Interfor Corporation
Fourth Quarter Report
For the three and twelve months ended December 31, 2017

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, 2017 ("Q4'17" and "2017", 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, 2017, 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 8, 2018.

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 2017 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, 2017", "Softwood Lumber Duties", "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 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; cyber-security measures; 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, 2017

Q4’17 Results

Interfor recorded net earnings in Q4’17 of $36.2 million, or $0.52 per share, compared to $16.8 million, or $0.24 per share in Q3’17 and $26.6 million, or $0.38 per share in Q4’16. Adjusted net earnings in Q4’17 were $45.1 million or $0.64 per share, compared to $20.0 million, or $0.29 per share in Q3’17 and $17.7 million, or $0.25 per share in Q4’16.

Adjusted EBITDA was a record $89.5 million on sales of $532.8 million in Q4’17 versus $60.5 million on sales of $489.2 million in Q3’17.

For the year, net earnings were $97.2 million, or $1.39 per share, compared to $65.6 million or $0.94 per share in 2016. Adjusted EBITDA and sales were both records at $287.8 million and $2.0 billion, respectively.

Notable items in the quarter included:

- Strong Lumber Prices
  - The key benchmark prices improved quarter-over-quarter with the SYP Composite, Western SPF Composite and KD H-F Stud 2x4 9’ increasing by US$30, US$35 and US$4 per mfbm, respectively. Interfor’s average lumber selling price increased $39 from Q3’17 to a record $650 per mfbm on 686 million board feet of lumber sales.
- Increased Production
  - Total lumber production was 655 million board feet or 10 million board feet more than the prior quarter. Production in the U.S. South region increased to 296 million board feet from 281 million board feet in the preceding quarter. The B.C. and U.S. Northwest regions accounted for 219 million board feet and 140 million board feet, respectively, compared to 225 million board feet and 139 million board feet in Q3’17, respectively.
- Significant Cash Flow
  - Interfor generated $83.4 million of cash from operations before changes in working capital, or $1.19 per share, plus a $3.3 million reduction in working capital, for total cash generated from operations of $86.7 million.
  - Capital spending was $25.0 million on a mix of high-return discretionary, maintenance and woodlands projects.
  - Net debt ended the quarter at $119.3 million, or 12.3% of invested capital.
- Tax Reform Impact
  - The U.S. tax reform enacted in December 2017 reduced the effective tax rate on Interfor’s U.S. operations from approximately 37% to 24%. As a result, Q4’17 deferred tax expense includes a $2.9 million recovery related to the preceding three quarters of 2017. The Company continues to have significant tax loss carry-forwards, with US$132.4 million and $66.7 million available as at December 31, 2017 in the U.S. and Canada, respectively.

Strategic Capital Plan

- Interfor continues to make progress on its multi-year strategic capital plan that involves a number of discretionary projects designed to capture the opportunities within its current operating platform and to pursue opportunities for further growth.
- The previously announced large scale projects at the Company’s Meldrim and Monticello sawmills, which represent a total investment of approximately US$65 million, are on track for completion in Q1’19. These two projects are designed to add annual lumber production capacity of approximately 150 million board feet and enhance operating margins at these operations. Positive progress on a series of smaller debottlenecking and optimization projects is also being made.

- Other large capital projects to enhance existing operations are continuing to be advanced from an engineering and feasibility standpoint and will be sequenced after the Meldrim and Monticello projects. These projects will be subject to Board approval in the normal course.
- Assessment of the greenfield sawmill opportunity in the Central Region of the U.S. South continues with a decision on the project expected by mid-2018. This sawmill would produce in excess of 200 million board feet of lumber per year for an estimated total cost, including working capital and start-up costs, of approximately US$115 million.

Softwood Lumber Duties

- In Q4'17, the U.S. Department of Commerce announced amended final rates for countervailing and anti-dumping duties of 14.19% and 6.04% on softwood lumber shipments from Canada, down from the preliminary rates set in Q2'17 of 19.88% and 6.87%, respectively. In addition, negative findings were made in respect of critical circumstances for both countervailing and anti-dumping duties. To reflect lower amended final rates set for U.S. countervailing and anti-dumping duties, Interfor recorded a $3.7 million reduction to duties expense in Q4'17 relating to shipments in Q2'17 and Q3'17.
- In Q4'17, Interfor shipped approximately 109 million board feet from its Canadian operations to the U.S. market, which represented approximately 16% of the Company's total lumber sales.
- Interfor is of the view that these duties imposed by the U.S. are without merit and are politically driven. Interfor will continue to work with the B.C. and Canadian governments to vigorously defend Canada's position through various appeal processes.

