14. EMPLOYEE FUTURE BENEFITS

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

Total cash payments for employee future benefits for 2012 were \$76.9 million (2011 - \$74.4 million), consisting of cash contributed by Canfor to its funded pension plans, cash payments directly to beneficiaries for its unfunded other benefit plans, cash contributed to its defined contribution plans, and cash contributed to forest industry union defined benefit plans.

DEFINED BENEFIT PLANS

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

In 2012, Canfor had five registered defined benefit plans for which actuarial valuations are performed every three years. The most recent actuarial valuation for funding purposes of Canfor's single largest pension plan was as of December 31, 2010, and the next required plan valuation is currently scheduled for December 31, 2013.

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

DEFINED BENEFIT PLAN ASSETS

| | 2012 | | 2011 | |
|---------------------------------------|-----------------------|---------------------|-----------------------|---------------------|
| | Pension Benefit Plans | Other Benefit Plans | Pension Benefit Plans | Other Benefit Plans |
| <i>(millions of Canadian dollars)</i> | | | | |
| Fair market value of plan assets | | | | |
| Beginning of year | \$ 529.9 | \$ - | \$ 513.5 | \$ - |
| Actual return on plan assets | 59.4 | - | 10.2 | - |
| Canfor contributions | 47.4 | 5.7 | 48.3 | 5.5 |
| Employee contributions | 0.7 | - | 0.8 | - |
| Settlements | (7.1) | - | - | - |
| Benefit payments | (38.5) | (5.7) | (42.9) | (5.5) |
| End of year | \$ 591.8 | \$ - | \$ 529.9 | \$ - |

Plan assets consist of the following:

| Asset category | As at | |
|-------------------|---------------------------|-------------------|
| | December 31, 2012 | December 31, 2011 |
| | Percentage of Plan Assets | |
| Equity securities | 66% | 61% |
| Debt securities | 33% | 39% |
| Other | 1% | - |
| | 100% | 100% |

DEFINED BENEFIT PLAN OBLIGATIONS

| | 2012 | | 2011 | |
|---------------------------------------|-----------------------|---------------------|-----------------------|---------------------|
| | Pension Benefit Plans | Other Benefit Plans | Pension Benefit Plans | Other Benefit Plans |
| <i>(millions of Canadian dollars)</i> | | | | |
| Accrued benefit obligation | | | | |
| Beginning of year | \$ 631.6 | \$ 174.5 | \$ 608.0 | \$ 150.8 |
| Current service cost | 9.5 | 2.4 | 10.2 | 1.8 |
| Interest cost | 31.0 | 8.9 | 32.7 | 8.3 |
| Employee contributions | 0.7 | - | 0.8 | - |
| Benefit payments | (38.5) | (5.7) | (42.9) | (5.5) |
| Plan amendments / settlements | (5.6) | (15.7) | - | - |
| Actuarial loss (gain) | 64.8 | 24.2 | 21.5 | 19.2 |
| Other | - | (0.4) | 1.3 | (0.1) |
| End of year | \$ 693.5 | \$ 188.2 | \$ 631.6 | \$ 174.5 |

Of the defined benefit plan obligation of \$693.5 million (2011 - \$631.6 million), \$11.3 million (2011 - \$12.2 million) relates to plans that are wholly unfunded and \$682.2 million (2011 - \$619.4 million) relates to plans that are wholly or partly funded. At December 31, 2012, certain liabilities for unregistered plans

were secured by a letter of credit in the amount of \$12.2 million (2011 - \$12.2 million).

The total obligation for the other benefit plans of \$188.2 million (2011 - \$174.5 million) is unfunded.

RECONCILIATION OF FUNDED STATUS OF BENEFIT PLANS TO AMOUNTS RECORDED IN THE FINANCIAL STATEMENTS

| | December 31, 2012 | | December 31, 2011 | |
|--|-----------------------|---------------------|-----------------------|---------------------|
| | Pension Benefit Plans | Other Benefit Plans | Pension Benefit Plans | Other Benefit Plans |
| <i>(millions of Canadian dollars)</i> | | | | |
| Fair market value of plans assets | \$ 591.8 | \$ - | \$ 529.9 | \$ - |
| Accrued benefit obligation | (693.5) | (188.2) | (631.6) | (174.5) |
| Funded status of plans – surplus (deficit) | \$ (101.7) | \$ (188.2) | \$ (101.7) | \$ (174.5) |
| Unamortized past service costs | - | (2.8) | - | 0.1 |
| Accrued benefit liability | \$ (101.7) | \$ (191.0) | \$ (101.7) | \$ (174.4) |
| Pension bridge benefits | (17.6) | - | (16.8) | - |
| Other pension plans | (2.8) | - | (2.4) | - |
| Total accrued benefit liability, net | \$ (122.1) | \$ (191.0) | \$ (120.9) | \$ (174.4) |

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

| | December 31, 2012 | | December 31, 2011 | |
|---------------------------------------|-----------------------|---------------------|-----------------------|---------------------|
| | Pension Benefit Plans | Other Benefit Plans | Pension Benefit Plans | Other Benefit Plans |
| <i>(millions of Canadian dollars)</i> | | | | |
| Long-term investments and other | \$ 1.4 | \$ - | \$ 3.0 | \$ - |
| Retirement benefit obligations | (123.5) | (191.0) | (123.9) | (174.4) |
| Total accrued benefit liability, net | \$ (122.1) | \$ (191.0) | \$ (120.9) | \$ (174.4) |

The following table shows the experience adjustments arising on plan liabilities and assets as a result of the differences between actuarial assumptions made at the beginning of the year and the actual experience during the year:

| | 2012 | | 2011 | |
|--|-----------------------|---------------------|-----------------------|---------------------|
| | Pension Benefit Plans | Other Benefit Plans | Pension Benefit Plans | Other Benefit Plans |
| <i>(millions of Canadian dollars)</i> | | | | |
| Experience gain (loss) arising on plan liabilities | \$ 1.9 | \$ (0.1) | \$ 3.7 | \$ 0.3 |
| Experience gain (loss) arising on plan assets | \$ 23.2 | \$ - | \$ (28.1) | \$ - |

COMPONENTS OF PENSION COST

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

| | 2012 | | 2011 | |
|---|-----------------------|---------------------|-----------------------|---------------------|
| | Pension Benefit Plans | Other Benefit Plans | Pension Benefit Plans | Other Benefit Plans |
| <i>(millions of Canadian dollars)</i> | | | | |
| Recognized in net income | | | | |
| Current service cost | \$ 9.5 | \$ 2.4 | \$ 10.2 | \$ 1.8 |
| Interest cost | 31.0 | 8.9 | 32.7 | 8.3 |
| Expected return on plan assets | (36.1) | - | (38.1) | - |
| Plan amendment / settlement loss (gain) | 1.5 | (12.9) | - | - |
| Other | - | (0.4) | 1.1 | (0.1) |
| Total, included in staff costs | \$ 5.9 | \$ (2.0) | \$ 5.9 | \$ 10.0 |
| Recognized in other comprehensive income | | | | |
| Actuarial loss (gain) immediately recognized | \$ 41.6 | \$ 24.2 | \$ 49.5 | \$ 19.2 |
| Effect of limit on recognition of asset | - | - | (4.1) | - |
| Total pension cost recognized in other comprehensive income | \$ 41.6 | \$ 24.2 | \$ 45.4 | \$ 19.2 |

In addition to the amounts shown above, the expense recorded in net income for the bridge benefits in 2012 was \$1.2 million (2011 - \$1.3 million), and \$1.1 million was charged to other comprehensive income (2011 - credit of \$1.4 million). Excluded from the above table are the amounts relating to the defined benefit pension plans of New South.

The expected return on plan assets is determined by taking into account the expected returns on the assets based on the Company's current investment policy.

SIGNIFICANT ASSUMPTIONS

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

| | December 31, 2012 | | December 31, 2011 | |
|--|-----------------------|---------------------|-----------------------|---------------------|
| | Pension Benefit Plans | Other Benefit Plans | Pension Benefit Plans | Other Benefit Plans |
| Accrued benefit obligations at reporting date: | | | | |
| Discount rate | 4.20% | 4.40% | 5.00% | 5.30% |
| Rate of compensation increases | 3.00% | n/a | 3.00% | n/a |
| Benefit costs for year ended December 31: | | | | |
| Discount rate | 5.00% | 5.30% | 5.50% | 5.75% |
| Expected return on plan assets | 7.00% | n/a | 7.00% | n/a |
| Future salary increases | 3.00% | n/a | 3.00% | n/a |

ASSUMED HEALTH CARE COST TREND RATES

| (weighted average assumptions) | December 31, 2012 | December 31, 2011 |
|--------------------------------------|-------------------|-------------------|
| Initial health care cost trend rate | 6.28% | 6.33% |
| Ultimate health care cost trend rate | 4.50% | 4.50% |
| Year ultimate rate is reached | 2029 | 2029 |

SENSITIVITY ANALYSIS

Assumed health care cost trend rates have a significant effect on the amounts reported for the other benefit plans. A one percentage point change in assumed health care cost trend rates would have the following effects for 2012:

| (millions of Canadian dollars) | 1% Increase | 1% Decrease |
|---|-------------|-------------|
| Effect on accrued benefit obligation | \$ 28.6 | \$ 22.9 |
| Effect on the aggregate service and interest cost | \$ 2.4 | \$ 1.9 |

For the Company's single largest pension plan, a one percentage point increase in the rate of return on plan assets over the year would reduce the funded deficit by an estimated \$4.1 million. A one percentage point increase in the discount rate used in calculating the actuarial estimate of future liabilities would reduce the funded deficit by an estimated \$58.3 million. These changes would only impact the Company's funding requirements in years where a new actuarial funding valuation was performed and approval for a change in annual funding contributions was obtained from the regulator.

As at December 31, 2012, Canfor estimated that it will make contribution payments of \$49.3 million to its defined benefit plans in 2013.

