

## 2012

## **Annual Report**

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#### **International Forest Products Limited**

#### FINANCIAL HIGHLIGHTS

(in millions of dollars, except share and per share amounts)

	2012	2011
Financial Summary		
Sales	849.2	758.2
EBITDA (1)	50.8	47.2
Net earnings (loss)	(8.7)	(13.5)
Per Share Data		
Net loss per common share		
- basic	(0.16)	(0.25)
- diluted	(0.16)	(0.25)
Price range per share		
\$ High	8.72	7.49
\$ Low	4.26	3.50
Book value per share	6.73	7.00
Cash Flow per share before working capital change	0.83	0.81
Weighted average shares outstanding (millions)	55.9	53.6
Financial Position		
Total assets	632.0	614.8
Total debt	135.0	110.7
Total shareholders' equity	376.0	390.8
Invested capital (1)	511.1	501.5
Financial Ratios (%)		
Net debt as a % of invested capital, adjusted (1)	24.2%	20.4%
Pre-tax return on total assets (1)	(1.3%)	(2.0%)

Notes:

"With stronger markets and prices, Grand Forks rounding into shape and the Rayonier acquisition closing on March 1<sup>st</sup>, we are optimistic about the prospects for 2013. Our goals, however, extend beyond short-term prospects. Our ultimate goal is to become the most profitable, valuable and respected lumber company in the world."

Message to Shareholders – February 2013

<sup>1.</sup> See Glossary for definition.



## International Forest Products Limited MESSAGE TO SHAREHOLDERS

#### **OVERVIEW**

Business conditions improved in 2012 as the year progressed. More important, Interfor moved ahead with a number of initiatives during the year which we believe will significantly enhance the value of the Company in the years ahead.

Highlights for the year included:

- Production and sales were up 7% and 10% respectively;
- Earnings and cash flow improved; and
- Strategic capital projects were completed at Adams Lake, Grand Forks and Castlegar

Subsequent to the end of the year, Interfor announced it had reached agreement to acquire Rayonier Inc's Wood Products Business in the U.S. Southeast. We also reached agreement with the members of our lending syndicate to extend and expand our credit agreements.

These steps, along with others taken in prior years, have altered Interfor's position in the industry and will make the Company stronger and more profitable as the markets recover.

I invite you to review the material covered in the next few pages and later in this report and to form your own views on our progress. Please feel free to forward any comments you would like to make to me directly at duncan.davies@interfor.com.

### INCREASED PRODUCTION AND SALES, HIGHER PRICES CONTRIBUTE TO IMPROVED RESULTS

Interfor took advantage of its strong market position to increase production and sales activity in 2012.

For the year, production volumes were up 7% to 1.35 billion board feet from 1.26 billion board feet in 2011, representing a capacity utilization rate of approximately 82% for the year.

In the B.C. Interior, production was up 2% versus 2011 in spite of curtailments at both Adams Lake and Grand Forks during the year to accommodate capital projects at those mills.

In the Pacific Northwest, production increased by 12% year-over-year as increases in timber harvesting activity and higher lumber prices supported higher operating rates at each of the mills in that region.

On the B.C. Coast, production levels were up 12% versus 2011 in spite of reduced shifting in the latter part of the year caused by log shortages which followed the extended summer fire closure.

Sales volumes kept pace with production during the year.

Lumber prices moved steadily upwards as the year progressed.

For the year, the Random Lengths Composite Index, which measures pricing levels for a basket of products, increased from US\$272 to US\$322 as conditions in the U.S. housing market continued to improve and volumes to offshore markets, particularly China, remained strong.

The commodity benchmark SPF 2x4 increased from US\$255 in 2011 to US\$299 and Hem-Fir studs increased from US\$285 to US\$335 in 2012.

The Canadian dollar traded within a fairly narrow range in 2012, averaging US\$1.00 versus US\$1.01 in 2011.

In financial terms, the benefits of increased production and sales volumes and higher prices had a positive impact on Interfor's financial results.

Excluding one-time items and share-based compensation expense, Interfor reported net income of \$3.7 million or \$0.07 per share in 2012 on sales of \$849.2 million compared with a loss of \$5.8 million or \$0.11 per share on sales of \$758.3 million in 2011. EBITDA, reported on the same basis, was \$60.5 million in 2012 versus \$47.3 million in 2011.

One-time items and share-based compensation expense amounted to \$12.4 million in 2012 versus \$7.7 million in 2011.

All-in, Interfor reported a net loss of \$8.7 million or \$0.16 per share in 2012 compared with a loss of \$13.5 million or \$0.25 per share in 2011.

#### CAPITAL PROJECTS COMPLETED AT ADAMS LAKE, GRAND FORKS AND CASTLEGAR

During 2012 Interfor continued to invest in high return and strategic capital projects which we believe will generate significant benefits in the years ahead.

In September, a new kiln was commissioned at Adams Lake. This new kiln will help balance the production and processing capacity at Adams Lake and reduce the amount of offsite processing required to support the sawmill. Also, by adding a steam conditioning system, the new kiln will enable the mill to meet stringent quality requirements on some of the product lines that were previously difficult to achieve on site.

In December, the new line at Grand Forks commenced its start-up procedures.

The project at Grand Forks involved the installation of a new small log line and an automated lumber grading system, utilizing similar technology to that installed at Adams Lake a few years ago.

The new line has ramped up very quickly and I'm able to report that it is now operating at full pro forma from a productivity standpoint and exceeding pro forma on product quality and recovery.

At Castlegar, a series of smaller projects were completed in 2012 including the installation of an automated lumber grading system and upgrades to the mill's process control and optimization systems. An upgrade to the edger at Castlegar originally planned for the fourth quarter of 2012 was re-scheduled until early 2013 to allow our Capital Projects group to focus on the final stages of the Grand Forks project.

#### **RAYONIER ACQUISITION ANNOUNCED**

Shortly after year-end Interfor announced agreement to acquire Rayonier Inc's Wood Products Business in the U.S. Southeast for \$80 million including working capital.

The operations to be acquired include three sawmills with a combined annual capacity of 360 million board feet of southern pine dimension lumber.

The acquisition is consistent with our strategy of adding capacity in attractive regional markets and will bring Interfor's total capacity to more than 2 billion board feet.

More important, the acquisition will establish a foothold for Interfor in the U.S. Southeast, a market we have been looking to enter for many years, and where we believe more opportunities for growth exist.

The transaction will be financed from Interfor's existing credit lines and is scheduled to close March 1<sup>st</sup>. The transaction is expected to be accretive to earnings and cash flow from the outset.

#### BALANCE SHEET REMAINS STRONG; CREDIT LINES EXTENDED AND EXPANDED

At year-end, Interfor had net debt outstanding of \$120.1 million compared with \$100.3 million at the end of 2011, representing a net debt to invested capital ratio of 24% versus 20% the year prior.

Maintaining a strong balance sheet has always been a key element of our management philosophy.

Subsequent to announcing the Rayonier transaction, Interfor reached agreement with the members of its lending syndicate to increase the overall facility to \$315 million and to extend its term by two years to 2017. All other terms of our credit lines remained substantially the same except for a reduction in pricing.

### LONG-STANDING BOARD MEMBERS ANNOUNCE RETIREMENT; TWO NEW MEMBERS APPOINTED

Two members of our Board of Directors, Harold Kalke and Shaun Sullivan, announced recently that they would not be standing for re-election at the Company's Annual General Meeting in May.

Harold was elected to Interfor's Board of Directors in July 2000. His knowledge of real estate markets and keen observations regarding broad economic and social trends provided useful perspective for Board discussion, especially during the global financial crisis in 2008-9.

Shaun joined Interfor's Board on the completion of the Primex acquisition in May 2001 and has served with distinction since that time. Shaun's knowledge of the forest products industry and insights on public policy and political issues has been extremely helpful, particularly during the 2001-6 period leading up to the signing of the Softwood Lumber Agreement.

On behalf of our Board and senior management, I would like to extend my sincere thanks to both Harold and Shaun for their contributions to our Company.

In anticipation of Harold and Shaun's retirement, Scott Thomson, Executive Vice-President and Chief Financial Officer of Talisman Energy Limited, and Andrew Mittag, President of Agrium Advanced Technologies Limited, were appointed to the Board of Directors in October. Scott and Andrew bring a wealth of experience in strategic planning and corporate development activities to the Board. Both will stand for election at the Company's upcoming AGM.

#### **BUSINESS OUTLOOK IMPROVING**

Positive signs are beginning to emerge in the U.S. and offshore laying the foundation for better market conditions in 2013 and beyond.

Clear signs of recovery are evident in the U.S. housing market, the single biggest driver in lumber consumption, and demand in key offshore markets such as China and Japan, have remained strong as well.

The net result has been higher prices on most items during the first two months of the year. The Random Lengths Composite Index is currently sitting at US\$416, almost 20% above the fourth quarter of 2012 while SPF 2x4 is at US\$390 and Hem-Fir studs are at US\$425, up 16% and 18% respectively over the same period. Concurrent with the increase in product prices, the duty on Canadian shipments to the US has dropped to zero for January and February and will remain at zero for March as well. The combination of higher prices and lower duties, if they continue, will have a significant positive impact on Interfor's profitability and cash flow in 2013.

#### **VISION REMAINS INTACT**

With stronger markets and prices, Grand Forks rounding into shape and the Rayonier acquisition closing on March 1<sup>st</sup>, we are optimistic about the prospects for 2013.

Our goals, however, extend beyond short-term prospects.

Our ultimate goal is to become the most profitable, valuable and respected lumber company in the world.

I believe we have made significant progress towards this goal in recent years. That said, there is more to do.

We have a number of plans on the drawing board for the next year that we believe will move us even closer to that goal.

We're convinced we're on the right track and look forward to additional progress in 2013.

Thank you for your continued support.

Duncan K. Davies President & Chief Executive Officer February 2013

# International Forest Products Limited MANAGEMENT DISCUSSION AND ANALYSIS Dated as of February 14, 2013

This Management's Discussion and Analysis ("MD&A") provides a review of Interfor's financial performance for the year ended December 31, 2012 relative to 2011, the Company's financial condition and future prospects. The MD&A should be read in conjunction with Interfor's Annual Information Form and Consolidated Financial Statements for the years ended December 31, 2012 and 2011 filed on SEDAR at www.sedar.com. The financial information contained in this MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS") except as noted herein. In this MD&A, reference is made to EBITDA and Adjusted EBITDA. EBITDA represents earnings before finance costs, taxes, depreciation, depletion, amortization, restructuring costs, other foreign exchange gains and losses, and impairments (reversals) of plant and equipment ("asset write-downs"). Adjusted EBITDA represents EBITDA adjusted for long term incentive compensation expense (recovery), other income (expense), and other income of the investee company. The Company discloses EBITDA as it is a measure used by analysts and Interfor's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance.

Unless otherwise noted, all financial references in this MD&A are in Canadian dollars.

References in this MD&A to "Interfor" and the "Company" mean International Forest Products Limited, together with its subsidiaries.

#### **FORWARD LOOKING INFORMATION**

This report contains forward-looking statements. Forward-looking statements are statements that address or discuss activities, events or developments that the Company expects or anticipates may occur in the future. Forward-looking statements are included in the description of areas which are likely to be impacted by the description of future cash flows and liquidity under the headings "Overview of 2012", "Acquisition of Rayonier's Wood Products Business", "Strong Financial Position", "Sales", "Income Taxes", "Financing Activities", "Liquidity and Capital Resources", and "Summary of Contractual Obligations"; changes in accounting policy under the heading "Future Accounting Policy Changes"; and in the description of economic conditions under the heading "Outlook". These forward-looking statements reflect management's current expectations and beliefs and are based on certain assumptions including assumptions as to general business and economic conditions in Canada, the U.S., Japan and China, as well as other factors management believes are appropriate in the circumstances including an assessment of risks as described under "Risks and Uncertainties". Such forward-looking statements are subject to risks and uncertainties and no assurance can be given that any of the events anticipated by such statements will occur or, if they do occur, what benefit the Company will derive from them. A number of factors could cause actual results, performance or developments to differ materially from those expressed or implied by such forward-looking statements, including those matters described in this 2012 annual Management's Discussion and Analysis under "Risks and Uncertainties" and in Interfor's current Annual Information Form available on www.sedar.com. Accordingly, readers should exercise caution in relying upon forward-looking statements and the Company undertakes no obligation to publicly revise them to reflect subsequent events or circumstance, except as required by law.

#### **OVERVIEW OF 2012**

North American lumber markets continued to improve in 2012 as positive economic signs began to emerge in the U.S. and concerns over sovereign debt issues in Europe were stabilized, at least in part, by government action. Activity levels in China and Japan improved as well as the year progressed. The net result was higher prices for most products especially in the second half of the year. Interfor took advantage of the improving market environment to increase operating rates with the combination of higher prices and increasing volumes contributing to better financial results relative to 2011.

#### **Markets and Pricing**

In 2012, overall North American lumber market demand increased over 2011 as the U.S. economy continued to improve through 2012 with rising GDP, employment and housing starts. The Canadian economy slowed somewhat in terms of GDP in the second half of 2012, however employment showed slight improvements and housing starts continued to show strength. Lumber shipments to China fell in the first nine months of 2012 but began to recover in the fourth quarter of 2012. Supply constraints and the increase in North American demand

impacted prices positively, year over year. Random Lengths Framing Lumber Composite price averaged US \$322 per thousand board feet (mfbm) in 2012, up 18% over 2011.

#### Lumber

#### Structural Lumber

1,500

2010

The U.S. housing market continued to recover in 2012. 2012 U.S. housing starts are estimated to be 780,000 compared to 609,000 in 2011, a 28% year over year increase. Canadian housing starts continued to grow at a slower pace with 2012 estimated to be 215,000 versus 2011 at 194,000 or an 11% year over year increase. In addition, lean field inventories, offshore demand and reduced capacity due to mill fires and closures contributed to an improved supply/demand relationship.

The Random Length average price for benchmark Western SPF 2x4 #2&Btr averaged US\$299 per mfbm for 2012 compared to US\$255 per mfbm in 2011. The benchmark SPF price for the fourth quarter of 2012 was US\$335 per mfbm and US\$370 per mfbm for the month of December 2012.

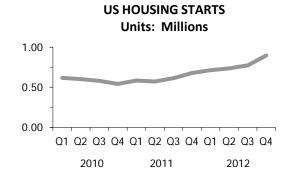


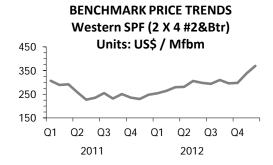
Q1 Q2 Q3 Q4 Q1 Q2 Q3 Q4 Q1 Q2 Q3 Q4

2012

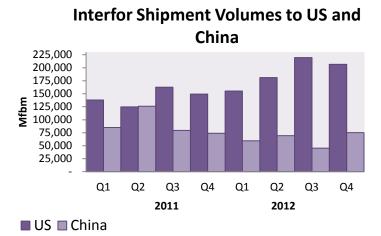
2011

**US TOTAL HOME INVENTORY** 





Source: Random Lengths, used with permission



#### Cedar

In 2012, the mild winter, low inventories and continued strength in renovation markets resulted in prices rising through the year, unlike 2011 when prices essentially remained flat. The increase in the Random Length year-over-year average price for knotty Western Red Cedar 2x6 was US\$15 per mfbm, with the annual average price in 2012 at US\$991 per mfbm compared to US\$976 in 2011.



Source: Random Lengths, used with permission

#### Japan

In 2012, despite rising demand related to reconstruction efforts from 2011's earthquake and tsunami and an increase of 6% in Post & Beam housing starts, prices remained flat for the year. Building activity in Japan is expected to increase further in 2013 in anticipation of a planned increase in the consumption tax and increased momentum in reconstruction efforts related to the 2011 earthquake and tsunami.



Source: Random Lengths, used with permission

#### Logs and Residuals

Interfor log sales revenue in 2012 was up by 5% compared to 2011 with improved domestic log prices offsetting lower export prices and export volumes for Canadian operations. Total Chips and other residual products revenues had a negligible change year over year as increased chip volumes in 2012 were offset by reduced prices.

#### **Export Tax**

As a result of the Softwood Lumber Agreement ("SLA") implemented by the federal governments of Canada and the United States on October 12, 2006, Canadian softwood lumber exporters pay an export charge when the price of lumber is at or below US\$355 per mfbm, as determined by the framing lumber composite price ("RLCI") produced by Random Lengths Publications Incorporated. The Province of B.C. has the right to choose between an export charge only ("Option A") or a lower export charge with a quota ("Option B"). The Province of B.C. chose Option A for both the B.C. Coast and the B.C. Interior which results in the Company's Canadian lumber exports to the United States being subject to the following tax rates:

Price (1)	Export Tax (%)
Over US \$355	Nil
US \$336 - \$355	5
US \$316 - \$335	10
US \$315 or under	15
TI Based on the prevailing RLCI	

The Option A export duty commenced 2012 at the 15% rate, but rising lumber prices dropped the tax to 5% or 10% rates for seven months in the year. December 2012's rate was 10% and January and February 2013 were set to nil.

In 2011, the Option A export charge remained at 15% all year.

On January 23, 2012, Canada and the U.S. signed a two year extension (from October 2013 to October 2015) to the SLA.

#### **Softwood Lumber Agreement Arbitration**

In October 2010, the U.S. Trade Representative's ("USTR") office filed a request for consultations with Canada under the terms of the SLA over its concern that the province of British Columbia is charging too low a price for certain grades of timber harvested on public lands in the B.C. Interior. In January, 2011, the USTR filed for arbitration.

On July 18, 2012, the arbitrator, the London Court of International Arbitration ("LCIA"), dismissed the U.S. complaint in its entirety. Decisions by the LCIA are final and binding on both parties.

In April, 2012 the U.S. Lumber Coalition approached the USTR's office with a complaint that the B.C. government is undercharging B.C. coastal forest companies for timber harvested on Crown lands.

As this complaint is in the preliminary stages of investigation, the existence of any potential claim has not been determined and no provision has been recorded in the consolidated financial statements as at December 31, 2012.

#### **Acquisition of Rayonier's Wood Products Business**

On January 21, 2013, the Company reached an agreement to acquire the assets of Rayonier Inc.'s Wood Products Business ("Rayonier Acquisition") for US\$73.9 million plus working capital. The transaction is scheduled to close on March 1, 2013.

Rayonier's Wood Products Business, headquartered in Baxley, Georgia, consists of three sawmills located in Baxley, Swainsboro and Eatonton, Georgia, with a combined annual capacity of 360 million board feet of southern pine dimension lumber. The acquisition is consistent with Interfor's strategy of adding capacity in attractive regional markets and will bring Interfor's annual capacity to more than 2 billion board feet.

The acquisition will be financed from Interfor's existing credit lines and is expected to be accretive from the outset.

#### **Debt Facility Modifications**

On January 24, 2013, the Company obtained a financing commitment from its lenders to increase and extend its syndicated credit facilities. The Revolving Term Line will increase from \$200 million to \$250 million, conditional upon completion of the Rayonier Acquisition. The existing Operating Line remains unchanged. The financing is scheduled to close on February 27, 2013.

The maturity dates of both the Operating Line and the Revolving Term Lines will be extended to a four year term. All other terms remain substantially unchanged except for a reduction in pricing.

On January 24, 2013, the Company also obtained a financing commitment from a U.S. lender for a US\$20 million Operating Line ("U.S. Line"). The U.S. Line will be secured by accounts receivable and inventories of Interfor U.S. Inc. (formerly Interfor Pacific Inc.), and have an initial term of two years.

#### **Strong Financial Position**

The Company maintained its financial strength through 2012, ending the year with net debt of \$120.1 million or 24% of invested capital. In addition, cash flow from operations, after working capital changes, for the year was positive \$45.4 million.

At December 31, 2012 the Company had unused available credit and cash of \$139.1 million.

The Company spent \$60.8 million in capital improvements on its mills, logging roads, timber and intangibles in 2012. These investments will continue to enhance Interfor's competitiveness productive capacity. The Company continues to balance production against demand, while maintaining its focus on margin enhancement and cost containment.

#### **REVIEW OF OPERATING RESULTS**

#### Selected Annual Financial Information 1

		International Financial Reporting Standards			Previous Canadian GAAP <sup>3</sup>		
		2012	2011	2010	2009	2008	
		(mill	re, per share a	ind			
				change rate		2212	
Sales	-Lumber <sup>2</sup>	631.2	538.4	480.2	291.0	296.0	
	-Logs	113.9	108.4	79.8	60.4	103.6	
	-Wood chips and other residual products	69.4	68.4	56.2	34.3	30.6	
	–Ocean freight and other <sup>4</sup>	34.7	43.1	7.7	6.4	5.6	
Total Sal	les	849.2	758.2	623.8	392.1	435.8	
Operatin	g loss before restructuring costs and asset impairments <sup>2</sup>	(1.9)	(4.7)	(5.6)	(44.1)	(34.9)	
Operatin	g loss²	(2.4)	(5.3)	(7.2)	(48.5)	(69.8)	
Net loss		(8.7)	(13.5)	(5.2)	(23.9)	(55.4)	
Net loss	per share – basic and diluted	(0.16)	(0.25)	(0.11)	(0.51)	(1.18)	
Net earn	ings (loss), adjusted for certain one-time and other items <sup>2,5</sup>	3.7	(5.8)	(3.2)	(29.5)	(19.9)	
	ings (loss) per share, adjusted for certain one-time and other s – per share <sup>2</sup>	0.07	(0.11)	(0.07)	(0.63)	(0.42)	
EBITDA9		50.8	47.2	51.8	18.9	12.3	
Adjusted	I EBITDA <sup>2,9</sup>	60.5	47.3	48.6	(8.0)	8.9	
Cash flow	N from operations per share <sup>6</sup>	0.83	0.81	0.86	(0.46)	0.28	
Shares o	outstanding – end of period (millions) <sup>7</sup>	55.9	55.9	47.4	47.1	47.1	
	<ul> <li>weighted average (millions)</li> </ul>	55.9	53.6	47.1	47.1	47.1	
Average	foreign exchange rate per US\$1.008	0.9996	0.9891	1.0303	1.1420	1.0660	
Closing f	oreign exchange rate per US\$1.00 <sup>8</sup>	0.9949	1.0170	0.9946	1.0510	1.2180	

<sup>1</sup> Tables may not add due to rounding.

The Company uses forward foreign exchange contracts which are designated as held for trading and are carried on the Statement of Financial Position at fair value. Previously changes in fair value were recorded as an adjustment to Sales in Net earnings. Effective January 1, 2012, the Company changed its accounting policy to align with the presentation adopted by companies in its peer group and changes in fair value are now recorded in Other foreign exchange gain (loss) in Net earnings.

The policy has been applied on a retrospective basis and comparative information has been restated. There is no change to Net earnings as a result of the adoption of this new policy.

<sup>3</sup> Years are not restated for conversion to IFRS.

<sup>4</sup> Other revenues include ocean freight revenues of Seaboard which are included in the consolidated results from the date of acquisition on January 5, 2011. The Company's share of Seaboard results was previously recognized in equity income.

Net earnings (loss) adjusted for certain one-time and other items represents the net loss before restructuring costs, long term incentive compensation expense (recovery), certain foreign exchange gains and losses, other income (expense), certain one-time items and the effect of unrecognized tax assets.

Net earnings (loss), adjusted for certain one-time and other items is not a defined term under IFRS, and may not be comparable to adjusted net earnings (loss) calculated by others. Net earnings (loss), adjusted for certain one-time and other items may be calculated as follows:

	International Financial Reporting Standards			Previous Canadian GAAP <sup>3</sup>	
	2012	2011	2010	2009	2008
		(millio	ons of dolla	ars)	
Net loss	(8.7)	(13.5)	(5.2)	(23.9)	(55.4)
Add (deduct):					
Restructuring costs, asset impairments and other costs	0.5	0.6	1.6	4.4	34.9
Long term incentive compensation expense (recovery)	10.1	0.4	2.0	3.2	(2.0)
Other foreign exchange (gains) losses	(0.2)	0.0	(1.5)	2.3	(2.3)
Other (income) expense	(0.3)	(0.4)	0.0	(23.0)	(1.4)
Other income of associate company	-	-	(5.2)	-	-
Income tax on adjustments	0.0	0.0	0.0	0.0	(8.9)
Deferred tax assets not recognized	2.4	2.4 7.0 5.1			15.2
Net loss, adjusted for certain one-time and other items	3.7	(5.8)	(3.2)	(29.5)	(19.9)

- 6 Cash generated from (used in) operations before taking account of changes in operating working capital.
- As at February 14, 2013, the numbers of shares outstanding by class are: Class A Subordinate Voting shares 54,847,176 Class B Common shares 1,015,779, Total 55,862,955.
- 8 Rates are based on Bank of Canada closing foreign exchange rates per US\$1.00.
- 9 The Company discloses EBITDA as it is a measure used by analysts and Interfor's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance. Adjusted EBITDA represents EBITDA adjusted for other income and other income of an associate company.

EBITDA and Adjusted EBITDA can be calculated from the statements of operations as follows:

	International Financial Reporting Standards			Previous Canadian GAAP <sup>3</sup>		
	2012	2011	2010	2009	2008	
	•	(millio	ons of dolla	ars)		
Net loss	(8.7)	(13.5)	(5.2)	(23.9)	(55.4)	
Add: Income taxes (recovery)	0.5	1.4	0.5	(9.9)	(11.0)	
Finance costs	6.3	7.1	10.4	7.8	5.1	
Depreciation, depletion and amortization	52.4	51.6	46.0	38.2	41.0	
Other foreign exchange (gains) losses	(0.2)	0.0	(1.5)	2.3	(2.3)	
Restructuring costs, asset impairments and other costs	0.5	0.6	1.6	4.4	34.9	
EBITDA	50.8	47.2	51.8	18.9	12.3	
Add (deduct)t:						
Long term incentive compensation (expense) recovery	10.1	0.4	2.0	3.2	(2.0)	
Other (income) expense	(0.3)	(0.4)	0.0	(23.0)	(1.4)	
Other income of associate company	-	-	(5.2)	-	-	
Adjusted EBITDA	60.5	47.3	48.6	(8.0)	8.9	

The definition of Adjusted EBITDA was changed in the fourth quarter, 2012 to include an adjustment for long term incentive compensation expense (recovery). Prior periods have been restated to reflect this change.

#### **Volume and Price Statistics**

		<u>2012</u>	<u> 2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Lumber sales	(million fbm)	1,432	1,301	1,132	668	503
Lumber production <sup>1</sup>	(million fbm)	1,351	1,264	1,110	661	498
Log sales <sup>2</sup>	(thousand cubic metres)	1,352	1,356	1,081	919	1,319
Log production <sup>2</sup>	(thousand cubic metres)	3,296	3,408	2,661	1,295	1,881
Average selling price – lumber <sup>3</sup>	(\$/thousand fbm)	\$441	\$414	\$424	\$436	\$588
Average selling price – logs <sup>2</sup>	(\$/cubic metre)	\$72	\$72	\$67	\$61	\$74
Average selling price – pulp chips	(\$/thousand fbm)	\$44	\$46	\$40	\$40	\$49

- 1 Excludes lumber produced on a custom cutting basis for customers who have previously purchased the logs
- 2 B.C. operations
- 3 Gross sales before duties and export taxes

#### Comparison of Year ended December 31, 2012 to Year ended December 31, 2011

Interfor increased sales revenues, produced and sold more lumber and increased EBITDA year over year. The Company recorded a net loss of \$8.7 million, or \$0.16 per share for 2012, as compared to a net loss of \$13.5 million, or \$0.25 per share in 2011.

Before restructuring costs, long term incentive compensation expense, certain foreign exchange gains (losses), a change in unrecognized deferred tax assets (refer to Income Taxes) and certain one-time items, the Company's net earnings for 2012 was \$3.7 million after-tax or \$0.07 per share, as compared to a net loss of \$5.8 million after-tax, or \$0.11 per share in 2011.

Long term incentive compensation expense ("LTIC") was significantly higher in 2012, totaling \$10.1 million or \$0.18 per share (2011 – \$0.4 million or \$0.01 per share) primarily due to an increase in the price of the Company's shares from \$4.30 at December 31, 2011 to \$7.99 at December 31, 2012.

EBITDA and Adjusted EBITDA for 2012 were \$50.8 million and \$60.5 million, respectively, compared to \$47.2 million and \$47.3 million for 2011.

#### Sales

Interfor's 2012 sales revenues totaled \$849.2 million compared to \$758.2 million in 2011, a \$91.0 million improvement.

Average lumber sales prices for 2012 increased by \$27 per mfbm or 7% over 2011 and lumber shipments improved by 131 million board feet over 2011 in response to increased demand and higher prices in the North American market. The improvement was driven by increased housing starts, repairs and renovations, lumber supply interruptions and replenishment of lean field inventories. Also, mild winter weather experienced in the first quarter and fourth quarter of 2012 contributed to the increase in North American demand.

Lumber shipments to China in 2012 dropped to 68% of 2011 levels, primarily due to oversupply from 2011 compounded by the Chinese government raising interest rates in the fall of 2011. However, demand was stronger in the fourth quarter of 2012 and is expected to carry into 2013. China remained a significant market for the Company, accounting for 18% of total lumber sales volume in 2012 (2011 - 29%).

Our 2012 Japan lumber shipments were essentially unchanged from 2011 levels at 9% of total sales volume. However, shipments are expected to increase in 2013 with the ongoing reconstruction activity and scheduled increases in consumption taxes in 2014 and 2015.

Log sales in 2012 increased by \$5.5 million or 5% compared to 2011 due to North American price increases offset in part by reductions in offshore export prices and volumes. Higher B.C. Coast log prices in 2012 reflected both improving lumber markets and reduced log availability due to fire restrictions on the B.C. Coast. North American log revenues in 2012 accounted for 80% of log sales revenues compared to 74% in 2011.

Wood chips and other residual products revenues in 2012 were virtually unchanged from 2011 as higher volumes from increased sawmill production were offset by lower chip prices due to weaker pulp and paper markets.

Ocean freight and other revenues decreased by \$8.4 million in 2012 compared to 2011 mainly due to lower ocean freight of \$4.4 million related to decreased break bulk volumes and lower contract services of \$4.1 million.

