INTERFOR

# Interfor Corporation
# First Quarter Report
## For the three months ended March 31, 2017

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## Management's Discussion and Analysis

**This Management's Discussion and Analysis ("MD&A") provides a review of financial condition and results of operations as at and for the three months ended March 31, 2017 ("Q1'17"). It should be read in conjunction with the unaudited consolidated financial statements of Interfor Corporation and its subsidiaries ("Interfor" or the "Company") for the three months ended March 31, 2017, and the notes thereto which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). This MD&A contains certain non-GAAP measures which, within the Non-GAAP Measures section, are discussed, defined and reconciled to figures reported in the Company's consolidated financial statements. This MD&A has been prepared as of May 4, 2017.**

**All figures are stated in Canadian Dollars, unless otherwise noted, and references to US$ / USD are to the United States Dollar. For definitions of technical terms and abbreviations used within this MD&A, refer to the Glossary in the Company's 2016 Annual Report.**

### Forward-Looking Statements

This MD&A contains information and statements that are forward-looking in nature, including, but not limited to, statements about the Company's business outlook, objectives, plans, strategic priorities and other statements that are not historical facts. A statement Interfor makes is forward-looking when it uses what is known today, to make a statement about the future. Forward-looking statements are included under the headings "Overview of First Quarter 2017", "Outlook", "Liquidity", "Capital Resources", "Off-Balance Sheet Arrangements", "Financial Instruments and Other Instruments", and "Accounting Policy Changes", and such statements may include words such as "believes", "will", "could", "should", "expected", "anticipate", "intend", "forecast", "target", "outlook" and "strategy". Such forward-looking statements are based on Interfor's current expectations and certain assumptions, including assumptions regarding lumber, log and wood chip prices; the Company's ability to compete; the availability and cost of log supply; the absence of natural or man-made disasters; currency exchange rates; no material changes in government regulation; the availability of the Company's allowable annual cut ("AAC"); the outcome of aboriginal claims and treaty settlements; the Company's ability to export its products; the outcome of the softwood lumber trade dispute between Canada and the U.S.; stumpage rates payable to the Province of British Columbia; environmental effects of the Company's operations; the absence of labour disruptions; and other factors referenced herein and in Interfor's 2016 annual Management's Discussion & Analysis under the heading "Risk and Uncertainties", which is available on www.sedar.com and www.interfor.com. Such forward-looking statements involve known and unknown risks and uncertainties that, if they eventuate, may cause Interfor's actual results to be materially different from those expressed or implied by those forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking information or statements. Interfor undertakes no obligation to update such forward-looking information or statements, except as required by law.

## Overview of First Quarter 2017

Q1'17 Results

Interfor recorded net earnings in Q1'17 of $19.7 million, or $0.28 per share, compared to $26.6 million, or $0.38 per share in Q4'16 and $0.8 million, or $0.01 per share in Q1'16. Adjusted net earnings in Q1'17 were $22.7 million or $0.32 per share, compared to $17.7 million, or $0.25 per share in Q4'16 and $2.7 million, or $0.04 per share in Q1'16.

Adjusted EBITDA was $60.3 million on sales of $456.8 million in Q1'17 versus $51.3 million on sales of $442.3 million in Q4'16.

Notable items in the quarter included:

- Higher Lumber Prices
  - Key benchmark lumber prices increased during Q1'17 as a result of strong demand in both North American and international markets. The Southern Pine Composite increased US$23 to US$416 per mfbm, while the Western SPF Composite and KD H-F Stud 2x4 9' benchmarks were up US$34 to US$339 per mfbm and US$42 to US$360 per mfbm, respectively.
  - Interfor's average lumber selling price increased from $588 per mfbm in Q4'16 to $604 per mfbm in Q1'17. A substantial portion of the announced price increases that occurred in Q1'17 were realized in the later part of the quarter. Therefore, Interfor's average lumber selling price for the month of March, 2017 was $27 per mfbm higher than the average lumber selling price for Q1'17.
- Strong Cash Flow
  - Interfor generated $59.7 million in cash from operations in Q1'17, or $0.85 per share, before considering working capital changes.
  - Working capital increased by $55.0 million during the quarter as a result of several seasonal and non-recurring items, including: (i) the US$10 million contingent payment that was made to the former owner of the Tacoma sawmill; (ii) a $7.5 million increase in B.C. Interior log inventories ahead of spring breakup; (iii) an $11.0 million increase in lumber inventories due to an increase in production and various logistics issues; (iv) a $15.6 million increase in accounts receivables driven by increased lumber shipments and lumber prices towards the end of the quarter; and (v) $12.4 million in payments related to annual employee incentive plans.
  - Capital spending was $20.7 million in Q1'17 as compared to $19.8 million in Q4'16.
  - Net debt ended the quarter at $306.7 million, or 27.6% of invested capital.
- Production Gains Across Most Regions
  - In order to meet strong customer demand, Interfor increased lumber production in most of its regions. This resulted in 640 million board feet of production in Q1'17, up 33 million board feet over the preceding quarter. Sales of Interfor–produced lumber were 624 million board feet in Q1'17 versus 598 million board feet in Q4'16.
  - Production in the U.S. South region was up in Q1'17, increasing to 285 million board feet (equivalent to an operating rate of 86%) from 260 million board feet in the preceding quarter. The B.C. and U.S. Northwest regions accounted for 215 million board feet (equivalent to operating rates of 97% in the B.C. Interior and 43% on the B.C. Coast) and 140 million board feet (equivalent to an operating rate of 88%) in Q1'17, respectively, compared with 209 million board feet and 137 million board feet in Q4'16, respectively.
  - The B.C. Coast logging business was negatively impacted by difficult winter conditions that resulted in log production and log revenues declining by 18% and 39%, respectively, in Q1'17 versus Q4'16.

- Progress on Optimization Initiative and EBITDA Gains
  - In early 2016, Interfor launched a Business Optimization Initiative to capture additional margin opportunities across the Company's operating platform, with a particular focus on the U.S. South region, where $35 million in annualized EBITDA gains were targeted by year-end 2017. In Q1'17, the Company realized on 45% of the targeted EBITDA gains.
  - The Q1'17 gains were mostly realized in the later part of the quarter when various operational and product mix improvements allowed the Company to proceed with its plan to add incremental operating hours at certain mills.
  - The Company previously stated that its goal was to achieve an operating rate in the South of 90% or more by Q4'17. The Company is ahead of schedule, with the operating rate averaging 91% during the month of March.

## Softwood Lumber Duties

Following the quarter end, the U.S. Department of Commerce ("DoC") preliminarily ruled on its case against Canadian softwood lumber producers. As a result, the U.S. Customs and Border Protection Agency will begin collecting deposits from Interfor on April 28, 2017, for countervailing duties at a preliminary rate of 19.88% on its shipments of softwood lumber from Canada into the U.S.

In addition, the DoC has taken the unjustified position that most Canadian lumber producers, including Interfor, may be required to submit a deposit for retroactive countervailing duties for the 90-day period from January 28 to April 27, 2017. Interfor does not believe the retroactive application of duties will stand up under final scrutiny which, in turn, should result in a full return of the related deposit to the Company.

