



**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 Canadian generally accepted accounting principles 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.

A handwritten signature in black ink, appearing to read "D. Davies".

Duncan K. Davies  
President and Chief Executive Officer

A handwritten signature in black ink, appearing to read "J. Horning".

John A. Horning  
Senior Vice President, Chief Financial Officer and  
Corporate Secretary

February 3, 2010



**International Forest Products Limited**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**AUDITORS' REPORT TO THE SHAREHOLDERS**

We have audited the consolidated balance sheets of International Forest Products Limited as at December 31, 2009 and 2008 and the consolidated statements of operations, retained earnings, cash flows, comprehensive income (loss) and accumulated other comprehensive income (loss) for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads "KPMG LLP". The signature is written in a cursive, slanted style. Below the signature is a long, horizontal, slightly curved line that extends to the right.

KPMG LLP, Chartered Accountants

Vancouver, Canada

February 3, 2010

**International Forest Products Limited**  
**Consolidated Balance Sheets**

(Expressed in thousands of Canadian dollars)  
December 31, 2009 and 2008

|   | 2009              | 2008                      |
|---|-------------------|---------------------------|
|   |                   | (restated -<br>note 1(b)) |
| <b>Assets</b>   |                   |                           |
| Current assets:   |                   |                           |
| Cash and cash equivalents                                 | \$ 3,802          | \$ 184                    |
| Accounts receivable                                       | 32,951            | 25,441                    |
| Income taxes recoverable                                  | 230               | 16,225                    |
| Inventories (note 4)                                      | 60,159            | 78,991                    |
| Prepaid expenses  | 7,777             | 7,779                     |
| Future income taxes (note 15)                             | 2,974             | 2,890                     |
|   | <u>107,893</u>    | <u>131,510</u>            |
| Investments and other assets (note 5)                     | 17,060            | 19,372                    |
| Property, plant and equipment (note 6)                    | 357,501           | 395,727                   |
| Logging roads and bridges (note 7)                        | 16,485            | 20,598                    |
| Timber tenures (note 7)                                   | 67,010            | 69,827                    |
| Goodwill  | 13,078            | 13,078                    |
| Long-lived assets held for sale (note 3)                  | 3,424             | 15,138                    |
|   | <u>\$ 582,451</u> | <u>\$ 665,250</u>         |
| <b>Liabilities and Shareholders' Equity</b>               |                   |                           |
| Current liabilities:                                      |                   |                           |
| Bank indebtedness (note 8(a))                             | \$ -              | \$ 30,589                 |
| Accounts payable and accrued liabilities                  | 43,510            | 45,163                    |
| Payable to investee company (notes 9 and 23(a))           | 3,096             | 3,651                     |
|   | <u>46,606</u>     | <u>79,403</u>             |
| Reforestation liability, net of current portion (note 11) | 14,724            | 15,685                    |
| Long-term debt (note 8(b))                                | 144,525           | 137,414                   |
| Other long-term liabilities (note 10)                     | 15,316            | 12,407                    |
| Future income taxes (note 15)                             | 3,286             | 14,159                    |
| Shareholders' equity:                                     |                   |                           |
| Share capital (note 12):                                  |                   |                           |
| Issued and fully paid:                                    |                   |                           |
| Class A subordinate voting shares                         | 284,500           | 284,500                   |
| Class B common shares                                     | 4,080             | 4,080                     |
| Contributed surplus (note 12(a))                          | 5,408             | 5,408                     |
| Accumulated other comprehensive loss                      | (24,855)          | (554)                     |
| Retained earnings   | 88,861            | 112,748                   |
|   | <u>357,994</u>    | <u>406,182</u>            |
|   | <u>\$ 582,451</u> | <u>\$ 665,250</u>         |

Commitments and contingencies (note 16)

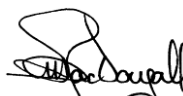
Subsequent events (note 23)

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:



E.L. Sauder, Director



G.H. MacDougall, Director

**International Forest Products Limited**  
**Consolidated Statements of Operations**

(Expressed in thousands of Canadian dollars, except earnings per share amounts)  
Years ended December 31, 2009 and 2008

|   | 2009           | 2008                      |
|---|----------------|---------------------------|
|   |                | (restated –<br>note 1(b)) |
| Sales   | \$ 389,775     | \$ 437,221                |
| Costs and expenses:   |                |                           |
| Production  | 374,488        | 411,479                   |
| Selling and administration  | 16,445         | 16,867                    |
| Long term incentive compensation (recovery)   | 3,211          | (1,990)                   |
| Export taxes  | 3,903          | 3,433                     |
| Amortization of plant and equipment   | 24,838         | 21,335                    |
| Depletion and amortization of timber, roads and other                                       | 13,340         | 19,619                    |
|   | <u>436,225</u> | <u>470,743</u>            |
| Operating loss before restructuring costs<br>and write-downs of plant, equipment and timber | (46,450)       | (33,522)                  |
| Restructuring costs and write-downs of plant, equipment<br>and timber (note 14)             | (4,367)        | (34,888)                  |
| Operating loss  | (50,817)       | (68,410)                  |
| Other earnings (expenses):  |                |                           |
| Interest expense on long-term debt  | (6,442)        | (4,543)                   |
| Other interest expense  | (1,401)        | (588)                     |
| Other foreign exchange gain   | 37             | 912                       |
| Other income (note 13)  | 22,965         | 1,418                     |
| Equity in earnings of investee companies (note 5)   | 1,885          | 4,825                     |
|   | <u>17,044</u>  | <u>2,024</u>              |
| Loss before income taxes  | (33,773)       | (66,386)                  |
| Income taxes (note 15):   |                |                           |
| Current (recovery)  | (183)          | (18,533)                  |
| Future (recovery)   | (9,703)        | 7,538                     |
|   | <u>(9,886)</u> | <u>(10,995)</u>           |
| Net loss  | \$ (23,887)    | \$ (55,391)               |
| Net loss per share (note 17):   |                |                           |
| Basic and diluted   | \$ (0.51)      | \$ (1.18)                 |

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Retained Earnings**

(Expressed in thousands of Canadian dollars)  
Years ended December 31, 2009 and 2008

|                                      | 2009       | 2008                      |
|--------------------------------------|------------|---------------------------|
|                                      |            | (restated –<br>note 1(b)) |
| Retained earnings, beginning of year | \$ 112,748 | \$ 168,139                |
| Net loss                             | (23,887)   | (55,391)                  |
| Retained earnings, end of year       | \$ 88,861  | \$ 112,748                |

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, 2009 and 2008

|   | 2009        | 2008                      |
|---|-------------|---------------------------|
| Cash provided by (used in):   |             | (restated -<br>note 1(b)) |
| Operating activities:   |             |                           |
| Net loss  | \$ (23,887) | \$ (55,391)               |
| Items not involving cash:   |             |                           |
| Amortization of plant and equipment   | 24,838      | 21,335                    |
| Depletion and amortization of timber, roads and other                                   | 13,340      | 19,619                    |
| Future income taxes (recovery)  | (9,703)     | 7,538                     |
| Other assets  | 759         | (544)                     |
| Reforestation liability   | (961)       | (4,421)                   |
| Other long-term liabilities   | 2,909       | (1,678)                   |
| Equity in earnings of investee company (note 5)   | (1,885)     | (4,825)                   |
| Write-down of plant, equipment and timber (note 14)                                     | 3,067       | 29,010                    |
| Unrealized foreign exchange losses (gains)  | (6,969)     | 3,941                     |
| Other (note 13)   | (23,089)    | (1,541)                   |
|   | (21,581)    | 13,043                    |
| Cash generated from (used in) operating working capital:                                |             |                           |
| Accounts receivable   | (8,580)     | 13,335                    |
| Inventories   | 16,882      | 12,025                    |
| Prepaid expenses  | (625)       | (117)                     |
| Accounts payable and accrued liabilities  | 2,702       | (16,358)                  |
| Income taxes  | 15,976      | (8,187)                   |
|   | 4,774       | 13,741                    |
| Investing activities:   |             |                           |
| Additions to property, plant and equipment  | (20,781)    | (73,364)                  |
| Additions to logging roads and timber   | (6,811)     | (17,512)                  |
| Proceeds on disposal of property, plant and equipment (note 13)                         | 36,985      | 5,096                     |
| Acquisitions (note 2)   | -           | (76,919)                  |
| Deposit held in escrow for acquisition (note 2)   | -           | 8,943                     |
| Investments and other assets  | (942)       | (2,116)                   |
|   | 8,451       | (155,872)                 |
| Financing activities:   |             |                           |
| Issuance of share capital, net of expenses (note 12(a))                                 | -           | 56                        |
| Increase (decrease) in bank indebtedness  | (30,589)    | 30,589                    |
| Funds from promissory note payable to investee company (note 9)                         | 3,096       | 3,651                     |
| Additions to long-term debt (note 8(b))   | 59,000      | 139,064                   |
| Repayments of long-term debt (note 8(b))  | (41,000)    | (48,925)                  |
|   | (9,493)     | 124,435                   |
| Foreign exchange gain (loss) on cash and cash equivalents held<br>in a foreign currency | (114)       | 85                        |
| Increase (decrease) in cash and cash equivalents  | 3,618       | (17,611)                  |
| Cash and cash equivalents, beginning of year  | 184         | 17,795                    |
| Cash and cash equivalents, end of year  | \$ 3,802    | \$ 184                    |
| Supplementary disclosures:  |             |                           |
| Cash interest paid, net   | \$ 7,843    | \$ 5,131                  |
| Cash income taxes received  | 16,179      | 12,330                    |

See accompanying notes to consolidated financial statements.