#### **Operations**

In 2012 Interfor produced 1.35 billion fbm of lumber compared to 1.26 billion fbm in 2011. The increase in production volume came from higher operating rates at a number of the Company's mills, offset partly by a reduction at Grand Forks due to downtime taken late in 2012 to complete the mill rebuild project.

- B.C. Coastal 2012 log production decreased by 231 thousand cubic metres compared to 2011. This 13% decrease was due mainly to reduced production from an extended fire season. B.C. Coastal log production unit costs increased by 12% when compared to 2011 due mainly to higher helicopter logging costs.
- B.C. Interior log production increased by 119 thousand cubic metres or 7% to meet higher operating rates and inventory targets compared to 2011. B.C. Interior delivered log costs increased by 13% over 2011 mainly due to higher hauling, stumpage and log purchase costs.

Log costs at most of the U.S. mills were up due to market log availability and weather. With reduced log export demand, prices at Port Angeles decreased slightly compared to 2011.

In 2012, lumber manufacturing unit costs increased by 4% over 2011. The increase was due mainly to the higher cost of logs in 2012 and the inclusion in 2011 of a \$1.7 million business interruption insurance recovery. Increased unit costs were mitigated in part by higher operating rates when compared to 2011.

The export tax paid in 2012 was virtually the same as in 2011. This was the result of year over year increase in Canadian shipment volumes to the U.S. of 22%, which was offset by a lower average export tax rate in 2012 versus 2011. In the first five months of 2012 the export tax rate was 15% with the remaining months fluctuating between 5% and 10%, while in 2011, the 15% export tax rate was paid all year.

Amortization of plant and equipment increased by \$1.5 million in 2012 over 2011 or 5%, due to increased operating rates.

Road amortization and depletion expense decreased year over year \$0.6 million as a result of changes to operating areas offset by increased helicopter logging in the B.C. Coast.

#### Corporate and Other

In 2012, Selling and Administrative costs remained relatively constant compared to 2011. LTIC was \$10.1 million compared to \$0.4 million in 2011 primarily due to an increase in the price of the Company's shares in 2012.

#### **Income Taxes**

The Company recorded an income tax expense in 2012 of \$0.5 million and increased its unrecognized deferred tax asset by \$2.4 million in relation to certain unused tax losses that are available to be carried forward against future taxable income. Although the Company expects to realize the full benefit of the loss carry-forwards and other deferred tax assets, due to the cyclical nature of the wood products industry and the economic conditions over the last several years the Company has not recognized the benefit of its deferred tax asset in excess of its deferred tax liabilities, except in limited circumstances.

The Company's Canadian non capital loss carry forwards and U.S. net operating loss carry forwards totaling \$292 million (2011 - \$241 million) expire between 2014 and 2032 and are available to reduce future taxable income. The overall effective tax rate is significantly different from the Canadian statutory rate of 25% (2011 - 26.5%) due mainly to unrecognized deferred assets of \$2.4 million (2011 - \$7.0 million).

#### Net Loss

For the year ended December 31, 2012, Company recorded a net loss of \$8.7 million or \$0.16 per share compared to a net loss of \$13.5 million or \$0.25 per share in 2011. The improved performance was a result of increased prices and higher production volumes offset partly by the significant increase in LTIC.

#### **Cash Flows**

#### **Operating Activities**

The Company generated \$46.6 million from operations, before changes in working capital, in 2012 as compared to \$43.6 million in 2011. Total cash generated from operations after changes in working capital was \$45.4 million for the year, a significant increase from \$28.4 million for 2011.

Higher North American shipments and sales prices, lower export taxes and higher operating rates improved cash earnings for 2012.

Cash used in working capital in 2012 was \$1.3 million compared to \$15.2 million in 2011. In 2012, a shift from export markets to meet North American demand resulted in increased accounts receivable of \$3.8 million, offsetting the impact of higher sales values and shipment volumes. Increased operating rates in 2012 and increased B.C. Interior stumpage rates in the fourth quarter, 2012, contributed to increases in accounts payable of \$5.6 million.

In 2011, significant increases in lumber production and a subsequent slowing of the market resulted in a lumber and log inventory build-up of \$25.6 million offset in part by decreases in accounts receivable of \$3.2 million and increases in accounts payable of \$9.6 million.

Throughout the year, the Company focused on optimizing inventory levels, matching production with export and domestic demand, and purchasing logs and producing products that would provide positive margins.

#### **Investing Activities**

Cash capital expenditures totaled \$60.8 million for 2012 (2011 - \$36.2 million), with \$27.8 million spent on capital upgrades for the Grand Forks and Castlegar mills, \$4.3 million on other high-return discretionary projects, \$7.8 million on other business maintenance expenditures, and \$20.9 million on road construction and timber licences.

The increase in capital spending over 2011 related primarily to the installation of a new small log line at Grand Forks, and the installation of automated lumber grading systems at Grand Forks and Castlegar. All upgrades were substantially completed in 2012, with the Grand Forks improvements completed six months ahead of schedule and successfully started up in December, 2012. These expenditures were funded by net drawings of \$25.0 million on the Company's Revolving Term Line and through cash generated by operations during 2012.

In January, 2011, by virtue of the withdrawal of all other partners in the Seaboard General Partnership ("SGP"), Interfor acquired control of its net assets. Cash generated from investments in 2011 includes cash of \$4.8 million received on acquisition of SGP.

#### **Financing Activities**

In 2011, the Company closed a public offering of 8,222,500 Class A Subordinate Voting shares at a price of \$7.00 per share for net proceeds of \$54.9 million. In addition, in the first half of 2011, several stock option holders exercised their options generating \$1.4 million in cash. The share issuance proceeds were used to repay drawings under the Revolving Term Line in 2011. No shares were issued in 2012.

During 2012, Interfor drew funds on the Revolving Term Line primarily to fund the high-return discretionary capital upgrades at Grand Forks and Castlegar. The Operating Line remained undrawn in 2011 and 2012, other than for letters of credit. As at December 31, 2012 the unused available credit under these facilities totaled \$124.8 million and, combined with unrestricted cash of \$14.3 million, gave the Company a total of \$139.1 million of liquidity available. After deducting the Company's drawings under its Revolving Term Line, the Company ended 2012 with net debt of \$120.1 million or 24% of invested capital.

#### **FINANCIAL POSITION**

#### Summary of Financial Position<sup>1</sup>

	Internation	al Financial Standards		Previous Canadian GAAP <sup>4</sup>	
	2012	2011	2010	2009	2008
		•	llions of dolla	ars)	
Current assets	172.2	162.8	135.4	107.9	131.5
Current liabilities	82.1	75.9	75.8	46.6	79.4
Working capital	90.1	86.9	59.6	61.3	52.1
Total assets	632.0	614.8	614.6	582.5	665.3
Total long-term liabilities and deferred income taxes	174.0	148.1	191.3	177.9	179.7
Operating debt	-	-	-	-	30.6
Payable to investee company	-	-	15.7	3.1	3.7
Long-term debt	135.0	110.7	156.0	144.5	137.4
Total debt	135.0	110.7	171.7	147.6	171.7
Shareholders' equity	376.0	390.8	347.5	358.0	406.2
Invested capital	511.1	501.5	519.2	505.6	577.9
Ratio and Investment Information <sup>1</sup>					
Current ratio	2.1	2.1	1.8	2.3	1.7
Net debt as a percentage of invested capital, adjusted <sup>2</sup>	24.2%	20.4%	29.7%	28.2%	29.2%
Pre-tax return on total assets <sup>2</sup>	(1.3)%	(2.0)%	(0.5)%	(9.0)%	(5.1)%
Cash flow from operations as a percentage of total debt <sup>2</sup>	34.5%	39.4%	23.7%	(14.6)%	7.6%
Equity per share	\$6.73	\$7.00	\$7.34	\$7.60	\$8.62
	2012	2011	2010	2009	2008
			(millions)		
Weighted average shares outstanding for the year Number of shares outstanding at year end:	55.9	53.6	47.1	47.1	47.1
Class A subordinate voting <sup>3</sup>	54.9	54.9	46.3	46.1	46.1
Class B common <sup>3</sup>	1.0	1.0	1.0	1.0	1.0
	55.9	55.9	47.4	47.1	47.1

	2012	2011	2010	2009	2008
Re-investment of Cash		(mil	lions of dolla	ars)	_
Cash flow from operations <sup>2</sup>	46.6	43.6	40.7	(21.6)	13.0
Cash generated from (used in) operating working capital	(1.3)	(15.2)	(10.9)	26.4	0.7
Proceeds on disposal of assets	0.5	0.3	1.3	37.0	5.1
Capital expenditures and acquisitions	(60.8)	(36.2)	(42.2)	(27.6)	(158.9)

- 1 Tables may not add due to rounding.
- 2 See Glossary in Annual Information Form for definition.
- 3 As at February 14, 2013, the numbers of shares outstanding by class are: Class A Subordinate Voting shares 54,847,176 Class B Common shares 1,015,779, Total 55,862,955.
- 4 Years are not restated for IFRS

#### **Current Assets**

Cash on hand and deposits at December 31, 2012 totaled \$15.0 million, an increase of \$4.6 million over 2011.

Accounts receivable at December 31, 2012 were \$47.4 million, compared to \$44.0 million in 2011 primarily due to increased lumber sales in the fourth quarter, 2012 as compared to the prior year, mitigated by a shift from export markets to North America.

Lumber inventory levels at December 31, 2012 were \$31.8 million, compared to \$31.7 million in 2011, with an increase of 14% in unit carrying values as a result of improved North American sales values. Lumber inventory volumes declined by 12%, reflective of the shift in demand from export markets to North America.

Log inventory levels at December 31, 2012 were \$59.8 million, compared to \$59.4 million in 2011 with higher market pricing reflected in higher unit carrying values. Log inventory volumes declined on the B.C. Coast due to lower logging rates in the fourth quarter, 2012, and in the U.S. Pacific NorthWest due to the absence of a log export program in 2012. These declines were more than offset by increases in the B.C. Interior with the seasonal build up of logs prior to spring breakup and to meet higher consumption requirements, particularly at Grand Forks.

#### Other investments and assets

The improvement in North American lumber sales prices supported higher bid prices for timber sales, resulting in an increase in successful bids for longer term and economic fibre supply for the U.S. Pacific NorthWest sawmills. Long term timber and other deposits increased by \$2.0 million to \$2.7 million as at December 31, 2012. Other investments and assets includes prepaid financing fees of \$1.5 million (2011 - \$2.2 million).

#### Property, Plant and Equipment, Timber Licences, Logging Roads, Bridges and Other Intangibles

The Company's net book value of \$441.6 million for property, plant and equipment, logging roads and bridges, timber licences, and other intangible assets increased \$6.8 million compared to 2011. Cash capital expenditures were \$60.8 million, of which \$20.7 million related to investments in road building and the balance of \$40.1 million was for the capital upgrades at Grand Forks and Castlegar, equipment upgrades, maintenance of operations, timber and intangibles. The stronger Canadian dollar at the end of 2012 compared to the end of 2011 resulted in a decrease in our U.S. capital assets of \$2.9 million due to foreign currency revaluations. Offsetting the investments in capital assets were amortization and depletion expense of \$52.4 million.

#### **Current Liabilities**

As at December 31, 2012, the Company had an Operating Line of \$65.0 million. Drawings under this line are subject to borrowing base calculations dependent upon accounts receivable, inventories and certain accounts payable. At year end, the Company had no borrowings other than letters of credit of \$5.2 million under its Operating Line, with available credit of \$59.8 million. The Company's working capital ratio at December 31, 2012 was 2.1 to 1.

Accounts payable levels at December 31, 2012 were \$70.6 million, an increase of \$9.9 million over 2011. The increase in trade accounts payables and provisions results from increased operating rates, increased B.C. Interior stumpage rates, and a sharp rise in the share price impacting the current portion of long-term incentive compensation.

The current portion of reforestation decreased by \$3.3 million due to decreased B.C. log harvest in 2012 and transfer of a \$1.9 million obligation which had been classified as current in 2011.

#### **Long-Term Liabilities**

The Revolving Term Line bears interest at rates based on bank prime plus a premium, depending upon a financial ratio or, at the Company's option, at rates for Bankers' Acceptances or LIBOR based loans.

At December 31, 2012, the Revolving Term Line was drawn by \$105.0 million (2011 - \$80.0 million), and by US\$30.2 million (2011 - US\$30.2 million) revalued at the year-end exchange rate to \$30.0 million (2011 - \$30.7 million) for total drawings of \$135.0 million (2011 - \$110.7 million) and leaving an unused available line of \$65.0 million.

Overall, long-term liabilities excluding long-term debt increased by \$1.5 million, due mainly to:

- increases in employee future benefits of \$1.4 million;
- a rise in the share price driving increased long-term incentive compensation of \$2.3 million; and
- a revision to the estimated costs to remediate the landfill at the Castlegar sawmill site after an environmental consultant undertook groundwater and other testing, reducing the environmental provision by \$1.3 million.

#### **Liquidity and Capital Resources**

As at December 31, 2012 the Company had working capital of \$90.1 million (2011 - \$86.9 million), available operating and term lines of \$124.8 million (2011 - \$149.2 million) and unrestricted cash of \$14.4 million (2011 - \$10.3 million).

On January 24, 2013, the Company obtained a financing commitment from its lenders to increase and extend its syndicated credit facilties. The Revolving Term Line will increase from \$200 million to \$250 million, conditional upon completion of the Rayonier Acquisition. The amount available under the existing Operating Line remains unchanged. The financing is scheduled to close on February 27, 2013 and have a term of four years, extended from July 28, 2015.

All other terms remain substantially unchanged except for a reduction in pricing.

On January 24, 2013, the Company also obtained a financing commitment from a U.S. lender for a US\$20 million Operating Line ("U.S. Line"). The U.S. Line will be secured by accounts receivable and inventories of Interfor U.S. Inc. (formerly Interfor Pacific Inc.), and have an initial term of two years.

These resources, in addition to cash generated from operations, will be used to support our working capital requirements, debt servicing commitments, and capital expenditures.

Interfor has had positive EBITDA for each of the past seven fiscal years, in spite of the difficult economic climate for four of the most recent five years.

The Company believes that its cash flow and credit lines will be sufficient to satisfy the funding of operating and capital requirements for the foreseeable future.

#### **Summary of Contractual Obligations**

The payments due in respect of contractual and legal obligations including projected major capital improvements are summarized as follows:

	Payments due by period						
		Up to	2-3	4-5	After 5		
	Total	1 year	years	years	years		
		(millior	ns of dollars)				
Trade accounts payable							
and accrued liabilities	\$ 57.6 \$	57.6 \$	- \$	- 9	-		
Income taxes payable	0.6	0.6	-	-	-		
Long-term debt	135.0	-	135.0	-	-		
Reforestation liability	28.6	10.9	6.8	5.8	5.2		
Provisions and other liabilities	30.4	12.1	6.1	1.7	10.5		
Pension solvency payments	1.9	0.8	0.8	0.1	0.3		
Operating leases and							
contractual commitments	 26.6	10.0	8.6	4.2	3.9		
Total contractual obligations <sup>1</sup>	\$ 280.8 \$	91.9 \$	157.4 \$	11.8 \$	5 19.8		

Table may not add due to rounding.

#### **Related Party Transactions**

Lumber sales to a significant shareholder amounted to \$1.1 million (2011 - \$0.7 million).

These transactions were conducted on a normal commercial basis, including terms and prices and did not result in any ongoing contractual or other commitments.

#### **Off-Balance Sheet Arrangements**

The Company has off-balance sheet arrangements which include letters of credit and surety performance bonds, primarily for timber sales. These are more fully described in Note 9 and Note 19(c) in the Consolidated Financial Statements. At December 31, 2012, the total of such instruments aggregated \$23.0 million (2011 - \$18.5 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.

#### Summary of Issuance of Shares

In 2011, the Company closed a public offering of 8,222,500 Class A Subordinate Voting shares at a price of \$7.00 per share for net proceeds of \$54.9 million. In addition, several stock option holders exercised their options generating \$1.4 million in cash.

No shares were issued in 2012.

#### SELECTED QUARTERLY FINANCIAL INFORMATION 1

Quarterly Earnings Summary		20	12		2011			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
	(millions	s of dollars	except sha	are, per sha	are and for	eign excha	nge rate an	nounts)
Sales – Lumber <sup>2</sup>	173.3	161.9	162.4	133.6	133.6	139.6	133.7	131.4
– Logs	24.5	26.8	35.6	27.0	22.9	36.0	28.6	20.8
<ul> <li>Wood chips and other residual products</li> </ul>	15.9	17.5	17.8	18.2	17.5	17.6	16.8	16.4
- Other	8.7	8.5	9.6	7.9	14.6	9.9	8.7	10.0
Total Sales	222.4	214.7	225.4	186.7	188.7	203.1	187.9	178.6
Operating earnings (loss) before restructuring costs and asset impairments <sup>2</sup>	(1.9)	2.5	2.9	(5.5)	(6.2)	3.9	(2.3)	(0.1)
Operating earnings (loss) <sup>2</sup>	(2.2)	2.4	2.8	(5.5)	(6.1)	4.2	(2.4)	(1.0)
Net earnings (loss)	(3.6)	1.1	0.3	(6.5)	(6.5)	0.0	(5.3)	(1.7)
Net earnings (loss) per share – basic and diluted	(0.06)	0.02	0.01	(0.12)	(0.12)	0.00	(0.10)	(0.04)
Net earnings (loss), adjusted for certain one-time and other items <sup>2,3</sup>	3.7	2.9	1.1	(3.9)	(2.8)	1.4	(6.3)	1.9
Net earnings (loss), adjusted for certain one-time and other items – per $\mbox{share}^2$	0.07	0.05	0.02	(0.07)	(0.05)	0.03	(0.11)	0.04
EBITDA <sup>7</sup>	13.2	15.2	16.5	6.0	6.7	17.6	11.3	11.6
Adjusted EBITDA <sup>2,7</sup>	19.4	17.2	16.7	7.2	7.7	16.3	8.2	15.1
Cash flow from operations per share <sup>4</sup>	0.24	0.20	0.24	0.15	0.08	0.26	0.22	0.27
Shares outstanding – end of period (millions) <sup>5</sup>	55.9	55.9	55.9	55.9	55.9	55.9	55.9	47.5
<ul><li>weighted average (millions)</li></ul>	55.9	55.9	55.9	55.9	55.9	55.9	55.2	47.4
Average foreign exchange rate per US\$1.00 <sup>6</sup>	0.9914	0.9954	1.0104	1.0010	1.0230	0.9808	0.9680	0.9856
Closing foreign exchange rate per US\$1.00 <sup>6</sup>	0.9949	0.9832	1.0181	0.9975	1.0170	1.0482	0.9645	0.9696

<sup>1</sup> Tables may not add due to rounding.

The Company uses forward foreign exchange contracts which are designated as held for trading and are carried on the Statement of Financial Position at fair value. Previously changes in fair value were recorded as an adjustment to Sales in Net earnings. Effective January 1, 2012, the Company changed its accounting policy to align with the presentation adopted by companies in its peer group and changes in fair value are now recorded in Other foreign exchange gain (loss) in Net earnings.

The policy has been applied on a retrospective basis and comparative information has been restated. There is no change to Net earnings as a result of the adoption of this new policy.

Net earnings (loss) adjusted for certain one-time and other items represents the net loss before restructuring costs, long term incentive compensation expense (recovery), certain foreign exchange gains and losses, other income (expense) and the effect of unrecognized tax assets.

Net earnings (loss), adjusted for certain one-time and other items is not a defined term under IFRS, and may not be comparable to adjusted net earnings (loss) calculated by others. Net earnings (loss), adjusted for certain one-time and other items may be calculated as follows:

		201	12		2011			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
				(millions o	f dollars)			
Net earnings (loss)	(3.6)	1.1	0.3	(6.5)	(6.5)	0.0	(5.3)	(1.7)
Add (deduct):								
Restructuring costs, asset impairments and other costs (recovery)	0.3	0.1	0.1	-	(0.1)	(0.3)	0.1	0.8
Long term incentive compensation expense (recovery)	6.2	2.3	0.2	1.3	0.9	(0.9)	(3.1)	3.5
Other foreign exchange (gains) losses	(0.2)	(0.1)	0.5	(0.4)	(1.1)	2.5	(0.2)	(1.1)
Other (income) expense	0.0	(0.2)	(0.0)	(0.1)	0.0	(0.4)	(0.0)	(0.0)
Income tax on adjustments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deferred tax assets not recognized (recognized)	1.0	(0.4)	0.0	1.8	3.9	0.6	2.2	0.3
Net earnings (loss), adjusted for certain one-time and other items	3.7	2.9	1.1	(3.9)	(2.8)	1.4	(6.3)	1.9

- 4 Cash generated from operations before taking account of changes in operating working capital.
- 5 As at February 14, 2013, the numbers of shares outstanding by class are: Class A Subordinate Voting shares 54,847,176 Class B Common shares 1,015,779, Total 55,862,955.
- 6 Rates are based on Bank of Canada closing foreign exchange rates per US\$1.00.
- The Company discloses EBITDA as it is a measure used by analysts and Interfor's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance. Adjusted EBITDA represents EBITDA adjusted for other income. EBITDA and Adjusted EBITDA can be calculated from the statements of operations as follows:

	2012 20			201	011			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
				(millions o	f dollars)			
Net earnings (loss)	(3.6)	1.1	0.3	(6.5)	(6.5)	0.0	(5.3)	(1.7)
Add: Income taxes (recovery)	0.0	0.0	0.3	-	0.2	0.5	1.2	(0.4)
Finance costs	1.5	1.6	1.7	1.5	1.3	1.7	1.9	2.3
Depreciation, depletion and amortization	15.1	12.4	13.6	11.3	13.0	13.3	13.6	11.7
Other foreign exchange (gains) losses	(0.2)	(0.1)	0.5	(0.4)	(1.1)	2.5	(0.2)	(1.1)
Restructuring costs, asset impairments and other costs (recoveries)	0.3	0.1	0.1	-	(0.1)	(0.3)	0.1	0.8
EBITDA	13.2	15.2	16.5	6.0	6.7	17.6	11.3	11.6
Add (deduct):								
Long term incentive compensation expense (recovery)	6.2	2.3	0.2	1.3	0.9	(0.9)	(3.1)	3.5
Other (income) expense	0.0	(0.2)	(0.0)	(0.1)	0.0	(0.4)	(0.0)	(0.0)
Adjusted EBITDA	19.4	17.2	16.7	7.2	7.7	16.3	8.2	15.1

The definition of Adjusted EBITDA was changed in the fourth quarter, 2012 to include an adjustment for long term incentive compensation expense (recovery). Prior periods have been restated to reflect this change.

Val	ııma	and	Drico	Statistic	_
voi	ume	ana	Price	STATISTIC	•

			2012			2011			
		Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Lumber sales	(million fbm)	384	366	363	320	318	336	334	313
Lumber production	(million fbm)	347	350	333	323	294	313	325	332
Log sales <sup>1</sup>	(thousand cubic metres)	267	345	379	361	310	430	314	301
Log production <sup>1</sup>	(thousand cubic metres)	748	817	840	892	795	1,002	796	816
Average selling price – lumber <sup>2</sup>	(\$/thousand fbm)	\$452	\$442	\$448	\$418	\$420	\$415	\$400	\$419
Average selling price – logs <sup>1</sup>	(\$/cubic metre)	\$76	\$75	\$75	\$64	\$69	\$74	\$82	\$61
Average selling price – pulp chips	(\$/thousand fbm)	\$39	\$43	\$46	\$48	\$51	\$48	\$44	\$40

- 1 B.C. operations
- 2 Gross sales before duties and export taxes

Quarterly trends normally reflect the seasonality of the Company's operations. Logging operations are seasonal due to a number of factors including weather, ground conditions and fire season closures. Generally, the Company's B.C. Coastal logging divisions experience higher production levels in the latter half of the first quarter, throughout the second and third quarters and in the first half of the fourth quarter. Logging activity in the B.C. Interior is generally higher in the first half of the first quarter, slows during spring thaw and increases in the third and fourth quarters. Sawmill operations are less seasonal than logging operations but are dependent on the availability of logs from logging operations, including those from suppliers. In addition, the market demand for lumber and related products is generally lower in the winter due to reduced construction activity, which increases during the spring, summer and fall.

Operating rates started strong in the first quarter, 2011, with rapid growth in demand from export markets, particularly China, offset by weak North American demand due to the languishing housing sector and record low starts. Rates tapered marginally through the end of the third quarter, 2011, as China introduced measures to cool its overheated housing market and U.S. demand remained weak. Demand from China stabilized through 2012, and modest but steady recoveries in the U.S. housing market helped drive up domestic demand and pricing through the end of 2012.

The volatility of the Canadian dollar also impacted results, given that historically over 75% of the Canadian operation's lumber sales are to U.S. and export markets and are priced in U.S. dollars. A weaker Canadian dollar increases the lumber sales realizations in Canada, but increases the impact of losses in U.S. operations when converted to Canadian dollars.

No deferred tax assets arising from loss carry-forwards were recognized during 2011 or 2012, with one minor exception in the fourth quarter, 2012.

#### Quarter 4, 2012 Compared to Quarter 4, 2011

#### <u>Overview</u>

The Company recorded a net loss of \$3.6 million, or \$0.06 per share, for the fourth quarter of 2012 compared to a net loss of \$6.5 million, or \$0.12 per share in the fourth quarter, 2011. Before restructuring costs, long term incentive compensation, certain foreign exchange gains (losses), certain other one-time items and the effect of unrecognized tax assets, the Company's net earnings for the fourth quarter, 2012 was \$3.7 million, or \$0.07 per share, as compared to a net loss of \$2.8 million, or \$0.05 per share for the fourth quarter, 2011.

EBITDA and Adjusted EBITDA for the fourth quarter of 2012 were \$13.2 million and \$19.4 million, respectively, compared to \$6.7 million and \$7.7 million, for the same period in 2011.

During the fourth quarter of 2012, lumber prices in the North American market continued their rise, with the average price reported by Random Lengths for SPF 2x4 #2&Btr at US\$335 per mfbm for the fourth quarter, 2012 as compared to US\$238 per mfbm for the same quarter in 2011, and US\$35 per mfbm higher than the

third quarter, 2012. Higher prices also drove lower export tax rates in the fourth quarter, 2012 vis-à-vis the same quarter, 2011, positively impacting sales realizations.

The stronger average Canadian dollar in the fourth quarter, 2012, which appreciated by 3 cents relative to its U.S. counterpart, had a negative impact on sales as compared to the same period, 2011.

#### Sales

The Company's record lumber shipments achieved in the third quarter, 2012 were surpassed in the fourth quarter, 2012 as the Company's lumber sales volumes reached 384 million fbm, an improvement of 21% over the fourth quarter, 2011. Increases reflect the stronger domestic demand driven by improved U.S. housing starts which increased from an average of 678,000 units in the fourth quarter, 2011 to 898,000 units, or 32% in the fourth quarter, 2012.

Fourth quarter, 2012 shipments to North America grew rapidly relative to the previous three quarters, 2012, and exceeded shipments in the same quarter, 2011 by 30% in response to higher demand. Increases in operating rates allowed the Company to also meet export demand, as shipments to export markets remained constant in the fourth quarter, 2012 vis-à-vis the same quarter, 2011.

Improvements in average unit lumber sales values of \$32 per mfbm, or 8%, in the fourth quarter, 2012 over the respective period, 2011 reflects the higher North American pricing, supplemented by higher realizations in China.

Log sales were up 1.6 million, or 1.6 milli

Compared to the same periods of 2011, pulp chip and other residuals revenues for the fourth quarter of 2012 were down \$1.7 million, resulting from lower overall chip prices. Average chip prices for the fourth quarter, 2012 decreased by 22% over the same quarter, 2011, reflecting slower pulp markets and, in the U.S. Pacific Northwest, decreases in export logs which increased the availability of fibre used in whole log chipping.

#### Operations

Production costs for the fourth quarter of 2012 increased by \$22.6 million, or 13% compared to the same quarter, 2011. The Company continued to achieve close to record lumber production, at 347 million fbm, an 18% improvement over the same quarter, 2011. Market driven increases in operating rates, supported by the availability of economic fibre supply for the U.S. Pacific Northwest sawmills more than offset curtailments at the Grand Forks sawmill for start-up of the new production line.

Unit cash conversion costs for the fourth quarter, 2012 remained constant as compared to the same period, 2011 despite improved operating rates, primarily due to the start-up costs related to the new production line at Grand Forks. Unit costs of logs consumed increased 4% quarter-over-quarter for 2012 as compared to 2011, resulting from higher log prices and higher logging, hauling and stumpage costs in the B.C. Interior, slightly mitigated by reduced export pressure on the Olympic Peninsula which provided more affordable supply.

Compared to the same period in 2011, B.C. log production fell by 47,000 cubic metres or 6% as the B.C. Coast continued to see hangover from the extended fire season.

Export taxes declined by \$0.5 million for the fourth quarter, 2012 as compared to the same period, 2011 despite an increase of 6.5 million fbm, or 12%, in Canadian shipments to the U.S. As a result of the lift in commodity lumber prices in the latter half of 2012, the export tax paid under the SLA declined to 5% for October, 2012 and 10% for November and December, 2012, as compared to a 15% export tax rate in the fourth guarter, 2011.

Depreciation of plant and equipment for the fourth quarter, 2012 increased by \$0.8 million in comparison to the same period in 2011, largely driven by increased operating rates.

Road amortization and depletion expense for the fourth quarter of 2012 increased by \$1.3 million or 21% compared to the same quarter, 2011 as a result of a shift on the B.C. Coast to logging on more difficult and higher cost terrain.

#### Corporate and Other

Selling and administrative costs for the fourth quarter, 2012 remained constant compared to the same quarter, 2011. Fourth quarter, 2012 LTIC expense increased almost sevenfold over the fourth quarter, 2011, reflecting changes in the estimated fair value of the share-based compensation plans. Though not a direct correlation, the movement in the Company's share price had the greatest impact on this expense, as reflected by increases in the closing share price of 35% for the fourth quarter, 2012 (Quarter 4, 2011 – 8%).

Finance costs increased by \$0.3 million for the fourth quarter, 2012, compared to the same period, 2011 resulting from an overall increase in average debt levels. Other foreign exchange gains (losses) fell \$1.0 million when compared to the fourth quarter, 2011 as volatility of the Canadian dollar and the timing, rates and amount of forward foreign exchange contracts impact these gains and losses.