Executive Appointments Announced

At its meeting earlier today, the Company's Board of Directors confirmed the appointments of Ian Fillinger as Senior Vice-President & Chief Operating Officer, and Marty Juravsky as Senior Vice-President & Chief Financial Officer, effective February 9, 2018. Fillinger, who is 49, joined Interfor in 2005 as General Manager of the Company's Adams Lake Division and has served in a series of increasingly responsible positions since that time. He was appointed Senior Vice-President & Head of Operations with responsibility for all of the Company's operations and capital project activities in December 2015. Juravsky, who is 54, and a CPA, CA, joined Interfor in 2012 in a consulting capacity and took formal responsibility for the Company's corporate development activities in 2013. He has more than twenty years of experience working with some of North America's largest investment banks including Salomon Brothers/Citigroup and National Bank Financial. Immediately prior to his appointment, Juravsky served as the Company's Senior Vice-President, Corporate Development & Strategy.

Outlook

Interfor expects demand for lumber to continue to grow over the mid-term as the U.S. housing market recovers and market promotion efforts in North America and offshore take full effect. In addition, the Company is focused on a multi-year strategic capital plan across its operations in both the U.S. and Canada that should contribute to Interfor's financial results.

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, 2017	Dec. 31, 2016	Sep. 30, 2017	For the year ended Dec. 31 2017	2016	2015
Financial Highlights(2)							
Total sales	$MM	532.8	442.3	489.2	1,990.1	1,792.7	1,687.4
Lumber	$MM	446.0	363.5	410.2	1,679.4	1,458.3	1,361.2
Logs, residual products and other	$MM	86.8	78.8	79.0	310.7	334.4	326.2
Operating earnings (loss)	$MM	47.9	22.3	28.3	149.3	75.9	(35.9)
Net earnings (loss)	$MM	36.2	26.6	16.8	97.2	65.6	(30.4)
Net earnings (loss) per share, basic	$/share	0.52	0.38	0.24	1.39	0.94	(0.44)
Adjusted net earnings (loss)(3)	$MM	45.1	17.7	20.0	116.5	58.7	(18.9)
Adjusted net earnings (loss) per share, basic(3)	$/share	0.64	0.25	0.29	1.66	0.84	(0.27)
Adjusted EBITDA(3)	$MM	89.5	51.3	60.5	287.8	199.6	91.7
Adjusted EBITDA margin(3)	%	16.8%	11.6%	12.4%	14.5%	11.1%	5.4%
Total assets	$MM	1,353.0	1,301.6	1,296.3	1,353.0	1,301.6	1,389.8
Total debt	$MM	250.9	308.8	249.6	250.9	308.8	468.8
Net debt to invested capital(3)	%	12.3%	26.9%	17.9%	12.3%	26.9%	38.4%
Operating Highlights							
Lumber production	million fbm	655	607	645	2,595	2,490	2,497
Total lumber sales	million fbm	686	619	671	2,677	2,561	2,652
Lumber sales - Interfor produced	million fbm	666	598	650	2,594	2,469	2,544
Lumber sales - wholesale and commission	million fbm	20	21	21	83	92	108
Lumber - average selling price(4)	$/thousand fbm	650	588	611	627	570	513
Average USD/CAD exchange rate(5)	1 USD in CAD	1.2713	1.3341	1.2528	1.2986	1.3248	1.2787
Closing USD/CAD exchange rate(5)	1 USD in CAD	1.2545	1.3427	1.2480	1.2545	1.3427	1.3840

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 2017 Financial Performance

Sales

Interfor recorded $532.8 million of total sales, up 20.5% from $442.3 million in the fourth quarter of 2016, driven by the sale of 686 million board feet of lumber at an average price of $650 per mfbm. Lumber sales volume increased 67 million board feet, or 10.8%, while average selling price increased $62 per thousand board feet, or 10.6%, as compared to the same quarter of 2016.

The increase in the average selling price of lumber reflects significantly higher prices across all benchmark products in Q4'17 as compared to Q4'16. The Western SPF Composite improved by US$134 to US$439 per mfbm, while the KD HF Stud 2x4 9' benchmark and the Southern Pine Composite improved US$87 to US$405 per mfbm and US$23 to US$416 per mfbm, respectively. The positive impact of increased U.S. Dollar lumber prices was somewhat reduced by the strengthening of the Canadian Dollar against the U.S. Dollar by 4.7% on average in Q4'17 as compared to Q4'16.

Sales generated from logs, residual products and other increased by $8.0 million or 10.2% compared to the same quarter of 2016. Increased availability of surplus logs and higher chip volumes resulted from increased log and lumber production as compared to Q4'16.

Operations

Production costs increased by $45.8 million, or 12.0% over Q4'16, explained primarily by an increase of 67 million board in lumber sales volume and higher average log costs in the U.S. Northwest, somewhat offset by the stronger Canadian Dollar in Q4'17 compared to Q4'16.