**International Forest Products Limited**  
**Consolidated Statements of Comprehensive Income (Loss)**

(Expressed in thousands of Canadian dollars)  
Years ended December 31, 2009 and 2008

|   | 2009               | 2008                      |
|---|--------------------|---------------------------|
|   |                    | (restated -<br>note 1(b)) |
| Net loss  | \$ (23,887)        | \$ (55,391)               |
| Other comprehensive loss:   |                    |                           |
| Net change in unrealized foreign currency<br>translation gains (losses) on translation of<br>self-sustaining foreign subsidiaries | (24,301)           | 33,218                    |
| Other comprehensive income (loss)   | (24,301)           | 33,218                    |
| <b>Comprehensive loss</b>   | <b>\$ (48,188)</b> | <b>\$ (22,173)</b>        |

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Accumulated Other Comprehensive Income (Loss)**

(Expressed in thousands of Canadian dollars)  
Years ended December 31, 2009 and 2008

|  | 2009               | 2008                      |
|--|--------------------|---------------------------|
|  |                    | (restated -<br>note 1(b)) |
| Accumulated other comprehensive loss,<br>beginning of year | \$ (554)           | \$ (33,772)               |
| Other comprehensive income (loss)                          | (24,301)           | 33,218                    |
| <b>Accumulated other comprehensive loss, end of year</b>   | <b>\$ (24,855)</b> | <b>\$ (554)</b>           |

See accompanying notes to consolidated financial statements.

# International Forest Products Limited

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Notes to Consolidated Financial Statements  
Years ended December 31, 2009 and 2008

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

## 1. Significant accounting policies and change in accounting policies:

International Forest Products Limited (the "Company") is incorporated under the *Business Corporations Act* (British Columbia) and its primary business activity is the production of wood products in British Columbia and the U.S. Pacific Northwest for sale to markets around the world.

### (a) Principles 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 and transactions have been eliminated on consolidation.

### (b) Adoption of changes in accounting policies:

Effective January 1, 2009, the Company adopted two new Canadian Institute of Chartered Accountants ("CICA") accounting standards. The main requirements of these new standards are described below.

#### (i) Goodwill and Intangible Assets:

Handbook Section 3064, *Goodwill and Intangible Assets* replaces CICA Handbook Section 3062, *Goodwill and Intangible Assets*, and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of various preproduction and start-up costs and requires that these costs be expensed as incurred, with the concurrent withdrawal of CICA Emerging Issues Committee Abstract 27 ("EIC 27"). This change in accounting policy has been given retrospective treatment.

The Company previously deferred start-up costs on major plant construction to the extent these costs met the criteria under EIC 27 and the site met sustainable production levels defined as the earlier of:

(a) Seventy percent of production capacity for two consecutive months; or

(b) Six months

and to a maximum of twenty percent of the total project.

Start-up costs were amortized over five years on a straight-line basis.

The following changes to historical financial statements have been made to reflect the new policy:

|   | As previously<br>reported | Adjustment | As adjusted |
|---|---------------------------|------------|-------------|
| Consolidated Balance Sheet as at<br>December 31, 2008:                        |                           |            |             |
| Property, plant and equipment   | \$ 396,387                | \$ (660)   | \$ 395,727  |
| Accumulated other comprehensive loss  | 539                       | 15         | 554         |
| Retained Earnings, ending   | 113,393                   | (645)      | 112,748     |
| Consolidated Statement of Operations for the<br>year ended December 31, 2008: |                           |            |             |
| Amortization of plant and equipment   | 21,846                    | (511)      | 21,335      |
| Restructuring costs and write-downs of plant,<br>equipment and timber         | 37,305                    | (2,417)    | 34,888      |
| Future income tax expense   | 6,410                     | 1,128      | 7,538       |
| Net loss  | (57,191)                  | 1,800      | (55,391)    |
| Net loss per share, basic and diluted   | (1.21)                    | 0.03       | (1.18)      |

**1. Significant accounting policies and change in accounting policies (continued):**

(b) Adoption of change in accounting policy (continued):

(i) Goodwill and Intangible Assets (continued):

|   | As previously<br>reported | Adjustment | As adjusted |
|---|---------------------------|------------|-------------|
| <b>Consolidated Statement of Retained Earnings<br/>for the year ended December 31, 2008:</b>                          |                           |            |             |
| Retained earnings, beginning  | \$ 170,584                | \$ (2,445) | \$ 168,139  |
| Retained earnings, ending   | 113,393                   | (645)      | 112,748     |
| <b>Consolidated Statement of Comprehensive Income<br/>for the year ended December 31, 2008:</b>                       |                           |            |             |
| Net loss  | (57,191)                  | 1,800      | (55,391)    |
| Other comprehensive income  | 33,353                    | (135)      | 33,218      |
| Comprehensive loss  | (23,838)                  | 1,665      | (22,173)    |
| <b>Consolidated Statement of Accumulated Other<br/>Comprehensive Income for the year ended<br/>December 31, 2008:</b> |                           |            |             |
| Accumulated other comprehensive loss,<br>beginning  | (33,892)                  | 120        | (33,772)    |
| Other comprehensive income  | 33,353                    | (135)      | 33,218      |
| Accumulated other comprehensive loss,<br>ending   | (539)                     | (15)       | (554)       |

(ii) Financial instruments disclosure:

Handbook Section 3862, *Financial Instruments - Disclosures* establishes revised standards for the disclosure of financial instruments. The new standard establishes a three-tier hierarchy as a framework for disclosing fair value of financial instruments based on inputs used to value the Company's investments. The hierarchy of inputs and description of inputs is described as follows:

- Level 1 – fair values are based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – fair values are based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); or
- Level 3 – fair values are based on inputs for the asset or liability that are not based on observable market data, which are unobservable inputs.

Changes in valuation methods may result in transfers into or out of an investment's assigned level.

This additional disclosure has been provided in note 22(b).

(c) 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.

(d) 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.

**1. Significant accounting policies and change in accounting policies (continued):**

## (d) Inventories (continued):

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 for 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.

## (e) Investments and advances:

Investments over which the Company is able to exert significant influence are accounted for on the equity basis. Advances are accounted for at amortized cost.

The Company is the holder of 60% of the outstanding common shares of Seaboard Shipping Company Ltd. ("Seaboard"). The remaining common shares are held by other British Columbia forestry companies. Seaboard's subsidiary company operates ocean-going vessels that provide service to world ports with contractual commitments for lumber and plywood volumes, as well as other cargo. Although the Company owns over 50% of the common shares of Seaboard, the shareholders have entered into agreements that limit the Company's ability to control Seaboard's strategic decisions. In addition, net earnings of Seaboard are distributed based on a percentage of shipments of product by the shareholders and not based on common share ownership.

The Company accounts for its investment in Seaboard using the equity method with the investment adjusted for earnings of Seaboard based on the Company's percentage of earnings as determined based on its shipment percentage and decreased for distributions made by Seaboard.

## (f) Property, plant and equipment and timber and logging roads:

Property, plant and equipment and timber and logging roads are recorded at cost. Amortization on plant and equipment is provided on a straight-line basis during periods of production at rates (ranging from 5% to 25%) based on the estimated useful lives of the assets. Timber licence depletion and road amortization are 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 periodically to ensure they are aligned with estimates of remaining economic useful lives of the associated capital assets.

## (g) Reforestation liability:

Forestry legislation in British Columbia requires the Company to incur the cost of reforestation on its forest, timber and tree farm licences. Accordingly, the Company records the fair value of the costs of reforestation 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. In periods subsequent to the initial measurement, changes in the liability resulting from the passage of time and revisions to fair value calculations are recognized in the statement of operations as they occur. These costs are included in the cost of current production.

**1. Significant accounting policies and change in accounting policies (continued):**

## (h) 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.

## (i) Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect 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. Significant areas requiring the use of management estimates relate to the determination of restructuring, reforestation, road deactivation, environmental and tax obligations, recoverability of assets, rates for depletion and amortization, and determination of fair values of assets and liabilities acquired in business combinations. Actual results could differ from those estimates.

## (j) Income taxes:

Income taxes are accounted for under the asset and liability method. Future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the substantive enactment date. When the realization of future tax assets is not considered to be more likely than not, a valuation allowance is provided.

## (k) Share-based compensation:

The Company has share option plans and other share-based compensation plans for directors, officers and certain other eligible employees.

The Company follows the fair value method of accounting for share options granted to directors, officers and employees. Under the fair value method, 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.

For other share based compensation plans which are based on changes in the value of the Company's share price, the Company records a liability and recognizes an expense (recovery) for changes in the estimated compensation over the vesting period based on the quoted market price of the Company's shares over the strike price of the grant.

## (l) Sales recognition and presentation policies:

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 countervailing and antidumping duties and export taxes.

## (m) Employee future 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.

**1. Significant accounting policies and change in accounting policies (continued):**

## (m) Employee future benefits (continued):

The actuarial liability, and the associated annual cost of accruing benefits for the defined benefit pension plans and other post-retirement benefits is calculated using the projected accrued benefit cost method pro-rated on service.

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

Actuarial gains and losses arise from actual experience being different from the assumptions, or changes in actuarial assumptions used to determine the actuarial liability.

The unamortized net actuarial gains or losses in excess of ten percent of the greater of the benefit obligation and the fair value of the plan assets are amortized on a straight-line basis over the average remaining service period of active employees. The average remaining service period of the active employees covered by the plans is thirteen years in 2009 (2008 - thirteen years).

## (n) Hedging relationships and accounting for derivative financial instruments:

The Company at times uses derivative financial instruments for economic hedging purposes in the management of foreign currency and interest rate exposures. 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, on-going basis to ensure the derivatives are effective in offsetting changes in fair values or cash flows of hedged items. 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.

Exposure to interest rates on a component of long-term debt was managed through the use of a cross currency interest rate swap. This swap agreement required the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. Foreign exchange adjustments accounted for under the cross currency interest rate swap agreement are recognized in Other foreign exchange gain (loss) on the Statement of Operations. The cross currency interest rate swap matured on September 1, 2009.

The Company has chosen to not designate its derivative forward foreign exchange contracts, options and interest rate swap as hedges. Consequently, derivatives for which hedge accounting is not applied are carried on the balance sheet at fair value, with changes in fair value being recorded in the statement of operations.

