



**2008**

## **Annual Report**

**Includes:**

- Financial Highlights 2008
- Message to Shareholders
- Management Discussion and Analysis Dated February 12, 2009
- Consolidated Financial Statements
- Annual Information Form Dated February 12, 2009

**International Forest Products Limited**



**International Forest Products Limited****FINANCIAL HIGHLIGHTS**

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(in millions of dollars, except share and per share amounts)		
<b>Financial Summary</b>			
Sales	437.2	611.0	824.4
EBITDA <sup>(1)</sup>	13.7	31.8	185.7
Net earnings (loss)	(57.2)	(13.3)	95.5
<b>Per Share Data</b>			
Net earnings (loss) per common share			
- basic	(1.21)	(0.28)	1.97
- diluted	(1.21)	(0.28)	1.95
Price range per share			
\$ High	6.19	9.84	8.11
\$ Low	1.20	5.02	5.91
Book value per share	8.63	9.14	9.98
Cash Flow per share before working capital change	0.28	0.53	2.95
Weighted average shares outstanding (millions)	47.1	47.6	48.5
<b>Financial Position</b>			
Total assets	665.9	549.1	677.6
Total debt <sup>(2)</sup>	168.0	34.7	41.4
Total shareholders' equity	406.8	430.6	480.4
Invested capital <sup>(1)</sup>	578.5	465.3	521.8
<b>Financial Ratios (%)</b>			
Return on average shareholders' equity <sup>(1)</sup>	(13.7%)	(2.9%)	22.0%
Return on average invested capital, adjusted <sup>(1)</sup>	(10.6%)	(3.5%)	24.7%
Net debt as a % of invested capital, adjusted <sup>(1)</sup>	29.2%	1.9%	(28.9%)

## Notes:

1. See Glossary for definition.
2. Total debt, excluding short-term advances from the Seaboard partnership (2008 - \$3.7m, 2007/6 - nil)

*"2008 was one of the most difficult years in the lumber industry in decades. The global financial crisis and its impact on lumber markets worldwide had a material impact on our financial performance last year. In spite of these challenges, we made significant progress towards our goal of becoming one of North America's leading lumber and building products companies."*

*Message to Shareholders – March 2009*

**For further highlights, please see the Message to Shareholders and Management's Discussion and Analysis on the following pages.**



## International Forest Products Limited

### MESSAGE TO SHAREHOLDERS

#### **OVERVIEW**

2008 was one of the most difficult years in the lumber industry in decades. The global financial crisis and its impact on lumber markets worldwide had a material impact on our financial performance last year. In spite of these challenges, we made significant progress towards our goal of becoming one of North America's leading lumber and building products companies.

Highlights for the year included:

- Significant progress on the construction of the new Adams Lake sawmill;
- The acquisition of 2 mills from Pope & Talbot in the Southern Interior of British Columbia and another mill from Portac in Washington State;
- Agreement-in-principle to acquire additional timber rights in the Southern B.C. Interior from Weyerhaeuser; and
- Permanent closure of the Queensboro and Albion operations on the B.C. Coast.

These steps, along with others taken in recent years, have dramatically altered Interfor's asset base and position in the industry. We are confident these changes will contribute to superior returns for our shareholders when markets recover.

We invite you to review the material covered in the next few pages and in the detailed material contained later in this report, and to form your own views on our progress. Please feel free to forward any comments you would like to make to me directly at [duncan.davies@interfor.com](mailto:duncan.davies@interfor.com).

#### **GLOBAL FINANCIAL CRISIS IMPACTS LUMBER MARKETS AND FINANCIAL RESULTS**

The global financial crisis, with its roots in the sub-prime mortgage market in the United States, spread rapidly in mid 2008 resulting in severe restrictions on credit availability and a full-blown collapse in U.S. housing sales and new home construction in the last few months of the year.

Housing starts for the year totaled 904,000 units, a 33% year-over-year decline, and a 56% drop from the peak year of 2005. In December, starts declined to an annualized rate of 550,000 units, 45% below December 2007 and the lowest level in 50 years.

At year-end, the inventory of unsold homes in the U.S. totaled just over 4.0 million units, something in the range of 45 to 50% above "normal" levels.

Lumber prices collapsed in the fourth quarter as falling demand outpaced contractions in supply. The price of the benchmark SPF 2X4 averaged US\$221 per thousand board feet in 2008, down US\$29 or 12% compared to 2007. However, the December average of US\$167 per thousand board feet was a full \$60 or 26% below December 2007.

Interfor's strategy to diversify its regional exposure and product portfolio once again helped to offset the drop in commodity prices in 2008. In spite of reduced demand, the prices for most cedar product lines remained strong until the last quarter, when some weakening of prices occurred.

Prices for the Company's key offshore product lines remained stable, supported in part by favourable currency shifts.

At the end of the day, Interfor recorded a net loss (before one-time items) of \$16.4 million or \$0.35 per share on sales of \$437.2 million in 2008. Including restructuring charges of \$37.3 million (pre-tax) relating primarily to the permanent closure of our Queensboro sawmill and a valuation charge of \$15.1 million against future tax assets, the Company's net loss was \$57.2 million or \$1.21 per share for the year.

### **ADAMS LAKE REBUILD WELL UNDERWAY; TOTAL SPENDING TOPS \$90 MILLION**

In spite of the challenges faced by the industry in 2008, Interfor stayed true to its strategy of positioning for long-term success.

Construction of the new Adams Lake sawmill, which began in 2007, gained momentum in 2008. A total of \$64.6 million was spent on the project in 2008, bringing the total spent-to-date to \$84.2 million. Construction is on-time and on-budget, with approximately \$16 million left to spend as at year-end. The first line of the new mill was commissioned in December with very encouraging results; a full start-up is scheduled for the second quarter of 2009.

In total, capital spending in 2008 amounted to \$90.9 million, including \$17.5 million on roads.

### **ACQUISITIONS ADD TO REGIONAL AND PRODUCT MIX**

In addition to Adams Lake, Interfor continued to pursue opportunities to broaden its regional and product mix in 2008 with the acquisition of two mills from Pope & Talbot in the Southern Interior of British Columbia in April and the purchase of Portac's operation on the Olympic Peninsula in Washington in September.

The acquisition of the Grand Forks and Castlegar operations in the B.C. Interior adds critical mass in one of the Company's core operating areas. The Grand Forks mill started up in August with very encouraging results. The Castlegar operation – which has traditionally been a high cost operation – remains curtailed while changes to the mill's operating regime are put in place. Good progress has been made in recent months but there is more work to do. All-in-all, we remain confident both mills will make strong contributions to the Company's results in the years ahead.

The former Portac operation in Washington is an excellent fit with our existing operations in the area both in terms of log supply and product mix. The mill has been renamed the "Beaver Division" and has been operating at about the same rate as our other mills in the Pacific Northwest.

### **TENURE ACQUISITION SUPPORTS INVESTMENT IN ADAMS LAKE**

Early in 2008, Interfor reached agreement to acquire a timber tenure in the Kamloops region from Weyerhaeuser. The tenure, which currently provides for an allowable annual cut of approximately 275,000 m<sup>3</sup>, will strengthen the long-term fibre supply for the new mill at Adams Lake and help offset potential impacts in future supply as a result of the Mountain Pine Beetle infestation. Closing of the transaction has been delayed for a number of reasons, but is expected to be finalized in early 2009.

### **QUEENSBORO AND ALBION DIVISIONS CLOSED**

Following a prolonged curtailment, a decision was made in July to permanently close the Company's Queensboro Division in New Westminster, B.C.

The mill – which was formerly known as Western Whitewood or 3W – was significantly rebuilt in 2003/4 at a cost of \$25.8 million. Unfortunately, the mill was never able to achieve the cost structure anticipated when the project was undertaken. After considering a number of alternatives, a decision was made to permanently close the mill and \$23.9 million in after-tax restructuring charges were taken related to the closure.

The Queensboro property, which comprises 50 acres, is actively being marketed with a sale anticipated in 2009. The proceeds of the sale are expected to exceed the amount of the restructuring charge taken when the mill was closed.

As well, a decision was made to close the Albion remanufacturing plant in Maple Ridge in 2008. The Albion plant's cost structure was high relative to other alternatives and its continued operation could not be justified.

### **BALANCE SHEET REMAINS STRONG; NEW FINANCING AGREEMENT IN PLACE**

In spite of the losses incurred in 2008, Interfor's balance sheet remains one of the strongest in the sector. At year-end, the Company had net debt of \$168 million or 29% of invested capital.

In February 2009, a commitment was obtained from our lending syndicate to extend the maturities of our credit lines. At the same time, a realignment of the amounts available under the various lines had the net effect of increasing the total amount of credit available to the Company by \$30 to \$35 million.

With our strong balance sheet, renewed credit facilities and cash expected from property sales, Interfor is well-positioned to weather a prolonged downturn in product markets.

### **SHARE PRICE DOES NOT REFLECT UNDERLYING VALUE**

We take our responsibility to shareholders very seriously. The drop in the Company's share price during 2008 was, we feel, an overreaction to the broader challenges faced by the industry and concerns over the prospects of renewing our credit agreements.

In our view, the current share price significantly underestimates the value of the Company. We fully expect the price to move into line with our industry peers, and ultimately, into a range which more fully reflects the quality of the Company's asset base and its cash generating capability.

### **OUTLOOK IS CHALLENGING; FOCUS REMAINS INTACT**

Business conditions have deteriorated since the end of 2008. U.S. housing starts in January came in at 466,000 units and lumber prices continue to fall. To-date, efforts to stabilize the global economy have proven insufficient.

We expect it will be some time before matters stabilize and the stimulus packages introduced by governments around the world encourage renewed activity.

In the face of the uncertain economic environment, Interfor will maintain its disciplined approach to production and strict controls on capital spending.

We remain absolutely convinced we are on track to build significant value for our shareholders.

Thank you for your support and patience.

Duncan K. Davies  
President and Chief Executive Officer  
February 2009

**International Forest Products Limited**  
**MANAGEMENT DISCUSSION AND ANALYSIS**  
**Dated as of February 12, 2009**

This Management's Discussion and Analysis ("MD&A") provides a review of Interfor's financial performance for the year ended December 31, 2008 relative to 2007, the Company's financial condition and future prospects. The MD&A should be read in conjunction with Interfor's Annual Information Form and Consolidated Financial Statements for the years ended December 31, 2008 and 2007 filed on SEDAR at [www.sedar.com](http://www.sedar.com). The financial information contained in this MD&A has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). In this MD&A, reference is made to EBITDA and Adjusted EBITDA. EBITDA represents earnings before interest, taxes, depletion, amortization, restructuring costs, other foreign exchange gains and losses, and write-downs of property, plant, equipment and timber ("asset write-downs"). Adjusted EBITDA represents EBITDA adjusted for net U.S. duty refunds, and other income. The Company discloses EBITDA as it is a measure used by analysts and Interfor's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance.

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

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

### **FORWARD LOOKING INFORMATION**

This report contains information and statements that are forward-looking in nature, including, but not limited to, statements containing the words "believe", "may", "will", "expects", "estimates", "projects", "continues", "anticipates", "intends", and similar expressions. Such forward-looking statements involve known and unknown risks and uncertainties that may cause Interfor's actual results to be materially different from those expressed or implied by those forward-looking statements. Such risks and uncertainties include, among others: general economic and business conditions, product selling prices, raw material and operating costs, changes in foreign-currency exchange rates and other factors referenced herein (see "Risks and Uncertainties" below) and in Interfor's current Annual Information Form available on [www.sedar.com](http://www.sedar.com). The forward-looking information and statements contained in this report are based on Interfor's current expectations and beliefs. Readers are cautioned not to place undue reliance on forward-looking information or statements. Interfor undertakes no obligation to update such forward-looking information or statements, except where required by law.

### **OVERVIEW OF 2008**

2008 was one of the most difficult periods experienced in the lumber industry in recent history. The unprecedented turmoil in financial markets combined with the lowest level of U.S. housing starts in over 50 years had a significant impact on the Company's results. Including one-time items, Interfor reported a net loss of \$57.2 million, or \$1.21 per share, for the year ended December 31, 2008. Before restructuring charges of \$37.3 million, primarily from the permanent closure of the Queensboro sawmill, and a valuation charge of \$15.1 million against future tax assets, the Company had a net loss of \$16.4 million, or \$0.35 per share.

Despite the extraordinary challenges of 2008, the Company maintained positive EBITDA in each quarter of 2008 and reported EBITDA of \$13.7 million for the year. Interfor continued to benefit from the execution of its strategy of diversification of product lines and markets, focusing on effective cash management and cost control, investing in core assets, and capitalizing on attractive growth opportunities. A brief overview of the more significant developments in 2008 is presented below.

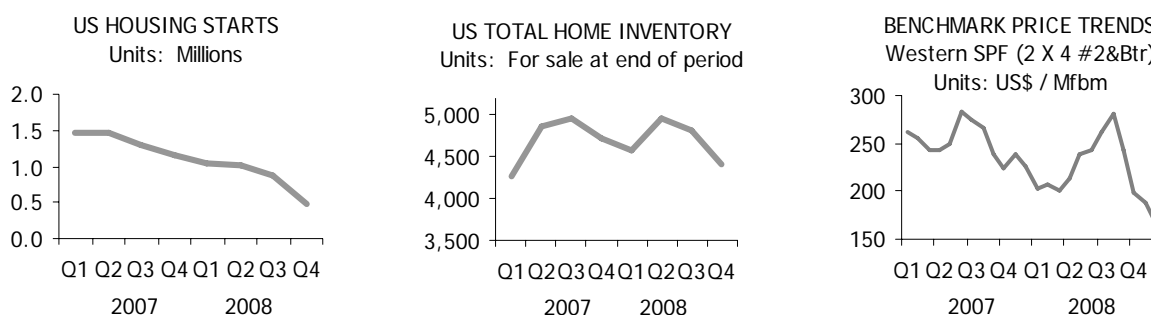
## Markets and Pricing

### Lumber

- North American Structural Lumber

The downturn of the U.S. housing market dominated North American structural lumber markets in 2008. Construction activity fell off sharply in the second half of the year as the impact of the squeeze on credit availability and the overall economic climate impacted the sector. Seasonally adjusted housing starts in December 2008 were down 45% year-over-year, and for the full year were down 33% compared to 2007. Total home inventories remain high ending the year at 9.5 months supply.

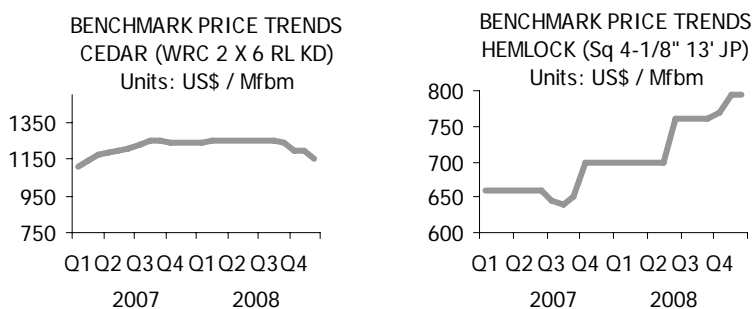
As mill curtailments reduced supply, prices rallied modestly in the second quarter and part of the third quarter of 2008. However, beginning in September 2008, prices collapsed as falling demand greatly outpaced contractions in supply. For 2008, the average price reported by Random Lengths for Western SPF 2"x4" was down US\$29 per thousand board feet (mfbm), or 12%, compared to 2007. Reflecting the steep decline in the latter few months of the year, the December 2008 price was down US\$60 per mfbm, or 26%, compared to December 2007.



Source: Random Lengths, used with permission

- Cedar

Demand for the Company's cedar products remained steady for the first six months of 2008 partially supported by strong offshore demand and tight supply. However, North American demand eroded during the last half of the year as the economy slowed resulting in lower prices on North American product lines over the last six months of 2008. The year-over-year average price for knotty Western Red Cedar 2"x 6" increased by US\$25 per mfbm.



Source: Random Lengths, used with permission

- Japan

Stable economic conditions and the stronger Yen relative to the US\$ supported steady prices for the Company's products in Japan. Compared to 2007, the average 2008 price for Hemlock Square 4-1/8", as reported by Random Lengths, was up US\$76 per mfbm, or 11%.

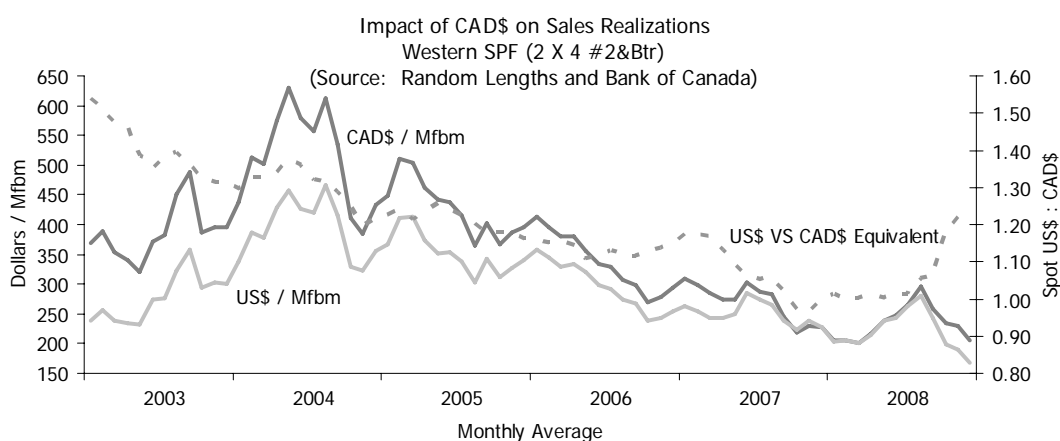
## Logs and Residuals

Log sales revenue declined 13% compared to 2007 due to falling demand from lumber producers and a drop in demand late in the year from pulp producers. Chip and by-products sales revenue declined 39% year over year as lower sales volumes were available due to lower operating rates at many of the Company's operations.

## Volatility of the Canadian Dollar

In the fourth quarter of 2008, the CAD\$ weakened against the US\$, ending the year at CAD\$1.218, down 23%, from the end of 2007. Year-over-year, the average CAD\$ was marginally stronger at \$1.066 in 2008 compared to \$1.075 in 2007.

The significance of the volatility of the CAD\$ on Canadian lumber producers' sales realizations is highlighted in the following chart, which shows the average US\$ price and CAD\$ equivalent of a thousand board feet of Western SPF 2"x4" 2&Btr for the period 2003 through 2008.



## Export Tax

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

Price <sup>(1)</sup>	Export Tax (%)
Over US \$355	Nil
US \$336 - \$355	5
US \$316 - \$335	10
US \$315 or under	15

<sup>(1)</sup> Based on the prevailing RLCI

The Option A export charge through 2008 and 2007 was 15% as the prevailing RLCI throughout that period was below US\$315 per mfbm.

## Closure of Queensboro Sawmill

The duration of the market downturn, together with the volatility of the CAD\$, significantly undermined the economics of the Company's Queensboro sawmill division, located in New Westminster, B.C. In July 2008, following a prolonged curtailment, the Company decided to permanently close the mill and took



\$23.9 million in after tax restructuring charges during 2008 related to the closure. The property is being actively marketed with a sale anticipated in 2009.

### **Closure of Albion Remanufacturing Facility**

During 2008, the Company permanently closed its Albion remanufacturing operation located in Maple Ridge, B.C. as the operation's cost structure was unfavourable relative to the Company's remanufacturing alternatives.

### **Acquisition of Pope and Talbot, Inc. Sawmill Assets**

On April 30, 2008, the Company concluded the acquisition of the Castlegar, B.C. and Grand Forks, B.C. sawmills, related timber harvesting rights and other related assets from Pope and Talbot, Inc. ("P&T"). At acquisition, a portion of the purchase price paid was placed in escrow, pending final determination of the purchase adjustments and the obtaining of certain authorizations in accordance with the P&T Asset Purchase Agreement.

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. This agreement was approved by the U.S. Bankruptcy Court on December 1, 2008 and \$9.5 million (US\$7.7 million) was released from escrowed funds to the Company. Including the adjustments for escrowed funds, the purchase price was finalized at \$62.3 million for the sawmills, related timber harvesting rights and other related assets. In addition, the Company paid \$9.3 million for current assets, primarily log inventories.

The acquisition of the two sawmills increased Interfor's lumber production capacity in the B.C. Interior by approximately 330 million board feet per year. The mills have added critical mass in one of the Company's core operating regions and have broadened the Company's product lines in both specialty and commodity grades. The timber tenures acquired represent annual harvesting rights of approximately 1.0 million cubic metres in the Southern B.C. Interior.

### **Acquisition of Portac, Inc. Assets**

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\$32.2 million, of which US\$30.2 million was financed through its Revolving Term Line and the balance of US\$2.0 million through cash. 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, have been renamed "Beaver Division" and are being operated by Interfor's U.S. subsidiary, Interfor Pacific Inc.

The Portac assets acquisition is in keeping with the Company's strategy of diversifying its geographic base and is an excellent fit with existing Interfor operations at Port Angeles, producing dimension products and small timbers in lengths up to 20 feet to complement Interfor's product mix and presence in the Puget Sound market. The Portac assets acquisition brings Interfor's production capacity in the U.S. Pacific Northwest to 635 million board feet on an annual basis.