HISTORICAL INFORMATION

The historical information below includes both funded and unfunded pension benefit plans in aggregate.

| (millions of Canadian dollars) | 2012 | 2011 | 2010 |
|--|------------|------------|------------|
| Fair value of the plan assets | \$ 591.8 | \$ 529.9 | \$ 513.5 |
| Present value of the defined benefit obligation | (881.7) | (806.1) | (758.8) |
| Pension bridge benefits | (17.6) | (16.8) | (18.4) |
| Other pension plans | (2.8) | (2.4) | (1.0) |
| Unamortized past service costs | (2.8) | 0.1 | - |
| Effect of limit on recognition of asset | - | - | (4.1) |
| Funded status of the plans – deficit | \$ (313.1) | \$ (295.3) | \$ (268.8) |
| Experience gain (loss) arising on plan liabilities | \$ 1.8 | \$ 4.0 | \$ 19.9 |
| Experience gain (loss) arising on plan assets | \$ 23.2 | \$ (28.1) | \$ 11.8 |

DEFINED CONTRIBUTION AND OTHER PLANS

The total cost recognized in 2012 for Canfor's defined contribution plans was \$5.0 million (2011 - \$4.0 million).

Canfor contributes to various forest industry union defined benefit pension 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 cost recognized for defined contribution plans above, amounted to \$17.4 million in 2012 (2011 - \$15.1 million).

EMPLOYEE FUTURE BENEFIT PLAN AMENDMENTS / SETTLEMENTS

During the fourth quarter of 2012, the Company amended the salaried post retirement benefit plans for certain employees and retirees. The amendments reduced the Company's

retirement benefit obligation by \$15.7 million (before tax). As a result of the plan amendments, Canfor recognized an accounting gain of \$12.9 million (before tax) for vested past-service costs and deferred a gain of \$2.8 million (before tax) for unvested past-service costs. The deferred gain will be recognized on a straight line basis over the vesting period. In addition, certain other pension plan settlements in 2012 resulted in a loss of \$1.5 million (before tax).

OTHER

Canfor's total employee benefits expense includes expense for salaries and wages, benefits and employee future benefits. The total employee benefits expense in 2012 was \$487.8 million (2011 - \$436.7 million).

15. DEFERRED REFORESTATION OBLIGATIONS

The following table provides a reconciliation of the deferred reforestation obligations as at December 31, 2012 and 2011:

| [millions of Canadian dollars] | 2012 | 2011 |
|--|----------|---------|
| Reforestation obligations at beginning of year | \$ 96.6 | \$ 92.2 |
| Expense for year | 38.4 | 29.1 |
| Accretion expense | 0.7 | 1.2 |
| Additions due to acquisition (Note 32) | 16.5 | - |
| Changes in estimates | (1.7) | (1.1) |
| Paid during the year | (34.8) | (24.8) |
| Reforestation obligations at end of year | \$ 115.7 | \$ 96.6 |
| Less: current portion | (37.3) | (31.6) |
| Long-term portion | \$ 78.4 | \$ 65.0 |

The total undiscounted amount of the estimated cash flows required to settle the obligations at December 31, 2012 was \$120.0 million (2011 - \$100.7 million) with payments spread over 15 years. Due to the general long-term nature of the liability,

the most significant area of uncertainty in estimating the provision is the future costs that will be incurred. The estimated cash flows have been adjusted for inflation and discounted using risk-free rates ranging from 1.1% to 2.3% at December 31, 2012.

16. ASSET RETIREMENT OBLIGATIONS

The following table provides a reconciliation of the asset retirement obligations as at December 31, 2012 and 2011:

| [millions of Canadian dollars] | 2012 | 2011 |
|---|--------|--------|
| Asset retirement obligations at beginning of year | \$ 6.6 | \$ 6.3 |
| Accretion expense | 0.2 | 0.6 |
| Paid during the year | (0.1) | (0.1) |
| Change in estimate | - | (0.2) |
| Additions due to acquisition (Note 32) | 0.3 | - |
| Asset retirement obligations at end of year | \$ 7.0 | \$ 6.6 |

Canfor's asset retirement obligations include \$3.3 million in relation to landfill closure costs at CPPI. These obligations represent estimated undiscounted future payments of \$7.2 million to remediate the landfills at the end of their useful lives. The payments are expected to occur at periods ranging from 6 to 39 years and have been discounted at risk-free rates ranging from 1.6% to 2.4%.

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. RESTRUCTURING, MILL CLOSURE AND SEVERANCE COSTS

Restructuring, mill closure and severance costs represent costs associated with the indefinite or permanent closures of facilities and staff reductions. The expense for the year ended December 31, 2012 amounted to \$18.5 million (2011 - \$38.3 million) and principally related to ongoing costs of the Company's indefinitely idled PolarBoard panels plant and the costs of the Company's Radium sawmill prior to its restart in the fourth quarter of 2012. Costs associated with the permanently closed Rustad sawmill and permanently closed Tackama panel operations and certain restructuring costs made up the balance.

Of the 2011 expense, \$11.9 million related to severance and other costs associated with the closure of the Rustad sawmill, and \$10.6 million related to severance and other costs for the closure of the Tackama mill, both of which were announced in the fourth quarter of 2011 and took effect in January 2012. The significant majority of the remaining 2011 expense related to the ongoing costs of the Company's indefinitely idled PolarBoard panel and the costs of the Company's Vavenby sawmill prior to its restart in the third quarter of 2011.

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

| (millions of Canadian dollars) | 2012 | 2011 |
|--------------------------------|----------------|----------------|
| Lumber | \$ 11.0 | \$ 21.2 |
| Pulp & paper | 1.7 | - |
| Unallocated and other | 5.8 | 17.1 |
| | \$ 18.5 | \$ 38.3 |

The following table provides a reconciliation of the restructuring, mill closure and severance liability for the years ended December 31, 2012 and 2011:

| (millions of Canadian dollars) | 2012 | 2011 |
|--|---------------|----------------|
| Accrued liability at beginning of year | \$ 28.3 | \$ 18.4 |
| Costs accrued in the year | 7.7 | 21.8 |
| Paid during the year | (27.0) | (11.9) |
| Accrued liability at end of year | \$ 9.0 | \$ 28.3 |

18. 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

| (millions of Canadian dollars, except number of shares) | 2012 | | 2011 | |
|---|--------------------|-------------------|------------------|------------|
| | Number of Shares | Amount | Number of Shares | Amount |
| Common shares, beginning of year | 142,721,764 | \$ 1,125.9 | 142,669,347 | \$ 1,125.4 |
| Stock options exercised (Note 19) | 30,667 | 0.3 | 52,417 | 0.5 |
| Common shares, end of year | 142,752,431 | \$ 1,126.2 | 142,721,764 | \$ 1,125.9 |

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.

19. SHARE-BASED COMPENSATION

Canfor has two share-based compensation plans, which are described below.

DEFERRED SHARE UNIT PLANS

On January 1, 2002, the Company implemented a Deferred Share Unit Plan for non-employee directors of the Company. A Deferred Share Unit ("DSU") is a right granted to a non-employee director to receive one common share of the Company, purchased on the open market, or the cash equivalent at their option, on a deferred payment basis. The maximum number of DSUs outstanding under the plan is 1,000,000. Effective July 27, 2011, the Board determined to cease the issuance of DSUs for non-employee directors.

The value of the 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. The total expense recorded in relation to the DSUs for 2012 was \$0.8 million due to the revaluation of existing units (2011 - credit of \$0.1 million). The value of outstanding DSUs at December 31, 2012 was \$2.0 million (2011 - \$1.2 million).

In addition, in May 2007, the Company implemented a Deferred Share Unit Plan for the Company's former CEO (the "CEO Plan"). Pursuant to the terms of the plan, the former CEO received his annual salary in DSUs. The value of the DSUs when redeemed equalled the market value of the shares on the redemption date. The DSUs under the CEO Plan were redeemed during 2011 when the former CEO ceased employment with the Company. The CEO Plan ceased to be in use at that date. The total credit recorded in relation to the CEO Plan for 2011 was \$0.3 million.

STOCK OPTION PERFORMANCE PLAN

The Company has a stock option performance plan pursuant to which stock options were granted to selected senior officers. No new stock options were granted in 2011 or 2012. The stock option performance plan provided for the issuance of up to a maximum of 5.8 million common shares at an exercise price equal to the market price of the Company's common shares on the date of grant. However, there are various criteria that limit the amount of options exercisable during each option year within the option period. The options are for a term of 10 years and vest equally over three years. All options have fully vested. A summary of the status of the plan as of December 31, 2012 and 2011, and changes during the years ending on those dates, is presented below:

| | 2012 | | 2011 | |
|----------------------------------|------------------|---------------------------------|------------------|---------------------------------|
| | Number of Shares | Weighted Average Exercise Price | Number of Shares | Weighted Average Exercise Price |
| Outstanding at beginning of year | 38,667 | \$ 9.85 | 97,418 | \$ 9.73 |
| Exercised | (30,667) | \$ 9.86 | (52,417) | \$ 9.72 |
| Cancelled | (8,000) | \$ 9.80 | (6,334) | \$ 9.09 |
| Outstanding at end of year | - | \$ - | 38,667 | \$ 9.85 |

20. FINANCE EXPENSE, NET

(millions of Canadian dollars)

| | 2012 | 2011 |
|-----------------------|-----------|-----------|
| Finance expense | \$ (25.0) | \$ (27.9) |
| Less: Interest income | 0.3 | 1.9 |
| Finance expense, net | \$ (24.7) | \$ (26.0) |

Finance expense, net is comprised of:

(millions of Canadian dollars)

| | 2012 | 2011 |
|---------------------------------|-----------|-----------|
| Short-term finance expense, net | \$ (5.2) | \$ (5.1) |
| Long-term finance expense, net | (19.5) | (20.9) |
| Finance expense, net | \$ (24.7) | \$ (26.0) |

For the year ended December 31, 2012, short-term finance expense, net was comprised of stand-by fees for operating loans and letter of credit charges of \$5.5 million (2011 - \$6.9 million), offset by interest income on cash and cash equivalents of \$0.3 million (2011 - \$1.8 million). Long-term finance expense,

net related substantially to interest expense on long-term debt, employee future benefit expense and accretion expense related to the Company's asset retirement and deferred reforestation obligations.

