Interfor Corporation
Fourth Quarter Report
For the three and twelve months ended December 31, 2018

Management's Discussion and Analysis

This Management's Discussion and Analysis ("MD&A") provides a review of financial condition and results of operations as at and for the three and twelve months ended December 31, 2018 ("Q4'18" and "2018", respectively). It should be read in conjunction with the audited consolidated financial statements of Interfor Corporation and its subsidiaries ("Interfor" or the "Company") for the year ended December 31, 2018, and the notes thereto which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). This MD&A contains certain non-GAAP measures which, within the Non-GAAP Measures section, are discussed, defined and reconciled to figures reported in the Company's consolidated financial statements. This MD&A has been prepared as of February 7, 2019.

All figures are stated in Canadian Dollars, unless otherwise noted, and references to US$/USD are to the United States Dollar. For definitions of technical terms and abbreviations used within this MD&A, refer to the Glossary in the Company's 2018 Annual Report.

Forward-Looking Information

This MD&A contains forward-looking information about the Company's business outlook, objectives, plans, strategic priorities and other information that is not historical fact. A statement contains forward-looking information when the Company uses what it knows and expects today, to make a statement about the future. Forward-looking information is included under the headings "Overview of Fourth Quarter, 2018", "Strategic Capital Plan Update", "Outlook", "Liquidity", "Capital Resources", "Off-Balance Sheet Arrangements", "Financial Instruments and Other Instruments", "Accounting Policy Changes" and "Risks and Uncertainties". Statements containing forward-looking information may include words such as: will, could, should, believe, expect, anticipate, intend, forecast, projection, target, outlook, opportunity, risk or strategy.

Readers are cautioned that actual results may vary from the forward-looking information in this report, and undue reliance should not be placed on such forward-looking information. Risk factors that could cause actual results to differ materially from the forward-looking information in this report, are described under the heading "Risks and Uncertainties". Material factors and assumptions used to develop the forward-looking information in this report, include volatility in the selling prices for lumber, logs and wood chips; the Company's ability to compete on a global basis; the availability and cost of log supply; natural or man-made disasters; currency exchange rates; changes in government regulations; the availability of the Company's allowable annual cut ("AAC"); claims by and treaty settlements with Indigenous peoples; the Company's ability to export its products; the softwood lumber trade dispute between Canada and the U.S.; stumpage fees payable to the Province of British Columbia ("B.C."); environmental impacts of the Company's operations; labour disruptions; information systems security; and the assumptions described under the heading "Critical Accounting Estimates" herein.

Unless otherwise indicated, the forward-looking statements in this report are based on the Company's expectations at the date of this report. Interfor undertakes no obligation to update such forward-looking information or statements, except as required by law.

Overview of Fourth Quarter, 2018

Interfor recorded net earnings of $111.7 million, or $1.60 per share, in 2018, compared to $97.2 million, or $1.39 per share in 2017. Adjusted EBITDA was $280.4 million on record annual sales of $2.2 billion.

Interfor recorded a net loss in Q4'18 of $13.2 million, or $0.19 per share, compared to net earnings of $28.1 million, or $0.40 per share in Q3'18 and $36.2 million, or $0.52 per share in Q4'17. Adjusted net loss in Q4'18 was $19.8 million compared to Adjusted net earnings of $28.2 million in Q3'18 and $45.1 million in Q4'17.

Adjusted EBITDA was $6.2 million on sales of $468.5 million in Q4'18 versus $69.4 million on sales of $570.5 million in Q3'18.

Notable items in the quarter included:

- Lumber Price Volatility
  - Key benchmark prices decreased in Q4'18 versus Q3'18. The Western SPF Composite and KD H-F Stud 2x4 9' benchmarks fell US$117 and US$132 per mfbm, respectively. The SYP Composite decreased US$77 to US$386 per mfbm.
  - Interfor's average lumber selling price fell $102 to $599 per mfbm, on 647 million board feet of lumber sales.
- Lumber Production Decline Due to Temporary Factors
  - Total lumber production was 607 million board feet, down 67 million board feet quarter-over-quarter. This decline reflects Interfor's previously announced plan to temporarily reduce production across its B.C. Interior operating platform. In addition, project related down-time in the U.S. South and normal holiday-related operating schedules further contributed to the lower lumber production.
  - Production in the B.C. region declined to 174 million board feet from 224 million board feet in the preceding quarter. The U.S. South and U.S. Northwest regions accounted for 303 million board feet and 130 million board feet, respectively, compared to 313 million board feet and 137 million board feet in Q3'18, respectively.
  - Lumber inventory levels ended at 32 million board feet lower than Q3'18.
- Log Cost Inflation in B.C.
  - Operating cost increases were driven by B.C. log cost inflation, which was impacted by higher stumpage rates and open market log costs.
  - Interfor's operating costs were also impacted by an increase in its net realizable value provision for log and lumber inventories by $8.2 million in Q4'18.
- Financial Flexibility
  - Net debt ended the quarter at $63.8 million, or 6.1% of invested capital, resulting in available liquidity of $506.9 million.
  - Interfor generated $6.7 million of cash from operations before changes in working capital, or $0.10 per share, and total cash from operations of $18.0 million. The $11.3 million net cash inflow from working capital was driven by reduced accounts receivable and lumber inventory volumes, partially offset by a seasonal increase in B.C. Interior log volumes.
  - Capital investments of $59.4 million in Q4'18 included $38.1 million on U.S. South focused high-return discretionary projects, with the remainder related to maintenance capital and woodlands projects.
  - Interfor purchased and cancelled 1,680,295 of its Common Shares ("Shares") at a cost of $25.0 million in Q4'18, for a total of 2,277,540 Shares purchased at a cost of $36.9 million in 2018. The Company's normal course issuer bid ("NCIB") was amended in December 2018 and permits the purchase of up to 6,934,456 Shares until its expiry on March 6, 2019.

- Softwood Lumber Duties
  - Interfor expensed $9.7 million of duties in the quarter, representing the full amount of countervailing (“CV”) and anti-dumping (“AD”) duties incurred on its Canadian shipments of softwood lumber into the U.S. at a combined rate of 20.23%.
  - Cumulative duties of US$60.4 million have been paid by Interfor since the inception of the current trade dispute and are held in trust by the U.S. With the exception of US$3.3 million recorded as a long-term receivable in respect of overpayments arising from duty rate adjustments, Interfor has recorded the duty deposits as an expense.

Strategic Capital Plan Update

- Interfor continues to make progress on previously announced Phase I and II strategic capital projects in the U.S. South.
- The Phase I projects total US$65 million at the Meldrim, Georgia and Monticello, Arkansas sawmills, with completion scheduled for Q2’19. The related capital expenditures through Q4’18 total US$34.6 million and expected total costs through completion remain in-line with initial guidance.
- The Phase II projects total US$240 million at the Thomaston and Eatonton sawmills in Georgia and the Georgetown sawmill in South Carolina. These projects are on track for completion in various stages over the period of 2019 to 2021. The related capital expenditures through Q4’18 total US$15.3 million and the projects remain on budget.

Outlook

Interfor expects demand for lumber to continue to grow over the mid-term, particularly in the North American repair and renovation, residential and industrial segments, as well as in offshore markets.

Interfor’s strategy of maintaining a diversified portfolio of lumber operations allows the Company to both reduce risk and maximize returns on invested capital over the business cycle. Interfor will continue its disciplined approach to production, cost control, inventory management and capital spending. At the same time, Interfor will remain alert to growth opportunities to position the Company for long term success.