Other income for the fourth quarter of 2012 and 2011 was negligible, consisting primarily of minor surplus equipment and scrap sales.

#### Income Taxes

The Company's income tax expense, negligible for the fourth quarter, 2012 and 2011, excludes the benefit of \$1.0 million related to the reduction of certain unrecognized deferred income tax assets arising from loss carry-forwards available to reduce future taxable income (Quarter 4, 2011 - \$3.9 million). Although the Company expects to realize the full benefit of the loss carry-forwards and other deferred tax assets, due the cyclical nature of the forest products industry and the economic conditions over the last several years, the Company has not recognized the benefit of its deferred tax assets in excess of its deferred tax liabilities, with one minor exception.

#### Cash Flow

The Company generated cash of \$13.4 million from operations, before changes in working capital, during the fourth quarter, 2012, an improvement of \$8.8 million over the fourth quarter, 2011. Higher domestic shipments and North American sales prices, lower export taxes and higher operating rates drove cash earnings for the fourth quarter, 2012.

Cash generated from operations, after changes in working capital, improved \$10.7 million for the fourth quarter, 2012, compared to the same period, 2011, reflecting the shift to domestic markets in 2012, lower logging production and the curtailment of Grand Forks during start-up in the fourth quarter, 2012. Increased export demand drove the build-up of inventory in the fourth quarter, 2011.

In the fourth quarter of 2012, funds drawn on the Revolving Term Line equalled funds repaid during the quarter. In the fourth quarter, 2011 funds drawn from the Revolving Term Line exceeded repayments by \$5.0 million, and were used to fund capital spending.

Cash capital expenditures for the fourth quarter, 2012 totalled \$15.4 million, with \$7.9 million spent on the capital upgrades for the Grand Forks and Castlegar mills, \$1.1 million on other high-return discretionary projects, \$1.7 million on other maintenance of operating capacity, and \$4.8 million on road construction. Comparable spending for the fourth quarter, 2011 of \$9.0 million saw \$2.2 million invested in high return discretionary projects and \$1.3 million on maintenance of operating capacity, with a further \$5.4 million on road construction.

The Company had cash of \$15.0 million at December 31, 2012 and ended the quarter with net debt of \$120.1 million or 24% of invested capital as compared to 20% at December 31, 2011, primarily as a result of the sawmill rebuild at Grand Forks.

#### **Controls and Procedures**

As required by National Instrument 52-109 issued by the Canadian Securities Administrators, Interfor carried out an evaluation of the design and effectiveness of the Company's disclosure controls and procedures as of December 31, 2012. The evaluation was carried out under the supervision of, and with the participation of the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based on the evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures were effective as of December 31, 2012.

As required by National Instrument 52-109 issued by the Canadian Securities Administrators, Interfor carried out an evaluation of the design and effectiveness of the Company's internal controls over financial reporting ("ICFR") as of December 31, 2012. The evaluation was carried out within the COSO framework and under the supervision of, and with the participation of the CEO and the CFO. Based on the evaluation, the CEO and CFO concluded that the Company's ICFR were effective as of December 31, 2012.

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 most recent interim period ended December 31, 2012 which materially affected, or are reasonably likely to materially affect, the Company's ICFR.

#### **Critical Accounting Estimates**

Valuation of Accounts Receivable. Interfor regularly reviews the collectability of its accounts receivable and records an allowance for doubtful accounts based on its best estimate of any potentially uncollectible accounts. Consideration is given to current economic conditions and specific customer circumstances to determine the amount of any bad debt expenses to be recorded.

The Company's exposure to credit risk is dependent upon individual characteristics of each customer. Each new customer is assessed for creditworthiness before standard payment and delivery terms and conditions are offered, with such review encompassing any external ratings, and bank and other references. Purchase limits are established for each customer, and are regularly reviewed. In some cases, where customers fail to meet the Company's benchmark creditworthiness, the Company may choose to transact with the customer on a prepayment basis.

All North American sales are conducted under standard industry terms. All log and lumber sales outside of the North American markets are either insured to 90% of their value by the Export Development Corporation or letters of credit or are prepaid in advance of shipment.

On January 31, 2012, Catalyst Paper Corporation ("Catalyst") announced that the company and certain of its subsidiaries had obtained an Initial Order from the Supreme Court of British Columbia under the Companies' Creditors Arrangement Act ("CCAA"). Catalyst is the primary buyer of Interfor's chips on the B.C. Coast, under long-term purchase contracts. Catalyst is also a purchaser of Interfor's pulp logs and other residuals. The Court granted the Company a security interest as a critical supplier on products purchased during the restructuring process.

In June, 2012, Catalyst trade accounts receivable of \$0.2 million related to pre-CCAA filing were written off. A restructuring plan was approved by Catalyst's creditors in June, 2012 and approved by the B.C. Supreme Court in July, 2012. Catalyst emerged from creditor protection in September, 2012 and continues to meet its obligations to the Company.

Historically, the Company has experienced minimal bad debts and this held true for 2012, despite the residual impacts of the global economic downturn on customers, including Catalyst. Based on this past experience and its detailed review of trade accounts receivable past due, a \$0.1 million reserve (2011 - \$0.1 million) was set up for specific trade receivables.

Although Interfor has not experienced any significant bad debt expenses in prior periods, declines in the economy could result in collectability concerns. Accounts receivable balances for individual customers could potentially be material at any given time.

Valuation of Inventories. Interfor values its lumber inventories 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. Other inventories consist primarily of seedlings, spare parts, and supplies and are recorded at the lower of cost and replacement cost. The unit net realizable value for lumber inventories and Coastal 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 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 actual cost, lagged by one month and adjusted for unusual items. The unit cost for Coastal logs is based on a twelve month moving average actual cost and for Interior logs is based on a three month moving average actual cost, both lagged by one month and adjusted for unusual items. The unit cost for U.S. logs is based on actual specific cost. Instances where net realizable value is lower than cost result in a charge to operating earnings in the period. Downward movements in commodity prices could result in a material write-down of inventory at any given time.

Recoverability of Property, Plant and Equipment, Logging Roads and Bridges, Timber licences, Other Intangible Assets, and Goodwill. Interfor's assessment of recoverability of property, plant and equipment, logging 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 fair value 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 and Resources Information Systems Inc., 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 export tax rate, future capital required to maintain the assets in their current operation condition, and other items.

There is a high degree of uncertainty in such assumptions and, as such, any significant change in assumptions could result in a conclusion that the carrying value of these assets could 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 rate applied to the model for years four through twenty represents the published Bank of Canada consumer price index as at December 31, 2012.

Interfor assesses the recoverability of Property, Plant and Equipment, Logging 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 an impairment may exist. The Company assessed the recoverability of these assets as at December 31, 2012, and concluded that there were no impairments.

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 cost of reforestation as the 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 liability 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 charge against operating earnings.

The Company also has a legal obligation to deactivate certain roads constructed and used to access timber once that access is no longer required. Accordingly, Interfor also accrues the cost of road deactivation as the 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 liability could be materially impacted by unfavourable terrain, changing legislative requirements and standards, or inaccurate projections, which could result in a charge against operating earnings.

Each of these estimates is reviewed regularly on an ongoing basis.

Environmental Obligations. Environmental expenditures that relate to an existing condition caused by past operations are charged as current production costs once existence of a liability and costs of rehabilitation efforts can be reasonably determined. Interfor engages independent third party experts to assist in determining the existence of environmental liabilities, appropriate prescriptions for treatment and related costs. Estimates of environmental obligations could be materially impacted by a number of factors including incorrect or incomplete problem definition and identification of treatments, or inaccurate cost projections. Incorrect estimates could result in a material charge against operating earnings.

Pension and Other Post-retirement Benefits. Interfor sponsors various defined contribution pension plans available, based on eligibility requirements, to all Canadian salaried and all U.S. employees. The Company sponsors three defined benefit plans for those hourly employees not covered by forest industry union plans and for a small group of salaried employees. It also sponsors two post-retirement medical and life insurance plans.

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 obligations and values include assumptions of 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, and assumed rates of increase for employee compensation and health care costs. 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 federal, provincial and foreign 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 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 income tax assets and liabilities is reasonably likely to change from period to period due to the uncertainties surrounding these assumptions.

#### **ACCOUNTING POLICY CHANGES**

#### **Change in Accounting Policy**

The Company uses derivative forward exchange contracts and options which are designated as at fair value through profit or loss and are carried on the Statement of Financial Position at fair value. Previously, changes in fair value were recorded as an adjustment to Sales in Net earnings. Effective, January 1, 2012, the Company changed its accounting policy to align with the presentation adopted by companies in its peer group and changes in fair value are now recorded in Other foreign exchange gain (loss) in Net earnings.

The policy has been applied on a retrospective basis and comparative information has been restated. The change had no effect on the comparative Statement of Financial Position.

#### **Future Accounting Policy Changes**

IFRS 9, *Financial Instruments*, replaces 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. This standard is in effect for accounting periods beginning on or after January 1, 2015, with earlier adoption permitted.

IAS 19, *Employee Benefits*, was revised to eliminate the option to defer recognition of gains and losses, known as the "corridor method", and to enhance disclosure requirements for defined benefit plans. As the Company did not choose the corridor method in accounting for its defined benefit plans, there is no impact on its financial statements as a result of the elimination of this option.

Application of this standard will also impact the calculation of finance costs, resulting in an increase to Production expense in the Statement of Earnings, which will be fully offset by an increase in Defined benefit plan actuarial gains (losses) in the Statement of Comprehensive Income. Prior to this standard, the impact of defined benefit plans on Net earnings included an interest cost on the obligation using the discount rate (based on current bond yields), and a credit on the plan assets using the expected rate of return (based on long term expected bond and equity returns). Under the new standard, the credit on plan assets will no longer recognize the equity risk premium and will be based on the discount rate only.

This standard is in effect for accounting periods beginning on or after January 1, 2013.

As at the reporting date, no assessment has been made of the impact of these standards on the Company's financial statements other than the effect of the elimination of the corridor method.

The standard-setting bodies that set IFRS have significant ongoing projects that could impact the IFRS accounting policies selected. Specifically, it is anticipated that there will be additional new or revised IFRS or IFRIC standards in relation to financial instruments and leases currently on the International Accounting Standards Board agenda.

#### **RISKS AND UNCERTAINTIES**

#### **Pricing**

Interfor's operating results are affected by fluctuations in the selling prices for lumber, logs and wood chips. Product selling prices are, in turn, affected by such factors as the general level of economic activity in the markets in which Interfor sells its products, interest rates, construction activity (in particular, housing starts in the United States, Canada, Japan and China), and log and chip supply/demand relationships. Interfor's financial results may be significantly affected by changes in the selling prices of its products. Based on 2012 levels of operations, a \$10 change in the Company's average selling price of its products would impact net earnings as follows:

Lumber \$10 increase per thousand fbm \$10.7 million increase in net income

Chips \$10 increase per unit<sup>1</sup> \$4.8 million increase in net income

1 Interfor sells chips in either volumetric units (VU's or GPU's - B.C. Coastal operations) or bone dry units (BDU's - B.C. Interior and Pacific Northwest operations).

#### 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 Interfor's lumber production is sold in markets where Interfor competes against many producers of approximately the same or larger capacity. Some of Interfor's competitors have greater financial resources than the Company and a number are, in certain product lines, lower cost producers than Interfor.

Factors which affect the Company's competitive position include:

- the foreign exchange rate;
- the cost of labour;
- the costs of harvesting or purchasing logs;
- the ability to secure a quality log supply matched to the 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 cost of export taxes payable on sales to the U.S.; and

its ability to maintain high operating rates and thus lower manufacturing costs.

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

#### **Availability of Log Supply**

The log requirements of Interfor's mills 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 Interfor's mills are either traded for suitable logs or sold on the open market. Operating at normal capacity, the Company's Canadian mills generally purchase less than 50% of their log requirements either through purchase agreements or on the open market. The Company relies almost entirely on purchased fibre through timber sales or purchase agreements for its U.S. based mills, with a small volume supplied by the Company's Canadian coastal logging operations for the sawmills located on the Olympic Peninsula. As a result, fluctuations in the price, quality or availability of log supply can have a material effect on Interfor's business, financial position, results of operations and cash flow.

Additionally, in order to ensure uninterrupted access to logs harvested from its timber tenures in Canada, Interfor 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. Interfor expects to fund its ongoing road development through the cash generated from operations and through utilization of its existing bank facilities.

#### **Use of Financial 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 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.

#### **Currency Exchange Sensitivity**

The Company's Canadian operations ordinarily sell approximately 75% of their lumber into export markets, with the majority of these sales denominated in foreign currency, predominantly US\$ and a small amount in Japanese Yen. While the Canadian operations also incur some US\$ denominated expenses, primarily for ocean freight and other transportation, and equipment operating leases, the majority of expenses are incurred in CAD\$.

An increase in the value of the CAD\$ relative to the US\$ would reduce the amount of revenue in CAD\$ realized by the Company from lumber sales made in US\$. This would reduce the Company's operating margin and the cash flow available to fund operations. As a result, any such increase in the value of the CAD\$ relative to the US\$ could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

The Company actively manages its currency exchange risk for fluctuations in US\$ and Japanese Yen by identifying opportunities from time to time to enter into foreign exchange contracts and options to effectively hedge its net exposure. As at December 31, 2012, the Company has outstanding forward contract obligations to sell a maximum of US\$2.7 million at an average rate of CAD\$0.9989 to the US\$1.00, call option obligations to sell a maximum of US\$3.0 million at a rate of CAD\$1.01 to the US\$1.00 and put option obligations to buy a maximum of CAD\$6.1 million at a rate of CAD\$1.01 to the US\$1.00 during 2013. All foreign currency gains or losses to December 31, 2012 have been recognized in Other foreign exchange gain (loss) in Net earnings and the fair value of the foreign currency contracts has been recorded as an asset of \$0.1 million in Trade accounts

receivable and other (2011 - \$0.3 million asset fair value recorded in Trade accounts receivable and other).

Based on the Company's net exposure to foreign currencies resulting from forward contracts in 2012, the sensitivity of Interfor's net earnings is as follows:

US\$ \$0.01 increase vs. CAD\$ \$2.0 million increase in net income

Japanese Yen 1¥ increase vs. US\$ \$0.1 million increase in net income

With poor U.S. housing starts and increased demand from China and other overseas markets, Interfor's U.S. operations grew their export sales significantly in 2011. In 2012, as U.S. housing starts and North American prices started to improve, Interfor's U.S. operations produced and sold products almost exclusively for the U.S. market. All revenues and expenses are denominated in US\$. All foreign currency denominated assets and liabilities of the U.S. foreign operations with a U.S. dollar functional currency are translated at exchange rates in effect at the Statement of Financial Position date. Revenues and expenses are translated at the average rates for the period. 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 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 Statement of Earnings.

The Company recorded a \$2.9 million unrealized foreign exchange loss on translation of its U.S. operations with a functional currency of \$US (2011 - \$2.7 million gain) to Other comprehensive income (loss) in 2012.

On October 1, 2008, the Company designated the US\$30.2 million drawn under its Revolving Term Line for the acquisition of its Beaver operations as a hedge against its investment in its U.S. operations. Unrealized foreign exchange gains of \$0.7 million (2011 - \$0.7 million losses) have been recorded in Other comprehensive income (loss) in 2012.

#### Cost of Debt Financing and Sensitivity

As at December 31, 2012 Interfor had drawn from its operating and term credit facilities of floating rate debt a total of \$135.0 million (2011 - \$110.7 million), including letters of credit.

The Company's operating and term credit facilities bear interest at the bank prime rate plus a premium, or, at the Company's option, at rates for Bankers' Acceptances for CAD\$ loans or at LIBOR for US\$ loans, in all cases depending upon a financial ratio.

On August 25, 2011, the Company entered into two interest rate swaps, each with notional value of \$25 million and maturing July 28, 2015. Under the terms of the swaps the Company pays an amount based on a fixed annual interest rate of 1.56% and receives a 90 day BA CDOR which is recalculated at set interval dates. The intent of these swaps is to convert floating-rate interest expense to fixed-rate interest expense. As these interest rate swaps have been designated as cash flow hedges the fair value of these interest rate swaps at December 31, 2012 being a liability of \$0.1 million (measured based on Level 2 of the fair value hierarchy) has been recorded in Trade accounts payable and accrued liabilities) and a gain of \$0.4 million (2011 - \$0.5 million loss) has been recognized in Other comprehensive income.

Based on the Company's average debt level during 2012, the sensitivity of a 100 basis point increase in interest rates would result in an approximate decrease of \$0.5 million in net earnings.

#### **Regulatory Issues**

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

From time to time the 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")

Interfor holds cutting rights in B.C. that represent an AAC of approximately of 3.77 million cubic meters. Of this amount 3.5 million cubic meters is in the form of replaceable tenures. The remaining portion is held in non-replaceable tenures (timber licences and non-replaceable forest licences) that will expire over time.

The AAC is regulated by the Ministry of Forests, Lands and Natural Resource Operations and subject to periodic reviews that assess and then make determinations to 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.

Reductions in Interfor's AAC from any new protected areas are subject to compensation, once these areas have been formally removed. Currently there are no compensation claims outstanding.

The amount of timber available for harvest in the B.C. Southern Interior is expected to remain high for the next five years as a consequence of an accelerated harvest to address the impact from the mountain pine beetle epidemic. The overall timber supply is expected to be reduced in the B.C. Interior once the surplus of dead pine is no longer useable. The changes in AAC will vary by location as determined by the provincial Chief Forester.

#### **Aboriginal Issues**

Aboriginal groups have claimed aboriginal title and rights over substantial portions of British Columbia, including areas where Interfor'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 aboriginal groups throughout British Columbia in order to resolve aboriginal rights and title claims. In addition, the governments have entered, and may continue to enter, into interim measures agreements with aboriginal groups. 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 aboriginal claims or treaty settlements on Interfor's forest tenures or the amounts of compensation to Interfor, if any, cannot be estimated at this time.

The courts have also established that the Crown has a duty to consult with aboriginal groups and where appropriate accommodate aboriginal interests. However, questions of responsibility and appropriateness of balancing interests will continue to evolve as the parties try to address these long standing complex issues. In British Columbia the Province has initiated a New Relationship process with First Nations that is intended to improve the functional relationship between the Crown and aboriginal groups prior to treaty settlement. The Province and First Nations groups on the B.C. Coast have signed Reconciliation Protocols that provides a shared decision making process for resource and land use, as well as new forest sector opportunities. These agreements overlap portions of Interfor's Coastal tenures. The agreement will be assessed and monitored in the years ahead to determine the extent of any implications on those operations.

#### Stumpage Fees

Stumpage is the fee the Crown charges companies to 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 go into determining an individual stumpage rate for each cutting permit.

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

#### **Environment**

Interfor has incurred, and will continue to incur, costs to minimize environmental impact, prevent pollution and for continuous improvement of its environmental performance. Interfor may discover currently unknown

environmental problems or conditions relating to its past or present operations, or it may be faced with 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 Interfor's financial condition and results of operations.

#### **Labour Disruptions**

The Company's Acorn, Hammond, Grand Forks, and Castlegar sawmill employees are members of the Canadian United Steelworkers' Union ("USW") union. The collective agreement with the Southern Interior USW agreement (Grand Forks and Castlegar) has an expiry date of June 30, 2013 while the USW agreement for the B.C. Coast (Acorn and Hammond) expires on June 15, 2014. The Company also has 24 employees in the B.C. Interior who are members of the Canadian Marine Service Guild, and their collective agreement expires September 30, 2014.

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.

#### OUTLOOK

Business conditions are expected to continue to improve, albeit slowly. In the U.S. the housing market is expected to continue to recover, China remains an important market for North American lumber and further growth is expected. Building activity in Japan is expected to gain momentum in 2013 in anticipation of a planned increase in the consumption tax and as a result of reconstruction efforts following the 2011 earthquake and tsunami. Interest rates are forecasted to remain low and the Canadian dollar is expected to trade at close to parity against the U.S. Dollar.

Interfor's recently announced acquisition of the three Rayonier mills will add another 360 million board feet to the Company's production capacity. While the near term outlook is more positive than it has been for some years, there are numerous challenges to the global economy that have the potential to undermine the economic recovery. With this uncertainty in mind, Interfor intends to maintain its disciplined approach to production, cost control, and inventory management while, at the same time, remaining alert to opportunities to position the Company for long-term success.

#### **ADDITIONAL INFORMATION**

Additional information relating to the Company and its operations can be found on its website at www.interfor.com and in the Annual Information Form and on SEDAR at www.sedar.com. Interfor's trading symbol on the Toronto Stock Exchange is IFP.A.



## International Forest Products Limited CONSOLIDATED FINANCIAL STATEMENTS MANAGEMENT RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of International Forest Products Limited (Interfor) is responsible for preparing the accompanying consolidated financial statements. The financial statements were prepared in accordance with International Financial Reporting Standards and are necessarily based in part on management's best estimates and judgements. The financial information included elsewhere (in the Statutory Reports) is consistent with that in the consolidated financial statements.

Interfor maintains a system of internal accounting control which management believes provides reasonable assurance that financial records are reliable and form a proper basis for preparation of financial statements. The internal accounting control process includes communications to employees of Interfor's standards for ethical business conduct.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Board exercises this responsibility through its Audit Committee, the members of which are neither officers nor employees of Interfor. The Committee meets periodically with management and the independent Auditors to satisfy itself that each group is properly discharging its responsibilities and to review the consolidated financial statements and the independent Auditors' report. The Company's Auditors have full and free access to the Audit Committee. The Audit Committee reports its findings to the Board of Directors for consideration in approving the consolidated financial statements for issuance to the shareholders. The Committee also makes recommendations to the Board with respect to the appointment and remuneration of the Auditors.

The consolidated financial statements have been examined by the independent Auditors, KPMG LLP and their report follows.

Duncan K. Davies

President and Chief Executive Officer

John A. Horning

Senior Vice President and Chief Financial Officer

February 14, 2013

# International Forest Products Limited CONSOLIDATED FINANCIAL STATEMENTS INDEPENDENT AUDITORS' REPORT

#### To the Shareholders

We have audited the accompanying consolidated financial statements of International Forest Products Limited (the "Company") which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011, the consolidated statements of earnings, comprehensive income, changes in equity and cash flows for the years ended December 31, 2012 and December 31, 2011, and notes, comprising a summary of significant accounting policies and other explanatory information.

#### Management's Responsibility for the Consolidated Financial Statements

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

#### Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

#### Opinion

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

KPMG LLP, Chartered Accountants

KPMG LLP

February 14, 2013 Vancouver, Canada

### **International Forest Products Limited Consolidated Statements of Financial Position**

(Expressed in thousands of Canadian dollars) December 31, 2012 and 2011

		Dec	ember 31	December 31	
	Note		2012		2011
Assets					
Current assets:					
Cash and cash equivalents	9	\$	14,994	\$	10,435
Trade accounts receivable and other			47,392		44,000
Inventories	5		98,024		97,645
Prepayments			11,749		10,757
			172,159		162,837
Employee future benefits	21		878		1,256
Other investments and assets	6		4,198		2,836
Property, plant and equipment	7		349,779		340,034
Logging roads and bridges	8		17,316		16,753
Timber licences	8		73,796		76,792
Other intangible assets	8		738		1,250
Goodwill	8		13,078		13,078
Deferred income taxes	18		98		-
		\$	632,040	\$	614,836
Liabilities and Shareholders' Equity					
Current liabilities:					
Trade accounts payable and provisions		\$	70,597	\$	60,692
Reforestation liability	11		10,864		14,121
Income taxes payable	18		593		1,058
			82,054		75,871
Reforestation liability	11		17,621		17,777
Long-term debt	9		135,046		110,713
Employee future benefits	21		9,631		8,186
Provisions and other liabilities	10		11,658		11,467
Equity:					
Share capital:					
Issued and fully paid:	12				
Class A subordinate voting shares			342,285		342,285
Class B common shares			4,080		4,080
Contributed surplus	12		7,476		7,476
Translation reserve			(7,818)		(4,929)
Hedge reserve			(132)		(503)
Retained earnings			30,139		42,413
			376,030		390,822
		\$	632,040	\$	614,836

Commitments and contingencies *(note 19)*; Subsequent events *(note 26)*. See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

L. Sauder, Director

D.W.G. Whitehead, Director

# **International Forest Products Limited Consolidated Statements of Earnings**

(Expressed in thousands of Canadian dollars, except earnings per share amounts) Years ended December 31, 2012 and 2011

	Note	2012	2011
Sales	4	\$ 849,196	\$ 758,245
Costs and expenses:			
Production		758,893	681,363
Selling and administration		20,719	20,548
Long term incentive compensation		10,065	449
Export taxes		9,044	9,029
Depreciation of plant and equipment	7	28,745	27,291
Depletion and amortization of timber, roads and other	8	23,648	24,263
		851,114	762,943
Operating loss before restructuring costs			
and write-downs of plant and equipment and roads		(1,918)	(4,698)
Restructuring costs and write-downs of plant and			
and equipment and roads	17	(529)	(580)
Operating loss		(2,447)	(5,278)
Other earnings (expenses):			
Finance costs	15	(6,324)	(7,094)
Other foreign exchange gain (loss)	4	189	(25)
Other income (expense)	16	334	371
		(5,801)	(6,748)
Loss before income taxes		(8,248)	(12,026)
Income taxes:	18		
Current		640	817
Deferred		(182)	610
		458	1,427
Net loss		\$ (8,706)	\$ (13,453)
Net loss per share, basic and diluted	20	\$ (0.16)	\$ (0.25)

# **International Forest Products Limited**

# **Consolidated Statements of Comprehensive Income**

(Expressed in thousands of Canadian dollars, except earnings per share amounts) Years ended December 31, 2012 and 2011

	Note	2012	2011
Net loss		\$ (8,706)	\$ (13,453)
Other comprehensive loss:			
Foreign currency translation differences		(2,805)	2,632
Defined benefit plan actuarial losses	21	(3,568)	(4,541)
Loss in fair value of interest rate swaps	<i>25</i>	371	(503)
Income tax on other comprehensive loss	18	(84)	250
		(6,086)	(2,162)
Comprehensive loss		\$ (14,792)	\$ (15,615)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Equity
(Expressed in thousands of Canadian dollars, except earnings per share amounts)
Years ended December 31, 2012 and 2011

		Clas	s A Share	Class	B Share	Cor	ntributed	Tr	anslation		Hedge	Retained	Total
	Note		Capital		Capital		Surplus		Reserve	R	eserve	Earnings	Equity
Balance at December 31, 2010		\$	285,362	\$	4,080	\$	5,408	\$	(7,646)	\$	-	\$ 60,246	\$ 347,450
Net loss:			-		-		-		-		-	(13,453)	(13,453)
Other comprehensive loss: Foreign currency translation differences, net of tax Defined benefit plan actuarial losses, net of tax	18 18, 21		-		-		-		2,717		-	- (4,376)	2,717 (4,376)
Loss in fair value of interest rate swaps	25		-		-		-		-		(503)	(4,570)	(503)
Contributions: Share options exercised Share issuance, net of share issue expenses and tax	12 12		1,370 55,553		-		-		-		-	- -	1,370 55,553
Changes in ownership interests in investee: Acquisition of subsidiary			-		-		2,068		-		-	(4)	2,064
Balance at December 31, 2011			342,285		4,080		7,476		(4,929)		(503)	42,413	390,822
Net loss:			-		-		-		-		-	(8,706)	(8,706)
Other comprehensive loss: Foreign currency translation differences, net of tax Defined benefit plan actuarial losses, net of tax Gain in fair value of interest rate swaps	18 18, 21 25		- - -		- - -		- - -		(2,889) - -		- - 371	(3,568) -	(2,889) (3,568) 371
Balance at December 31, 2012		\$	342,285	\$	4,080	\$	7,476	\$	(7,818)	\$	(132)	\$ 30,139	\$ 376,030

See accompanying notes to consolidated financial statements.

# International Forest Products Limited Consolidated Statements of Cash Flows

(Expressed in thousands of Canadian dollars) Years ended December 31, 2012 and 2011

	Note		2012		2011
Cash provided by (used in):					
Operating activities:					
Net loss		\$	(8,706)	\$	(13,453)
Items not involving cash:					
Depreciation of plant and equipment	7		28,745		27,291
Depletion and amortization of timber, roads and other	8		23,648		24,263
Income tax expense	18		458		1,427
Finance costs	15		6,324		7,094
Other assets			(1,953)		238
Reforestation liability	11		(516)		(90)
Other liabilities and provisions			(1,361)		(2,761)
Write-down (reversals) of plant, equipment, and roads	5 7,8		164		(423)
Unrealized foreign exchange losses			150		191
Other income			(309)		(184)
			46,644		43,593
Cash generated from (used in) operating working capital:					
Trade accounts receivable and other			(3,798)		3,191
Inventories			(879)		(25,613)
Prepayments			(1,087)		(1,698)
Trade accounts payable and accrued liabilities			5,592		9,588
Income taxes paid			(1,090)		(622)
<u> </u>			45,382		28,439
Investing activities:			,		,
Additions to property, plant and equipment	7		(39,830)		(16,099)
Additions to logging roads	8		(20,662)		(19,987)
Additions to timber and other intangible assets	8		(319)		(126)
Proceeds on disposal of property, plant and equipment			537		273
Cash received on acquisition of subsidiary	3(a)(ii)		-		4,846
Investments and other assets	( ) ( )		(298)		(921)
			(60,572)		(32,014)
Financing activities:			(,- )		(- ,,
Issuance of share capital, net of expenses	12		-		56,256
Interest payments			(5,241)		(5,629)
Additions to long-term debt	9		82,000		100,000
Repayments of long-term debt	9		(57,000)		(146,000)
_ 1 7 3			19,759		4,627
Foreign exchange gain (loss) on cash and cash equivalents hel	d		17/107		1,027
in a foreign currency			(10)		82
Increase in cash and cash equivalents			4,559		1,134
Cash and cash equivalents, beginning of year			10,435		9,301
Cash and cash equivalents, end of year		\$	14,994	\$	10,435
Cash and Cash Equivalents, end of year		ψ	14,774	φ	10,433

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

#### 1. Nature of operations:

International Forest Products Limited and its subsidiaries (the "Company" or "Interfor") produce wood products in British Columbia and in the U.S. Pacific Northwest for sale to markets around the world.