## (o) Foreign currency translation:

Foreign currency monetary assets and liabilities of the Company's integrated foreign operations of the Company are translated into Canadian Dollars at exchange rates in effect at the balance sheet date, while foreign currency non-monetary assets and liabilities are translated into Canadian dollars at the historical exchange rate in effect when the related asset was acquired or obligation incurred. Related unrealized translation gains and losses are included in Operating earnings or Other foreign exchange gain (loss) in the Statement of Operations, depending upon the nature of the item translated.

Foreign currency denominated assets and liabilities of its self-sustaining foreign operations are translated into Canadian Dollars at exchange rates in effect at the balance sheet date. Related unrealized gains and losses are included in the net change in unrealized foreign currency translation gains (losses) in the Statement of Comprehensive Income.

**1. Significant accounting policies and change in accounting policies (continued):**

## (o) Foreign currency translation (continued):

Long-term obligations denominated in foreign currencies are from time to time designated as a hedge of the Company's investments in self-sustaining foreign operations and hedge accounting is utilized with resulting unrealized foreign exchange gains and losses recorded in Other Comprehensive Income in the period in which they occur. 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 Accumulated Other Comprehensive Income. 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 the Statement of Operations.

Unrealized foreign exchange gains and losses residing in Accumulated Other Comprehensive Income will be released to the Statement of Operations upon the reduction of the net investment in self-sustaining foreign operations through the sale, reduction or substantial liquidation of an investment position.

Revenues and expenses denominated in foreign currencies are translated at average rates for the period with the exception of depreciation and amortization of foreign currency denominated long term assets of the Company's integrated foreign operations, which are translated at historical exchange rates.

## (p) Net earnings (loss) per share:

Basic earnings (loss) per share are computed by dividing net earnings by the weighted average shares outstanding during the reporting period. Diluted earnings (loss) per share are computed using the treasury stock method.

## (q) Asset retirement obligations:

Asset retirement obligations are recognized at the fair value in the period in which the legal obligation was incurred, with fair value of a liability determined with reference to the present value of estimated future cash flows. In periods subsequent to the initial measurement, changes in the liability resulting from the passage of time and revisions to fair value calculations are recognized in the statement of operations as they occur.

## (r) Impairment of long-lived assets, goodwill and related measurement uncertainty:

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Company determines if an impairment loss exists by comparing the carrying amount of a long-lived asset to the sum of the undiscounted cash flows expected to result from its use and eventual disposition. If an impairment loss exists, the amount of the loss is measured as the amount by which the long-lived asset's carrying amount exceeds its fair value.

As at December 31, 2009, the Company tested the recoverability of substantially all of its long-lived assets. The recoverability tests performed include management forecasts of cash flows arising from the use and disposition of the relevant assets. Based on the management forecasts, undiscounted cash flows exceed the carrying value of the Company's long-lived assets and no impairment charge is required at December 31, 2009.

Goodwill is tested for impairment annually, and whenever events or changes in circumstances indicate that an impairment may exist. The Company determines if an impairment loss exists by estimating the fair value of the goodwill and related reporting unit and comparing it to the carrying amount of the goodwill and related reporting unit. When the carrying value of a reporting unit's goodwill exceeds its fair value, an impairment loss is recognized in an amount equal to the excess.

**1. Significant accounting policies and change in accounting policies (continued):**

## (r) Impairment of long-lived assets, goodwill and related measurement uncertainty (continued):

The Company uses a discounted cash flow methodology to estimate the fair value of the goodwill and related reporting unit. The cash flows are based on management forecasts and an appropriate discount rate as determined by reference to current market conditions and specific company factors. For the year ended December 31, 2009, the estimated fair value of the goodwill and related reporting unit exceeds the carrying value of these assets. Therefore, no impairment charge is required.

Numerous assumptions are required in conducting the recoverability tests and the more significant ones include lumber and residual chip sales prices, applicable foreign exchange rates, operating rates of the assets, raw material and conversion costs, and the amount of sales to the U.S. from Canada and the level of export taxes. The Company has analyzed external data in determining appropriate assumptions.

Given the judgements and estimates required to carry out the tests for recoverability of long-lived assets and goodwill, and the sensitivity of results to significant assumptions used, it is possible that future conditions may change and may result in different assumptions in the future, which could result in impairment of the carrying values of the assets at that time.

## (s) Comparative figures:

Certain of the prior year's figures have been reclassified to conform to the presentation adopted in the current year.

## (t) Future accounting changes:

## (i) International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian generally accepted accounting principles ("Canadian GAAP") will be converged with International Financial Reporting Standards ("IFRS") for fiscal years commencing January 1, 2011. The transition from Canadian GAAP to IFRS will be applicable for the Company for the first quarter of 2011 when the Company will prepare both the current and comparative financial information using IFRS.

While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences on recognition, measurement, and disclosures. While the effects of IFRS have not yet been fully determined, the Company has identified a number of key areas which are likely to be impacted by changes in accounting policy, including: property, plant, and equipment; impairment of assets; provisions, including reforestation liabilities and asset retirement obligations; and employee future benefits.

## (ii) Business combinations

Effective January 1, 2010, the Company will adopt three new CICA accounting standards:

- Handbook Section 1582, *Business Combinations* which replaces CICA Handbook Section 1581, *Goodwill and Business Combinations*, and establishes revised standards for the recognition, measurement, presentation and disclosure of business acquisitions and aligns Canadian GAAP with IFRS standards.
- Handbook Section 1601, *Consolidated Financial Statements* and Handbook Section 1602, *Non-Controlling Interests*, which replace Handbook Section 1600, *Consolidated Financial Statements*, and establish revised standards for the preparation of consolidated financial statements.

Adoption of these standards has no retrospective impact on the consolidated financial statements.

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## 2. Acquisitions:

During 2008, the Company completed two business acquisitions, the details of which are more fully described below.

The purchase price of each of these business acquisitions was allocated to the fair value of assets acquired and related liabilities arising from the transactions, based on management's best estimates. These acquisitions were accounted for using the purchase method and the purchase price was allocated as follows:

|  | Kootenay<br>Acquisition<br>(note 2(a)) | Beaver and Forks<br>Acquisition<br>(note 2(b)) | Total     |
|--|--|--|-----------|
| Net assets acquired:   |  |  |           |
| Current assets   | \$ 9,245                               | \$ 3,560                                       | \$ 12,805 |
| Property, plant and equipment  | 22,226                                 | 30,659   | 52,885    |
| Timber and logging roads   | 40,092                                 | 56   | 40,148    |
|  | 71,563                                 | 34,275   | 105,838   |
| Liabilities assumed:   |  |  |           |
| Current liabilities  | 13,711                                 | 19   | 13,730    |
| Reforestation, post-retirement benefits<br>and other long-term obligations | 13,458                                 | -  | 13,458    |
| Future income taxes  | 1,731                                  | -  | 1,731     |
|  | \$ 42,663                              | \$ 34,256                                      | \$ 76,919 |
| Cash consideration funded by:  |  |  |           |
| Cash on hand   | \$ 15,947                              | \$ 2,117                                       | \$ 18,064 |
| Deposit held in escrow   | 9,007                                  | -  | 9,007     |
| Revolving Term Line  | 17,709                                 | 32,139   | 49,848    |
|  | \$ 42,663                              | \$ 34,256                                      | \$ 76,919 |

### (a) Kootenay operations acquisition from Pope and Talbot, Inc.:

On November 19, 2007, the Company and Pope and Talbot, Inc. ("P&T") entered into an Asset Purchase Agreement ("P&T APA"), as subsequently amended, for the acquisition of two southern B.C. interior sawmills and their related timber tenures and one sawmill in Spearfish, South Dakota. Subsequently, the Company assigned the right to purchase the Spearfish, South Dakota sawmill to Neiman Enterprises, Inc. ("Neiman"), a company based in Wyoming. The Company paid a US\$8,800,000 interest-bearing deposit held in escrow in respect of the transaction.

On April 30, 2008, the Company concluded the acquisition of the Castlegar, B.C. and Grand Forks, B.C. ("Kootenay operations") sawmills, related timber harvesting rights and other related assets and assumption of liabilities and Neiman concluded its acquisition of the Spearfish sawmill and related assets.

To acquire these assets, the Company paid \$49,689,000, of which \$9,007,000 was funded through the deposit held in escrow, \$17,709,000 was financed through its Canadian revolving term line of credit ("Revolving Term Line"), and the balance of \$22,973,000 through cash on hand. Amounts paid in US\$ were translated to CAD\$ at the April 29, 2008 rate of CAD\$1.0119 : US\$1.00.

**2. Acquisitions (continued):**

## (a) Kootenay operations acquisition from Pope and Talbot, Inc. (continued):

At completion, a portion of the consideration paid was placed in escrow, pending final determination of the purchase price adjustments and obtaining of certain authorizations in accordance with the P&T APA. Because the amount to be released to the Company from escrow funds could not be determined until the Company had reached an agreement with P&T, no amounts were recorded as recoverable at acquisition.

On October 20, 2008, the Company reached an agreement with PricewaterhouseCoopers Inc., in its capacity as the Receiver of P&T, to settle all outstanding claims. Upon receipt of Court approval on December 1, 2008, the Company received US\$7,675,000 (\$9,494,000) from escrowed funds and after settlement with Neiman for its portion and finalization of transaction costs, the purchase price was reduced to \$42,663,000.

The assets acquired include manufacturing facilities, timber harvesting rights and working capital. The Company assumed certain liabilities of P&T including pension and other employee related obligations. P&T compensated the Company for the future management of certain of these liabilities, including forestry related obligations, resulting in the transfer of portions of these liabilities to the Company at closing. Results of the operations of the acquired assets have been included in the Statement of Operations of the Company commencing May 1, 2008.

## (b) Beaver and Forks operations acquisition from Portac, Inc.:

On September 30, 2008, the Company completed the acquisition of a sawmill, planer mill and inventories from Portac, Inc. ("Portac"), a subsidiary of Mitsui U.S., Inc. To acquire these assets, the Company paid US\$32,181,000 (\$34,256,000), of which US\$30,200,000 (\$32,139,000) was financed through its Revolving Term Line and the balance of US\$1,981,000 (\$2,117,000) through cash on hand.