In Q1'17, Interfor shipped approximately 100 million board feet from its Canadian operations to the U.S. market, which represented approximately 16% of the Company's total lumber sales. Interfor is of the view that the DoC's positions are without merit and are politically driven. Interfor intends to vigorously defend the Company's and the Canadian industry's positions through various appeal processes, in conjunction with the B.C. and Canadian Governments.

## Outlook

Interfor expects demand for lumber to continue to grow over the mid-term as the U.S. housing market recovers and market promotion efforts in North America and offshore take full effect. In addition, the Company is focused on a series of targeted initiatives related to margin improvement opportunities across its operations in both the U.S. and Canada that should contribute to Interfor's financial results.

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

## Financial and Operating Highlights [1]

| | Unit | Mar. 31 2017 | Mar. 31 2016 | Dec. 31, 2016 |
|---|---|---|---|---|
| | | For the 3 months ended | | |
| **Financial Highlights[2]** | | | | |
| Total sales | $MM | 456.8 | 433.9 | 442.3 |
| Lumber | $MM | 389.6 | 348.9 | 363.5 |
| Logs, residual products and other | $MM | 67.2 | 85.0 | 78.8 |
| Operating earnings | $MM | 30.4 | 3.5 | 22.3 |
| Net earnings | $MM | 19.7 | 0.8 | 26.6 |
| Net earnings per share, basic | $/share | 0.28 | 0.01 | 0.38 |
| Adjusted net earnings [3] | $MM | 22.7 | 2.7 | 17.7 |
| Adjusted net earnings per share, basic [3] | $/share | 0.32 | 0.04 | 0.25 |
| Adjusted EBITDA[3] | $MM | 60.3 | 33.4 | 51.3 |
| Adjusted EBITDA margin[3] | % | 13.2% | 7.7% | 11.6% |
| Total assets | $MM | 1,318.8 | 1,323.8 | 1,301.6 |
| Total debt | $MM | 325.4 | 439.3 | 308.8 |
| Pre-tax return on total assets[3] | % | 9.5% | 1.3% | 7.4% |
| Net debt to invested capital[3] | % | 27.6% | 37.8% | 26.9% |
| **Operating Highlights** | | | | |
| Lumber production | million fbm | 640 | 618 | 607 |
| Total lumber sales | million fbm | 645 | 637 | 619 |
| Lumber sales - Interfor produced | million fbm | 624 | 609 | 598 |
| Lumber sales - wholesale and commission | million fbm | 21 | 28 | 21 |
| Lumber - average selling price[4] | $/thousand fbm | 604 | 548 | 588 |

Notes:

(1) Figures in this table may not equal or sum to figures presented elsewhere due to rounding.
(2) Financial information presented for interim periods in this MD&A is prepared in accordance with IFRS and is unaudited.
(3) Refer to the Non-GAAP Measures section of this MD&A for a definition and reconciliation of this measure to figures reported in the Company's consolidated financial statements.
(4) Gross sales before export taxes.

## Summary of First Quarter 2017 Financial Performance

### Sales

Interfor recorded $456.8 million of total sales, up 5.3% from $433.9 million in the first quarter of 2016, driven by the sale of 645 million board feet of lumber at an average price of $604 per mfbm. Lumber sales volume increased 8 million board feet, or 1.3%, while average selling prices increased $56 per mfbm, or 10.2%, as compared to the same quarter of 2016.

The increase in the average selling price of lumber reflects higher prices across all benchmark products in Q1'17 as compared to Q1'16. The Western SPF Composite and Southern Pine Composite benchmark improved US$77 to US$339 per mfbm and US$53 to US$416 per mfbm, respectively. The KD HF Stud 2x4 9' benchmark was up US$28 to US$360 per mfbm. The positive impact of increased U.S. Dollar lumber prices was somewhat lessened by the strengthening of the Canadian Dollar against the U.S. Dollar by 3.6% on average in Q1'17 as compared to Q1'16.

Sales generated from logs, residual products and other decreased by $17.8 million or 20.9% compared to the same quarter of 2016. This decrease is related to a 34.9% drop in log production on the B.C. Coast due to winter storms, lower chip prices and chip sales volumes, and the stronger Canadian Dollar in Q1'17 versus Q1'16. Q1'16 log sales revenues were also higher as the Tacoma sawmill wound down operations and disposed of log inventories.

Operations

Production costs decreased by $6.1 million or 1.5% over the first quarter of 2016, explained primarily by the stronger Canadian Dollar as noted above, partially offset by an increase in lumber sales volumes by 8 million board feet, and higher average log and cash conversion costs in Q1’17 compared to Q1’16.

Depreciation of plant and equipment was $19.6 million, down by 2.8%, affected by the stronger Canadian Dollar, on average, in Q1’17 versus Q1’16.

Depletion and amortization of timber, roads and other was $6.3 million, down $1.7 million from Q1’16, as winter storms hampered logging on the B.C. Coast.

Corporate and Other

Selling and administration expenses were $12.4 million, up $1.6 million from the first quarter of 2016. The first quarter of 2017 included accruals for short term incentive compensation and certain IT infrastructure improvements, not reflected in the Q1’16 comparative.

The $3.6 million long term incentive compensation expense mostly reflects the impact of incentive awards maturing, coupled with a 14.3% increase during the quarter in the price of Interfor Common Shares used to value share-based awards. The $0.2 million long term incentive compensation expense in Q1’16 resulted primarily from the impact of incentive awards maturing, partially offset by a 2.4% decrease in the market price for Interfor Common Shares during that quarter.

Finance costs were $4.1 million, or $1.1 million lower than the first quarter of 2016, due mainly to a lower average level of debt outstanding in Q1’17 as compared to Q1’16.

Restructuring charges in Q1’17 relate to costs associated with the relocation of a sales office. Q1’16 restructuring charges relate to costs associated with the closure of the Tacoma sawmill and severance costs.

Other foreign exchange loss of $0.2 million in Q1’17 and $0.9 million in Q1’16 result primarily from unrealized losses on short-term intercompany funding.

Income Taxes

The Company recorded an income tax expense of $6.3 million in Q1’17, comprised of a $0.3 million current tax expense and a $6.0 million deferred tax expense. The Company started to recognize deferred tax expense in respect of its Canadian operations in Q4’16 following full recognition of previously unrecognized assets for non-capital loss carry-forwards.

Net Earnings

The Company recorded net earnings of $19.7 million or $0.28 per share, compared to net earnings of $0.8 million or $0.01 per share in the comparable period, 2016. Adjusted net earnings were $22.7 million or $0.32 per share compared with $2.7 million or $0.04 per share in Q1’16.