21. OTHER INCOME (EXPENSE), NET

| (millions of Canadian dollars) | 2012 | 2011 |
|---|----------|--------|
| Foreign exchange gain (loss) on translation of working capital | \$ (1.5) | \$ 2.0 |
| Increase in fair value of asset-backed commercial paper (Note 10) | 1.3 | 0.2 |
| Royalty fair value adjustment | 0.5 | 2.2 |
| Other, net | (0.7) | 1.5 |
| Total other income (expense), net | \$ (0.4) | \$ 5.9 |

During 2012, the Company recognized a \$0.5 million positive fair value adjustment (2011 - \$2.2 million) related to a royalty agreement associated with the 2010 sale of the Howe Sound Pulp and Paper Limited Partnership (now called 6382 Pulp and Paper Limited Partnership), a kraft pulp and newsprint mill operation jointly owned by Canfor and Oji Paper Co. Ltd.

22. INCOME TAXES

The components of income tax recovery (expense) are as follows:

| (millions of Canadian dollars) | 2012 | 2011 |
|--------------------------------|-----------|----------|
| Current | \$ (2.9) | \$ (1.7) |
| Deferred | (11.4) | 22.2 |
| Income tax recovery (expense) | \$ (14.3) | \$ 20.5 |

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

| (millions of Canadian dollars) | 2012 | 2011 |
|---|-----------|---------|
| Income tax recovery (expense) at statutory rate 2012 - 25.0% (2011 - 26.5%) | \$ (13.9) | \$ 2.6 |
| Non-taxable income related to non-controlling interests in limited partnerships | 1.7 | 17.9 |
| Entities with different income tax rates and other tax adjustments | (2.4) | 1.0 |
| Tax recovery (expense) at rates other than statutory rate | 0.1 | (0.9) |
| Permanent difference from capital gains and losses and other non-deductible items | 0.2 | (0.1) |
| Income tax recovery (expense) | \$ (14.3) | \$ 20.5 |

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, 2012 | As at December 31, 2011 |
|---|-------------------------------|-------------------------------|
| Deferred income tax assets | | |
| Accruals not currently deductible | | |
| Current | \$ 12.1 | \$ 16.2 |
| Non-current | 22.9 | 18.9 |
| Derivative financial instruments | | |
| Current | 0.9 | 0.1 |
| Non-current | 0.2 | - |
| Loss carryforwards | 75.5 | 66.4 |
| Retirement benefit obligations | 78.4 | 62.6 |
| Other | 1.4 | 1.5 |
| | \$ 191.4 | \$ 165.7 |
| Deferred income tax liabilities | | |
| Depreciable capital assets | \$ (289.2) | \$ (235.5) |
| Other intangible assets | (3.0) | (4.4) |
| Unrealized foreign exchange gains on debt | | |
| Current | (5.0) | (2.0) |
| Non-current | - | (3.6) |
| Other | (5.3) | (5.4) |
| | \$ (302.5) | \$ (250.9) |
| Total deferred income taxes, net | \$ (111.1) | \$ (85.2) |
| Less: Entities in a net deferred tax asset position | 39.7 | 18.1 |
| Deferred income taxes liability, net | \$ (150.8) | \$ (103.3) |

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

In addition to the amounts recorded to net income, a tax recovery of \$17.0 million was recorded to other comprehensive income for the year ended December 31, 2012 (2011 - recovery of \$14.2 million) in relation to actuarial losses on defined benefit employee compensation plans.

23. EARNINGS PER SHARE

Basic net income (loss) per share is calculated by dividing the net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is calculated by dividing the net income (loss) available to common shareholders by the weighted average number of common shares during the period using the treasury stock method. Under this method,

proceeds from the potential exercise of stock options are assumed to be used to purchase the Company's common shares. When there is a net loss, the exercise of stock options would result in a calculated diluted net loss per share that is anti-dilutive. As at December 31, 2012, there were no outstanding stock options.

| | 2012 | 2011 |
|--|-------------|-------------|
| Weighted average number of common shares | 142,749,096 | 142,698,624 |
| Incremental shares from potential exercise of options ¹ | - | 4,023 |
| Diluted number of common shares ¹ | 142,749,096 | 142,698,624 |

(1) Where the addition of share options to the total shares outstanding has an anti-dilutive impact on the diluted net income (loss) per share calculation, those share options have not been included in the total common shares outstanding for purposes of the calculation of diluted net income (loss) per share.

24. NET CHANGE IN NON-CASH WORKING CAPITAL

| (millions of Canadian dollars) | 2012 | 2011 |
|---|-----------|----------|
| Accounts receivable | \$ 0.4 | \$ 36.6 |
| Inventories | (60.8) | (22.6) |
| Prepaid expenses | (1.4) | 6.1 |
| Accounts payable, accrued liabilities and current portion of deferred reforestation obligations | (13.5) | (25.7) |
| Net decrease (increase) in non-cash working capital | \$ (75.3) | \$ (5.6) |

25. 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.

33.3% interest in both entities. In 2012, Canfor purchased \$2.6 million in chips (2011 - \$11.5 million) and \$4.9 million in logs (2011 - nil). The balance owed to Lakeland Mills Ltd. and Winton Global Lumber Ltd. at December 31, 2012 was \$0.2 million (2011 - \$0.9 million).

ASSOCIATES

LAKELAND MILLS LTD. AND WINTON GLOBAL LUMBER LTD.

Canfor purchases chips, lumber and logs from Lakeland Mills Ltd. and Winton Global Lumber Ltd., in which Canfor has a

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) | 2012 | 2011 |
|--------------------------------|--------|--------|
| Short-term benefits | \$ 5.8 | \$ 4.0 |
| Post-employment benefits | 0.3 | 0.3 |
| Restructuring costs | - | 1.0 |
| Other long-term benefits | - | 0.3 |
| Share-based payments | 0.8 | (0.4) |
| | \$ 6.9 | \$ 5.2 |

Short-term benefits for most members of the Board of Directors include an annual retainer as well as attendance fees. As described in note 19, members of the Board and the former CEO received deferred share units until July 27, 2011, and the related expense, including share price revaluations, is in share-based payments above.

OTHER RELATED PARTIES

During the year, Canfor made contributions to certain post-employment benefit plans for the benefit of Canfor employees. Note 14 Employee Future Benefits contains further details.

During 2012, Jim Pattison Lease provided lease management services to Canfor totalling \$0.7 million and no amounts were outstanding at December 31, 2012.

26. JOINT VENTURE

Canfor and Louisiana-Pacific jointly own Canfor-LP OSB which owns and operates an oriented strand board plant in Fort St. John, BC. Canfor has agreed to supply 330,000 cubic metres of timber annually to the joint venture from its existing timber

tenure in the area where the mill is located. During 2012, Canfor received net distributions of \$13.5 million from Canfor-LP OSB (2011 - net contributions of \$6.0 million).

The following balances, which represent Canfor's 50% ownership interest in Canfor-LP OSB, have been proportionately consolidated in Canfor's consolidated financial statements:

| (millions of Canadian dollars) | As at December 31, 2012 | As at December 31, 2011 |
|--------------------------------|-------------------------------|-------------------------------|
| Balance sheets | | |
| Current assets | \$ 10.9 | \$ 5.7 |
| Non-current assets | 68.8 | 79.4 |
| Current liabilities | (4.7) | (3.5) |
| Net assets | \$ 75.0 | \$ 81.6 |

| (millions of Canadian dollars) | 2012 | 2011 |
|------------------------------------|---------------|------------------|
| Statements of income (loss) | | |
| Sales | \$ 71.2 | \$ 44.8 |
| Costs and expenses | (64.3) | (61.1) |
| Net income (loss) | \$ 6.9 | \$ (16.3) |

In the fourth quarter of 2012, Canfor entered into a Letter of Intent with Louisiana Pacific to sell its 50% interest in Canfor-LP OSB (Note 6).

27. 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 manufacture and sale of various grades, widths and lengths of lumber products.
- ▶ *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"). This segment includes 100% of CPPI and the Taylor pulp mill.

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.

The Company's panels business does not meet the criteria to be reported fully as a separate segment. Sales for panels operations for the year ended December 31, 2012 were \$78.8 million (2011 - \$46.8 million).

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

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

| (millions of Canadian dollars) | Lumber | Pulp & Paper | Unallocated & Other | Elimination Adjustment | Consolidated |
|-------------------------------------|------------|--------------|---------------------|------------------------|--------------|
| Year ended December 31, 2012 | | | | | |
| Sales to external customers | \$ 1,711.8 | 923.5 | 78.8 | - | \$ 2,714.1 |
| Sales to other segments | \$ 111.9 | - | - | (111.9) | \$ - |
| Operating income (loss) | \$ 75.4 | 26.6 | (25.1) | - | \$ 76.9 |
| Amortization | \$ 101.8 | 69.0 | 16.4 | - | \$ 187.2 |
| Capital expenditures ¹ | \$ 110.9 | 88.7 | 0.2 | - | \$ 199.8 |
| Identifiable assets | \$ 1,553.7 | 774.6 | 159.6 | - | \$ 2,487.9 |
| Year ended December 31, 2011 | | | | | |
| Sales to external customers | \$ 1,317.1 | 1,057.5 | 46.8 | - | \$ 2,421.4 |
| Sales to other segments | \$ 127.1 | - | - | (127.1) | \$ - |
| Operating income (loss) | \$ (81.5) | 152.9 | (59.5) | - | \$ 11.9 |
| Amortization | \$ 83.9 | 68.0 | 17.4 | - | \$ 169.3 |
| Capital expenditures ¹ | \$ 155.3 | 156.2 | 0.8 | - | \$ 312.3 |
| Identifiable assets | \$ 1,413.8 | 812.3 | 175.5 | - | \$ 2,401.6 |

(1) Capital expenditures represent cash paid for capital assets during the period. Pulp & Paper includes capital expenditures by CPPI that are financed by the government-funded Green Transformation Program.