### **Agreement to Purchase Kamloops Timber Tenure**

In early 2008, the Company entered into an agreement, subject to certain approvals, to acquire a timber tenure in the Kamloops region currently owned by Weyerhaeuser Company Limited. The tenure will strengthen the Company's long term timber supply for the new Adams Lake sawmill and will help to offset anticipated declines in future supply as a result of the Mountain Pine Beetle infestation. During the fourth quarter of 2008, the parties agreed to a reduced volume of approximately 275,000 m<sup>3</sup>. As a result of the transaction being the subject of a lengthy regulatory review, the transaction was not completed by the end of the year. That process has recently been challenged by a First Nations band. The parties are continuing to work towards a completion of the transaction but there is currently no certainty of the timing of completion.

## New Adams Lake Sawmill

In April 2007, the Company's Board of Directors approved the construction of a new \$100 million two-line sawmill at Adams Lake to replace the existing facility. Construction, commenced in the summer of 2007, is on budget and was substantially complete as at the end of 2008. The first line was commissioned in 2008 with a full start-up scheduled for the second quarter of 2009. This mill will have a two-shift capacity of 285 mfbm.

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

## Strong Financial Position

The Company maintained a strong financial position throughout 2008, ending the year with net debt of \$171.5 million, including a \$3.7 million payable to an investee company, or 30% of invested capital. Cash flow from operations, before working capital changes, for the year was positive at \$13.0 million. The increase in the debt during the course of 2008 was for partial funding of the acquisition of the P&T and Portac assets and the construction of the new Adams Lake sawmill.

On February 5, 2009, the Company obtained a financing commitment from its lenders in respect of its syndicated credit facilities. The Revolving Term Line will increase \$35 million to \$150 million, which will be due April 2011. The Operating Line will decrease \$35 million to \$65 million and will be extended 364 days to April, 2010. Except for an increase in pricing, all other terms and conditions of the lines remain substantially unchanged. This adjustment allows the Company to fully utilize all of its credit during times of reduced operating levels.

The Company has a number of properties classified as held for sale. Interfor expects to generate a significant amount of cash from the sale of these properties that will further strengthen the Company's liquidity.

The financial crisis impacting the global economy has had a material effect on credit availability and construction activity and has resulted in sharply lower prices for most product lines in the latter months of 2008 and early 2009. We expect it will take some months for markets to stabilize and a clear direction to emerge. In light of this uncertainty, the Company's focus is on cash management, as operations balance production against sales and reduce capital spending.

## REVIEW OF OPERATING RESULTS

### Selected Annual Financial Information

	2008	2007	2006	2005	2004
	(millions of dollars except share and per share amounts)				
Sales					
–Lumber	297.4	434.5	625.6	661.5	633.9
–Logs	103.6	118.6	103.2	105.1	137.0
–Wood chips and other by-products	30.6	50.2	41.9	34.1	38.3
–Other	5.6	7.7	53.7	41.9	34.7
Total Sales	437.2	611.0	824.4	842.6	843.9
Operating earnings (loss) before U.S. duty refunds, net of restructuring costs and asset write-downs	(34.0)	(25.3)	14.4	10.2	23.8
Operating earnings (loss)	(71.3)	(27.2)	103.7	(31.5)	(2.2)
Net earnings (loss)	(57.2)	(13.3)	95.5	19.7	24.7
Net earnings (loss) per share – basic	(1.21)	(0.28)	1.97	0.41	0.51
Net earnings (loss) per share – diluted	(1.21)	(0.28)	1.95	0.40	0.50
EBITDA <sup>3</sup>	13.7	31.8	185.7	116.3	109.5

Cash flow from operations per share <sup>1</sup>	0.28	0.53	2.95	0.93	1.20
Shares outstanding – end of period (millions) <sup>2</sup>	47.1	47.1	48.1	48.7	48.6
– weighted average (millions)	47.1	47.6	48.5	48.7	48.4
Adjusted EBITDA <sup>3</sup>	12.3	25.8	68.6	74.7	88.0

- Cash generated from operations before taking account of changes in operating working capital.
- As at February 12, 2009, the numbers of shares outstanding by class are: Class A Subordinate Voting shares – 46,101,476 Class B Common shares – 1,015,779, Total – 47,117,255.
- The Company discloses EBITDA as it is a measure used by analysts and Interfor's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance. Adjusted EBITDA represents EBITDA adjusted for net U.S. duty refunds and other income.

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

	2008	2007	2006	2005	2004
	(millions of dollars)				
Net earnings (loss)	\$(57.2)	\$(13.3)	\$95.5	\$19.7	\$24.7
Add: Income taxes (recovery)	(12.1)	(13.7)	42.2	(7.2)	0.4
Net interest (income) expense	5.1	(1.3)	3.4	4.7	3.2
Interest income on U.S. duty refunds, net of special charge	-	-	(12.7)	-	-
Depletion and amortization	41.5	50.9	52.0	57.5	55.2
Other foreign exchange (gains) losses	(0.9)	7.3	(2.3)	-	-
Restructuring costs, asset write-downs and other	37.3	2.0	7.6	41.7	26.0
EBITDA	13.7	31.8	185.7	116.3	109.5
Deduct:					
U.S. duty refunds, net	-	-	96.9	-	-
Other Income	(1.4)	6.0	20.2	41.6	21.5
Adjusted EBITDA	\$12.3	\$25.8	\$68.6	\$74.7	\$88.0

### Volume and Price Statistics

		2008	2007	2006	2005	2004
Lumber sales	(million fbm)	503	870	1,172	1,161	894
Lumber production <sup>1</sup>	(million fbm)	498	856	1,165	1,143	901
Log sales <sup>2</sup>	(thousand cubic metres)	1,319	1,223	1,190	1,360	1,636
Log production <sup>2</sup>	(thousand cubic metres)	1,881	1,767	2,381	2,558	2,964
Average selling price – lumber <sup>3</sup>	(\$/thousand fbm)	\$591	\$499	\$534	\$570	\$709
Average selling price – logs <sup>2</sup>	(\$/cubic metre)	\$74	\$95	\$86	\$76	\$84
Average selling price – pulp chips	(\$/thousand fbm)	\$49	\$49	\$33	\$26	\$37

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

### Comparison of Year ended December 31, 2008 to Year ended December 31, 2007

The Company recorded a net loss of \$57.2 million, or \$1.21 per share, for the year ended December 31, 2008, compared to a net loss of \$13.3 million, or \$0.28 per share, for the year ended December 31, 2007.

EBITDA for the year ended December 31, 2008 was \$13.7 million, compared to \$31.8 million in 2007. Adjusted EBITDA for the year ended December 31, 2008 was \$12.3 million, compared to \$25.8 million in 2007.

## Sales

Total sales revenues were \$437.2 million in 2008, down \$173.8 million from \$611.0 million in 2007.

Lumber sales revenue decreased by \$137.0 million, or 32%, in 2008 compared to 2007, due to the unfavourable structural lumber markets and the continued strength in the CAD\$. Average unit sales values for lumber in 2008 were up 18% reflecting the positive impact of the Company's strategic diversification. Although U.S. structural lumber prices continued to decline, the impact was more than offset by a change in product mix to a higher percentage of higher-value specialty product which provided higher average unit sales prices. Lumber shipments were down 42% compared to 2007 reflecting the significant decline in demand in the U.S. structural lumber market due to the 33% decline in annualized U.S. housing starts. The CAD\$ remained close to par with the US\$ through most of 2008.

Log sales revenue in 2008 was down \$15.0 million, or 13%, compared to 2007, mostly due to a decrease in B.C. average log prices of 22% driven by falling demand from lumber producers and a drop in demand late in the year from pulp producers. Chip and other by-product revenues decreased by \$19.7 million, or 39%, in 2008 compared to 2007. This decline was due to lower available sales volumes arising from lower operating rates at many of the Company's operations and the closure of the old Adams Lake sawmill, partially offset by newly acquired productive capacity. The average sales values remained steady.

## Operating Costs

Production costs for the year ended December 31, 2008 were \$411.5 million, down \$148.9 million, or 27%, compared to 2007. This was primarily due to a reduction of 358,000 mfbm, or 42%, in lumber production volumes from the already strike-reduced 2007 volumes. As demand in the U.S. structural lumber market continued to fall off during the year, the Company operated 41% fewer shifts at its sawmills in 2008 as compared to 2007. Additional available capacity from the acquisition of the P&T and Portac assets was more than offset by the closure of the old Adams Lake sawmill and increased sawmill curtailments during the latter half of 2008. The reduced volume drove the Company's per unit cost of conversion up as there was less volume available to absorb fixed costs.

Log costs weakened in B.C. and the U.S. Pacific NorthWest in 2008 compared to 2007 as the decline in log demand from lumber and pulp producers began to impact the log market. Export taxes decreased by \$5.3 million, or 61% from 2007. As prices in both years were low enough to attract the maximum rate of 15% tax, the reduction in the dollar amount of export taxes is mainly related to a 57% reduction in Canadian shipments to the U.S. and a \$0.6 million export tax refund. In 2008, the majority of the Company's U.S. structural lumber sales were supplied from its U.S. operations.

Selling and administration costs in 2008 were \$16.9 million, up only slightly from \$16.8 million in 2007, notwithstanding the Company's two acquisitions. Long-term incentive compensation ("LTIC"), which is impacted by the Company's share price, the number of grants made under the various plans and vesting periods, showed a recovery of \$2.0 million in 2008 (2007 - LTIC recovery of \$0.5 million).

Amortization of plant and equipment at \$21.8 million in 2008 was substantially lower than the \$30.1 million in 2007 as sawmill curtailments reduced amortization on production plant and equipment. Timber depletion and road amortization costs were \$19.6 million in 2008, a decrease of \$1.1 million compared to \$20.7 million in 2007 as more heli-logging was undertaken in 2008 compared to 2007.

Restructuring costs and asset write-downs totaled \$37.3 million in 2008, compared to \$2.0 million in 2007. Restructuring costs in 2008 include \$34.7 million related to the permanent closure of the Queensboro sawmill located in New Westminster, B.C., following more than a year of continuous curtailment. The \$34.7 million charge was comprised of voluntary and shutdown severance costs of \$3.9 million, site remediation costs of \$1.0 million and a write-down of \$29.8 million to adjust the carrying value of plant and equipment at the site to expected recovery amounts. The site has been substantially cleared and is being actively marketed with a sale expected in 2009. The Queensboro assets have been classified as held for sale on the Balance Sheet.

Also included in 2008 restructuring costs are a \$1.3 million charge for impairment as the old Adams Lake sawmill was closed, a \$0.9 million charge for early retirement and other severance costs, and a \$0.4 million charge for impairment of timber.

Restructuring costs in 2007 consisted of early retirement and other severance costs and contractor buyout costs, totaling \$2.3 million, which were partially offset by the recovery of \$0.3 million from the B.C. Forestry Revitalization Trust set up by the Government of British Columbia. The following table shows the components of restructuring costs and write-downs of plant and equipment for both years:

	<b>2008</b>	<b>2007</b>
	(millions of dollars)	
Plant, equipment and timber write-downs	\$ 31.4	\$ -
Severance and other restructuring costs, net of recoveries	5.9	2.0
	<u>\$ 37.3</u>	<u>\$ 2.0</u>

#### Interest Expense on Long-term Debt

In 2008, the Company recorded \$4.5 million of interest expense on long-term debt, compared to \$2.8 million in 2007. The change related to the increase in average debt used primarily to partially fund the P&T and Portac asset acquisitions and for construction of the new Adams Lake sawmill.

#### Interest Income (Expense)

Net interest expense was \$0.6 million in 2008 compared to net interest income of \$4.2 million in 2007. Through most of 2007, the Company had a significant average investment balance from the U.S. duty refund received in late 2006. These investments were liquidated during the course of 2007 in order to fund reinvestment activities, income tax payments and payment of the special charge on the U.S. duty refund received in 2006.

#### Other Foreign Exchange Gain (Loss)

Other net foreign exchange gain was \$0.9 million in 2008 compared to a net foreign exchange loss of \$7.3 million in 2007, which arose due to the following items.

	<b>2008</b>	<b>2007</b>
	(millions of dollars)	
Gain (loss) on		
Settlement of forward exchange contract	\$ 3.7	\$ -
Mark to market revaluation of interest rate swap	4.2	(3.6)
Revaluation of US\$ denominated debt	(7.9)	5.7
Revaluation of foreign denominated investments	-	(9.1)
Other	0.9	(0.3)
	<u>\$ 0.9</u>	<u>\$ (7.3)</u>

#### Other Income

	<b>2008</b>	<b>2007</b>
	(millions of dollars)	
Gain on disposal of surplus property, plant and equipment and timber	\$ 0.8	\$ 4.8
Gain on settlement of timber takeback	0.7	1.3
Other, net	(0.1)	(0.1)
	<u>\$ 1.4</u>	<u>\$ 6.0</u>

#### Equity Income

The Company recorded equity income of \$4.8 million in 2008 compared to \$0.2 million in 2007. The increase was attributable to increased earnings of Seaboard Shipping Company ("Seaboard") due to increased capacity utilization. The United Steel Workers ("USW") strike in 2007 significantly reduced volumes and net income for Seaboard in the comparative period.

## Income Taxes

The Company recorded an income tax recovery of \$12.1 million for 2008 (2007 – recovery of \$13.7 million) with an overall effective rate of 17.5% (2007 – 50.7%). The rate in 2008 differed from the Canadian statutory rate of 31% mainly due to the non-taxable portion of income that is accounted for by the equity method, different tax rates for U.S. subsidiaries, declining future income tax rates in Canada, and a \$15.1 million charge to record a valuation allowance against future income tax (“FIT”) assets.

The Company has US\$96.7 million (CAD\$117.8 million) of loss-carryforwards in the U.S. that are available to reduce future taxable income. Unless utilized, these losses will expire over the period 2023 to 2028. The Company also has \$15.2 million of loss-carryforwards in Canada that will expire, unless utilized, over the period 2014 to 2028. Net of temporary differences between book and tax income, the Company has a \$17.4 million long term FIT asset. Although the Company expects to realize the full benefit of the loss-carryforwards, due to the cyclical nature of the wood products industry and current economic conditions, the Company has recorded a full valuation allowance of \$17.4 million against the FIT asset of which \$15.1 million has been recorded as a reduction in tax recovery.

## Net Earnings (Loss)

As a result of the above factors, the Company recorded net loss of \$57.2 million, \$1.21 per share, for the year ended December 31, 2008 compared to a net loss of \$13.3 million, \$0.28 per share, for the year ended December 31, 2007.

## **Cash Flows**

### Operating Activities

Total cash generated from operations was \$13.7 million for the year (2007 - \$45.0 million cash used in operations).

Cash generated by operations, before working capital changes, was \$13.0 million for 2008 (2007 - \$25.3 million). The net loss for the year of \$57.2 million contained a significant number of non-cash charges including amortization and depletion of \$41.5 million and restructuring charges of \$31.4 million mainly related to the Queensboro sawmill closure.

Cash generated from working capital was \$0.7 million (2007 – use of \$70.3 million) as accounts payable declined \$16.4 million due to reduced operating levels and income taxes receivable increased as the Company filed for refund of taxes paid in prior years. Offsetting the use of cash was a \$13.3 million decrease in accounts receivable and a \$12.0 million decrease in cash invested in inventories due to reduced sales revenues and operating levels. Although inventory balances increased slightly year over year, \$14.6 million of inventory change was due to acquisitions and foreign exchange.

### Investing Activities

Cash invested in property, plant and equipment, timber and logging roads and asset acquisitions totaled \$158.9 million (2007 - \$74.0 million). The Company incurred expenditures of \$73.4 million for property, plant and equipment and \$17.5 million for road construction. Expenditures on plant and equipment are expected to enhance the competitive position of the Company and maintain the efficiency of the Company's operations. The major capital project in 2008 was the construction of the new Adams Lake sawmill which was substantially complete as at the end of 2008. The first line was commissioned in 2008 with a full start-up scheduled for the second quarter of 2009.

As described in the Overview section, Interfor completed the acquisition of the P&T and Portac assets, resulting in net cash outflow during 2008 of \$68.0 million.

Cash proceeds from the sale of non-core assets in 2008 totaled \$5.1 million (2007 - \$8.3 million).

### Financing Activities

On April 25, 2008, the Company obtained an increase in its Canadian operating and revolving term lines of credit from \$50 million to \$215 million. During the course of 2008, Interfor drew on the lines for partial funding of the acquisition of the P&T and Portac assets and the construction of the new Adams Lake sawmill.

On January 3, 2008, the Company received approval to commence a Normal Course Issuer Bid ("NCIB"), entitling it to purchase up to 1,300,000 Class A Shares through the Exchange. The program commenced on January 8, 2008 and terminated on January 7, 2009. The Company did not repurchase any Class A shares through the NCIB in 2008.

On November 9, 2006, the Company commenced a NCIB to acquire up to 2,366,000 Class A Shares through the Toronto Stock Exchange ("Exchange"). The NCIB expired on November 8, 2007. During 2007 the Company acquired 1,220,100 Class A shares at a total cost of \$9.8 million.

In December 2008, the Seaboard Partnership made an advance to its partners, with Interfor's share being \$3.7 million, which was repaid by way of set-off on January 2, 2009 when Seaboard declared an income distribution to its partners.

## FINANCIAL POSITION

### Summary of Financial Position

	2008	2007	2006	2005	2004
	(millions of dollars)				
Current assets	131.5	158.3	289.7	173.7	186.8
Current liabilities	<u>79.4</u>	<u>50.0</u>	<u>123.8</u>	<u>145.4</u>	<u>86.4</u>
Working capital	<u>52.1</u>	<u>108.3</u>	<u>165.9</u>	<u>28.3</u>	<u>100.4</u>
Total assets	<u>665.9</u>	<u>549.2</u>	<u>677.6</u>	<u>602.0</u>	<u>567.4<sup>4</sup></u>
Total long-term liabilities	<u>179.7</u>	<u>68.5</u>	<u>73.4</u>	<u>67.6</u>	<u>108.3</u>
Operating debt	30.6	0.0	0.6	8.1	0.0
Payable to investee company	<u>3.7</u>	<u>0.0</u>	<u>0.0</u>	<u>54.3</u>	<u>0.0</u>
Long-term debt	<u>137.4</u>	<u>34.7</u>	<u>40.8</u>	<u>40.7</u>	<u>74.2</u>
Total debt	171.7	34.7	41.4	103.1	74.2
Shareholders' equity	<u>406.8</u>	<u>430.6</u>	<u>480.4</u>	<u>389.0</u>	<u>372.7<sup>4</sup></u>
Invested capital	<u>578.5</u>	<u>465.3</u>	<u>521.8</u>	<u>492.1</u>	<u>446.9<sup>4</sup></u>

### Ratio and Investment Information

Current ratio	1.7	3.2	2.3	1.2	2.2
Net debt as a percentage of invested capital, adjusted <sup>1</sup>	29.2%	1.9%	(28.9)%	17.8%	13.0% <sup>4</sup>
Total debt as a percentage of invested capital	29.7%	7.5%	7.9%	21.0%	16.6% <sup>4</sup>
Return on average shareholders' equity <sup>1</sup>	(13.7)%	(2.9)%	22.0%	5.2% <sup>4</sup>	6.9% <sup>4</sup>
Return on average invested capital, adjusted <sup>1</sup>	(10.6)%	(3.5)%	24.7%	5.4% <sup>4</sup>	6.8% <sup>4</sup>
Pre-tax return on total assets <sup>1</sup>	(5.2)%	(4.3)%	2.3%	2.1% <sup>3</sup>	5.2% <sup>4</sup>
Cash flow from operations as a percentage of total debt <sup>1</sup>	7.6%	73.0%	345.8%	44.1%	78.0%
Equity per share	\$8.63	\$9.14	\$9.98	\$7.99	\$7.66 <sup>4</sup>

	2008	2007	2006	2005	2004
	(millions)				
Weighted average shares outstanding for the year	47.1	47.6	48.5	48.7	48.4
Number of shares outstanding at year end:					
Class A subordinate voting <sup>2</sup>	46.1	46.1	47.1	47.7	47.6
Class B common <sup>2</sup>	<u>1.0</u>	<u>1.0</u>	<u>1.0</u>	<u>1.0</u>	<u>1.0</u>
	<u>47.1</u>	<u>47.1</u>	<u>48.1</u>	<u>48.7</u>	<u>48.6</u>

	2008	2007	2006	2005	2004
	(millions of dollars)				
<b>Re-investment of Cash</b>					
Cash flow from operations <sup>1</sup>	13.0	25.3	143.1	45.5	57.9
Cash generated from (used in) operating working capital	0.7	(70.3)	43.3	23.3	5.1
Proceeds on disposal of assets	5.1	8.3	49.2	47.8	33.0
Capital expenditures and acquisitions	(158.9)	(74.0)	(90.6)	(157.0)	(156.6)

1 See Glossary in Annual Information Form for definition.

2 As at February 12, 2009, the numbers of shares outstanding by class are: Class A Subordinate Voting shares – 46,101,476 Class B Common shares – 1,015,779, Total – 47,117,255.

3 Amount has not been restated for retrospective restatement of equity in earnings of investee company as information is not available from investee company (see "Accounting Changes").