Lumber production of 655 million board feet in Q4'17 was 48 million board feet higher than Q4'16, which supported the sales volume growth.

Production from the Company's nine U.S. South sawmills totaled 296 million board feet in Q4'17, up 36 million board feet compared to Q4'16, as the Company increased operating schedules at several of the mills.

Canadian production totaled 219 million board feet in Q4'17, up 10 million board feet as compared to Q4'16, primarily in the B.C. Interior where productivity was impacted by winter-related issues in Q4'16.

Production from the Company's U.S. Northwest operations totaled 140 million board feet in Q4'17, representing an increase of 3 million board feet from Q4'16.

U.S. countervailing ("CV") and anti-dumping ("AD") duty deposits are levied on Interfor's shipments of softwood lumber from Canada into the U.S. Q4'17 charges of $1.9 million represent an expense for AD duties, net of an adjustment of $4.2 million to correct the 2017 duty expense to the amended final CV and AD duty rates of 14.19% and 6.04%, respectively. CV duties ceased in August, 2017, and did not resume again until December 28, 2017. AD duties were applicable throughout Q4'17 except for one day in December.

Depreciation of plant and equipment was $19.2 million, an increase of $0.7 million over Q4'16, mostly as a result increased operating hours partially offset by the stronger average Canadian Dollar. Depletion and amortization of timber, roads and other was $11.9 million, up $4.1 million from Q4'16, as a result of increased conventional logging on the B.C. Coast as compared to Q4'16 which was impacted by winter storms.

Corporate and Other

Selling and administration expenses were $14.0 million, up $4.4 million from Q4'16. The fourth quarter, 2017, included an incremental accrual for short term incentive compensation and certain IT project and improvement costs.

The $3.1 million long term incentive compensation expense mostly reflects the impact of a 6.8% increase in the market price for Interfor Common Shares during the quarter. The Q4'16 long term incentive compensation expense of $0.2 million is due primarily to the vesting of awards in the quarter.

Restructuring charges of $7.4 million in Q4'17 relate to impairment charges on operating equipment to be replaced in conjunction with planned capital projects in the U.S. South in 2018. In Q4'16, the Company recorded $1.2 million in impairment charges on surplus equipment, $0.6 million in costs associated with the closure of the Tacoma sawmill, and $0.5 million for the settlement of a defined benefit pension plan.

Finance costs decreased to $3.1 million in Q4'17 from $4.1 million in the fourth quarter, 2016 as a result of a reduced average debt level.

Other foreign exchange gains of $0.4 million in Q4'17 and $1.1 million in Q4'16 resulted primarily from unrealized gains on short-term intercompany funding.

Other income in Q4'17 decreased by $15.5 million as compared to Q4'16, primarily as the result of the sale of the Tacoma sawmill property which completed on November 30, 2016.

Income Taxes

The Company recorded an income tax expense of $8.0 million in Q4'17, comprised of $0.4 million of current income taxes and $7.6 million of deferred tax expense. Tax legislation enacted in the U.S. at the end of 2017 substantially reduced the federal U.S. corporate tax rate applicable to years after 2017. As a result, Interfor recorded deferred income tax expense in respect of its U.S. operations at an income tax rate of 24% (2016 - 37.37%) in Q4'17. Under pre-U.S. tax reform rates, the deferred income tax expense for Q4'17 would have been $1.8 million higher. In addition, Interfor recorded a deferred income tax recovery of $2.9 million in Q4'17 for the preceding three quarters previously recognized at a higher rate.

Net Earnings

The Company recorded Net earnings of $36.2 million or $0.52 per share, compared to Net earnings of $26.6 million or $0.38 per share in the comparable period, 2016. Adjusted net earnings were $45.1 million or $0.64 per share compared with $17.7 million or $0.25 per share in Q4'16.

Summary of 2017 Financial Performance

Sales

Interfor recorded $2.0 billion in total sales, up 11.0% from $1.8 billion in 2016, driven by the sale of 2.7 billion board feet of lumber at an average price of $627 per mfbm. Lumber sales volume increased 116 million board feet, or 4.5%, while average selling price increased $57 per thousand board feet, or 10.1%, as compared to 2016.

Sales volume was up in 2017 as a result of returning to more normal shift schedules in the U.S. South following temporary reductions taken for capital and business optimization projects at several mills in 2016.

The increase in the average selling price of lumber reflects significantly higher prices across all benchmark products in 2017 as compared to 2016. The Western SPF Composite improved by US$95 to US$390 per mfbm, while the KD HF Stud 2x4 9' benchmark and the Southern Pine Composite improved US$56 to US$391 per mfbm and US$27 to US$409 per mfbm, respectively. The positive impact of increased U.S. Dollar lumber prices was somewhat reduced by the strengthening of the Canadian Dollar against the U.S. Dollar by 2.0% on average in 2017 as compared to 2016.