Amounts paid in US\$ were translated to CAD\$ at the September 30, 2008 rate of CAD\$1.0642: US\$1.00.

The assets, which are located on the Olympic Peninsula in Washington State, were renamed "Beaver Division". Results of the operations of the acquired facilities have been included in the Statement of Operations of the Company commencing October 1, 2008.

**3. Long-lived assets held for sale:**

The Company has developed formal plans to dispose of certain surplus properties and has classified these assets as assets held for sale. During 2009, the Company was able to dispose of the properties and improvements of the former Queensboro sawmill site located in New Westminster, B.C. as well as surplus property and buildings located in Maple Ridge, B.C. (see also Other income note 13). These properties, together with the property at the former Field sawmill site located in Courtenay, B.C., were classified as held for sale at December 31, 2008. As at December 31, 2009, the property at the former Field sawmill site remains classified as held for sale.

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Notes to Consolidated Financial Statements

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**4. Inventories:**

|        | 2009      | 2008      |
|--------|-----------|-----------|
| Logs   | \$ 31,011 | \$ 51,158 |
| Lumber | 24,301    | 22,484    |
| Other  | 4,847     | 5,349     |
|        | \$ 60,159 | \$ 78,991 |

Inventory expensed in the period includes production costs, amortization of plant and equipment, and depletion and amortization of timber, roads and other. The inventory writedown to record inventory at the lower of cost and net realizable value at December 31, 2009 was \$9,578,000 (2008 - \$20,270,000).

**5. Investments and other assets:**

|  | 2009      | 2008      |
|--|-----------|-----------|
| Seaboard Shipping Company Limited                        | \$ 8,774  | \$ 10,540 |
| Other investments and deposits                           | 563       | 1,686     |
| Pension asset (note 18(b))                               | 7,121     | 6,581     |
| Deferred financing fees, net of accumulated amortization | 602       | 565       |
|  | \$ 17,060 | \$ 19,372 |

Summarized information of Seaboard is as follows:

|                                | 2009      | 2008      |
|--------------------------------|-----------|-----------|
| Total assets                   | \$ 21,620 | \$ 29,009 |
| Shareholders' equity           | 17,699    | 24,238    |
| Net sales                      | 36,278    | 45,434    |
| Interfor's shipment percentage | 75.7%     | 62.2%     |
| Interfor's equity in earnings  | \$ 1,885  | \$ 4,825  |
| Distributions received         | 3,651     | -         |

In 2009, a cash distribution was made to the partners, of which the Company's share was \$3,651,000. In accordance with equity accounting, the distributions were recorded as a reduction of the investment. See also Payable to investee company, note 9.

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Notes to Consolidated Financial Statements

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**6. Property, plant and equipment:**

| 2009                    | Cost       | Accumulated<br>amortization | Net book<br>value |
|-------------------------|------------|-----------------------------|-------------------|
| Land                    | \$ 15,990  | \$ -                        | \$ 15,990         |
| Buildings               | 71,198     | 29,324                      | 41,874            |
| Machinery and equipment | 420,160    | 151,110                     | 269,050           |
| Mobile equipment        | 8,892      | 6,778                       | 2,114             |
| Computer equipment      | 20,509     | 11,321                      | 9,188             |
| Site improvements       | 25,400     | 7,088                       | 18,312            |
| Other                   | 4,588      | 3,615                       | 973               |
|                         | \$ 566,737 | \$ 209,236                  | \$ 357,501        |
| 2008                    |            |                             |                   |
| Land                    | \$ 16,408  | \$ -                        | \$ 16,408         |
| Buildings               | 68,891     | 30,536                      | 38,355            |
| Machinery and equipment | 445,206    | 142,562                     | 302,644           |
| Mobile equipment        | 9,547      | 6,276                       | 3,271             |
| Computer equipment      | 25,204     | 13,744                      | 11,460            |
| Site improvements       | 26,849     | 5,643                       | 21,206            |
| Other                   | 5,811      | 3,428                       | 2,383             |
|                         | \$ 597,916 | \$ 202,189                  | \$ 395,727        |

**7. Roads, bridges and timber tenures:**

| 2009              | Cost       | Accumulated<br>amortization | Net book<br>value |
|-------------------|------------|-----------------------------|-------------------|
| Roads and bridges | \$ 41,730  | \$ 25,245                   | \$ 16,485         |
| Timber tenures    | 101,718    | 34,708                      | 67,010            |
|                   | \$ 143,448 | \$ 59,953                   | \$ 83,495         |
| 2008              |            |                             |                   |
| Roads and bridges | \$ 44,586  | \$ 23,988                   | \$ 20,598         |
| Timber tenures    | 102,588    | 32,761                      | 69,827            |
|                   | \$ 147,174 | \$ 56,749                   | \$ 90,425         |

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Notes to Consolidated Financial Statements  
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(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

## 8. Bank indebtedness and long-term debt:

### (a) Bank indebtedness:

|  | Canadian<br>Operating<br>Facility | U.S.<br>Operating<br>Facility | Total      |
|--|-----------------------------------|-------------------------------|------------|
| 2009   |                                   |                               |            |
| Available line of credit                                   | \$ 65,000                         | \$ -                          | \$ 65,000  |
| Maximum borrowing available                                | 61,926                            | -                             | 61,926     |
| Operating Line drawings                                    | -                                 | -                             | -          |
| Outstanding letters of credit included in line utilization | 4,997                             | -                             | 4,997      |
| Unused portion of line                                     | 56,929                            | -                             | 56,929     |
| 2008   |                                   |                               |            |
| Available line of credit                                   | \$ 100,000                        | \$ 12,180                     | \$ 112,180 |
| Maximum borrowing available                                | 54,234                            | 7,836                         | 62,070     |
| Operating Line drawings                                    | 25,747                            | 6,090                         | 31,837     |
| Outstanding letters of credit included in line utilization | 5,105                             | 146                           | 5,251      |
| Unused portion of line                                     | 23,382                            | 1,600                         | 24,982     |

In 2009, the Company renewed its existing Canadian operating line of credit ("Operating Line"), decreasing the maximum available operating credit to \$65,000,000 (2008 - \$100,000,000). The 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. Borrowings levels under the line are subject to a borrowing base calculation dependent on certain accounts receivable and inventories.

As part of the amendment, margining availability was extended to include inventory domiciled in the United States. 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 line matures on April 23, 2010. As at December 31, 2009, there were no drawings under the Operating Line (2008 - \$25,747,000).

On December 14, 2009, the Company received a financing commitment with respect to its Operating Line from its lenders, details of which are described in Subsequent events, note 23(b).

As a consequence of the extension of margining coverage, all U.S. working capital is included in the Operating Line facility and the Company did not renew its U.S. operating line of credit ("U.S. Line") when it matured on April 24, 2009, repaying all outstanding drawings. As at December 31, 2008, the U.S. Line was drawn by US\$5,000,000, revalued at the year-end exchange rate to \$6,090,000.

In 2008, drawings under the operating lines were offset by cash balances less outstanding cheques of \$1,248,000.

### (b) Long-term debt:

The Company amended its existing Revolving Term Line in 2009 increasing it from \$115,000,000 to \$150,000,000. The terms and conditions of the line remained unchanged, except for an increase to the interest rate margins. 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. The line matures on April 24, 2011.

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Notes to Consolidated Financial Statements  
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(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

## 8. Bank indebtedness and long-term debt (continued):

### (b) Long-term debt (continued):

As at December 31, 2009, the Revolving Term Line was drawn by US\$30,200,000 revalued at the year-end exchange rate to \$31,740,000, and \$76,000,000 for total drawings of \$107,740,000 (2008 - \$94,784,000), leaving an unused available line of \$42,260,000 (2008 - \$20,216,000). The portion of the line drawn in \$US funds was designated as a hedge against the Company's investment in its self-sustaining U.S. operations effective October 1, 2008 and unrealized foreign exchange gains of \$5,043,000 (2008 - \$4,645,000 loss) arising on revaluation of the Revolving Term Line were recognized in Other comprehensive income for 2009.

The U.S. dollar non-revolving term line (the "Non-Revolving Term Line") remains fully drawn at US\$35,000,000 (2008 - US\$35,000,000) and was revalued at the year-end exchange rate to \$36,785,000 (2008 - \$42,630,000). The Non-Revolving Term Line matures on September 1, 2010. The Non-Revolving Term Line bears interest at rates based on bank prime plus a margin or, at the Company's option, at rates for LIBOR based loans plus a margin, in all cases depending upon a financial ratio. The foreign exchange gain for the year ended December 31, 2009 of \$5,845,000 (2008 - \$7,934,000 loss) arising on revaluation of the Non-Revolving Term Line was recognized in Other foreign exchange gain (loss) on the Statement of Operations for 2009.

Both of the term 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 sawmills. The term lines are subject to certain financial covenants including a minimum working capital requirement and a maximum ratio of total debt to total capitalization and a minimum net worth calculation.

On December 14, 2009, the Company received a financing commitment with respect to its Revolving Term Line from its lenders extending and modifying its syndicated credit facilities effective January 15, 2010 (see Subsequent events, note 23(b)). In conjunction with the amendments to its credit facilities, the Company drew on its new Revolving Term Line, being a long-term facility, and repaid and cancelled its existing Non-Revolving Term Line of US\$35,000,000 on January 15, 2010. Accordingly, the Non-Revolving Term Line has been classified as long-term.

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

|      |                        |
|------|------------------------|
| 2010 | \$ 36,785 <sup>1</sup> |
| 2011 | 107,740 <sup>1</sup>   |
| 2012 | -                      |
| 2013 | -                      |
| 2014 | -                      |
|      | <hr/>                  |
|      | \$ 144,525             |

<sup>1</sup> The long-term debt was refinanced on January 15, 2010, and maturity dates were extended (see Subsequent events, note 23(b) for further details).