Financial and Operating Highlights [1]

	Unit	For the three months ended Dec. 31, 2018	Dec. 31, 2017	Sep. 30, 2018	For the year ended Dec. 31 2018	2017	2016
Financial Highlights [2]							
Total sales	$MM	468.5	532.8	570.5	2,186.6	1,990.1	1,792.7
Lumber	$MM	387.7	446.0	480.3	1,841.1	1,679.4	1,458.3
Logs, residual products and other	$MM	80.8	86.8	90.2	345.5	310.7	334.4
Operating earnings (loss)	$MM	(17.0)	47.9	41.3	156.6	149.3	75.9
Net earnings (loss)	$MM	(13.2)	36.2	28.1	111.7	97.2	65.6
Net earnings (loss) per share, basic	$/share	(0.19)	0.52	0.40	1.60	1.39	0.94
Adjusted net earnings (loss) [3]	$MM	(19.8)	45.1	28.2	114.1	116.5	58.7
Adjusted net earnings (loss) per share, basic [3]	$/share	(0.29)	0.64	0.40	1.64	1.66	0.84
Operating cash flow per share (before working capital changes) [3]	$/share	0.10	1.19	1.00	3.95	3.91	2.75
Adjusted EBITDA [3]	$MM	6.2	89.5	69.4	280.4	287.8	199.6
Adjusted EBITDA margin [3]	%	1.3%	16.8%	12.2%	12.8%	14.5%	11.1%
Total assets	$MM	1,529.5	1,353.0	1,539.5	1,529.5	1,353.0	1,301.6
Total debt	$MM	272.8	250.9	258.9	272.8	250.9	308.8
Net debt [3]	$MM	63.8	119.3	3.8	63.8	119.3	289.6
Net debt to invested capital [3]	%	6.1%	12.3%	0.4%	6.1%	12.3%	26.9%
Annualized return on invested capital [3]	%	2.4%	36.4%	27.7%	27.9%	28.1%	17.7%
Operating Highlights							
Lumber production	million fbm	607	655	674	2,635	2,595	2,490
Total lumber sales	million fbm	647	686	685	2,680	2,677	2,561
Lumber sales - Interfor produced	million fbm	639	666	675	2,638	2,594	2,469
Lumber sales - wholesale and commission	million fbm	8	20	10	42	83	92
Lumber - average selling price [4]	$/thousand fbm	599	650	701	687	627	570
Average USD/CAD exchange rate [5]	1 USD in CAD	1.3204	1.2713	1.3070	1.2957	1.2986	1.3248
Closing USD/CAD exchange rate [5]	1 USD in CAD	1.3642	1.2545	1.2945	1.3642	1.2545	1.3427

Notes:

(1) Figures in this table may not equal or sum to figures presented elsewhere due to rounding.
(2) Financial information presented for interim periods in this MD&A is prepared in accordance with IFRS and is unaudited.
(3) Refer to the Non-GAAP Measures section of this MD&A for definitions and reconciliations of these measures to figures reported in the Company's consolidated financial statements.
(4) Gross sales before duties.
(5) Based on Bank of Canada foreign exchange rates.

Summary of Fourth Quarter 2018 Financial Performance

Sales

Interfor recorded $468.5 million of total sales, down 12.1% from $532.8 million in the fourth quarter of 2017, driven by the sale of 647 million board feet of lumber at an average price of $599 per mfbm. Lumber sales volume decreased 39 million board feet, or 5.7%, while average selling price decreased $51 per mfbm, or 7.8%, as compared to the same quarter of 2017.

The decrease in the average selling price of lumber reflects significantly lower prices across all benchmark products in Q4'18 as compared to Q4'17. The Western SPF Composite decreased by US$121 to US$318 per mfbm, while the KD HF Stud 2x4 9' benchmark and the Southern Pine Composite decreased US$69 to US$336 per mfbm and US$30 to US$386 per mfbm, respectively. The negative impact of decreased U.S. Dollar lumber prices was somewhat offset by the weakening of the Canadian Dollar against the U.S. Dollar by 3.9% on average in Q4'18 as compared to Q4'17.

Sales generated from logs, residual products and other decreased by $6.0 million or 6.9% compared to the same quarter of 2017 due mainly to reduced availability of surplus logs.

Operations

Production costs increased by $13.1 million, or 3.1%, over Q4'17 despite a 5.7% drop in lumber sales volume. This is explained primarily by market driven log cost increases including higher stumpage rates in B.C., higher average conversion costs in part due to the market related downtime and an $8.2 million increase in log and lumber inventory valuation adjustments to reflect lumber prices declines.

Lumber production of 607 million board feet in Q4'18 was 48 million board feet lower than Q4'17.

Production from the Canadian operations declined by 45 million board feet to 174 million board feet in Q4'18, compared to Q4'17, as a result of temporary market driven curtailments in the B.C. Interior sawmills in Q4'18. Production from the Company's U.S. South sawmills totaled 303 million board feet in Q4'18, up 6 million board feet compared to Q4'17, as the Company increased operating schedules at several mills. Production from the Company's U.S. Northwest operations totaled 130 million board feet in Q4'18, down 10 million board feet compared to Q4'17.

Interfor expensed the full amount of CV and AD duty deposits levied on its Canadian shipments of softwood lumber into the U.S., which totaled $9.7 million for Q4'18, up $7.8 million from Q4'17. This increase is attributable to the fact that CV duties ceased in August 2017, and did not resume again until December 28, 2017.

Depreciation of plant and equipment was $19.3 million, comparable to Q4'17. Depletion and amortization of timber, roads and other was $8.6 million, down $3.3 million from Q4'17, as a result decreased conventional logging on the B.C. Coast.

Corporate and Other

Selling and administration expenses were $12.1 million, down $1.8 million from Q4'17. The fourth quarter of 2017 included a higher accrual for short term incentive compensation and certain additional IT project and improvement costs.

The $9.2 million long term incentive compensation recovery mostly reflects the impact of a 24.7% decrease in the market price for Interfor Common Shares during the quarter. The Q4'17 long term incentive compensation expense of $3.1 million is due primarily to a 6.8% increase in the market price for Interfor Common Shares during that quarter.

The majority of capital asset write-downs and restructuring costs in Q4'17 and Q4'18 relate to non-cash impairments, primarily on buildings and equipment in the U.S. South that will be replaced in conjunction with the Company's strategic capital projects. Additional charges in both quarters relate to the settlement of various human resource matters.

Finance costs decreased to $2.3 million in Q4'18 from $3.1 million in Q4'17 as a result of lower average levels of debt outstanding and increased interest revenue on short term investments.

Other foreign exchange gains of $3.3 million in Q4'18 result primarily from gains on U.S. Dollar cash held by Canadian operations as the closing Canadian Dollar weakened by 5.4% quarter over quarter and the Company significantly increased its U.S. Dollar cash balances in 2018. Other foreign exchange gains of $0.4 million in Q4'17 are comprised primarily of foreign exchange movements on short term intercompany funding.

Other income of $1.3 million in Q4'18 and Other expense of $1.0 million in Q4'17 resulted from the disposal of surplus equipment.

Income Taxes

The Company recorded an income tax recovery of $1.5 million in Q4'18, comprised of a negligible amount of current income tax and a $1.5 million deferred tax recovery.

Net Earnings

The Company recorded a Net loss of $13.2 million, or $0.19 per share, compared to Net earnings of $36.2 million, or $0.52 per share in the comparable period of 2017. Adjusted net loss was $19.8 million, or $0.29 per share, compared with Adjusted net earnings of $45.1 million, or $0.64 per share in Q4'17.

Summary of 2018 Financial Performance

Sales

Interfor recorded $2.2 billion in total sales, up 9.9% from $2.0 billion in 2017, driven by the sale of 2.7 billion board feet of lumber at an average price of $687 per mfbm. Lumber sales volume was consistent year over year while average selling price increased $60 per mfbm, or 9.6%, as compared to 2017.