4 Amount has not been restated for retrospective restatement of investment and equity in earnings of investee company as information is not available from investee company (see "Accounting Changes").

### Current Assets

Cash on hand and deposits at December 31, 2008 totaled \$0.2 million, down \$26.4 million from 2007, as the cash and deposits at December 31, 2007 were utilized to partially fund acquisitions and the new Adams Lake sawmill.

Accounts receivable at December 31, 2008 were \$25.4 million, 32% lower than 2007, primarily as a result of lower sales volume and sales values.

The Company had current income taxes recoverable of \$16.2 million at December 31, 2008 (2007 - \$8.8 million recoverable).

Lumber inventory levels at December 31, 2008 were \$22.5 million, up \$3.9 million compared to 2007. Lumber inventory volumes increased by 15% as the additional volume associated with the acquired sawmills in Grand Forks, B.C. and Beaver, WA, more than offset the reduced operating levels of the other sawmills and the closure of the old Adams Lake sawmill. Lumber inventory unit values increased 5%, primarily reflecting a heavier cedar component in 2008 year-end inventories.

Log inventory levels at December 31, 2008 were \$49.9 million, down \$3.7 million compared to 2007. Log inventory volumes were down 8% in Canada and 34% in the U.S. year-over-year as curtailments at our sawmills more than offset the additional log volume associated with the acquired P&T and Portac assets.

### Investments and Other Assets

Investments and Other Assets increased to \$19.4 million, up \$7.1 million from the prior year end. This was due to the Company's \$4.8 million share of profits from Seaboard, which are recorded as an increase in the investment in the Seaboard, pension asset funding of \$1.5 million, and other minor items.

### Property, Plant and Equipment, Timber and Logging Roads

The Company's net book value of \$502.0 million for property, plant and equipment, timber, logging roads, and assets held for sale was an increase of \$143.5 million over 2007. Capital expenditures were \$91.8 million, mainly related to construction of the new Adams Lake sawmill and investments in road building. The Company also invested \$93.0 million for the acquisition of the P&T and Portac capital assets. The weakening Canadian dollar at the end of 2008 resulted in foreign exchange translation impact on capital assets of U.S. operations of \$34.9 million. Offsetting the investments in capital assets were amortization and depletion expense of \$41.1 million, a \$31.0 million write-down of the Queensboro and old Adams Lake sawmills, and various other minor write-downs and disposals.

Cash investments in property, plant and equipment consisted of high-return discretionary projects of \$69.5 million, maintenance of business projects of \$2.1 million, and \$2.6 million for development costs related to surplus land being prepared for sale. The major capital project in 2008 was the construction of the new Adams Lake sawmill which was substantially complete as at the end of 2008. The first line was commissioned in 2008 with a full start-up scheduled for the second quarter of 2009.



### Current Liabilities

As at December 31, 2008, the Company had a Canadian operating line of credit ("Operating Line") of \$100.0 million and a U.S. operating line of credit ("U.S. Line") of US\$10.0 million, respectively. Drawings under these lines are subject to borrowing base calculations dependent upon accounts receivable, inventories and certain accounts payable. At year end, the Company's unused available Operating Line was \$23.4 million, after outstanding letters of credit of \$5.1 million, and its unused available U.S. Line was \$1.6 million. The Company's working capital ratio at December 31, 2008 was 1.7 to 1.

On February 5, 2009, the Company obtained a financing commitment from its lenders in respect of its syndicated credit facilities. See further description below under Long-Term Liabilities.

Accounts payable levels at December 31, 2008 were \$45.2 million, a decrease of \$4.8 million. The decline in trade accounts payable resulted from reduced operating rates in the second half of 2008. These factors more than offset the additional accruals required for reforestation, environmental, and related costs associated with the P&T assets acquisition.

### Long-Term Liabilities

In 2008, the Canadian revolving term line (the "Revolving Term Line") was increased from \$10.0 million to \$115.0 million with an extension of the maturity date to April 24, 2011. The Revolving Term Line bears interest at rates based on bank prime plus a premium, depending upon a financial ratio or, at the Company's option, at rates for Bankers' Acceptances or LIBOR based loans.

The Revolving Term Line was drawn on during the year to partially fund the P&T and Portac assets acquisitions, and the construction of the new Adams Lake sawmill, for a total outstanding at December 31, 2008 of \$94.8 million. The Revolving Term Line was undrawn at December 31, 2007.

The US\$ non-revolving term line (the "Non-Revolving Term Line") remained fully drawn at US\$35.0 million (2007 – US\$35.0 million) and was revalued at the year-end exchange rate to \$42.6 million (2007 - \$34.7 million). The Non-Revolving Term Line bears interest at rates based on bank prime plus a premium depending upon a financial ratio or, at the Company's option, at rates for LIBOR based loans, and matures on September 1, 2010.

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

On February 5, 2009, the Company obtained a financing commitment from its lenders in respect of its syndicated credit facilities. The Revolving Term Line will increase \$35 million to \$150 million, which will be due April 2011. The Operating Line will decrease \$35 million to \$65 million and will be extended 364 days to April, 2010. Except for an increase in pricing, all other terms and conditions of the lines remain substantially unchanged. This adjustment allows the Company to fully utilize all of its credit during times of reduced operating levels.

Upon acquisition of the P&T assets, the Company assumed certain related liabilities including reforestation, road deactivation, environmental, pensions, and restructuring obligations, which increased long-term liabilities by \$10.7 million as at December 31, 2008 compared to the prior year end.

### Liquidity and Capital Resources

As at December 31, 2008, the Company had working capital of \$52.1 million (2007 - \$108.3 million) and \$45.2 million available on its operating and term lines. These resources, in addition to cash generated from operations, will be used to support our working capital requirements, debt servicing commitments, capital asset investment priorities, and other general corporate purposes.

Interfor has had positive EDITDA for seven of the past eight quarters and in each of the past five years in total.

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.

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 based on this past experience, the Company believes that no impairment allowance is necessary in respect of trade accounts receivable past due. As at December 31, 2008, there were no trade accounts receivable past due which were considered uncollectible.

The Company's Operating Line was due to mature on April 24, 2009 but on February 5, 2009, the Company obtained a financing commitment from its lenders in respect of its syndicated credit facilities. The Operating Line will decrease from \$100 million to \$65 million and the maturity date will be extended 364 days to April 23, 2010. In addition, the Revolving Term Line will increase from \$115 million to \$150 million, with no change to its maturity date.

Interfor believes that its existing principal sources of liquidity - positive EBITDA, current working capital, surplus assets held for sale, and existing credit lines - will be sufficient to satisfy the funding of operating and capital requirements for the year ending December 31, 2009.

#### Summary of Contractual Obligations

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

	<b>Payments due by period</b>				
	<b>Total</b>	<b>Up to 1 year</b>	<b>2-3 years</b>	<b>4-5 years</b>	<b>After 5 years</b>
	(millions of dollars)				
Operating debt <sup>(1)</sup>	31.8	31.8	-	-	-
Long-term debt	137.4	-	137.4	-	-
Reforestation liability	24.4	8.7	7.2	4.6	3.9
Other long-term liabilities	17.7	5.3	5.0	1.4	6.0
Operating leases and contractual commitments	25.4	11.3	7.4	4.4	2.3
<b>Total contractual obligations</b>	<b>236.7</b>	<b>57.1</b>	<b>157.0</b>	<b>10.4</b>	<b>12.2</b>

<sup>(1)</sup> Subsequent to December 31, 2008, the maturity date on this debt was extended by 364 days. See note 23(c) to the Company's December 31, 2008 Consolidated Financial Statements.

#### Related Party Transactions

Lumber sales to a significant shareholder amounted to \$1.0 million (2007 - \$0.5 million). Shipping services provided by Seaboard Shipping Company Limited totaled \$5.6 million (2007 - \$8.0 million). These transactions were conducted on a normal commercial basis, including terms and prices and did not result in any ongoing contractual or other commitments.

#### Off-Balance Sheet Arrangements

The Company has off-balance sheet arrangements which encompass letters of credit and surety performance bonds, primarily for timber sales. These are more fully described in Note 8(a) and Note 16(c) to the Consolidated Financial Statements. At December 31, 2008, the total of such instruments aggregated \$11.9 million (2007 - \$11.7 million). Off-balance sheet arrangements have not had, and are not reasonably likely to have, any material impact on the Company's current or future financial condition, results of operations or cash flows.

### Summary of Issuance of Shares

There have been no issuances of shares over the last five years, other than those shares issued on exercised employee options.

### SELECTED QUARTERLY FINANCIAL INFORMATION

#### Quarterly Earnings Summary

	2008				2007			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
	(millions of dollars except share and per share amounts)							
Sales – Lumber	65.6	73.4	82.2	76.2	70.7	93.2	143.0	127.5
– Logs	18.3	28.8	25.7	30.9	35.6	30.3	33.2	19.4
– Wood chips and other by-products	8.8	8.9	7.4	5.5	7.2	10.0	17.1	16.0
– Other	0.8	0.9	2.1	1.8	1.9	2.0	2.1	1.7
Total Sales	93.5	112.0	117.4	114.4	115.4	135.5	195.4	164.6
Operating earnings (loss) before restructuring costs and asset write-downs	(8.1)	(12.8)	(11.8)	(1.3)	(15.3)	(4.6)	(3.5)	(1.8)
Operating earnings (loss)	(8.9)	(14.1)	(44.8)	(3.5)	(15.7)	(4.6)	(4.9)	(2.1)
Net earnings (loss)	(18.5)	(8.1)	(29.4)	(1.1)	(8.9)	(1.6)	(3.4)	0.6
Net earnings (loss) per share – basic	(0.39)	(0.17)	(0.62)	(0.02)	(0.19)	(0.03)	(0.07)	0.01
– diluted	(0.39)	(0.17)	(0.62)	(0.02)	(0.19)	(0.03)	(0.07)	0.01
EBITDA <sup>3</sup>	2.0	0.7	2.5	8.5	(4.6)	8.9	14.5	13.0
Cash flow from operations per share <sup>1</sup>	0.12	0.06	(0.06)	0.22	(0.06)	0.10	0.12	0.37
Shares outstanding – end of period (millions) <sup>2</sup>	47.1	47.1	47.1	47.1	47.1	47.1	47.6	47.8
– weighted average (millions)	47.1	47.1	47.1	47.1	47.1	47.4	47.8	48.0
Adjusted EBITDA <sup>3</sup>	1.7	0.1	1.9	8.5	(4.7)	7.2	12.6	10.8

1 Cash generated from operations before taking account of changes in operating working capital.

2 As at February 12, 2009, the numbers of shares outstanding by class are: Class A Subordinate Voting shares – 46,101,476 Class B Common shares – 1,015,779, Total – 47,117,255.

3 EBITDA represents earnings before interest, taxes, depletion, amortization and restructuring costs and asset write-downs. The Company discloses EBITDA as it is a measure used by analysts to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance. Adjusted EBITDA represents EBITDA adjusted for U.S. duty refunds and other income. EBITDA and Adjusted EBITDA can be calculated from the statements of operations as follows:

	2008				2007			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
	(millions of dollars)							
Net earnings (loss)	(18.5)	(8.1)	(29.4)	(1.1)	(8.9)	(1.6)	(3.4)	0.6
Add: Income taxes (recovery)	10.2	(5.2)	(14.6)	(2.5)	(7.1)	(1.8)	(4.5)	(0.3)
Interest expense	2.5	1.5	0.8	0.4	0.2	(0.1)	(0.5)	(0.9)
Depletion and amortization	7.9	11.3	13.1	9.1	10.7	11.7	16.2	12.2
Other foreign exchange (gains) losses	(0.9)	-	(0.4)	0.4	0.2	0.7	5.3	1.1
Restructuring costs, asset write-downs and other	0.8	1.3	33.0	2.2	0.3	-	1.4	0.3
EBITDA	2.0	0.7	2.5	8.5	(4.6)	8.9	14.5	13.0
Deduct:								
Other income	(0.3)	0.6	0.6	-	0.2	1.7	1.9	2.2
Adjusted EBITDA	1.7	0.1	1.9	8.5	(4.7)	7.2	12.6	10.8

## Volume and Price Statistics

		2008				2007			
		Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Lumber sales	(million fbm)	133	132	125	113	161	196	270	244
Lumber production	(million fbm)	118	148	128	104	150	187	269	249
Log sales <sup>1</sup>	(thousand cubic metres)	236	372	312	399	382	315	319	207
Log production <sup>1</sup>	(thousand cubic metres)	290	501	679	411	373	401	626	366
Average selling price – lumber <sup>2</sup>	(\$/thousand fbm)	\$494	\$555	\$658	\$672	\$441	\$476	\$530	\$522
Average selling price – logs <sup>1</sup>	(\$/cubic metre)	\$69	\$70	\$79	\$75	\$91	\$95	\$101	\$91
Average selling price – pulp chips	(\$/thousand fbm)	\$58	\$48	\$47	\$41	\$37	\$43	\$54	\$56

1 B.C. operations

2 Gross sales before duties and export taxes

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

The operating losses for the last eight quarters relate primarily to weak U.S. structural lumber markets and the stronger Canadian dollar. The fourth quarter of 2008 includes the effect of a valuation charge of \$15.1 million against future tax assets. The second quarter 2008 loss also reflects a restructuring charge of \$33.0 million primarily for the Queensboro sawmill closure. In the third and fourth quarters of 2007, USW strike action also contributed to the reported operating loss. The weak markets, strong dollar, and 2007 USW strike contributed to lower operating rates and lumber sales realizations over the past eight quarters.

### Quarter 4, 2008 Compared to Quarter 4, 2007

#### Overview

The Company recorded a net loss of \$3.4 million, or \$0.07 per share, for the fourth quarter of 2008, before a non-cash valuation allowance of \$15.1 million relating to future income tax assets, compared to net loss of \$8.9 million or \$0.19 per share in the fourth quarter of 2007. Including the valuation allowance, Interfor's net loss in the fourth quarter of 2008 was \$18.5 million, or \$0.39 per share.

EBITDA and Adjusted EBITDA for the fourth quarter of 2008 were \$2.0 million and \$1.7 million, respectively, compared to \$(4.6) million and \$(4.7) million, for the comparative quarter in 2007.

The operating loss in the fourth quarter of 2008 reflected the sharp decline in North American structural lumber volumes and prices, offset slightly by a weakening CAD\$. On a per unit basis, the Company's average lumber selling price increased due to the heavier weighting toward the cedar and Japanese markets. The weakening lumber and pulp markets resulted in lower volume and prices for the Company's log sales. The decline in lumber prices negatively impacted log and lumber inventory valuations.

#### Sales

Lumber shipments were down 28 million board feet for the fourth quarter of 2008 compared to the same quarter of 2007, reflecting lower operating rates in all regions. Unit lumber sales values over the same period were up \$53 per mfbm as the Canadian dollar weakened and the sales mix was weighted more

heavily toward higher value cedar and Japanese products. Compared to the average of the fourth quarter of 2007, the Canadian dollar was down 23 cents relative to its U.S. counterpart, while the average Western SPF 2x4 2&Btr price was down US\$45 per mfbm.

Log sales were down 146,000 m<sup>3</sup> and the average sales value was down \$22 per m<sup>3</sup>. The decline was mainly due to falling demand from lumber producers and a fourth quarter 2008 drop in demand from pulp producers.

Pulp chip and other by-product revenues for the fourth quarter of 2008 were up \$1.7 million, or 24%, compared to the same quarter of 2007. Chip sales volumes were off slightly in the fourth quarter of 2008 compared to the same period of 2007, as the decline in sawmill operating rates was partially offset by more available supply from the Company's acquired sawmill operations. Average chip prices were up reflecting the impact on realizations as the Canadian dollar weakened and supply was curtailed in the Pacific Northwest region.

#### Operating Costs

Production costs for the fourth quarter of 2008 declined \$25.8 million, or 22%, compared to the same period in 2007. For the most part, the decline was explained by the reduced log and lumber production levels, offset partially by 24% higher per mfbm lumber manufacturing costs as fixed costs were absorbed by significantly lower volumes. Lumber production was down 32 million board feet, or 22%, while B.C. log production decreased 83,000 cubic metres, or 21%. Also contributing to the decrease in costs were lower log prices on the B.C. Coast as a result of weaker demand.

The Canada/U.S. lumber export tax remained at 15% through the fourth quarter of 2008. Export taxes were down \$0.5 million because of a refund of export taxes received pursuant to provisions under the export charge act that depend on the relative U.S. market shares of Canadian and third country lumber producers. The impact on export taxes of reduced shipments from Canada to the U.S. markets was offset by the weakening CAD\$.

The Company recorded a LTIC recovery of \$0.9 million for the fourth quarter of 2008, reflecting a decline in the Company's share price over the period (fourth quarter of 2007 – LTIC recovery of \$1.0 million).

Amortization and depletion expense for the fourth quarter of 2008 was down \$2.8 million compared to the fourth quarter of 2007 due to the impact of lower operating rates.

#### Interest, Other Foreign Exchange Gain (loss), Other Income

Interest expense increased to \$2.5 million from \$0.2 million quarter-over-quarter reflecting the increase in the Company's average Operating and Revolving Term Lines balances due to the acquisitions of P&T and Portac during 2008 and the construction of the new Adams Lake sawmill. The Company recorded a foreign exchange gain of \$0.9 million for the three months ended December 31, 2008, in contrast to a loss of \$0.2 million for the fourth quarter of 2007. Other income for the fourth quarter of 2008 included the Company's \$1.9 million share of Seaboard's earnings for the quarter.

#### Income Taxes

In the fourth quarter of 2008, the Company recorded an income tax expense of \$10.2 million, comprised of a tax recovery of \$4.9 million offset by the non-cash valuation allowance of \$15.1 million taken against future income tax assets. The rate in the fourth quarter differed from the Canadian statutory rate of 31% mainly due to the valuation allowance charge, the non-taxable portion of income that is accounted for by the equity method, different tax rates for U.S. subsidiaries, and declining future income tax rates in Canada.

#### Cash Flow

Cash used by the Company in operations, after changes in working capital, was \$2.6 million for the fourth quarter of 2008, compared to cash used of \$9.8 million for the fourth quarter of 2007. The improvement in cash used was principally the result of the lower cash operating loss in the fourth quarter of 2008 due to the factors described above.

Capital expenditures for the fourth quarter of 2008 totaled \$31.0 million (Quarter 4, 2007 - \$15.6 million). Cash spending was comprised of \$26.0 million on discretionary projects, almost all of which was

on the new Adams Lake sawmill, \$0.4 million on maintenance projects, \$3.4 million on roads, and \$1.2 million on preparation of property for sale. There were no shares purchased under the Company's NCIB for the fourth quarter of 2008.

The Company had cash and deposits at December 31, 2008 totaling \$0.2 million, working capital of \$52.1 million, and total debt of \$171.7 million.

### **Controls and Procedures**

As required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, Interfor carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures as of December 31, 2008. The evaluation was carried out under the supervision of, and with the participation of the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based on the evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures were effective as of December 31, 2008.

As required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, Interfor carried out an evaluation of the effectiveness of the Company's internal controls over financial reporting ("ICFR") as of December 31, 2008. The evaluation was carried out within the COSO framework and under the supervision of, and with the participation of the CEO and the CFO. Based on the evaluation, the CEO and CFO concluded that the Company's ICFR were effective as of December 31, 2008.

The CEO and CFO acknowledge responsibility for the design of ICFR, and confirm that there were no changes in these controls that occurred during the most recent interim period ended December 31, 2008 which materially affected, or are reasonably likely to materially affect, the Company's ICFR.

### **Critical Accounting Estimates**

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

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

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

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 based on this past experience, the Company believes that no impairment allowance is necessary in respect of trade accounts receivable past due. As at December 31, 2008, there were no trade accounts receivable past due which were considered uncollectible (2007 - \$nil), and no reserve in respect of doubtful accounts was set up (2007 - \$nil).

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

*Valuation of Inventories.* Interfor values its lumber inventories at the lower of cost and net realizable value on a specific product basis. Log inventories are valued at the lower of cost and net realizable value on a specific boom or sort basis. Other inventories consist primarily of seedlings, spare parts, and supplies and are recorded at the lower of cost and replacement cost. The unit net realizable value for lumber and Coastal log inventories is determined by a reference to the average net sales by specific product in the periods immediately following and preceding the reporting date. The unit realizable value for Interior and U.S. log inventories is determined by reference to the value of the projected lumber

outturn. The unit cost for lumber is based on a three month moving average actual cost, lagged by one month, and for logs is based on a twelve month moving average actual cost, lagged by one month, both adjusted for unusual items. Instances where net realizable value is lower than cost result in a charge to operating earnings in the period. Downward movements in commodity prices could result in a material write-down of inventory at any given time.

*Recoverability of Property, Plant and Equipment, Timber and Logging Roads.* Interfor's assessment of recoverability of property, plant and equipment, timber and logging roads is made with reference to projections of future cash flows to be generated by its operations. These projections necessitate the estimation of sales and production volumes, future commodity pricing, operating costs, foreign currency exchange rates, export taxes and other factors. There is a high degree of uncertainty in such estimations, and, as such, any significant change in assumptions could result in a conclusion that the carrying value of these assets could not be recovered, which could necessitate a material charge against operating earnings.