## 9. Payable to investee company:

On December 29, 2009, the Seaboard Limited Partnership ("the Seaboard Partnership"), made an advance to its partners, with Interfor's share of the advance being \$3,096,000. The Company signed an unsecured promissory note which is payable on demand on or before January 4, 2010 and is non-interest bearing until January 4, 2010 and bears interest at the rate of 4% per annum thereafter.

This advance was subsequently repaid (see Subsequent events, note 23(a)).

**9. Payable to investee company (continued):**

On December 29, 2008, the Seaboard Partnership made an advance to its partners, with Interfor's share of the advance being \$3,651,000. On January 2, 2009, the Seaboard Partnership declared an income distribution to its partners, of which the Company's share of \$3,651,000 was received by way of setoff against the promissory note payable to the Seaboard Partnership.

**10. Other long-term liabilities:**

|  | 2009             | 2008             |
|--|------------------|------------------|
| Road deactivation and environmental                              | \$ 5,026         | \$ 4,817         |
| Pension and other post-retirement benefits (notes 18(b) and (e)) | 4,706            | 4,922            |
| Long term incentive compensation                                 |                  |                  |
| Share based (notes 12(c) and (d))                                | 1,550            | 340              |
| Total shareholder return plan                                    | 2,280            | 810              |
| Other  | 1,754            | 1,518            |
|  | <b>\$ 15,316</b> | <b>\$ 12,407</b> |

In 2003, the Company introduced a Total Shareholder Return Plan ("TSR Plan") for certain key executives. Under the TSR Plan, 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. For the three year period which commenced in fiscal 2007, a minimum target award has been guaranteed for the Chief Operating Officer irrespective of the actual compound growth rate.

The Company recorded compensation expense under the TSR Plan of \$1,470,000 (2008 - \$405,000) for the year ended December 31, 2009.

**11. Reforestation liability:**

The Company has an obligation to reforest areas harvested under various timber rights. The obligation is incurred as production 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:

|  | 2009             | 2008             |
|--|------------------|------------------|
| Reforestation liability, beginning of year             | \$ 24,345        | \$ 16,429        |
| Reforestation expense on current production            | 2,779            | 3,317            |
| Reforestation liability addition on acquisition of     |                  |                  |
| Kootenay operations                                    | -                | 14,289           |
| Reforestation expenditures                             | (5,969)          | (10,392)         |
| Accretion expense                                      | 1,098            | 831              |
| Changes in estimated future reforestation expenditures | (757)            | (129)            |
|  | <b>\$ 21,496</b> | <b>\$ 24,345</b> |

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## 11. Reforestation liability (continued):

|  | 2009             | 2008             |
|--|------------------|------------------|
| Consisting of:   |                  |                  |
| Current portion included in accounts payable and accrued liabilities | \$ 6,772         | \$ 8,660         |
| Long term reforestation liability                                    | 14,724           | 15,685           |
|  | <u>\$ 21,496</u> | <u>\$ 24,345</u> |

The total undiscounted amount of the estimated future expenditures required to settle the reforestation obligation at December 31, 2009 is \$24,610,000 (2008 - \$27,339,000). The reforestation expenditures are expected to occur over the next one to seventeen years and have been discounted at the Company's estimated credit-adjusted risk-free interest rate of 7.0%. Reforestation expense incurred due to current production and accretion expense are included in production costs for the year.

## 12. Share capital:

### (a) Share transactions:

Authorized capital at December 31, 2009 and 2008 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 2009 and 2008 were as follows:

|                                      | Number     |           |            | Amount     |
|--------------------------------------|------------|-----------|------------|------------|
|                                      | Class A    | Class B   | Total      |            |
| Balance, December 31, 2007           | 46,089,076 | 1,015,779 | 47,104,855 | 288,524    |
| Shares issued on exercise of options | 12,400     | -         | 12,400     | 56         |
| Balance, December 31, 2008 and 2009  | 46,101,476 | 1,015,779 | 47,117,255 | \$ 288,580 |

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 January 3, 2008, the Company received approval to make a normal course issuer bid to acquire up to 1,300,000 Class A shares (representing approximately 2.8% of the outstanding Class A shares as at December 31, 2007) through the facilities of the Toronto Stock Exchange. Any Class A shares purchased by the Company are at market prices and are cancelled as purchased. The program commenced on January 8, 2008 and terminated on January 7, 2009.

The Company did not repurchase any Class A shares through the normal course issuer bid in 2008 or 2009.

There was no change in contributed surplus in 2009 or 2008.

**12. Share capital (continued):**

(a) Share transactions (continued):

At December 31, 2009, 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) 2,154,940 Class A shares are reserved for possible issuance pursuant to the share option plan.

(b) Share option plan:

The Company has 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. Options outstanding at December 31, 2009 are exercisable at prices ranging from \$3.65 to \$4.94 per share, being the closing market price for the shares on the dates that the options were granted. The options expire at various dates between January 30, 2010 and April 30, 2011.

Details of the Company's share option plan for the years ended December 31, 2009 and 2008 are as follows:

|                                | 2009      |                                 | 2008      |                                 |
|--------------------------------|-----------|---------------------------------|-----------|---------------------------------|
|                                | Options   | Weighted average exercise price | Options   | Weighted average exercise price |
| Outstanding, beginning of year | 1,021,340 | \$ 4.59                         | 1,409,840 | \$ 4.51                         |
| Granted                        | -         | -                               | -         | -                               |
| Exercised                      | -         | -                               | (12,400)  | 4.49                            |
| Expired or cancelled           | (270,000) | 5.00                            | (376,100) | 4.31                            |
| Outstanding, end of year       | 751,340   | \$ 4.44                         | 1,021,340 | \$ 4.59                         |
| Options exercisable, year end  | 751,340   | \$ 4.44                         | 1,021,340 | \$ 4.59                         |

The options outstanding at December 31, 2009 have a weighted average remaining life of 1.8 years.

(c) 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. Under the SAR Plan, awards will be expensed over the vesting periods when the market price of the common shares exceeds the strike price under the plan. Changes in the quoted market value of those shares between the date of grant and the measurement date result in a change in the measure of the compensation for the award and will be amortized over the remaining vesting periods. 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 (see Other long-term liabilities, note 10).

**12. Share capital (continued):**

(c) Share Appreciation Rights Plan (continued):

|                                | 2009      |                               | 2008      |                               |
|--------------------------------|-----------|-------------------------------|-----------|-------------------------------|
|                                | Units     | Weighted average strike price | Units     | Weighted average strike price |
| Outstanding, beginning of year | 1,428,320 | \$ 5.90                       | 1,226,720 | \$ 5.99                       |
| Granted                        | 363,500   | 1.38                          | 352,000   | 5.21                          |
| Exercised                      | -         | -                             | (3,900)   | 4.33                          |
| Expired or cancelled           | (59,240)  | 4.28                          | (146,500) | 5.02                          |
| Outstanding, end of year       | 1,732,580 | \$ 5.01                       | 1,428,320 | \$ 5.90                       |
| Units exercisable, year end    | 921,960   | \$ 5.85                       | 793,140   | \$ 5.62                       |

Details of units outstanding under the SAR Plan at December 31, 2009 are as follows:

| Strike price  | Number outstanding, December 31, 2009 | Units outstanding                          |                               | Units exercisable                     |                               |
|---------------|---------------------------------------|--|-------------------------------|---------------------------------------|-------------------------------|
|               |                                       | Weighted average remaining unit life (yrs) | Weighted average strike price | Number exercisable, December 31, 2009 | Weighted average strike price |
| \$1.38        | 341,000                               | 9.1  | \$ 1.38                       | -                                     | \$ -                          |
| \$4.33-\$5.21 | 645,360                               | 5.0  | 4.76                          | 328,360                               | 4.33                          |
| \$6.07-\$7.30 | 597,720                               | 4.2  | 6.60                          | 534,200                               | 6.55                          |
| \$8.02        | 148,500                               | 7.1  | 8.02                          | 59,400                                | 8.02                          |
|               | 1,732,580                             |  | \$ 5.01                       | 921,960                               | \$ 5.85                       |

The Company recorded compensation expense of \$546,000 (2008 – recovery of \$728,000) for the year ended December 31, 2009. Accrued compensation payable on unexercised units totaled \$546,000 (2008 - \$nil) at December 31, 2009, of which \$184,000 (2008 - \$nil) was classified current and recorded in accounts payable and accrued liabilities and the balance was recorded in long-term liabilities (see Other long-term liabilities, note 10).

(d) Deferred Share Unit Plan:

In January 2004, the Company introduced a Deferred Share Unit ("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 credited to a cash account under the DSU Plan. There were no DSU's issued under the TSR Plan in 2008.

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. In 2009 a total of 31,602 DSU's (2008 – 42,669) were granted to or taken by Directors under the plan at an average value of \$2.29 (2008 - \$4.12) per unit.

**12. Share capital (continued):**

(d) Deferred Share Unit Plan (continued):

The Company recorded compensation expense of \$1,170,000 (2008 – recovery of \$1,667,000) for the year ended December 31, 2009 in respect of the DSU Plan. Subsequent changes to share values will result in adjustments to the compensation accrual and expense. At December 31, 2009, the Company had 361,465 (2008 – 363,863) DSU's outstanding. At December 31, 2009, accrued compensation payable in respect of the DSU Plan totaled \$1,781,000 (2008 - \$526,000), of which \$593,000 (2008 - \$186,000) was classified current and recorded in accounts payable and accrued liabilities and the balance was recorded in long-term liabilities (see Other long-term liabilities, note 10).