The Company is a publicly listed company incorporated under the *Business Corporations Act* (British Columbia) with shares listed on the Toronto Stock Exchange. Its head office, principal address and records office are located at Suite 3500, 1055 Dunsmuir Street, Vancouver, British Columbia, Canada, V7X 1H7.

The consolidated financial statements of the Company as at and for the year ended December 31, 2012 comprise the Company and its subsidiaries.

### 2. Statement of Compliance:

# (a) Statement of compliance:

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") and were approved by the Board of Directors on February 14, 2013.

### (b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis except for the following material items in the Statement of Financial Position:

- (i) Derivative financial instruments are measured at fair value
- (ii) Liabilities for cash-settled share-based payment arrangements are measured at fair value; and
- (iii) The employee benefit assets and liabilities are recognized as the net of the fair value of the plan assets and the present value of the defined benefit obligations on a plan by plan basis.

### (c) Functional and presentation currency:

These consolidated financial statements are presented in Canadian dollars, which is the parent company's functional currency. Certain of the Company's subsidiaries have a functional currency of the U.S. dollar and are translated to Canadian dollars. All financial information presented in Canadian dollars has been rounded to the nearest thousand except per share amounts.

#### (d) Use of estimates and judgements:

The preparation of the consolidated financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 2. Statement of Compliance (continued):

### (d) Use of estimates and judgements (continued):

Significant areas requiring the use of management estimates relate to the determination of restructuring, reforestation, road deactivation, environmental and tax obligations, share-based compensation, recoverability of assets, rates for depreciation, depletion and amortization, and determination of fair values of assets and liabilities acquired in business combinations and impairment analysis of non-financial assets including goodwill.

Information about the use of management estimates that have the most significant effect on the amounts recognized in the consolidated financial statements is included in the following notes:

Note 3(e)	Inventories
Note 3(i)	Impairment of non-financial assets
Note 3(j)	Reforestation and other decommissioning liabilities
Note 8	Roads and bridges, timber tenures, other intangible assets and goodwill
Note 11	Reforestation liability

The critical judgement in applying accounting policies that has the most significant effect on the amounts recognized in the consolidated financial statements is the determination of cash generating units as discussed in Note 3(i).

### 3. Significant accounting policies:

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

### (a) Basis of consolidation:

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries from their respective dates of acquisition or incorporation. All intercompany balances, transactions and unrealized income and expenses arising from intercompany transactions have been eliminated on consolidation.

### (i) Business combinations:

For business acquisitions on or after January 1, 2010, the Company measures goodwill at the acquisition date as the fair value of the consideration transferred including any non-controlling interest less the fair value of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. When the excess is negative, a bargain purchase gain is recognized immediately in Net earnings. Transaction costs, other than those associated with the issue of debt or equity securities, are expensed as incurred.

### (ii) Investment in associate companies:

Investments over which the Company is able to exert significant influence but not control are accounted for on the equity basis and are recognized initially at cost. The consolidated financial statements include the Company's share of the profit or loss and other comprehensive income of equity-accounted investees, after adjustments to align the accounting policies with those of the Company, from the date that significant influence commences until the date that it ceases.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 3. Significant accounting policies (continued):

- (a) Basis of consolidation (continued):
  - (ii) Investment in associate companies (continued):

Until January 5, 2011, the Company held 60% of the outstanding common shares of Seaboard Shipping Company Ltd. ("SSCL") with the remaining common shares held by other British Columbia forestry companies. Although the Company owned over 50% of the common shares of SSCL, the shareholders had entered into agreements that limited the Company's ability to control SSCL's strategic decisions. In addition, net earnings of SSCL were distributed based on a percentage of shipments of product by the shareholders and not based on common share ownership. The Company accounted for its investment in SSCL using the equity method with the investment adjusted for earnings of SSCL based on the Company's percentage of earnings as determined based on its shipment percentage and decreased for distributions made by SSCL.

On January 5, 2011 Seaboard became a wholly owned subsidiary of the Company and its accounts are consolidated from the date of change in control.

### (b) Foreign currency:

(i) Foreign currency transactions:

Transactions in foreign currencies are translated to the respective functional currency at exchange rates at the transaction date. Monetary assets and liabilities denominated in foreign currencies are revalued at each reporting date. Non-monetary assets and liabilities denominated in foreign currencies measured at historical cost are translated using the transaction date exchange rate.

Foreign currency gains or losses arising on revaluation are recognized in Net earnings. Where revaluations relate to trade accounts receivable those foreign currency gains or losses are adjusted to sales revenue; where revaluations relate to trade accounts payable those foreign currency gains or losses are adjusted to production costs.

# (ii) Foreign operations:

Certain of the Company's subsidiaries have a functional currency of the U.S. dollar. Revenues and expenses denominated in foreign currencies are translated to Canadian dollars at average rates for the period, which approximate the transaction date.

Foreign currency denominated assets and liabilities are translated into Canadian dollars at exchange rates in effect at the reporting date. Related unrealized gains and losses are included in Foreign currency translation differences in Other comprehensive income and in the Translation reserve in equity.

Unrealized foreign exchange gains and losses 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.

Foreign exchange gains or losses arising from a monetary item receivable from a foreign operation, the settlement of which is neither planned nor likely in the foreseeable future and which in substance is considered to form part of the net investment in the foreign operation, are recognized in Foreign currency translation differences in Other comprehensive income and presented in the Translation reserve in equity.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 3. Significant accounting policies (continued):

- (b) Foreign currency (continued):
  - (iii) Hedge of net investment in a foreign operation:

Financial liabilities denominated in foreign currencies are from time to time designated as a hedge of the Company's investments in foreign operations.

Foreign currency differences arising on the re-translation of a financial liability designated as a hedge of a net investment in a foreign operation are recognized in Foreign currency translation differences in Other Comprehensive Income to the extent that the hedge is effective and presented in the Translation Reserve in equity. To the extent that the hedge is ineffective, such differences are recognized in Other foreign exchange gain (loss) in Net earnings.

When the Company terminates the designation of the hedging relationship and discontinues its use of hedge accounting any accumulated unrealized foreign exchange gains and losses remain in the Translation reserve. Unrealized foreign exchange gains and losses arising subsequent to termination of the designation of the hedge relationship are recorded in Other foreign exchange gain (loss) in Net earnings. When the hedged net investment is disposed of, the relevant amount in the Translation reserve is reclassified to Net earnings as part of the gain or loss on disposal.

### (c) Financial instruments:

(i) Non-derivative financial instruments:

Non-derivative financial instruments are comprised of cash and cash equivalents, trade and other receivables, trade accounts payable and accrued liabilities, provisions, and loans and borrowings including long-term debt. The Company recognizes receivables, payables and loans on the date that they originate at fair value plus any direct transaction costs. All other financial assets are recognized initially on the trade date at which the Company becomes party to the contractual provisions of the instrument.

Cash and cash equivalents comprise cash on deposit and short-term interest bearing securities with maturities at their purchase date of three months or less. Cash and cash equivalents and trade and other receivables are designated as loans and receivables are initially measured at fair value plus any direct transactions costs and thereafter at amortized cost using the effective interest rate method, less any impairment losses.

Trade payables and accrued liabilities, provisions, and loans and borrowings including long-term debt are designated as other financial liabilities and are initially measured at fair value and thereafter at amortized cost using the effective interest rate method.

There are no financial instruments classified as available-for-sale or held-to-maturity.

(ii) Derivative financial instruments:

The Company at times uses derivative financial instruments for economic hedging purposes in the management of foreign currency exposures. Foreign exchange exposure to foreign currency receipts and related receivables, primarily U.S. currency, is managed through the use of foreign exchange forward contracts and options.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 3. Significant accounting policies (continued):

- (c) Financial instruments (continued):
  - (ii) Derivative financial instruments (continued):

The Company has chosen not to designate its derivative forward foreign exchange and option contracts as hedges. These derivative financial instruments are designated as held for trading and, consequently, are carried on the Statement of Financial Position at fair value, with changes in fair value being recorded in Other foreign exchange gain (loss) in Net earnings.

The Company also trades lumber futures in managing price risk and which are designated as held for trading with changes in fair value being recorded in Other income (expense) in Net earnings. Trading activities are closely monitored and restricted including a maximum number of outstanding contracts outstanding at any point in time.

The Company at times holds derivative interest rate swaps to hedge its interest rate risk exposures and may designate these financial instruments as the hedging instrument in a cash flow hedge of fluctuations in market interest rates associated with specific drawings under its long-term debt. The effective portion of changes in the fair value of the derivative are recognized in Other comprehensive income and presented in the Hedging Reserve in equity. Any ineffective portion of changes in the fair value of the derivative is recognized immediately in Net earnings.

The risk management strategies and relationships are formally documented and assessed on a regular, on-going basis.

### (iii) Share capital:

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

### (d) Cash and cash equivalents:

Cash consists of cash on deposit and short-term interest bearing securities with maturities at their purchase date of three months or less.

# (e) Inventories:

Lumber inventories are valued at the lower of cost and net realizable value on a specific product basis. Cost is determined as the weighted average of cost of production on a three month rolling average, lagged by one month and adjusted for exceptional costs, as in the case of a curtailment.

Log inventories are valued at the lower of cost and net realizable value on a specific boom basis where logs are in boom form, or in aggregate on a species and sort basis where the logs do not exist in boom form. Cost for internally produced log inventories is determined as the weighted average cost of logging on a twelve month rolling average on the B.C. Coast and on a three month rolling average in the B.C. Interior. For both areas, costs are lagged by one month and adjusted for exceptional costs, as in the case of a curtailment. Log inventories purchased from external sources are costed at acquisition cost. Net realizable value of logs is based on either replacement cost or, for logs which have been committed to processing into lumber, on estimated net realizable value after taking into consideration costs of completion and sale.

Other inventories consist primarily of supplies which are recorded at lower of cost and replacement cost.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 3. Significant accounting policies (continued):

### (f) Property, plant and equipment:

Property, plant and equipment are recorded at cost or deemed cost less accumulated depreciation and accumulated impairment losses. Depreciation on machinery and equipment is provided on the basis of hours operated relative to the asset's lifetime estimated operating hours. Depreciation on all other assets is provided on a straight-line basis (ranging from 2.5% to 33%) over the estimated useful lives of the assets.

Depreciation methods, useful lives and residual values are reviewed annually and adjusted if appropriate.

Maintenance costs are recorded as expenses during the period as incurred, with the exception of programs that extend the useful life of the asset or increase its value, which are then capitalized.

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

### (g) Logging roads and bridges:

Logging roads and bridges are recorded at cost less accumulated amortization and accumulated impairment losses. Road and bridge amortization is computed on the basis of timber cut relative to available timber.

Amortization methods, useful lives and residual values are reviewed annually and adjusted if appropriate.

### (h) Intangible assets:

#### (i) Timber licences:

Timber licences are recorded at cost less accumulated depletion and accumulated impairment losses. Timber licence depletion is computed on the basis of timber cut relative to available timber. Tree farm and forest licences are depleted on a straight-line basis over 40 years. Amortization rates are reviewed annually to ensure they are aligned with estimates of remaining economic useful lives of the associated intangible assets.

### (ii) Goodwill:

Goodwill is measured at cost less accumulated impairment losses. See note 3(a) for the policy on measurement of goodwill at initial recognition. In respect of acquisitions prior to January 1, 2010, goodwill is included on the basis of its deemed cost, which represents the amount recognized under previous Canadian generally accepted accounting principles, prior to adoption of IFRSs.

### (iii) Other intangible assets:

Other intangible assets are recorded at cost less accumulated amortization and accumulated impairment losses. Amortization on other intangible assets is provided on a straight-line basis over five years being the estimated useful lives of the assets. Amortization rates are reviewed annually to ensure they are aligned with estimates of remaining economic useful lives of the associated intangible assets.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 3. Significant accounting policies (continued):

### (i) Impairment of non-financial assets:

At each reporting date, the Company assesses its non-financial assets to determine whether there are any indications of impairment. Impairment tests are carried out annually for goodwill.

The Company conducts a review of external and internal sources of information to assess for any indications of impairment. 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 and Resources Information Systems Inc., 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 export tax rate, future capital required to maintain the assets in their current operation condition, and other items.

If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated. The recoverable amount is determined as the higher of the fair value less direct costs to sell for the asset and the asset's value in use. If the carrying amount of the asset exceeds its recoverable amount, the asset is impaired and an impairment loss is charged to Net earnings to reduce the carrying amount in the Statement of Financial Position to its recoverable amount.

Fair value is determined as the amount that would be obtained from the sale, net of direct selling costs, of the asset in an arm's length transaction between knowledgeable and willing parties.

Value in use is determined as the present value of the estimated future cash flows expected to arise from the continued use of the asset in its present form and its eventual disposal. Value in use is determined by applying assumptions specific to the Company's continued use of the asset and does not take into account future capital enhancements.

In testing for indications of impairment and performing impairment calculations, assets are considered as collective groups, referred to as cash generating units ("CGUs"). CGUs are the smallest identifiable group of assets, liabilities and associated goodwill that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Impairment losses recognized for a CGU are first allocated to reduce the carrying amount of goodwill, if any, assigned to the CGU, and then to reduce the carrying amounts of the other assets in the CGU on a pro-rata basis.

Impairment assessments are based on a range of estimates and assumptions, including lumber and chip sales prices, operating rates of the assets, raw material and conversion costs, sales volumes, the level of export taxes, and an appropriate discount rate. The Company has analyzed external data in determining appropriate assumptions.

For non-financial assets other than goodwill, impairments previously recognized may be reversed if the internal and external factors and estimates that led to the initial recognition of an impairment in a prior period indicate that the loss has decreased or no longer exists. An impairment loss is reversed if the recoverable amount exceeds the current carrying amount. The reversal is only to a maximum of the carrying amount that would have been recorded had the impairment loss not been recognized originally. An impairment loss for goodwill is not reversed.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 3. Significant accounting policies (continued):

### (j) Reforestation and other decommissioning provisions:

Forestry legislation in British Columbia requires the Company to incur the cost of reforestation on its forest, timber and tree farm licences and to deactivate logging roads once harvesting is complete and access is no longer required. Accordingly, the Company records the fair value of the costs of reforestation and road deactivation in the period in which the timber is cut, with the fair value of the liability determined with reference to the present value of estimated future cash flows.

Provisions are measured at the expected value of future cash flows, discounted to their present value and determined according to the probability of alternative estimates of cash flows occurring for each operation. The measurement under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, is based on best estimate and can be based on internal or external costs, depending upon which is most likely. Significant judgements and estimates are involved in forming expectations of future activities and the amount and timing of the associated cash flows. Those expectations are formed based on existing regulatory requirements and the expertise of Registered Professional Foresters and Engineers employed or contracted by the Company. Examples of 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 in terms of reforestation; and road structure and terrain for road deactivation.

Discount rates reflect the risks specific to the decommissioning provision. Adjustments are made to decommissioning provisions each period for changes in the timing or amount of cash flows, changes in the discount rate and the unwinding of the discount. As such, the discount rate reflects the current risk-free rate given that risks are incorporated into the future cash flow estimates.

In periods subsequent to the initial measurement, changes in the liability resulting from the passage of time are recognized as Finance costs and revisions to fair value calculations are recognized as Production costs in Net earnings as they occur.

# (k) Environmental costs:

Environmental expenditures are expensed or capitalized depending upon their future economic benefit. Expenditures that prevent future environmental contamination are capitalized as plant and equipment. Expenditures that relate to an existing condition caused by past operations are expensed. Liabilities are recorded when rehabilitation efforts are likely to occur and the costs can be reasonably estimated.

Provisions are measured at the expected value of future cash flows, discounted to their present value and determined according to the probability of alternative estimates of cash flows using a current pre-tax rate that reflects the risks specific to the liability. The unwinding of the discount is recognized as a Finance cost in Net earnings.

### (I) Employee benefits:

The estimated costs for defined benefit pensions and other post-retirement benefits provided to employees by the Company are accrued using actuarial methods and assumptions, including Management's best estimates of the discount rate, future investment earnings, salary escalation, and health care costs.

The defined benefit obligation, and the associated annual cost of accruing benefits for the defined benefit pension plans and other post-retirement benefits is calculated using the projected unit credit method.

For the purpose of calculating the expected return on plan assets, those assets are valued at fair value.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 3. Significant accounting policies (continued):

### (I) Employee benefits (continued):

Actuarial gains and losses arise from actual experience being different from the assumptions, or changes in actuarial assumptions used to determine the defined benefit obligation. Actuarial gains and losses are recognized in Retained earnings through Other comprehensive income in the year they arise.

For defined contribution plans, pension expense is the amount of contributions the Company is required to make in respect of services rendered by employees, the Company has no legal or constructive obligation to pay further amounts. Plans administered by the government are treated as defined contribution plans as is the industry-wide unionized employees' pension plan.

# (m) Equity-settled share based compensation:

The Company has a Share Option Plan and follows the fair value method of accounting for share options. Compensation expense is recorded for share options over the vesting period based on the estimated fair market value of the option at the date of grant with a corresponding increase to contributed surplus. In accordance with IFRS 2, *Share-based Payment*, no compensation cost has been recognized for share options granted prior to November 7, 2002. No share options have been granted after November 7, 2002.

# (n) Cash-settled share based compensation:

The Company has a Share Appreciation Rights ("SAR") Plan, a Deferred Share Unit ("DSU") Plan and a Total Shareholder Return ("TSR") Plan for directors, officers and certain other eligible employees. The TSR Plan was modified in 2011 to allow for the issuance of Performance Share Units ("PSUs"). The Company follows the fair value method of accounting for SARs, DSUs, and TSRs.

Compensation expense is recorded for SARs over the vesting period based on the estimated fair value of the SARs at the date of grant. Fair value is measured using a Black-Scholes option pricing model and is adjusted to reflect the number of SARs expected to vest.

Compensation expense is recorded for DSUs at the time of the grant, as the DSU Plan allows for immediate vesting, based on the fair value at the date of the grant.

Compensation expense is recorded for TSRs over the performance period based on the estimated fair value of the TSRs at the date of the grant. Fair value is measured using a combination of call options which are valued using a Black-Scholes pricing model.

The fair value of the SARs, DSUs, and TSRs are subsequently measured at each reporting date with any changes in fair value reflected in the Long-term incentive compensation in Net earnings. Liabilities are recorded in Trade accounts payable and accrued liabilities and in Other liabilities on the Statement of Financial Position.

# (o) Sales revenue:

The Company recognizes sales to external customers when the product is shipped and title passes. Sales are recorded on a gross basis, before freight, wharfage and handling costs, and export taxes.

### (p) Finance income and costs:

Finance income comprises net interest income on funds invested.

Finance costs comprise net interest expense on borrowings, the unwinding of the discount on decommissioning provisions, the amortization of prepaid finance costs and other related transaction costs.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 3. Significant accounting policies (continued):

# (q) Income tax:

Income tax expense comprises current and deferred income tax. Current tax and deferred income tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

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

Deferred income tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred income tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred income tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill.

Deferred income tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred income tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred income tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred income tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

# (r) Earnings per share:

Basic earnings per share are computed by dividing Net earnings by the weighted average shares outstanding during the reporting period. Diluted earnings (loss) per share is determined by adjusting the Net earnings and the weighted average shares outstanding during the reporting period for the effects of all dilutive potential common shares, which comprise share options granted.

# (s) New standards and interpretations not yet adopted:

A number of new standards, and amendments to standards and interpretations, are not yet effective for the year ended December 31, 2012, and have not been applied in preparing these consolidated financial statements. The following pronouncements are those that the Company considers most significant and are not intended to be a complete list of new pronouncements that may affect the financial statements.

IFRS 9, *Financial Instruments*, replaces 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. This standard is in effect for accounting periods beginning on or after January 1, 2015, with earlier adoption permitted.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 3. Significant accounting policies (continued):

(s) New standards and interpretations not yet adopted (continued):

IAS 19, *Employee Benefits*, was revised to eliminate the option to defer recognition of gains and losses, known as the "corridor method", and to enhance disclosure requirements for defined benefit plans. As the Company did not choose the corridor method in accounting for its defined benefit plans, there is no impact on its financial statements as a result of the elimination of this option.

Application of this standard will also impact the calculation of finance costs, resulting in an increase to Production expense in the Statement of Earnings, which will be fully offset by an increase in Defined benefit plan actuarial gains (losses) in the Statement of Comprehensive Income. Prior to this standard, the impact of defined benefit plans on Net earnings included an interest cost on the obligation using the discount rate (based on current bond yields), and a credit on the plan assets using the expected rate of return (based on long term expected bond and equity returns). Under the new standard, the credit on plan assets will no longer recognize the equity risk premium and will be based on the discount rate only.

This standard is in effect for accounting periods beginning on or after January 1, 2013.

As at the reporting date, no assessment has been made of the impact of these standards on the Company's financial statements other than the effect of the elimination of the corridor method.

### 4. Change in accounting policy:

The Company uses derivative forward exchange contracts and options which are designated as at fair value through profit or loss and are carried on the Statement of Financial Position at fair value. Previously, changes in fair value were recorded as an adjustment to Sales in Net earnings. Effective, January 1, 2012, the Company changed its accounting policy to align with the presentation adopted by companies in its peer group and changes in fair value are now recorded in Other foreign exchange gain (loss) in Net earnings.

The policy has been applied on a retrospective basis and comparative information has been restated. The following changes to historical financial statements have been made to reflect the new policy:

	As	previously Reported	Ac	djustment	Restated
Consolidated Statement of Earnings for the Year ended December 31, 2011					
Sales	\$	758,016	\$	229	\$ 758,245
Other foreign exchange gain (loss)		204		(229)	(25)

There are no changes to previously issued Statements of Financial Position as a result of this change in accounting policy.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 5. Inventories:

	2012	2011
Logs Lumber Other	\$ 59,772 31,833 6,419	\$ 59,412 31,729 6,504
	\$ 98,024	\$ 97,645

Inventory expensed in the period includes production costs, depreciation of plant and equipment, and depletion and amortization of timber, roads and other. The inventory write-down to record inventory at the lower of cost and net realizable value at December 31, 2012 was \$7,050,000 (2011 - \$10,006,000).

### 6. Investments and other assets:

	2012	2011
Timber deposits and other investments and deposits Deferred financing fees, net of accumulated amortization	\$ 2,651 1,547	\$ 642 2,194
	\$ 4,198	\$ 2,836

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 7. Property, plant and equipment:

				achinery and	Mobile	Computer	Site		Projects in	
Cost		Land	Buildings	Equipment	Equipment	Equipment	Improvements	Other	Process	Total
Balance at December 31, 2010	\$	35,022 \$	61,760 \$	401,647 \$	13,615 \$	15,871	\$ 32,002	\$ 6,112 \$	3,684 \$	569,713
Additions		36	-	6	759	145	296	403	14,454	16,099
Disposals		-	-	(2,872)	(575)	-	-	-	(15)	(3,462)
Transfers		-	496	12,433	793	1,098	986	15	(15,821)	-
Exchange rate movements		56	463	3,530	61	177	190	20	(2)	4,495
Balance at December 31, 2011		35,114	62,719	414,744	14,653	17,291	33,474	6,550	2,300	586,845
Additions		8	-	(172)	303	706	-	620	40,018	41,483
Disposals		-	(1,286)	(26,127)	(45)	-	-	(980)	-	(28,438)
Transfers		-	519	28,403	845	1,218	4,736	22	(35,743)	-
Exchange rate movements		(56)	(456)	(3,466)	(59)	(168)	. ,	(20)	(7)	(4,419)
Balance at December 31, 2012	\$	35,066 \$	61,496 \$		15,697 \$	19,047	\$ 38,023	\$ 6,192 \$	6,568 \$	595,471
				achinery and	Mobile	Computer	Site			
Accumulated Depreciation			Buildings	Equipment	Equipment	Equipment	Improvements	Other		Total
Balance at December 31, 2010		\$	22,443 \$	158,370 \$	11,045 \$	10,803	\$ 14,662	\$ 4,400	\$	221,723
Depreciation			2,965	19,621	762	1,457	2,072	414		27,291
Disposals			-	(2,802)	(571)	-	-	-		(3,373)
Impairment (reversal)			-	(423)	-	-	-	-		(423)
Exchange rate movements			146	1,152	36	147	95	17		1,593
Balance at December 31, 2011			25,554	175,918	11,272	12,407	16,829	4,831		246,811
Depreciation			2,853	20,918	964	1,442	2,222	346		28,745
Disposals			(1,270)	(26,029)	(45)	-	-	(969)		(28,313)
Transfers			5	(5)	-	-	-	-		-
Exchange rate movements			(144)	(1,113)	(36)	(147)	(109)	(2)		(1,551)
Balance at December 31, 2012		\$	26,998 \$	169,689 \$	12,155 \$	13,702	\$ 18,942	\$ 4,206	\$	245,692
Net book value at										
December 31, 2011	\$	35,114 \$	37,165 \$	238,826 \$	3,381 \$	4,884	\$ 16,645	\$ 1,719 \$	2,300 \$	340,034
December 31, 2012	*	35,066	34,498	243,693	3,542	5,345	19,081	1,986	6,568	349,779

The amount of borrowing costs capitalized in 2012 totals \$447,000 (2011 - \$nil) which was determined based on an estimate of the average interest costs on borrowings of 5.6%. As at December 31, 2012, additions includes \$1,653,000 in accrued contract costs (2011 - \$nil).

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 8. Roads and bridges, timber tenures, other intangible assets and goodwill:

	Roads and	Timber	Other	
Cost	Bridges	Licences	Intangibles	Goodwill
Balance at December 31, 2010 Additions	\$ 43,958 19,987	\$ 117,597 -	\$ 4,563 126	\$ 13,955 -
Disposals Exchange rate movements	(15,669)	-	32	-
Balance at December 31, 2011 Additions Disposals Exchange rate movements	48,276 20,662 (16,189) (5)	117,597 230 (1,547)	4,721 89 - (32)	13,955 - - -
Balance at December 31, 2012	\$ 52,744	\$ 116,280	\$ 4,778	\$ 13,955
Accumulated amortization	Roads and Bridges	Timber Licences	Other Intangibles	Goodwill
Balance at December 31, 2010 Amortization Disposals Exchange rate movements	\$ 26,895 20,297 (15,669)	\$ 37,443 3,362 -	\$ 2,840 604 - 27	\$ 877 - - -
Balance at December 31, 2011 Amortization Disposals Impairment Exchange rate movements	31,523 19,826 (16,085) 164	40,805 3,226 (1,547) -	3,471 596 - - (27)	877 - - -
Balance at December 31, 2012	\$ 35,428	\$ 42,484	\$ 4,040	\$ 877
Net book value at December 31, 2011 December 31, 2012	\$ 16,753 17,316	\$ 76,792 73,796	\$ 1,250 738	\$ 13,078 13,078

For the purpose of impairment testing, all goodwill is attributable to the Coastal Whitewood cash-generating unit ("CWW CGU"). The recoverable amount of the CWW CGU for impairment assessment was based on its value in use and was determined by discounting the future cash flows generated from the continuing use of the unit for a period of twenty years. The cash flows were projected based on past experience, actual operating results and the 5-year business plan in both 2011 and 2012. Due to the cyclical nature of the forest industry, cash flows for a further 15 years were extrapolated based on an average trend year.

The recoverable amount of the CWW CGU as at December 31, 2012, and December 31, 2011 was determined to be higher than the related carrying amount and no impairment has been recognized.

Key assumptions used are based on industry sources, including Forest Economic Advisors, LLC and Resources Information Systems Inc., as well as management estimates. These assumptions include 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 export tax rate and the future capital required to maintain the assets in their current operating condition.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 8. Roads and bridges, timber tenures, other intangible assets and goodwill (continued):

A pre-tax discount rate of 14.7 percent (2011 – 14.5 percent) was applied in determining the recoverable amount of the CWW CGU. The discount rate was estimated with the assistance of investment bankers, past experience, and the industry average weighted average cost of capital. An inflation rate of 0.8 percent (2011 – 2.3 percent) is applied to the model for years four through twenty.

The values assigned to key assumptions represent management's assessment of future trends in the forest industry and are based on both external sources and internal historical data.

# 9. Cash and borrowings:

		Revolving	
	Operating	Term	
2012	Line	Line	Total
Available line of credit	\$ 65,000	\$ 200,000	\$ 265,000
Maximum borrowing available	65,000	200,000	265,000
Drawings	-	135,046	135,046
Outstanding letters of credit			
included in line utilization	5,190	-	5,190
Unused portion of line	59,810	64,954	124,764
2011			
Available line of credit	\$ 65,000	\$ 200,000	\$ 265,000
Maximum borrowing available	65,000	200,000	265,000
Drawings	-	110,713	110,713
Outstanding letters of credit			
included in line utilization	5,062	-	5,062
Unused portion of line	59,938	89,287	149,225

### (a) Operating Line:

The Canadian operating line of credit ("Operating Line") may be drawn in either CAD\$ or US\$ advances, and bears interest at bank prime plus a margin or, at the Company's option, at rates for Bankers' Acceptances or LIBOR based loans plus a margin, and in all cases dependent upon a financial ratio of total debt divided by twelve months' trailing EBITDA¹. Borrowing levels under the line are subject to a borrowing base calculation dependent on certain accounts receivable and inventories.

The Operating Line is secured by a general security agreement which includes a security interest in all accounts receivable and inventories, charges against timber tenures, and mortgage security on sawmills. The Operating Line is subject to certain financial covenants including a minimum working capital requirement, a maximum ratio of total debt to total capitalization and a minimum net worth calculation.

The maturity date of the Operating Line is July 28, 2015. See also Subsequent events, note 26(b).

<sup>&</sup>lt;sup>1</sup>EBITDA represents earnings before interest, taxes, depletion and amortization.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 9. Cash and borrowings (continued):

### (b) Revolving Term Line (continued):

The Revolving Term Line may be drawn in either CAD\$ or US\$ advances, and bears interest at bank prime plus a margin or, at the Company's option, at rates for Bankers' Acceptances or LIBOR based loans plus a margin, and in all cases dependent upon a financial ratio of total debt divided by twelve months' trailing EBITDA<sup>1</sup>.

The Revolving Term Line is secured by a general security agreement which includes a security interest in all accounts receivable and inventories, charges against timber tenures, and mortgage security on sawmills. The term line is subject to certain financial covenants including a minimum working capital requirement, a maximum ratio of total debt to total capitalization and a minimum net worth calculation.

The maturity date of the Revolving Term Line is July 28, 2015.