Interfor assesses the recoverability of Property, Plant and Equipment, Timber and Logging Roads as conditions and events warrant. The Company assessed the recoverability of these assets as at December 31, 2008, and concluded that there was no impairment.

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

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

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

*Pension and Other Post-retirement Benefits.* In Canada, the Company maintains savings and retirement plans which include a Group Registered Retirement Savings Plan and a Deferred Profit Sharing Plan that are available to all salaried employees, a defined benefit pension plan that is available to substantially all hourly employees not covered by a union pension plan, and a defined benefit pension plan and post-retirement medical and life insurance plan for certain unionized employees in the Interior of B.C. In addition, the Company contributes to an industry-wide benefit plan for United Steelworkers unionized employees. In the U.S., the Company maintains a 401(k) plan that is available to all employees. The Company also maintains supplementary pension plans for senior management in both Canada and the U.S.

The Company retains independent actuarial consultants to value its defined pension benefit obligations and plan asset values. Actuarial assumptions used in the valuation of obligations and values include assumptions of the discount rate used in calculations of net present value of obligations, expected rates of return on plan assets to be used to fund obligations, and assumed rates of increase for employee

compensation and for health care costs. Actual experience can vary materially from estimates and could result in a material charge against operating earnings as well as necessitate a current cash funding requirement.

*Income Taxes.* The Company's provision for income taxes, both current and future, is based on various judgments, assumptions and estimates including the tax treatment of transactions recorded in the Company's consolidated financial statements. Interfor records provisions for federal, provincial and foreign taxes based on the respective tax rules and regulations in the jurisdictions in which the Company operates. Due to the number of variables associated with the judgments, assumptions and estimates, and differing tax rules and regulations across the multiple jurisdictions, the precision and reliability of the resulting estimates are subject to uncertainties and may change as additional information becomes known.

Income tax assets and liabilities, both current and future, are measured according to the income tax legislation that is expected to apply when the asset is realized or the liability settled. Future income tax assets and liabilities are comprised of the tax effect of temporary differences between the carrying amount and tax basis of assets and liabilities, tax loss carry forwards and tax credits. Assumptions underlying the composition of tax assets and liabilities include estimates of future results of operations and the timing of the reversal of temporary differences as well as the tax rates and laws in the applicable jurisdictions at the time of the reversal. The composition of income tax assets and liabilities is reasonably likely to change from period to period due to the uncertainties surrounding these assumptions.

## **NEW ACCOUNTING POLICIES AND ACCOUNTING POLICY CHANGES**

Effective January 1, 2008, the Company adopted newly effective Canadian Institute of Chartered Accountants ("CICA") accounting standards, together with a change in accounting policy of an investee company. The main requirements of these new standards and the change in accounting policy and the resulting financial statement impact are described below.

### *Capital Disclosures*

Section 1535, *Capital Disclosures*, specifies the disclosure of the Company's objectives, policies and processes for managing capital, including: a description of what components of liabilities and shareholders' equity the Company defines as capital, and their balances; and the nature of any externally imposed capital restrictions, how those are managed, and the consequence of any non-compliance, if any.

### *Inventories*

Handbook Section 3031, *Inventories*, provides significantly more guidance on the measurement of inventories, with an expanded definition of cost, and the requirement that inventory must be measured at the lower of cost and net realizable value. In addition, the section has additional disclosure requirements, including accounting policies, carrying values, and amount of any inventory writedowns.

The adoption of this new standard had no financial effect on the comparative consolidated financial statements of the Company.

### *Financial Instruments – Disclosure and Presentation*

Handbook Section 3862, *Financial Instruments – Disclosures*, and Section 3863, *Financial Instruments – Presentation*, replace Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing disclosure requirements to provide additional information on the nature and extent of risks arising from financial instruments to which the Company is exposed and how it manages those risks.

### *Accounting Changes*

Seaboard Shipping Company Limited ("Seaboard"), an equity investment of the Company, recently adopted the deferral method of accounting for dry-dock activities whereby actual costs incurred are deferred and amortized on a straight-line basis over the period until the next scheduled dry-dock activity. Previously, dry-dock activities were accounted for using the accrue-in-advance method. In accordance with CICA Handbook Section 1506, *Accounting Changes*, Seaboard adopted this policy retrospectively, resulting in the restatement of prior years' results.



As the investment in Seaboard is accounted for using the equity method, the Company has recorded its share of the impact of the restatement as follows:

	As previously reported	Adjustment	As adjusted
<b>Consolidated Statement of Retained Earnings</b>			
for the year ended December 31, 2007:			
Retained earnings, beginning	\$ 181,477	\$ 2,428	\$ 183,905
<b>Consolidated Balance Sheet as at</b>			
December 31, 2007:			
Investments and other assets	9,842	2,428	12,270
Retained earnings, ending	168,156	2,428	170,584

### **Future Accounting Policy Changes**

#### *Goodwill and Intangible Assets*

Effective January 1, 2009, the Company will adopt new CICA Handbook Section 3064, *Goodwill and Intangible Assets*. This section 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.

The Company does not anticipate a material impact to its consolidated financial statements from the adoption of this new Standard.

#### *Convergence with International Financial Reporting Standards*

In February 2008, Canada's Accounting Standards Board confirmed that Canadian GAAP, as used by public companies, will be converged with International Financial Reporting Standards (IFRS) effective 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. The Company commenced its IFRS conversion project in 2008 with the provision of training to key employees. In the first half of 2009, the Company plans to assemble a cross functional team and, utilizing external expertise where required, will begin a high level review of the major differences between Canadian GAAP and IFRS as applicable to the Company and will establish the project plan and key milestones.

Changes in accounting policies are likely. These changes may materially impact the Company's consolidated financial statements.

### **RISKS AND UNCERTAINTIES**

#### **Pricing**

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

Based on 2008 levels of operations, a \$10 change in the Company's average selling price of its products would impact net earnings as follows:

Lumber	\$10 increase per thousand fbm	\$3.5 million increase in net income
Chips	\$10 increase per unit <sup>1</sup>	\$1.8 million increase in net income

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

## Competition

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

Factors which affect the Company's competitive position include:

- the foreign exchange rate;
- the cost of labour;
- the costs of harvesting or purchasing logs;
- the quality of its products and customer service;
- the cost of export taxes payable on sales to the U.S.; and
- its ability to maintain high operating rates and thus lower manufacturing costs.

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

## Availability of Log Supply

The log requirements of Interfor's mills are met using logs harvested from its timber tenures, by long-term trade and purchase agreements and by purchases on the open market. Logs produced but unsuitable for use in Interfor's mills are either traded for suitable logs or sold on the open market. Operating at normal capacity, the Company's Canadian mills generally purchase less than 50% of their log requirements either through long-term trade and purchase agreements or on the open market. The Company relies on 100% purchased wood for its U.S. based mills. As a result, fluctuations in the price, quality or availability of log supply can have a material effect on Interfor's business, financial position, results of operations and cash flow.

Additionally, in order to ensure uninterrupted access to logs harvested from its timber tenures in Canada, Interfor must also focus on the continuous development of road networks. This encompasses an integrated plan by foresters, engineers and logging operations personnel to identify future logging areas and develop the engineering for roads. Interfor expects to fund its ongoing road development through the cash generated from operations and through utilization of its existing bank facilities.

## Use of Financial and Other Instruments

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

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

## Currency Exchange Sensitivity

The Company's Canadian operations ordinarily sell approximately 70% of their lumber into export markets, with the majority of these sales denominated in foreign currency, predominantly US\$ and a small amount of Japanese Yen. While the Canadian operations also incur some US\$ denominated expenses, primarily for ocean freight, and other transportation and equipment operating leases, the majority of its expenses are incurred in CAD\$.

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

The Company actively manages its currency exchange risk in fluctuations in US\$ and Japanese Yen by identifying opportunities from time to time to enter into foreign exchange contracts to effectively hedge its net exposure. As at December 31, 2008, the Company has outstanding obligations to sell a maximum of US\$4.5 million at an average rate of US\$1.2339 to the CAD\$1.00 and sell Japanese ¥51.0 million at an average rate of ¥83.11 to the CAD\$1.00 and sell Japanese ¥65.0 million at an average rate of ¥92.85 to the US\$1.00 and sell Euros €90,000 at an average rate of \$1.5908 to the CAD\$1.00 during 2009. All foreign currency gains or losses to December 31, 2008 have been recognized in the Statement of Operations and the fair value of the foreign currency contracts of \$0.1 million has been recorded in accounts payable and accrued liabilities.

Based on the Company's net exposure to foreign currencies in 2008 and US\$ denominated cash held in deposits and short term investments at year end and US\$ denominated debt and related financial instruments, the sensitivity of Interfor's net earnings is as follows:

US\$	\$0.01 increase vs. CAD\$	\$500,000 increase in net income
Japanese Yen	1¥ increase vs. CAD\$	\$50,000 increase in net income

Interfor's U.S. operations produce and sell products almost exclusively for the U.S. market. All revenues and expenses are denominated in US\$. All foreign currency denominated assets and liabilities of the self-sustaining operations are translated at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at the average rates for the period. Unrealized gains and losses arising upon translation of net foreign currency investment positions in self-sustaining operations, together with any gain or losses arising from hedges of those net investment positions to the extent effective, are credited or charged to net change in unrealized foreign currency translation gains (losses) in the Statement of Comprehensive Income. Upon sale, reduction or substantial liquidation of an investment position, the previously recorded net unrealized gains (losses) thereon in Accumulated Other Comprehensive Income ("AOCI") are reclassified to the Statement of Operations.

The Company recorded a \$33.4 million unrealized foreign exchange gain on translation of its self-sustaining operations in 2008 (2007 - \$27.5 million loss) to other comprehensive income.

On October 1, 2008, the Company designated the US\$30.2 million drawn under its Revolving Term Line for the acquisition of its Beaver operations as a hedge against its investment in its self-sustaining U.S. operations. Unrealized foreign exchange losses have been recorded in Other comprehensive Income.

The Company had previously designated its US\$35.0 million Non-Revolution 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 as a result of applying hedge accounting totaled \$5.5 million and continue to be recorded in AOCI. Unrealized foreign exchange losses arising subsequent to termination of the designation of the hedge relationship totaled \$7.9 million (2007 - \$5.7 million gain) and were recorded in Other foreign exchange gain (loss) in the Statement of Operations.

### **Cost of Debt Financing and Sensitivity**

As at December 31, 2008 Interfor had drawn a total of \$168.0 million (2007 - \$34.7 million) of floating rate debt under its operating and term credit facilities.

The Company's operating and term credit facilities bear interest at the bank prime rate plus a premium, or, at the Company's option, at rates for Bankers' Acceptances for CAD\$ loans or at LIBOR for US\$ loans, in all cases depending upon a financial ratio. The lines are subject to certain financial covenants including a minimum working capital requirement, a maximum ratio of total debt to total capitalization, and a minimum net worth requirement.

During September 2005, the Company entered into a cross currency interest rate swap. The Company has agreed to receive US\$20.0 million at maturity on September 1, 2009 in exchange for payment of CAD\$23.5 million (an exchange rate of 1.1765). In addition, during the term of the swap the Company will pay an amount based on annual interest of 5.84% on the CAD\$23.5 million and will receive 90 day LIBOR plus a spread of 200 basis points on the US\$20.0 million. LIBOR will be recalculated at set interval dates. The swap will mature on September 1, 2009 and has been marked to market with all gains or losses on the swap recognized in the Statement of Operations and total foreign exchange gains of \$4.2 million recognized in 2008 (2007 - \$3.6 million loss). The fair value of \$0.4 million has been recorded in accounts receivable (2007 - \$3.6 million recorded in accounts payable).

Based on the Company's average debt level during 2008, the sensitivity of a 100 basis point increase in interest rates would result in an approximate decrease of \$0.5 million in net earnings.

### **Forest Policy Changes in British Columbia**

Over the last several years the Crown has initiated a number of changes to forest policy that will encourage a more viable and competitive forest industry in B.C. Policy changes that have been implemented, for example, include a results based Forest Practices Code; First Nation tenure opportunities and revenue sharing; market based timber pricing; the elimination of minimum cut control regulations; the elimination of existing timber processing regulations; and the Forestry Revitalization Plan ("FRP") that included a reallocation of tenure that reduced the AAC of major licence holders, including Interfor, by 20%. The FRP stated that approximately half of this volume would be redistributed to woodlots, community forests, and First Nations, and the other half would be available for public auction under the Timber Sales Program.

In 2008, the Crown initiated two major policy review processes. The first is a Forest Regulatory Review process aimed at streamlining existing regulations. The second is the creation of a Forestry Roundtable that was tasked to provide recommendations on future policy changes that will help strengthen the industry in years to come.

The impact of some of the new policy changes are expected to take effect in 2009 while others remain to be fully implemented. Until the details of all such changes are announced and implemented, the full impact of these changes on the Company's production, costs, financial position and results of operations cannot be determined.

### **Allowable Annual Cut ("AAC")**

Interfor holds cutting rights in B.C. that represent an AAC of approximately of 3.6 million cubic metres. Of this amount 3.3 million cubic metres is in the form of replaceable tenures. The remaining portion is held in non-replaceable tenures (Timber licences and non-replaceable Forest licences) that will expire over time.

The AAC is regulated by the Ministry of Forests and Range (MoFR) and subject to periodic reviews that assess and then make determinations to set harvesting rates for each tenure. Many factors affect the AAC such as timber inventory, operable land base, growth rates, regulations, forest health, land use and environmental and social considerations.

Interfor's AAC in the Central Coast and North Coast regions has been reduced to take into account the impact of the new protected area additions. A further reduction is anticipated to address future impacts associated with the implementation of Ecosystem Based Management ("EBM") practices. The Company's portion of this reduction is estimated to be 127,000 cubic metres, or approximately 8% of the Company's AAC within this region. 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 and does not anticipate a significant change in the current harvest rate in comparison to the harvest in recent years as a result of this decision.

Reductions in Interfor's AAC from new protected areas are subject to compensation, once these areas have been formally removed. Although the Crown acknowledged that licensees would be fairly compensated for the return of tenure and related infrastructure costs, there can be no assurance that the amounts of such reductions, if any, will not be material or the amounts of compensation, if any, for such reductions will be fair and adequate.

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

Interfor's B.C. Interior operation has had a temporary increase in their AAC resulting from the acquisition of new non-replaceable cutting rights directed at beetle damaged and killed stands in the Kamloops and 100 Mile Forest Districts. The amount of timber available for harvest in the B.C. Southern Interior is expected to remain high for the next five to ten years as a consequence of an accelerated harvest to address the impacts from the pine beetle epidemic. The longer term impact of the beetle is expected to reduce the overall timber supply once the surplus of dead pine is no longer useable. The amount and duration of the increase and subsequent decline cannot be determined at this time and will vary by location.

In 2008, the Company received \$4.8 million in compensation for the loss of logging rights for timber licences, forestry and engineering work and other expenditures related to the timber returned pursuant to the decisions. Compensation received as settlement of expenditures previously expensed was recorded as a recovery of production costs in 2008.

### **Aboriginal Issues**

In 1997, the Supreme Court of Canada, in the *Delgamuukw* decision, confirmed the continued existence of aboriginal title and rights in areas of British Columbia, which are not covered by treaties. Accordingly, aboriginal groups have claimed aboriginal title and rights over substantial portions of British Columbia, including areas where Interfor's forest tenures are situated, creating uncertainty as to the status of competing property rights. The Federal and Provincial governments have been seeking to negotiate settlements with aboriginal groups throughout British Columbia in order to resolve aboriginal rights and title claims. In addition, the governments have entered, and may continue to enter, into interim measures agreements with aboriginal groups. Any interim measures agreements or settlements that may result from the treaty process may involve a combination of cash, resources, grants of conditional rights to resources on public lands and rights of self government. The impact of aboriginal claims or treaty settlements on Interfor's forest tenures or the amounts of compensation to Interfor, if any, cannot be estimated at this time.

The duty to consult and accommodate aboriginal groups has become a central issue facing governments and the forest industry. While the courts have established that the Crown has a duty to consult and accommodate aboriginal groups, there was uncertainty as to how and to what this requirement will be applied. Uncertainty also existed in what responsibility a company may have as a result of the Crown's failure to carry out its duties. In a Supreme Court of Canada's decision on November 18, 2004, it was made clear that third parties (tenure holders) are not responsible for consultation and accommodation of aboriginal interests. It is the Crown's obligation to consult and, where appropriate, accommodate aboriginal interests. The questions of responsibility and appropriateness of balancing interests will continue to evolve as the courts provide greater clarity to these complex issues. In addition the Province has initiated a New Relationship process with First Nation leaders that is intended to improve the functional relationship between the Crown and aboriginal groups prior to treaty settlement.

### **Stumpage Fees**

Stumpage is the fee the Crown charges companies to harvest timber from Crown land. Prior to February 29, 2004, the amount of stumpage paid for each cubic metre of wood harvested was based on a target rate set by government. Stumpage payments for a harvesting area took into consideration specific operating conditions, timber quality and administrative procedures.

Amending the stumpage system is complex and the subject of discussion involving, among other things, lumber trade agreements between Canada and the United States. The move to a more open and competitive market pricing system ("MPS") for timber and logs for the Coastal and Interior forest sector have been implemented by the British Columbia government. The primary variable in MPS is log pricing established through open market bidding for standing timber. In addition to bid prices, there are a number of operational and administrative factors that go into determining an individual stumpage rate for each cutting permit. Periodic changes in the British Columbia government's administrative policy can affect stumpage costs and the viability of individual logging operations. There can be no assurance that current changes or future changes will not have a material impact on stumpage rates.

## **Environment**

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

## **Labour Disruptions**

The Company's Canadian B.C. Coastal, Grand Forks, and Castlegar sawmill employees are members of the USW. The collective agreement with the USW for the B.C. Coast expires in June 2010. The collective agreement with the USW for the B.C. Interior (Grand Forks and Castlegar) expires in June 2009. The Company also has 19 employees in the B.C. Interior who are members of the Canadian Marine Service Guild, and their collective agreement expires September 30, 2011.

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

## **OUTLOOK**

With U.S. housing starts at their lowest level in five decades, and no immediate end to the financial and general economic crisis in sight, the Company expects North American structural lumber market conditions to remain very challenging throughout 2009, with little prospect of any meaningful price recovery on the horizon. Export taxes on sales to the U.S. are expected to remain at 15% through 2009.

Demand for Cedar in the first quarter of 2009 is likely to be slower than normal. The availability of credit continues to be a major concern with customers and, accordingly, any inventory positions taken may be substantially lower than normal. Demand for the remainder of 2009 is expected to improve as consumption increases and supply remains restricted due to sawmill curtailments.

In Japan, the housing market is expected to remain steady as concerns over credit and the global financial crisis are offset by home buying tax incentives offered by the government. Lack of available supply from North America due to mill curtailments is expected to support lumber prices at close to current levels.

With respect to currency, the outlook for the CAD\$ versus the US\$ and yen for 2009 is very difficult to predict, given the volatility of the currency markets witnessed in 2008.

Residual chip prices have declined as pulp producers have curtailed production to balance supply. Stumpage rates on the B.C. Coast, which are tied to log prices through a formula, are expected to decline in 2009 reflecting lower market prices for logs.

With the prospect of a difficult year ahead, the Company intends to maintain very tight control over cash, while focusing on the monetization of surplus properties. Completion of the construction of the new Adams Lake sawmill is the only major capital investment currently approved for 2009.

## **ADDITIONAL INFORMATION**

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



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

The management of International Forest Products Limited (Interfor) is responsible for preparing the accompanying consolidated financial statements. The financial statements were prepared in accordance with 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 "John A. Horning".

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

February 5, 2009



**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, 2008 and 2007 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, 2008 and 2007 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 single horizontal line that starts under the 'K' and ends under the 'P'.