**13. Other income:**

|   | 2009             | 2008            |
|---|------------------|-----------------|
| Gain on disposal of surplus property, plant,<br>and equipment, and investment | \$ 22,085        | \$ 794          |
| Gain on settlement of timber takeback   | 1,004            | 747             |
| Other   | (124)            | (123)           |
|   | <b>\$ 22,965</b> | <b>\$ 1,418</b> |

In 2009, the Company completed the sale of its former Queensboro millsite, located in New Westminster, B.C. and its remaining surplus equipment, yielding net proceeds of \$30,197,000 and a gain of \$21,169,000. The Company also disposed of surplus property and buildings in Maple Ridge, B.C. which, combined with other disposals of surplus equipment and an investment, generated sales proceeds of \$4,788,000 and a gain of \$916,000. The Queensboro millsite and surplus property and buildings in Maple Ridge, B.C. had been classified as held for sale at December 31, 2008.

In addition, under the terms of the *Forest Act*, the Company received \$2,000,000 as advance compensation for timber, roads and bridges resulting from the 2006 legislated takeback of certain logging rights on the B.C. Coast, and recorded a gain of \$1,004,000 (see also Commitments and contingencies, note 16(b)).

In 2008, the Company disposed of surplus investments, plant, property, and equipment as well as a timber licence. In addition, the Company received compensation from the Province of British Columbia for the loss of logging rights for timber licences in the Central Coast and for obsolete infrastructure. These dispositions combined to generate sales proceeds of \$5,096,000 and a gain of \$1,541,000.

**14. Restructuring costs and write-downs of plant, equipment and timber:**

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

|   | 2009            | 2008             |
|---|-----------------|------------------|
| Plant, equipment and timber write-downs | \$ 3,067        | \$ 29,010        |
| Severance costs                         | 1,565           | 4,852            |
| Other (recovery)                        | (265)           | 1,026            |
|   | <b>\$ 4,367</b> | <b>\$ 34,888</b> |

During 2009, the Company determined certain assets were impaired in the current operating environment and recorded \$3,067,000 in asset write-downs. In addition, total severance costs of \$1,565,000 were recorded as the Company downsized its workforce in response to reduced operating rates. A successful defense of a legal dispute in 2009 allowed the Company to reverse restructuring costs of \$265,000 previously accrued.

During 2008, the Company permanently closed both its Albion remanufacturing operation located in Maple Ridge, B.C., and its Queensboro sawmill located in New Westminster, B.C. The Company recorded severance and remediation costs totaling \$5,437,000 related to the permanent closures as well as an impairment charge of \$27,333,000 on the plant and equipment to reduce the carrying values of these assets to estimated fair values.

Also during 2008, due to deteriorating market conditions, the Company indefinitely curtailed the old Adams Lake sawmill and recorded an impairment charge of \$1,243,000 on the plant and equipment and severance costs of \$689,000.

Additional restructuring charges during 2008 include a timber impairment charge of \$434,000 offset by a net recovery of other restructuring costs of \$248,000.

As at December 31, 2009, \$1,359,000 (2008 - \$2,850,000) in severance and other cash restructuring costs are included in accounts payable and accrued liabilities. The Company expects to pay this amount in 2010 in accordance with its restructuring plans. In addition, a further \$618,000 (2008 - \$862,000) in other restructuring reserves are also included in accounts payable and accrued liabilities.

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**15. Income taxes:**

Future income taxes are determined as follows:

|   | 2009      | 2008        |
|---|-----------|-------------|
| Future income tax assets:   |           |             |
| Losses carried forward  | \$ 68,502 | \$ 47,440   |
| Reforestation, restructuring and other accruals<br>deductible when paid | 7,139     | 10,390      |
| Tax credits   | 2,779     | 1,149       |
|   | 78,420    | 58,979      |
| Valuation allowance   | (22,734)  | (18,336)    |
|   | 55,686    | 40,643      |
| Future income tax liabilities:  |           |             |
| Property, plant and equipment   | (58,013)  | (51,782)    |
| Other   | 2,015     | (130)       |
|   | \$ (312)  | \$ (11,269) |
| Current future income tax assets  | \$ 2,974  | \$ 2,890    |
| Non-current future income tax liabilities                               | (3,286)   | (14,159)    |
|   | \$ (312)  | \$ (11,269) |

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

|  | 2009        | 2008        |
|--|-------------|-------------|
| Income tax expense (recovery) at the statutory rate of<br>30.0% (2008 – 31.0%) | \$ (10,132) | \$ (20,580) |
| Valuation allowance on U.S. future income tax assets                           | 7,449       | 15,247      |
| Non-taxable income of investments accounted for by<br>the equity method        | (565)       | (1,496)     |
| Entities with different tax rates  | (1,245)     | (1,122)     |
| Non-taxable portion of capital losses (gains)                                  | (6,013)     | 331         |
| Change in future tax rates and statutory and tax recovery<br>rate difference   | 789         | (1,143)     |
| Other  | (169)       | (2,232)     |
|  | \$ (9,886)  | \$ (10,995) |

The Company's Canadian non-capital loss carry-forwards and U.S. net operating loss carry-forwards totalling approximately \$216,000,000 (2008 - \$133,000,000) expire between 2014 and 2029, and are available to reduce future taxable income. The Company has provided a valuation allowance in respect of approximately \$62,000,000 (2008 - \$49,000,000) of its U.S. operating loss carry-forwards, net of temporary differences. The Company has no Alternative Minimum Tax Credits (2008 - \$252,000) arising from its U.S. operations. The Company also has B.C. Manufacturing and Processing tax credit and Canadian investment tax credit carry-forwards of \$2,779,000 (2008 - \$897,000) which expire between 2010 and 2026.

**16. 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:

|      |          |
|------|----------|
| 2010 | \$ 4,660 |
| 2011 | 3,100    |
| 2012 | 2,440    |
| 2013 | 1,940    |
| 2014 | 1,760    |

(b) Central and North Coast Land Use Decisions:

In 2006, the Government of B.C. announced land use decisions for the Central Coast and the North Coast regions of B.C. which recently resulted in permanent reductions in the Company's allowable annual cut ("AAC") in the plan areas. The Company has not been harvesting its full AAC in this region for a number of years due to temporary reductions put in place during the negotiation period and uncertainty around operating areas.

In 2009, the Company received \$2,500,000 as an advance of compensation under the Forest Act for timber, roads and bridges, and forestry and engineering work related to timber returned pursuant to the Plan. The Company recorded \$2,000,000 as proceeds on disposition of related assets, and \$500,000 as a recovery of production costs.

The amount and timing of any further compensation payable to the Company as a result of the AAC reductions is not yet determinable, and will be recorded when the amounts can be reasonably estimated.

(c) Surety Performance Bonds

The Company has posted \$7,114,000 in surety performance bonds, with expiry dates ranging from March 2010 through November 2014.

(d) Commitment

On July 3, 2009, the Company finalized a revised agreement to acquire a timber tenure and related reforestation liabilities in the Kamloops region from Weyerhaeuser Company Limited. The transfer of the tenure requires regulatory approval. Subject to receiving the required approval, the Company expects to conclude this transaction in early 2010.

(e) Contingency

The P&T assets acquired have pipe insulation and board in the kiln decks that may contain asbestos. There are no plans to disturb or remove this material and the Company is unable to determine the amount of asbestos that may be present. As such there is insufficient information to apply expected present value techniques to these conditional asset retirement obligations and no liability has been recorded.

(f) 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.

**17. Net earnings per share:**

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

|                  | 2009        |                                   |           | 2008        |                                   |           |
|------------------|-------------|-----------------------------------|-----------|-------------|-----------------------------------|-----------|
|                  | Net loss    | Weighted average number of Shares | Per share | Net loss    | Weighted average number of Shares | Per share |
| Basic earnings   |             |                                   |           |             |                                   |           |
| (loss) per share | \$ (23,887) | 47,117                            | \$ (0.51) | \$ (55,391) | 47,109                            | (1.18)    |
| Share options    | -           | -                                 | -         | -           | 45*                               | -         |
| Diluted earnings |             |                                   |           |             |                                   |           |
| (loss) per share | \$ (23,887) | 47,117                            | \$ (0.51) | \$ (55,391) | 47,109                            | \$ (1.18) |

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

**18. Pension and other post-retirement plans:**

In Canada, the Company maintains a number of savings and retirement plans that are available to employees that meet certain eligibility requirements. A Group Registered Retirement Savings Plan ("RRSP") and a Deferred Profit Sharing Plan ("DPSP") is available to salaried employees. A defined benefit pension plan is available to non-union hourly employees at the Adams Lake operations. A defined benefit pension plan and a post-retirement medical and life insurance plan is available to Canadian Merchant Service Guild ("CMSG") unionized employees in the Interior of B.C. In addition, the Company contributes to an industry-wide defined benefit pension plan for United Steelworkers unionized employees.

In the U.S., the Company maintains a 401(k) plan that is available to all eligible employees.

The Company also maintains supplementary pension plans for certain senior management in both Canada and the U.S.

Total cash payments for employee future benefits for 2009, consisting of cash contributed by the Company to its funded pension plans, cash contributed to the DPSP and 401(k) plans, cash contributed to a multiemployer defined benefit pension plan, and cash paid under senior management supplementary pension plans was \$4,675,000 (2008 - \$5,837,000).

(a) RRSP AND DPSP for Canada:

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 the RRSP. The Company matches employees' RRSP contributions in the 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 crediting contributions to an employee's account. For 2009, the pension expense for this plan is equal to the Company's contribution of \$1,145,000 (2008 - \$1,273,000).