## Summary of Quarterly Results[1]

| | Unit | 2017 Q1 | 2016 Q4 | 2016 Q3 | 2016 Q2 | 2016 Q1 | 2015 Q4 | 2015 Q3 | 2015 Q2 |
|---|---|---|---|---|---|---|---|---|---|
| **Financial Performance (Unaudited)** | | | | | | | | | |
| Total sales | $MM | 456.8 | 442.3 | 457.6 | 458.8 | 433.9 | 411.4 | 430.8 | 429.7 |
| Lumber | $MM | 389.6 | 363.5 | 374.8 | 371.1 | 348.9 | 325.0 | 343.3 | 352.2 |
| Logs, residual products and other | $MM | 67.2 | 78.8 | 82.8 | 87.7 | 85.0 | 86.4 | 87.5 | 77.5 |
| Operating earnings (loss) | $MM | 30.4 | 22.3 | 20.1 | 30.0 | 3.5 | (6.3) | (11.6) | (25.8) |
| Net earnings (loss) | $MM | 19.7 | 26.6 | 15.1 | 23.2 | 0.8 | (3.5) | (6.1) | (20.6) |
| Net earnings (loss) per share, basic | $/share | 0.28 | 0.38 | 0.22 | 0.33 | 0.01 | (0.05) | (0.09) | (0.29) |
| Adjusted net earnings (loss)[2] | $MM | 22.7 | 17.7 | 20.7 | 17.5 | 2.7 | 4.5 | (16.6) | (10.3) |
| Adjusted net earnings (loss) per share, basic[2] | $/share | 0.32 | 0.25 | 0.30 | 0.25 | 0.04 | 0.06 | (0.24) | (0.15) |
| Adjusted EBITDA[2] | $MM | 60.3 | 51.3 | 58.1 | 56.9 | 33.4 | 35.8 | 11.5 | 12.7 |
| Shares outstanding - end of period | million | 70.0 | 70.0 | 70.0 | 70.0 | 70.0 | 70.0 | 70.0 | 70.0 |
| Shares outstanding - weighted average | million | 70.0 | 70.0 | 70.0 | 70.0 | 70.0 | 70.0 | 70.0 | 70.0 |
| **Operating Performance** | | | | | | | | | |
| Lumber production | million fbm | 640 | 607 | 628 | 637 | 618 | 568 | 618 | 672 |
| Total lumber sales | million fbm | 645 | 619 | 647 | 658 | 637 | 615 | 686 | 719 |
| Lumber sales - Interfor produced | million fbm | 624 | 598 | 627 | 634 | 609 | 586 | 663 | 688 |
| Lumber sales - wholesale and commission | million fbm | 21 | 21 | 20 | 24 | 28 | 29 | 23 | 31 |
| Lumber - average selling price[3] | $/thousand fbm | 604 | 588 | 580 | 564 | 548 | 529 | 500 | 490 |
| Average USD/CAD exchange rate[4] | 1 USD in CAD | 1.3238 | 1.3341 | 1.3050 | 1.2886 | 1.3732 | 1.3354 | 1.3089 | 1.2297 |
| Closing USD/CAD exchange rate[4] | 1 USD in CAD | 1.3322 | 1.3427 | 1.3117 | 1.3009 | 1.2971 | 1.3840 | 1.3394 | 1.2474 |

Notes:

(1) Figures in this table may not add due to rounding.
(2) Refer to the Non-GAAP Measures section of this MD&A for a definition and reconciliation of this measure to figures reported in the Company's consolidated financial statements.
(3) Gross sales before export taxes.
(4) Based on Bank of Canada foreign exchange rates.

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

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

The permanent closure of the Tacoma sawmill and the acquisition of the Monticello sawmill impacted production and sales subsequent to May 22, 2015 and June 29, 2015, respectively. Reduced production in Q4'15 primarily reflects temporary market-related adjustments to operating schedules across the U.S. South platform and severe weather events which impacted certain sawmills in that region. Severe weather conditions also impacted B.C. Coastal log production and lumber production at certain sawmills in B.C. and the U.S. Northwest in Q4'17 and Q1'17.

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

## Liquidity

Balance Sheet

Net debt at March 31, 2017 was $306.7 million, or 27.6% of invested capital, representing a decrease of $121.4 million from March 31, 2016 and an increase of $17.1 million from December 31, 2016. A slightly stronger Canadian Dollar against the U.S. Dollar offset Q1'17 borrowings by $2.7 million as the majority of debt is denominated in U.S. Dollars.

| Thousands of dollars | For the 3 months ended March 31, 2017 | 2016 |
|---|---|---|
| **Net debt** | | |
| Net debt, period opening, CAD | $ 289,551 | $ 452,303 |
| Net drawing on credit facilities, CAD | 19,250 | 53 |
| Impact on U.S. Dollar denominated debt from strengthening CAD | (2,704) | (29,495) |
| Decrease in cash and cash equivalents, CAD | 579 | 5,201 |
| Net debt, period ending, CAD | $ 306,676 | $ 428,062 |
| **Net debt components by currency** | | |
| U.S. Dollar debt, period opening, USD | $ 230,000 | $ 338,699 |
| Net drawing (repayment) on credit facilities, USD | 5,979 | (7) |
| U.S. Dollar debt, period ending, USD | 235,979 | 338,692 |
| Spot rate, period end | 1.3322 | 1.2971 |
| U.S. Dollar debt expressed in CAD | 314,371 | 439,317 |
| Canadian Dollar debt, including bank indebtedness, CAD | 4,987 | - |
| Canadian Dollar operating line, CAD | 6,009 | - |
| Total debt, CAD | 325,367 | 439,317 |
| Cash and cash equivalents, CAD | (18,691) | (11,255) |
| Net debt, period ending, CAD | $ 306,676 | $ 428,062 |

Cash Flow from Operating Activities

The Company generated $59.7 million of cash flow from operations before changes in working capital in Q1'17, up $28.7 million over the first quarter of 2016 driven primarily by increased lumber sales margins and volume.

There was a net cash inflow from operations after changes in working capital of $4.7 million in Q1'17, with $55.0 million of cash invested in operating working capital related to higher sales prices, building of inventories, and the payment of the Simpson contingent liability of US$10.0 million and accrued 2016 incentive compensation in Q1'17. There was a net cash outflow from operations after changes in working capital of $20.0 million in Q1'16, with $11.0 million invested in operating working capital.

Cash Flow from Investing Activities

Investing activities totaled $20.8 million in Q1'17, including $12.7 million for property, plant and equipment and $7.1 million for development of logging roads and bridges. Discretionary mill improvements of $6.5 million during the period included $2.6 million for kilns at the Monticello and Swainsboro sawmills in the U.S. South. Maintenance mill improvements of $6.2 million during Q1'17 included $3.0 million for a kiln conversion project at the Preston sawmill in the U.S. South.

In the first quarter of 2016, investing activities totaled $18.4 million, including $12.6 million for property, plant and equipment and $5.1 million for development of logging roads and bridges. Discretionary spending of $8.7 million during the period included $4.2 million for completion of the Castlegar sawmill rebuild.

Cash Flow from Financing Activities

The financing activity inflow of $15.6 million in Q1'17 included net drawings of $19.3 million used to fund the US$10.0 million Simpson contingent payment and various operating activities, offset by $3.5 million in interest payments. Drawings in the comparable quarter, 2016, were nominal, with financing activity outflow of $7.5 million related primarily to $6.8 million in interest payments on higher average debt levels than in Q1'17.