GEOGRAPHIC INFORMATION

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

| (millions of Canadian dollars) | 2012 | 2011 |
|--------------------------------------|------------|------------|
| Sales by location of customer | | |
| Canada | \$ 429.9 | \$ 291.4 |
| Asia | 950.0 | 965.5 |
| United States | 1,175.2 | 956.4 |
| Europe | 119.1 | 166.1 |
| Other | 39.9 | 42.0 |
| | \$ 2,714.1 | \$ 2,421.4 |

| (millions of Canadian dollars) | 2012 | 2011 |
|--|------------|------------|
| Capital assets and goodwill by location | | |
| Canada | \$ 1,571.9 | \$ 1,590.9 |
| United States | 134.0 | 149.4 |
| Asia and Other | 0.1 | 0.2 |
| | \$ 1,706.0 | \$ 1,740.5 |

At December 31, 2012, an amount of \$68.8 million pertaining to assets in Canada, was reclassified from property, plant and equipment to assets held for sale (Note 6).

28. CONTINGENCIES

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

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

Canfor has other contingent liabilities in respect of legal claims arising in the ordinary course of business. It is not anticipated that any material liabilities will arise from such contingent liabilities.

29. COMMITMENTS

At the end of the year, Canfor had contractual commitments for the acquisition of property, plant and equipment for \$55.8 million (2011 - \$21.7 million). The majority of these commitments are expected to be settled over the following year.

Canfor has committed to operating leases for property, plant and equipment. As at December 31, 2012 and 2011, the future minimum lease payments under these operating leases were as follows:

| (millions of Canadian dollars) | As at December 31, 2012 | As at December 31, 2011 |
|--------------------------------|-------------------------------|-------------------------------|
| Within one year | \$ 9.1 | \$ 9.4 |
| Between one and five years | 11.2 | 12.5 |
| After five years | 0.6 | 0.2 |
| Total | \$ 20.9 | \$ 22.1 |

During the year ended December 31, 2012, \$15.1 million (2011 - \$16.9 million) was recognized as an expense in the income statement in respect of operating leases.

In addition to the above commitments, the Company has several operational agreements with minimum usage requirements. No issues were identified with meeting these obligations.

30. 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 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 customer, bank or third party to a derivative instrument fails to meet its contractual obligations.

Financial instruments that are subject to credit risk include cash and cash equivalents, accounts receivable, and long-term investments and other. Cash and cash equivalents includes cash held through major Canadian and international financial institutions as well as temporary investments with an original maturity date of three months or less. The cash and cash equivalents balance at December 31, 2012 is nil (2011 - \$28.9 million).

Canfor utilizes credit insurance to mitigate the risk associated with some of its trade receivables. As at December 31, 2012, approximately 50% of the outstanding trade receivables are covered by credit insurance (2011 - 60%). Canfor's trade receivable balance at December 31, 2012 is \$106.6 million, net of an allowance for doubtful accounts of \$2.6 million (2011 - \$105.1 million and \$2.8 million, respectively). Of the total trade receivable balance, \$3.9 million was reclassified from accounts receivable to assets held for sale. At December 31, 2012, approximately 97% of the trade accounts receivable balance was within Canfor's established credit terms (2011 - 99%).

LIQUIDITY RISK:

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

At December 31, 2012, Canfor had \$27.0 million drawn on its operating loans (2011 - nil), accounts payable and accrued liabilities of \$257.7 million (2011 - \$290.5 million) and current debt obligations of \$184.1 million (2011 - \$50.9 million), all of which fall due for payment within one year of the balance sheet date. Of the total accounts payable and accrued liabilities, an amount of \$2.0 million was reclassified from accounts payable and accrued liabilities to liabilities held for sale.

In the fourth quarter of 2012, CPPI obtained a new \$110 million operating loan facility replacing its previous \$40 million operating loan facility. The maturity date of the new facility is November 30, 2016.

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 and commodity prices.

(i) INTEREST RATE RISK:

Canfor is exposed to interest rate risk through its current financial assets and financial obligations bearing variable interest rates. Canfor's cash and cash equivalents include term deposits with original maturity dates of three months or less.

Changes in the market interest rates do not have a significant impact on Canfor's results of operations due to the short-term nature of the respective financial assets and obligations. Canfor utilizes interest rate swaps to reduce its exposure to interest rate risk associated with financial obligations bearing variable interest rates. At December 31, 2012, Canfor had \$205.0 million in fixed interest rate swaps with interest rates ranging from 1.55% to 2.59% with maturities between 2014 and 2017. The Company had no interest rate swaps at December 31, 2011.

(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 and all long-term debt is denominated in US dollars. In addition, Canfor holds financial assets and liabilities primarily related to New South, based in South Carolina, 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 \$0.7 million in relation to working capital balances denominated in US dollars at year end (including

cash, accounts receivable and accounts payable); and a (iii) 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 and the US dollar denominated debt. A portion of the remaining exposure is covered by foreign exchange collar contracts that effectively limit the minimum and maximum Canadian dollar recovery related to the sale of those US dollars.

Canfor had the following foreign exchange derivatives at December 31, 2012 and 2011:

| | As at December 31, 2012 | | As at December 31, 2011 | |
|------------------------------------|--------------------------|---------------------------------|--------------------------|---------------------------------|
| | Notional Amount | Exchange Rates | Notional Amount | Exchange Rates |
| US Dollar Collars | (millions of US dollars) | (protection/topside per dollar) | (millions of US dollars) | (protection/topside per dollar) |
| 0-12 months | \$ 12.0 | \$ 1.0000/ \$ 1.1000 | \$ 256.8 | \$ 0.9500/ \$ 1.1461 |
| US Dollar Forward Contracts | (millions of US dollars) | (range of rates, per dollar) | (millions of US dollars) | (range of rates, per dollar) |
| 0-12 months | \$ 40.8 | \$ 0.9926 - \$ 1.0043 | \$ 70.9 | \$ 0.9984 - \$ 1.0470 |

(iii) **ENERGY PRICE RISK:**

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

The exposure is 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 heating oil, Brent oil and Western Texas Intermediate oil ("WTI") contracts to hedge its exposure.

As at December 31, 2012, the Company had 210 thousand barrels of Brent and WTI oil collars, which will be settled in 2013, with weighted average protection of \$90.36 per barrel and topside of \$111.78 per barrel. The Company had no heating oil collars outstanding at December 31, 2012.

As at December 31, 2011, the Company had 5.3 million gallons of heating oil collars with weighted average protection of \$2.55 per gallon and topside of \$2.95 per gallon, and 65.2 thousand barrels of Brent collars, with weighted average protection of \$84.00 per barrel and topside of \$109.00 per barrel.

(iv) **COMMODITY PRICE RISK:**

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

Canfor had the following lumber futures contracts at December 31, 2012 and 2011:

| | As at December 31, 2012 | | As at December 31, 2011 | |
|---------------------------------------|-------------------------|-----------------------|-------------------------|-----------------------|
| | 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 | 115.9 | \$ 338.45 | 59.7 | \$ 286.10 |

An increase (decrease) in the futures market price of lumber of US\$10 per Mfbm would result in a pre-tax gain (loss) of approximately \$1.2 million in relation to the lumber futures held at year end.

CAPITAL MANAGEMENT

Canfor's objectives when managing capital are to maintain a strong balance sheet and a globally competitive cost structure that ensure 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, 2012 | As at December 31, 2011 |
|--|-------------------------------|-------------------------------|
| Total debt (including operating loans) | \$ 311.1 | \$ 239.0 |
| Cheques issued in excess of cash on hand | 14.7 | - |
| Less: Cash and cash equivalents | - | (28.9) |
| Net debt | \$ 325.8 | \$ 210.1 |
| Total equity | 1,309.8 | 1,360.1 |
| | \$ 1,635.6 | \$ 1,570.2 |

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

Separately, CPPI has leverage and interest coverage ratios calculated by reference to operating earnings before interest, taxes and amortization.

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. Management reviews results and forecasts to monitor Canfor's compliance with its debt covenants. Canfor was in compliance with all its debt covenants for the years ended December 31, 2012 and 2011.

There were no changes in the Company's approach to capital management in the year.

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

31. FINANCIAL INSTRUMENTS

CLASSIFICATION AND MEASUREMENT OF FINANCIAL INSTRUMENTS

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

ABCP and derivative instruments are measured at fair value. IFRS 7, Financial Instruments: Disclosures, requires classification of these items within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly;
- Level 3 – Inputs that are not based on observable market data.

The following table summarizes Canfor's financial instruments at December 31, 2012 and 2011, and shows the level within the fair value hierarchy in which they have been classified (for financial instruments measured at fair value):

| (millions of Canadian dollars) | Fair Value Hierarchy Level | As at December 31, 2012 | As at December 31, 2011 |
|--|----------------------------------|-------------------------------|-------------------------------|
| Financial assets | | | |
| Held for trading | | | |
| ABCP | Level 2 | \$ - | \$ 11.8 |
| Derivative financial instruments | Level 2 | 0.7 | 1.6 |
| Loans and receivables | | | |
| Cash and cash equivalents | n/a | - | 28.9 |
| Accounts receivable (excluding derivatives) | n/a | 156.1 | 169.2 |
| Other deposits, loans and advances | n/a | 6.5 | 7.1 |
| Royalty receivable | Level 3 | 6.4 | 8.0 |
| Available for sale | | | |
| Investments in other entities | n/a | 23.7 | 24.3 |
| | | \$ 193.4 | \$ 250.9 |
| Financial liabilities | | | |
| Held for trading | | | |
| Derivative financial instruments | Level 2 | \$ 4.8 | \$ 1.8 |
| Other liabilities | | | |
| Cheques issued in excess of cash on hand | n/a | 14.7 | - |
| Operating loans | n/a | 27.0 | - |
| Accounts payable and accrued liabilities (excluding derivatives) | n/a | 252.9 | 288.7 |
| Long-term debt (including current portion) | n/a | 284.1 | 239.0 |
| | | \$ 583.5 | \$ 529.5 |

Included above are \$3.9 million in accounts receivable and \$2.0 million in accounts payable and accrued liabilities that have been reclassified to assets and liabilities held for sale (Note 6). The royalty receivable balance is recorded in other accounts receivable and long-term investments and other.