In 2012, the Company had net drawings of \$25,000,000 on its Revolving Term Line.

As at December 31, 2012, the Revolving Term Line was drawn by US\$30,200,000 (2011 – US\$30,200,000) revalued at the year-end exchange rate to \$30,046,000 (2011 - \$30,713,000), and \$105,000,000 (2011 - \$80,000,000) for total drawings of \$135,046,000 (2011 - \$110,713,000), and leaving an unused available line of \$64,954,000 (2011 - \$89,287,000).

The US\$30,200,000 drawing under the Revolving Term Line has been designated as a hedge against the Company's investment in its U.S. operations and unrealized foreign exchange gains of \$667,000 (2011 - \$676,000 loss) arising on revaluation of the Non-Revolving Term Line were recognized in Foreign currency translation differences in Other comprehensive income.

See also Subsequent events, note 26(b).

Minimum principal amounts due on long-term debt within the next five years are follows:

\$ -	2013
-	2014
135,046	2015 2016
-	2016
-	2017

\$ 135,046

# (c) Cash and cash equivalents:

At December 31, 2012, the Company's cash balances are restricted by \$652,000 for contractor holdback payments (2011 - \$134,000 for outstanding letters of credit).

<sup>&</sup>lt;sup>1</sup>EBITDA represents earnings before interest, taxes, depletion and amortization.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

#### 10. Provisions and other liabilities:

2012	Note	Current	No	n-current	Total
Restructuring	10(a),17	\$ 441	\$	16	\$ 457
Road deactivation	10(a)	838		3,169	4,007
Environmental	10(a)	47		785	832
Cash-settled equity based compen-	sation				
Share appreciation rights plan	10(b)	4,773		1,223	5,996
Total shareholder return plan	10(c)	2,688		1,634	4,322
Deferred share unit plan	10(d)	294		3,791	4,085
Deferred compensation payable	10(e)	2,281		-	2,281
Storm damage remediation funds	10(f)	337		507	844
Other		900		533	1,433
		\$ 12,599	\$	11,658	\$ 24,257
2011	Note	Current	No	n-current	Total
Restructuring	10(a),17	\$ 347	\$	512	\$ 859
Road deactivation	10(a)	1,211		3,459	4,670
Environmental	10(a)	162		2,130	2,292
Cash-settled equity based compen-					
Share appreciation rights plan	10(b)	1,418		508	1,926
Total shareholder return plan	10(c)	2,385		1,549	3,934
Deferred share unit plan	10(d)	914		1,014	1,928
Deferred compensation payable	10(e)	_		1,307	1,307
Storm damage remediation funds	10(f)	676		476	1,152
Other		68		512	580
		\$ 7,181	\$	11,467	\$ 18,648

The current portion of provisions and other liabilities is included in Trade accounts payable and other accrued liabilities in the Statement of financial position.

#### (a) Provisions:

Forestry legislation in British Columbia requires the Company to deactivate logging roads once harvesting is complete and access is no longer required. Accordingly, the Company records the fair value of the costs of road deactivation in the period in which the timber is harvested, with the fair value of the liability determined with reference to the present value of estimated future cash flows.

Environmental provisions are made when rehabilitation efforts are likely to occur and the costs can be reasonably estimated. The environmental provision relates primarily to obligations assumed in 2008 upon acquisition of the Castlegar sawmill.

In 2012, the Company engaged an environmental consultant to undertake groundwater and other testing at a landfill at its Castlegar sawmill site to update its assessment of potential remediation costs. Based on the results of the testing undertaken, the Company revised its estimate of the environmental provision and recorded a recovery of \$1,321,000 in Production costs.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 10. Provisions and other liabilities (continued):

### (a) Provisions (continued):

Provisions are measured at the expected value of future cash flows, discounted to their present value and determined according to the probability of alternative estimates of cash flows using a current pre-tax discount rate that reflects the risks specific to the liability. The unwinding of the discount is recognized as a Finance cost in Net earnings (loss).

	Note	Restr	ucturing	Road dea	activation	Envir	onmental
Balance at December 31, 2010		\$	1,713	\$	4,655	\$	2,017
Provisions made during year	<i>17</i>		1,003		508		22
Expenditures made during year	ar		(1,857)		(617)		-
Unwind of discount			-		113		49
Changes in estimated future e	expend	itures	-		11		204
Balance at December 31, 2011			859		4,670		2,292
Provisions made during year	17		724		412		39
Expenditures made during year	ar		(767)		(518)		(110)
Reversal of provision							
during year	<i>17</i>		(359)		(537)		(68)
Unwind of discount			-		67		27
Changes in estimated future e	expend	itures	-		(87)		(1,348)
Balance at December 31, 2012		\$	457	\$	4,007	\$	832

### (b) Share Appreciation Rights Plan:

Awards under the Share Appreciation Rights Plan ("SAR Plan") have been granted to directors, officers and senior managers of the Company. The vesting of the SARs occurs at a rate of 40% two years after granting and 20% per annum thereafter. SARs expire ten years after the date of the grant. The SAR Plan uses notional units that are valued based on the Company's common share price on the Toronto Stock Exchange. The units are exercisable for cash and recorded as liabilities. Under the SAR Plan, awards will be expensed over the vesting periods based on the estimated fair value of the SARs at the date of grant. Fair value is measured using a Black-Scholes option pricing model and is adjusted to reflect the number of SARs expected to vest. Fair value of the SARs is subsequently measured at each reporting date with any change in fair value resulting in a change in the measure of the compensation for the award and will be amortized over the remaining vesting periods.

Details of the Company's SAR Plan for the years ended December 31, 2012 and 2011 are:

	20	)12	2011			
	Weighted			Weighted		
		average		average		
	Units	strike price	Units	strike price		
Outstanding, beginning of year	2,128,030	\$ 5.25	1,958,180	\$ 5.01		
Granted	318,500	4.65	306,500	5.94		
Exercised	(262,400)	4.90	(136,650)	3.39		
Expired or cancelled	(285,420)	4.60	-			
Outstanding, end of year	1,898,710	\$ 5.29	2,128,030	\$ 5.25		
Units exercisable, end of year	995,310	\$ 5.83	1,204,930	\$ 5.73		

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 10. Provisions and other liabilities (continued):

(b) Share Appreciation Rights Plan (continued):

Weighted average fair value assumptions for grants made in 2012 and 2011 are as follows:

	2012	2011
Risk-free interest rate	1.7%	3.1%
Expected life	8.2 years	8.2 years
Annualized volatility	44%	44%
Dividend rate	0%	0%
Termination rate	12%	12%
Grant date fair value	\$2.37	\$3.17

Details of units outstanding under the SAR Plan at December 31, 2012 are as follows:

		Units outsta	Units outstanding		exercisable
	Number	Weighted		Number	
	outstanding,	average	Weighted	exercisable,	Weighted
Strike	December 31,	remaining	average	December 31,	average
price	2012	unit life (yrs)	strike price	2012	strike price
\$1.38	221,850	6.1	\$ 1.38	104,450	\$ 1.38
\$3.40-\$	5.40 779,300	7.3	4.85	274,800	5.05
\$6.01-\$	7.30 761,060	3.9	6.40	479,560	6.63
\$8.02	136,500	4.1	8.02	136,500	8.02
	1,898,710		\$ 5.29	995,310	\$ 5.83

The Company recorded a Long term incentive compensation expense in respect of the SAR Plan of \$4,395,000 (2011 – recovery of \$742,000) for the year ended December 31, 2012.

# (c) Total shareholder return plan:

In 2003, the Company introduced a Total Shareholder Return Plan ("TSR Plan") for certain key executives. Under the TSR Plan prior to 2011, the Company will pay compensation to the TSR Plan members if the compound annual growth rate of the Company's share price exceeds 5% per annum over a three year period. The amount of compensation payable varies with the amount of the compound annual growth rate to a maximum of 15% per annum, the member's salary and a target award amount.

Effective January 1, 2011, the Company modified the TSR Plan to allow for the issuance of Performance Share Units ("PSUs"). Under the terms of the plan a participant will receive a target number of PSUs based on a target award divided by the value of the Company's Class "A" Subordinate Voting shares at the effective date of the grant. The number of PSUs which will ultimately vest will be in a range from 50% to 150% of the original grant based on total shareholder return over the performance period.

The number of PSU's outstanding at December 31, 2012 are as follows:

2012	2011
366,397	-
385,097	366,397
(88,543)	
662,951	366,397
	366,397 385,097 (88,543)

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 10. Provisions and other liabilities (continued):

### (c) Total shareholder return plan (continued):

Compensation expense is recorded for the TSR Plan over the performance period based on the estimated fair value of the TSR Plan payable at the date of the grant. The fair value of the TSR Plan payable is subsequently measured at each measurement date with any changes in fair value reflected in Long term incentive compensation expense in Net earnings (loss).

Fair value of the TSR Plan, including the grants with PSUs, is measured using a combination of call options which are valued using a Black-Sholes pricing model with weighted average assumptions for grants as follows:

	2012	2011
Risk-free interest rate	1.38%	2.30%
Expected life	3 years	3 years
Annualized volatility	47% to 56%	43% to 78%
Dividend rate	0.00%	0.00%
Termination rate	0.00%	0.00%
Grant date fair value	\$1,231	\$1,623

The Company recorded Long term incentive compensation expense under the TSR Plan of \$3,567,000 (2011 – \$1,610,000) for the year ended December 31, 2012.

#### (d) Deferred Share Unit Plan:

In January 2004, the Company introduced a DSU Plan for Directors and senior officers of the Company. The Plan, which allows for immediate vesting, is intended to provide a better link between share performance and compensation for the participants, in that DSU's either increase or decrease in value in a direct relationship with the Company's Class "A" Subordinate Voting shares.

Participants in the TSR Plan may elect, subject to the approval of the Company's Board of Directors, to receive their award in DSU's at the end of any performance period. In respect of the guaranteed 2009 TSR award, the Board exercised its discretion and required the award to be converted in March 2010 into a long-term payable account under the Deferred Share Unit Plan.

DSU's may also be granted directly to Directors or senior employees of the Company at the discretion of the Board and Directors may also elect to take DSU's as payment of their annual retainer.

The number of DSU's outstanding at December 31, 2012 are as follows:

	20	)12	20	11
	Average			Average
	Units	unit value	Units	unit value
Outstanding, beginning of year	458,821	\$ 4.20	408,249	\$ 5.23
Granted <sup>1</sup>	46,004	5.21	50,572	4.93
Outstanding, end of year	504,825	\$ 8.09	458,821	\$ 4.20

Changes to share values subsequent to issuance of awards will result in adjustments to the compensation accrual and Long term incentive compensation expense in Net earnings (loss). The Company recorded a Long term incentive compensation expense of \$1,916,000 (2011 – recovery of \$456,000) for the year ended December 31, 2012 in respect of the DSU Plan.

<sup>&</sup>lt;sup>1</sup>Fair value at the date of the grant.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 10. Provisions and other liabilities (continued):

### (e) Deferred compensation payable:

TSR Plan awards for the former Chief Operating Officer for the three year periods which matured on December 31, 2009 and December 31, 2011 were converted in March 2010 and 2012 respectively into long-term compensation payable. Valuation adjustments are made monthly to the plan based on the rate of return of a referenced investment fund and compensation expense of \$187,000 (2011 - \$37,000) was recorded as Long term incentive compensation expense for the year ended December 31, 2012.

# (f) Storm damage remediation funds:

In the latter half of September 2010, heavy rains and strong winds on northern Vancouver Island and the B.C. Central Coast triggered mudslides, road washouts and flooding and caused bridge and culvert damage. Certain losses relating to the 2010 storm damage were covered by insurance and in June, 2011 the Company settled with its insurers for recovery of qualifying expenditures, net of the insurance deductible for total proceeds of \$4,836,000.

In 2011, the Company recorded business interruption insurance recoveries of \$2,714,000 as a reduction in Production costs in Net earnings (loss), applied \$525,000 against amounts previously set up as a receivable for costs already incurred and the remainder of \$1,576,000 was set up as a provision for future remediation on roads and bridges. Under the terms of the insurance settlement, the insurance proceeds must be used for remediation.

As at December 31, 2012 \$844,000 (2011 - \$1,152,000) of these provisions remain unspent.

#### 11. Reforestation liability:

The Company has an obligation to reforest areas harvested under various timber rights. The obligation is incurred as logging occurs and the fair value of the liability for reforestation is determined with reference to the present value of estimated future cash flows required to settle the obligation.

Changes in the reforestation liability for the years ended December 31 are as follows:

changes in the reforestation liability for the years ended better	CITIDOT 3		٧٥.	
		2012		2011
Reforestation liability, beginning of year	\$	31,898	\$	27,110
Reforestation expense on current logging and				
market logging agreements		10,847		12,998
Reforestation expenditures		(12,345)		(9,225)
Transfer of obligation		(1,900)		-
Unwind of discount		360		545
Changes in estimated future reforestation expenditures		(375)		470
	\$	28,485	\$	31,898
Consisting of:				
Current reforestation liability	\$	10,864	\$	14,121
Long term reforestation liability		17,621		17,777
	\$	28,485	\$	31,898

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

## 11. Reforestation liability (continued):

The total undiscounted amount of the estimated future expenditures required to settle the reforestation obligation at December 31, 2012 is \$28,601,000 (2011 - \$33,282,000). The reforestation expenditures are expected to occur over the next one to fifteen years and have been discounted at the long term risk-free interest rate of 2%. Reforestation expense resulting from obligations arising from current logging are included in Production costs for the year and expense related to the unwinding of the discount is included in Finance costs.

# 12. Share capital:

### (a) Share transactions:

Authorized capital at December 31, 2012 and 2011 consists of:

100,000,000 Class A subordinate voting shares without par value

1,700,000 Class B common shares without par value

5,000,000 preference shares without par value

Share transactions during 2012 and 2011 were as follows:

	Class A	Class B	Total	Amount
Balance, December 31, 2010	46,337,676	1,015,779	47,353,455	\$ 289,442
Share issuance, net of share issue				
expenses and tax	8,222,500	-	8,222,500	55,553
Shares issued on exercise of options	287,000	-	287,000	1,370
Balance, December 31, 2011 and 2012	54,847,176	1,015,779	55,862,955	\$ 346,365

The first 13-1/3¢ per share per annum of dividends to common shareholders declared are paid on the Class A shares. Any additional dividends must be declared in equal per share amounts on the Class A and B shares.

The Class B shares (carrying ten votes per share) are exchangeable into Class A shares (carrying one vote per share) at any time at the option of the holder or, under certain conditions which will result in the automatic conversion of the Class B shares into Class A shares, on the basis of one Class A share for one Class B share.

On April 8, 2011 the Company closed a public offering of 8,222,500 Class A Subordinate Voting shares at a price of \$7.00 per share for gross proceeds of \$57,557,000 less transaction costs of \$2,671,000 to net cash proceeds of \$54,886,000.

Changes in contributed surplus were as follows:

	Note	2012	2011
Contributed surplus, beginning of year Addition to contributed surplus upon		\$ 7,476	\$ 5,408
acquisition of subsidiary	3(a)(ii)	-	2,068
		\$ 7,476	\$ 7,476

At December 31, 2012, Class A shares are reserved for possible future issuance as follows:

- (i) 1,015,779 Class A shares are reserved for the conversion of Class B shares; and
- (ii) 1,631,740 Class A shares are reserved for possible issuance pursuant to the share option plan.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 12. Share capital (continued):

# (b) Share option plan:

The Company had an employee share option plan for its key employees and directors. The vesting of the options occurs at a rate of 40% two years after granting and 20% per annum thereafter. Options expire ten years after the date of the grant. There were no options outstanding at December 31, 2012 and 2011. No share options have been granted after November 7, 2002.

Details of the Company's share option plan for the years ended December 31, 2012 and 2011 are as follows:

_	2012			2	2011		
	Weighted				Weighted		
	average			average			
	Options	exercise pr	exercise price		exercise price		
Outstanding, beginning of year	-	\$	\$ -		\$ 4.77		
Granted	-		-	-	-		
Exercised	-		-	(287,000)	4.77		
Expired or cancelled	-		-	-			
Outstanding, end of year	-	\$	-	-	\$ -		
Options exercisable, end of year	-	\$	-	-	\$ -		

# 13. Depreciation, depletion and amortization:

Depreciation, depletion and amortization allocated by function are as follows:

· ·	·	2012	2011
Production	\$	51,471	\$ 50,644
Selling and administration		922	910
	\$	52,393	\$ 51,554

### 14. Personnel expenses:

	Note	2012		2011
Wages and salaries		\$ 100,743	\$	91,242
Government administered pensions and				
unemployment insurance		5,671		5,132
Workers' compensation insurance		3,716		3,257
Contributions to defined contribution plans	21	4,778		4,557
Expenses related to defined benefit plans	21	157		338
Cash-settled share-based payment transactions				
and other long term compensation expense	10	10,065		449
Medical, dental, group insurance and other		8,848		8,785
		\$ 133,978	\$ 1	13,760

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

#### 15. Finance income and costs:

Recognized in Net earnings (loss):

	2012	2011
Interest on borrowing Unwind of discount on provisions Amortization of prepaid finance costs	\$ (5,221) (454) (649)	\$ (5,608) (707) (779)
	\$ (6,324)	\$ (7,094)
Recognized in Other comprehensive income (loss):		
	2012	2011
Effective portion of changes in fair value of interest rate swap	\$ 371	\$ (503)

### 16. Other income:

	2012	2011
Gain on disposal of surplus equipment, licenses and roads	\$ 309	\$ 184
Gain on lumber futures trading	25	187
	\$ 334	\$ 371

# 17. Restructuring costs and write-downs of plant and equipment:

The Company recorded restructuring costs, and write-downs of plant and equipment and roads consisting of the following:

	Note	2012	2011
Severance costs	10	\$ 724	\$ 265
Contractor buyout	10	-	840
Plant, equipment and road write-downs (reversal)	7	164	(423)
Other (recovery)	10	(359)	(102)
		\$ 529	\$ 580

Restructuring costs in 2012 included severance costs of \$285,000 resulting from the early retirement of hourly workers and \$439,000 in management reorganizations resulting from the implementation of the Company's "Achieving Excellence" program.

In addition, the cancellation of cutting permits in 2012 gave rise to a recovery of previously accrued restructuring of \$359,000, partially offsetting a \$164,000 impairment of related road infrastructure.

During 2011, restructuring costs of \$580,000 resulted from the buyout of a logging contractor's Bill 13 entitlements, reversal of a write-down for an asset previously considered impaired, severance costs related to early retirement of hourly workers, and a revision of a previous estimate for an onerous contract.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 18. Income taxes:

Income tax expense is as follows:

		2012		2011
Current tax expense:				_
Current year	\$	522	\$	655
Adjustments for prior periods		118		162
		640		817
Deferred income tax expense (recovery):				
Origination and reversal of temporary differences		(2,612)		(6,370)
Changes in tax rates		57		(24)
Change in unrecognized deductible temporary differences		2,373		7,004
		(182)		610
	\$	458	\$	1,427
Income tax (expense) recovery recognized in Other comprehense	sive inc	come is as fo	ollows:	
		2012		2011
Loss (gain) on hedge of net investment in foreign operation Defined benefit plan actuarial losses	\$ (84) -		\$	85 165
	\$	(84)	\$	250

The reconciliation of income taxes at the statutory rate to the income tax expense is as follows:

	2012	2011
Income tax recovery at the statutory rate of		
25% (2011 – 26.5%)	\$ (2,062)	\$ (3,187)
Unrecognized deferred income tax assets	2,373	7,004
Entities with different tax rates	(3)	(1,315)
Benefit of capital losses	-	(1,064)
Change in future tax rates and statutory and tax recovery		
rate difference	57	(24)
Other	93	13
	\$ 458	\$ 1,427

# Unrecognized deferred income taxes:

The Company has unrecognized deferred income tax assets in relation to certain deductible temporary differences and unused tax losses that are available to carry forward against future taxable income. The Company's Canadian non-capital loss carry-forwards and U.S. net operating loss carry-forwards totaling approximately \$292,000,000 (2011 - \$241,000,000) expire between 2014 and 2032, and are available to reduce future taxable income.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 18. Income taxes (continued):

Although the Company expects to realize the full benefit of the loss carry-forwards and other deferred income tax assets, due to the cyclical nature of the wood products industry and the economic conditions over the last several years, the Company has not recognized the benefit of its deferred income tax assets in excess of its deferred income tax liabilities, except in limited circumstances. Deferred income tax assets are not recognized in respect of the following:

	2012	2011
Losses carried forward	\$ 117,203	\$ 106,888
Deductible temporary differences	7,584	4,386
	\$ 124,787	\$ 111,274

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 18. Income taxes (continued):

Recognized deferred income taxes:

				Reco	gnized					
		Recog	gnized in	in	Other	Acqu	uired in	Recogn	ized in	
	Opening	Inc	ome Tax	Compreh	nensive	Bı	usiness	Shareh	olders'	Ending
December 31, 2012	Balance		Expense	Income	e (loss)	Comb	ination		Equity	Balance
Deferred income tax assets										
Losses \$	42,228	\$	10,243	\$	-	\$	-	\$	-	\$ 52,471
Reserves	12,818		(424)		-		-		-	12,394
Tax credits	938		17		-		-		-	955
Defined benefit plan actuarial losses	788		-		-		-		-	788
Share issuance costs	668		-		-		-		-	668
Other	2,319		(904)		-		-		-	1,415
Deferred income tax liabilities										
Capital assets	(59,581)		(8,750)		-		-		-	(68,331)
Loss (gain) on hedge of net										
investment in foreign operation	(178)		-		(84)		-		-	(262)
Total \$	_	\$	182	\$	(84)	\$	_	\$	-	\$ 98
				Reco	gnized					
		Reco	gnized in		Other	Acqu	uired in	Recogn	ized in	
	Opening	Inc	ome Tax	Compreh	nensive	Вı	usiness	Shareh	olders'	Ending
December 31, 2011	Balance		Expense	Income	e (loss)	Comb	ination		Equity	Balance
Deferred income tax assets										
Losses \$	52,654	\$	(10,426)	\$	-	\$	-	\$	-	\$ 42,228
Reserves	12,215		910		-		(307)		-	12,818
Tax credits	2,520		(1,582)		-		-		-	938
Defined benefit plan actuarial losses	623		-		165		-		-	788
Share issuance costs	-		-		-		-		668	668
Other	1,791		528		-		-		-	2,319
Deferred income tax liabilities										
Capital assets	(69,540)		9,959		-		-		-	(59,581)
Loss (gain) on hedge of net	*									ŕ
investment in foreign operation	(263)		-		85		-		-	(178)
Total \$	_	\$	(611)	\$	250	\$	(307)	\$	668	\$

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 19. Commitments and contingencies:

### (a) Operating leases and contractual obligations:

The Company is obligated under various operating leases and contracts requiring minimum annual payments in each of the next five years as follows:

2013 2014 2015 2016	\$ 9,970 4,950 3,630 2,670
2017	1,550

# (b) Softwood Lumber Agreement:

In April, 2012 the U.S. Lumber Coalition approached the U.S. Trade Representative's office asserting that the B.C. government is undercharging B.C. Coastal forest companies for timber harvested on Crown lands. As this complaint is in the very preliminary stages of investigation, the existence of any potential claim has not been determined and no provision has been recorded in the financial statements as at December 31, 2012.

## (c) Surety Performance Bonds

The Company has posted \$17,801,000 in surety performance bonds, with various expiry dates extending through 2016.

# (d) Other contingencies:

The Company is subject to a number of claims arising in the normal course of business in respect of which either an adequate provision has been made or for which no material liability is expected.

### 20. Net earnings per share:

Net earnings per share is based on the earnings attributable to shareholders and a weighted average number of shares outstanding for the year. Diluted net earnings per share is based on profit attributable to shareholders and a weighted average number of shares outstanding for the year adjusted for the dilutive effects of share options.

The reconciliation of the numerator and denominator is determined as follows:

			2012					2011		
	Weighted					Weighted				
	average			ge average						
	number of				number of					
		Net loss	Shares	Pe	r share		Net loss	Shares	Pe	er share
Basic and diluted										
loss per share	\$	(8,706)	55,863	\$	(0.16)	\$	(13,453)	53,611	\$	(0.25)

There were no share options outstanding at December 31, 2012 (2011 – nil).

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 21. Employee future benefits and other post-retirement plans:

The Company maintains a number of savings and retirement plans that are available to employees that meet certain eligibility requirements.

# (a) Defined contribution plans:

In Canada, salaried employees of the Company are provided with the opportunity of making voluntary contributions based on a percentage of an employee's earnings to a Registered Retirement Savings Plan ("RRSP"). The Company matches employees' RRSP contributions with contributions to a Deferred Profit Sharing Plan ("DPSP") with the employee's future retirement benefits based on these contributions along with investment earnings on the contributions.

For the DPSP, the Company's funding obligations are satisfied upon making cash contributions to an employee's account. For 2012, the pension expense for this plan is equal to the Company's contribution of \$1,265,000 (2011 - \$1,175,000).

Certain eligible employees of the Canadian Merchant Services Guild ("CMSG") are required to make contributions based on a percentage of earnings into a defined contribution plan. For 2012, the pension expense is equal to the Company's contribution of \$46,000 (2011 - \$27,000).

Employees of Interfor U.S. Inc. (formerly Interfor Pacific Inc.) and Cedarprime Inc., the Company's U.S. operating subsidiaries, contribute a percentage of their earnings to a 401(k) plan which the Company matches and which vest immediately. The Company's funding obligations are satisfied upon making cash contributions to an employee's account. For 2012, the pension expense for this plan is equal to the Company's contribution of \$730,000 (2011 - \$644,000).

#### (b) Unionized employees' pension plan:

The Company contributes to an industry-wide benefit plan for unionized employees based on a predetermined amount per hour worked by an employee. For 2012, the pension expense for these plans is equal to the Company's contribution of \$2,358,000 (2011 - \$2,119,000). As there is insufficient information available to enable the Company to account for this plan as a defined benefit plan, the plan has been accounted for as a defined contribution plan. The Company's liability is limited to its contributions.

### (c) Senior management supplementary pension plans:

The Company provides supplementary pension benefits to certain members of its senior management in the form of a notional extension to the DPSP in Canada and the 401(k) plan in the U.S. These commitments are not funded but are fully accrued by the Company, with a portion of the commitments being secured by irrevocable letters of credit.

During 2012 the Company recorded an expense of \$378,000 (2011 - \$592,000) in respect of these plans. The amounts accrued for defined contribution commitments is \$4,423,000 (2011 - \$4,339,000).

The accrued liabilities are included in the Company's Statement of Financial Position as follows:

	2012	2011
Trade accounts payable and other accruals Employee future benefits obligation	\$ 294 4,129	\$ 203 4,136
	\$ 4,423	\$ 4,339

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 21. Employee future benefits and other post-retirement plans (continued):

# (d) Defined benefit plans:

The Company and the non-union hourly employees at the Adams Lake operations make contributions to a defined benefit pension plan that provides pension benefits upon retirement. The plan entitles a retired employee to receive monthly payments based on a schedule of defined benefit accruals for different periods of service.

The Company makes contributions to a defined benefit pension plan that provides pension benefits to certain eligible employees of the CMSG upon retirement. The plan provides a retired employee a monthly payment based on a percentage of their average earnings at retirement, and their years of service. In addition, the Company provides post retirement medical and life insurance benefits to certain eligible CMSG retirees.

The Company maintains a non-contributory defined benefit pension plan for a former senior executive.

The Company makes contributions to a defined benefit pension plan that provides pension benefits to the eligible employees of SSCL upon retirement. The plan provides a retired employee a monthly payment based on a percentage of their final average salary at retirement, and their years of service. In addition, the Company provides post retirement life insurance benefits to eligible SSCL retirees. Specified individuals at SSCL also receive a supplemental pension upon retirement based on a percentage of final average earnings at retirement, and years of service.

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

The most recent and the next scheduled actuarial valuations for funding purposes for the significant pension plans are:

	Most Recent Valuation	Next Scheduled Valuation
Adams Lake Pension Plan	December 31, 2009	December 31, 2012
CMSG Pension Plan	December 31, 2009	December 31, 2012
SSCL Plan	December 31, 2011	December 31, 2012

The results of the December 31, 2012 actuarial valuations will be received in 2013.

The Company has determined, that in accordance with statutory requirements of the plans (such as minimum funding requirements), that the present value of refunds or reductions in future contributions is not lower than the balance of the total fair value of the plan assets less the total present value of obligations. The decrease in the defined benefit asset as a result of the asset ceiling limit at December 31, 2012 is \$nil (2011 - \$162,000).