## Capital Resources

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

| Thousands of Canadian dollars | Operating Line | Revolving Term Line | Senior Secured Notes | U.S. Operating Line | Total |
|---|---|---|---|---|---|
| Available line of credit | $ 65,000 | $ 200,000 | $ 266,440 | $ 66,610 | $ 598,050 |
| Maximum borrowing available | $ 65,000 | $ 200,000 | $ 266,440 | $ 66,610 | $ 598,050 |
| Less: | | | | | |
| Drawings | 10,996 | 13,322 | 266,440 | 34,609 | 325,367 |
| Outstanding letters of credit included in line utilization | 10,394 | - | - | 4,230 | 14,624 |
| Unused portion of facility | $ 43,610 | $ 186,678 | $ - | $ 27,771 | $ 258,059 |
| Add cash and cash equivalents | | | | | 18,691 |
| Available liquidity at Mar. 31, 2017 | | | | | $ 276,750 |

As of March 31, 2017, the Company had commitments for capital expenditures totaling $7.6 million, related to both maintenance and discretionary projects.

Interfor continues to maintain its disciplined focus on monitoring discretionary capital expenditures, optimizing inventory levels and matching production with offshore and domestic demand.

As at March 31, 2017, the Company had net working capital of $190.8 million and available capacity on operating and term facilities of $258.1 million. These resources, in addition to cash generated from operations, will be used to support working capital requirements, debt servicing commitments and capital expenditures. We believe that Interfor will have sufficient liquidity to fund operating and capital requirements for the foreseeable future.

## Transactions between Related Parties

Other than transactions in the normal course of business with key management personnel, the Company had no transactions between related parties in the three months ended March 31, 2017.

## Off-Balance Sheet Arrangements

The Company has off-balance sheet arrangements which include letters of credit and surety performance and payment bonds, primarily for timber purchases. At March 31, 2017, such instruments aggregated $46.0 million (December 31, 2016 - $45.7 million). Off-balance sheet arrangements have not had, and are not reasonably likely to have, any material impact on the Company's current or future financial condition, results of operations or cash flows.

## Financial Instruments and Other Instruments

From time to time, the Company employs financial instruments, such as interest rate swaps and foreign currency forward and option contracts, to manage exposure to fluctuations in interest rates and foreign currency exchange rates. The Company's policy is to not use derivatives for trading or speculative purposes. 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 are the Company's Canadian bankers who are highly-rated, thereby mitigating the risk of credit loss on such instruments. There were no derivative contracts outstanding at March 31, 2017.

## Outstanding Shares

As of May 4, 2017, Interfor had 70,030,455 Common Shares issued and outstanding. These shares are listed on the Toronto Stock Exchange under the symbol IFP.

## Controls and Procedures

There have been no changes in the Company's internal controls over financial reporting ("ICFR") during the three months ended March 31, 2017, that have materially affected, or are reasonably likely to materially affect, its ICFR.

## Critical Accounting Estimates

There were no significant changes to the Company's critical accounting estimates during the quarter ended March 31, 2017. Interfor's critical accounting estimates are described in its MD&A for the year ended December 31, 2016, filed under the Company's profile on www.sedar.com.

## Accounting Policy Changes

The Company adopted the disclosure requirements in Disclosure Initiative (Amendments to IAS 7), which came into effect on January 1, 2017. Consequently, the Company has provided additional disclosure in relation to the changes in borrowings arising from financing activities for the quarter ended March 31, 2017.

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

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

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

The Company is still in the process of assessing IFRS 9 and IFRS 15, but does not currently believe either will have a significant impact on its financial statements.

IFRS 16, *Leases*, eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Under the new standard, operating leases become an on-balance sheet liability that attracts interest, together with a corresponding right-of-use asset. In addition, lessees will recognize a front-loaded pattern of expense for most leases, even when cash rentals are constant. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted. The Company has not yet completed an assessment of the impact of this standard on its financial statements.

## Non-GAAP Measures

This MD&A makes reference to the following non-GAAP measures: Adjusted net earnings (loss), Adjusted net earnings (loss) per share, EBITDA, Adjusted EBITDA, Pre-tax return on total assets, Net debt to invested capital and Operating cash flow per share (before working capital changes) which are used by the Company and certain investors to evaluate operating performance and financial position. These non-GAAP measures do not have any standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other issuers. The following table provides a reconciliation of these non-GAAP measures to figures as reported in the Company's unaudited interim consolidated financial statements prepared in accordance with IFRS:

| | For the 3 months ended | | |
|---|---|---|---|
| Thousands of Canadian dollars except number of shares and per share amounts | Mar. 31 2017 | Mar. 31 2016 | Dec. 31, 2016 |
| **Adjusted Net Earnings** [1] | | | |
| Net earnings | $ 19,667 | $ 795 | $ 26,550 |
| Add: | | | |
| Restructuring costs and capital asset write-downs | 345 | 1,203 | 2,281 |
| Other foreign exchange loss (gain) | 181 | 899 | (1,072) |
| Long term incentive compensation expense | 3,593 | 178 | 199 |
| Other (income) expense | 189 | (93) | (14,452) |
| Beaver sawmill post-closure wind-down costs | 7 | 8 | 128 |
| Tacoma sawmill post-acquisition losses and closure costs | 1 | 372 | (13) |
| Income tax effect of above adjustments | (1,249) | (754) | 4,895 |
| Recognition of previously unrecognized deferred tax assets | - | 116 | (769) |
| Adjusted net earnings | $ 22,734 | $ 2,724 | $ 17,747 |
| *Weighted average number of shares - basic ('000)* | *70,030* | *70,030* | *70,030* |
| Adjusted net earnings per share | $ 0.32 | $ 0.04 | $ 0.25 |
| **Adjusted EBITDA** | | | |
| Net earnings | $ 19,667 | $ 795 | $ 26,550 |
| Add: | | | |
| Depreciation of plant and equipment | 19,603 | 20,169 | 18,534 |
| Depletion and amortization of timber, roads and other | 6,297 | 7,969 | 7,833 |
| Restructuring costs and capital asset write-downs | 345 | 1,203 | 2,281 |
| Finance costs | 4,062 | 5,184 | 4,074 |
| Other foreign exchange loss (gain) | 181 | 899 | (1,072) |
| Income tax expense (recovery) | 6,320 | (3,326) | 7,236 |
| EBITDA | 56,475 | 32,893 | 65,436 |
| Add: | | | |
| Long term incentive compensation expense | 3,593 | 178 | 199 |
| Other (income) expense | 189 | (93) | (14,452) |
| Beaver sawmill post-closure wind-down costs | 7 | 8 | 128 |
| Tacoma sawmill post-acquisition losses and closure costs | 1 | 372 | (13) |
| Adjusted EBITDA | $ 60,265 | $ 33,358 | $ 51,298 |
| **Pre-tax return on total assets** | | | |
| Operating earnings before restructuring costs | $ 30,764 | $ 4,662 | $ 24,617 |
| Total assets [2] | $1,301,648 | $1,389,796 | $1,326,792 |
| Pre-tax return on total assets [3] | 9.5% | 1.3% | 7.4% |
| **Net debt to invested capital** | | | |
| Net debt | | | |
| Total debt | $ 325,367 | $ 439,317 | $ 308,821 |
| Cash and cash equivalents | (18,691) | (11,255) | (19,270) |
| Total net debt | $ 306,676 | $ 428,062 | $ 289,551 |
| Invested capital | | | |
| Net debt | $ 306,676 | $ 428,062 | $ 289,551 |
| Shareholders' equity | 804,748 | 705,214 | 786,667 |
| Total invested capital | $1,111,424 | $1,133,276 | $1,076,218 |
| Net debt to invested capital [4] | 27.6% | 37.8% | 26.9% |
| **Operating cash flow per share (before working capital changes)** | | | |
| Cash provided by operating activities | $ 4,682 | $ 20,043 | $ 48,981 |
| Cash used in operating work capital | 55,033 | 10,979 | 1,399 |
| Operating cash flow (before working capital changes) | $ 59,715 | $ 31,022 | $ 50,380 |
| *Weighted average number of shares - basic ('000)* | *70,030* | *70,030* | *70,030* |
| *Operating cash flow per share (before working capital changes)* | *$ 0.85* | *$ 0.44* | *$ 0.72* |