The increase in the average selling price of lumber reflects higher prices across all benchmark products in 2018 as compared to 2017. The Western SPF Composite improved by US$50 to US$440 per mfbm, while the KD HF Stud 2x4 9' benchmark and the Southern Pine Composite improved US$68 to US$459 per mfbm and US$48 to US$457 per mfbm, respectively.

Sales generated from logs, residual products and other increased by $34.9 million, or 11.2% compared to 2017. Most of this increase is related to a 12.7% increase in average log selling price from B.C. operations with a greater proportion of export log sales, and higher chip prices in B.C.

Operations

Production costs increased by $166.9 million or 10.2% as compared to 2017, explained primarily by market driven log cost increases including higher stumpage rates in B.C., higher average conversion costs and a $10.3 million increase in log and lumber inventory valuation adjustments to reflect reduced lumber prices at year-end.

Lumber production of 2.6 billion board feet in 2018 was 40 million board feet higher than in 2017.

Production from the Canadian operations declined by 44 million board feet to 831 million board feet in 2018, compared to 2017, as a result of temporary market driven curtailments in the B.C. Interior sawmills in Q4'18. Production from the Company's U.S. South sawmills totaled 1.2 billion board feet in 2018, up 87 million board feet compared to 2017, as the Company increased operating schedules at several mills. Production from the Company's U.S. Northwest operations totaled 561 million board feet in 2018, down 3 million board feet compared to 2017.

Interfor expensed $53.3 million of CV and AD duty deposits in 2018, representing the full amount of U.S. CV and AD duty deposits levied on its Canadian shipments of softwood lumber into the U.S. Interfor. The increase of $34.7 million over 2017 is attributable to increased shipments and prices somewhat offset by lower rates in 2018. In addition, CV and AD duties were only levied for a portion of 2017, with CV duties only in effect from April 28, 2017 to August 26, 2017 and from December 28, 2017 onward, and AD duties in effect from June 30, 2017 onward.

Depreciation of plant and equipment was $80.3 million, up 3.5% from 2017. This increase is attributable to a full years' depreciation on capital projects completed in 2017 and increased operating hours in 2018.

Depletion and amortization of timber, roads and other was $36.0 million, down 6.7% as compared with 2017, as a result of decreased conventional logging on the B.C. Coast as compared to 2017.

Corporate and Other

Selling and administration expenses were $53.0 million, up $2.2 million from 2017. 2018 included an incremental accrual for short term incentive compensation and certain other costs not reflected in the 2017 comparative.

The $7.8 million long term incentive compensation recovery in 2018 mainly reflects a 31.7% decrease in the market price of Interfor Common Shares over the same period, partially offset by the impact of incentive awards maturing. The $13.0 million long term incentive compensation expense in 2017 resulted from an increase of 40.5% in the market price of Interfor Common Shares over the same period, coupled with the impact of incentive awards maturing.

The majority of capital asset write-downs and restructuring costs in 2017 and 2018 relate to non-cash impairments, primarily on buildings and equipment in the U.S. South that will be replaced in conjunction with the Company's strategic capital projects. Additional charges in both years relate to the settlement of various human resource matters, slightly offset by adjustments to prior period accruals.

Finance costs decreased to $10.4 million in 2018 from $14.0 million in 2017 as a result of lower average levels of debt outstanding and increased interest revenue on short term investments.

Other foreign exchange gains of $3.5 million in 2018 result primarily from gains on U.S. Dollar cash held by Canadian operations as the Canadian Dollar weakened by 8.7% year over year and the Company significantly increased its U.S. Dollar cash balances. Other foreign exchange losses of $2.0 million in 2017 are comprised primarily of foreign exchange movements on short term intercompany funding.

Other income of $1.2 million in 2018 and Other expense of $2.0 million in 2017 result from the disposal of surplus equipment.

Income Taxes

The Company recorded an income tax expense of $39.2 million in 2018, comprised of a $3.0 million current tax expense and a $36.2 million deferred tax expense. Current taxes relate mostly to U.S. state income taxes. The 2017 income tax expense of $34.1 million is comprised of a $1.1 million current tax expense and a $33.0 million deferred tax expense.

Net Earnings

The Company recorded Net earnings of $111.7 million, or $1.60 per share, compared to Net earnings of $97.2 million, or $1.39 per share in 2017. Adjusted net earnings was $114.1 million, or $1.64 per share, in 2018 compared with Adjusted net earnings of $116.5 million, or $1.66 per share in 2017.

Summary of Quarterly Results[1]

	Unit	2018 Q4	2018 Q3	2018 Q2	2018 Q1	2017 Q4	2017 Q3	2017 Q2	2017 Q1
Financial Performance[2]									
Total sales	$MM	468.5	570.5	619.9	527.6	532.8	489.2	511.4	456.8
Lumber	$MM	387.8	480.3	527.0	445.9	446.0	410.2	433.7	389.6
Logs, residual products and other	$MM	80.7	90.2	92.9	81.7	86.8	79.0	77.7	67.2
Operating earnings (loss)	$MM	(17.0)	41.3	85.9	46.5	47.9	28.3	42.7	30.4
Net earnings (loss)	$MM	(13.2)	28.1	63.8	33.0	36.2	16.8	24.5	19.7
Net earnings (loss) per share, basic	$/share	(0.19)	0.40	0.91	0.47	0.52	0.24	0.35	0.28
Adjusted net earnings (loss)[3]	$MM	(19.8)	28.2	68.9	36.8	45.1	20.0	28.7	22.7
Adjusted net earnings (loss) per share, basic[3]	$/share	(0.29)	0.40	0.98	0.52	0.64	0.29	0.41	0.32
Operating cash flow per share (before working capital changes)[3]	$/share	0.10	1.00	1.76	1.08	1.19	0.82	1.05	0.85
Adjusted EBITDA[3]	$MM	6.2	69.4	123.8	81.1	89.5	60.5	77.4	60.3
Adjusted EBITDA margin[3]	%	1.3%	12.2%	20.0%	15.4%	16.8%	12.4%	15.1%	13.2%
Annualized return on invested capital[3]	%	2.4%	27.7%	48.5%	32.4%	36.4%	23.9%	28.9%	22.0%
Shares outstanding - end of period	million	67.8	69.4	70.0	70.0	70.0	70.0	70.0	70.0
Shares outstanding - weighted average	million	68.9	69.9	70.0	70.0	70.0	70.0	70.0	70.0
Operating Performance									
Lumber production	million fbm	607	674	688	666	655	645	655	640
Total lumber sales	million fbm	647	685	700	648	686	671	675	645
Lumber sales - Interfor produced	million fbm	639	675	689	635	666	650	654	624
Lumber sales - wholesale and commission	million fbm	8	10	11	13	20	21	21	21
Lumber - average selling price[4]	$/thousand fbm	599	701	753	688	650	611	642	604
Average USD/CAD exchange rate[5]	1 USD in CAD	1.3204	1.3070	1.2911	1.2647	1.2713	1.2528	1.3449	1.3238
Closing USD/CAD exchange rate[5]	1 USD in CAD	1.3642	1.2945	1.3168	1.2894	1.2545	1.2480	1.2977	1.3322

Notes:

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(4) Gross sales before duties.
(5) Based on Bank of Canada foreign exchange rates.

The Company's quarterly financial trends are most impacted by seasonality, levels of lumber production, log costs, market prices for lumber and the USD/CAD foreign currency exchange rate.

Logging operations are seasonal due to a number of factors including weather, ground conditions and fire season closures. Generally, production from the Company's B.C. Coastal logging operations is relatively low in the second half of the fourth quarter and the first half of the first quarter due to the impact of winter storms. Logging activity in the B.C. Interior is typically reduced during the annual spring break-up. Sawmill operations are dependent on the availability of logs from our logging operations and our suppliers. In addition, the market demand for lumber and related products is generally lowest in the winter season due to reduced construction and renovation activities.