Sales generated from logs, residual products and other decreased by $23.7 million, or 7.1% compared to 2016 due to reduced availability of surplus logs and lower chip prices in 2017.

Operations

Production costs increased by $82 million or 5.3% as compared to 2016, explained primarily by the 4.5% increase in lumber sales volume and higher log costs on average at the Company's B.C. Interior and U.S. Northwest operations somewhat offset by a stronger Canadian Dollar on average.

Lumber production of 2.6 billion board feet in 2017 was 105 million board feet higher than in 2016.

Production from the Company's nine U.S. South sawmills totaled 1.2 billion board feet in 2017, up 113 million board feet compared to 2016, as a result of returning to more normal shift schedules in the U.S. South following temporary reductions taken for capital and business optimization projects at several mills in 2016.

Canadian production totaled 875 million board feet in 2017, down 2 million board feet as compared to 2016. Production from the Company's U.S. Northwest operations totaled 564 million board feet in 2017, for a decline of 6 million board feet from 2016.

CV and AD duty deposits totalled $18.6 million in 2017, reflecting CV and AD amended final duty rates of 14.19% and 6.04%, respectively, on Interfor's shipments of softwood lumber from Canada into the U.S. CV duties were in effect from April 28, 2017 through August, 26, 2017, and resumed again on December 28, 2017. AD duties were in effect from June 30, 2017 through December 26, 2017, and resumed again on December 28, 2017.

Depreciation of plant and equipment was $77.6 million, up 2.0% from 2016 due to increased operating hours partially offset by the stronger average Canadian Dollar. Depletion and amortization of timber, roads and other was $38.6 million, up 10.6% as compared with 2016, as a result of increased conventional logging on the B.C. Coast as compared to 2016.

<u>Corporate and Other</u>

Selling and administration expenses were $50.8 million, up $7.7 million from 2016. 2017 included an incremental accrual for short term incentive compensation, certain IT project and improvement costs, and costs related to the softwood lumber dispute not reflected in the 2016 comparative.

The $13.0 million long term incentive compensation expense in 2017 mainly reflects a 40.5% increase in the market price of Interfor Common Shares over the same period, coupled with the impact of incentive awards maturing. The $4.6 million long term incentive compensation expense in 2016 resulted from an increase of 7.6% in the market price of Interfor Common Shares over the same period, coupled with the impact of incentive awards maturing.

In 2017, the Company recognized restructuring charges of $9.2 million, related primarily to the settlement of various human resource matters and a $7.0 million impairment charge on operating equipment to be replaced in conjunction with planned capital projects in the U.S. South in 2018. In 2016, Interfor recorded restructuring charges of $4.3 million for the Tacoma site and $3.0 million related to a number of costs, the most significant of which was a $1.2 million impairment charge on surplus equipment.

Finance costs decreased to $14.0 million from $18.6 million in 2016 as a result of lower average levels of debt outstanding in 2017 as compared to 2016, together with the impact of a stronger Canadian Dollar.

Other foreign exchange losses of $2.0 million in 2017 and gains of $1.5 million in 2016 are comprised primarily of foreign exchange movements on short term intercompany funding.

Other expense of $2.0 million in 2017 is comprised of the disposal of surplus equipment. Other income of $14.1 million in 2016 is comprised primarily of a gain on the sale of the Tacoma sawmill property which completed on November 30, 2016.

<u>Income Taxes</u>

The Company recorded an income tax expense of $34.1 million in 2017, comprised of $1.1 million of current income taxes and $33.1 million in deferred income tax expense. Tax legislation enacted in the U.S. at the end of 2017 substantially reduced the federal U.S. corporate tax rate applicable to years after 2017. As a result, Interfor recorded deferred income tax expense in respect of its U.S. operations at an income tax rate of 24% (2016 - 37.37%). Under pre-U.S. tax reform rates, the deferred income tax expense for 2017 would have been $4.7 million higher.

<u>Net Earnings</u>

The Company recorded Net earnings of $97.2 million or $1.39 per share, compared to Net earnings of $65.6 million or $0.94 per share in 2016. Adjusted net earnings were $116.5 million or $1.66 per share in 2017 compared with Adjusted net earnings of $58.7 million or $0.84 per share in 2016.