KPMG LLP, Chartered Accountants

Vancouver, Canada

February 5, 2009



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

(Expressed in thousands of Canadian dollars)  
December 31, 2008 and 2007

	2008	2007
<b>Assets</b>		restated - note 1(b)(iv)
Current assets:		
Cash and cash equivalents	\$ 184	\$ 17,795
Deposit (note 2)	-	8,761
Accounts receivable	25,441	37,172
Income taxes recoverable	16,225	8,838
Inventories (note 4)	78,991	76,429
Prepaid expenses	7,779	6,267
Future income taxes (note 15)	2,890	3,083
	<u>131,510</u>	<u>158,345</u>
Investments and other assets (note 5)	19,372	12,270
Property, plant and equipment (note 6)	396,387	300,150
Timber and logging roads (note 7)	90,425	55,050
Goodwill and other intangible assets	13,078	13,078
Future income taxes (note 15)	-	7,000
Long-lived assets held for sale (note 3)	15,138	3,239
	<u>\$ 665,910</u>	<u>\$ 549,132</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Bank indebtedness (note 8(a))	\$ 30,589	\$ -
Accounts payable and accrued liabilities	45,163	49,999
Payable to investee company (notes 9 and 23(a))	3,651	-
	<u>79,403</u>	<u>49,999</u>
Reforestation liability, net of current portion (note 11)	15,685	11,874
Long-term debt (note 8(b))	137,414	34,696
Other long-term liabilities (note 10)	12,407	8,859
Future income taxes (note 15)	14,159	13,080
Shareholders' equity:		
Share capital (note 12):		
Issued and fully paid:		
Class A subordinate voting shares	284,500	284,444
Class B common shares	4,080	4,080
Contributed surplus (note 12(a))	5,408	5,408
Accumulated other comprehensive income (loss)	(539)	(33,892)
Retained earnings	113,393	170,584
	<u>406,842</u>	<u>430,624</u>
	<u>\$ 665,910</u>	<u>\$ 549,132</u>

Commitments and contingencies (note 16)  
Subsequent events (note 12(a) and note 23)  
See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:



E.L. Sauder, Director



H.C. Kalke, Director

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

(Expressed in thousands of Canadian dollars, except earnings per share amounts)  
 Years ended December 31, 2008 and 2007

	2008	2007
Sales	\$ 437,221	\$ 611,008
Costs and expenses:		
Production	411,479	560,348
Selling and administration	16,867	16,776
Long term incentive compensation (recovery)	(1,990)	(476)
Export taxes	3,433	8,755
Amortization of plant and equipment	21,846	30,129
Depletion and amortization of timber, roads and other	19,619	20,726
	<u>471,254</u>	<u>636,258</u>
Operating loss before restructuring costs and write-downs of plant, equipment and timber	(34,033)	(25,250)
Restructuring costs and write-downs of plant, equipment and timber (note 14)	(37,305)	(1,975)
Operating loss	(71,338)	(27,225)
Other earnings (expenses):		
Interest expense on long-term debt	(4,543)	(2,835)
Other interest income (expense), net	(588)	4,163
Other foreign exchange gain (loss)	912	(7,308)
Other income (note 13)	1,418	5,983
Equity in earnings of investee companies (note 5)	4,825	218
	<u>2,024</u>	<u>221</u>
Loss before income taxes	(69,314)	(27,004)
Income taxes (note 15):		
Current (recovery)	(18,533)	(9,570)
Future (recovery)	6,410	(4,113)
	<u>(12,123)</u>	<u>(13,683)</u>
Net loss	<u>\$ (57,191)</u>	<u>\$ (13,321)</u>
Net loss per share (note 17):		
Basic and diluted	\$ (1.21)	\$ (0.28)

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Retained Earnings**

(Expressed in thousands of Canadian dollars)  
 Years ended December 31, 2008 and 2007

	2008	2007
Retained earnings, beginning of year, as restated (note 1(b)(iv))	\$ 170,584	\$ 183,905
Net loss	(57,191)	(13,321)
Retained earnings, end of year	<u>\$ 113,393</u>	<u>\$ 170,584</u>

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, 2008 and 2007

	2008	2007
Cash provided by (used in):		
Operating activities:		
Net loss	\$ (57,191)	\$ (13,321)
Items not involving cash:		
Amortization of plant and equipment	21,846	30,129
Depletion and amortization of timber, roads and other	19,619	20,726
Future income taxes (recovery)	6,410	(4,113)
Other assets	(544)	1,030
Reforestation liability	(4,421)	(1,336)
Other long-term liabilities	(1,678)	257
Share of earnings net (in excess) of cash distributions of investee company (note 5)	(4,825)	4,151
Write-down of plant, equipment and timber (note 14)	31,427	-
Unrealized foreign exchange losses (gains)	3,941	(6,094)
Other (note 13)	(1,541)	(6,117)
	13,043	25,312
Cash generated from (used in) operating working capital:		
Accounts receivable	13,335	12,438
Inventories	12,025	2,791
Prepaid expenses	(117)	(2,289)
Accounts payable and accrued liabilities	(16,358)	(46,839)
Income taxes	(8,187)	(36,399)
	13,741	(44,986)
Investing activities:		
Additions to property, plant and equipment	(73,364)	(44,726)
Additions to logging roads and timber	(17,512)	(28,340)
Additions to deferred start up costs	-	(959)
Proceeds on disposal of property, plant and equipment	5,096	8,256
Acquisitions (note 2)	(76,919)	-
Deposit held in escrow for acquisition (note 2)	8,943	(8,761)
Investments and other assets	(2,116)	(2,010)
	(155,872)	(76,540)
Financing activities:		
Repurchase of share capital (note 12(a))	-	(9,846)
Issuance of share capital, net of expenses (note 12(a))	56	892
Increase (decrease) in bank indebtedness	30,589	(582)
Funds from promissory note payable to investee company (note 9)	3,651	-
Additions to long-term debt (note 8(b))	139,064	-
Repayments of long-term debt (note 8(b))	(48,925)	-
	124,435	(9,536)
Foreign exchange gain (loss) on cash and cash equivalents held in a foreign currency	85	(314)
Decrease in cash and cash equivalents	(17,611)	(131,376)
Cash and cash equivalents, beginning of year	17,795	149,171
Cash and cash equivalents, end of year	\$ 184	\$ 17,795
Supplementary disclosures:		
Cash interest paid (received), net	\$ 5,131	\$ (1,328)
Cash income taxes paid (received)	(12,330)	26,977

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, 2008 and 2007

	2008	2007
Net loss	\$ (57,191)	\$ (13,321)
Other comprehensive loss:		
Net change in unrealized foreign currency translation gains (losses) on translation of self-sustaining foreign subsidiaries	33,353	(27,531)
Other comprehensive income (loss)	33,353	(27,531)
Comprehensive loss	\$ (23,838)	\$ (40,852)

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, 2008 and 2007

	2008	2007
Accumulated other comprehensive loss, beginning of year	\$ (33,892)	\$ (6,361)
Other comprehensive income (loss)	33,353	(27,531)
Accumulated other comprehensive loss, end of year	\$ (539)	\$ (33,892)

See accompanying notes to consolidated financial statements.

**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 new accounting policies and accounting change:

Commencing January 1, 2008, the Company adopted five new Canadian Institute of Chartered Accountants ("CICA") accounting standards, together with a change in accounting policy of an investee company. The main requirements of these new standards and the change in accounting policy and the resulting financial statement impact are described below.

(i) Capital Disclosures:

Section 1535, *Capital Disclosures*, specifies the disclosure of the Company's objectives, policies and processes for managing capital, including: a description of what components of liabilities and shareholders' equity the Company defines as capital, and their balances; and the nature of any externally imposed capital restrictions, how those are managed, and the consequence of any non-compliance, if any. Refer to note 21 for additional disclosures.

(ii) Inventories:

Handbook Section 3031, *Inventories*, provides significantly more guidance on the measurement of inventories, with an expanded definition of cost, and the requirement that inventory must be measured at the lower of cost and net realizable value. In addition, the section has additional disclosure requirements for accounting policies, carrying values, and the amount of any inventory writedowns.

The adoption of this new standard had no financial effect on the comparative consolidated financial statements of the Company. Refer to note 4 for additional disclosures.

(iii) Financial Instruments – Disclosure and Presentation:

Handbook Section 3862, *Financial Instruments – Disclosures*, and Section 3863, *Financial Instruments – Presentation*, replace Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing disclosure requirements to provide additional information on the nature and extent of risks arising from financial instruments to which the Company is exposed and how it manages those risks. Refer to note 22 for additional disclosures.

(iv) Accounting Changes:

Seaboard Shipping Company Limited ("Seaboard"), an equity investment of the Company, recently adopted the deferral method of accounting for dry-dock activities whereby actual costs incurred are deferred and amortized on a straight-line basis over the period until the next scheduled dry-dock activity. Previously, dry-dock activities were accounted for using the accrue-in-advance method. In accordance with CICA Handbook Section 1506, *Accounting Changes*, Seaboard adopted this policy retrospectively, resulting in the restatement of prior years' results.

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

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

(iv) Accounting Changes (continued):

As the investment in Seaboard is accounted for using the equity method, the Company has recorded its share of the impact of the restatement as follows:

	As previously reported	Adjustment	As adjusted
<b>Consolidated Statement of Retained Earnings for the year ended December 31, 2007:</b>			
Retained earnings, beginning	\$ 181,477	\$ 2,428	\$ 183,905
<b>Consolidated Balance Sheet as at December 31, 2007:</b>			
Investments and other assets	9,842	2,428	12,270
Retained earnings, ending	168,156	2,428	170,584

The restatement has not affected net loss previously reported for any of the periods presented in the Statement of Operations.

(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.

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, 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 and 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.

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

## (e) Investments and advances (continued):

The Company is the holder of 60% of the outstanding common shares of Seaboard. The remaining common shares are held by other British Columbia forestry companies. Seaboard 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 financing, investing and operating 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) Deferred start-up costs:

Start-up costs on major plant construction are deferred to the extent these costs meet the criteria under CICA Emerging Issues Committee Abstract 27 and the site reaches sustainable productions levels which are defined as the earlier of:

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

(ii) Six months

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

Startup-costs are amortized over five years on a straight-line basis and are included on the balance sheet in property, plant and equipment.

## (h) 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.

## (i) 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.

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

## (j) 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.

## (k) 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.

## (l) 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 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.

## (m) 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.

## (n) 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.

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.



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

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

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 2008 (2007 - ten years).

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

The Company 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 is managed through the use of a cross currency interest rate swap. This swap agreement requires 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 is recognized in Other foreign exchange gain (loss) on the Statement of Operations.

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.

## (p) 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):**

## (p) 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 to the termination date. 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.

## (q) Net earnings per share:

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

## (r) 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.

## (s) Impairment of long-lived assets 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 then determines if an impairment loss exists, by determining if the carrying amount of a long-lived asset exceeds 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, 2008, the Company tested the recoverability of substantially all of its long-lived assets. The recoverability test performed included management forecasts of undiscounted cash flows arising from the use and disposition of the long-lived assets. Several assumptions are required in conducting these forecasts and the more significant ones include lumber and 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. Based on the assumptions used, the forecasted undiscounted cash flows exceed the carrying value of the Company's long-lived assets and no impairment charge is required at December 31, 2008.

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

(s) Impairment of long-lived assets and related measurement uncertainty (continued):

Given the judgements and estimates required to carry out the test for recoverability 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.

(t) Comparative figures:

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

(u) Future accounting changes:

(i) International Financial Reporting Standards

The CICA has announced that it will transition Canadian generally accepted accounting principles ("GAAP") for publicly accountable entities to International Financial Reporting Standards ("IFRS"). The Company's consolidated financial statements are to be prepared in accordance with IFRS for the fiscal year commencing January 1, 2011.

(ii) Goodwill and Intangible Assets

Effective January 1, 2009, the Company will adopt new CICA Handbook Section 3064, *Goodwill and Intangible Assets* which 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.

The Company is currently evaluating the implications of the adoption of these new Standards on its consolidated financial statements.

**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 has been allocated to the fair value of assets acquired and related liabilities arising from the transactions, based on management's best estimates. These acquisitions have been accounted for using the purchase method and the purchase price is allocated as follows:

	Kootenay Acquisition (note 2(a))	Beaver and Forks Acquisition (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 and other long-term obligations	13,458	-	13,458
Future income taxes	1,731	-	1,731
	\$ 42,663	\$ 34,256	\$ 76,919

**2. Acquisitions (continued):**

	Kootenay Acquisition	Beaver and Forks Acquisition	Total
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.

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.

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## 2. Acquisitions (continued):

(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, have been 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 (see also Subsequent events, note 23(b)). These assets include the properties and improvements of the former Queensboro sawmill site located in New Westminster, B.C. and the former Field sawmill site located in Courtenay, B.C. as well as surplus property and buildings located in Maple Ridge, B.C.

## 4. Inventories:

	2008	2007
Logs	\$ 49,941	\$ 53,631
Lumber	22,484	18,588
Other	6,566	4,210
	\$ 78,991	\$ 76,429

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, 2008 was \$20,270,000 (2007 - \$16,019,000).

## 5. Investments and other assets:

	2008	2007
Seaboard Shipping Company Limited	\$ 10,540	\$ 5,715
Other investments	1,686	1,582
Pension asset (note 18(b))	6,581	4,875
Deferred financing fees, net of accumulated amortization	565	98
	\$ 19,372	\$ 12,270

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**5. Investments and other assets (continued):**

Summarized information of Seaboard is as follows:

	2008	2007
Total assets	\$ 29,009	\$ 22,166
Shareholders' equity	24,238	16,967
Net sales	45,434	48,130
Interfor's shipment percentage	62.2%	58.0%
Interfor's equity in earnings	\$ 4,825	\$ 218
Distributions received	-	4,369

In 2007, a cash distribution was made to the partners, of which the Company's share was \$4,369,000. In accordance with equity accounting, the distributions were recorded as a reduction of the investment. See also note 9.

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

2008	Cost	Accumulated amortization	Net book value
Land	\$ 16,408	\$ -	\$ 16,408
Buildings	62,851	30,539	32,312
Machinery and equipment	470,312	148,766	321,546
Automotive equipment	9,547	6,276	3,271
Computer equipment	8,194	6,255	1,939
Site improvements	26,761	8,138	18,623
Deferred startup costs	996	336	660
Other	3,843	2,215	1,628
	\$ 598,912	\$ 202,525	\$ 396,387
2007			
Land	\$ 13,880	\$ -	\$ 13,880
Buildings	65,151	38,861	26,290
Machinery and equipment	385,044	148,971	236,073
Automotive equipment	11,927	10,548	1,379
Computer equipment	7,169	5,831	1,338
Site improvements	27,416	10,393	17,023
Deferred startup costs	5,810	2,358	3,452
Other	2,688	1,973	715
	\$ 519,085	\$ 218,935	\$ 300,150

In light of significant capital improvements and sawmill rebuilds undertaken in 2006 and early 2007, the Company performed a review of its estimates of remaining economic useful life of its plant and equipment in 2007. This resulted in a revision of amortization rates for certain operations to align with current estimates of economic useful life and designed capacity. The recalculated amortization rates have been applied on a prospective basis and did not have a material impact on amortization expense.

At December 31, 2008, machinery and equipment cost includes \$84,178,000 (2007 - \$19,610,000) for the construction of the new Adams Lake sawmill, with the small log line successfully completed in late 2008 and the balance of the project to be completed in early 2009.

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**7. Timber and logging roads:**

2008	Cost	Accumulated amortization	Net book value
Timber	\$ 102,588	\$ 32,761	\$ 69,827
Roads	44,586	23,988	20,598
	\$ 147,174	\$ 56,749	\$ 90,425
<b>2007</b>			
Timber	\$ 67,645	\$ 29,851	\$ 37,794
Roads	43,956	26,700	17,256
	\$ 111,601	\$ 56,551	\$ 55,050

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

## (a) Bank indebtedness:

2008	Canadian Operating Facility	U.S. Operating Facility	Total
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
<b>2007</b>			
Available line of credit	\$ 40,000	\$ 9,913	\$ 49,913
Maximum borrowing available	40,000	9,913	49,913
Operating Line drawings	-	-	-
Outstanding letters of credit included in line utilization	4,818	119	4,937
Unused portion of line	35,182	9,794	44,976

In 2008, the Company renewed its existing Canadian operating line of credit ("Operating Line"), increasing the maximum available operating credit to \$100,000,000 (2007 - \$40,000,000). 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. 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 and a maximum ratio of total debt to total capitalization and a minimum net worth calculation. The line matures on April 24, 2009. As at December 31, 2008, the Operating Line was drawn by \$25,747,000 (2007 - \$nil).

On February 5, 2009, the Company received a financing commitment with respect to its Operating Line from its lenders, details of which are described in note 23(c).

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

## (a) Bank indebtedness (continued):

The Company renewed its existing U.S. operating line of credit ("U.S. Line") in 2008. The terms and conditions of the line remained unchanged, except for an increase to the interest rate margins and the provision of a parent guarantee. The U.S. Line is subject to a borrowing base calculation dependent upon certain accounts receivable and inventories of the Company's subsidiary, Interfor Pacific Inc. ("IPI"). As at December 31, 2008, the maximum borrowing available was US\$6,433,000 (2007 – US\$10,000,000), of which US\$1,314,000 (2007 – US\$9,880,000) was unused. The line utilization includes outstanding letters of credit of US\$120,000 (2007 – US\$120,000). The U.S. Line bears interest at U.S. bank prime plus a margin or, at the Company's option, at rates for LIBOR plus a margin, dependent in all cases upon a financial ratio. The line is secured by the accounts receivables and inventories of IPI and is subject to certain financial covenants including a maximum ratio of total debt to total capitalization. The U.S. Line matures on April 24, 2009.

Offsetting drawings under the operating lines are cash balances less outstanding cheques of \$1,248,000 (2007 - \$nil).

## (b) Long-term debt:

The Company renewed its existing Revolving Term Line in 2008 increasing it from \$10,000,000 to \$115,000,000. 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.

To fund the Kootenay and Beaver acquisitions and the Adams Lake sawmill capital project, the Company utilized the Revolving Term Line. As at December 31, 2008, the Revolving Term Line was drawn by US\$30,200,000 revalued at the December 31, 2008 exchange rate to \$36,784,000, and \$58,000,000 for total drawings of \$94,784,000 (2007 - \$nil), leaving an unused available line of \$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 losses of \$4,645,000 (2007 - \$nil) arising on revaluation of the Non-Revolving Term Line were recognized in Other comprehensive income.

On February 5, 2009, the Company received a financing commitment with respect to its Non-Revolving Term Line from its lenders, details of which are described in note 23(c).

The U.S. dollar non-revolving term line (the "Non-Revolving Term Line") remains fully drawn at US\$35,000,000 (2007 – US\$35,000,000) and was revalued at the year-end exchange rate to \$42,630,000 (2007 - \$34,696,000). Effective September 1, 2008, the maturity date of the Non-Revolving Term Line was extended to 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 loss of \$7,934,000 (2007 - \$5,716,000 gain) arising on revaluation of the Non-Revolving Term Line was recognized in Other foreign exchange gain (loss) on the Statement of Operations.

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.



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

(b) Long-term debt (continued):

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

2009	\$	-
2010		42,630
2011		94,784
2012		-
2013		-

\$ 137,414

**9. Payable to investee company:**

On December 29, 2008, the Seaboard Limited Partnership ("the Seaboard Partnership"), made an advance to its partners, with Interfor's share of the advance being \$3,651,000. The Company signed an unsecured promissory note which was payable on demand on or before January 2, 2009 and was non-interest bearing until January 2, 2009 and bears interest at the rate of 4% per annum thereafter.

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

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

	2008	2007
Road deactivation and environmental	\$ 4,817	\$ 3,150
Pension and other post-retirement benefits (notes 18(b) and (e))	4,927	3,304
Long term incentive compensation		
Share and option based (notes 12(b), (c), and (d))	340	1,461
Total shareholder return plan	810	405
Other	1,513	539
	<u>\$ 12,407</u>	<u>\$ 8,859</u>

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 of \$405,000 (2007 - \$405,000) for the year ended December 31, 2008.

**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.

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**11. Reforestation liability (continued):**

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

	2008	2007
Reforestation liability, beginning of year	\$ 16,429	\$ 20,437
Reforestation expense on current production	3,317	2,460
Reforestation liability addition on acquisition of Kootenay operations	14,289	-
Reforestation liability reduction on disposal of timberlands	-	(199)
Reforestation expenditures	(10,392)	(6,577)
Accretion expense	831	925
Changes in estimated future reforestation expenditures	(129)	(617)
	<b>\$ 24,345</b>	<b>\$ 16,429</b>
Consisting of:		
Current portion included in accounts payable and accrued liabilities	\$ 8,660	\$ 4,555
Long term reforestation liability	15,685	11,874
	<b>\$ 24,345</b>	<b>\$ 16,429</b>

The total undiscounted amount of the estimated future expenditures required to settle the reforestation obligation at December 31, 2008 is \$27,339,000 (2007 - \$19,200,000). The reforestation expenditures are expected to occur over the next one to fifteen 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, 2008 and 2007 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 2008 and 2007 were as follows:

	Number			Amount
	Class A	Class B	Total	
Balance, December 31, 2006	47,119,896	1,015,779	48,135,675	\$ 295,166
Shares issued on exercise of options	189,280	-	189,280	892
Share repurchases	(1,220,100)	-	(1,220,100)	(7,534)
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	46,101,476	1,015,779	47,117,255	\$ 288,580

**12. Share capital:**

(a) Share transactions (continued):

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. During 2007 the Company acquired 1,220,100 Class A shares at a total cost of \$9,846,000 and the shares were cancelled as purchased with the excess of the cost of the shares over the assigned value totalling \$2,312,000 charged to contributed surplus.

Movements in contributed surplus during 2008 and 2007 were as follows:

	2008	2007
Beginning balance, contributed surplus	\$ 5,408	\$ 7,720
Excess of cost of shares over assigned value on shares repurchased and cancelled	-	(2,312)
Ending balance, contributed surplus	\$ 5,408	\$ 5,408

At December 31, 2008, 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, 2008 are exercisable at prices ranging from \$3.65 to \$5.00 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 April 25, 2009 and April 30, 2011.

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

(b) Share option plan:

Details of the Company's share option plan for the years ended December 31, 2008 and 2007 are as follows:

	2008		2007	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding, beginning of year	1,409,840	\$ 4.51	1,633,920	\$ 4.63
Granted	-	-	-	-
Exercised	(12,400)	4.49	(189,280)	4.71
Expired or cancelled	(376,100)	4.31	(34,800)	9.00
Outstanding, end of year	1,021,340	\$ 4.59	1,409,840	\$ 4.51
Options exercisable, year end	1,021,340	\$ 4.59	1,409,840	\$ 4.51

The options outstanding at December 31, 2008 have a weighted average remaining life of 1.4 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.