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 21. Employee future benefits and other post-retirement plans (continued):

# (d) Defined benefit plans (continued):

		Pension	Bene	efits	Othe	er Post-retir	emer	t Benefits
		2012		2011		2012		2011
Defined benefit obligation:								
Beginning of year	\$	49,645	\$	34,065	\$	1,627	\$	1,169
Acquisitions		-		12,223		-		326
Service cost		585		580		35		29
Employee contributions		297		283		-		-
Interest cost		2,422		2,495		80		80
Benefit payments		(2,691)		(2,505)		(104)		(95)
Settlements		-		(290)		-		-
Actuarial loss		4,554		2,794		195		118
End of year	\$	54,812	\$	49,645	\$	1,833	\$	1,627
Plan assets:								
Beginning of year	\$	48,516	\$	33,536	\$	-	\$	-
Acquisitions		-		13,882		-		-
Expected return on plan asse	ets	2,965		2,899		-		-
Employer contributions		1,791		2,231		104		95
Employee contributions		297		283		-		-
Benefit payments		(2,691)		(2,505)		(104)		(95)
Settlements		-		(343)		-		-
Actuarial gain (loss)		1,019		(1,467)		-		<u>-</u>
End of year	\$	51,897	\$	48,516	\$	-	\$	-

The following summarizes the balances recognized on the Statement of Financial Position:

The following summarizes the	Dalain	oco i ccogn	IZCU	on the stat	CHICI	it of Fillancia	11 1 0	3111011.
		Pension	Bene	efits	Othe	er Post-retire	mer	nt Benefits
		2012		2011		2012		2011
		5.1 OOF		10.517				
Fair value of plan assets	\$	51,897	\$	48,516	\$	-	\$	-
Present value of unfunded								
obligations		447		471		1,833		1,627
Present value of funded oblig	ations	54,365		49,174		-		_
Deficit		(2,915)		(1,129)		(1,833)		(1,627)
Effect of asset ceiling limit		<u>-</u>		(162)		-		
Accrued obligation	\$	(2,915)	\$	(1,291)	\$	(1,833)	\$	(1,627)

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 21. Employee future benefits and other post-retirement plans (continued):

# (d) Defined benefit plans (continued):

The actuarial losses recognized in Retained earnings through Other comprehensive income are as follows:

	Pension	Ben	efits	Othe	er Post-retir	eme	nt Benefits
	2012		2011		2012		2011
Cumulative amount,							
beginning of year	\$ 6,947	\$	2,377	\$	243	\$	113
Acquisitions	-		147		-		12
Actuarial losses	3,535		4,261		195		118
Effect of asset ceiling limit	(162)		162		-		-
Cumulative amount,	•		•	•			
end of year	\$ 10,320	\$	6,947	\$	438	\$	243

The Company's accrued benefit assets (liabilities) are included in the Company's Statement of Financial Position as follows:

	Pension Benefits			Other Post-retirement Benefits			
	2012		2011		2012		2011
Employee future benefits asset \$ Trade accounts payable and	878	\$	1,256	\$	-	\$	-
other accrued liabilities	(74)		(74)		(50)		(50)
Employee future benefits obligation	(3,719)		(2,473)		(1,783)		(1,577)
\$	(2,915)	\$	(1,291)	\$	(1,833)	\$	(1,627)

Plan assets consist of:

Asset category	2012	2011
	Percentage of	f plan assets
Equity securities	53%	48%
Debt securities	43%	48%
Other	4%	4%
Total	100%	100%

The Company's net expense for the defined benefit plans has been recognized in Production expense in Net earnings (loss) as follows:

		Pension	Ben	efits	Oth	er Post-retii	eme	nt Benefits
		2012		2011		2012		2011
Current service cost	\$	585	\$	580	\$	35	\$	29
Interest cost		2,422		2,495		80		80
Expected return on plan asse	ts	(2,965)		(2,899)		-		-
Settlement loss		-		53		-		-
	\$	42	\$	229	\$	115	\$	109
	Ψ	72	Ψ	227	Ψ	113	Ψ	107

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 21. Employee future benefits and other post-retirement plans (continued):

# (d) Defined benefit plans (continued):

Actuarial assumptions used in accounting for the Company maintained benefit plans (expressed as weighted averages) are:

	Pension Benefits		Other Post-retirement Benefits			
	2012	2011	2012	2011		
Defined benefit obligation as of Dece	ember 31			-		
Discount rate	4.19%	4.87%	4.25%	4.94%		
Compensation increases <sup>1</sup>	3.39%	3.39%	-	-		
Pension expense						
Discount rate	4.88%	5.37%	4.95%	5.42%		
Expected return on plan assets	6.16%	6.31%	-	-		
Compensation increases <sup>1</sup>	3.39%	3.39%	-	-		

<sup>&</sup>lt;sup>1</sup>Compensation increases only relate to the CMSG plan and the Seaboard plans.

For measurement purposes at December 31, 2012, the Company has assumed a 5.40% health care cost trend in 2013 grading down to 4.27% in 2015 (2011 – 6.79% health care cost trend in 2012 grading down to 4.27% in 2015).

A one percentage point increase in assumed healthcare cost trend rates would have the following effects:

Health Care Trend Rate	Plu	s 1%	Minus 1%		
Effect on aggregate service and interest cost	\$	110	\$ 89		
Effect on defined benefit obligation		1,673	1,341		

The overall expected long-term rate of return on assets is 6.16%. The expected long term rate of return is based on market conditions at the calculation date and each plan's asset mix. The actual return on plan assets in 2012 was \$3,984,000 (2011 - \$1,432,000).

Experience adjustments arising on plan liabilities in 2012 were \$132,000 (2011 – \$58,000) and experience adjustments arising on plan assets in 2012 were \$19,000 (2011 - \$262,000).

The Company expects to pay contributions of \$1,590,000 to its defined benefit plans in 2013.

# 22. Related party transactions:

### (a) Key management personnel compensation:

Key management personnel are comprised of the Company's directors and executive officers. The remuneration of key management personnel, including directors, was as follows:

	2012	2011
Salary and short-term employee benefits	\$ 2,841	\$ 3,305
Post-employment benefits	346	344
Other long-term benefits	2,538	1,230
Share-based compensation expense (recovery)	4,195	(46)
	\$ 9,920	\$ 4,833

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 22. Related party transactions (continued):

(a) Key management personnel compensation (continued):

Obligations in relation to key management personnel, including directors, is as follows:

	2012	2011
Trade accounts payable and accrued liabilities	\$ 6,419	\$ 3,640
Employee benefits obligation	2,556	2,457
Provisions and other liabilities	5,582	3,964
	\$ 14,557	\$ 10,061

(b) In 2012 the Company had lumber sales to a significant shareholder in the amount of \$1,069,000 (2011 - \$748,000).

All transactions were conducted on a normal commercial basis, including terms and prices.

# 23. Segmented information:

The Company manages its business as a single operating segment, solid wood. The Company harvests and purchases logs which are sorted by species, size and quality and then either manufactured into lumber products at the Company's sawmills, or sold. Substantially all operations are located in British Columbia, Canada and the Pacific Northwest, U.S.A.

	2012	2011
Canada	\$ 234,750	\$ 214,876
United States	365,096	263,395
China/Taiwan	103,982	137,421
Japan	105,952	98,088
Other export	 39,416	 44,465
	\$ 849,196	\$ 758,245
Sales by product line are as follows:		
· · · · · · · · · · · · · · · · · · ·	2012	2011
Lumber	\$ 631,238	\$ 538,367
Logs	113,902	108,413
Wood chips and other by products	69,376	68,355
Ocean freight and other	34,680	43,110
	\$ 849,196	\$ 758,245
Non-current assets by geographic location are as follows:		
	2012	2011
Canada	\$ 333,304	\$ 315,343
United States	126,577	136,656

\$ 459,881

\$ 451,999

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 24. Capital management:

The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Company monitors the return on average invested capital, which it defines as net earnings plus after tax interest cost divided by the average of opening and closing invested capital comprised of the total of bank indebtedness, long-term debt and shareholders' equity.

The Company seeks to maintain a balance between the higher returns that might be possible with the leverage afforded by higher borrowing levels and the security afforded by a sound capital position. The Company's target is to create value for its shareholders over the long-term through increases in share value.

In 2011, as the economy recovered from the sharp downturn of 2009 and export markets offered growth opportunities the Company reassessed its capital spending programs and approved some capital spending on discretionary projects in addition to expenditures related to maintenance of operating capacity and increased expenditures on road construction.

The Company closed a public offering of 8,222,500 Class A Subordinate Voting shares at a price of \$7.00 per share for net cash proceeds of \$54,886,000 in early April, 2011. Proceeds were initially used to reduce the Company's debt levels, and subsequently for investments in capital.

In October, 2011, the Board of Directors approved a \$24 million capital plan to upgrade the Company's Grand Forks and Castlegar sawmills. These projects were substantially completed in 2012 with the installation of a new small log line and an automated lumber grading system at Grand Forks and a series of high return projects including the installation of an automated lumber grading system at the Castlegar sawmill to focus on increasing productivity and value extraction at that mill.

There were no changes in the Company's approach to capital management during 2012. Under its debt financing agreement, the Company cannot exceed a total debt to total capitalization ratio of 45%, with total debt defined as the total of bank indebtedness, including letters of credit, and long-term debt, net of cash and cash equivalents and total capitalization defined as total debt plus Shareholders' Equity. The financial covenants under the debt financing agreement also carry a minimum working capital and a minimum net worth requirement.

The Company is in compliance with all of its debt covenants and expects to remain in compliance.

#### 25. Financial instruments:

(a) Fair value of financial instruments:

At December 31, 2012, the fair value of the Company's long-term debt and bank indebtedness approximated its carrying value of \$135,046,000 (2011 - \$110,713,000). The fair values of other financial instruments approximate their carrying values due to their short-term nature.

(b) Derivative financial instruments:

The Company employs financial instruments such as foreign currency forward and option contracts to manage exposure to fluctuations in foreign exchange rates and interest rate swaps to manage exposure to changes in interest rates. The Company does not expect any credit losses in the event of non-performance by counterparties as the counterparties are the Company's Canadian bankers, which are all highly rated.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 25. Financial instruments (continued):

# (b) Derivative financial instruments (continued):

As at December 31, 2012, the Company has outstanding foreign currency forward contract obligations to sell a maximum of US\$2,725,000 at an average rate of CAD\$0.9989 to the US\$1.00, call option obligations to sell a maximum of US\$3,000,000 at a rate of CAD\$1.01 to the US\$1.00 and put option obligations to buy a maximum of CAD\$6,060,000 at a rate of CAD\$1.01 to the US\$1.00 during 2013. All foreign currency gains or losses to December 31, 2012 have been recognized in Other foreign exchange gain (loss) in Net earnings and the fair value of these foreign currency contracts, being an asset of \$134,000 (measured based on Level 2 of the fair value hierarchy), has been recorded in Trade accounts receivable and other (December 31, 2011 - \$283,000 asset recorded in Trade accounts receivable and other measured based on Level 2 of the fair value hierarchy).

On August 25, 2011, the Company entered into two interest rate swaps, each with a notional value of \$25,000,000 and maturing July 28, 2015. Under the terms of the swaps the Company pays an amount based on a fixed annual interest rate of 1.56% and receives a 90 day BA CDOR which is recalculated at set interval dates. The intent of these swaps is to convert floating-rate interest expense to fixed-rate interest expense. As these interest rate swaps have been designated as cash flow hedges the fair value of these interest rate swaps at December 31, 2012, being a liability of \$133,000 (measured based on Level 2 of the fair value hierarchy), has been recorded in Trade accounts payable and accrued liabilities (December 31, 2011 - \$503,000 liability recorded in Trade accounts payable and accrued liabilities measured based on Level 2 of the fair value hierarchy) and a gain of \$371,000 (December 31, 2011 - \$503,000 loss) has been recognized in Other comprehensive income for the year ending December 31, 2012.

The Company also traded lumber futures to manage price risk and which were designated as held for trading with changes in fair value recorded in Other income (expense) in Net earnings. At December 31, 2012 there were no outstanding lumber futures contracts and a gain of \$25,000 was recognized in Other income (expense) on completed contracts for the year ended December 31, 2012 (December 31, 2011 - \$187,000 gain).

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.

#### (c) Hedge of investment in foreign operations:

On October 1, 2008, the Company designated the US\$30,200,000 funds drawn under its Revolving Term Line for the acquisition of its Beaver operations as a hedge against its investment in its foreign U.S. operations. Unrealized foreign exchange gains of \$667,000 in 2012 (2011 - \$676,000 loss) have been recorded in Other comprehensive income.

#### (d) Financial risk management:

Financial instrument assets include cash and cash equivalents, deposits and accounts receivable. Cash and cash equivalents and deposits and accounts receivable are designated as loans and receivables and measured at amortized cost.

Financial instrument liabilities include bank indebtedness, accounts payable and other accrued liabilities, long-term debt, and certain other long-term liabilities. All financial liabilities are designated as other liabilities and are initially measured at fair value plus any direct transaction costs and subsequently at amortized cost using the effective interest method.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 25. Financial instruments (continued):

# (d) Financial risk management (continued):

There are no financial instruments classified as available-for-sale or held-to-maturity.

The use of financial instruments exposes the Company to credit, liquidity and market risk.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities. Through its standards and procedures, management has developed a control environment in which employees are clear on roles and obligations and management regularly monitors compliance with its risk management policies and procedures.

#### (i) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises primarily from the Company's receivables from customers and from cash and cash equivalents.

#### Accounts receivable

The Company's exposure to credit risk is dependent upon individual characteristics of each customer. Each new customer is assessed for creditworthiness before standard payment and delivery terms and conditions are offered, with such review encompassing any external ratings, and bank and other references. Purchase limits are established for each customer, and are regularly reviewed. In some cases, where customers fail to meet the Company's benchmark creditworthiness, the Company may choose to transact with the customer on a prepayment basis.

All North American sales are conducted under standard industry terms. All lumber sales outside of the North American markets are either insured as to 90% of receivable amounts by the Export Development Corporation or are secured by irrevocable letters of credit.

The Company regularly reviews the collectability of its accounts receivable and establishes an allowance for doubtful accounts based on its best estimate of any potentially uncollectible accounts. Historically, the Company has managed its credit tightly and experienced minimal bad debts, despite the impacts of the global economic downturn and the growth in export markets. Based on this past experience and its detailed review of trade accounts receivable past due which were considered uncollectible, a reserve in respect of doubtful accounts of \$91,000 was recorded as at December 31, 2012 (2011 - \$146,000) for specific trade receivables.

On January 31, 2012, Catalyst Paper Corporation ("Catalyst") announced that the company and certain of its subsidiaries had obtained an Initial Order from the Supreme Court of British Columbia under the Companies' Creditors Arrangement Act ("CCAA"). Catalyst is the primary buyer of Interfor's chips on the B.C. Coast, under long-term purchase contracts. Catalyst is also a purchaser of Interfor's pulp logs and other residuals. The Court granted the Company a security interest as a critical supplier on products purchased during the restructuring process.

In June, 2012, Catalyst trade accounts receivable of \$150,000 related to pre-CCAA filing were written off. A restructuring plan was approved by Catalyst's creditors in June, 2012 and approved by the B.C. Supreme Court in July, 2012. Catalyst emerged from creditor protection in September, 2012 and continues to meet its obligations to the Company.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 25. Financial instruments (continued):

# (d) Financial risk management (continued):

# (i) Credit risk (continued):

# Deposits

The Company limits it exposure to credit risk by only investing in liquid securities and only with counterparties that have a high credit rating. As such, management does not expect any counterparty to fail to meet its obligations.

#### Guarantees

The Company did not provide any guarantees in 2012.

# Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure for receivables in North America. As log and lumber sales outside of the North American markets are insured by the Export Development Corporation to 90% or secured by irrevocable letters of credit, credit exposure for these sales is limited.

Accounts receivable carrying value at the reporting date by geographic region were:

	2012	2011
Canada	\$ 15,974	\$ 15,204
United States	17,586	14,823
Japan	6,286	8,091
China/Taiwan	4,600	3,375
Other	2,946	2,507
	\$ 47,392	\$ 44,000

#### (ii) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company ensures, as far as possible, that it will always have sufficient liquidity to meet obligations when due and monitors cash flow requirements daily and projections weekly. Weekly debt graphs are reviewed by senior management to monitor cash balances and debt line utilizations. Given the global economic downturn experienced through most of 2009 and economic uncertainty in 2010 and 2011, Company executives focused on cash management to ensure maintenance of adequate liquidity and continued this discipline through 2012.

The Company also maintains a revolving Operating Line and a Revolving Term Line that can be drawn on to meet financing needs.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 25. Financial instruments (continued):

- (d) Financial risk management (continued):
  - (ii) Liquidity risk (continued):

The estimated cash payments due in respect of contractual and legal obligations including projected major capital improvements are summarized as follows: 1

	Payments due by period						
		Up to	2-3	4-5		After 5	
	Total	1 year	years	years		years	
Trade accounts payable and							
accrued liabilities	\$ 57,581	\$ 57,581	\$ -	\$ -	\$	-	
Income taxes payable	593	593	-	-		-	
Long-term debt	135,046	-	135,046	-		-	
Reforestation liability	28,601	10,864	6,797	5,766		5,174	
Provisions and other liabilities	30,445	12,117	6,144	1,703		10,481	
Pension solvency payments	1,909	761	800	77		271	
Operating leases and expected							
capital commitments	26,620	9,970	8,580	4,220		3,850	
	•						
Total obligations	\$280,795	\$ 91,886	\$157,367	\$ 11,766	\$	19,776	

# (iii) Market risk:

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices, will affect the Company's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

# Currency risk

The Company is exposed to currency risk on cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities 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 (CAD) and U.S. dollars (USD), but also the Euro, Sterling and Yen. The Company uses forward exchange contracts and options to manage its currency risk from time to time, as described in Note 25(b), Derivative financial instruments. Daily, the Company assesses its foreign exchange exposure by reviewing outstanding contracts, pending order files and working capital denominated in foreign currencies.

At December 31, 2012, the Company has US\$ drawings under its Revolving Term Line of US\$30,200,000 (2011 – US\$30,200,000). The US\$ drawings under this Line have been designated as a hedge against the investment in the Company's net investment in its U.S. operations.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 25. Financial instruments (continued):

- (d) Financial risk management (continued):
  - (iii) Market risk (continued):

As at December 31, the Company's accounts receivable were denominated in the following currencies (in thousands):

Tollowing currencies (in thousands).			
2012	CAD	USD	Japanese ¥
Accounts receivable	17,389	14,882	79,471
Accounts receivable held by foreign			
subsidiaries with \$US functional currency	8	14,841	
	17,397	29,723	79,471
2011	CAD	USD	Japanese ¥
Accounts receivable	16,256	14,072	100,688
Accounts receivable held by foreign			
subsidiaries with \$US functional currency	-	11,898	
	16,256	25,970	100,688

As at December 31, 2012, the domestic operations of the Company held cash and cash equivalents of US\$3,982,000 (2011 – US\$3,008,000). Cash and cash equivalents held by foreign subsidiaries totaled US\$9,265,000 (2011 - US\$6,125,000).

Based on the Company's net exposure to foreign currencies as at December 31, 2012, including USD denominated cash held in deposits and cash equivalents and USD denominated long-term debt and other USD denominated financial instruments, the sensitivity of the USD balances to the Company's net annual earnings is as follows:

U.S. Dollar \$0.01 increase vs CAD\$

\$negligible decrease in net income

Based on the Company's net exposure to foreign currencies as at December 31, 2012, in respect of its net investment in U.S. subsidiaries, the sensitivity of the USD balances to the Company's Other comprehensive income (loss) is as follows:

U.S. Dollar \$0.01

\$0.01 increase vs CAD\$

\$1,271,000 decrease in OCI

#### Interest rate risk

The Company reduced its exposure to changes in interest rates on borrowings by entering into two interest rate swaps in 2011, as described in Note 25(b) Derivative financial instruments. These agreements mature on July 28, 2015. The intent of these swaps is to convert floating-rate interest expense to fixed-rate interest expense.

Based on the Company's average debt level during 2012, the sensitivity of a 100 basis point increase in interest rates would result in an approximate decrease of \$472,000 (2011 - \$424,000) in net annual earnings.

### Other market price risk

The Company does not enter into commodity contracts other than to meet the Company's expected usage and sale requirements and such contracts are not settled net.

Notes to Consolidated Financial Statements Years ended December 31, 2012 and 2011

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

# 26. Subsequent events:

#### (a) Acquisitions:

On January 21, 2013, the Company reached an agreement to acquire three sawmills in Georgia, U.S.A. from Rayonier Inc. ("Rayonier Acquisition") for US\$73,900,000 plus working capital. The transaction is scheduled to close on March 1, 2013.

# (b) Bank financing:

On January 24, 2013, the Company obtained a financing commitment from its lenders to increase and extend its syndicated credit facilties. The Revolving Term Line will increase from \$200,000,000 to \$250,000,000, conditional upon completion of the Rayonier Acquisition. The existing Operating Line remains unchanged. The financing is scheduled to close on February 27, 2013 and have a term of four years, extended from July 28, 2015.

All other terms remain substantially unchanged except for a reduction in pricing.

On January 24, 2013, the Company obtained a financing commitment from a U.S. lender for a a US\$20,000,000 Operating Line ("U.S. Line"). The U.S. Line will be secured by accounts receivable and inventories of Interfor U.S. Inc. (formerly Interfor Pacific Inc.), and have a term of two years.



# **ANNUAL INFORMATION FORM**

Dated as of February 14, 2013

#### **FORWARD LOOKING INFORMATION**

This report contains forward-looking statements. Forward-looking statements are statements that address or discuss activities, events or developments that the Company expects or anticipates may occur in the future. Forward-looking statements are included in the description of areas which are likely to be impacted by the description of future cash flows and liquidity under the headings. These forward-looking statements reflect management's current expectations and beliefs and are based on certain assumptions including assumptions as to general business and economic conditions in the U.S. and Canada, as well as other factors management believes are appropriate in the circumstances. Such forward-looking statements are subject to risks and uncertainties and no assurance can be given that any of the events anticipated by such statements will occur or, if they do occur, what benefit the Company will derive from them. A number of factors could cause actual results, performance or developments to differ materially from those expressed or implied by such forward-looking statements, including those matters described in the 2012 annual Management's Discussion and Analysis under "Risks and Uncertainties" and in Interfor's current Annual Information Form. Accordingly, readers should exercise caution in relying upon forward-looking statements and the Company undertakes no obligation to publicly revise them to reflect subsequent events or circumstance, except as required by law.

# **DESCRIPTION OF THE BUSINESS**

Interfor is a leading global supplier, with one of the most diverse lines of lumber products in the world. We have operations in British Columbia ("B.C."), Washington and Oregon, including two sawmills in the Coastal region of B.C., three in the B.C. Interior, two in Washington and two in Oregon. We also operate a value-added remanufacturing facility in Washington.

Our Company was incorporated under the *Company Act (British Columbia)* on May 6, 1963. On December 1, 1979 we amalgamated with our subsidiary, Whonnock Forest Products Limited. On January 1, 1988 we changed our name from Whonnock Industries Limited to International Forest Products Limited. On February 10, 2006 we transitioned under the *Business Corporations Act (British Columbia)*. Our head office as well as our registered and records offices are located at Suite 3500, 1055 Dunsmuir Street, Vancouver, British Columbia, V7X 1H7.

In this document, a reference to the "Company", "Interfor", "we" or "our" means International Forest Products Limited and its predecessors and all our subsidiaries. Our major subsidiary, Interfor U.S. Inc. (formerly Interfor Pacific Inc.), owns and operates our U.S. sawmills. It is wholly owned and is incorporated in the State of Washington. Other wholly owned subsidiaries whose operations are described below are CEDARPRIME Inc. (incorporated in the State of Washington), Interfor Sales & Marketing Ltd. (incorporated in British Columbia) and Interfor Japan Ltd. (incorporated in British Columbia). Effective January 5, 2011, Seaboard Shipping Company Limited ("Seaboard") became a wholly owned subsidiary of Interfor.

# **HISTORY AND RECENT DEVELOPMENT OF THE BUSINESS**

Our business originated in the 1930's with a sawmill in Whonnock, about 48 kilometres east of Vancouver B.C. Since that time, we have made significant investments to expand, upgrade and diversify our production facilities and timber base through capital programs and the acquisition of manufacturing plants and timber resources from other companies.

#### 2008

2008 was one of the most difficult periods experienced in the lumber industry in recent history. The unprecedented turmoil in financial markets along with significantly reduced demand for lumber and lower prices had a significant impact on the Company's results.

In July 2008, following a prolonged curtailment, the Company permanently closed its Queensboro sawmill division, located in New Westminster, B.C. The property was sold in the third quarter of 2009 for gross proceeds of \$30.1 million.

During the course of 2008, we acquired the Castlegar, B.C. and Grand Forks, B.C. sawmills, related timber harvesting rights and other related assets from Pope and Talbot, Inc., and acquired the Beaver and Forks sawmill, planer mill and inventories on the Olympic Peninsula, WA from Portac, Inc.

#### 2009

2009 saw extremely weak North American markets continue to challenge the lumber industry. The turbulence in financial markets, particularly in the first half of the year, combined with historically low levels of U.S. housing starts and a stronger Canadian dollar, had a significant impact on the Company's results.

Important 2009 accomplishments included the completion and impressive ramp-up of the new Adams Lake sawmill, a return to positive EBITDA for the final two quarters of 2009, and a continued strong financial position.

# 2010

2010 provided many opportunities and successes for Interfor, despite the challenges faced with stagnant U.S. housing starts. A refocus on export markets, particularly China, provided alternate markets for production and greater support for product prices, resulting in higher sales values and operating rates.

Important accomplishments in 2010 included the acquisition of a timber tenure in the Kamloops region from Weyerhaeuser Company Limited to support the increased fibre requirements of the Adams Lake sawmill; increase in lumber and log exports to take advantage of demand from China; improvements in the operating structure at the Castlegar sawmill allowed that mill to resume production and contribute to earnings. Operating earnings in the fourth guarter, 2010 were positive for the first time since 2006.

#### 2011

Overseas markets, particularly China, continued their growth in 2011 helping to offset weak North American demand and providing some stability for pricing.

In January, 2011, the Company acquired full control of Seaboard. In April, 2011, the Company closed a public offering of 8,222,500 Class "A" Subordinate Voting shares at a price of \$7.00 per share for gross proceeds of \$57.6 million in April, 2011. The net proceeds of \$54.9 million were initially used to reduce debt levels. The Company also launched a new brand initiative to build the Company's presence in the marketplace and support future growth. At the end of 2011, the Company received Board approval for capital upgrades at the Castlegar and Grand Forks sawmills.

#### 2012

North American lumber markets continued to improve in 2012 as positive economic signs began to emerge in the U.S. and concerns over sovereign debt issues in Europe were stabilized, at least in part, by government action. Activity levels in China and Japan improved as well as the year progressed. The net result was higher prices for most products especially in the second half of the year. Interfor took advantage of the improving market environment to increase operating rates with the combination of higher prices and increasing volumes contributing to better financial results relative to 2011.

In 2012, overall North American lumber market demand increased over 2011 as the U.S. economy continued to improve through 2012 with rising GDP, employment and housing starts. The Canadian economy, slowed somewhat in terms of GDP in the second half of 2012, however employment showed slight improvements and housing starts continued to show strength. Lumber shipments to China fell in

the first nine months of 2012 but began to recover in the fourth quarter of 2012. Supply constraints and the increase in North American demand impacted prices positively, year over year. Random Lengths Framing Lumber Composite price averaged US \$322 per thousand board feet (mfbm) in 2012, up 18% over 2011.

# Continued Strong Financial Position

The Company maintained its financial strength through 2012, ending the year with net debt of \$120.1 million or 24% of invested capital. In addition, cash flow from operations, after working capital changes, for the year was positive \$45.4 million.

At December 31, 2012 the Company had unused available credit and cash of \$139.1 million.

The Company spent \$60.8 million in capital improvements on its mills, logging roads, timber and intangibles in 2012. These investments will continue to enhance Interfor's competitiveness productive capacity. The Company continues to balance production against demand, while maintaining its focus on margin enhancement and cost containment.

#### Outlook

Business conditions are expected to continue to improve, albeit slowly. In the U.S. the housing market is expected to continue to recover, China remains an important market for North American lumber and further growth is expected. Building activity in Japan is expected to gain momentum in 2013 in anticipation of a planned increase in the consumption tax and as a result of reconstruction efforts following the 2011 earthquake and tsunami. Interest rates are forecasted to remain low and the Canadian dollar is expected to trade at close to parity against the U.S. Dollar.

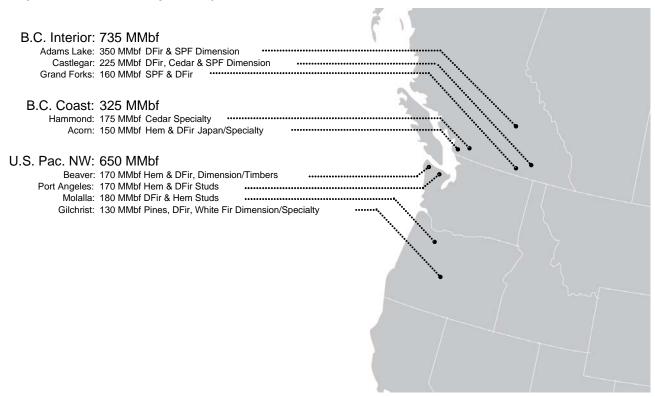
Interfor's recently announced acquisition of the three Rayonier mills will add another 360 million board feet to the Company's production capacity. While the near term outlook is more positive than it has been for some years, there are numerous challenges to the global economy that have the potential to undermine the economic recovery. With this uncertainty in mind, Interfor intends to maintain its disciplined approach to production, cost control, and inventory management while, at the same time, remaining alert to opportunities to position the Company for long-term success.

See our Management Discussion and Analysis for the year ended December 31, 2012, a copy of which is available from SEDAR at www.sedar.com.

# **MANUFACTURING**

We operate nine sawmills and one remanufacturing plant in B.C., Washington and Oregon. These operations produce a wide range of products for sale in North American and offshore markets. The products range from commodity structural lumber through to specialty products, such as exterior decking and siding, machine stress rated products, industrial timbers and a wide range of appearance grade items.

# Interfor Sawmills - Capacity (based on two-shift operation)



The mills are capable of cutting logs of various species and grades ranging in diameter from 4 inches to 80 inches. Many of our manufacturing facilities have recently been upgraded and modified to improve the matching of timber resources with customers' lumber requirements.

In addition to improving our manufacturing capability through upgrades, we have increased our efficiency and geographic diversity and expanded our capacity through recent additions of sawmills in Washington and B.C. These acquisitions also enabled us to expand our business while closing sawmills for which upgrades would not have represented a viable investment.

Rated capacity and production of lumber, by mill, for each of the periods specified, is set out in the following table:

Sawmills	Number of Shifts	Present Rated Capacity (1)	Years ended December 31				
			2012	2011	2010	2009	2008
	(per day)		(mill	ions of bo	pard feet)		
B.C. Coast							
Hammond (2)	2	175	89	80	89	80	106
Acorn	2	150	114	102	118	104	108
B.C. Interior							
Adams Lake (3)	2	350	352	353	339	134	48
Castlegar (4)	2	225	166	136	60	_	_
Grand Forks (4)	2	160	105	124	113	28	28
U.S. Pacific Northwest							
Gilchrist	2	130	102	104	90	43	56
Molalla	2	180	209	185	125	110	66
Port Angeles	2	170	120	128	103	79	72
Beaver (5)	2	170	94	52	73	83	14
Total		1,710	1,351	1,264	1,110	661	498

- (1) Based on two shifts per day and 250 operating days per year.
- (2) Volumes include lumber custom-cut at third party facilities under the direction of Hammond management amounting to 9.0 million board feet for Hammond in 2012.
- (3) The old Adams Lake sawmill was closed during 2008. The new Adams Lake sawmill began production in April 2009.
- (4) Castlegar and Grand Forks were acquired on April 30, 2008. Volumes reported are Interfor only. Castlegar was curtailed until July, 2010. Grand Forks was curtailed from February to September 2009, inclusive.
- (5) Beaver was acquired September 30, 2008.