DERIVATIVE FINANCIAL INSTRUMENTS

The Company uses a variety of derivative financial instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, interest rates, lumber prices and energy costs. At December 31, 2012, the fair value of derivative

financial instruments was a net liability of \$4.1 million (2011 - net liability of \$0.2 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, 2012 and 2011:

| (millions of Canadian dollars) | 2012 | 2011 |
|---|-----------------|---------------|
| Foreign exchange collars and forward contracts | \$ 3.2 | \$ (2.7) |
| Energy derivatives | 0.6 | 0.6 |
| Lumber futures | (3.6) | 5.6 |
| Interest rate swaps | (1.0) | - |
| Gain (loss) on derivative financial instruments | \$ (0.8) | \$ 3.5 |

The following table summarizes the fair market value of the derivative financial instruments included in the balance sheets at December 31, 2012 and 2011:

| (millions of Canadian dollars) | As at December 31, 2012 | As at December 31, 2011 |
|--|-------------------------------|-------------------------------|
| Foreign exchange collars and forward contracts | \$ 0.3 | \$ (0.4) |
| Energy derivatives | 0.3 | (0.2) |
| Interest rate swaps | (0.6) | - |
| Lumber futures | (4.1) | 0.4 |
| Total asset (liability), net | (4.1) | (0.2) |
| Less: current portion asset (liability), net | (3.5) | (0.2) |
| Long-term portion asset (liability), net | \$ (0.6) | \$ - |

32. ACQUISITION OF TEMBEC ASSETS

On March 23, 2012, the Company completed the acquisition of Tembec's southern British Columbia Interior wood products assets for cash consideration of \$65.6 million, including a payment on account of net working capital, excluding certain liabilities retained by Tembec. The acquisition has been accounted for in accordance with IFRS 3 *Business Combinations*.

The acquisition included Tembec's Elko and Canal Flats sawmills and approximately 1.1 million cubic metres of combined Crown, private land and contract annual allowable cut. The transaction also included a long-term agreement to provide residual fibre supply for Tembec's Skookumchuck pulp mill. The assets acquired increase the Company's fibre availability and production capacity.

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

(millions of Canadian dollars)

| | | |
|------------------------------------|----|--------|
| Land | \$ | 3.0 |
| Buildings, equipment and mobile | | 6.5 |
| Timber licenses | | 43.5 |
| Deferred reforestation obligations | | (16.5) |
| Non-cash working capital, net | | 29.1 |
| Total net identifiable assets | \$ | 65.6 |

If the acquisition had occurred on January 1, 2012, consolidated sales would have increased by approximately \$37.0 million, with no material change to consolidated income. In determining these amounts, the fair value adjustments that arose on the acquisition date have been assumed to be the same as if the acquisition had occurred on January 1, 2012.

The Company incurred acquisition-related costs of \$1.3 million, principally relating to external legal fees and due diligence costs, which have been included in selling and administration costs, and severance costs of \$2.5 million related to restructuring of the acquired assets. These amounts are recorded in the Company's consolidated statement of income (loss) for the year ended December 31, 2012.

33. SHARE EXCHANGE

On March 2, 2012, Canadian Forest Products Ltd. ("CFP"), a wholly owned subsidiary of Canfor, acquired 35,776,483 common shares of CPPI in exchange for its 35,776,483 Class B Exchangeable LP Units of CPLP and 35,776,483 common shares of Canfor Pulp Holding Inc. ("Canfor Holding"), pursuant to the terms of an Exchange Agreement made as of January 1, 2011 among CFP, CPPI, Canfor Holding and CPLP.

As of the date of exchange, the Company consolidated the balances of CPPI and Canfor Holding, including an additional deferred income tax liability of \$31.4 million and cash of \$6.8 million. The non-controlling interest in consolidated equity increased by \$25.0 million on the date of exchange, representing the additional non-controlling interest balances in CPPI and Canfor Holding.

Prior to the share exchange, CFP and CPPI entered into a one-time dividend waiver agreement, waiving CFP's right to the first \$7.8 million of future dividends declared by CPPI. As such, \$7.8 million was included in non-controlling interests to account for future distributions which the Company had waived its entitlement to. The full \$7.8 million dividend was paid by CPPI during the second quarter of 2012.

SUMMARY OF CONSOLIDATED PRODUCTION AND SHIPMENTS

(unaudited)

PRODUCTION

| 2012 | 1st Qtr | 2nd Qtr | 3rd Qtr | 4th Qtr | Year |
|---|---------|---------|---------|---------|---------|
| Lumber SPF – MMfbm | 903.7 | 994.4 | 973.9 | 985.5 | 3,857.5 |
| Lumber SYP – MMfbm | 114.3 | 124.4 | 118.6 | 121.8 | 479.1 |
| Oriented strand board – MMsf 3/8" basis | 66.4 | 71.3 | 75.4 | 71.0 | 284.1 |
| Pulp – 000 mt | 315.9 | 263.1 | 276.8 | 314.1 | 1,169.9 |
| Kraft paper – 000 mt | 32.9 | 30.0 | 31.9 | 35.4 | 130.2 |

| 2011 | 1st Qtr | 2nd Qtr | 3rd Qtr | 4th Qtr | Year |
|---|---------|---------|---------|---------|---------|
| Lumber SPF – MMfbm | 772.3 | 787.6 | 813.6 | 760.8 | 3,134.3 |
| Lumber SYP – MMfbm | 94.8 | 112.8 | 117.3 | 106.4 | 431.3 |
| Oriented strand board – MMsf 3/8" basis | 67.1 | 67.9 | 60.9 | 74.5 | 270.4 |
| Pulp – 000 mt | 316.9 | 314.7 | 273.9 | 294.5 | 1,200.0 |
| Kraft paper – 000 mt | 34.5 | 31.8 | 36.7 | 33.5 | 136.5 |

SHIPMENTS

| 2012 | 1st Qtr | 2nd Qtr | 3rd Qtr | 4th Qtr | Year |
|--|---------|---------|---------|---------|---------|
| Lumber – MMfbm | | | | | |
| Canfor produced SPF | 852.3 | 1,010.5 | 996.8 | 1,007.9 | 3,867.5 |
| Canfor produced SYP | 117.6 | 132.8 | 127.9 | 133.5 | 511.8 |
| Purchased from other wholesale producers | 24.5 | 14.3 | 7.9 | 8.0 | 54.7 |
| Total Lumber | 994.4 | 1,157.6 | 1,132.6 | 1,149.4 | 4,434.0 |
| Oriented strand board – MMsf 3/8" basis | 65.3 | 72.4 | 74.8 | 72.6 | 285.1 |
| Pulp – 000 mt | 327.8 | 282.1 | 268.9 | 297.8 | 1,176.6 |
| Kraft paper – 000 mt | 29.6 | 36.8 | 30.6 | 32.1 | 129.1 |

| 2011 | 1st Qtr | 2nd Qtr | 3rd Qtr | 4th Qtr | Year |
|--|---------|---------|---------|---------|---------|
| Lumber – MMfbm | | | | | |
| Canfor produced SPF | 715.3 | 821.6 | 812.0 | 833.9 | 3,182.8 |
| Canfor produced SYP | 90.9 | 123.6 | 122.7 | 112.7 | 449.9 |
| Purchased from other wholesale producers | 51.2 | 27.7 | 34.2 | 27.4 | 140.5 |
| Total Lumber | 857.4 | 972.9 | 968.9 | 974.0 | 3,773.2 |
| Oriented strand board – MMsf 3/8" basis | 63.3 | 68.5 | 61.6 | 75.3 | 268.7 |
| Pulp – 000 mt | 318.4 | 303.7 | 291.2 | 275.4 | 1,188.7 |
| Kraft paper – 000 mt | 32.6 | 32.7 | 32.1 | 30.2 | 127.6 |

Certain previously published and prior years' figures have been reclassified to conform to the current presentation.

2012 SELECTED QUARTERLY FINANCIAL INFORMATION

| (unaudited) | 1st Qtr | 2nd Qtr | 3rd Qtr | 4th Qtr | Year |
|---|-----------|----------|-----------|----------|------------|
| Sales and income (millions of dollars) | | | | | |
| Sales | \$ 607.6 | \$ 700.9 | \$ 683.8 | \$ 721.8 | \$ 2,714.1 |
| Manufacturing and product costs | 429.6 | 465.2 | 459.7 | 465.7 | 1,820.2 |
| Freight and other distribution costs | 122.4 | 133.0 | 123.3 | 125.0 | 503.7 |
| Export taxes | 11.2 | 13.9 | 10.6 | 9.8 | 45.5 |
| Amortization | 45.1 | 46.0 | 45.7 | 50.4 | 187.2 |
| Asset impairments | - | - | - | 0.8 | 0.8 |
| Restructuring, mill closure and severance costs | 4.8 | 1.9 | 7.0 | 4.8 | 18.5 |
| Selling and administration costs | 16.0 | 14.9 | 15.2 | 15.2 | 61.3 |
| Operating income (loss) | (21.5) | 26.0 | 22.3 | 50.1 | 76.9 |
| Finance expense, net | (6.2) | (6.2) | (5.8) | (6.5) | (24.7) |
| Foreign exchange gain (loss) on long-term debt and investments, net | 4.0 | (3.8) | 6.5 | (2.0) | 4.7 |
| Gain (loss) on derivative financial instruments | 7.4 | (6.3) | 6.8 | (8.7) | (0.8) |
| Other income (expense), net | (0.2) | 2.6 | (2.6) | (0.2) | (0.4) |
| Net income (loss) before income taxes | (16.5) | 12.3 | 27.2 | 32.7 | 55.7 |
| Income tax recovery (expense) | 5.6 | (5.3) | (6.5) | (8.1) | (14.3) |
| Net income (loss) | \$ (10.9) | \$ 7.0 | \$ 20.7 | \$ 24.6 | \$ 41.4 |
| Net income (loss) attributable to: | | | | | |
| Equity shareholders of the Company | \$ (16.2) | \$ 4.5 | \$ 22.2 | \$ 21.6 | \$ 32.1 |
| Non-controlling interests | 5.3 | 2.5 | (1.5) | 3.0 | 9.3 |
| | \$ (10.9) | \$ 7.0 | \$ 20.7 | \$ 24.6 | \$ 41.4 |
| Net income (loss) per common share: (dollars) | | | | | |
| Attributable to equity shareholders of the Company | | | | | |
| – Basic and diluted | \$ (0.11) | \$ 0.03 | \$ 0.16 | \$ 0.15 | \$ 0.22 |
| Cash generated from (used in) (millions of dollars) | | | | | |
| Operating activities | \$ (55.2) | \$ 119.1 | \$ 33.9 | \$ 33.4 | \$ 131.2 |
| Financing activities | | | | | |
| Long-term debt | 50.1 | - | - | - | 50.1 |
| Other | 86.9 | (92.6) | (4.4) | 2.0 | (8.1) |
| | 137.0 | (92.6) | (4.4) | 2.0 | 42.0 |
| Investing activities | | | | | |
| Property, plant, equipment (net of Green Transformation Program proceeds from Federal Government) | (45.7) | (43.3) | (44.1) | (47.0) | (180.1) |
| Acquisition of Tembec assets | (64.9) | (0.7) | - | - | (65.6) |
| Other | 8.6 | 14.8 | 1.5 | 4.0 | 28.9 |
| | (102.0) | (29.2) | (42.6) | (43.0) | (216.8) |
| Decrease in cash and cash equivalents | \$ (20.2) | \$ (2.7) | \$ (13.1) | \$ (7.6) | \$ (43.6) |