	2008		2007	
	Units	Weighted average strike price	Units	Weighted average strike price
Outstanding, beginning of year	1,226,720	\$ 5.99	1,162,700	\$ 5.62
Granted	352,000	5.21	170,500	7.93
Exercised	(3,900)	4.33	(92,980)	4.75
Expired or cancelled	(146,500)	5.02	(13,500)	7.08
Outstanding, end of year	1,428,320	\$ 5.90	1,226,720	\$ 5.99
Units exercisable, year end	793,140	\$ 5.62	766,680	\$ 5.28

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

(c) Share Appreciation Rights Plan (continued):

Details of units outstanding under the SAR Plan at December 31, 2008 are as follows:

Strike price	Number outstanding, December 31, 2008	Units outstanding		Units exercisable	
		Weighted average remaining unit life (yrs)	Weighted average strike price	Number exercisable, December 31, 2008	Weighted average strike price
\$4.33-\$5.21	665,360	6.1	\$ 4.78	328,360	\$ 4.33
\$6.07-\$7.30	610,960	5.3	6.60	464,780	6.53
\$8.02	152,000	8.1	8.02	-	-
	1,428,320		\$ 5.90	793,140	\$ 5.62

The Company recorded a compensation recovery of \$728,000 (2007 – recovery of \$705,000) for the year ended December 31, 2008. Accrued compensation payable on unexercised units totaled \$nil (2007 - \$732,000) at December 31, 2008.

(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 to receive their award in DSU's at the end of any performance period. As there were no awards earned under the TSR Plan in 2008, this option was not utilized (2007 - no DSU's issued under the TSR Plan).

DSU's may also be granted directly to Directors or senior employees of the Company at the discretion of the Board and Directors may also elect to take DSU's as payment of their annual retainer. In 2008 a total of 42,669 DSU's (2007 – 37,839) were granted to or taken by Directors under the plan at an average value of \$4.12 (2007 - \$7.79) per unit.

The Company recorded compensation recovery of \$1,667,000 (2007 – recovery of \$175,000) for the year ended December 31, 2008 in respect of the DSU Plan. Subsequent changes to share values will result in adjustments to compensation expense. At December 31, 2008, the Company had 363,863 (2007 – 359,194) DSU's outstanding. At December 31, 2008, accrued compensation payable in respect of the DSU Plan totaled \$526,000 (2007 - \$2,041,000).

**13. Other income:**

	2008	2007
Gain on disposal of investments, surplus property, plant, equipment and timber	\$ 794	\$ 4,767
Gain on settlement of timber takeback	747	1,350
Other, net	(123)	(134)
	\$ 1,418	\$ 5,983

**13. Other income (continued):**

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 (see note 16(b)) and for obsolete infrastructure. These dispositions combined to generate sales proceeds of \$5,096,000 and a gain of \$1,541,000.

In 2007, the Company disposed of surplus property, plant and equipment and sold its interest in Tree Farm Licence 54. These dispositions combined to generate sales proceeds of \$6,906,000 and a gain of \$4,767,000. In addition, under the terms of the *Forest Revitalization Act*, the Company received \$1,350,000 in additional compensation for bridges resulting from the 2003 legislated takeback of certain logging rights on the B.C. Coast. The Company recorded \$1,350,000 as proceeds on the disposal of bridges in 2007.

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

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

	2008	2007
Plant, equipment and timber write-downs	\$ 31,427	\$ -
Severance and other restructuring costs, net of recoveries	4,852	1,975
Other	1,026	-
	<b>\$ 37,305</b>	<b>\$ 1,975</b>

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 \$29,750,000 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.

In 2007, the Company recorded severance and other restructuring costs totalling \$2,315,000 in respect of early retirements and contractor buyouts, partially offset by the recovery of \$340,000 from the B.C. Forestry Revitalization Trust set up by the Government of British Columbia as reimbursement for severance costs of workers who were displaced by the reductions in harvesting rights taken under the *Forestry Revitalization Act*.

As at December 31, 2008, \$2,850,000 (2007 - \$2,115,000) in severance and other cash restructuring costs are included in accounts payable and accrued liabilities. The Company expects to pay this amount in 2009 in accordance with its restructuring plans. In addition, a further \$862,000 (2007 - \$nil) in other restructuring reserves are also included in accounts payable and accrued liabilities.

**15. Income taxes:**

Future income taxes are determined as follows:

	2008	2007
Future income tax assets:		
Losses carried forward	\$ 47,440	\$ 25,035
Reforestation, restructuring and other accruals deductible when paid	10,390	8,571
Tax credits	1,149	203
	58,979	33,809
Valuation allowance	(18,336)	-
	40,643	33,809
Future income tax liabilities:		
Property, plant and equipment	(51,782)	(36,544)
Other	(130)	(262)
	\$ (11,269)	\$ (2,997)
Current future income tax assets	\$ 2,890	\$ 3,083
Non-current future income tax assets	-	7,000
Non-current future income tax liabilities	(14,159)	(13,080)
	\$ (11,269)	\$ (2,997)

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

	2008	2007
Income tax expense (recovery) at the statutory rate of 31.00% (2007 – 34.12%)	\$ (21,488)	\$ (9,213)
Valuation allowance on U.S. future income tax assets	15,057	-
Non-taxable income of investments accounted for by the equity method	(1,496)	(74)
Entities with different tax rates	(1,122)	(621)
Non-taxable portion of capital losses (gains)	331	(590)
Decrease in future income tax rates	(1,157)	(1,171)
Other	(2,248)	(2,014)
	\$ (12,123)	\$ (13,683)

The Company's Canadian non-capital loss carry-forwards and U.S. net operating loss carry-forwards totalling approximately \$133,000,000 (2007 - \$69,700,000) expire between 2014 and 2028, and are available to reduce future taxable income. The Company has provided a valuation allowance in respect of approximately \$49,000,000 of its U.S. operating loss carry-forwards, net of temporary differences. The Company has \$252,000 (2007 - \$203,000) of Alternative Minimum Tax Credits arising from its U.S. operations which have an indefinite carry-forward. The Company also has B.C. Manufacturing and Processing tax credit and Canadian investment tax credit carry-forwards of \$897,000 which expire between 2010 and 2014.

**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:

2009	\$ 11,330
2010	4,430
2011	2,930
2012	2,450
2013	1,930

(b) Central and North Coast Land Use Decisions:

On February 7, 2006, the Crown announced land use decisions for the Central Coast and the North Coast containing detailed agreements for the use and management of public lands in the region.

On September 29, 2006, the Chief Forester of the Crown announced temporary reductions in the allowable annual cut ("AAC") in the plan areas by 572,000 cubic metres. The Company's portion of this reduction is estimated to be 127,000 cubic metres, or approximately 8% of the Company's AAC within this region. In addition, the land use decisions affected several timber licences (temporary tenures) that represented approximately 5% of the harvesting rights in the region.

The Crown acknowledged that licensees would be fairly compensated for the return of tenure and related infrastructure costs. In 2008, the Company received \$4,750,000 in compensation for the loss of logging rights for timber licences, forestry and engineering work and other expenditures related to the timber returned pursuant to the decisions. Compensation received as settlement of expenditures previously expensed was recorded as a recovery of production costs in 2008. The amount and timing of any further compensation payable to Interfor as a result of 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 \$6,611,000 in surety performance bonds, with expiry dates ranging March 2009 through August 2014.

(d) Commitment

In early 2008, the Company entered into an agreement, subject to certain approvals, to acquire a timber tenure in the Kamloops region currently owned by Weyerhaeuser Company Limited. The Company expects to conclude this agreement during 2009.

(e) Contingency

The P&T assets acquired may have pipe insulation and board in the kiln decks that 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:

	2008			2007		
	Net loss	Weighted average number of Shares	Per share	Net loss	Weighted average number of Shares	Per share
Basic earnings						
(loss) per share	\$ (57,191)	47,109	\$ (1.21)	\$ (13,321)	47,575	(0.28)
Share options	-	45*	-	-	556*	-
Diluted earnings						
(loss) per share	\$ (57,191)	47,109	\$ (1.21)	\$ (13,321)	47,575	\$ (0.28)

\*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 savings and retirement plans which include a Group Registered Retirement Savings Plan ("RRSP") and a Deferred Profit Sharing Plan ("DPSP") that are available to all salaried employees, a defined benefit pension plan that is available to all hourly employees not covered by a union pension plan, and a defined benefit pension plan and post-retirement medical and life insurance plan for certain 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 employees.

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

Total cash payments for employee future benefits for 2008, 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 \$5,837,000 (2007 - \$6,419,000).

(a) RRSP AND DPSP for Canada:

In Canada, all 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 2008, the pension expense for this plan is equal to the Company's contribution of \$1,273,000 (2007 - \$1,688,000).

**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 pension plan and post-retirement benefits obligations acquired under the P&T asset acquisition was April 30, 2008, and for the original pension plan was as of December 31, 2006. The next required funding valuations for the defined benefit pension plans will be 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	
	2008	2007	2008	2007
<b>Accrued benefit obligation:</b>				
Beginning of year	\$ -	\$ -	\$ 21,738	\$ 18,203
Acquisitions (note 2)	1,010	-	8,915	-
Actuarial (gain) loss	-	-	-	2,595
Service cost	13	-	390	557
Interest cost on accrued benefit obligation	40	-	1,539	1,153
Benefit payments	(37)	-	(1,297)	(770)
Impact of new discount rate at year-end	(152)	-	(5,974)	-
End of year	874	-	25,311	21,738
<b>Plan assets:</b>				
Fair value, beginning of year	-	-	21,361	19,611
Acquisitions (note 2)	-	-	8,031	-
Expected return on plan assets	-	-	1,892	1,424
Employer contributions	37	-	2,347	1,971
Employee contributions	-	-	116	270
Benefit payments	(37)	-	(1,297)	(770)
Actuarial gain (loss)	-	-	(6,875)	(1,145)
Fair value, end of year	-	-	25,575	21,361
<b>Funded status</b>				
- plan surplus (deficit)	(874)	-	264	(377)
Unamortized actuarial loss (gain)	(152)	-	5,918	5,252
Accrued benefit asset (liability) \$	(1,026) \$	- \$	6,182 \$	4,875 \$
<b>Plan assets consist of:</b>				
Asset category			2008	2007
			Percentage of plan assets	
Equity securities			56%	62%
Debt securities			40%	35%
Other			4%	3%
Total			100%	100%

**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 (notes 5 and 10):

	Post-Retirement Benefits		Pension Benefits	
	2008	2007	2008	2007
Investments and other assets	\$ -	\$ -	\$ 6,581	\$ 4,875
Accounts payable and accrued liabilities	(40)	-	-	-
Other long-term liabilities	(986)	-	(399)	-
	\$ (1,026)	\$ -	\$ 6,182	\$ 4,875

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	
	2008	2007	2008	2007
Current service cost	\$ 13	\$ -	\$ 274	\$ 279
Interest cost	40	-	1,539	1,153
Expected return on plan assets	-	-	(1,892)	(1,424)
Amortization of experience losses	-	-	235	169
	\$ 53	\$ -	\$ 156	\$ 177

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

	Post-Retirement Benefits		Pension Benefits	
	2008	2007	2008	2007
Accrued benefit obligation as of December 31				
Discount rate	7.25%	-	7.25%	5.5%
Compensation increases <sup>1</sup>	-	-	3.5%	Not applicable
Pension expense				
Discount rate <sup>2</sup>	6.0%	-	5.5%	5.5%
Expected return on plan assets	-	-	7.0%	7.0%
Compensation increases <sup>1</sup>	3.5%	-	Not applicable	Not applicable

For measurement purposes at December 31, 2008, Interfor has assumed a 7.60% health care cost trend in 2009 grading down to 4.27% in 2015 (2007 – not applicable).

<sup>1</sup>Compensation increases only relate to the Canadian Merchant Service Guild ("CMSG") plans.

<sup>2</sup>The discount rate for the CMSG pension plan 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 2008, the pension expense for these plans is equal to the Company's contribution of \$1,492,000 (2007 - \$1,476,000). The Company's liability is limited to its contributions.

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

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

For the 401(k) plan, 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 2008, the pension expense for this plan is equal to the Company's contribution of \$495,000 (2007 - \$582,000).

A second component to the 401(k) plan with contributions based on a discretionary profit sharing allocation was replaced with the matching component in 2005. Previous contributions under profit sharing allocation component continue to vest in years two through six of employment at a rate of 20% per annum. During 2008 the Company made no cash contributions (2007 - \$nil) and recorded no expense in respect of this component of the plan (2007 - \$nil).

(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. 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 the survivor of a retired senior executive. The accrued benefit obligation is \$761,000 (2007 - \$947,000), of which \$304,000 (2007 - \$415,000) is funded.

The amounts accrued are as follows:

	2008	2007
Accrual for defined contribution commitments	\$ 3,361	\$ 3,058
Accrual for defined benefit commitments	457	532

**19. Related party transactions:**

Lumber sales to a significant shareholder amounted to \$1,021,000. In 2007 the Company had lumber sales to an affiliate of a significant shareholder in the amount of \$511,000. Shipping services provided by Seaboard totaled \$5,553,000 (2007 - \$7,991,000). 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:

	2008	2007
Canada	\$ 162,825	\$ 222,276
United States	162,352	272,571
Japan	40,823	51,402
Other export	71,221	64,759
	<b>\$ 437,221</b>	<b>\$ 611,008</b>

**20. Segmented information (continued):**

Sales by product line are as follows:

	2008	2007
Lumber	\$ 297,434	\$ 434,468
Logs	103,620	118,571
Wood chips and other by products	30,610	50,260
Other	5,557	7,709
	<b>\$ 437,221</b>	<b>\$ 611,008</b>

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

	2008	2007
Canada	\$ 317,141	\$ 232,988
United States	197,887	138,529
	<b>\$ 515,028</b>	<b>\$ 371,517</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 January 2008, the Company filed a normal course issuer bid, as described in note 12. 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. No shares were acquired under the program in 2008 despite extremely low market prices as the Company's cash resources were utilized to fund its acquisitions (note 2) and the global economy downturn resulted in a focus on cash conservation.

There were no changes in the Company's approach to capital management during the period. Under its debt financing agreements, 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.

**22. Financial instruments:**

(a) Fair value of financial instruments:

At December 31, 2008, the fair value of the Company's long-term debt and bank indebtedness approximated its carrying value of \$168,003,000 (2007 - \$34,696,000). The fair values of other financial instruments approximate their carrying values due to their short-term nature.

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

## (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, 2008, the Company has outstanding obligations to sell a maximum of US\$4,500,000 at an average rate of US\$1.2339 to the CAD\$1.00, sell Japanese ¥51,000,000 at an average rate of ¥83.11 to the CAD\$1.00, and Japanese ¥65,000,000 at an average rate of ¥92.85 to the USD\$1.00, and sell Euros €90,000 at an average rate of \$1.5908 to the CAD\$1.00 during 2009. All foreign currency gains or losses to December 31, 2008 have been recognized in the Statement of Operations and the fair value of these foreign currency contracts of \$113,000 has been recorded in accounts payable and accrued liabilities. In 2008, the Company had entered into a forward contract to purchase US\$15,000,000 which was unwound at December 31, 2008, and the Company recorded \$3,657,000 in realized foreign exchange gains.

During September 2005, the Company entered into a cross currency interest rate swap. The Company has 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 will pay an amount based on annual interest of 5.84% on the CAD\$23,530,000 and will receive 90 day LIBOR plus a spread of 200 basis points on the US\$20,000,000. LIBOR will be recalculated at set interval dates. The swap will mature on September 1, 2009 and has been marked to market with all gains or losses on the swap recognized in the Statement of Operations and total foreign exchange gains of \$4,179,000 recognized in 2008 (2007 - \$3,584,000 loss). The fair value of this cross currency interest rate swap is \$409,000 at December 31, 2008 and has been recorded in accounts receivable (2007 - \$3,584,000 fair value recorded in accounts payable and accrued liabilities).

## (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 losses of \$4,645,000 have been recorded in Other comprehensive Income.

The Company had previously designated its US\$35,000,000 dollar Non-Revolver 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 losses of \$7,934,000 (2007 - \$5,716,000 gain) were recorded in Other foreign exchange gain (loss) in the Statement of Operations.

## (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.

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

## (d) Financial risk management (continued):

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.

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 based on this past experience, the Company believes that no impairment allowance is necessary in respect of trade accounts receivable past due. As at December 31, 2008, there were no trade accounts receivable past due which were considered uncollectible (2007 - \$nil), and no reserve in respect of doubtful accounts was set up (2007 - \$nil).

*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 is in compliance with the Company's policy to provide financial guarantees only with respect to wholly-owned subsidiary companies.

*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.

**22. Financial instruments:**

(d) Financial risk management (continued):

(i) Credit risk (continued):

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

	2008
Canada	\$ 7,644
United States	8,728
Japan	3,976
Other	5,093
	<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.

The Company also maintains a revolving Canadian Operating Line and a U.S. Operating Line of credit that can be drawn down to meet short-term financing needs.

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

	Total	Payments due by period			
		Up to 1 year	2-3 years	4-5 years	After 5 years
Operating Line (note 23(c))	\$ 31,837	\$ 31,837	\$ -	\$ -	\$ -
Long-term debt	137,414	-	137,414	-	-
Reforestation liability	24,345	8,660	7,153	4,652	3,880
Other long-term liabilities	17,698	5,291	5,003	1,393	6,011
Operating leases and contractual commitments	25,380	11,330	7,360	4,380	2,310
<b>Total contractual obligations</b>	<b>\$236,674</b>	<b>\$ 57,118</b>	<b>\$156,930</b>	<b>\$ 10,425</b>	<b>\$ 12,201</b>

On February 5, 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 note 23(c). The maturity date of the Operating Line will be extended 364 days to April 23, 2010.

(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.



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

(d) Financial risk management (continued):

(iii) Market risk (continued):

*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. The Company uses forward exchange contracts and cross currency interest rate swaps to hedge 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.

At December 31, 2008, the Company has US\$ drawings under its Revolving Term Line of US\$30,200,000 (2007 – US\$nil). 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, 2008, the Non-Revolving Term Line remains fully drawn at US\$35,000,000 (2007 - US\$35,000,000). To March 31, 2007, the Company designated the Non-Revolving 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, 2008, the Company's accounts receivable were denominated in the following currencies:

	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, 2008, the domestic operations of the Company held cash and cash equivalents of US\$179,000 and bank indebtedness of \$26,786,000. Bank indebtedness of self-sustaining and other foreign U.S. subsidiaries totalled US\$3,913,000.

Based on the Company's net exposure to foreign currencies as at December 31, 2008, 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\$	\$500,000 increase in net income
Japanese Yen	1 ¥ increase vs CAD\$	\$50,000 increase in net income

*Interest rate risk*

The Company reduces its exposure to changes in interest rates on borrowings by entering into cross currency interest rate swaps, as described in Note 22(b) Derivative financial instruments.

Based on the Company's average debt level during 2008, the sensitivity of a 100 basis point increase in interest rates would result in an approximate decrease of \$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 2, 2009, the Seaboard Partnership declared an income distribution to its partners. Interfor's share was \$3,651,000 and was paid to the Company by way of setoff against the promissory note payable to the Seaboard Partnership.

## (b) Property sale:

On December 31, 2008, the Company received a non-refundable deposit in respect of the sale of one of its properties classified as held for sale. This sale is expected to close in early 2009 for net proceeds of \$4,150,000.

## (c) Bank financing

On February 5, 2009, the Company obtained a written financing commitment from its lenders in respect of its syndicated credit facilities. The Operating Line will decrease from \$100,000,000 to \$65,000,000 and the maturity date will be extended 364 days to April 23, 2010. In addition, the Revolving Term Line will increase from \$115,000,000 to \$150,000,000, with no change to its maturity date. Except for an increase in pricing, all other terms and conditions of the lines remain substantially unchanged.



## International Forest Products Limited

### ANNUAL INFORMATION FORM

Dated as of February 12, 2009

#### **FORWARD LOOKING INFORMATION**

This report contains information and statements that are forward-looking in nature, including, but not limited to, statements containing the words "believe", "may", "will", "expects", "estimates", "projects", "continue", "anticipates", "intends", and similar expressions. Such forward-looking statements involve known and unknown risks and uncertainties that may cause Interfor's actual results to be materially different from those expressed or implied by those forward-looking statements. Such risks and uncertainties include, among others: general economic and business conditions, product selling prices, raw material and operating costs, changes in foreign-currency exchange rates and other factors referenced herein and in Interfor's current Management Discussion and Analysis (see "Risks and Uncertainties") available on [www.sedar.com](http://www.sedar.com). The forward-looking information and statements contained in this report are based on Interfor's current expectations and beliefs. Readers are cautioned not to place undue reliance on forward-looking information or statements. Interfor undertakes no obligation to update such forward-looking information or statements, except where required by law.

#### **DESCRIPTION OF THE BUSINESS**

We are one of the Pacific Northwest's largest producers of quality wood products for sale to markets around the world. We have operations in British Columbia ("B.C."), Washington and Oregon, including two sawmills in the Coastal region of B.C., three in the B.C. Interior, two in Washington and two in Oregon. We also operate a value-added remanufacturing facility in Washington.