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## 18. Pension and other post-retirement plans (continued):

(b) Defined benefit plans:

The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation of the CMSG pension plan and post-retirement benefits obligations was as of April 30, 2008, and for the Adams Lake pension plan was as of December 31, 2006. The next required funding valuations for the defined benefit pension plans is as of December 31, 2009 and the next scheduled valuation for the other post-retirement benefits obligation will be as of April 30, 2011.

|   | Other Post-retirement Benefits |                   | Pension Benefits          |               |
|---|--------------------------------|-------------------|---------------------------|---------------|
|   | 2009                           | 2008              | 2009                      | 2008          |
| <b>Accrued benefit obligation:</b>          |                                |                   |                           |               |
| Beginning of year                           | \$ 874                         | \$ -              | \$ 25,311                 | \$ 21,738     |
| Acquisitions (note 2)                       | -                              | 1,010             | -                         | 8,915         |
| Actuarial (gain) loss                       | 9                              | -                 | -                         | -             |
| Service cost                                | 15                             | 13                | 275                       | 390           |
| Interest cost on accrued benefit obligation | 62                             | 40                | 1,797                     | 1,539         |
| Benefit payments                            | (59)                           | (37)              | (1,593)                   | (1,297)       |
| Impact of new discount rate at year-end     | 124                            | (152)             | 3,346                     | (5,974)       |
| <b>End of year</b>                          | <b>1,025</b>                   | <b>874</b>        | <b>29,136</b>             | <b>25,311</b> |
| <b>Plan assets:</b>                         |                                |                   |                           |               |
| Fair value, beginning of year               | -                              | -                 | 25,575                    | 21,361        |
| Acquisitions (note 2)                       | -                              | -                 | -                         | 8,031         |
| Expected return on plan assets              | -                              | -                 | 1,787                     | 1,892         |
| Employer contributions                      | 59                             | 37                | 1,379                     | 2,347         |
| Employee contributions                      | -                              | -                 | 125                       | 116           |
| Benefit payments                            | (59)                           | (37)              | (1,593)                   | (1,297)       |
| Actuarial gain (loss)                       | -                              | -                 | 2,608                     | (6,875)       |
| <b>Fair value, end of year</b>              | <b>-</b>                       | <b>-</b>          | <b>29,881</b>             | <b>25,575</b> |
| <b>Funded status</b>                        |                                |                   |                           |               |
| – plan surplus (deficit)                    | (1,025)                        | (874)             | 745                       | 264           |
| <b>Unamortized actuarial loss (gain)</b>    | <b>(14)</b>                    | <b>(152)</b>      | <b>6,376</b>              | <b>5,918</b>  |
| <b>Accrued benefit asset (liability) \$</b> | <b>(1,039) \$</b>              | <b>(1,026) \$</b> | <b>7,121 \$</b>           | <b>6,182</b>  |
| <b>Plan assets consist of:</b>              |                                |                   |                           |               |
| Asset category                              |                                |                   | 2009                      | 2008          |
|   |                                |                   | Percentage of plan assets |               |
| Equity securities                           |                                |                   | 55%                       | 56%           |
| Debt securities                             |                                |                   | 42%                       | 40%           |
| Other                                       |                                |                   | 3%                        | 4%            |
| <b>Total</b>                                |                                |                   | <b>100%</b>               | <b>100%</b>   |

**18. Pension and other post-retirement plans (continued):**

(b) Defined benefit plans (continued):

The Company's accrued benefit asset (liabilities) are included in the Company's balance sheet as follows (see Investments and other assets, note 5 and Other long-term liabilities, note 10):

|  | Post-Retirement Benefits |            | Pension Benefits |          |
|--|--------------------------|------------|------------------|----------|
|  | 2009                     | 2008       | 2009             | 2008     |
| Investments and other assets             | \$ -                     | \$ -       | \$ 7,121         | \$ 6,581 |
| Accounts payable and accrued liabilities | (50)                     | (40)       | -                | -        |
| Other long-term liabilities              | (989)                    | (986)      | -                | (399)    |
|  | \$ (1,039)               | \$ (1,026) | \$ 7,121         | \$ 6,182 |

The Company's net expense for the Company's defined benefit pension and post-retirement benefits plans are as follows:

|  | Post-Retirement Benefits |       | Pension Benefits |         |
|--|--------------------------|-------|------------------|---------|
|  | 2009                     | 2008  | 2009             | 2008    |
| Current service cost                     | \$ 15                    | \$ 13 | \$ 150           | \$ 274  |
| Interest cost                            | 62                       | 40    | 1,797            | 1,539   |
| Expected return on plan assets           | -                        | -     | (1,787)          | (1,892) |
| Amortization of actuarial gains (losses) | (5)                      | -     | 280              | 235     |
|  | \$ 72                    | \$ 53 | \$ 440           | \$ 156  |

Actuarial assumptions used in accounting for the Company maintained benefit plans are:

|  | Post-Retirement Benefits |       | Pension Benefits |       |
|--|--------------------------|-------|------------------|-------|
|  | 2009                     | 2008  | 2009             | 2008  |
| Accrued benefit obligation as of December 31 |                          |       |                  |       |
| Discount rate                                | 6.25%                    | 7.25% | 6.25%            | 7.25% |
| Compensation increases <sup>1</sup>          | -                        | -     | 3.5%             | 3.5%  |
| Pension expense                              |                          |       |                  |       |
| Discount rate <sup>2</sup>                   | 7.25%                    | 6.0%  | 7.25%            | 5.5%  |
| Expected return on plan assets               | -                        | -     | 7.0%             | 7.0%  |
| Compensation increases <sup>1</sup>          | -                        | -     | 3.5%             | 3.5%  |

For measurement purposes at December 31, 2009, the Company has assumed a 7.90% health care cost trend in 2010 grading down to 4.27% in 2015 (2008 – 7.60% health care cost trend in 2009 grading down to 4.27% in 2015).

<sup>1</sup>Compensation increases only relate to the CMSG plan.

<sup>2</sup>The discount rate for the CMSG pension plan in 2008 was 6%.

(c) 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 2009, the pension expense for these plans is equal to the Company's contribution of \$1,276,000 (2008 - \$1,492,000). The Company's liability is limited to its contributions.

**18. Pension and other post-retirement plans (continued):**

(d) 401(k) plan for U.S.:

IPI and Cedarprime Inc., the Company's U.S. operating subsidiaries, match employee contributions based on a percentage of the employee's earnings and vest immediately. The Company's funding obligations are satisfied upon crediting contributions to an employee's account. For 2009, the pension expense for this plan is equal to the Company's contribution of \$573,000 (2008 - \$495,000).

In 2005, contributions based on a discretionary profit sharing allocation were replaced with the matching component. Previous contributions under profit sharing allocation component continue to vest in years two through six of employment at a rate of 20% per annum.

(e) 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 of the Deferred Profit Sharing Plan in Canada and the 401(k) plan in the U.S. These commitments are not funded but are fully accrued by the Company (note 10), with a portion of the commitments being secured by irrevocable letters of credit.

The Company also maintains a defined benefit pension plan for a former senior executive. The accrued benefit obligation is \$733,000 (2008 - \$761,000), of which \$361,000 (2008 - \$304,000) is funded.

During 2009 the Company made cash payments of \$243,000 (2008 - \$193,000) and recorded an expense of \$459,000 (2008 - \$467,000) in respect of these plans.

The amounts accrued are as follows:

|  | 2009            | 2008            |
|--|-----------------|-----------------|
| Accrual for defined contribution commitments | \$ 3,629        | \$ 3,361        |
| Accrual for defined benefit commitments      | 372             | 457             |
|  | <b>\$ 4,001</b> | <b>\$ 3,818</b> |

The accrued liabilities are included in the Company's balance sheet as follows:

|  | 2009            | 2008            |
|--|-----------------|-----------------|
| Accounts payable and accrued liabilities | \$ 284          | \$ 281          |
| Other long-term liabilities (note 10)    | 3,717           | 3,537           |
|  | <b>\$ 4,001</b> | <b>\$ 3,818</b> |

**19. Related party transactions:**

Lumber sales to a significant shareholder amounted to \$926,000. In 2008 the Company had lumber sales to an affiliate of a significant shareholder in the amount of \$1,021,000. Shipping services provided by Seaboard totaled \$4,175,000 (2008 - \$5,553,000). These transactions were conducted on a normal commercial basis, including terms and prices.

**20. 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.

The Company sells to both foreign and domestic markets as follows:

|               | 2009              | 2008              |
|---------------|-------------------|-------------------|
| Canada        | \$ 116,655        | \$ 162,825        |
| United States | 160,955           | 162,352           |
| Japan         | 54,542            | 40,823            |
| Other export  | 57,623            | 71,221            |
|               | <b>\$ 389,775</b> | <b>\$ 437,221</b> |

Sales by product line are as follows:

|                                  | 2009              | 2008              |
|----------------------------------|-------------------|-------------------|
| Lumber                           | \$ 288,627        | \$ 297,434        |
| Logs                             | 60,443            | 103,620           |
| Wood chips and other by products | 34,349            | 30,610            |
| Other                            | 6,356             | 5,557             |
|                                  | <b>\$ 389,775</b> | <b>\$ 437,221</b> |

Capital assets, goodwill and other intangibles by geographic location are as follows:

|               | 2009              | 2008              |
|---------------|-------------------|-------------------|
| Canada        | \$ 299,365        | \$ 317,141        |
| United States | 158,133           | 197,227           |
|               | <b>\$ 457,498</b> | <b>\$ 514,368</b> |

**21. 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 (loss) 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 2009, in the face of the global economic downturn and extremely poor housing markets, the Company's focus was on managing the business for cash, severely curtailing discretionary capital spending and ensuring adequate liquidity was maintained.

**21. Capital management (continued):**

In January 2008, the Company filed a normal course issuer bid, as described in note 12, which expired in January 2009. As all purchases are made at market prices, the timing of any purchases are managed based on the share price and available cash flow. The Company considers its shares to be undervalued, and a buy-back program is consistent with the Company's goal of creating long-term value for its shareholders. Despite extremely low market prices, particularly at the end of 2008, no shares were acquired under the program as the global economic downturn resulted in a focus on cash conservation and, in 2008, the Company's cash resources were utilized to fund its acquisitions (note 2).

There were no changes in the Company's approach to capital management during the period. 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 for the foreseeable future.

**22. Financial instruments:****(a) Fair value of financial instruments:**

At December 31, 2009, the fair value of the Company's long-term debt and bank indebtedness approximated its carrying value of \$144,525,000 (2008 - \$168,003,000). 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 interest rate swaps and foreign currency forward and option contracts, to manage exposure to fluctuations in interest rates and foreign exchange rates. The Company does not expect any credit losses in the event of non-performance by counter parties as the counterparties are the Company's Canadian bankers, which are highly rated.