Summary of Quarterly Results[1]

	Unit	2017 Q4	2017 Q3	2017 Q2	2017 Q1	2016 Q4	2016 Q3	2016 Q2	2016 Q1
Financial Performance[2]									
Total sales	$MM	532.8	489.2	511.4	456.8	442.3	457.6	458.8	433.9
Lumber	$MM	446.0	410.2	433.7	389.6	363.5	374.8	371.1	348.9
Logs, residual products and other	$MM	86.8	79.0	77.7	67.2	78.8	82.8	87.7	85.0
Operating earnings	$MM	47.9	28.3	42.7	30.4	22.3	20.1	30.0	3.5
Net earnings	$MM	36.2	16.8	24.5	19.7	26.6	15.1	23.2	0.8
Net earnings per share, basic	$/share	0.52	0.24	0.35	0.28	0.38	0.22	0.33	0.01
Adjusted net earnings[3]	$MM	45.1	20.0	28.7	22.7	17.7	20.7	17.5	2.7
Adjusted net earnings per share, basic[3]	$/share	0.64	0.29	0.41	0.32	0.25	0.30	0.25	0.04
Adjusted EBITDA[3]	$MM	89.5	60.5	77.4	60.3	51.3	58.1	56.9	33.4
Shares outstanding - end of period	million	70.0	70.0	70.0	70.0	70.0	70.0	70.0	70.0
Shares outstanding - weighted average	million	70.0	70.0	70.0	70.0	70.0	70.0	70.0	70.0
Operating Performance									
Lumber production	million fbm	655	645	655	640	607	628	637	618
Total lumber sales	million fbm	686	671	675	645	619	647	658	637
Lumber sales - Interfor produced	million fbm	666	650	654	624	598	627	634	609
Lumber sales - wholesale and commission	million fbm	20	21	21	21	21	20	24	28
Lumber - average selling price[4]	$/thousand fbm	650	611	642	604	588	580	564	548
Average USD/CAD exchange rate[5]	1 USD in CAD	1.2713	1.2528	1.3449	1.3238	1.3341	1.3050	1.2886	1.3732
Closing USD/CAD exchange rate[5]	1 USD in CAD	1.2545	1.2480	1.2977	1.3322	1.3427	1.3117	1.3009	1.2971

Notes:

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(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.

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 Q4'16 and Q1'17 and in the U.S. South in Q3'17. 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 stronger Canadian Dollar decreases the lumber sales realizations of Canadian operations, all else equal, and decreases net earnings of U.S. operations when translated to Canadian Dollars.

Liquidity

Balance Sheet

Interfor strengthened its financial position throughout 2017, with strong cash flow generated from operations used to repay debt and fund capital projects. Net debt at December 31, 2017 was $119.3 million, or 12.3% of invested capital, representing a decrease of $170.3 million from the level of net debt at December 31, 2016.

A strengthening of the Canadian Dollar against the U.S. Dollar by 6.6%, contributed $17.7 million to the net debt reduction in 2017 over 2016 as all debt held was denominated in U.S. Dollars.

	For the 3 months ended			**For the year ended**	
Thousands of Dollars	**Dec. 31, 2017**	**Dec. 31, 2016**	**Sep. 30, 2017**	**Dec. 31, 2017**	**Dec. 31, 2016**
Net debt					
Net debt, period opening, CAD	$177,787	$346,929	$218,252	$289,551	$452,303
Net drawing (repayment) on credit facilities, CAD	(1)	(66,178)	2	(40,217)	(143,882)
Impact on U.S. Dollar denominated debt from (strengthening) weakening CAD	1,301	9,678	(9,942)	(17,704)	(16,056)
Increase in cash and cash equivalents, CAD	(59,787)	(878)	(30,525)	(112,330)	(2,814)
Net debt, period ending, CAD	$119,300	$289,551	$177,787	$119,300	$289,551
Net debt components by currency					
U.S. Dollar debt, period opening, USD	$200,000	$274,709	$200,000	$230,000	$338,699
Net repayment on credit facilities, USD	-	(44,709)	-	(30,000)	(108,699)
U.S. Dollar debt, period ending, USD	$200,000	$230,000	$200,000	200,000	230,000
Spot rate, period end				1.2545	1.3427
U.S. Dollar debt expressed in CAD				250,900	308,821
Cash and cash equivalents, CAD				(131,600)	(19,270)
Net debt, period ending, CAD				$119,300	$289,551

As at December 31, 2017, the Company had net working capital of $257.1 million and available liquidity of $443.8 million, including cash and borrowing capacity on operating and term line facilities.

On May 12, 2017, the Company extended the maturity of its U.S. Operating Line from May 1, 2018 to May 1, 2019, with no other significant changes. On September 15, 2017, the Company extended the maturity of its Operating Line and Revolving Term Line from May 19, 2019 to September 15, 2021 with an additional borrowing margin and stand-by fee tier, reducing the cost for both drawn and undrawn amounts. There were no other significant changes.