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

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

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

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

##### **2006**

In 2006, structural lumber prices in the North American market began a sharp decline which has continued through the end of 2008.

On April 27, 2006 the federal governments of Canada and the United States reached a framework softwood lumber agreement ("SLA") to resolve the softwood lumber dispute. On October 12, 2006 the terms of the SLA were implemented and the U.S. Department of Commerce revoked the antidumping and countervailing duty orders effective May 22, 2002 and instructed U.S. Customs and Border Protection to cease collecting duties effective October 12, 2006 and to refund duties collected since May 22, 2002

together with accrued interest. The Company received total refunds of countervailing and antidumping duties and related interest of US\$118.9 million, before the deduction of a special charge of 18.06% of this amount which was paid to the Canadian federal government on January 31, 2007.

During 2006 we disposed of numerous non-core assets including the Marysville and MacKenzie sawmills, B.W. Creative Wood Industries Ltd., our helicopter logging operation, non-core timber tenures, surplus land and other surplus logging and manufacturing assets. Total proceeds generated from these sales were \$49.2 million. We also completed the contracting out or closure of all remaining Company owned logging operations. During 2006, we increased capital spending with major infrastructure and high-return projects at the Adams Lake, Port Angeles and Molalla sawmills.

## **2007**

2007 was a very challenging year for the Company, with a combination of depressed North American structural lumber prices, a record-high Canadian dollar, and a 15% export tax. In addition, a 15 week strike by the United Steel Workers ("USW") in the second half of 2007 disrupted our B.C. Coastal lumber and logging operations.

In February 2007, the Company completed the installation of a new primary breakdown line at its Port Angeles operation. In late 2007, a new log merchandizer and planer were installed at Port Angeles. By year end, both installations were generating targeted productivity improvements. In April 2007, the Company's Board of Directors (the "Board") approved the construction of a new sawmill at Adams Lake, to replace the existing facility.

## **2008**

2008 was one of the most difficult periods experienced in the lumber industry in recent history. The unprecedented turmoil in financial markets along with the lowest level of U.S. housing starts in over 50 years had a significant impact on the Company's results.

### *Closure of Queensboro Sawmill*

The severity and duration of the market downturn, together with the volatile CAD\$, significantly undermined the economics of the Company's Queensboro sawmill division, located in New Westminster, B.C. In July 2008, following a prolonged curtailment, the Company decided to permanently close the mill. The property is being actively marketed and a sale is expected to complete in 2009. On an after-tax basis, proceeds are expected to more than offset the writedown taken for the permanent closure.

### *Closure of Albion Remanufacturing Facility*

During 2008, the Company permanently closed its Albion remanufacturing operation located in Maple Ridge, B.C. as the operation's cost structure was unfavourable relative to the Company's remanufacturing alternatives.

### *New Adams Lake Sawmill*

In April 2007, the Company's Board of Directors approved the construction of a new \$100 million sawmill at Adams Lake to replace the existing facility. Construction, commenced in the summer of 2007, is on budget and was substantially complete as at the end of 2008. The first line was commissioned in 2008 with a full start-up scheduled for the second quarter of 2009. This mill will have a two-shift capacity of 285 mfbm.

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

### *Acquisitions*

During the course of 2008, we acquired the Castlegar, B.C. and Grand Forks, B.C. sawmills, related timber harvesting rights and other related assets from Pope and Talbot, Inc., and acquired the Olympic

Peninsula, WA sawmill, planer mill and inventories from Portac, Inc. These acquisitions are described below.

### *Strong Financial Position*

The Company maintained a strong financial position throughout 2008, ending the year with net debt of \$167.8 million, or 29% of invested capital. Cash flow from operations, before working capital changes, for the year was positive at \$13.0 million. The increase in the debt during the course of 2008 was for partial funding of the acquisition of the P&T and Portac assets and the construction of the new Adams Lake sawmill.

On February 5, 2009, the Company obtained a financing commitment from its lenders in respect of its syndicated credit facilities. The Revolving term line will increase \$35 million to \$150 million, which will be due April 2011. The Operating line will decrease \$35 million to \$65 million and will be extended 364 days to April, 2010. Except for an increase in pricing, all other terms and conditions of the lines remain substantially unchanged. This adjustment allows the Company to fully utilize all of its credit during times of reduced operating levels.

The Company has a number of properties classified as held for sale. Interfor expects to generate a significant amount of cash from the sale of these properties that will further strengthen the Company's liquidity.

### *Outlook*

With the prospect of a difficult year ahead, the Company intends to maintain very tight control over cash, while focusing on the monetization of surplus properties. Completion of the construction of the new Adams Lake sawmill is the only major capital investment currently approved for 2009.

See our Management Discussion and Analysis for the year ended December 31, 2008, a copy of which is available from SEDAR at [www.sedar.com](http://www.sedar.com).

## **Significant Acquisitions during 2008**

### *Acquisition of Pope and Talbot, Inc. Sawmill Assets*

On April 30, 2008, we concluded the acquisition of the Castlegar, B.C. and Grand Forks, B.C. sawmills, related timber harvesting rights and other related assets from Pope and Talbot, Inc. ("P&T") for a final purchase price of \$62.3 million.

The acquisition of the two sawmills increased our lumber production capacity in the B.C. Interior by approximately 330 million board feet per year to approximately 615 million board feet. The mills have added critical mass in one of our core operating regions and have broadened our product lines in both specialty and commodity grades. The timber tenures acquired represent annual harvesting rights of approximately 1.0 million cubic metres in the Southern B.C. Interior.

### *Acquisition of Portac, Inc. Assets*

On September 30, 2008, we 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, we paid US\$32.2 million that was primarily financed through our Revolving Line.

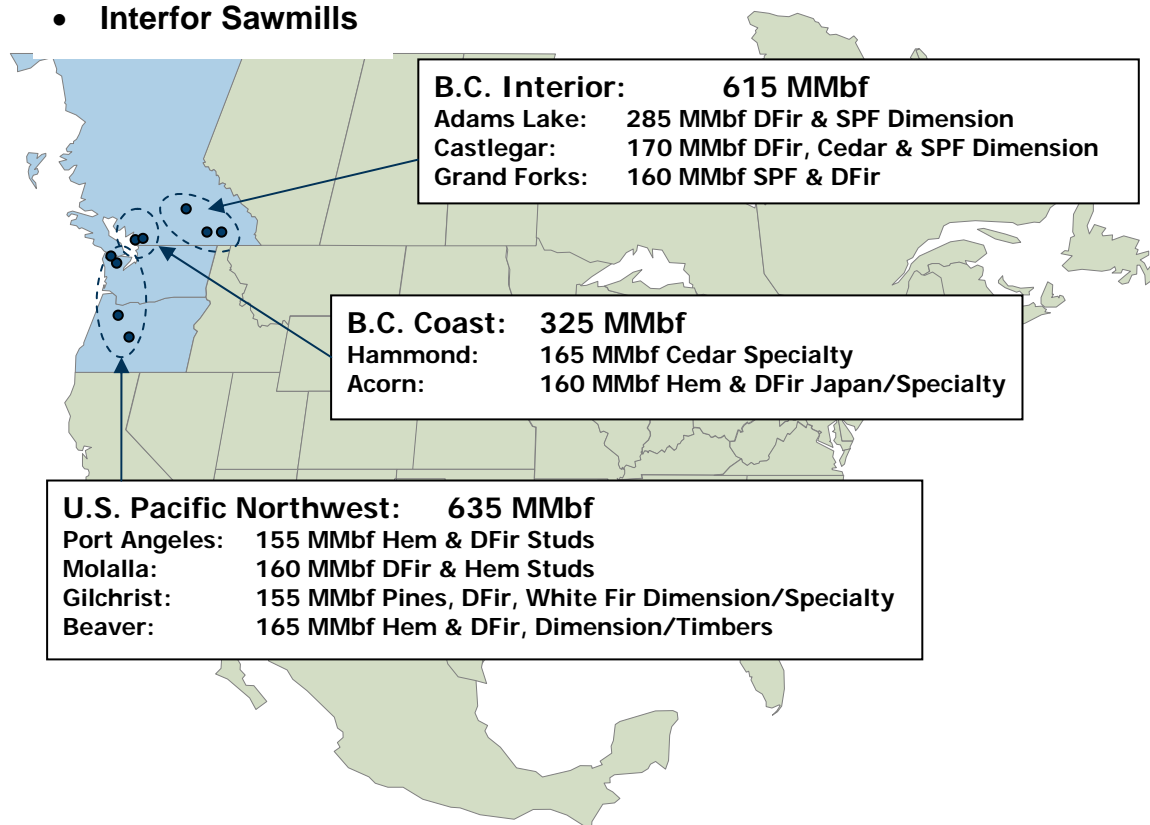
The assets, which are located on the Olympic Peninsula in Washington State, have been renamed "Beaver Division" and are being operated by our U.S. subsidiary, Interfor Pacific Inc.

The Portac acquisition is in keeping with our strategy of diversifying our geographic base and is an excellent fit with our existing operations at Port Angeles, producing dimension products and small timbers in lengths up to 20 feet to complement our product mix and presence in the Puget Sound market. The Portac acquisition brings our production capacity in the U.S. Pacific Northwest to 635 million board feet on an annual basis.

## **MANUFACTURING**

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

### • **Interfor Sawmills**



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

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

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

Sawmills	Number of Shifts (per day)	Present Rated Capacity <sup>(1)</sup>	Years ended December 31				
			2008	2007	2006	2005	2004
			(millions of board feet)				
<b>B.C. Coast</b>							
Hammond (2)	2	165	106	96	158	175	192
Acorn (2)	2	160	108	108	154	162	180
<b>B.C. Interior</b>							
Adams Lake (3)	2	285	48	206	286	273	219
Castlegar (4)	2	170	—	—	—	—	—
Grand Forks (4)	2	160	28	—	—	—	—
<b>U.S. Pacific Northwest</b>							
Gilchrist (5)	2	155	56	127	136	160	53
Molalla (6)	2	160	66	151	194	136	—
Port Angeles (5)	2	155	72	129	96	123	41
Beaver (7)	2	165	14	—	—	—	—
<b>Sawmills Closed or Sold</b>							
Queensboro (8)			—	38	111	53	82
MacKenzie (9)			—	—	43	57	47
Field (10)			—	—	—	—	94
Marysville (5)(11)			—	—	—	22	9
<b>Total</b>		<u>1,575</u>	<u>498</u>	<u>855</u>	<u>1,178</u>	<u>1,161</u>	<u>917</u>

(1) Based on two shifts per day and 250 operating days per year.

(2) Volumes include lumber custom-cut at third party facilities under the direction of Hammond and Acorn management amounting to 12 million board feet for Hammond and 1 million board feet for Acorn in 2008.

(3) The old Adams Lake sawmill was closed during 2008. The new Adams Lake sawmill is expected to begin production during the second quarter of 2009.

(4) Castlegar and Grand Forks were acquired in April 2008. Volumes reported are Interfor only. Castlegar has been curtailed since acquisition.

(5) Gilchrist, Marysville and Port Angeles were acquired on September 1, 2004.

(6) Molalla was acquired on May 31, 2005.

(7) Beaver was acquired September 30, 2008.

(8) Queensboro (formerly Western Whitewood) was curtailed indefinitely in December 2007 and permanently closed in July 2008.

(9) Volumes include custom-cutting.

(10) Field was permanently closed in February 2006.

(11) Marysville was permanently closed in December 2005.

## B.C. Coast Operations

### *Hammond*

The Hammond operation is located on the Fraser River in Maple Ridge, B.C. The facility is focused on Western Red Cedar and supplies siding, decking, fascia and timbers for both offshore and North American markets. The facility consists of a three-line sawmill, a planer mill and dry kilns. New kilns were installed in 1999 & 2001 at a cost of \$8 million. In addition an upgrade was completed in 2002 on the trim line and mill flow to enhance productivity at a cost of \$5 million.

*Acorn*

The Acorn operation is located on leased land in Delta, B.C. The facility consists of a log dewatering and merchandizing system, a sawmill, a planer mill and dry kilns. In 2001, capital projects totaling \$18.0 million were completed upgrading the mill's log processing, lumber sorting, optimized trimming and lumber drying capability. The sawmill specializes in sizes and grades of lumber for use in Japanese traditional housing made primarily from hemlock and Douglas-fir logs.

**B.C. Interior Operations***Adams Lake*

Adams Lake is our Interior sawmill located near Kamloops, B.C. The mill manufactures kiln-dried lumber for the U.S. and Canadian construction markets as well as for offshore markets. Adams Lake has the capability to cut Douglas-fir as well as spruce-pine-fir ("SPF"), western red cedar, and hemlock. In 2003, a planer and sorter were installed at a cost of \$6.8 million and an additional dry kiln was constructed at a cost of \$1.0 million. In 2006 and 2007 we spent \$32.1 million on an energy system, new hog and barker and infrastructure improvements to facilitate further growth and cost savings.

In 2007, to complete the overall plan for the site, the Company commenced the construction of a new sawmill at Adams Lake, to replace the existing facility. Construction, commenced in the summer of 2007, is on budget and was substantially complete as at the end of 2008. The first line was commissioned in 2008 with a full start-up scheduled for the second quarter of 2009. This mill will have a two-shift capacity of 285 mfbm.

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

*Grand Forks*

Our Grand Forks mill was acquired May 1, 2008 as part of our purchase of Pope and Talbot's southern B.C. assets. The mill is located in the southern interior of B.C. approximately 100 km from Castlegar on a 75 acre site. We also acquired timber tenures with an allowable annual cut of 502,000 m<sup>3</sup>. The two line mill manufactures kiln dried lumber for the U.S. and Canadian construction markets as well as the housing market in Japan. Grand Forks cuts 60% spruce-pine-fir (SPF) and 40% Fir-Larch. In 2006, the previous owner invested \$20.0 million for a new planermill and two new thermal oil kilns.

*Castlegar*

Our Castlegar facilities were acquired May 1, 2008 as part of our purchase of Pope and Talbot's southern B.C. assets. In addition to timber tenures with an allowable annual cut of 491,000 m<sup>3</sup>, the facilities include a sawmill, dry kilns and planer capable of manufacturing 170,000 mfbm annually of fir-larch, SPF, cedar and hemlock dimension lumber. The operation has been idle since February, 2008 due to poor market conditions and an unfavourable cost structure.

**U.S. Operations***Gilchrist*

The Gilchrist mill is located in Gilchrist, Oregon on approximately 140 acres. The previous owner invested approximately US\$28 million in 2000 and 2001 to modernize the facility to efficiently convert small diameter logs. The mill primarily processes lodgepole pine, ponderosa pine and white fir to produce a wide range of specialty and dimension lumber products. The mill has an on-site cogeneration plant to produce electricity for its own use as well as steam for its dry kilns. At this location, we own and operate a short line railroad to connect to a mainline for shipment of lumber and chips and to deliver logs to the mill. In 2005 and 2006 we installed six new dry kilns at a cost of US\$5.7 million to replace obsolete kilns and increase drying capacity.



### *Port Angeles*

The Port Angeles mill was newly constructed in 1998 at a total cost of US\$30 million. It is situated in Port Angeles, Washington on a 64 acre site near major highways and waterways which are convenient for shipping lumber and chips as well as for receiving logs at the mill. The mill primarily processes hemlock and Douglas-fir logs to produce stud dimension lumber for the U.S. market but is also capable of producing metric sizes for export. In 2005, we modified the dry kilns at a cost of US\$1.1 million to increase drying capacity. We also installed a new planer grade optimizer, trimmer and sorter at a cost of US\$5.0 million to increase planer capacity and significantly reduce planing costs. In 2006 and 2007, we constructed a new primary saw line at a cost of US\$18.3 million to increase recovery and lumber production. This new line was commissioned in February 2007 and exceeded expected targets in April. In October 2007, we installed a new log merchandiser, planer and planer infeed at a total cost of US\$5.8 million.

### *Beaver*

The Beaver sawmill consists of a single line 20' dimension sawmill on a 45 acre owned site originally constructed in 1991 in by Portac Inc. We acquired the assets on September 30, 2008. The boiler, dry kilns, and planer mill is situated approximately 10 miles south of the sawmill on a 29 acre site leased from the City of Forks. The operation is 45 miles west of our Port Angeles facility and is a strong strategic fit with that operation. The mill has traditionally produced Hemlock, Douglas Fir and Spruce products for domestic markets. Recently we have begun to add some export products to complement the domestic programs.

### *Molalla*

The Molalla mill was acquired in May 2005. It is located in Molalla, Oregon approximately 30 miles southeast of Portland. The mill primarily processes hemlock and Douglas-fir logs to produce stud dimension lumber for the U.S. market. The mill's machine centres are fully optimized following an investment of more than US\$10 million by the previous owners. A number of infrastructure improvements were undertaken in 2005 and 2006 at a cost of US\$5.8 million. In 2006, we also completed the construction of two dry kilns for US\$2.4 million and a new planer mill complex with grade optimization for US\$10.3 million. The new planer mill has reduced costs and increased grade realizations.

### *Cedarprime*

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

## **SALES, MARKETING AND COMPETITIVE POSITION**

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

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

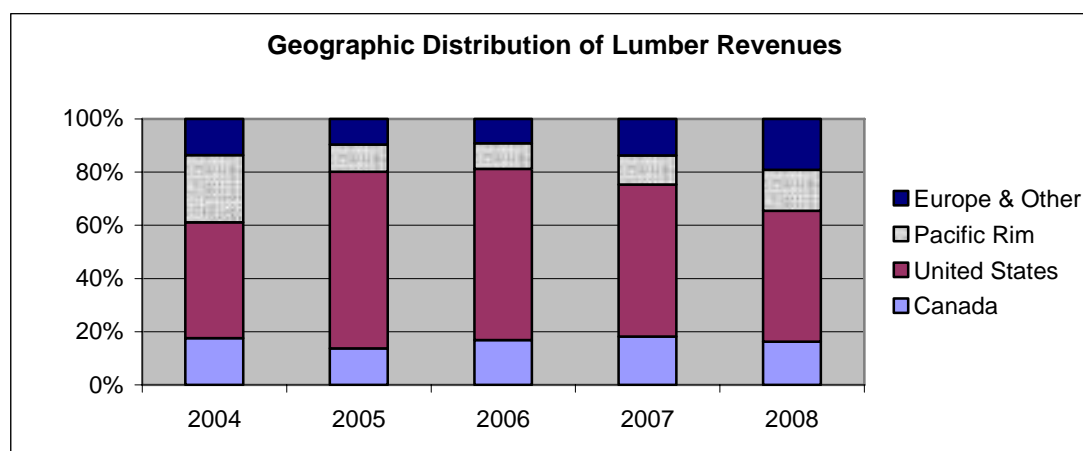
	Years ended December 31				
	2008	2007	2006	2005	2004
	(thousands of dollars)				
Lumber					
— Canada	\$ 45,996	\$ 76,909	\$ 102,996	\$ 88,621	\$106,537
— U.S.A	139,394	241,398	393,222	427,334	263,313
— Other export	<u>104,187</u>	<u>104,392</u>	<u>114,937</u>	<u>128,109</u>	<u>234,909</u>
	289,577	422,699	611,155	644,064	604,759
Offshore transportation and handling	7,857	11,769	14,397	17,419	29,106
Logs	103,620	118,571	103,250	105,107	136,921
Wood chips and other by-products	30,610	50,260	41,868	34,118	38,351
Contract services and other	<u>5,557</u>	<u>7,709</u>	<u>53,769</u>	<u>41,875</u>	<u>34,700</u>
<b>Total sales</b>	<u>\$437,221</u>	<u>\$611,008</u>	<u>\$824,439</u>	<u>\$842,583</u>	<u>\$843,837</u>

### Lumber Sales

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

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

The following graph shows the percentage of lumber sales revenue to our major markets in the past five years:



### Log Sales

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

### Wood Chip and Sawmill Residuals Sales

As a by-product of lumber production, our sawmills produce wood chips. Essentially all of our wood chips produced in B.C. are sold under contracts to pulp producers with terms varying from 1 to 25 years, with some contracts perpetually renewable by the pulp producer. Most of these wood chips are sold at prices related to current Northern Bleached Softwood Kraft ("NBSK") pulp prices, while the balance is sold at current market prices for chips.

Chips from our Washington and Oregon operations are sold to pulp producers or fibre board manufacturers under short-term arrangements.

### DISTRIBUTION

We use various modes of surface transportation to deliver our lumber products. We have a 62% interest in Seaboard Shipping Company Limited and arrange substantially all of our offshore transportation through them. Shipments of lumber within North America are made by truck and rail. Chips and logs are normally delivered by tug and barge or by truck. In Gilchrist, Oregon, and in Grand Forks, B.C., we own short line railroads to connect to a mainline for shipping lumber and chips.

### TIMBER SUPPLY

#### British Columbia

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

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

Our timber supply needs are met by a combination of: internal logs harvested from our own timber tenures, long-term trade and supply agreements, and by purchases on the open market. When operating at normal capacity, our Coastal mills obtain approximately one-quarter of their log supply from

external sources. Our Adams Lake mill acquires approximately three-quarters of its log supply from external sources.

We hold various Forest Licence ("FL"), Tree Farm Licence ("TFL") and Timber Licence ("TL") tenures that currently provide for an allowable annual cut ("AAC") of approximately of 3.6 million cubic metres (m<sup>3</sup>). The majority of Interfor's tenures are long-term renewable agreements that are generally replaced every five years.