As at December 31, 2009, the Company has outstanding obligations to sell a maximum of US\$16,900,000 at an average rate of CAD\$1.0638 to the US\$1.00, buy a maximum of US\$35,000,000 at an average rate of CAD\$1.0467 to the US\$1.00, and sell Japanese ¥50,000,000 at an average rate of ¥92.41 to the CAD\$1.00 during 2010. All foreign currency gains or losses to December 31, 2009 have been recognized in the Statement of Operations and the fair value of these foreign currency contracts being an asset of \$403,000 and measured based on Level 1 has been recorded in accounts receivable (2008 - \$113,000 liability fair value measured based on Level 1 and recorded in accounts payable).

During September 2005, the Company entered into a cross currency interest rate swap. The Company had agreed to receive US\$20,000,000 at maturity on September 1, 2009 in exchange for payment of CAD\$23,530,000 (an exchange rate of 1.1765). In addition, during the term of the swap the Company paid an amount based on annual interest of 5.84% on the CAD\$23,530,000 and received a 90 day LIBOR plus a spread of 200 basis points on the US\$20,000,000. LIBOR was recalculated at set interval dates. The swap matured on September 1, 2009 and total foreign exchange losses of \$2,050,000 were recognized in 2009 (2008 - \$4,179,000 gain). The fair value of this cross currency interest rate swap was an asset of \$409,000 at December 31, 2008 and was recorded in accounts receivable.

**22. Financial instruments (continued):**

## (c) Hedge of investment in self-sustaining foreign operation:

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 self-sustaining U.S. operations. Unrealized foreign exchange gains of \$5,043,000 in 2009 (2008 - \$4,645,000 loss) have been recorded in Other Comprehensive Income.

The Company had previously designated its US\$35,000,000 dollar Non-Revolving Term Line as a hedge against its investment in its self-sustaining U.S. operations. Effective April 1, 2007, the Company terminated the designation of the hedging relationship and discontinued its hedge accounting. Previously recognized unrealized foreign exchange gains of \$5,544,000 as a result of applying hedge accounting continue to be recorded in Accumulated Other Comprehensive Income. Unrealized foreign exchange gains of \$5,845,000 (2008 - \$7,934,000 loss) were recorded in Other foreign exchange gain (loss) in the Statement of Operations in 2009.

## (d) Financial risk management:

Financial instrument assets include cash resources, deposits and accounts receivable. Cash resources and deposits are designated as held-for-trading and measured at fair value, while accounts receivable are designated as loans and receivables and measured at amortized cost.

Financial instrument liabilities include bank indebtedness, accounts payable and accrued liabilities, long-term debt, and certain other long-term liabilities. All financial liabilities are designated as other liabilities and are measured at amortized cost.

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 short-term investments.

*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 by the Export Development Corporation or are secured by irrevocable letters of credit.

**22. Financial instruments (continued):**

(d) Financial risk management (continued):

(i) Credit risk (continued):

*Accounts receivable (continued)*

The Company regularly reviews the collectibility 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 experienced minimal bad debts and this held true for 2009, despite the impacts of the global economic downturn and historically low housing starts on the forest industry. 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 \$57,000 was recorded (2008 - \$nil) for specific trade receivables.

*Deposits*

The Company limits its 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*

In 2008, the Company provided a parent guarantee on the U.S. Line utilized by its U.S. operating subsidiary. This was in compliance with the Company's policy to provide financial guarantees only with respect to wholly-owned subsidiary companies.

In 2009, the U.S. Line was not extended when it matured on April 24, 2009 and the guarantee was withdrawn.

*Exposure to credit risk*

The carrying amount of financial assets represents the maximum credit exposure for receivables in North America. As 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 was:

|               | 2009             | 2008             |
|---------------|------------------|------------------|
| Canada        | \$ 11,626        | \$ 7,644         |
| United States | 11,438           | 8,728            |
| Japan         | 5,365            | 3,976            |
| Other         | 4,522            | 5,093            |
|               | <b>\$ 32,951</b> | <b>\$ 25,441</b> |

(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 in late 2008 and through most of 2009, Company executive focused intently on cash management to ensure maintenance of adequate liquidity.

The Company also maintains a revolving Canadian Operating Line that can be drawn down to meet short-term financing needs. In early 2009, the Company amended and extended its existing Canadian syndicated credit facilities and as part of the amendment, margining availability was extended to include inventory domiciled in the United States.

**22. Financial instruments (continued):**

(d) Financial risk management (continued):

(ii) Liquidity risk (continued):

As a consequence of the extension of margining coverage, all U.S. working capital is included in the Canadian operating facility and the U.S. Line was not extended when it matured on April 24, 2009 and all outstanding drawings under the U.S. Line were repaid.

The payments due in respect of contractual and legal obligations are summarized as follows:

|   | Total            | Payments due by period |                  |                 |                  |
|---|------------------|------------------------|------------------|-----------------|------------------|
|   |                  | Up to<br>1 year        | 2-3<br>years     | 4-5<br>years    | After 5<br>years |
| Operating Line (note 23(b))                     | \$ -             | \$ -                   | \$ -             | \$ -            | \$ -             |
| Accounts payable and<br>accrued liabilities     | 33,021           | 33,021                 | -                | -               | -                |
| Payable to investee<br>company (note 23(a))     | 3,096            | 3,096                  | -                | -               | -                |
| Long-term debt (note 23(b))                     | 144,525          | 36,785                 | 107,740          | -               | -                |
| Reforestation liability                         | 21,496           | 6,772                  | 7,064            | 4,069           | 3,591            |
| Other long-term liabilities                     | 19,033           | 3,717                  | 5,607            | 1,372           | 8,337            |
| Pension solvency payments                       | 1,816            | 1,073                  | 743              | -               | -                |
| Operating leases and<br>contractual commitments | 16,700           | 4,660                  | 5,540            | 3,700           | 2,800            |
| <b>Total contractual obligations</b>            | <b>\$239,687</b> | <b>\$ 89,124</b>       | <b>\$126,694</b> | <b>\$ 9,141</b> | <b>\$ 14,728</b> |

On December 14, 2009, the Company received a financing commitment with respect to its Operating Line and Revolving Term Line from its lenders, details of which are described in Subsequent events, note 23(b). The maturity date of the Operating Line was extended from April 23, 2010 to February 28, 2011. The maturity date of the Revolving Term Line was extended from April 24, 2011 to February 28, 2012 and the Non-Revolving Term Line was fully repaid and refinanced through drawings under the new Revolving Term Line.

(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 deposits, sales, purchases and loans 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. As required, the Company uses forward exchange contracts and cross currency interest rate swaps to manage its currency risk, as described in Note 22(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.

**22. Financial instruments (continued):**

(d) Financial risk management (continued):

(iii) Market risk: (continued):

*Currency risk (continued)*

At December 31, 2009, the Company has US\$ drawings under its Revolving Term Line of US\$30,200,000 (2008 – US\$30,200,000). The US\$ drawings under this Line have been designated as a hedge against the investment in the Company’s self-sustaining U.S. operations.

At December 31, 2009, the Non-Revolver Term Line remains fully drawn at US\$35,000,000 (2008 - US\$35,000,000). To March 31, 2007, the Company designated the Non-Revolver Term Line as a hedge against its investment in its self-sustaining U.S. operations. On April 1, 2007, the Company terminated the designation of the hedging relationship and discontinued its use of hedge accounting.

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

| 2009   | CAD    | USD    | Japanese ¥ |
|--|--------|--------|------------|
| Accounts receivable  | 14,661 | 9,507  | 46,853     |
| Accounts receivable held by self-sustaining foreign subsidiaries | -      | 7,362  | -          |
|  | 14,661 | 16,869 | 46,853     |
| 2008   | CAD    | USD    | Japanese ¥ |
| Accounts receivable  | 11,936 | 6,176  | 6,623      |
| Accounts receivable held by self-sustaining foreign subsidiaries | -      | 4,855  | -          |
|  | 11,936 | 11,031 | 6,623      |

As at December 31, 2009, the domestic operations of the Company held cash and cash equivalents of US\$1,462,000 (2008 – US\$179,000) and no bank indebtedness (2008 - \$26,786,000). Cash and cash equivalents held by self-sustaining and other foreign U.S. subsidiaries totalled US\$1,348,000 (2008 - US\$3,913,000 bank indebtedness).

Based on the Company’s net exposure to foreign currencies as at December 31, 2009, including USD denominated cash held in deposits and cash equivalents and USD denominated 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\$ | \$600,000 increase in net income |
| Japanese Yen | 1 ¥ increase vs CAD\$    | \$100,000 increase in net income |

*Interest rate risk*

The Company reduced its exposure to changes in interest rates on borrowings by entering into cross currency interest rate swap, as described in Note 22(b) Derivative financial instruments. This agreement matured on September 1, 2009.

Based on the Company’s average debt level during 2009, the sensitivity of a 100 basis point increase in interest rates would result in an approximate decrease of \$1,140,000 (2008 - \$500,000) 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.

**23. Subsequent events:**

## (a) Seaboard Partnership income distribution:

On January 4, 2010, the Seaboard Partnership declared an income distribution to its partners. Interfor's share was \$3,096,000 and was paid to the Company by way of setoff against the promissory note payable to the Seaboard Partnership (see Payable to investee company, note 9).

## (b) Bank financing

On December 14, 2009, the Company obtained a written financing commitment from its lenders extending and modifying its syndicated credit facilities effective January 15, 2010. The maturity of the Operating Line was extended from April 23, 2010 to February 28, 2011. The credit available under the Revolving Term Line increased from \$150,000,000 to \$200,000,000 and the maturity date was extended from April 24, 2011 to February 28, 2012 with all other terms and conditions of the lines substantially unchanged.

In conjunction with the amendments to its credit facilities, the Company repaid and cancelled its existing Non-Revolving Term Line of US\$35,000,000 on January 15, 2010.