Severe weather conditions impacted B.C. Coastal log production and lumber production at certain sawmills in B.C. and the U.S. Northwest in Q4'17 and Q1'18 and in the U.S. South in Q3'18. Market driven curtailments in the B.C. Interior impacted lumber production in Q4'18. Countervailing and anti-dumping duties imposed on Canadian lumber shipments to the U.S. affected results subsequent to Q1'17.

The volatility of the Canadian Dollar against the U.S. Dollar also impacted results. A weaker Canadian Dollar increases the lumber sales realizations of Canadian operations, all else equal, and increases net earnings of U.S. operations when translated to Canadian Dollars.

Liquidity

Balance Sheet

Interfor strengthened its financial position throughout 2018, with strong cash flow generated from operations used to fund capital projects, invest in marketable securities and repurchase Shares. Net debt at December 31, 2018 was $63.8 million, or 6.1% of invested capital, representing a decrease of $55.5 million from the level of net debt at December 31, 2017. Net debt was negatively impacted by a weakened Canadian Dollar against the U.S. Dollar as all debt held was denominated in U.S. Dollars; this was partially hedged by the Company's U.S. Dollar cash and marketable securities balances.

	For the 3 months ended			For the year ended	
Thousands of Dollars	Dec. 31, 2018	Dec. 31, 2017	Sep. 30, 2018	Dec. 31, 2018	Dec. 31, 2017
Net debt					
Net debt, period opening	$3,800	$176,866	$34,415	$119,300	$289,551
Net drawing (repayment) on credit facilities	(1)	(1)	112	110	(40,217)
Impact on U.S. Dollar denominated debt from (strengthening) weakening CAD	13,941	1,301	(4,572)	21,830	(17,704)
Decrease (increase) in cash and cash equivalents	7,286	(59,698)	61,248	(23,968)	(114,789)
Decrease (increase) in marketable securities	49,871	921	(91,011)	(41,140)	-
Impact on U.S. Dollar denominated cash and cash equivalents and marketable securities from strengthening (weakening) CAD	(11,072)	(89)	3,608	(12,307)	2,459
Net debt, period ending	$63,825	$119,300	$3,800	$63,825	$119,300

As at December 31, 2018, the Company had net working capital of $359.2 million and available liquidity of $506.9 million, including cash, marketable securities and borrowing capacity on operating and term line facilities.

On June 15, 2018, the Company extended the maturity of its U.S. Operating line from May 1, 2019 to June 15, 2021, with no other significant changes. On August 14, 2018, Interfor completed an agreement to extend US$84 million of its 2021 to 2023 Senior Secured Note maturities to 2027 to 2029. As a result, Interfor's weighted average fixed interest rate on its term debt rose to 4.47%.

These resources, in addition to cash generated from operations, will be used to support working capital requirements, debt servicing commitments and capital expenditures. We believe that Interfor will have sufficient liquidity to fund operating and capital requirements for the foreseeable future.

Cash Flow from Operating Activities

The Company generated $275.1 million of cash flow from operations before changes in working capital in 2018, for a $1.2 million increase over 2017. There was a net cash inflow from operations after changes in working capital of $255.2 million in 2018, with $19.9 million of cash invested in operating working capital. Reduced sales in Q4'18 contributed to the $27.4 million inflow related to receivables, while increases in B.C. Interior log inventories to higher seasonal levels contributed to the $33.8 million total inventories outflow. In 2017, $258.2 million of cash was generated from operations with $15.7 million of cash invested in operating working capital.

Cash Flow from Investing Activities

Capital spending included $106.6 million for plant and equipment, timber licenses and other intangibles and $32.2 million for development of roads. Discretionary mill improvements of $78.9 million in 2018 include a number of projects in the U.S. South, the most significant of which relate to the modernizations of the Monticello and Meldrim sawmills, and the installation of an autograder at the sawmill in Perry. Maintenance capital investments excluding roads totaled $27.5 million in 2018, of which the majority was spent on U.S. South operations.

Investing activities totaled $184.8 million in 2018, including capital spending and $48.4 million primarily on marketable securities, net of $2.4 million in proceeds on the disposal of property, plant and equipment.

In 2017, total investing activities of $91.1 million were net of $3.8 million in proceeds on the disposal of property, plant and equipment and investments. Spending included $62.7 million for property, plant and equipment, timber licenses and other intangibles, and $32.2 million for development of roads. Discretionary improvements totaled $25.4 million during 2017, the majority of which was spent in the U.S. South. Maintenance capital investments of $37.3 million in 2017 included a number of projects in the U.S. South, the most significant of which was $5.0 million for completion of the kiln conversion project at the Company's Preston sawmill in Georgia.

Cash Flow from Financing Activities

The net cash outflow of $46.5 million in 2018 resulted from $36.9 million used to purchase shares under the Company's NCIB, and interest payments of $9.7 million, slightly offset by proceeds received on the issuance of shares under the Company's stock option plan.

Activity on the Company's credit facilities included the repayment of US$84 million of its Series A and B Senior Secured Notes with maturities of 2021 to 2023, issuance of US$84 million of Series D and E Senior Secured Notes with maturities of 2027 to 2029, and short-term funding activities under the Revolving Term Line.

Cash used for financing activities totaled $53.3 million in 2017, including net repayments of $40.2 million on credit facilities and interest payments of $12.2 million.

Summary of Contractual Obligations

The estimated cash payments due in respect of contractual and legal obligations as at December 31, 2018, including debt and interest payments and major capital improvements are summarized as follows:

		Payments due by Period			
Thousands of Canadian Dollars	**Total**	**Up to 1 Year**	**2-3 Years**	**4-5 Years**	**After 5 Years**
Trade accounts payable and provisions	$145,985	$145,985	$ -	$ -	$ -
Income taxes payable	356	356	-	-	-
Reforestation liability	44,277	13,947	13,685	8,023	8,622
Long term debt	366,762	12,186	31,822	38,226	284,528
Provisions and other liabilities	31,563	8,184	5,684	2,336	15,359
Operating leases and capital commitments	441,160	198,380	223,250	8,720	10,810
Total obligations	$1,030,103	$379,038	$274,441	$57,305	$319,319

Capital Resources

The following table summarizes Interfor's credit facilities and availability as of December 31, 2018:

Thousands of Canadian Dollars	**Operating Line**	**Revolving Term Line**	**Senior Secured Notes**	**U.S. Operating Line**	**Total**
Available line of credit	$65,000	$200,000	$272,840	$68,210	$606,050
Maximum borrowing available	$65,000	$200,000	$272,840	$50,590	$588,430
Less:					
Drawings	-	-	272,840	-	272,840
Outstanding letters of credit included in line utilization	14,858	-	-	2,810	17,668
Unused portion of facility	$50,142	$200,000	$ -	$47,780	297,922
Add:					
Cash and cash equivalents					166,152
Marketable securities					42,863
Available liquidity at December 31, 2018					$506,937

As of December 31, 2018, the Company had commitments for capital expenditures totaling $161.4 million for both maintenance and discretionary capital projects.

Transactions between Related Parties

Other than transactions in the normal course of business with key management personnel, the Company had no transactions between related parties in the year ended December 31, 2018.

Off-Balance Sheet Arrangements

The Company has off-balance sheet arrangements which include letters of credit and surety performance and payment bonds, primarily for timber purchases and AD and CV duty deposits. At December 31, 2018, such instruments aggregated $64.7 million (December 31, 2017 - $56.2 million). Off-balance sheet arrangements have not had, and are not reasonably likely to have, any material impact on the Company's current or future financial condition, results of operations or cash flows.