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 $273.9 million of cash flow from operations before changes in working capital in 2017, or a $81.3 million increase over 2016, driven by significant improvements in lumber sales margins and volumes, and slightly offset by a strengthened Canadian Dollar and countervailing and anti-dumping duties. In 2016, incremental cash flow generated from increased sales margins coupled with the weaker Canadian Dollar and elimination of export taxes were slightly offset by a reduction in sales volumes.

There was a net cash inflow from operations after changes in working capital of $258.2 million in 2017, with $15.7 million of cash used in operating working capital. In 2016, $199.3 million of cash was generated from operations with $6.7 million of total cash generated from operating working capital.

Cash Flow from Investing Activities

Investing activities totaled $91.1 million in 2017, net of $3.6 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 mill improvements totalled $25.4 million in 2017, of which the majority was spent on U.S. South operations. Maintenance mill improvements of $37.3 million in 2017 include 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.

In 2016, total investing activities of $36.2 million were net of $41.4 million in proceeds on the disposal of property, plant and equipment, resulting primarily from the monetization of the Tacoma sawmill property. Spending included $52.1 million for property, plant and equipment, timber licenses and other intangibles, and $24.6 million for development of roads. Discretionary improvements of $17.8 million during 2016 included $7.6 million for the finalization of the Castlegar sawmill rebuild. Maintenance mill improvements of $34.3 million during 2016 included $16.1 million for a kiln conversion project at the Company's Preston sawmill.

Cash Flow from Financing Activities

Net repayments under the Company's credit facilities were $40.2 million, as the Company utilized surplus cash generated from operations to reduce debt. Cash used for financing activities totaled $53.3 million in 2017.

In 2016, net repayments on the Company's credit facilities were $143.9 million as the Company utilized surplus cash generated from operations and the proceeds from the Tacoma sawmill property sale to reduce debt. Cash used for financing activities totaled $162.2 million in 2016.

Summary of Contractual Obligations

The estimated cash payments due in respect of contractual and legal obligations as at December 31, 2017, including 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 accrued liabilities	$141,013	$141,013	$ -	$ -	$ -
Income taxes payable	224	224	-	-	-
Reforestation liability	42,550	12,873	13,112	7,580	8,985
Long term debt	307,317	10,469	20,937	101,078	174,833
Provisions and other liabilities	44,278	11,226	8,041	2,140	22,871
Operating leases and capital commitments	96,927	50,097	20,459	11,630	14,741
Total obligations	$632,309	$225,902	$ 62,549	$122,428	$221,430

Capital Resources

The following table summarizes Interfor's credit facilities and availability as of December 31, 2017:

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	$250,900	$62,725	$578,625
Maximum borrowing available	$65,000	$200,000	$250,900	$62,725	$578,625
Less:					
Drawings	-	-	250,900	-	250,900
Outstanding letters of credit included in line utilization	12,515	-	-	2,634	15,149
Unused portion of facility	$52,485	$200,000	$ -	$60,091	312,576
Add: Unrestricted cash and cash equivalents					131,263
Available liquidity at December 31, 2017					$443,839

As of December 31, 2017, the Company had commitments for capital expenditures totaling $27.3 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, 2017.

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. At December 31, 2017, such instruments aggregated $41.0 million (December 31, 2016 - $45.7 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

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 Canadian 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.

Interest Rate Swaps

As at December 31, 2017, Interfor had no floating rate debt on its credit facilities and US$200,000,000 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 consist of Series A and Series B Senior Secured Notes (each US$50,000,000 and bearing interest at 4.33% and 4.02%, respectively) and Series C Senior Secured Notes (US$100,000,000, bearing interest at 4.17%).

In order to convert floating-rate interest expense to fixed-rate interest expense, the Company held two interest rate swaps, each with a notional value of US$25,000,000, at December 31, 2016. Both interest rate swaps matured on February 27, 2017, and were not replaced.

Based on the Company's average debt level during 2017, the sensitivity of a 100 basis point increase in interest rates would result in an approximate decrease of $0.3 million in Net earnings.

Foreign Currency

The Company is exposed to currency risk on cash and cash equivalents, accounts receivable, accounts payable and provisions and long term debt that are denominated in a currency other than the respective functional currencies of the Company's domestic and foreign operations, primarily Canadian and U.S. Dollars, but also the Euro, Sterling and Yen. The Company uses foreign currency exchange contracts to manage its currency risk from time to time. The Company routinely assesses its foreign exchange exposure by reviewing outstanding contracts, pending order files and working capital denominated in foreign currencies.

As at December 31, 2017, the Company had no outstanding foreign currency exchange contract obligations (2016 – nil).

Unrealized gains and losses arising upon translation of net foreign currency investment positions in U.S. Dollar functional currency foreign operations, together with any gain or losses arising from hedges of those net investment positions, to the extent effective, are credited or charged to net change in unrealized foreign currency translation gains (losses) in the Consolidated Statement of Comprehensive Income. Upon sale, reduction or substantial liquidation of an investment position, the previously recorded net unrealized gains (losses) thereon in the Translation reserve are reclassified to the Consolidated Statement of Earnings.