Notes:
(1) Certain historical periods have been recast to exclude the recognition of previously unrecognized deferred tax assets from Adjusted net earnings.
(2) Total assets at period beginning for three month periods.
(3) Annualized rate.
(4) Net debt to invested capital as of the period end.

## Risks and Uncertainties

The Company is exposed to many risks and uncertainties in conducting its business including, but not limited to: price volatility; competition; availability and cost of log supply; natural or man-made disasters; foreign currency exchange fluctuations; government regulation; barriers to lumber trade between Canada and the U.S.; environmental matters; and labour disruptions. These risks and uncertainties are described in the Company's MD&A for the year ended December 31, 2016, filed under the Company's profile on www.sedar.com. There have been no significant changes to the Company's risks and uncertainties during the three month period ended March 31, 2017.

## Additional Information

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

## CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

**For the three months ended March 31, 2017 and 2016 (unaudited)**

| (thousands of Canadian dollars except earnings per share) | 3 Months Mar. 31, 2017 | 3 Months Mar. 31, 2016 |
|---|---|---|
| **Sales (note 12)** | $ 456,780 | $ 433,944 |
| **Costs and expenses:** | | |
| Production | 384,077 | 390,136 |
| Selling and administration | 12,446 | 10,830 |
| Long term incentive compensation | 3,593 | 178 |
| Depreciation of plant and equipment (note 8) | 19,603 | 20,169 |
| Depletion and amortization of timber, roads and other (note 8) | 6,297 | 7,969 |
| | 426,016 | 429,282 |
| **Operating earnings before restructuring costs** | 30,764 | 4,662 |
| Restructuring costs (note 9) | 345 | 1,203 |
| **Operating earnings** | 30,419 | 3,459 |
| Finance costs (note 10) | (4,062) | (5,184) |
| Other foreign exchange loss | (181) | (899) |
| Other income (expense) | (189) | 93 |
| | (4,432) | (5,990) |
| **Earnings (loss) before income taxes** | 25,987 | (2,531) |
| Income tax expense (recovery) | | |
| Current | 306 | 131 |
| Deferred | 6,014 | (3,457) |
| | 6,320 | (3,326) |
| **Net earnings** | $ 19,667 | $ 795 |
| **Net earnings per share, basic and diluted (note 11)** | $ 0.28 | $ 0.01 |

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

**For the three months ended March 31, 2017 and 2016 (unaudited)**

| | 3 Months Mar. 31, 2017 | 3 Months Mar. 31, 2016 |
|---|---|---|
| **Net earnings** | $ 19,667 | $ 795 |
| **Other comprehensive income (loss):** | | |
| **Items that will not be recycled to Net earnings:** | | |
| Defined benefit plan actuarial gain, net of tax | 824 | 634 |
| **Items that are or may be recycled to Net earnings:** | | |
| Foreign currency translation differences for foreign operations, net of tax | (2,505) | (21,439) |
| Loss in fair value of interest rate swaps (note 14) | (11) | (107) |
| **Total items that are or may be recycled to Net earnings** | (2,516) | (21,546) |
| **Total other comprehensive loss, net of tax** | (1,692) | (20,912) |
| **Comprehensive income (loss)** | $ 17,975 | $ (20,117) |

**See accompanying notes to consolidated financial statements**

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
**For the three months ended March 31, 2017 and 2016 (unaudited)**

| (thousands of Canadian dollars) | 3 Months Mar. 31, 2017 | 3 Months Mar. 31, 2016 |
|---|---|---|
| **Cash provided by (used in):** | | |
| **Operating activities:** | | |
| **Net earnings** | $ 19,667 | $ 795 |
| **Items not involving cash:** | | |
| Depreciation of plant and equipment (note 8) | 19,603 | 20,169 |
| Depletion and amortization of timber, roads and other (note 8) | 6,297 | 7,969 |
| Income tax expense (recovery) | 6,320 | (3,326) |
| Finance costs (note 10) | 4,062 | 5,184 |
| Other assets | (49) | (201) |
| Reforestation liability | 2,543 | 1,614 |
| Provisions and other liabilities | 815 | (1,175) |
| Stock options | 106 | 77 |
| Unrealized foreign exchange (gain) loss | (8) | 9 |
| Other | 359 | (93) |
| | 59,715 | 31,022 |
| **Cash generated from (used in) operating working capital:** | | |
| Trade accounts receivable and other | (15,568) | (919) |
| Inventories | (15,240) | 2,744 |
| Prepayments and other | (2,784) | (2,147) |
| Trade accounts payable and provisions | (21,150) | (10,399) |
| Income taxes paid | (291) | (258) |
| | 4,682 | 20,043 |
| **Investing activities:** | | |
| Additions to property, plant and equipment | (12,743) | (12,551) |
| Additions to logging roads and bridges | (7,102) | (5,089) |
| Additions to timber licences and other intangible assets | (834) | (136) |
| Proceeds (costs) on disposal of property, plant and equipment | (25) | 175 |
| Investments and other assets | (117) | (789) |
| | (20,821) | (18,390) |
| **Financing activities:** | | |
| Interest payments | (3,542) | (6,811) |
| Debt refinancing costs | (128) | (732) |
| Change in operating line components of long term debt (note 6) | 40,853 | 6,734 |
| Additions to long term debt (note 6) | 76,107 | - |
| Repayments of long term debt (note 6) | (97,710) | (6,680) |
| | 15,580 | (7,489) |
| **Foreign exchange gain (loss) on cash and cash equivalents held in a foreign currency** | (20) | 635 |
| **Decrease in cash** | (579) | (5,201) |
| **Cash and cash equivalents, beginning of period** | 19,270 | 16,456 |
| **Cash and cash equivalents, end of period** | $ 18,691 | $ 11,255 |