Financial Instruments and Other Instruments

The Company purchases high grade liquid marketable securities with varying maturities no greater than twelve months to yield a higher return on surplus cash. Primary considerations in selecting investments for the temporary employment of surplus funds are safety of principal and liquidity, with yield a secondary consideration.

In addition, from time to time, the Company employs financial instruments, such as interest rate swaps and foreign currency forward and option contracts, to manage exposure to fluctuations in interest rates and foreign exchange rates. The Company also trades lumber futures from time-to-time to manage price risk. The Company's policy is not to use derivatives for trading or speculative purposes. The risk management strategies and relationships are formally documented and assessed on a regular, ongoing basis to ensure derivatives are effective in offsetting changes in fair values or cash flows of hedged items.

The counter-parties for all derivative contracts except lumber futures are the Company's bankers who are highly-rated and, hence, the risk of credit loss on the instruments is mitigated.

Lumber futures are traded through a well-established financial services firm with a long history of providing trading, exchange and clearing services for commodities and foreign currencies. As trading activities are closely monitored by senior management and restricted including a maximum number of outstanding contracts at any point in time, the risk of credit loss on these instruments is considered low.

The Company did not trade any foreign exchange contracts and had minimal trades in lumber futures in 2018 and 2017.

Borrowings

As at December 31, 2018, Interfor had no floating rate debt on its credit facilities and US$200 million of fixed rate debt through the Senior Secured Notes.

The Company's facilities bear interest at the bank prime rate plus a premium, or, at the Company's option, at rates for Bankers' Acceptances for Canadian Dollar loans or at LIBOR for U.S. Dollar loans, in all cases dependent upon a financial ratio.

The Company's Senior Secured Notes have a weighted average fixed interest rate of 4.47%.

During 2018, the Company had minimal borrowings subject to variable interest rates under its credit facilities. As a result, based on the Company's average debt level during 2018, the sensitivity of a 100 basis point increase in interest rates would result in a negligible decrease in Net earnings.

Foreign Currency

Certain of the Company's subsidiaries have a functional currency of the U.S. Dollar. Unrealized gains and losses arising upon translation of these net foreign currency investment positions, together with any gain or losses arising from hedges of those net investment positions, are recognized in Other comprehensive income, and recorded to the Translation reserve in Equity. Foreign currency translation differences residing in the Translation reserve will be released to Net earnings upon the reduction of the net investment in foreign operations through the sale, reduction or substantial liquidation of an investment position.

As at December 31, 2018, the Company had designated the US$200 million drawn under its Senior Secured Notes as a hedge against the net investment in its U.S. operations.

The Company recorded a $43.7 million after tax unrealized foreign exchange gain on translation of its U.S. operations with a U.S. Dollar functional currency, net of revaluations of debt designated as hedges against the net investment in U.S. operations, to Other comprehensive income in 2018 (2017 - $28.9 million loss).

Outstanding Shares

As of December 31, 2018, Interfor had 67,760,622 Common Shares issued and outstanding. These shares are listed on the Toronto Stock Exchange under the symbol IFP. The Company issued 7,707 Shares in 2018 as a result of share option exercises.

On March 1, 2018, the Company renewed its NCIB through March 6, 2019, whereby it can purchase for cancellation up to 3,500,000 Shares, amended to 6,934,356 Shares on December 18, 2018.

During 2018, Interfor purchased 2,277,540 Shares at a cost of $36.9 million. All Shares repurchased were cancelled.

As at the close of business on February 7, 2019, Interfor had purchased 439,900 Shares at a cost of $6.6 million since December 31, 2018.

Controls and Procedures

The Company's management, under the supervision of the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), has evaluated the design and effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures were effective as of December 31, 2018.

The Company's management, under the supervision of the CEO and CFO, has evaluated the design and effectiveness of the Company's internal controls over financial reporting ("ICFR") based on the criteria established within the 2013 COSO framework. Based on this evaluation, the CEO and CFO have concluded that the Company's ICFR were effective as of December 31, 2018.

The CEO and CFO acknowledge responsibility for the design of ICFR and confirm that there were no changes in these controls that occurred during the year ended December 31, 2018, which materially affected, or are reasonably likely to materially affect, the Company's ICFR.

Critical Accounting Estimates

The Company's financial statements include critical accounting estimates made by management, as described below. The use of different assumptions could have a material impact on the Company's financial condition and performance.

Valuation of Inventories. Lumber inventories are valued at the lower of cost and net realizable value on a specific product basis. Log inventories are valued at the lower of cost and net realizable value on a specific boom or sort basis. The unit net realizable value for lumber inventories and for B.C. Coast log inventories is determined by reference to the average sales values by specific product in the period immediately following the reporting date. The unit realizable value for B.C. Interior and U.S. log inventories is determined by reference to the value of the projected lumber and residual outturns. The unit cost for lumber is based on a three month moving average cost, lagged by one month and adjusted for abnormal costs, as in the case of a curtailment. The unit cost for B.C. Coast logs is based on a twelve month moving average cost lagged one month and for B.C. Interior logs is based on the three month moving average cost lagged one month, both adjusted for abnormal costs. The unit cost for U.S. logs is based on purchase cost. The Company records a charge to operating earnings when net realizable value is lower than carrying value. Downward movements in commodity prices could result in a material write-down of log and/or lumber inventories at any given time.

Recoverability of Property, Plant and Equipment, Roads and Bridges, Timber licences, Other Intangible Assets, and Goodwill. Interfor's assessment of recoverability of property, plant and equipment, roads, bridges, timber licences and other intangible assets is made with reference to projections of future cash flows to be generated by its operations. The assessment of recoverability of goodwill is also made with reference to projections of future cash flows to be generated by the related cash generating unit. In both cases the projected cash flows are discounted to estimate the recoverable amount of the related assets.

The Company conducts a review of external and internal sources of information to assess existence of any impairment indicators. External factors include adverse changes in expected future prices, costs and other market and economic factors. Internal factors include changes in the expected useful life of the asset or changes to the planned capacity of the asset.

Key assumptions used are based on industry sources as well as management estimates. Assumptions encompass lumber and residual chip sales prices, applicable foreign exchange rates, operating rates of the assets, raw material and conversion costs, the level of sales to the U.S. from Canada, the CV and AD duty rates, future capital required to maintain the assets in their current operating condition, and other items.

A high degree of uncertainty exists in these assumptions and, as such, any significant change in assumptions could result in a conclusion that the carrying value of these assets may not be recovered, which could necessitate a material charge against operating earnings.

Appropriate discount rates are determined by reference to current market conditions, specific company factors and asset specific factors. The inflation rates applied within the cash flow projections represent the published Bank of Canada consumer price index and the published Bureau of Labor Statistics consumer price index.

Interfor assesses the recoverability of Property, Plant and Equipment, Roads and Bridges, Timber Licences and Other Intangible Assets whenever events or circumstances indicate that the carrying value may not be recoverable. Goodwill is tested for impairment annually, and whenever events or changes in circumstances indicate that impairment may exist. The Company assessed the recoverability of goodwill as at December 31, 2018 and concluded that there was no impairment.

Reforestation and Other Forestry-related Liabilities. Crown legislation requires the Company to complete reforestation activities on its forest and timber tenures. Accordingly, Interfor records the estimated liability for reforestation as timber is cut, and includes these expenses in the cost of current production. The estimate of future reforestation costs is based on detailed prescriptions of reforestation as prepared by Registered Professional Foresters employed or contracted by the Company. Considerations include the specifics of the areas logged and the treatments prescribed for those areas, as well as the timing and success rates of the planned activities. Estimates of reforestation liabilities could be materially impacted by forest fires, wildlife grazing, unfavourable weather conditions, changing legislative requirements and standards, or inaccurate projections, which could result in a material charge against operating earnings.