As at December 31, 2017, the Company had designated the US$200.0 million drawn under its Senior Secured Notes as hedges against the net investment in its U.S. operations.

The Company recorded a $28.9 million unrealized foreign exchange loss 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 2017 (2016 - $7.9 million loss).

Lumber Futures

To manage price risk, the Company also traded lumber futures which were designated as held for trading with changes in fair value recorded to Sales in Net earnings. At December 31, 2017, the Company recognized a gain of $254,000 (2016 - $nil) in Sales in respect of lumber futures contracts and $6,000 (2016 - $nil) in Trade accounts payable and other in respect of the fair value of outstanding contracts measured based on Level 2 of the fair value hierarchy.

Outstanding Shares

As of December 31, 2017, Interfor had 70,030,455 Common Shares issued and outstanding. These shares are listed on the Toronto Stock Exchange under the symbol IFP.

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, 2017.

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, 2017.

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, 2017, 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. Management is required to make various assumptions about matters that are highly uncertain at the time accounting estimates are made; the use of different assumptions could have a material impact on the Company's financial condition and performance. These critical accounting estimates are described below.

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, 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, including Forest Economic Advisors, LLC, 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 countervailing duty and anti-dumping 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, 2017 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 regularly 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 assumptions for 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

The Company adopted the disclosure requirements in Disclosure Initiative (Amendments to IAS 7), which came into effect on January 1, 2017. Consequently, the Company has provided additional disclosure in its financial statements in relation to the changes in borrowings arising from financing activities for the three months and year ended December 31, 2017.

A number of new standards, and amendments to existing standards and interpretations, were not yet effective for the year ended December 31, 2017, and have not been applied in preparing the Company's consolidated financial statements. The following pronouncements are considered by the Company to be the most significant of several pronouncements that may affect future financial statements:

IFRS 9, *Financial Instruments*, will replace the multiple classification and measurement models in IAS 39, *Financial Instruments: Recognition and Measurement*, with a single model that has only two classification categories: amortized cost and fair value. IFRS 9 is effective for annual periods beginning on or after January 1, 2018.

IFRS 15, *Revenue from Contracts with Customers*, will replace all existing IFRS revenue requirements and is effective for annual periods beginning on or after January 1, 2018.

Neither IFRS 9, nor IFRS 15 will have a significant impact on the Company's financial statements.

IFRS 16, *Leases*, 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, operating leases become an on-balance sheet liability that attracts interest, together with a corresponding right-of-use asset, which will be depreciated. Lease expense, which is currently recorded as a Production cost in the Statement of earnings, will be replaced by Depreciation and Finance costs. In addition, lessees will recognize a front-loaded pattern of expense for most leases, even when cash rentals are constant. IFRS 16 is effective for annual periods beginning on or after

January 1, 2019, with earlier adoption permitted. The Company has not yet completed an assessment of the impact of this standard on its financial statements.