**See accompanying notes to consolidated financial statements**

INTERFOR

## CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

**March 31, 2017 and December 31, 2016 (unaudited)**

| (thousands of Canadian dollars) | Mar. 31, 2017 | Dec. 31, 2016 |
|---|---|---|
| **Assets** | | |
| **Current assets:** | | |
| Cash and cash equivalents | $ 18,691 | $ 19,270 |
| Trade accounts receivable and other | 110,297 | 95,059 |
| Income tax receivable | 173 | 222 |
| Inventories (note 5) | 169,322 | 154,535 |
| Prepayments and other | 17,120 | 14,016 |
| Investments and other assets | 3,061 | 2,911 |
| | 318,664 | 286,013 |
| **Employee future benefits** | 3,374 | 2,471 |
| **Investments and other assets** | 2,286 | 2,341 |
| **Property, plant and equipment** | 719,091 | 730,981 |
| **Logging roads and bridges** | 23,969 | 20,739 |
| **Timber licences** | 68,589 | 69,273 |
| **Other intangible assets** | 18,005 | 19,017 |
| **Goodwill** | 155,380 | 156,502 |
| **Deferred income taxes** | 9,426 | 14,311 |
| | $ 1,318,784 | $ 1,301,648 |
| **Liabilities and Shareholders' Equity** | | |
| **Current liabilities:** | | |
| Trade accounts payable and provisions | $ 115,467 | $ 138,029 |
| Reforestation liability | 12,070 | 11,609 |
| Income taxes payable | 287 | 317 |
| | 127,824 | 149,955 |
| **Reforestation liability** | 28,585 | 25,931 |
| **Long term debt (notes 6 and 14)** | 325,367 | 308,821 |
| **Employee future benefits** | 8,009 | 8,136 |
| **Provisions and other liabilities** | 21,831 | 21,290 |
| **Deferred income taxes** | 2,420 | 848 |
| **Equity:** | | |
| Share capital (note 7) | 555,388 | 555,388 |
| Contributed surplus | 8,105 | 7,999 |
| Translation reserve | 67,069 | 69,574 |
| Hedge reserve | - | 11 |
| Retained earnings | 174,186 | 153,695 |
| | 804,748 | 786,667 |
| | $ 1,318,784 | $ 1,301,648 |

**Contingency (note 13) and Subsequent event (note 15)**

**See accompanying notes to consolidated financial statements**

Approved on behalf of the Board:

*"L. Sauder"*
Director

*"D.W.G. Whitehead"*
Director

INTERFOR

## CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

**For the three months ended March 31, 2017 and 2016 (unaudited)**

| (thousands of Canadian dollars) | Common Shares | Contributed Surplus | Translation Reserve | Hedging Reserve | Retained Earnings | Total |
|---|---|---|---|---|---|---|
| **Balance at December 31, 2016** | $ 555,388 | $ 7,999 | $ 69,574 | $ 11 | $ 153,695 | $ 786,667 |
| **Net earnings:** | - | - | - | - | 19,667 | 19,667 |
| **Other comprehensive earnings (loss):** | | | | | | |
| Foreign currency translation differences for foreign operations, net of tax | - | - | (2,505) | - | - | (2,505) |
| Defined benefit plan actuarial gain, net of tax | - | - | - | - | 824 | 824 |
| Loss in fair value of interest rate swaps (note 14) | - | - | - | (11) | - | (11) |
| **Contributions:** | | | | | | |
| Stock options | - | 106 | - | - | - | 106 |
| **Balance at March 31, 2017** | $ 555,388 | $ 8,105 | $ 67,069 | $ - | $ 174,186 | $ 804,748 |
| **Balance at December 31, 2015** | $ 553,559 | $ 7,665 | $ 77,425 | $ 62 | $ 86,543 | $ 725,254 |
| **Net earnings:** | - | - | - | - | 795 | 795 |
| **Other comprehensive earnings (loss):** | | | | | | |
| Foreign currency translation differences for foreign operations, net of tax | - | - | (21,439) | - | - | (21,439) |
| Defined benefit plan actuarial gain, net of tax | - | - | - | - | 634 | 634 |
| Loss in fair value of interest rate swaps (note 14) | - | - | - | (107) | - | (107) |
| **Contributions:** | | | | | | |
| Stock options | - | 77 | - | - | - | 77 |
| **Balance at March 31, 2016** | $ 553,559 | $ 7,742 | $ 55,986 | $ (45) | $ 87,972 | $ 705,214 |

**See accompanying notes to consolidated financial statements**

## 1. Nature of operations:

Interfor Corporation and its subsidiaries (the "Company" or "Interfor") produce wood products in British Columbia, the U.S. Northwest and the U.S. South for sale to markets around the world.

Interfor Corporation exists 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.

These unaudited condensed consolidated interim financial statements as at and for the three months ended March 31, 2017 and 2016 comprise the accounts of Interfor Corporation and its subsidiaries.

## 2. Basis of Preparation:

### (a) Statement of compliance:

These financial statements, including comparatives, have been prepared in accordance with IAS 34 *Interim Financial Reporting* using accounting policies consistent with the International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). These financial statements were approved by Interfor's Board of Directors on May 4, 2017.

### (b) Basis of measurement:

These financial statements are prepared on the historical cost basis except for the following items in the Statements 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) Employee benefit plan assets and liabilities are recognized as the net of the fair value of the plan assets and the present value of the benefit obligations on a plan by plan basis.

The functional and presentation currency of the parent company is the Canadian Dollar.

## 3. Significant accounting policies:

Except for the change noted below, these financial statements have been prepared using the significant accounting policies and methods of computation consistent with those applied in the Company's audited December 31, 2016 annual consolidated financial statements, which are available on www.sedar.com.

### (a) Change in accounting policy:

The Company has adopted the disclosure requirements in *Disclosure Initiative (Amendments to IAS 7),* which came into effect on January 1, 2017. Consequently, the Company has provided additional disclosure in relation to the changes in borrowings arising from financing activities for the quarter ended March 31, 2017 (note 6).

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

A number of new standards, and amendments to standards and interpretations, are not yet effective for the quarter ended March 31, 2017, and have not been applied in preparing these financial statements. The following pronouncements are considered by the Company to be the most significant of several pronouncements that may affect future financial statements.

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

IFRS 15, *Revenue from Contracts with Customers*, will supersede IAS 18, *Revenue*, IAS 11, *Construction Contracts* and related interpretations. The new standard is effective for annual periods beginning on or after January 1, 2018.

The Company is still in the process of assessing IFRS 9 and IFRS 15, but does not currently believe either will have a significant impact on its financial statements.

IFRS 16, *Leases*, eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Under the new standard, operating leases become an on-balance sheet liability that attracts interest, together with a corresponding right-of-use asset. In addition, lessees will recognize a front-loaded pattern of expense for most leases, even when cash rentals are constant. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted. The Company has not yet completed an assessment of the impact of this standard on its financial statements.

## 4. Seasonality of operating results:

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

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

## 5. Inventories:

| | Mar. 31, 2017 | Dec. 31, 2016 |
|---|---|---|
| Lumber | $ 91,064 | $ 80,726 |
| Logs | 62,713 | 58,739 |
| Other | 15,545 | 15,070 |
| | $ 169,322 | $ 154,535 |

Inventory cost includes production costs, depreciation of plant and equipment, and depletion and amortization of timber, roads and other. The inventory write-down in order to record inventory at the lower of cost and net realizable value at March 31, 2017 was $6,780,000 (December 31, 2016 - $7,922,000).