Certain previously published figures have been reclassified to conform to the current presentation.

2011 SELECTED QUARTERLY FINANCIAL INFORMATION

| (unaudited) | 1st Qtr | 2nd Qtr | 3rd Qtr | 4th Qtr | Year |
|---|------------------|------------------|------------------|------------------|-------------------|
| Sales and income (millions of dollars) | | | | | |
| Sales | \$ 624.0 | \$ 619.1 | \$ 602.1 | \$ 576.2 | \$ 2,421.4 |
| Manufacturing and product costs | 408.5 | 398.4 | 399.6 | 421.0 | 1,627.5 |
| Freight and other distribution costs | 112.6 | 123.8 | 117.9 | 113.6 | 467.9 |
| Export taxes | 10.8 | 9.4 | 10.1 | 9.6 | 39.9 |
| Amortization | 41.5 | 40.3 | 39.9 | 47.6 | 169.3 |
| Asset impairments | - | - | - | 9.2 | 9.2 |
| Restructuring, mill closure and severance costs | 2.8 | 6.9 | 5.8 | 22.8 | 38.3 |
| Selling and administration costs | 15.5 | 12.9 | 13.4 | 15.6 | 57.4 |
| Operating income (loss) | 32.3 | 27.4 | 15.4 | (63.2) | 11.9 |
| Finance expense, net | (7.2) | (5.8) | (7.9) | (5.1) | (26.0) |
| Foreign exchange gain (loss) on long-term debt and investments, net | 4.7 | 2.0 | (16.6) | 4.9 | (5.0) |
| Gain (loss) on derivative financial instruments | 4.7 | 1.3 | (12.1) | 9.6 | 3.5 |
| Other income (expense), net | (1.7) | 1.1 | 5.2 | 1.3 | 5.9 |
| Net income (loss) before income taxes | 32.8 | 26.0 | (16.0) | (52.5) | (9.7) |
| Income tax recovery (expense) | (0.5) | 0.2 | 6.4 | 14.4 | 20.5 |
| Net income (loss) | \$ 32.3 | \$ 26.2 | \$ (9.6) | \$ (38.1) | \$ 10.8 |
| Net income (loss) attributable to: | | | | | |
| Equity shareholders of the Company | \$ 7.0 | \$ 2.1 | \$ (21.6) | \$ (44.1) | \$ (56.6) |
| Non-controlling interests | 25.3 | 24.1 | 12.0 | 6.0 | 67.4 |
| | \$ 32.3 | \$ 26.2 | \$ (9.6) | \$ (38.1) | \$ 10.8 |
| Net income (loss) per common share: (dollars) | | | | | |
| Attributable to equity shareholders of the Company | | | | | |
| – Basic and diluted | \$ 0.05 | \$ 0.01 | \$ (0.15) | \$ (0.31) | \$ (0.40) |
| Cash generated from (used in) (millions of dollars) | | | | | |
| Operating activities | \$ (6.0) | \$ 69.8 | \$ 60.9 | \$ 38.3 | \$ 163.0 |
| Financing activities | | | | | |
| Long-term debt | (33.8) | (48.1) | - | - | (81.9) |
| Other | (41.2) | (32.0) | (18.7) | (17.6) | (109.5) |
| | (75.0) | (80.1) | (18.7) | (17.6) | (191.4) |
| Investing activities | | | | | |
| Property, plant, equipment (net of Green Transformation Program proceeds from Federal Government) | (39.3) | (34.0) | (72.4) | (91.0) | (236.7) |
| Other | 32.5 | 1.8 | 1.5 | (2.1) | 33.7 |
| | (6.8) | (32.2) | (70.9) | (93.1) | (203.0) |
| Decrease in cash and cash equivalents | \$ (87.8) | \$ (42.5) | \$ (28.7) | \$ (72.4) | \$ (231.4) |

Certain 2011 amounts have been restated due to a change in accounting policy for the treatment of net interest expense for the Company's defined benefit post-retirement plans. In addition, certain previously published figures have been reclassified to conform to the current presentation.

FIVE-YEAR COMPARATIVE REVIEW

| (unaudited) | International Financial Reporting Standards | | | Previous Canadian GAAP | |
|---|---|-----------------|-----------------|------------------------|-------------------|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| Sales and income (millions of dollars) | | | | | |
| Sales | \$ 2,714.1 | \$ 2,421.4 | \$ 2,430.4 | \$ 2,075.8 | \$ 2,559.6 |
| Manufacturing and product costs | 1,820.2 | 1,627.5 | 1,514.3 | 1,584.9 | 1,901.1 |
| Freight and other distribution costs | 503.7 | 467.9 | 428.0 | 410.4 | 476.2 |
| Export taxes | 45.5 | 39.9 | 40.0 | 48.7 | 55.1 |
| Amortization | 187.2 | 169.3 | 167.7 | 155.3 | 171.2 |
| Asset impairments | 0.8 | 9.2 | - | - | - |
| Restructuring, mill closure and severance costs | 18.5 | 38.3 | 32.4 | 29.9 | 53.5 |
| Selling and administration costs | 61.3 | 57.4 | 61.3 | 57.0 | 60.6 |
| Operating income (loss) | 76.9 | 11.9 | 186.7 | (210.4) | (158.1) |
| Finance expense, net | (24.7) | (26.0) | (26.8) | (29.3) | (25.4) |
| Foreign exchange gain (loss) on long-term debt and investments, net | 4.7 | (5.0) | 14.7 | 50.4 | (100.3) |
| Gain (loss) on derivative financial instruments | (0.8) | 3.5 | 0.1 | 24.4 | (88.5) |
| Gain on sale of mill property | - | - | - | 44.6 | - |
| North Central Plywoods mill fire, net | - | - | - | (3.0) | 57.9 |
| Prince George Pulp and Paper mill fire, net | - | - | - | - | 8.2 |
| Asset impairments | - | - | - | - | (169.6) |
| Other income (expense), net | (0.4) | 5.9 | 8.1 | (11.4) | 12.7 |
| Net income (loss) before income taxes | 55.7 | (9.7) | 182.8 | (134.7) | (463.1) |
| Income tax recovery (expense) | (14.3) | 20.5 | (9.5) | 71.9 | 141.9 |
| Net income (loss) | \$ 41.4 | \$ 10.8 | \$ 173.3 | \$ (62.8) | \$ (321.2) |
| Net income (loss) attributable to: | | | | | |
| Equity shareholders of the Company | \$ 32.1 | \$ (56.6) | \$ 81.4 | \$ (70.5) | \$ (345.2) |
| Non-controlling interests | 9.3 | 67.4 | 91.9 | 7.7 | 24.0 |
| | \$ 41.4 | \$ 10.8 | \$ 173.3 | \$ (62.8) | \$ (321.2) |
| Per common share (dollars) | | | | | |
| Net income (loss) attributable to equity shareholders of the Company | | | | | |
| - Basic and diluted | \$ 0.22 | \$ (0.40) | \$ 0.57 | \$ (0.50) | \$ (2.42) |
| Book value per share at year end | \$ 7.78 | \$ 7.90 | \$ 8.56 | \$ 9.73 | \$ 10.48 |
| Balance Sheet (millions of dollars) | | | | | |
| Working capital, net | \$ 166.1 | \$ 195.4 | \$ 408.3 | \$ 443.3 | \$ 531.4 |
| Property, plant and equipment | 1,081.7 | 1,139.2 | 1,049.1 | 1,066.3 | 1,176.2 |
| Timber licenses | 554.6 | 530.1 | 546.7 | 610.3 | 622.3 |
| Goodwill and other intangibles | 80.4 | 83.0 | 84.5 | 90.1 | 108.6 |
| Long term investments and other | 44.6 | 62.8 | 89.1 | 76.9 | 102.8 |
| Deferred income taxes, net | 39.7 | 18.1 | 9.4 | - | - |
| Deferred charges and other assets | - | - | - | 117.1 | 110.2 |
| Net assets | \$ 1,967.1 | \$ 2,028.6 | \$ 2,187.1 | \$ 2,404.0 | \$ 2,651.5 |
| Long term debt | \$ 100.0 | \$ 188.1 | \$ 235.6 | \$ 333.3 | \$ 428.7 |
| Retirement benefit obligations | 314.5 | 298.3 | 272.2 | 132.2 | 127.0 |
| Deferred reforestation obligations | 78.4 | 65.0 | 60.6 | 60.3 | 63.1 |
| Other long-term liabilities | 13.6 | 13.8 | 17.5 | 17.3 | 18.7 |
| Deferred income taxes, net | 150.8 | 103.3 | 131.2 | 200.8 | 242.4 |
| Non-controlling interests | 198.9 | 232.8 | 249.5 | 273.3 | 276.8 |
| Equity attributable to shareholders of the Company | 1,110.9 | 1,127.3 | 1,220.5 | 1,386.8 | 1,494.8 |
| | \$ 1,967.1 | \$ 2,028.6 | \$ 2,187.1 | \$ 2,404.0 | \$ 2,651.5 |
| Additions to property, plant, equipment and timber (millions of dollars) | \$ 199.8 | \$ 312.3 | \$ 142.2 | \$ 59.0 | \$ 80.2 |

Certain 2011 amounts have been restated due to a change in accounting policy for the treatment of net interest expense for the Company's defined benefit post-retirement plans. Financial information for 2009 and 2008 shown above are in accordance with previous Canadian GAAP and have not been restated to be shown in accordance with IFRS. However, certain previously published figures have been reclassified to conform to the current presentation.