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, 2017	Dec. 31, 2016	Sep. 30, 2017	For the year ended Dec. 31, 2017	2016	2015
Adjusted Net Earnings (Loss)						
Net earnings (loss)	$36,196	$26,550	$16,778	$97,153	$65,643	$(30,386)
Add:						
Restructuring (recovery) costs and capital asset write-downs	7,422	2,281	(21)	9,203	7,280	12,829
Other foreign exchange loss (gain)	(412)	(1,072)	1,353	2,035	(1,468)	1,651
Long term incentive compensation expense (recovery)	3,110	199	3,004	12,977	4,551	(5,431)
Other (income) expense	995	(14,452)	347	1,987	(14,094)	(757)
Post closure wind-down costs and losses (recoveries)	5	115	(39)	(21)	909	11,374
Income tax effect of above adjustments	(2,260)	4,895	(1,456)	(6,848)	2,008	(9,311)
Recognition of previously unrecognized deferred tax assets	-	(769)	-	-	(6,171)	1,136
Adjusted net earnings (loss)	$45,056	$17,747	$19,966	$116,486	$58,658	$(18,895)
Weighted average number of shares - basic ('000)	70,030	70,030	70,030	70,030	70,030	69,488
Adjusted net earnings (loss) per share	$0.64	$0.25	$0.29	$1.66	$0.84	$(0.27)
Adjusted EBITDA						
Net earnings (loss)	$36,196	$26,550	$16,778	$97,153	$65,643	$(30,386)
Add:						
Depreciation of plant and equipment	19,217	18,534	18,836	77,623	76,092	71,492
Depletion and amortization of timber, roads and other	11,879	7,833	10,435	38,635	34,895	37,478
Restructuring (recovery) costs and capital asset write-downs	7,422	2,281	(21)	9,203	7,280	12,829
Finance costs	3,139	4,074	3,294	14,030	18,602	17,569
Other foreign exchange loss (gain)	(412)	(1,072)	1,353	2,035	(1,468)	1,651
Income tax expense (recovery)	7,968	7,236	6,559	34,136	7,207	(24,017)
EBITDA	85,409	65,436	57,234	272,815	208,251	86,616
Add:						
Long term incentive compensation expense (recovery)	3,110	199	3,004	12,977	4,551	(5,431)
Other (income) expense	995	(14,452)	347	1,987	(14,094)	(757)
Post closure wind-down costs and losses (recoveries)	5	115	(39)	(21)	909	11,291
Adjusted EBITDA	$89,519	$51,298	$60,546	$287,758	$199,617	$91,719
Net debt to invested capital						
Net debt						
Total debt	$250,900	$308,821	$249,600	$250,900	$308,821	$468,759
Cash and cash equivalents	(131,600)	(19,270)	(71,813)	(131,600)	(19,270)	(16,456)
Total net debt	$119,300	$289,551	$177,787	$119,300	$289,551	$452,303
Invested capital						
Net debt	$119,300	$289,551	$177,787	$119,300	$289,551	$452,303
Shareholders' equity	854,188	786,667	817,676	854,188	786,667	725,254
Total invested capital	$973,488	$1,076,218	$995,463	$973,488	$1,076,218	$1,177,557
Net debt to invested capital[(1)]	12.3%	26.9%	17.9%	12.3%	26.9%	38.4%
Operating cash flow per share (before working capital changes)						
Cash provided by operating activities	$86,749	$48,981	$60,977	$258,224	$199,272	$101,377
Cash used in (generated from) operating working capital	(3,332)	1,399	(3,474)	15,696	(6,695)	(34,531)
Operating cash flow (before working capital changes)	$83,417	$50,380	$57,503	$273,920	$192,577	$ 66,846
Weighted average number of shares - basic ('000)	70,030	70,030	70,030	70,030	70,030	69,488
Operating cash flow per share (before working capital changes)	$1.19	$0.72	$0.82	$3.91	$2.75	$0.96

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 markets for the Company's products are highly competitive on a global basis and producers compete 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 many producers of approximately the same or larger capacity. Some of the Company's competitors have greater financial resources and a number are, in certain product lines, lower-cost producers.

Factors which affect the Company's competitive position include:

- foreign currency exchange rates;
- the cost of labour;
- costs of harvesting or purchasing logs;
- the ability to secure a quality log supply matched to a sawmill's requirements;
- the quality of its products and customer service;
- the ability to secure space on vessels for overseas shipments and on trucks and railcars for North American shipments;
- the existence and rate of duties payable on sales from Canada to the United States; and
- its ability to maintain high operating rates to leverage fixed manufacturing costs.

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.

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 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 3.46 million cubic metres. Of this amount, 3.41 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 and Natural Resource Operations 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.

In 2017, the B.C. Government formally set aside some additional area for conservation purposes in the Great Bear Rainforest Forest Management Area that affected some of the Company's Timber Licences, triggering a claim for compensation in accordance with the Forest Act. The Company and the Government have not agreed to a fair market value at this time. In late 2017, the Company initiated arbitration proceedings, but is currently still in active negotiations with the Government.

Regulatory changes made to meet new Ecosystem Based Management ("EBM") requirements in the Central Coast of B.C. have also impacted the Company's timber supply, and these are not compensable. The AAC impact represents approximately a 6% reduction of the company's timber supply in B.C.

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. A portion of Interfor's tenures can expect some modest AAC declines over this period, 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 in the imposition of U.S. protective measures such as countervailing ("CV") and anti-dumping ("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.

In 2017, Interfor paid $22.8 million to the U.S. in duties, which includes $4.2 million paid in excess of the amended final rates, which Interfor is seeking to recover following a successful appeal or through settlement. It is unclear at this time when any duty amounts paid will be recovered or if amounts 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 both 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. The primary variable in the MPS is log pricing established through open market bidding for standing timber. In addition to bid prices, there are a number of operational and administrative factors that determine an individual stumpage rate for each cutting permit.

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 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 Southern Interior USW agreement (Grand Forks and Castlegar) expires on June 30, 2018, while the USW agreement for the B.C. Coast (Acorn and Hammond) expires on June 14, 2019. The Company also has 22 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.

In 2015, the Company acquired sawmills in Meldrim, Georgia and Longview, Washington where employees were represented by the American USW and the International Association of Machinist and Aerospace Workers ("IAM"), respectively. The American USW at the Meldrim sawmill was decertified on April 28, 2016, while 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.