The Company also has a legal obligation to deactivate certain roads constructed for access to timber, once that access is no longer required. Accordingly, Interfor accrues the cost of road deactivation as related timber is cut, including those expenses in the cost of current production. The estimate of future road deactivation cost is based on comprehensive plans prepared by Professional Foresters and Engineers employed by Interfor and includes such considerations as road structure and terrain. Estimates of road deactivation liabilities could be materially impacted by unfavourable terrain, changing legislative requirements and standards, or inaccurate projections, which could result in a material charge against operating earnings. Each of these estimates is reviewed on an ongoing basis.

Pension and Other Post-retirement Benefits. The Company sponsors two defined benefit pension plans for those hourly employees not covered by forest industry union plans. It also sponsors two post-retirement medical and life insurance plans and a non-contributory defined benefit pension plan for a former senior executive.
The Company retains independent actuarial consultants to value the defined pension benefit obligations, the post-retirement medical and life insurance obligations and related plan asset values. Actuarial assumptions used in the valuation of plan obligations and assets include the discount rate used in calculations of net present value of obligations, expected rates of return on plan assets to be used to fund obligations, assumed rates of increase for employee compensation and health care costs, and mortality rates. Actual experience can vary materially from estimates and could result in a material charge against operating earnings as well as necessitate a current cash funding requirement.

Income Taxes. The Company's provision for income taxes, both current and deferred, is based on various judgments, assumptions and estimates including the tax treatment of transactions recorded in the Company's consolidated financial statements. Interfor records provisions for income taxes based on the respective tax rules and regulations in the jurisdictions in which the Company operates. Due to the number of variables associated with the judgments, assumptions and estimates, and differing tax rules and regulations across the multiple jurisdictions, the precision and reliability of the resulting estimates are subject to uncertainties and may change as additional information becomes known. Income tax assets and liabilities, both current and deferred, are measured according to the income tax legislation that is expected to apply when the asset is realized or the liability settled. Deferred income tax assets and liabilities are comprised of the tax effect of temporary differences between the carrying amount and tax basis of assets and liabilities, tax loss carry forwards and tax credits. Assumptions underlying the composition of deferred income tax assets and liabilities include estimates of future results of operations and the timing of the reversal of temporary differences as well as the tax rates and laws in the applicable jurisdictions at the time of the reversal. The composition of deferred income tax assets and liabilities is reasonably likely to change from period to period due to the uncertainties surrounding these assumptions.

Accounting Policy Changes

Effective January 1, 2018, the Company adopted IFRS 9, *Financial Instruments* and IFRS 15, *Revenue from Contracts with Customers*. Neither of these has had a significant impact on the Company's financial statements, while additional disclosure requirements have been adopted.

IFRS 9, *Financial Instruments* replaced the multiple classification and measurement models in IAS 39, *Financial Instruments: Recognition and Measurement*, and set out requirements for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items.

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost; fair value through other comprehensive income; and fair value through profit and loss. The classification categories for financial liabilities remained largely unchanged.

IFRS 9 also replaces the "incurred loss" model in IAS 39 with an "expected credit loss" ("ECL") model to calculate the impairment of financial assets.

IFRS 15, *Revenue from Contracts with Customers*, replaced IAS 18, *Revenue*, IAS 11, *Construction Contracts* and related interpretations. IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised.

A number of new standards, and amendments to standards and interpretations, are not yet effective for the year ended December 31, 2018, and have not been applied in preparing these consolidated financial statements. Of these pronouncements, IFRS 16, Leases, replacing IAS 17, Leases, is considered to be the most significant and has a required adoption date of January 1, 2019.

IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Under the new standard, a lessee recognizes a right-of-use asset, representing its right to use the underlying asset, and a lease obligation, representing its obligation to make lease payments. Lease expense, which is currently recorded as a Production cost, will be replaced by depreciation on the right-of-use asset and interest expense on the lease obligation.

Right-of-use assets will be accounted for under IAS 16, Property, Plant and Equipment, and will initially be measured at cost, which includes the initial measurement of the lease obligation and other costs, less lease incentives. Lease obligations will initially be measured at the present value of future lease payments, and will subsequently be measured at amortized cost using the effective interest rate method.

The Company intends to adopt the standard using the full retrospective approach with restatement of each prior reporting period presented. Interfor expects to utilize certain practical expedients and apply exemptions for short term and low-value leases.

The Company is in the final stages of validating its calculations of the financial impact of adoption of IFRS 16 on January 1, 2019. Adoption of the standard is expected to result in the following changes to Interfor's consolidated financial statements:

		Estimated impact as at January 1, 2019
Statement of Financial Position		
Right of Use Asset, net of accumulated amortization	Increase to Assets	$38,000
Lease obligation	Increase to Liabilities	45,000
Provisions and other liabilities	Increase to Liabilities	500
Deferred income tax	Decrease to Liabilities	1,800
Equity	Decrease to Equity	5,700

		Estimated impact for the year ended December 31, 2018
Statement of Earnings		
Production costs and Selling and administration	Decrease	$10,500
Depreciation	Increase	10,000
Finance costs	Increase	2,000
Deferred income tax expense	Decrease	10
Net earnings	Decrease	1,490
Net earnings per share	Decrease	$0.02
Statement of Cash Flows		
Cash provided by:		
Operating activities	Increase	10,500
Financing activities	Decrease	10,500

The figures presented may change as a result of finalizing adjustments required on transition during the first quarter of 2019.

Application of the new standard is not anticipated to have a negative impact on any bank covenant calculations.

Non-GAAP Measures

This MD&A makes reference to the following non-GAAP measures: Adjusted net earnings, Adjusted net earnings per share, EBITDA, Adjusted EBITDA, Net debt to invested capital and Operating cash flow per share (before working capital changes) which are used by the Company and certain investors to evaluate operating performance and financial position. These non-GAAP measures do not have any standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other issuers.

The following table provides a reconciliation of these non-GAAP measures to figures as reported in the Company's audited consolidated financial statements (unaudited for interim periods) prepared in accordance with IFRS:

Thousands of Canadian Dollars except number of shares and per share amounts	For the 3 months ended Dec. 31, 2018	Dec. 31, 2017	Sep. 30, 2018	For the year ended Dec. 31, 2018	2017	2016
Adjusted Net Earnings (Loss)						
Net earnings (loss)	$(13,165)	$36,196	$28,092	$111,678	$97,153	$65,643
Add:						
Capital asset write-downs and restructuring costs	4,551	7,422	5,848	15,304	9,203	7,280
Other foreign exchange loss (gain)	(3,330)	(412)	1,847	(3,474)	2,035	(1,468)
Long term incentive compensation expense (recovery)	(9,180)	3,110	(7,503)	(7,829)	12,977	4,551
Other expense (income)	(1,254)	995	(192)	(1,188)	1,987	(14,094)
Post closure wind-down costs and losses (recoveries)	-	5	-	4	(21)	909
Income tax effect of above adjustments	2,530	(2,260)	149	(396)	(6,848)	2,008
Recognition of previously unrecognized deferred tax assets	-	-	-	-	-	(6,171)
Adjusted net earnings (loss)	$(19,848)	$45,056	$28,241	$114,099	$116,486	$58,658
Weighted average number of shares - basic ('000)	68,884	70,030	*69,908*	69,713	70,030	70,030
Adjusted net earnings (loss) per share	$(0.29)	$0.64	$0.40	$1.64	$1.66	$0.84
Adjusted EBITDA						
Net earnings (loss)	$(13,165)	$36,196	$28,092	$111,678	$97,153	$65,643
Add:						
Depreciation of plant and equipment	19,283	19,217	20,071	80,273	77,623	76,092
Depletion and amortization of timber, roads and other	8,566	11,879	9,715	36,048	38,635	34,895
Capital asset write-downs and restructuring costs	4,551	7,422	5,848	15,304	9,203	7,280
Finance costs	2,254	3,139	2,465	10,410	14,030	18,602
Other foreign exchange loss (gain)	(3,330)	(412)	1,847	(3,474)	2,035	(1,468)
Income tax expense (recovery)	(1,518)	7,968	9,044	39,191	34,136	7,207
EBITDA	16,641	85,409	77,082	289,430	272,815	208,251
Add:						
Long term incentive compensation expense (recovery)	(9,180)	3,110	(7,503)	(7,829)	12,977	4,551
Other (income) expense	(1,254)	995	(192)	(1,188)	1,987	(14,094)
Post closure wind-down costs and losses (recoveries)	-	5	-	4	(21)	909
Adjusted EBITDA	$6,207	$89,519	$69,387	$280,417	$287,758	$199,617
Sales	$468,544	$532,781	$570,486	$2,186,567	$1,990,106	$1,792,712
Adjusted EBITDA margin	1.3%	16.8%	12.2%	12.8%	14.5%	11.1%
Net debt to invested capital						
Net debt						
Total debt	$272,840	$250,900	$258,900	$272,840	$250,900	$308,821
Cash and cash equivalents	(166,152)	(131,600)	(165,553)	(166,152)	(131,600)	(19,270)
Marketable securities	(42,863)	-	(89,547)	(42,863)	-	-
Total net debt	$63,825	$119,300	$3,800	$63,825	$119,300	$289,551
Invested capital						
Net debt	$63,825	$119,300	$3,800	$63,825	$119,300	$289,551
Shareholders' equity	974,065	854,188	985,316	974,065	854,188	786,667
Total invested capital	$1,037,890	$973,488	$989,116	$1,037,890	$973,488	$1,076,218
Net debt to invested capital(1)	6.1%	12.3%	0.4%	6.1%	12.3%	26.9%
Operating cash flow per share (before working capital changes)						
Cash provided by operating activities	$18,037	$86,749	$84,956	$255,233	$258,224	$199,272
Cash used in (generated from) operating working capital	(11,303)	(3,332)	(15,223)	19,868	15,696	(6,695)
Operating cash flow (before working capital changes)	$6,734	$83,417	$69,733	$275,101	$273,920	$192,577
Weighted average number of shares - basic ('000)	68,884	70,030	*69,908*	69,713	70,030	70,030
Operating cash flow per share (before working capital changes)	$0.10	$1.19	$1.00	$3.95	$3.91	$2.75
Annualized return on invested capital						
Adjusted EBITDA	$6,207	$89,519	$69,387	$280,417	$287,758	$199,617
Invested capital, beginning of period	$989,116	$994,542	$1,011,709	$973,488	$1,076,218	$1,177,557
Invested capital, end of period	1,037,890	973,488	989,116	1,037,890	973,488	1,076,218
Average invested capital	$1,013,503	$984,015	$1,000,413	$1,005,689	$1,024,853	1,126,888
Adjusted EBITDA divided by average invested capital	0.6%	9.1%	6.9%	27.9%	28.1%	17.7%
Annualization factor	4.0	4.0	4.0	1.0	1.0	1.0
Annualized return on invested capital	2.4%	36.4%	27.7%	27.9%	28.1%	17.7%

Notes:
(1) Net debt to invested capital as of the period end.

Risks and Uncertainties

The Company is exposed to many risks and uncertainties in conducting its business including, but not limited to the factors described below.

Price Volatility

The Company's operating results are affected by fluctuations in the selling prices for lumber, logs and wood chips. Prices are affected by such factors as the general level of economic activity in the markets in which the Company sells its products, interest rates, construction activity (in particular, housing starts in the United States, Canada, Japan and China), duty rates, and log and chip supply/demand relationships. The Company's financial results may be significantly affected by changes in the selling prices of its products.

Competition

The global markets for the Company's products are highly competitive, primarily on the basis of price. In addition, a majority of the Company's lumber production is sold in markets where the Company competes against several producers of approximately the same or larger capacity. Some of the Company's competitors have greater financial resources and may be, in certain product lines, lower-cost producers.

Factors which could affect the Company's competitive position include:(i) its industry-relative costs for logs, labour and other manufacturing inputs; (ii) its ability to access the US and foreign markets, including the existence of duties; (iii) the strength of the U.S. Dollar relative to the Canadian Dollar and certain foreign currencies; (iv) the availability and cost of trucks, railcars and vessels for shipment of lumber; (v) product quality and fit with end-user demand; and (vi) the availability and price of substitute products.

If the Company is unable to successfully compete on a global basis, its financial condition could suffer.

Availability and Cost of Log Supply

The log requirements of the Company's sawmills are met using logs harvested from its timber tenures, by long term trade and purchase agreements and by purchases on the open market and through timber sale bids. Logs produced but unsuitable for use in the Company's sawmills are either traded for suitable logs or sold on the open market. Operating at normal capacity, the Company's Canadian sawmills generally purchase less than 40% of their log requirements either through purchase agreements or on the open market. The Company relies almost entirely on purchased fibre through purchase agreements for its U.S. based sawmills. As a result, fluctuations in the price, quality or availability of log supply can have a material effect on the Company's business, financial position, results of operations and cash flow. In addition, weather-related issues can restrict timely access to log supply as well as increase cost for available logs.

The Company relies on third-party independent contractors to harvest timber in areas over which it holds timber tenures. Increases in rates charged by these independent contractors or the limited availability of these independent contractors may increase the Company's timber harvesting costs.

Additionally, in order to ensure uninterrupted access to logs harvested from its timber tenures in Canada, the Company must also focus on the continuous development of road networks. This encompasses an integrated plan by foresters, engineers and logging operations personnel to identify future logging areas and develop the engineering for roads. The Company also relies on third-party independent contractors to construct roads in areas over which it holds timber tenures. Increases in rates charged by these independent contractors or the limited availability of these independent contractors may increase the Company's timber harvesting costs.

The Company expects to fund its ongoing road development with cash generated from operations and through utilization of its existing credit facilities.

Natural or Man-Made Disasters

The Company's operations are subject to adverse natural or man-made events such as forest fires, severe weather conditions, climate change, timber disease and insect infestation and earthquake activity. These events could damage or destroy the Company's physical facilities or timber supply and similar events could also affect the facilities of the Company's suppliers or customers. Any such damage or destruction could adversely affect the Company's financial results due to decreased production output or increased operating costs. Although management believes it has reasonable insurance arrangements in place to cover certain of such incidents, there can be no assurance that these arrangements will be sufficient to fully protect the Company against such losses. As is common in the industry, the Company does not insure loss of standing timber for any cause.

Currency Exchange Sensitivity

The Company's Canadian operations ordinarily sell approximately 80% of their lumber into export markets, with the majority of these sales denominated in U.S. Dollars and, to a lesser extent, in Japanese Yen. While the Canadian operations also incur some U.S. Dollar–denominated expenses, primarily for ocean freight and other transportation, CV and AD duties, and for equipment operating leases, the majority of expenses are incurred in Canadian Dollars. The Company's operations in the United States transact primarily in U.S. Dollars.

An increase in the value of the Canadian Dollar relative to the U.S. Dollar would reduce the amount of revenue in Canadian Dollars realized by the Company from lumber sales made in U.S. Dollars. This would reduce the Company's operating margin and the cash flow available to fund operations. Consequently, a significant strengthening of the Canadian Dollar against the U.S. Dollar could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

Government Regulation

The Company's operations are subject to extensive provincial, state, federal or other laws and regulations that apply to most aspects of its business activities. Where applicable, the Company is required to obtain approvals, permits and licences for its operations as a condition to operate.