FIVE-YEAR COMPARATIVE REVIEW

| (unaudited) | International Financial Reporting Standards | | | Previous Canadian GAAP | |
|--|---|------------|----------|------------------------|----------|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| Cash generated from (used in) (millions of dollars) | | | | | |
| Operating activities | \$ 131.2 | \$ 163.0 | \$ 381.6 | \$ (68.6) | \$ 151.8 |
| Financing activities | | | | | |
| Long term debt | 50.1 | (81.9) | (35.1) | (175.5) | (14.8) |
| Cash distributions paid to non-controlling interest | (15.9) | (91.0) | (79.0) | (8.9) | (52.3) |
| Other | 7.8 | (18.5) | (25.2) | (23.9) | 24.7 |
| | 42.0 | (191.4) | (139.3) | (208.3) | (42.4) |
| Investing activities | | | | | |
| Property, plant, equipment and timber, net | (199.8) | (312.3) | (142.2) | (3.7) | (74.6) |
| Proceeds from Green Transformation Program | 19.7 | 75.6 | 20.2 | - | - |
| Changes in long-term investments | 12.9 | 29.8 | 4.6 | 19.9 | - |
| Business acquisitions | (65.6) | - | - | - | (0.8) |
| Other | 16.0 | 3.9 | 2.0 | 31.7 | 32.9 |
| | (216.8) | (203.0) | (115.4) | 47.9 | (42.5) |
| Increase (decrease) in cash and cash equivalents | \$ (43.6) | \$ (231.4) | \$ 126.9 | \$ (229.0) | \$ 66.9 |
| Financial statistics | | | | | |
| Operating income (loss) before amortization | \$ 264.1 | \$ 181.2 | \$ 354.4 | \$ (55.1) | \$ 13.1 |
| Return on capital employed | 3.3% | (3.3)% | 7.2% | (3.1)% | (17.2)% |
| Return on common shareholders' equity | 2.9% | (4.8)% | 6.8% | (4.9)% | (18.5)% |
| Ratio of current assets to current liabilities | 1.3:1 | 1.5:1 | 2.0:1 | 2.6:1 | 2.0:1 |
| Ratio of net debt to capitalization | 20% | 13% | 4% | 12% | 13% |
| Production statistics | | | | | |
| Lumber SPF – MMfbm | 3,857.5 | 3,134.3 | 2,886.7 | 2,766.8 | 3,299.4 |
| Lumber SYP– MMfbm | 479.1 | 431.3 | 355.0 | 267.5 | 388.6 |
| Plywood – MMsf 3/8" basis | - | - | - | - | 233.4 |
| Oriented strand board – MMsf 3/8" basis | 284.1 | 270.4 | 259.3 | 218.5 | 434.8 |
| Pulp – 000 mt | 1,169.9 | 1,200.0 | 1,229.0 | 1,192.0 | 1,124.6 |
| Kraft paper – 000 mt | 130.2 | 136.5 | 136.7 | 131.1 | 132.6 |
| Sales by product line | | | | | |
| Lumber – Canfor produced | 56% | 47% | 44% | 46% | 47% |
| Pulp and kraft paper | 34 | 43 | 46 | 43 | 36 |
| Plywood | 0 | 0 | 0 | 0 | 3 |
| Lumber – other producers | 1 | 3 | 2 | 2 | 2 |
| Oriented strand board | 3 | 2 | 2 | 2 | 3 |
| Miscellaneous | 6 | 5 | 6 | 7 | 9 |
| | 100% | 100% | 100% | 100% | 100% |
| Sales by location of customer | | | | | |
| United States | 43% | 39% | 46% | 49% | 53% |
| Asia | 35 | 40 | 32 | 26 | 20 |
| Canada | 16 | 12 | 12 | 15 | 19 |
| Europe | 4 | 7 | 8 | 8 | 7 |
| Other | 2 | 2 | 2 | 2 | 1 |
| | 100% | 100% | 100% | 100% | 100% |

Certain 2011 amounts have been restated due to a change in accounting policy for the treatment of net interest expense for the Company's defined benefit post-retirement plans. Financial information for 2009 and 2008 shown above are in accordance with previous Canadian GAAP and have not been restated to be shown in accordance with IFRS. However, certain previously published figures have been reclassified to conform to the current presentation.

DIRECTORS AND OFFICERS

DIRECTORS

The names, principal occupations, municipalities of residence and dates of appointment of the Directors of the Company are as below. For more information visit www.canfor.com

Peter J.G. Bentley, O.C., LL.D. ⁽²⁾⁽³⁾⁽⁴⁾⁽⁶⁾
Chairman Emeritus
Canfor Corporation
Vancouver, British Columbia
Director since 1966

Glen D. Clark ⁽⁴⁾⁽⁵⁾
President
The Jim Pattison Group
Vancouver, British Columbia
Director since 2009

Ronald L. Cliff, C.M., FCA ⁽¹⁾⁽³⁾
Co-Chairman
Canfor Corporation
Chairman of the Board,
Heathcliff Properties Ltd.
West Vancouver, British Columbia
Director since 1983

Michael J. Korenberg ⁽¹⁾⁽⁵⁾⁽⁶⁾
Deputy Chairman and Managing Director
The Jim Pattison Group
Co-Chairman
Canfor Corporation
West Vancouver, British Columbia
Director since 2003

James A. Pattison, O.C., O.B.C. ⁽²⁾⁽³⁾
Managing Director,
Chief Executive Officer and Chairman
The Jim Pattison Group
West Vancouver, British Columbia
Director since 2003

Conrad A. Pinette ⁽²⁾⁽³⁾⁽⁴⁾⁽⁶⁾
Corporate Director
Vancouver, British Columbia
Director since 2008

J. McNeill (Mack) Singleton ⁽⁴⁾⁽⁶⁾
Corporate Director
Myrtle Beach, South Carolina
Director since 2007

Ross S. Smith, C.M., FCA ⁽¹⁾⁽²⁾⁽⁵⁾
Corporate Director
West Vancouver, British Columbia
Director since 2009

William W. Stinson ⁽²⁾⁽⁶⁾
Chairman and CEO
Westshore Terminals Investment Corp.
Vancouver, British Columbia
Director since 2011

OFFICERS

The names and municipalities of residence of the officers of the Company and the offices held by each of them are as below. For more information visit www.canfor.com

Peter J.G. Bentley
Chairman Emeritus
Vancouver, British Columbia

Ronald L. Cliff
Co-Chairman
West Vancouver, British Columbia

Michael J. Korenberg
Co-Chairman
West Vancouver, British Columbia

Don B. Kayne
President and Chief Executive Officer
Tsawwassen, British Columbia

Alan R. Nicholl
Senior Vice President, Finance and
Chief Financial Officer
West Vancouver, British Columbia

David M. Calabrigo, Q.C.
Senior Vice President, Corporate
Development, Legal Affairs and Human
Resources / Corporate Secretary
Vancouver, British Columbia

Alistair L.W. Cook
Senior Vice President, Operations Canada
Surrey, British Columbia

Mark F. Feldinger
Senior Vice President, Energy, Environment,
Transportation and Sourcing
Surrey, British Columbia

Wayne R. Guthrie
Senior Vice President, Sales and Marketing
White Rock, British Columbia

Onkar Athwal
Vice President, Human Resources
Delta, British Columbia

Patrick A.J. Elliott
Vice President and Treasurer
Vancouver, British Columbia

Doug J. Warstler
President, New South Companies, Inc.
Myrtle Beach, South Carolina

Bob Hayes
Vice President, Transportation,
Procurement and Distribution
Delta, British Columbia

Christine Kennedy
Vice President, Brand and External Relations
Vancouver, British Columbia

Tom Lewis
Vice President, Woodlands Canada
Prince George, British Columbia

(1) Member of the Audit Committee, which reviews the Company's financial statements, the scope and results of the external auditor's work, the adequacy of internal accounting and audit programs and compliance with accounting and reporting standards.

(2) Member of the Management Resources and Compensation Committee, which oversees human resources and compensation policies and ensures management development and succession programs are in place.

(3) Member of the Corporate Governance Committee, which ensures that the Company through its Board of Directors sustains an effective approach to corporate governance.

(4) Member of the Environmental, Health and Safety Committee, which develops, reviews and makes recommendations on matters related to the Company's environmental, health and safety policies, and monitors compliance with those policies and with government regulations.