## 6. Cash and borrowings:

| March 31, 2017 | Operating Line | Revolving Term Line | Senior Secured Notes | U.S. Operating Line | Total |
|---|---|---|---|---|---|
| Available line of credit | $ 65,000 | $ 200,000 | $ 266,440 | $ 66,610 | $ 598,050 |
| Maximum borrowing available | 65,000 | 200,000 | 266,440 | 66,610 | 598,050 |
| Drawings | 10,996 | 13,322 | 266,440 | 34,609 | 325,367 |
| Outstanding letters of credit included in line utilization | 10,394 | - | - | 4,230 | 14,624 |
| Unused portion of line | $ 43,610 | $ 186,678 | $ - | $ 27,771 | $ 258,059 |
| **December 31, 2016** | | | | | |
| Available line of credit | $ 65,000 | $ 200,000 | $ 268,540 | $ 67,135 | $ 600,675 |
| Maximum borrowing available | 65,000 | 200,000 | 268,540 | 65,627 | 599,167 |
| Drawings | - | 40,281 | 268,540 | - | 308,821 |
| Outstanding letters of credit included in line utilization | 10,026 | - | - | 3,296 | 13,322 |
| Unused portion of line | $ 54,974 | $ 159,719 | $ - | $ 62,331 | $ 277,024 |

Minimum principal amounts due on long term debt are as follows:

| | |
|---|---|
| Twelve months ending | |
| March 31, 2018 | $ - |
| March 31, 2019 | 34,609 |
| March 31, 2020 | 24,318 |
| March 31, 2021 | - |
| March 31, 2022 | 44,407 |
| Thereafter | 222,033 |
| | $ 325,367 |

Reconciliation of movements in borrowings to cash flows arising from financing activities:

| | 3 Months Mar. 31, 2017 | 3 Months Mar. 31, 2016 |
|---|---|---|
| Drawings at December 31 | $ 308,821 | $ 468,759 |
| Operating line net drawings | 40,853 | 6,734 |
| Additions to long term debt | 76,107 | - |
| Repayments of long term debt | (97,710) | (6,680) |
| Effect of changes in foreign exchange rates | (2,704) | (29,496) |
| Drawings at March 31 | $ 325,367 | $ 439,317 |

### (a) Operating Line and Revolving Term Line:

The Canadian operating line of credit and revolving term line (the "Lines") may be drawn in either CAD$ or US$ advances, and bear 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 trailing twelve months' EBITDA[1]. Borrowing levels under the Lines are subject to a borrowing base calculation dependent on certain accounts receivable and inventories.

The Lines are 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 certain of the Company's sawmills.

The Lines are 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 Lines mature on May 19, 2019.

As at March 31, 2017, including outstanding letters of credit, the Lines were drawn by $21,197,000 (December 31, 2016 - $10,026,000) and US$10,145,000 (December 31, 2016 - US$30,000,000) revalued at the quarter-end exchange rate to $13,515,000 (December 31, 2016 - $40,281,000) for total borrowings of $34,712,000 (December 31, 2016 - $50,307,000).

[1] EBITDA, as defined under the agreement, represents earnings before interest, taxes, depreciation, depletion, amortization and non-cash asset revaluations.

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

**6. Cash and borrowings (continued):**

**(a) Operating Line and Revolving Term Line (continued):**

As at March 31, 2017, $230,288,000 of the Lines were unused (December 31, 2016 - $214,693,000). All outstanding U.S. Dollar drawings under the Lines have been designated as a hedge against the Company's investment in its U.S. operations. The Company recognized unrealized foreign exchange gains of $369,000 (Quarter 1, 2016 - $11,103,000 gain) arising on revaluation of the Lines in Foreign currency translation differences in Other comprehensive income for the first quarter, 2017.

**(b) Senior Secured Notes:**

The Company's Senior Secured Notes consist of Series A Senior Secured Notes (US$50,000,000, bearing interest at 4.33%), Series B Senior Secured Notes (US$50,000,000, bearing interest at 4.02%) and Series C Senior Secured Notes (US$100,000,000, bearing interest at 4.17%). As at March 31, 2017, US$200,000,000 of Senior Secured Notes were outstanding (December 31, 2016 – US$200,000,000) and revalued at the quarter-end exchange rate to $266,440,000 (December 31, 2016 - $268,540,000).

The Senior Secured Notes are 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. Total payments of US$33,333,000 (US$16,667,000 for each of the Series A and Series B Senior Secured Notes) are required on each of June 26, 2021 and 2022, with the balance due on June 26, 2023 for the Series A and B Senior Secured Notes. Payments of US$33,333,000 are required on each of March 26, 2024 and 2025, with the balance due on March 26, 2026 for the Series C Senior Secured Notes.

The Senior Secured Notes have been designated as a hedge against the Company's investment in its U.S. operations and unrealized foreign exchange gains of $2,100,000 (Quarter 1, 2016 - $17,380,000 gain) arising on their revaluation were recognized in Foreign currency translation differences in Other comprehensive income for the first quarter, 2017.

**(c) U.S. Operating Line:**

The U.S. Operating Line bears interest at rates for LIBOR based loans plus a margin and is secured by accounts receivable and inventories of wholly-owned subsidiary, Interfor U.S. Inc. The U.S. Operating Line is subject to a minimum net worth covenant, with borrowing levels subject to a collateral calculation dependent upon certain accounts receivable and inventories. The U.S. Operating line matures on May 1, 2018.

As at March 31, 2017, the U.S. Operating Line was drawn by US$29,154,000, including outstanding letters of credit, revalued at the quarter-end exchange rate to $38,839,000 (December 31, 2016 - US$2,455,000 revalued at the quarter-end exchange rate to $3,296,000).

As at March 31, 2017, $27,771,000 (US$20,846,000) of the U.S. Operating Line was unused (December 31, 2016 - $62,331,000, or US$46,422,000).

**7. Share capital:**

The transactions in share capital are described below:

| | Number | Amount |
|---|---|---|
| Balance, December 31, 2015 | 70,030,455 | $ 553,559 |
| Deferred income tax on share issue costs | | 1,829 |
| Balance, December 31, 2016 and March 31, 2017 | 70,030,455 | $ 555,388 |

On March 2, 2017, the Company announced a normal course issuer bid ("NCIB") whereby it can purchase for cancellation up to 3,5000,000 common shares, representing approximately 5% of its common shares issued and outstanding as at March 2, 2017. This NCIB began on March 7, 2017 and expires on March 6, 2018. During the first quarter of 2017, Interfor did not purchase any common shares.