#### **B.C. Coast Operations**

#### Hammond

The Hammond operation is located on the Fraser River in Maple Ridge, B.C. The facility is focused on western red cedar and supplies siding, decking, fascia and timbers for both offshore and North American markets. The facility consists of a three-line sawmill, a planer mill and dry kilns. In late 2010 and early 2011, the Company spent \$2.6 million on a quad upgrade and in 2011, commenced a series of projects to improve productivity and recovery at the mill, at a cost of \$2.0 million.

#### Acorn

The Acorn operation is located on leased land in Delta, B.C. The facility consists of a log dewatering and merchandizing system, a sawmill, a planer mill and dry kilns. The sawmill specializes in sizes and grades of lumber for use in Japanese traditional housing made primarily from hemlock and Douglas-fir logs.

# **B.C. Interior Operations**

#### Adams Lake

Adams Lake is located near Kamloops, B.C. The mill manufactures kiln-dried lumber for the U.S. and Canadian construction markets as well as for offshore markets. Adams Lake has the capability to cut Douglas-fir as well as spruce-pine-fir ("SPF"), western red cedar, and hemlock.

In 2007, the Company commenced the construction of a new sawmill at Adams Lake. Construction was completed on time at a cost of \$100.3 million. The first line was commissioned in December 2008, had an extremely successful start-up and commenced full operation on April 20, 2009.

The mill has been specifically designed to match the current and future timber resource in the area and to address the challenges of sawing timber affected by the Mountain Pine Beetle. The mill incorporates proven technology that materially improved the operating efficiency and cost structure of the Adams Lake operation.

In 2010, Interfor acquired a timber tenure in the Kamloops region from Weyerhaeuser Company Limited to support the increased fibre requirements of the Adams Lake sawmill, adding approximately 275,000 m<sup>3</sup> of allowable annual cut.

In 2011, Interfor completed installation of a \$3.1 million automated lumber grading system at the site. In 2012, the Company installed a new kiln for \$2.9 million and commenced installation of a dust control system at an estimated cost of \$1.2 million.

#### Grand Forks

Our Grand Forks mill was acquired April 30, 2008 as part of our purchase of Pope and Talbot's southern B.C. assets. The mill is located in the southern interior of B.C. on a 75 acre site. We also acquired timber tenures with an allowable annual cut of 503,000 m³. The mill manufactures kiln dried lumber for the U.S. and Canadian construction markets as well as the housing market in Japan. Grand Forks cuts 75% SPF and 25% fir-larch. In 2006, the previous owner completed a modernization and upgrade of the sawmill with a new planer mill and two new thermal oil kilns.

In late 2011, Interfor approved the installation of a new small log line to replace the existing two-line facility and the installation of an automated lumber grading system. Construction started in late 2011 and was substantially completed in 2012, significantly ahead of schedule, with the new line commencing start-up procedures in December, 2012. Including the expanded scope of enhancements approved in 2012, the Company spent a total of \$20.1 million, and a further \$4.2 million on an upgrade of the mill's log and lumber storage.

#### Castlegar

Our Castlegar facilities were acquired April 30, 2008 as part of our purchase of Pope and Talbot's southern B.C. assets. In addition to timber tenures with an allowable annual cut of 450,000 m³, the facility includes a sawmill, dry kilns and planer and manufactures fir-larch, SPF, cedar and hemlock dimension lumber. The operation includes a complete transportation system for moving logs on Arrow Lake. The operation of the mill was curtailed from February, 2008 through June, 2010 due to poor market conditions and an unfavourable cost structure. Marked improvements to the cost structure through changes in the operating configuration achieved with the support of the mill's employees and other local stakeholders allowed the mill to restart in July, 2010.

In late 2011, Interfor approved a series of high return projects, including the installation of an automated lumber grading system focused on increasing productivity and value extraction. A total of \$4.2 million was spent on these projects in 2012.

# **U.S. Operations**

#### **Gilchrist**

The Gilchrist mill is located in Gilchrist, Oregon on approximately 140 acres. The mill primarily processes lodgepole pine, ponderosa pine and white fir to produce a wide range of specialty and dimension lumber products. The mill has an on-site cogeneration plant to produce electricity for its own use as well as steam for its dry kilns. At this location, we own and operate a short line railroad to connect to a mainline for shipment of lumber and chips. In late 2012, approval was given to install a state-of-the-art moulder with a budget of US\$4 million that will allow the mill to compete in the high-end board market, with construction to start in 2013.

# Port Angeles

The Port Angeles mill is situated in Port Angeles, Washington on a 64 acre site near a major highway and waterways which are convenient for shipping lumber and chips as well as for receiving logs at the mill. The mill primarily processes hemlock and Douglas-fir logs to produce stud dimension lumber for the U.S. market but is also capable of producing metric sizes for export.

#### Beaver

The Beaver sawmill consists of a single line 20' dimension sawmill on a 45 acre owned site originally constructed in 1991 by Portac Inc. We acquired the assets on September 30, 2008. The boiler, dry kilns, and planermill are situated approximately 15 kilometres south of the sawmill on a 29 acre site leased from the City of Forks. The operation is 75 kilometres west of our Port Angeles facility and is a strong strategic fit with that operation. The mill has traditionally produced hemlock, Douglas-fir and spruce products for domestic markets. Recently we have added some export products to complement the domestic programs.

#### Molalla

The Molalla mill was acquired in May 2005. It is located in Molalla, Oregon approximately 50 kilometres southeast of Portland. The mill primarily processes hemlock and Douglas-fir logs to produce stud lumber for the U.S. market. The mill's machine centres were fully optimized by the previous owners. A number of infrastructure improvements were undertaken in 2005 and 2006, including the construction of two dry kilns and a planermill complex with grade optimization.

# Cedarprime

CEDARPRIME Inc. is located on leased premises in Sumas, Washington approximately one kilometre south of the Canada/U.S. border. The plant has a siding line, chop line, planing and finger-jointing equipment as well as access to on-site dry kilns enabling it to produce 20 million board feet of finger-jointed and cut-stock products for both offshore and North American markets.

# SALES, MARKETING AND COMPETITIVE POSITION

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 Interfor's lumber production is sold in markets where Interfor competes against many producers of approximately the same or larger capacity. Some of Interfor's competitors have greater financial resources than the Company and a number may be, in certain product lines, lower cost producers than Interfor.

The following table shows our lumber sales by geographic area and total sales by product line for the past five years:

	Years ended December 31 <sup>1</sup>				
	2012	2011	2010	2009	2008
		(tho	usands of doll	ars)	
Lumber					
— Canada	\$ 84,760	\$ 64,412	\$ 70,247	\$ 40,886	\$ 45,996
— U.S.A	319,365	222,524	213,166	137,927	137,985
— Japan	87,609	78,423	65,314	48,726	35,766
— China	73,886	102,453	61,384	16,305	3,251
<ul><li>Other export</li></ul>	31,353	30,995	40,437	34,369	61,554
Offshore transportation and handling	34,265	39,560	29,636	12,765	11,473
	631,238	538,367	480,184	290,978	296,025
Logs	113,902	108,413	79,763	60,443	103,620
Wood chips and other residuals	69,376	68,355	56,217	34,349	30,610
Ocean freight, contract services					
and other	34,680	43,110	7,655	6,356	5,557
Total sales	\$849,196	\$758,245	\$623,819	\$392,126	\$435,812

The Company uses forward foreign exchange contracts which are designated as held for trading and are carried on the Statement of Financial Position at fair value. Previously changes in fair value were recorded as an adjustment to Sales in Net earnings. Effective January 1, 2012, the Company changed its accounting policy to align with the presentation adopted by companies in its peer group and changes in fair value are now recorded in Other foreign exchange gain (loss) in Net earnings. The policy has been applied on a retrospective basis and comparative information has been restated.

#### **Lumber Sales**

Lumber is similar to many other commodities in that demand is cyclical. Factors such as interest rates, exchange rates, freight rates, government tariff and import policies, and demand for housing affect the demand for lumber. In recent years, the residential repair and remodeling market in North America has become a significant consumer of lumber and has lessened the impact of fluctuations in new housing starts. In order to diminish the impact of rapid cyclical changes in any one market, we strategically target worldwide markets and maintain product diversification. The Company has a particular customer and product base in various countries, providing us with a diversified sales profile, including targeting the rapidly growing Wood Frame Construction market in China. Product and market diversification is particularly important for B.C. Coast producers where the variability inherent in the log resource produces a much wider spectrum of product sizes and quality than is the case in the B.C. Interior or U.S. Pacific Northwest (the "PNW"). A continuing priority for us is to develop products and markets that more fully realize the potential for higher grades, special dimensions and value-added items.

Lumber sales and marketing activities are organized into two sales groups to leverage global expertise: Export, and North America. Interfor Japan Ltd., with an office in Tokyo, has developed niche markets and has increased sales directly to end users. We also have an office in France to serve Continental Europe and Middle East markets and recently opened an office in China. The major market for our cedar lumber continues to be North America where markets are serviced through a combination of regional wholesale distributors and direct retail sales. Gains have been made, however, in diversifying cedar sales into offshore markets in Europe, China, Japan, and Australia. North American dimension and stud lumber produced in Canada and the U.S. is sold out of our office in Bellingham, Washington to leverage our market expertise and to provide a more diverse customer base for the Canadian mills in terms of geographic and market sectors.

# Log Sales

We purchase and sell logs in order to obtain the appropriate size, grade, and species of log to suit market conditions and each mill's cutting preferences. We buy or trade logs through agreements and open market transactions and sell logs that are either unsuitable for cutting or in excess of our manufacturing requirements.

# **Wood Chips and Other Residuals Sales**

As a by-product of lumber production, our sawmills produce wood chips and other residuals. Essentially all of our wood chips produced in B.C. are sold under short and long-term contracts to pulp producers. In general, wood chips produced on the B.C. Coast are sold at prices related to current Northern Bleached Softwood Kraft ("NBSK") pulp prices, while the wood chips produced in the B.C. Interior are sold at current market prices for chips. Chips from our Washington and Oregon operations are sold to pulp producers or fibre board manufacturers under short-term arrangements.

### **DISTRIBUTION**

We use various modes of surface transportation to deliver our lumber products. Shipments to export markets are made in container and breakbulk vessels while shipments of lumber within North America are made by truck and rail. The majority of breakbulk shipments are carried by Seaboard International Shipping Company Limited (Barbados) which is a wholly-owned subsidiary of Seaboard. In January, 2011 Seaboard became a wholly-owned subsidiary of Interfor. Chips and logs are normally delivered by tug and barge or by truck. In Gilchrist, Oregon, and in Grand Forks, B.C., we own short line railroads that connect to Class 1 railroads for shipping lumber and chips.

#### **TIMBER SUPPLY**

#### **British Columbia**

The Province of British Columbia (the "Crown") owns about 95% of the timberlands from which the majority of timber is harvested. The remaining 5% of timberland is private land which is primarily located on Vancouver Island and held by a few large industrial forest landowners.

The Province provides for the use of Crown forest land through the granting of various forms of timber tenures. These tenure agreements provide timber harvesting rights in exchange for management obligations and stumpage fees payable to the Crown.

Our timber supply needs are met by a combination of internal logs harvested from our own timber tenures, long-term trade and supply agreements, and by purchases on the open market. When operating at normal capacity, our mills in B.C. would require approximately one-third of their log supply from external sources.

We hold various Forest Licence ("FL"), Tree Farm Licence ("TFL") and Timber Licence ("TL") tenures that currently provide for an allowable annual cut ("AAC") of approximately of 3.8 million cubic metres ("m³"). The majority of Interfor's tenures are long-term (15 and 25 year) renewable agreements that are generally replaced every five years.

On the Coast, we harvest a variety of species consisting primarily of western hemlock, amabilis fir, western red cedar and Douglas-fir. In the Interior, the species mix consists of spruce, pine, fir, Douglas-fir, larch and cedar. The harvest is derived from both old growth and second growth stands. Whereas one-third of the harvest currently comes from second growth stands on the coast, this amount is expected to increase significantly over the next several decades.

The following table shows our AAC under our FL and TFL tenures and other cutting rights and the volume of timber harvested under our FLs and TFLs and other cutting rights in each region for the periods specified. They also show the volume of purchases and sales during that period.

	Years ended December 31					
B.C. Operations	2013	2012	2011	2010	2009	2008
	(thousands of cubic metres)					
Allowable Annual Cut (1)						
<ul><li>Forest Licences</li></ul>	2,684	2,684	2,701	2,426	2,418	2,084
<ul> <li>Non Replaceable Forest Licences</li> </ul>	286	286	220	313	313	375
— Tree Farm Licences	801	801	801	854	867	196
<ul> <li>Discretionary Annual Harvest Levels (2)</li> </ul>	40	40	40	40	40	40
	3,811	3,811	3,762	3,633	3,638	2,695
Log Production						
— Coast		1,526	1,757	1,522	1,081	1,754
<ul><li>Interior</li></ul>		1,770	1,651	1,139	214	127
Total Log Production	_	3,296	3,408	2,661	1,295	1,881
Log Purchases	<u>-</u>	1,156	1,133	1,349	795	448
Log Sales	_	1,352	1,356	1,081	919	1,319

- (1) AAC status at the beginning of each year (includes a provision for non-recoverable fibre).
- (2) Volumes not included in AAC.

#### **U.S. Pacific Northwest**

Timber supply in the PNW is sourced from a broad distribution of forest land ownership (forest industrial lands; small private landowners; and State and Federal lands). These sources represent a long-term supply base from which mills purchase their timber supply. About 70% of the log supply in the PNW comes from land that is owned by industrial and small private landowners, while the remainder is sourced from State, Federal and tribal lands.

Our timber supply requirements in Washington are weighted to western hemlock with lesser volumes of Douglas-fir and sitka spruce. In Molalla, Douglas-fir is the prominent species with smaller volumes of western hemlock and white fir. Both the Washington mills and Molalla depend on private industrial landowners and small private landowners for the majority of their supply. This timber is supplemented with State, Federal, and tribal volumes in the case of the Washington mills.

In Gilchrist, log purchases consist primarily of lodgepole pine, ponderosa pine and white fir that is harvested from second growth forests and the thinning of young stands from surrounding National Forests. This volume is supplemented with purchases from industrial and non industrial private land.

The total 2013 log supply requirement for the mills in the U.S. is projected to be supplied from various sources, estimated to be as follows:

U.S. Pacific Northwest Operations	Expected Sources of Timber 2013
State and Federal Lands	31%
Industrial Lands	62
Private Lands	<u>_7</u>
	<u>100%</u>

# Forestry and Logging in B.C.

Forest and timber harvesting operations on Crown land in B.C. are regulated under the B.C. Government's *Forest and Range Practices Act (British Columbia)* and the *Forest Act (British Columbia)*. The Government is responsible for setting the AAC, approving forest development plans and cutting permits, determining the stumpage system and managing compliance and enforcement.

Our Company is required to manage forest resources under our tenures in accordance with the requirements of the applicable laws and regulations. Forest management of our tenures is guided by a team of forest professionals that are engaged in a wide array of activities such as resource planning, forest development, road building and harvesting, reforestation, forest protection and environmental certification.

We pay stumpage to the Province for timber harvested on Crown land according to market pricing systems in place on the Coast and in the Interior. In addition the Crown charges an annual rent based on the AAC for each licence to cover general administration and fire preparedness.

Our Coastal logging operations are widely dispersed in primarily remote locations between Vancouver and Prince Rupert. Our Interior woodlands operations are located at Adams Lake, northeast of Kamloops, and in the Kootenay region at Nakusp and Grand Forks. Woodlands harvesting activities are performed entirely by independent logging contractors.

Logging operations are seasonal due to a number of factors including weather, ground conditions and fire season closures. These and other factors are described in the Selected Quarterly Financial Information section of our Management Discussion and Analysis for the year ended December 31, 2012, a copy of which is available on SEDAR at <a href="https://www.sedar.com">www.sedar.com</a>.

### **CAPITAL EXPENDITURES**

Our acquisitions and capital expenditures on sawmill and logging operations and timber holdings are as shown in the following table:

	Years ended December 31						
	2012	2011	2010	2009	2008		
	(thousands of dollars)						
Acquisitions Land, buildings, equipment and other intangibles							
Manufacturing     Forestry and logging	_	_	_	_	\$52,885 —		
Logging roads and timber		_	_	_	40,148		
	_	_	_	_	\$93,033		
Other capital expenditures Land, buildings, equipment and other intangibles							
<ul><li>Manufacturing and other</li><li>Forestry and logging</li></ul>	\$39,688 231	\$15,487 738	\$10,720 169	\$20,752 29	\$72,911 1,365		
Logging roads and timber	20,892	19,987	31,398	6,811	17,512		
	60,811	36,212	42,287	27,592	91,788		
Total	\$60,811	\$36,212	\$42,287	\$27,592	\$184,821		

Our capital expenditures over the five years ended December 31, 2012 were financed through internally generated funds, through our bank lines and through proceeds generated from share issuances and the sale of surplus land,logging and manufacturing assets.

#### **HUMAN RESOURCES**

In B.C., we directly employ approximately 980 people in our logging and manufacturing operations and corporate offices. The United Steel Workers ("USW") is the certified bargaining agent for approximately 490 of these people. The agreement with the USW for the B.C. Coast has an expiry date of June 15, 2014, while the Southern Interior USW agreement expires on June 30, 2013. The Canadian Marine Service Guild represents 24 employees, and their collective agreement expires September 30, 2014.

In the U.S., we employ approximately 565 employees in our sawmill and remanufacturing operations in Washington and Oregon and in our office located in Bellingham, Washington.

Our employees are governed by a Corporate Policy Manual, including an Anti-Bribery and Anti-Corruption Policy, Brand Use Policy, Code of Conduct, Compensation Policy, Disclosure Policy, Environment Policy, Financial Reporting Policy, Harassment Policy, Health and Safety Policy, Information Technology Use Policy, Insider Trading Policy, Social Media Policy and Whistleblower Policy. The Code of Conduct may be found on SEDAR at <a href="https://www.sedar.com">www.sedar.com</a>. The Environment and Health and Safety Policies are described below. Employees are also protected by a Privacy Policy. Our employees, management and directors have adopted the following Core Values:

#### **Core Values**

We will conduct ourselves with honesty, integrity and professionalism.

People: People are the foundation of our company.

• **Safety:** Safety is a prerequisite for work.

• **Environment:** Environmental integrity must be maintained in everything we do.

Customers: Customers pay our way.

Shareholders: Returns to our shareholders facilitate investment, employment and

public benefits.

We Are Responsible For Our Own Success

#### **HEALTH AND SAFETY**

Our Health and Safety Policy embodies our commitment to the health, safety and well-being of all employees.

Our Board approved the policy and established a committee of the Board to monitor these safety commitments. The Environment and Safety Committee of the Board ("E&S Committee") is mandated to monitor the implementation and maintenance of our policy of ongoing commitment to health and safety values and principles with continuous operational improvement. The E&S Committee ensures that our management develops, implements and maintains a comprehensive safety program.

Safety is a core value for us. We maintain an active and comprehensive safety program at each of our operations.

We continued to make good progress at each of our operations and our injury metrics in 2012 were comparable to 2011. Our Medical Incident Rate increased to 3.4 from 3.3 and our Lost Time Accident frequency increased to 1.1 from 1.0 when compared to 2011.

# **Health and Safety Policy**

Health and Safety is the uncompromised right and responsibility of all employees.

- We will integrate Health and Safety into our business with the knowledge that all accidents are preventable.
- We will hold all levels of management accountable for providing a safe work environment and enforcing safe work practices, including timely follow-up of safety incidents.
- We will train all employees to identify hazards and to protect themselves and fellow workers.
- We will hold all employees and contractors working for Interfor accountable for following safe work practices and reporting unsafe acts and conditions.
- We will use audits to measure and improve our Health and Safety performance.
- We will actively involve our employees in effective Safety programs.
- We will operate in compliance with Health and Safety Regulations.
- We will monitor and report regularly on our Health and Safety performance.

International Forest Products Limited is committed to the health, safety, and well being of all employees.

# THE ENVIRONMENT

Our Environment Policy embodies our commitment to responsible stewardship of the environment. Our Board approved the policy and established a committee of the Board to monitor our commitment to principles, values and policies on environmental matters.

# **Environment Policy**

We are committed to responsible stewardship of the environment.

- We will minimize environmental impact, prevent pollution and strive for continuous improvement of our environmental performance.
- We will operate in compliance with all applicable laws pertaining to the environment.
- We will regularly review our practices and procedures to monitor and report on environmental performance.
- We will provide training for employees and contractors in environmentally responsible work practices.
- We will manage our forest resources in a sustainable manner that is environmentally appropriate, socially beneficial and economically viable.
- We will promote the use of our wood products as a good choice for the environment.

# **Corporate Environment Oversight**

Management has implemented an environmental compliance program. We maintain an Environmental Management System ("EMS") for all of our woodlands and manufacturing facilities. The EMS provides a structure for identifying, addressing and managing environmental issues. Audits are performed regularly in both the woodlands and manufacturing operations to verify its effectiveness.

We are a global leader in environmental management through the application of science-based principles, collaborative approaches, sustainable forest practices and independent certifications. We were a recipient of the 2000 Millennium Business Award from the United Nations Environmental Programme and the International Chamber of Commerce, a co-recipient of World Wildlife Fund's Gift to the Earth award in 2007 and a recipient of an SFI Conservation Leadership award in 2009 for a partnership with Aboriginal people along British Columbia's Pacific Coast.

Additional information about our environmental work, audit summaries and Responsibility Report is available on our website at <a href="https://www.interfor.com">www.interfor.com</a>.

### Woodlands

Environmental Management Systems

Environmental Management Systems are in place for both Coastal Woodlands and Interior Woodland Operations. These systems are modeled after ISO 14001 Standards and provide a framework for continual improvement in our environmental management and for forest management.

Sustainable Forest Management

Sustainable forestry meets present day needs without compromising the ability to meet the needs of future generations. Sustainable forestry integrates the reforesting, stand tending and harvesting of trees with conservation of soil, air and water quality, biological diversity, wildlife and aquatic habitat, recreation and visual aesthetics.

The Company employs professional foresters to prepare detailed harvest and reforestation plans that integrate information from a variety of resource assessments. Interfor achieves its reforestation obligations by preparing site specific plans for each area harvested. Using a combination of planting with ecologically appropriate species and natural regeneration, each hectare harvested is restocked within a set time frame. In 2012 Interfor planted 10.6 million trees in B.C.

### Forest Management Certification

To provide our customers and stakeholders with added assurance of Interfor's superior performance in sustainable forest management, Interfor has achieved independent third party certification on 100 per cent of our woodlands operations.

The Company maintains two Sustainable Forestry Initiative ("SFI") forest management certifications: B.C. Coastal Woodlands Operations, and B.C. Interior Operations namely Adams Lake, Grand Forks and Castlegar.

In preparation for the external audits, internal audits were conducted by Company personnel. The audit protocol included both an office document review and a field review of selected harvesting, planning and silviculture activities. Action plans were developed to address a handful of minor issues. The internal audit reports and action plans were made available to the external auditor.

Annual external audits were conducted by KPMG Performance Registrar Inc. ("KPMG"). The audits found that both the coast and interior operations were in full compliance with the SFI requirements. There were no new non-conformances identified. In addition several 'Good Practices' and 'New Opportunities for Improvement' pertaining to planning and operational activities were noted in both the Coastal and Interior audits. Public summary reports of the external audits have been prepared by KPMG and are posted on our Company website.

Interfor also has Forest Stewardship Council ("FSC") forest management certification on its tenures in the mid-coast Timber Supply Area as part of group certification held by Coast Forest Conservation Initiative ("CFCI"). As of December 31, 2012 the certificate has been temporarily suspended pending resolution of a Corrective Action Request item related to public participation.

#### Regulatory Compliance

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

There were no new incidents reported from the Ministry of Forests and Natural Resource Operations Compliance and Enforcement Program in 2012.

#### Coast Forest Conservation Initiative

Interfor continues to be a member of the CFCI – a collaborative effort of five B.C. forest product businesses committed to finding new approaches to forest conservation and management in B.C.'s Central and North Coast.

CFCI collaborates with the Rainforest Solution Project (a group of environmental organizations namely Forest Ethics, Greenpeace and the Sierra Club, B.C. Chapter) in a forum known as the Joint Solutions Project ("JSP"). JSP works with the B.C. Government and First Nations on strategic items related to the implementation of ecosystem based management ("EBM"). In 2012 JSP focused considerable energy on negotiations regarding how best to attain full implementation of EBM by March 2014.

#### First Nations

First Nations ("FN") groups have claimed aboriginal title and rights over substantial portions of British Columbia. Interfor tenures overlap with the traditional territories of 57 different FN groups. The Company notifies each FN group prior to development activities as part of the Forest Stewardship Plan preparation process. It is our desire to establish a working relationship with each of the FN groups where we operate.

#### Mountain Pine Beetle

The Mountain Pine Beetle ("MPB") infestation has resulted in the mortality of a significant portion of the mature pine trees in the B.C. interior The greatest impact has been in the central interior region where there is a high percentage (over 60%) of pine in the forest. These areas will also see the greatest reductions in timber supply once the shelf life of the dead pine trees is exceeded in the next 5 to 10 years.

Interfor operations in the southern interior have a much lower percentage of pine (less than 30%) and are less affected by the MPB, both in terms of mortality and the impact on future timber supply. Harvesting the dead pine trees is a priority for the operations as part of a salvaging and recovery process. The longer term timber supply impacts of the MPB are not expected to have a significant impact on the Company's operating areas.

# Climate Change

The affects of climate change on forest ecosystems is not well understood. The Company monitors the current research being done by the Province and will modify practices as appropriate as part of our sustainable forest management plans.

# Continual Improvement

Interfor's approach to managing the environment involves the process of continual improvement. Each year a formal Management Review of the Company's program and performance is done by senior Company representatives. In 2012 a Management Review was completed for both the Coast and Interior operations.

#### Manufacturing

# Environmental Management System

We maintain an EMS for all of our manufacturing facilities. Each manufacturing business unit is responsible for compliance and ensuring the EMS is functioning as intended.

#### Mill Audits

Environmental compliance audits are carried out annually at each mill. In 2012 these audits were completed by independent environmental consultants at 10 mill sites.

### Regulatory Compliance

Interfor monitors its compliance with all applicable permits and environmental legislation. As at December 31, 2012 Interfor was in compliance with all regulatory permits.

#### Chain of Custody (CoC) and Responsible Purchasing

Interfor maintains Chain-of-Custody ("CoC") certification at certain mills that tracks certified logs coming from sustainably managed forests through the manufacturing process. Interfor's Canadian mills are certified to both SFI and PEFC CoC Standards. The coastal B.C. mills are also certified to FSC CoC Standards. The CoC certificates are subject to annual third party audits.

# Green House Gas Emissions

Reporting regulations for Green House Gas ("GHG") emissions are currently being implemented in both Canada and the U.S. All of the Company's mills are in compliance with GHG emission regulations.

#### **Energy Efficiency**

Interfor performs various energy system audits at its mill sites to improve energy efficiency and to compare alternative power systems. In 2012, the audits resulted in system improvements being made at the Castlegar and Hammond mills. Further analysis on boiler use and different fuel sources were done for our U.S. mills.

#### Carbon Reductions

At the Adams Lake sawmill a biomass-fired energy system had been installed to provide heat for lumber-drying and space-heating. The system replaced the reliance on liquefied natural gas and equates to an annual reduction of 16,000 tonnes of carbon emissions. In 2012 the Company successfully completed a verification of the carbon savings and received an offset credit from the Pacific Carbon Trust.

#### Best Practices

All mills have programs in place to recycle used oil, oil filters, steel wire, strapping, old equipment, batteries, cardboard, paper and fluid containers. Each year thousands of liters of used oil and several tonnes of used steel are recovered and recycled.

In 2012, Interfor produced a new "Responsibility Report" that describes the Company's approach to operating safe and sustainable operations. The report is available on our website.

#### **Environmental Liabilities**

#### Site Rehabilitation

As part of the Pope and Talbot purchase agreement in 2008 a \$1.1 million accrual was set up to address a potential future liability for the environmental cleanup of the Castlegar Mill foreshore and landfill site. In 2012 Interfor commissioned more detailed environmental ground water sampling of the land fill. The results from these tests were favourable, which resulted in the accrual amount being reduced to \$0.6 million to cover any future environmental cleanup costs.

#### RESEARCH AND DEVELOPMENT

We contribute to and participate in industry research organizations that have made numerous technical developments beneficial to us in areas such as sawing technology, drying techniques, and anti-sapstain applications. We also are committed to applied research and development in the areas of environment, health and safety, forest management and product and market development. We also conduct product and market research on our own in Canada and the U.S.

# **CAPITAL STRUCTURE**

The authorized share structure of the Company consists of:

- 100,000,000 Class "A" Subordinate Voting shares without par value ("Subordinate Voting Shares");
- 1,700,000 Class "B" Common shares without par value ("Multiple Voting Shares"); and
- 5,000,000 Preference shares without par value issuable in series with such special rights and restrictions as the Directors of the Company may determine before issue thereof ("Preference Shares").

The Subordinate Voting Shares and Multiple Voting Shares are referred to as "Equity Shares".

# **Subordinate Voting Shares**

The holders of Subordinate Voting Shares are entitled to non-cumulative preferential dividends of 13 1/3 cents per annum for each share in priority to any dividends paid on the Multiple Voting Shares and to further participate, share for share with the Multiple Voting Shares, in any dividends paid on the Equity Shares for any fiscal year after 13 1/3 cents per share has been paid or set aside for payment on the Subordinate Voting Shares. The holders of Subordinate Voting Shares are entitled to one vote on a poll for each share held and the holders of the Subordinate Voting Shares are entitled, as a class, to elect one member of the Board and if there are no Multiple Voting Shares outstanding, are entitled to elect the entire Board except in certain circumstances where the holders of Preference Shares are entitled to elect two Directors.