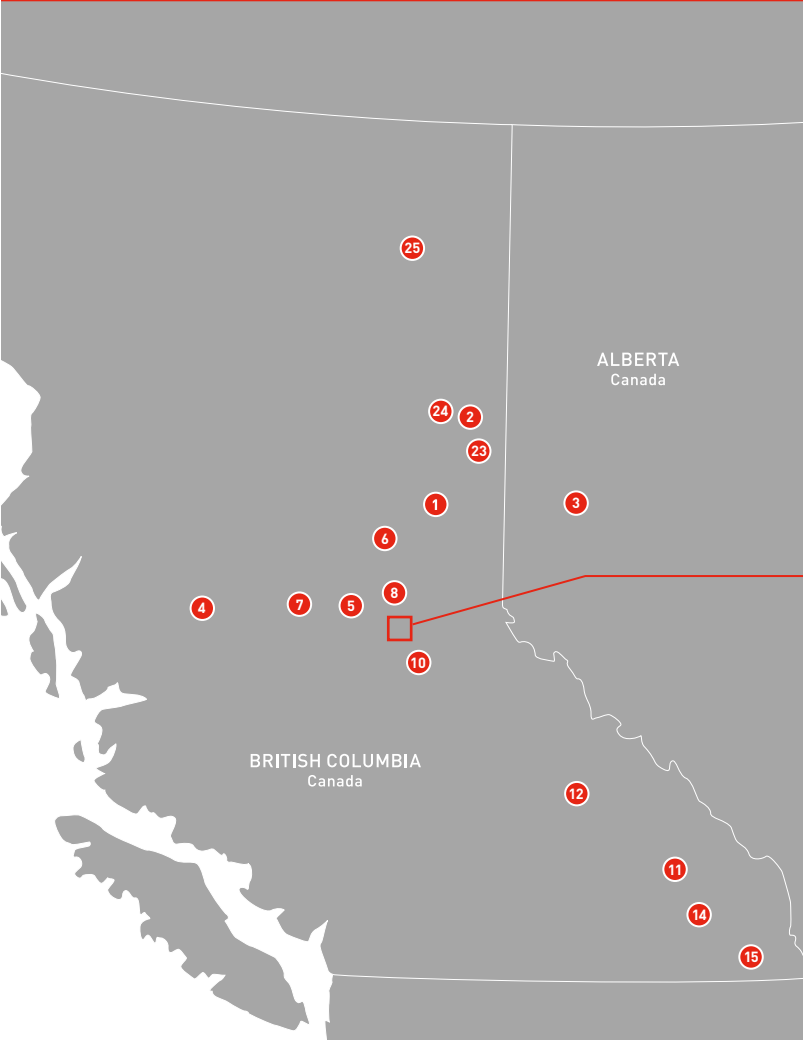
(5) Member of the Pension Committee, which oversees the administration, financial reporting and investment activities of the Company's pension plans.

(6) Member of the Joint Capital Expenditure Committee, which reviews proposed capital expenditures.

The term of office of each Director expires on the date of the next Annual General Meeting of the Company.

MAP OF OPERATIONS

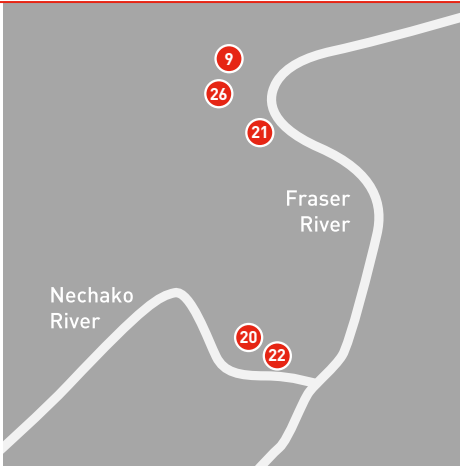
WESTERN CANADA



EAST COAST



PRINCE GEORGE



SAWMILLS

| | |
|----------------|---|
| Chetwynd | 1 |
| Fort St John | 2 |
| Grande Prairie | 3 |
| Houston | 4 |
| Isle Pierre | 5 |
| Mackenzie | 6 |
| Plateau | 7 |
| Polar | 8 |
| Prince George | 9 |

| | |
|----------------|----|
| Quesnel | 10 |
| Radium | 11 |
| Vavenby | 12 |
| Daaquam | 13 |
| Canal Flats | 14 |
| Elko | 15 |
| Graham, NC | 16 |
| Camden, SC | 17 |
| Conway, SC | 18 |
| Darlington, SC | 19 |

PULP & PAPER

| | |
|---------------------------------|----|
| Intercontinental ⁽¹⁾ | 20 |
| Northwood ⁽¹⁾ | 21 |
| Prince George ⁽¹⁾ | 22 |
| Taylor | 23 |

OSB

| | |
|---------------------------------|----|
| Peace Valley OSB ⁽²⁾ | 24 |
| PolarBoard OSB | 25 |

OTHER

| | |
|---------------------------|----|
| J.D. Little Forest Centre | 26 |
| Marion, SC | 27 |

(1) Canfor Pulp Limited Partnership - 50.2% ownership
 (2) Limited Partnership - 50% ownership

DEFINITIONS AND INFORMATION

MILL OPERATIONS

| | 2012 Production | Capacity |
|---|--------------------|----------------|
| LUMBER (MMfbm) | | |
| Total SPF | 3,857.5 | 4,600.0 |
| Total SYP | 479.1 | 600.0 |
| Total Lumber | 4,336.6 | 5,200.0 |
| OSB (MMsf 3/8" basis) ⁽¹⁾ | | |
| | 568.2 | 1,460.0 |
| PULP (000 tonnes) | | |
| Canfor Pulp Products Inc. ⁽¹⁾ | 955.7 | |
| Taylor Pulp | 214.2 | |
| Total Pulp | 1,169.9 | 1,315.0 |
| PAPER (000 tonnes) | | |
| Canfor Pulp Products Inc. ⁽¹⁾ | 130.2 | 140.0 |

(1) Partly owned - includes 100% of production.

CORPORATE AND SHAREHOLDER INFORMATION

Annual General Meeting

Canfor's Annual General Meeting will be held at Prince George Playhouse, 2833 Recreation Place, Prince George, BC on Wednesday May 1st, 2013 at 2:00 p.m.

Auditors

PricewaterhouseCoopers LLP
Vancouver, BC

Transfer Agent and Registrar

CIBC Mellon Trust Company
Vancouver, Calgary, Regina,
Winnipeg, Toronto, Montreal
and Halifax

Stock Listing

Toronto Stock Exchange
Symbol: CFP

Investor Contact

Patrick Elliott
Vice President & Treasurer
T: (604) 661-5441
F: (604) 661-5429
E: patrick.elliott@canfor.com

Canfor Corporation Head Office

#100 - 1700 West 75th Avenue
Vancouver, BC V6P 6G2
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Email: info@canfor.com
Web: www.canfor.com

Canfor also produces an Annual Information Form. To obtain this publication or more information about the company, please contact Canfor Corporation, Public Affairs or visit our website at www.canfor.com/investors

Public Affairs Contact

Christine Kennedy
Vice President,
Brand & External Relations
T: (604) 661-5225
F: (604) 661-5219
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DEFINITIONS OF SELECTED FINANCIAL TERMS

Book Value per Share is the equity at the end of the year, divided by the number of common shares outstanding at the end of the year.

Capital Employed consists of current bank loans, current portion of long-term debt, long-term debt and shareholders' equity, less cash and cash equivalents and temporary investments.

Net Debt is total debt less cash and cash equivalents and temporary investments.

Net Income (Loss) per Common Share is calculated as described in Note 23 to the Consolidated Financial Statements.

Return on Capital Employed is equal to net income (loss) attributable to shareholders of the Company plus interest, after tax, divided by the average capital employed during the year.

Return on Common Shareholders' Equity is equal to net income (loss) attributable to shareholders of the Company for the year, divided by the average total shareholders' equity during the year.

Return on Invested Capital is equal to operating income (loss), plus realized gains (losses) on derivatives and other income (expense), all net of minority interest, divided by the average invested capital during the year. Invested capital is equal to capital assets, plus long-term investments and net non-cash working capital, all excluding minority interest components.

OUR PRODUCTS

SPF DIMENSION LUMBER (SPRUCE-PINE-FIR)

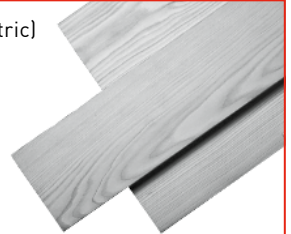
- ▶ Dimension Lumber (imperial/metric)
- ▶ Studs (Solid & Finger Joined) (imperial/metric)
- ▶ Prime Grade Appearance



Dimension Lumber

FIR LARCH DIMENSION LUMBER

- ▶ Dimension Lumber (imperial/metric)
- ▶ Studs (Solid & Finger Joined) (imperial/metric)
- ▶ Prime Grade Appearance



Dimension Lumber

MSR LUMBER

- ▶ MSR (Machine Stress Rated)
- ▶ SYP
- ▶ D.FIR/LARCH
- ▶ SPF



MSR

SYP LUMBER (SOUTHERN YELLOW PINE)

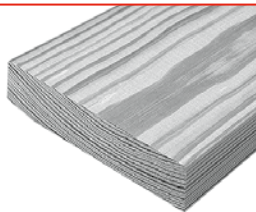
- ▶ Dimension Lumber
- ▶ Finger Joined Studs
- ▶ Prime Grade Appearance



SYP Lumber

GATOR GUARD (SOUTHERN YELLOW PINE)

- ▶ Treated Lumber
- ▶ Treated Plywood
- ▶ Treated Siding
- ▶ Treated Balusters
- ▶ Treated Spindles
- ▶ Treated Decking



Treated Lumber



Canfor is a leading Canadian integrated forest products company based in Vancouver, British Columbia, involved primarily in the lumber business, with production facilities in BC, Alberta, Quebec and the United States.

Canfor also has a 50.2% interest in the pulp and paper business of Canfor Pulp Products Inc, a 50% interest in the oriented strand board business of Peace Valley OSB and owns a Bleached Chemi-Thermo Mechanical Pulp mill, all located in BC. In late 2012, the Company has entered into a Letter of Intent with Louisiana-Pacific Corporation to sell Canfor's 50% share in the Peace Valley OSB joint venture. Canfor shares are traded on the Toronto Stock Exchange under the symbol CFP.

Canfor has an annual production capability of approximately 5 billion board feet of lumber, 1.5 billion square feet of OSB and 220,000 tonnes of BCTMP. Canfor also has approximately 11 million cubic meters of allowable annual cut for solid wood operations under its forest tenures, over 96% of which is certified either to the CSA or FSC standards for sustainable forest management. Canfor employs approximately 3,970 people in its wholly owned subsidiaries and 1,340 in jointly owned operations for a total of 5,310 employees.



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