**8. Depreciation, depletion and amortization:**

Depreciation, depletion and amortization by function are as follows:

| | 3 Months Mar. 31, 2017 | 3 Months Mar. 31, 2016 |
|---|---|---|
| Production | $ 23,925 | $ 26,020 |
| Selling and administration | 1,975 | 2,118 |
| | $ 25,900 | $ 28,138 |

**9. Restructuring costs:**

| | 3 Months Mar. 31, 2017 | 3 Months Mar. 31, 2016 |
|---|---|---|
| Severance | $ 336 | $ 789 |
| Tacoma sawmill: | | |
| Write-down of inventories | - | 122 |
| Site closure costs | 9 | 292 |
| | $ 345 | $ 1,203 |

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

## 10. Finance costs:

| | 3 Months Mar. 31, 2017 | 3 Months Mar. 31, 2016 |
|---|---|---|
| Interest on borrowings | $ 3,645 | $ 4,564 |
| Net interest expense on defined benefit obligations | 90 | 98 |
| Unwind of discount on provisions | 132 | 348 |
| Amortization of deferred finance costs | 195 | 174 |
| | $ 4,062 | $ 5,184 |

## 11. Net earnings per share:

Net earnings per share is calculated utilizing the treasury stock method for determining the dilutive effect of options issued. The reconciliation of the numerator and denominator is determined as follows:

| | 3 Months Mar. 31, 2017 | | | 3 Months Mar. 31, 2016 | | |
|---|---|---|---|---|---|---|
| | Net earnings | Weighted Average Number of Shares | Per share | Net earnings | Weighted Average Number of Shares | Per share |
| Issued shares at December 31 | | 70,030 | | | 70,030 | |
| Basic earnings per share | $ 19,667 | 70,030 | $ 0.28 | $ 795 | 70,030 | $ 0.01 |
| Effect of dilutive securities: | | | | | | |
| Stock options | | 14 | | | - | |
| Diluted earnings per share | $ 19,667 | 70,044 | $ 0.28 | $ 795 | 70,030 | $ 0.01 |

## 12. Segmented information:

The Company manages its business as a single operating segment, being 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 Northwest and Southeast regions of the U.S.

Sales to both foreign and domestic markets are as follows:

| | 3 Months Mar. 31, 2017 | 3 Months Mar. 31, 2016 |
|---|---|---|
| United States | $ 320,234 | $ 308,572 |
| Canada | 50,067 | 52,308 |
| Japan | 32,343 | 37,202 |
| China/Taiwan | 29,827 | 20,168 |
| Other export | 24,309 | 15,694 |
| | $ 456,780 | $ 433,944 |

Sales by product line are as follows:

| | 3 Months Mar. 31, 2017 | 3 Months Mar. 31, 2016 |
|---|---|---|
| Lumber | $ 389,624 | $ 348,904 |
| Logs | 29,276 | 42,981 |
| Wood chips and other by products | 36,205 | 38,609 |
| Freight and other | 1,675 | 3,450 |
| | $ 456,780 | $ 433,944 |

## 13. Contingency:

A Timber Licence held by Interfor for harvesting within the B.C. Coast region (the "Licence") was cancelled (or taken) by the Government of B.C., following the passing into law of the Great Bear Rainforest (Forest Management) Act (the "Act") and regulations, which took effect January 1, 2017.

Interfor is entitled to compensation from the Government of B.C. based upon the value of the harvesting rights under the Licence. Although it is not practicable at this time to estimate the value or form of compensation that would be received by Interfor, it is expected that such compensation would exceed the net book value of the Licence as at March 31, 2017.

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

## 14. Financial instruments:

Financial instruments in an asset position are classified as Trade accounts receivable and other in the Statements of Financial Position, while financial instruments in a liability position are classified as Trade accounts payable and provisions. Assets and liabilities are not netted, for purposes of presentation on the Statements of Financial Position.

At March 31, 2017, the fair value of the Company's long term debt exceeded its carrying value by $3,079,000 (December 31, 2016 – exceeded carrying value by $7,378,000) measured based on Level 2 of the fair value hierarchy. The fair values of other financial instruments approximate their carrying values due to their short-term nature.

The Company may use a variety of derivative financial instruments to reduce its exposures to risks associated with fluctuations in foreign exchange rates, lumber prices, and interest rates. These include foreign currency forward, collar and option contracts, and interest rate swaps. The Company's two interest rate swaps, each with a notional value of US$25,000,000 matured on February 27, 2017.

As at March 31, 2017, the Company has no outstanding obligations under foreign currency contracts or interest rate swaps.

The following table summarizes the gain (loss) on derivative financial instruments for the three months ended March 31, 2017 and 2016:

| | 3 Months Mar. 31, 2017 | 3 Months Mar. 31, 2016 |
|---|---|---|
| Foreign exchange collars and forward contracts [1] | $ 108 | $ 133 |
| Interest rate swaps [2] | (11) | (107) |
| Total gain, net | $ 97 | $ 26 |

Notes: [1] Recognized in Other foreign exchange loss in Net earnings.
[2] Recognized in Other comprehensive income.

## 15. Subsequent event:

On November 25, 2016, a petition was filed by the U.S. Lumber Coalition and other petitioners seeking countervailing and anti-dumping duties on Canadian softwood lumber imports to the U.S. and on January 6, 2017, a preliminary determination was announced by the U.S. International Trade Commission ("ITC") that there is reasonable indication that the U.S. industry is materially injured by imports of softwood lumber products from Canada.

On April 24, 2017, the U.S. Department of Commerce ("DoC") preliminarily ruled that Canadian softwood lumber producers benefit from government subsidies and imposed a company specific preliminary countervailing duty rate on each of the five companies reviewed ranging from 3.02% to 24.12%. All other companies, including Interfor, received the weighted average rate of the five companies reviewed of 19.88%. As a result, the U.S. Customs and Border Protection Agency ("CBPA") will begin collecting countervailing duties from Interfor on April 28, 2017, at a preliminary rate of 19.88%, to be posted by cash deposits or bonds, on its shipments of softwood lumber from Canada into the U.S. This preliminary duty is only applicable for a 120 day period until it is suspended in accordance with U.S. law pending final rulings by the DoC and ITC. In terms of impact to Interfor, this duty will apply to only a fraction of the Company's total lumber sales, or approximately 16% of its total volume on average.

In addition, the DoC ruled affirmatively on the existence of critical circumstances in each of the countervailing and anti-dumping cases, for all Canadian lumber producers except mandatory respondents. Thus, Interfor may be required to submit a deposit for retroactive countervailing duties for the 90-day period from January 28 to April 27, 2017. The total amount of the deposit is estimated to be US$8,359,000, of which US$5,616,000 relates to lumber shipments up to and including March 31, 2017. Since Interfor believes it is more likely than not that the ITC will subsequently rule against the retroactive application, resulting in a return of the deposit in full to Interfor by the CBPA, no liability has been recognized in these financial statements as at and for the three months ended March 31, 2017. It is not yet possible to reasonably estimate the deposit amount for retroactive anti-dumping duties that will be required as a result of the DoC's affirmative ruling on critical circumstances, as it is contingent on both the timing of the DoC's preliminary ruling and rate applicable to Interfor.

The DoC's preliminary ruling on its anti-dumping investigation is expected to occur in June 2017, with final rulings on its countervailing and anti-dumping investigations expected to occur in November 2017. ITC's final determinations on the countervailing and anti-dumping cases would follow approximately 45 days after the DoC final determinations.

Interfor is of the view that the DoC's positions are without merit and politically driven. As such, Interfor intends to vigorously defend the Company's and industry's positions through various appeals processes, in conjunction with the B.C. and Canadian Governments. The final amount and effective date of countervailing and anti-dumping duties that may be assessed on Canadian softwood lumber exports to the U.S. cannot be determined at this time and will depend on determinations yet to be made by the DoC and ITC and any reviewing courts, NAFTA or WTO panels to which those determinations may be appealed.

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