The provisions relating to the Subordinate Voting Shares may not be varied unless sanctioned by a special resolution of the holders of the Subordinate Voting Shares and the Multiple Voting Shares voting together and by separate resolutions of the respective holders of the Subordinate Voting Shares and the Multiple Voting Shares, the special resolution and separate resolutions in each case requiring a majority of three-fourths of the votes cast.

In the event of liquidation, dissolution or winding-up of the Company or any other distribution of its assets, holders of Subordinate Voting Shares are entitled to declared and unpaid dividends prior to the holders of the Multiple Voting Shares and thereafter to participate, share for share, with the Multiple Voting Shares, subject to all rights of the holders of Preference Shares.

# **Multiple Voting Shares**

The holders of Multiple Voting Shares are entitled to participate, share for share, with the Subordinate Voting Shares, in any dividends paid for any fiscal year after 13 1/3 cents has been provided for payment on the Subordinate Voting Shares. The holders of Multiple Voting Shares are entitled to ten votes on a poll for each share held and the holders of Multiple Voting Shares are entitled, as a class, to elect all members of the Board except one member to be elected by the holders of the Subordinate Voting Shares, as a class, and, in certain circumstances, two Directors to be elected by the holders of Preference Shares.

In the event of liquidation, dissolution, or winding-up of the Company or any distribution of its assets, holders of Multiple Voting Shares are entitled after payment of any declared and unpaid dividends on the Subordinate Voting Shares to participate, share for share, with the Subordinate Voting Shares, subject to all rights of the holders of Preference Shares.

Any holder of Multiple Voting Shares is entitled at any time to exchange his Multiple Voting Shares for Subordinate Voting Shares on a share for share basis without adjustment for any unpaid dividends.

The provisions relating to the Multiple Voting Shares may not be varied unless sanctioned by a special resolution of the holders of the Subordinate Voting Shares and the Multiple Voting Shares voting together and by separate resolutions of the respective holders of the Subordinate Voting Shares and the Multiple Voting Shares, the special resolution and separate resolutions in each case requiring a majority of three-fourths of the votes cast.

In the event of any subdivision, consolidation, or conversion of either Subordinate Voting Shares or Multiple Voting Shares, an appropriate adjustment is to be made in the rights and conditions attaching to the Subordinate Voting Shares and the Multiple Voting Shares to preserve the benefits conferred on the holders of each class.

# Rights on Take-Over Bids and Conversion of Multiple Voting Shares

Any transfer of a Multiple Voting Share:

- a. by any of W.L. Sauder's executors, administrators, or other trustee or legal representative with respect to his personal estate, members of his immediate family, their descendants and controlled companies (collectively the "Controlling Shareholder Group") to any person other than another member of the Controlling Shareholder Group or a person (the "Qualified Purchaser") who is acquiring a majority of the outstanding Multiple Voting Shares and who makes an offer to purchase all outstanding Subordinate Voting Shares, Preference Shares, and Multiple Voting Shares at an equivalent price; or
- b. by a Qualified Purchaser to any person other than another Qualified Purchaser,

will result in the automatic conversion of the Multiple Voting Shares into Subordinate Voting Shares.

The Multiple Voting Shares will be automatically converted into Subordinate Voting Shares if:

- a. the Controlling Shareholder Group or a Qualified Purchaser ceases to beneficially own more than 50% of the issued and outstanding Multiple Voting Shares; or
- b. the Controlling Shareholder Group or a Qualified Purchaser ceases to beneficially own equity shares carrying at least 9.2 million votes, subject to adjustments upon: (i) the subdivision, consolidation, or reclassification of any outstanding equity shares, or (ii) the issue of equity shares by way of a stock dividend other than an ordinary course stock dividend.

#### **Preference Shares**

The Preference Shares of each series rank on a parity with the Preference Shares of every other series, and are entitled to preference over the Equity Shares and over any other shares ranking junior to the Preference Shares with respect to payment of dividends and the distribution of assets of the Company in the event of liquidation, dissolution, or winding-up of the Company.

# **MARKET FOR SECURITIES OF THE COMPANY**

The Subordinate Voting Shares are listed on the Toronto Stock Exchange under the symbol IFP.A. The following table sets out the market price ranges and trading volumes for the Subordinate Voting Shares on the Toronto Stock Exchange for each month during 2012 (January 1, 2012 through December 31, 2012).

Toronto Stock Exchange (TSX) 2012 Trading Volumes Ticker: IFP.A					
Month	\$ High	\$ Low	Volume		
January	4.89	4.26	1,714,239		
February	4.78	4.26	3,007,331		
March	5.55	4.60	1,237,983		
April	4.89	4.39	862,471		
May	4.83	4.28	1,924,082		
June	5.10	4.50	1,901,252		
July	5.30	4.88	1,395,947		
August	5.90	5.10	788,809		
September	6.04	5.57	1,750,198		
October	6.50	5.86	2,517,912		
November	7.36	6.23	3,144,086		
December	8.72	7.10	8,536,755		

# **TRANSFER AGENTS**

The transfer agent for our Subordinate Voting Shares is Computershare Investor Services Inc. at its principal offices in Vancouver, British Columbia.

# **DIRECTORS AND OFFICERS**

# Directors as of February 14, 2013

The following table sets out the Company's directors as of February 14, 2013, their respective municipalities of residence, principal occupations within the past five years and the period during which each director has served as a director.

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Name and Municipality of Residence	Director Since	Principal Occupations	From	То
DUNCAN K. DAVIES Vancouver, BC, Canada	November 1998	President and Chief Executive Officer International Forest Products Limited	2000	Present
HAROLD C. KALKE West Vancouver, BC, Canada	July 2000	President and Founder Kalico Developments Ltd., a real estate development and management company	1971	Present
PETER M. LYNCH	October 2006	Corporate Director	2010	Present
Toronto, ON, Canada		Executive Vice President and Director Grant Forest Products Inc. (and its predecessor), a producer of OSB and engineered wood products	1993	2010
GORDON. H. MacDOUGALL West Vancouver, BC, Canada	February 2007	Vice Chairman and Director Connor, Clark & Lunn Investment Management Ltd., an asset management firm	2007	Present
		Partner Connor, Clark & Lunn Investment Management Partnership	1996	2006
<b>J. EDDIE McMILLAN</b> Pensacola, Florida, USA	October 2006	Independent Business Consultant	2002	Present
rensacoia, Fiorida, USA		Executive Vice President – Wood Products Group Willamette Industries, Inc., a forest products company	1998	2002
ANDREW K. MITTAG	October 2012	Senior Vice President, Agrium Inc. and President, Agrium Advanced Technologies, a major retail supplier of agricultural products and services, a global wholesale producer and marketer of major agricultural nutrients and industrial products	2005	Present
E. LAWRENCE SAUDER Vancouver, BC, Canada	April 1984	Chief Executive Officer Sauder Industries Limited, a manufacturer and distributor of building products	2010	Present
		Chairman Sauder Industries Limited	2007	Present
		Chairman Hardwoods Distribution Inc.	2008	Present
JOHN P. SULLIVAN Vancouver, BC, Canada	May 2001	Corporate Director	2003	Present
variedaver, 56, Gariada		Vice President International Forest Products Limited	2001	2003
L. SCOTT THOMSON	October 2012	Executive Vice-President, Finance and Chief Financial Officer, Talisman Energy Inc., a global upstream oil and gas company	2008	Present
		Executive Vice-President, Corporate Development and Planning, Bell Canada Enterprises, Inc. and Bell Canada	2006	2008

DOUGLAS W.G. WHITEHEAD North Vancouver, BC, Canada	April 2007	Corporate Director	2008	Present
		President and Chief Executive Officer Finning International Inc., a distributor of Caterpillar products and support services	2000	2008

To our knowledge, only one of the Company's directors has in the last 10 years been an officer or director of a company that, while the person was acting in that capacity, was subject to bankruptcy or similar proceedings or securities regulatory sanctions described in National Instrument 51-102 *Continuous Disclosure Obligations*. From 1993 to 2010, Mr. Lynch was an executive director of Grant Forest Products Inc. ("Grant Forest"). On June 25, 2009, Grant Forest filed and obtained protection under the Companies' Creditors Arrangement Act in order to restructure its business affairs.

The term of office for all current directors will end on the day of the next Annual General Meeting of the Company's shareholders. The next Annual General Meeting is scheduled for May 10, 2013.

#### **Committees of the Board**

The Company currently has four Committees of the Board:

- Audit Committee
- Corporate Governance & Nominating Committee
- Management Resources & Compensation Committee
- Environment & Safety Committee

The members of each Committee are indicated below.

	Audit Committee	Management Resources & Compensation Committee	Corporate Governance & Nominating Committee	Environment & Safety Committee
Duncan K. Davies				
Harold C. Kalke	X	X		
Peter M. Lynch	X		X	Χ
Gordon H. MacDougall		Chair	X	
James E. McMillan		X	Chair	
Andrew K. Mittag		X		Χ
E. Lawrence Sauder				Χ
John P. Sullivan	Х			Chair
L. Scott Thomson	х			Χ
Douglas W.G. Whitehead	Chair		Χ	

# Officers as of February 14, 2013

The following table sets out the Company's officers as of February 14, 2013, their respective municipalities of residence and their principal occupations for at least the last five years:

Name and Municipality of Residence	Positions Held	From	То
DUNCAN K. DAVIES Vancouver, BC, Canada	President & Chief Executive Officer International Forest Products Limited	2000	Present
JOHN A. HORNING West Vancouver, BC, Canada	Senior Vice President & Chief Financial Officer International Forest Products Limited	2002	Present
OTTO F. SCHULTE Black Creek, BC, Canada	Vice President, Coastal Operations International Forest Products Limited	2011	Present
	Vice President, Coastal Woodlands International Forest Products Limited	2000	2011
RICHARD J. SLACO Delta, BC, Canada	Vice President & Chief Forester International Forest Products Limited	2002	Present
<b>J. STEVEN HOFER</b> Bellingham, Washington, USA	Vice President, Sales & Marketing International Forest Products Limited	2011	Present
	General Manager, Sales & Marketing Interfor U.S. Inc. (formerly Interfor Pacific Inc.)	2004	2011
MARILYN LOEWEN MAURITZ Vancouver, BC, Canada	General Counsel & Corporate Secretary International Forest Products Limited	2012	Present
	General Counsel International Forest Products Limited	2007	Present
MARK STOCK North Vancouver, BC, Canada	Vice President, Human Resources International Forest Products Limited	2012	Present
	Vice President, Global Human Resources Tree Island Industries Ltd.	2007	2012

#### SHAREHOLDINGS OF DIRECTORS AND OFFICERS

As at December 31, 2012, the directors and officers of the Company as a group owned, directly or indirectly, or exercised control of or direction over 2,742,457 Subordinate Voting Shares representing approximately 5.0% of the outstanding Subordinate Voting Shares and 1,011,895 Multiple Voting Shares representing approximately 99.6% of the outstanding Multiple Voting Shares. In respect of the foregoing, the outstanding Multiple Voting Shares are owned by Sauder Industries Limited. Sauder Industries Limited is indirectly owned in part by Mr. Sauder, the non-executive Chairman of the Company. Mr. Sauder controls or directs the exercise of the voting rights attached to the voting securities of the Company held by Sauder Industries Limited with respect to routine matters such as the election of directors and appointment of auditors.

#### INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

Since the commencement of our most recently completed financial year, and for the three most recently completed financial years, no director or executive officer of the Company, no person or company that is the direct or indirect beneficial owner of, or who exercises control or direction over, more than 10% of the Company's voting securities or any associate or affiliate of such persons, has had any material interest in any transaction involving the Company.

#### **LEGAL PROCEEDINGS**

We are not a party to, and our property is not the subject of, any material legal proceedings which are currently in place or which we know to be contemplated.

# **INTEREST OF EXPERTS**

KPMG LLP are the external auditors of the Company and have confirmed that they are independent with respect to the Company within the meaning of the Rules of Professional Conduct of Institute of Chartered Accountants of British Columbia and the applicable rules and regulations thereunder.

#### **AUDIT COMMITTEE INFORMATION**

#### The Audit Committee Terms of Reference

The Audit Committee (the "Committee") is appointed by the Board to assist the Board in fulfilling its oversight responsibility relating to:

- a. the integrity of the Company's financial statements,
- b. the financial reporting process,
- c. the systems of internal accounting and financial controls,
- d. the professional qualifications and independence of the external auditors,
- e. the performance of the external auditors, risk management processes,
- f. financial plans,
- g. pension plans, and
- h. compliance by the Company with ethics and legal and regulatory requirements.

The Committee's Terms of Reference, attached as Appendix "A" to this Annual Information Form, sets out its responsibilities and duties.

The Committee met 4 times in 2012 in conjunction with regularly scheduled Board meetings.

#### **Composition of the Audit Committee**

The Committee consists of 5 directors: Douglas W.G. Whitehead (Chair), Harold C. Kalke, Peter M. Lynch, John P. Sullivan and L. Scott Thomson. Each Committee member is independent and financially literate in compliance with *Multilateral Instrument 52-110 – Audit Committees*.

# **Relevant Education and Experience**

The following is a brief summary of the education and experience of each member of the Committee that is relevant to the performance of his responsibilities as a member of the Committee, including any education or experience that has provided the member with an understanding of the accounting principles used by the Company to prepare its annual and interim financial statements.

Mr. Douglas W.G. Whitehead (Chairman of the Audit Committee)

Mr. Whitehead is a Corporate Director. From 2000 to 2008, he was the President and Chief Executive Officer of Finning International Inc. ("Finning"), a distributor of Caterpillar products and support services. Prior to joining Finning, Mr. Whitehead held a number of senior executive positions with Fletcher Challenge Canada, including President and Chief Executive Officer, Senior Vice President and Chief Operating Officer and Vice President of the Crown Packaging Division. Mr. Whitehead is also currently Chairman and director of Finning and a director of Belkorp Industries Inc., Inmet Mining Corporation and KAL Tire. He is also a member of the Board of Directors of the Vancouver General Hospital and the University of British Columbia Hospital Foundation.

Mr. Whitehead holds a Bachelor of Applied Sciences (Civil Engineering) from the University of British Columbia and a Master of Business Administration from the University of Western Ontario.

Mr. Whitehead has served on the Committee since April 2009 and chaired the Committee since May 2012.

Mr. Harold C. Kalke

Mr. Kalke is the founder and President of Kalico Developments Ltd., a real estate development and management company, since 1971. He has founded and operated several other companies in the real estate development business and oil and gas sector. Mr. Kalke is a past Chairman of the Board of Governors of the University of British Columbia.

Mr. Kalke holds a Bachelor of Science (Engineering) and a Masters of Business of Administration from the University of Western Ontario.

Mr. Kalke has served on the Committee since April 2012.

Mr. Peter M. Lynch

Mr. Lynch is a Corporate Director. From 1993 to 2010, he was the Executive Vice President and a director of Grant Forest Products Inc. (and its predecessor), a producer of OSB and engineered wood products. Prior thereto, he practiced law.

Mr. Lynch holds a Bachelor of Laws from Osgoode Law School and is a member of the Law Society of Upper Canada, the Canadian Bar Association and the Ontario Bar Association.

Mr. Lynch has served on the Committee since April 2009.

Mr. John P. Sullivan

Mr. Sullivan is a Corporate Director. From 2001 to 2003, he was Vice President of the Company. He joined the Company following the acquisition of Primex Forest Products Ltd. ("Primex"), where he was Vice President, Corporate Development from 1987 to 2001. Prior to 1987, he held various management positions at Primex. Over the past years, he has served on many boards including Primex, as well as several federal crown and private companies.

Mr. Sullivan has served on the Committee since April 2012.

#### Mr. L. Scott Thomson

Mr. Thomson is currently Executive Vice-President, Finance and Chief Financial Officer of Talisman Energy Inc., where he is responsible for finance, mergers and acquisitions, tax, treasury, investor relations, information technology, marketing and planning and is a key advisor on Talisman's current strategic direction. Previously, he was Executive Vice President, Corporate Development and Planning, and Vice President, Head of Mergers and Acquisitions at Bell Canada Enterprises Inc.

Mr. Thomson holds a Bachelor of Arts (Economics and Political Science) from Queen's University and a Masters of Business Administration (Finance and Accounting) from the University of Chicago.

Mr. Thomson has served on the Committee since November 2012.

#### **AUDIT FEES**

The Committee annually recommends the appointment of the Company's external auditors and approves the annual audit plan and compensation of the external auditors for all audit, audit related and non-audit services. In the case of non-audit services, the services and compensation is approved by the Committee before the services commence.

KPMG LLP, Chartered Accountants, Vancouver, are the independent auditors of the Company. Fees paid or accrued to KPMG LLP for audit and other services for the years ended December 31, 2012 and December 31, 2011 were as follows:

	2012	2011
Audit fees Fees billed for professional services rendered by KPMG	\$423,000	\$588,987
Audit-related fees Audit-related fees consist principally of fees for professional services rendered with respect to audits of a defined benefit pension plan, subsidiary companies, and consultation related to accounting issues.	62,500	43,000
Tax fees Tax fees consist of fees for tax compliance services, professional services related to U.S. cross border transfer pricing and sales tax and tax credit contingency fees which are based on percentage of recoveries	52,837	154,015
Other fees  Advice regarding the application of International Financial Reporting Standards and certifications (2011); assistance with defining business requirements for a new ERP system selection, a related process re-design and certifications (2012)	<u>174,800</u>	<u>64,400</u>
TOTAL	<u>\$713,137</u>	<u>\$850,402</u>

#### **CODE OF ETHICS**

We have adopted a code of ethics that applies to our directors, officers and employees. A copy of the code, entitled "Code of Conduct", can be found on our website at <a href="https://www.interfor.com">www.interfor.com</a>.

# **ADDITIONAL INFORMATION**

Additional information relating to the Company, including directors' and officers' remuneration and indebtedness, principal holders of the Company's securities and securities authorized for issuance under equity compensation plans, is contained in the Company's Information Circular.

Additional financial information about the Company is provided in the Company's financial statements and Management's Discussion and Analysis for the year ended December 31, 2012.

Copies of the documents referred to above are available on the SEDAR website at <a href="www.sedar.com">www.sedar.com</a> and may also be obtained upon request from:

International Forest Products Limited General Counsel & Corporate Secretary 3500-1055 Dunsmuir Street Vancouver, British Columbia Canada, V7X 1H7

Telephone: 604 689 6800 Facsimile: 604 689 6825 E-mail: info@interfor.com

Additional information relating to the Company may be found on the SEDAR website at www.sedar.com.

# Appendix "A"

# AUDIT COMMITTEE Terms of Reference

#### **PURPOSE**

The Audit Committee has been established by the Board and under powers delegated to it by the Board is mandated to oversee the accounting and financial reporting processes of the Company and audits of its financial statements in accordance with the Board's objectives.

#### COMPOSITION AND TERM OF OFFICE

- 1. The Audit Committee shall consist of four or more Directors.
- 2. All members of the Audit Committee shall be independent within the meaning of *Multilateral Instrument 52-110-Audit Committees*.
- 3. All members must be financially literate or become financially literate within a reasonable period following appointment and at least one member should have accounting or related expertise.
- 4. The Chairman of the Audit Committee along with other Audit Committee members will be appointed annually by the Board following the AGM to hold office until the next AGM, unless the member becomes unable to serve or is removed by the Board. A casual vacancy may be filled and additional members may be appointed at any time by the Board to hold office until the next AGM.
- 5. A quorum shall consist of a simple majority.

#### **DUTIES AND RESPONSIBILITIES**

The Audit Committee shall perform the following functions, as well as any other functions specifically authorized by the Board:

#### General

- 1. Schedule regular meetings and meet, at a minimum, four times per year. Extraordinary meetings may be called by any member of the Audit Committee or at the request of the Chairman of the Board.
- 2. Appoint a Secretary who shall record the proceedings of the Audit Committee's meetings.
- 3. Report to the Board activities and recommendations, if any, requiring Board approval.

# Financial Disclosure, Risk Management and Internal Controls

- 4. Review the following documents before the public disclosure of same by the Company, and, if appropriate, recommend approval by the Board of the Company's:
  - (a) annual and quarterly financial statements;
  - (b) Management's Discussion and Analysis; and
  - (c) annual and interim earnings press releases.

The review will involve direct discussions with Management and the Company's external auditor (the "Auditor"), including an opportunity for an in-camera meeting with the Auditor independent of Management.

Review and approve the disclosures required by applicable securities laws to be included in the Company's Annual Information Form and Management Information Circular relating to the Audit Committee and audit and non-audit services and fees.

- 5. Review the process for certification of the interim and annual financial statements by the CEO and Chief Financial Officer ("CFO") and the certification made by the CEO and CFO.
- 6. Review all news releases announcing financial results, containing financial information based on unreleased financial results or non-GAAP financial measures or providing earnings guidance, forward-looking financial information and future-oriented financial information or financial outlooks before the public disclosure of same by the Company.
- 7. Review financial information contained in any prospectus, take-over bid circular, issuer bid circular, rights offering circular and any other document that the Audit Committee is to review before the public disclosure of same by the Company, and, if appropriate, recommend approval by the Board.
- 8. Review matters related to internal controls over financial reporting of the Company and ensure the Company has adequate procedures in place in respect thereof. Ensure that the necessary measures are taken to follow up suggestions from the Auditor's reports.
- 9. Review the principal risks of the Company and ensure that an effective risk management strategy is in place.
- 10. Review the Company's derivatives policies and activities, including details of exposures to banks and other counterparties.

#### **External Auditor**

- 11. Review and recommend to the Board the appointment of the Auditor to be nominated for the purposes of preparing or issuing an Auditor's report and performing other audit, review or attest services for the Company.
- 12. Establish the mandate of the Auditor, including the annual engagement, audit plan, audit scope and compensation for the audit services, subject to shareholder approval.
- 13. Oversee the activities of the Auditor. The Auditor shall report directly to the Audit Committee.
- 14. Directly communicate and meet with the Auditor, with and without Management present, to discuss the results of their examinations.
- 15. Review the independence of the Auditor, any rotation of the partners assigned to the audit in accordance with applicable laws and professional standards, the internal quality control findings of the Auditor's firm and peer reviews.
- 16. Review the performance of the Auditor, including the relationship between the Auditor and Management and the evaluation of the lead partner of the Auditor.
- 17. Resolve disagreements between Management and the Auditor regarding financial reporting.
- 18. Review material written communications between the Auditor and Management.

#### **Non-Audit Services**

19. Pre-approve non-audit services. The Audit Committee may delegate to one or more of its members the authority to pre-approve non-audit services. The pre-approval of non-audit services by any member to whom authority has been delegated shall be presented to the Committee at its first scheduled meeting following such pre-approval.

# **Company Policies**

- 20. Satisfy itself that adequate procedures are in place for the review of the public disclosure of financial information extracted or derived from the Company's financial statements and periodically assess the adequacy of those procedures.
- 21. Establish and periodically review the policies and procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submissions by the employees of the Company regarding questionable accounting or auditing matters.
- 22. Review and approve the Company's hiring policies regarding partners, employees and former partners and employees of the former and present Auditor.

#### Insurance

23. Review the Company's insurance programs, including the Company's directors' and officers' insurance coverage, and make recommendations for their renewal or replacement.

#### **AUTHORITY**

- 1. The Audit Committee is authorized to engage any outside advisor it deems necessary to carry out its duties and responsibilities and to arrange payment of the advisor's compensation by the Company.
- 2. The Audit Committee may, at the request of the Board or at its own initiative, investigate such other matters as it considers appropriate in furtherance of the Audit Committee's purpose.

#### **GLOSSARY**

- "Adjusted EBITDA" EBITDA less other income, other income of associate company and long-term incentive compensation expense.
- "Allowable Annual Cut (AAC)" The average annual volume of timber which the holder of a licence from the Province of British Columbia may harvest on Crown land under the licence in a five-year control period.
- "Bone Dry Unit (BDU)" A unit of measurement for wood chips and other sawmill by-products, being equal to 2,400 pounds.
- "Cash flow from operations" Cash generated from operations before considering changes in operating working capital.
- "Custom cutting" An arrangement under which a mill contracts to cut logs owned by a customer into products of specifications defined by the customer.
- **"EBITDA"** Earnings before finance costs, income taxes, depreciation, depletion, amortization, restructuring costs, other foreign exchange gains and losses, and write-downs of plant and equipment and other non-financial assets.
- "Forest Licence" Replaceable, volume-based timber cutting rights for a specific volume of Crown timber within a Timber Supply area.
- "Invested Capital" The total of bank indebtedness, short term advances from the Seaboard partnership, long-term debt and shareholders' equity.
- "Invested Capital, adjusted" Invested Capital less cash, deposits and short term advances from the Seaboard partnership.
- "m³" A measure of one cubic metre of solid wood, British Columbia metric scale, as determined under the Forest Act, equal to 35.3 cubic feet of solid wood.
- "Mfbm" or "Mbf" One thousand foot board measure equal to one thousand square feet of lumber, one inch thick.
- "Net debt" Total Debt less cash, deposits and short term advances from the Seaboard partnership.
- "Pre-tax return on total assets" Earnings (loss) before taxes, restructuring costs, other foreign exchange gains and losses, and write-downs of plant and equipment and other non-financial assets, and Other income divided by closing total assets.
- "Silviculture" The art and science of controlling the establishment, growth, composition, health and quality of forests.
- "Stumpage" A charge assessed by the provincial government on all Crown timber harvested.
- "Sustained yield (sustainable log supply)" The yield that a forest area can produce on an ongoing basis without impairment of the long-term productivity of the land.
- "Timber Licence" Non-replaceable, area based, Crown timber cutting rights.
- "Total Debt" The total of bank indebtedness, short-term advances from the Seaboard partnership, long-term debt.
- "Tree Farm Licence" A renewable 25-year licence to manage a forest area to yield an annual harvest on a sustainable basis.
- "Value-added product" A commodity or other product that has been further processed to increase financial value.
- "**Volumetric unit**" A unit of measurement for wood chips and other sawmill by-products, being equal to 200 cubic feet. A volumetric unit represents between 60% and 85% of the chips in a Bone Dry Unit, depending on the species.
- "Whitewood" Includes the Coastal species hemlock, Balsam Fir, Douglas-fir and spruce; the term whitewood is used on British Columbia Coast to differentiate the above species from Red Cedar and Yellow Cedar.

**DIRECTORS** 

D.W.G. Whitehead (Lead Director)

North Vancouver, BC

D.K. Davies

Vancouver, BC

H.C. Kalke

West Vancouver, BC

P.M. Lynch

Toronto, ON

G.H. MacDougall

West Vancouver, BC

J.E. McMillan

Pensacola, Florida

A.K. Mittag

Calgary, AB

E.L. Sauder (Chairman of the Board)

Vancouver, BC

J.P. Sullivan

Vancouver, BC

L. Scott Thomson

Calgary, AB

**OFFICERS** 

E.L. Sauder

Chairman

D.K. Davies

President & Chief Executive Officer

J.A. Horning

Senior Vice President & Chief Financial Officer

J.S. Hofer

Vice President, Sales & Marketing

M.W. Stock

Vice President, Human Resources

O.F. Schulte

Vice President, Coastal Operations

R.J. Slaco

Vice President & Chief Forester

M.S. Loewen Mauritz

General Counsel & Corporate Secretary

#### **CORPORATE INFORMATION**

#### STOCK EXCHANGE

Class "A" shares listed on The Toronto Stock Exchange

Symbol: IFP.A

#### **AUDITORS**

KPMG LLP, Vancouver, BC

#### TRANSFER AGENT

Computershare Investor Services Inc. Vancouver, BC and Toronto, ON

#### MEDIA CONTACT

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### **SALES & MARKETING**

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#### **EUROPE**

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# OPERATIONS & LOCATIONS – CANADA

# ACORN DIVISION (Sawmill)

Tel: (604) 581-0494 Fax: (604) 581-5757 9355 Alaska Way Delta, BC, Canada V4C 4R7

# ADAMS LAKE DIVISION (Sawmill and Woodlands)

Tel: (250) 679-3234 Fax: (250) 679-3545 9200 Holding Road

Chase, BC, Canada V0E 1M2

# CASTLEGAR DIVISION (Sawmill)

Tel: (250) 365-4400 Fax: (604) 422-3252 P.O. Box 3728 2705 Arrow Lakes Drive Castlegar, BC, Canada V1N 3W4

# CASTLEGAR DIVISION (Woodlands)

Tel: (250) 265-3741 Fax: (604) 422-3251 P.O. Box 2000 442 Highway 6 West

Nakusp, BC, Canada VOG 1R0

# **COASTAL FIBRE SUPPLY**

Tel: (604) 422-3400 Fax: (604) 422-3452 600-2700 Production Way Burnaby, BC, Canada V5A 4X1

#### **COASTAL WOODLANDS DIVISION**

Tel: (250) 286-1881 Fax: (250) 286-3412 1250A Ironwood Street Campbell River, BC, Canada V9W 6H5

# GRAND FORKS DIVISION (Sawmill and Woodlands)

Tel: (250) 443-2400 Fax: (604) 422-3253 P.O. Box 39 570 68<sup>th</sup> Ave. Grand Forks, BC, Canada VOH 1H0

# HAMMOND DIVISION (Sawmill)

Tel: (604) 465-5401 Fax: (604) 422-3221 20580 Maple Crescent

Maple Ridge, BC, Canada V2X 1B1

# OPERATIONS & LOCATIONS – US

# BEAVER DIVISION (Sawmill)

Tel: (360) 327-3377 Fax: (360) 327-3563 P.O. Box 38 200673 Highway 101 West Beaver, WA 98305

# BEAVER DIVISION (Planermill)

Tel: (360) 374-4374 Fax: (360) 374-4331 P.O. Box 2299 143 Sitkum-Solduc Road Forks, WA 98331

# GILCHRIST DIVISION (Sawmill)

Tel: (541) 433-2222 Fax: (541) 433-9581 P.O. Box 638 #1 Sawmill Road Gilchrist, OR 97737

# MOLALLA DIVISION (Sawmill)

Tel: (503) 829-9131 Fax: (503) 829-5481 15555 S. Hwy. 211 Molalla, OR 97038

# PORT ANGELES DIVISION (Sawmill)

Tel: (360) 457-6266 Fax: (360) 457-1486 243701 Highway 101 West Port Angeles, WA 98363

# CEDARPRIME INC. A Subsidiary of International Forest Products Limited (Remanufacturing)

Tel: (360) 988-2120 Fax: (360) 988-2126 601C West Front Street Sumas, WA 98295