From time to time, changes in government policy or regulation may impact the Company's operations. Until the details of all such changes are announced and implemented, the full impact of these changes on the Company's production, costs, financial position and results of operations cannot be determined.

Allowable Annual Cut ("AAC")

The Company holds cutting rights in B.C. that represent an AAC of approximately of 3.39 million cubic metres. Of this amount, 3.34 million cubic metres is in the form of replaceable tenures (4 Tree Farm Licences and 27 Forest Licences). The remaining portion is held in non-replaceable Timber Licences that will expire over time.

The AAC is regulated by the Ministry of Forests, Lands, Natural Resource Operations and Rural Development and is subject to a periodic Timber Supply Review process to make determinations that set harvesting rates for each tenure. Many factors affect the AAC, such as timber inventory, operable land base, growth rates, regulations, forest health, land use and environmental and social considerations.

The amount of timber available for harvest in the south-central portion of the B.C. Interior is expected to decline over the next 10 years as the surplus of dead pine stands from the pine beetle epidemic become no longer useable. In 2018 we had a reduction of approximately 4% of our AAC from our interior tenures due to new timber supply determinations in the Kamloops Region. There may be further modest AAC declines in the years ahead to account for various forest management considerations, though a material impact on our internal supply is not expected.

Indigenous Peoples

Indigenous peoples have claimed title and rights over substantial portions of B.C., including areas where the Company's forest tenures are situated, creating uncertainty as to the status of competing property rights. The Federal and Provincial governments have been seeking to negotiate settlements with Indigenous peoples throughout B.C. in order to resolve their rights and title claims. In addition, the governments have entered, and may continue to enter, into interim measure (reconciliation) agreements with Indigenous peoples. Any interim measures, agreements or settlements that may result from the treaty process may involve a combination of cash, resources, grants of conditional rights to resources on public lands and rights of self-government. The impact of Indigenous peoples claims or treaty settlements on the Company's forest tenures or the amounts of compensation to the Company, if any, cannot be estimated at this time.

The courts have also established that the Crown has a duty to consult with Indigenous peoples and, where appropriate, accommodate their interests. However, questions of responsibility and appropriateness of balancing interests will continue to evolve as the parties try to address these long-standing and complex issues. The Government of B.C. has been working to improve the functional relationship between the Crown and Indigenous peoples prior to treaty settlement. The Province of B.C. and some Indigenous peoples on the coast of B.C. have signed Reconciliation Protocols that provide a shared decision making process for resource and land use, as well as new forest sector opportunities. These agreements overlap portions of the Company's coastal tenures. The agreements will be assessed and monitored in the years ahead to determine the extent of any implications on those operations.

Softwood Lumber Trade

The Company's financial results are dependent upon continued access to the U.S. market for approximately 15% of the Company's total lumber production that is manufactured in Canada and exported to the U.S. Tariffs and other trade barriers that restrict or prevent access represent a continuing risk to the Company's Canadian based operations.

In October 2016, the U.S. industry made a request to the U.S. Government to take trade action involving the imposition of U.S. protective measures such as CV and AD duties leveled against Canadian softwood lumber producers.

In Q2'17, the U.S. Department of Commerce ("DoC") made preliminary duty rate determinations of 19.88% and 6.87% for CV and AD duties, respectively, for a combined total 26.75% applicable to Interfor. In Q4'17, the DoC made a final determination on duties that lowered the combined rate to 20.83%, which it subsequently amended to 20.23%. The U.S. International Trade Commission ruling that the U.S. industry was materially injured by Canada's trade practices has set the stage for ongoing litigation.

The Government of Canada has indicated it will appeal the U.S. findings and defend itself vigorously against all claims of unfair trade practices made by the U.S. As in previous trade cases, the softwood lumber dispute may take years to resolve through the legal process, and remains open to a negotiated settlement at any time.

Cumulative duties of US$60.4 million paid by Interfor since inception of the current trade dispute remain held in trust by the U.S. pending the First Administrative Review and conclusion of all appeals of U.S. decisions. With the exception of US$3.3 million recorded as a long term receivable, Interfor has recorded the duty deposits as an expense. Interfor is seeking to recover these deposits following a successful appeal or through settlement.

It is unclear at this time when any duty amounts paid will be recovered or if amounts paid in excess of the amended final rates will be refunded.

Stumpage Fees

The Province of B.C. charges stumpage fees to companies that harvest timber from Crown land. Stumpage payments for a harvesting area are based on a competitive market pricing system ("MPS") that has been established for each of the Coast and Interior regions of B.C.

The stumpage system is complex and the subject of discussion involving, among other things, lumber trade agreements between Canada and the United States. MPS uses results and stand characteristics of competitively sold B.C. Timber Sales auctions of timber to develop regression equations that predict the market value of Crown timber harvested, and upon which stumpage rates are based. The regression model in each region is updated annually to reflect actual bid data and any changes required to other operational and administrative factors. Stumpage rates are also adjusted quarterly to reflect changes in log prices on the B.C. Coast, and lumber prices in the B.C. Interior.

Periodic changes in the Provincial government's administrative policy can affect the market price for timber and the viability of individual logging operations. There can be no assurance that future changes will not have a material impact on stumpage rates.

Environment

The Company has incurred, and will continue to incur, costs to minimize environmental impact, prevent pollution and for continuous improvement of its environmental performance. The Company may discover currently unknown environmental problems or conditions relating to its past or present operations, or it may be faced with an unforeseen environmental liability in the future. This may require site or other remediation costs to maintain compliance or correct violations of environmental laws and regulations or result in governmental or private claims for damage to person, property or the environment, which could have a material adverse effect on the Company's financial condition and results of operations.

Labour Disruptions

Production disruptions resulting from walkouts or strikes by unionized employees could result in lost production and sales, which could have a material adverse impact on the Company's business. The Company believes that its current labour relations are stable and does not anticipate any significant related disruptions to its operations in the foreseeable future.

The Company depends on a variety of third parties that employ unionized workers to provide critical services to the Company. Labour disputes by these third parties could lead to disruptions at the Company's facilities. The Company's Acorn, Hammond, Grand Forks, and Castlegar sawmill employees are members of the Canadian United Steelworkers union ("USW"). The collective agreement with the USW agreement for the B.C. Coast (Acorn and Hammond sawmills) expires on June 14, 2019, while the Southern Interior USW agreement (Grand Forks and Castlegar sawmills) expired on June 30, 2018, with negotiations ongoing. With the exception of a one day work stoppage at each of the Grand Forks and Castlegar sawmills, employees continue to work under the terms of the expired agreement with no workplace disruptions.

The Company also has 18 employees in the B.C. Interior who are members of the Canadian Marine Service Guild ("CMSG"). The collective agreement with the CMSG expires September 30, 2019.

Workers at the Longview, Washington sawmill are represented by the International Association of Machinist and Aerospace Workers ("IAM"). The IAM collective agreement expires on November 15, 2020.

Information Systems Security

The Company's operations and administration are dependent on both internal and third-party information technology ("IT") systems. The impact of a cyber-security breach or the non-availability of a key Company IT system could be significant, including but not limited to operational delays, financial loss, reputational damage or unauthorized access to confidential or sensitive information.

The Company's Audit Committee, in conjunction with management, is responsible for reviewing cyber-security risks and ensuring that an effective risk management strategy is in place. The Company has implemented controls, processes and practices to reduce its risk of a cyber-security breach and the impact on business continuity. These include staying updated on the latest threats, threat agents and attack vectors, the use of firewall and monitoring software as well as regular system back-up protocols. However, the nature of cyber threats continues to evolve and the Company's exposure to this risk cannot be fully mitigated.

Additional Information

Additional information relating to the Company and its operations, including the Company's Annual Information Form, can be found on its website at www.interfor.com and on SEDAR at www.sedar.com.