The B.C. Government (the "Crown") is responsible for making land use decisions that designate areas for primary uses such as parks or resource development. Most of the Province has completed comprehensive land use plans that involve an extensive public consultation process. In 2006, the Crown announced land use decisions for the Central Coast and the North Coast containing detailed agreements for the use and management of public lands in the region. The land use decisions protect vast areas of temperate rainforest, and a commitment to Ecosystem Based Management ("EBM"). The purpose of EBM is to adopt a set of practices that will ensure the well being of ecosystems, people and their communities.

To account for the new protected areas, in 2006 the Chief Forester of the Crown announced temporary reductions in the AAC in the plan areas by 572,000 cubic metres. Interfor's portion of this reduction is estimated to be 127,000 cubic metres, or approximately 8% of the Company's AAC within this region. New EBM legal objectives were introduced by the Crown in 2007 affecting a portion of the Company's operations. The AAC impact will be determined by a new timber supply analysis which has not yet been completed by the Crown. The Company anticipates there will be further reductions in AAC for areas impacted by the new EBM legal objective over the coming years. The magnitude of the AAC changes is not known at this time.

The Company anticipates receiving compensation for the AAC reductions and lost infrastructure once a permanent removal of AAC for the new protected areas has been made in accordance with the *Forest Act*. In 2008, the Company received \$4.8 million in compensation for the loss of logging rights for certain TLs, forestry and engineering work and other expenditures related to the timber returned pursuant to the decisions. Although the Company expects to receive further compensation for the FL AAC reductions, the amount and timing of the balance of compensation is not yet determinable.

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

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

<b>B.C. Operations</b>	<b>Years ended December 31</b>					
	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
	(thousands of cubic metres)					
<b>Allowable Annual Cut <sup>(1)</sup></b>						
— Forest Licences	2,418	2,084	2,105	2,325	2,293	2,603
— Non Replaceable Forest Licences	313	375	155	155		
— Tree Farm Licences	867	196	262	272	517	551
— Discretionary Annual Harvest Levels <sup>(2)</sup>	40	40	40	65	80	80
— Less Provision for Harvest Take-back <sup>(3)</sup>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(235)</u>	<u>(579)</u>
	<u>3,638</u>	<u>2,695</u>	<u>2,562</u>	<u>2,817</u>	<u>2,655</u>	<u>2,655</u>
<b>Log Production</b>						
— Coast		1,754	1,655	2,082	2,210	2,697
— Interior		<u>127</u>	<u>112</u>	<u>299</u>	<u>348</u>	<u>267</u>
Total Log Production		<u>1,881</u>	<u>1,767</u>	<u>2,381</u>	<u>2,558</u>	<u>2,964</u>
<b>Log Purchases</b>		<u>447</u>	<u>1,316</u>	<u>1,487</u>	<u>1,595</u>	<u>1,880</u>
<b>Log Sales</b>		<u>1,319</u>	<u>1,223</u>	<u>1,190</u>	<u>1,360</u>	<u>1,636</u>

(1) AAC status at the beginning of each year (includes a provision for non-recoverable fibre).

(2) Volumes not included in AAC.

(3) AAC take-back under the Forestry Revitalization Plan was completed during 2005.

### U.S. Pacific Northwest

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

Our timber supply needs in Washington are primarily met by purchases from local forest industry private lands as well as small, individual private landowners. In Oregon, the mills are supplied by a combination of Federal and State land timber sales and forest industry private land purchases.

In Washington, our log purchases are primarily western hemlock and some Douglas-fir that come from local second growth forests.

In Oregon, log purchases for the Gilchrist mill consist primarily of lodgepole pine, ponderosa pine and white fir that have come from second growth harvesting and the thinning of young stands from surrounding National Forests. The Molalla mill purchases western hemlock and Douglas-fir logs primarily from nearby private industrial suppliers.

The total log supply requirement for the mills in the U.S. is projected to be approximately 198 million board feet in 2009. The proportion of timber derived from various sources is estimated to be as follows:

<b>U.S. Pacific Northwest Operations</b>	<b>Expected Sources of Timber 2009</b>
State and Federal Lands	28%
Industrial Lands	63
Private Lands	<u>9</u>
	<u>100%</u>

## Forestry and Logging in B.C.

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

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

We pay stumpage to the Province for timber harvested on Crown land according to pricing systems in place on the Coast and in the Interior. In 2008, we paid \$21.1 million in stumpage to the Province for the harvest of Crown timber.

Our Coastal logging operations are widely dispersed in primarily remote locations between Vancouver and Prince Rupert. Our woodlands harvesting activities are performed entirely by independent logging contractors.

Our Interior woodlands operations are located at Adams Lake, northeast of Kamloops, and in the Kootenay region at Nakusp and Grand Forks.

Logging operations are seasonal due to a number of factors including weather, ground conditions and fire season closures. These and other factors are described in the Selected Quarterly Financial Information section of our Management Discussion and Analysis for the year ended December 31, 2008, a copy of which is available on SEDAR at [www.sedar.com](http://www.sedar.com).

## **CAPITAL EXPENDITURES**

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

	<b>Years ended December 31</b>				
	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
	(thousands of dollars)				
<b>Acquisitions</b>					
Land, buildings, equipment					
— Manufacturing	52,885	—	—	\$70,857	\$74,979
— Forestry and logging	—	—	—	—	—
Logging roads and timber	<u>40,148</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
	<u>93,033</u>	<u>—</u>	<u>—</u>	<u>\$70,857</u>	<u>\$74,979</u>
<b>Other capital expenditures</b>					
Land, buildings, equipment					
— Manufacturing and other	\$72,911	\$47,948	\$71,176	\$57,404	\$26,615
— Forestry and logging	1,365	130	733	1,323	2,075
Logging roads and timber	<u>17,512</u>	<u>28,340</u>	<u>18,694</u>	<u>20,136</u>	<u>28,940</u>
	<u>91,788</u>	<u>76,418</u>	<u>90,603</u>	<u>78,863</u>	<u>57,630</u>
<b>Total</b>	<u>\$184,821</u>	<u>\$76,418</u>	<u>\$90,603</u>	<u>\$149,720</u>	<u>\$132,609</u>

Our capital expenditures over the five years ended December 31, 2008 were financed through internally generated funds, through our bank lines and through proceeds generated from the sale of surplus land and other non-core and surplus logging and manufacturing assets.

## **HUMAN RESOURCES**

In B.C., we directly employ approximately 1,200 people in our logging and manufacturing operations and corporate offices. The United Steel Workers (USW) is the certified bargaining agent for approximately 700 of these people. The agreement with the USW for the B.C. Coast was renewed during 2007 and expires on June 14, 2010, while the Southern Interior USW agreement expires on June 30, 2009. The Canadian Marine Service Guild (CMSG) represents 19 employees, and their collective agreement expires September 30, 2011.

In the U.S., we employ approximately 390 employees in our sawmill and remanufacturing operations in Washington and Oregon and in our office located in Bellingham, Washington.

Our employees are governed by a Policy Manual, including a Code of Conduct, Environment Policy, Health and Safety Policy, Disclosure Policy, Whistleblower Policy, Financial Reporting Policy, Internet, Email and Computer Use Policy, Harassment Policy and Smoking, Drug and Alcohol Policy. The Code of Conduct may be found on SEDAR at [www.sedar.com](http://www.sedar.com). The Environment and Safety Policies are described below. Employees are also protected by a Privacy Policy. Our employees, management and directors have adopted the following Core Values:

### **Core Values**

We will conduct ourselves with honesty, integrity and professionalism.

- **People:** People are the foundation of our business.
- **Safety:** Safety is a prerequisite for work.
- **Environment:** Environmental integrity must be maintained in everything we do.
- **Customers:** Customers pay our way.
- **Shareholders:** Returns to our shareholders facilitate investment, employment, and public benefits.

**We Are Responsible For Our Own Success**

## **HEALTH AND SAFETY**

We maintain a Health and Safety Policy that demonstrates our commitment to the health, safety and well-being of all employees.

Our Board approved the policy and established a committee of the Board to monitor these safety commitments. The Environment and Safety Committee of the Board (the "E&S Committee") is mandated to monitor the implementation and maintenance of our policy of ongoing commitment to health and safety values and principles with continuous operational improvement. The E&S Committee ensures that our management develops, implements and maintains a comprehensive safety program.

Safety is a core value for us. We maintain an active and comprehensive safety program at each of our operations. Unfortunately in 2008 we suffered one employee and two contractor fatalities. One employee fatality and one contractor fatality occurred at our Coastal Woodlands operation, and one contractor fatality occurred at our Gilchrist operation. Senior managers of our manufacturing operations conducted a comprehensive review of all safety programs to highlight and implement best practices. Our safety programs have been successfully integrated into the operations acquired in 2008 at Castlegar and Grand Forks, BC and Beaver, WA.

The fatalities overshadowed some very good work at the other operations in the Company. Overall our Medical Incident Rate ("MIR") increased to 4.9 from 3.9 and our Loss Time Accident ("LTA") frequency increased to 2.8 from 1.2 when compared to 2007.

Our Coastal Woodlands operations became SAFE certified in 2007 for all of its direct employees. A number of our primary contractors also achieved SAFE certification during the year, and all have registered for the province-wide program managed by the B.C. Forest Safety Council.

### **Health And Safety Policy**

Health and Safety is the uncompromised right and responsibility of all employees.

- We will integrate Health and Safety into our business with the knowledge that all accidents are preventable.
- We will hold all levels of management accountable for providing a safe work environment and enforcing safe work practices, including timely follow-up of safety incidents.
- We will train all employees to identify hazards and to protect themselves and fellow workers.
- We will hold all employees and contractors working for Interfor accountable for following safe work practices and reporting unsafe acts and conditions.
- We will use audits to measure and improve our Health and Safety performance.
- We will actively involve our employees in effective Safety programs.
- We will operate in compliance with Health and Safety Regulations.

International Forest Products Limited is committed to the health, safety, and well being of all employees.

## **THE ENVIRONMENT**

We maintain an Environmental Policy that demonstrates our commitment to responsible stewardship of the environment.

Our Board approved the policy and established a committee of the Board to monitor our commitment to principles, values and policies on environment matters.

Management has implemented an environmental compliance program. External and internal audits are performed regularly in both the woodlands and manufacturing operations to verify its effectiveness.

All of our woodlands operations have been independently certified to internationally recognized standards. Certification systems provide independent verification that environment and sustainable forestry standards are being met.

Our woodlands have been certified to the Sustainable Forestry Initiative® Program ("SFI") as an international standard for certification of forest land. The SFI program is a comprehensive system of principles, objectives and performance measures that combine the perpetual growing and harvesting of trees with the protection of wildlife, plants, soil and water quality.

We maintain an Environmental Management System ("EMS") for all of our manufacturing facilities. The EMS provides a structure for identifying, addressing and managing environmental issues. Each manufacturing business unit is responsible for compliance and ensuring the EMS is functioning as intended.

We monitor environmental performance at our mill sites and conduct audits to identify issues and assess compliance. All of our mills have received a high rating for environmental compliance.

We have also received Chain-of-Custody ("CoC") certification that tracks certified logs coming from sustainable forests through the manufacturing process for certain mills.

We are a global leader in environmental management through the application of science-based principles, collaborative approaches, sustainable forest practices and independent certifications. We were a recipient of the 2000 Millennium Business Award from the United Nations Environmental Programme



and the International Chamber of Commerce and a co-recipient of World Wildlife Fund's Gift to the Earth award in 2007.

Additional information about our environmental work, audit summaries and Forest Sustainability Report is available on our website at [www.interfor.com](http://www.interfor.com).

### **Environment Policy**

We are committed to responsible stewardship of the environment.

- We will minimize environmental impact, prevent pollution and strive for continuous improvement of our environmental performance.
- We will operate in compliance with all applicable laws pertaining to the environment.
- We will regularly review our practices and procedures to monitor and report on environmental performance.
- We will provide training for employees and contractors in environmentally responsible work practices.
- We will manage our forest resources in a sustainable manner that is environmentally appropriate, socially beneficial and economically viable.
- We will promote the use of our wood products as a good choice for the environment.

### **RESEARCH AND DEVELOPMENT**

We contribute to and participate in industry research organizations that have made numerous technical developments beneficial to us in areas such as sawing technology, drying techniques, and anti-sapstain applications. We also are committed to applied research and development in the areas of environment, health and safety, forest management and product and market development. We also conduct product and market research on our own in Canada and the U.S.

### **CAPITAL STRUCTURE**

The authorized share structure of the Company consists of:

- 100,000,000 Class "A" Subordinate Voting shares without par value ("Subordinate Voting Shares");
- 1,700,000 Class "B" Common shares without par value ("Multiple Voting Shares"); and
- 5,000,000 Preference shares without par value issuable in series with such special rights and restrictions as the Directors of the Company may determine before issue thereof ("Preference Shares").

The Subordinate Voting Shares and Multiple Voting Shares are referred to as "Equity Shares".

#### **Subordinate Voting Shares**

The holders of Subordinate Voting Shares are entitled to non-cumulative preferential dividends of 13 1/3 cents per annum for each share in priority to any dividends paid on the Multiple Voting Shares and to further participate, share for share with the Multiple Voting Shares, in any dividends paid on the Equity Shares for any fiscal year after 13 1/3 cents per share has been paid or set aside for payment on the Subordinate Voting Shares. The holders of Subordinate Voting Shares are entitled to one vote for each share and the holders of the Subordinate Voting Shares are entitled, as a class, to elect one member of the Board and if there are no Multiple Voting Shares outstanding, are entitled to elect the entire Board except in certain circumstances where the holders of Preference Shares are entitled to elect two Directors.

The provisions relating to the Subordinate Voting Shares may not be varied unless sanctioned by a special resolution of the holders of the Subordinate Voting Shares and the Multiple Voting Shares voting together and by separate resolutions of the respective holders of the Subordinate Voting Shares and the Multiple Voting Shares, the special resolution and separate resolutions in each case requiring a majority of three-fourths of the votes cast.

In the event of liquidation, dissolution or winding-up of the Company or any other distribution of its assets, holders of Subordinate Voting Shares are entitled to declared and unpaid dividends prior to the holders of the Multiple Voting Shares and thereafter to participate, share for share, with the Multiple Voting Shares, subject to all rights of the holders of Preference Shares.

### **Multiple Voting Shares**

The holders of Multiple Voting Shares are entitled to participate, share for share, with the Subordinate Voting Shares, in any dividends paid for any fiscal year after 13 1/3 cents has been provided for payment on the Subordinate Voting Shares. The holders of Multiple Voting Shares are entitled to ten votes on a poll for each share held and the holders of Multiple Voting Shares are entitled, as a class, to elect all members of the Board except one member to be elected by the holders of the Subordinate Voting Shares and, in certain circumstances, two Directors to be elected by the holders of Preference Shares.

In the event of liquidation, dissolution, or winding-up of the Company or any distribution of its assets, holders of Multiple Voting Shares are entitled after payment of any declared and unpaid dividends on the Subordinate Voting Shares to participate, share for share, with the Subordinate Voting Shares, subject to all rights of the holders of Preference Shares.

Any holder of Multiple Voting Shares is entitled at any time to exchange his Multiple Voting Shares for Subordinate Voting Shares on a share for share basis without adjustment for any unpaid dividends.

The provisions relating to the Multiple Voting Shares may not be varied unless sanctioned by a special resolution of the holders of the Subordinate Voting Shares and the Multiple Voting Shares voting together and by separate resolutions of the respective holders of the Subordinate Voting Shares and the Multiple Voting Shares, the special resolution and separate resolutions in each case requiring a majority of three-fourths of the votes cast.

In the event of any subdivision, consolidation, or conversion of either Subordinate Voting Shares or Multiple Voting Shares, an appropriate adjustment is to be made in the rights and conditions attaching to the Subordinate Voting Shares and the Multiple Voting Shares to preserve the benefits conferred on the holders of each class.

### **Rights on Take-Over Bids and Conversion of Multiple Voting Shares**

Any transfer of a Multiple Voting Share:

- a. by any of W.L. Sauder's executors, administrators, or other trustee or legal representative with respect to his personal estate, members of his immediate family, their descendants and controlled companies (collectively the "Controlling Shareholder Group") to any person other than another member of the Controlling Shareholder Group or a person (the "Qualified Purchaser") who is acquiring a majority of the outstanding Multiple Voting Shares and who makes an offer to purchase all outstanding Subordinate Voting Shares, Preference Shares, and Multiple Voting Shares at an equivalent price; or
- b. by a Qualified Purchaser to any person other than another Qualified Purchaser,

will result in the automatic conversion of the Multiple Voting Shares into Subordinate Voting Shares.

The Multiple Voting Shares will be automatically converted into Subordinate Voting Shares if:

- a. the Controlling Shareholder Group or a Qualified Purchaser ceases to beneficially own more than 50% of the issued and outstanding Multiple Voting Shares; or
- b. the Controlling Shareholder Group or a Qualified Purchaser ceases to beneficially own equity shares carrying at least 9.2 million votes, subject to adjustments upon: (i) the subdivision, consolidation, or reclassification of any outstanding equity shares, or (ii) the issue of equity shares by way of a stock dividend other than an ordinary course stock dividend.

### **Preference Shares**

The Preference Shares of each series rank on a parity with the Preference Shares of every other series, and are entitled to preference over the Equity Shares and over any other shares ranking junior to the Preference Shares with respect to payment of dividends and the distribution of assets of the Company in the event of liquidation, dissolution, or winding-up of the Company.

### **MARKET FOR SECURITIES OF THE COMPANY**

The Subordinate Voting Shares are listed on the Toronto Stock Exchange under the symbol IFP.A. The following table sets out the market price ranges and trading volumes for the Subordinate Voting Shares on the Toronto Stock Exchange for each month during 2008 (January 1, 2008 through December 31, 2008).

<b>Toronto Stock Exchange 2008 Trading Volumes Ticker: IFP.A</b>			
<b>Month</b>	<b>High \$</b>	<b>Low \$</b>	<b>Volume</b>
January	6.19	5.20	2,057,951
February	5.70	4.92	2,869,708
March	5.90	4.77	1,606,973
April	6.00	5.26	885,247
May	5.95	5.52	1,147,087
June	5.94	5.13	2,050,537
July	5.50	4.90	3,834,814
August	5.70	4.90	2,345,209
September	5.40	4.10	2,873,208
October	4.41	2.85	6,734,668
November	3.25	1.35	1,213,213
December	2.00	1.20	3,278,728

### **TRANSFER AGENTS**

The transfer agent for our Subordinate Voting Shares is Computershare Investor Services Inc. at its principal offices in Vancouver, British Columbia.

### **NORMAL COURSE ISSUER BID**

On January 3, 2008, the Company received approval to conduct a normal course issuer bid (the "Bid") under which the Company was entitled, but not obligated, to purchase up to 1,300,000 Class "A" Subordinate Voting shares through the facilities of the Toronto Stock Exchange, representing approximately 2.8% of the 46,089,076 Class "A" Subordinate Voting shares that were issued and outstanding on December 31, 2007 and 3.9% of its public float, comprised of 33,333,975 Class "A" Subordinate Voting shares. The program commenced on January 8, 2008 and terminated on January 7, 2009. The Company did not purchase any shares under the Bid.

## **DIRECTORS AND OFFICERS**

### **Directors as of February 12, 2009**

The following table sets out the Company's directors as of February 12, 2009, their respective municipalities of residence, principal occupations within the past five years and the period during which each director has served as a director.

<b>Name and Municipality of Residence</b>	<b>Director Since</b>	<b>Principal Occupations</b>	<b>From</b>	<b>To</b>
<b>LAWRENCE I. BELL</b> <sup>(3)(4)(5)</sup> Vernon, BC, Canada	April 1998	Corporate Director	2007	Present
		Non-executive Chairman British Columbia Hydro and Power Authority	2003	2007
		Chairman and Chief Executive Officer British Columbia Hydro and Power Authority	2001	2003
<b>DUNCAN K. DAVIES</b> Vancouver, BC, Canada	November 1998	President and Chief Executive Officer International Forest Products Limited	2000	Present
		President and Chief Operating Officer International Forest Products Limited	1998	2000
<b>HAROLD C. KALKE</b> <sup>(1)(3)</sup> West Vancouver, BC, Canada	July 2000	President Kalico Developments Ltd.	1971	Present
<b>PETER M. LYNCH</b> <sup>(2)(4)</sup> Toronto, ON, Canada	October 2006	Executive Vice President and Director Grant Forest Products Inc. (and its predecessor)	1993	Present
<b>GORDON. H. MacDOUGALL</b> <sup>(1)(2)</sup> West Vancouver, BC, Canada	February 2007	Vice Chairman and Director Connor, Clark & Lunn Investment Management Ltd.	2007	Present
		Partner Connor, Clark & Lunn Investment Management Partnership	1996	2006
		Head of Portfolio Strategy Team and Head of Client Solutions Team Connor, Clark & Lunn Investment Management Ltd.	1996	2006
<b>J. EDDIE McMILLAN</b> <sup>(1)(4)</sup> Perdido Key, Florida, USA	October 2006	Independent Business Consultant	2002	Present
		Executive Vice President – Wood Products Group Willamette Industries, Inc.	1998	2002
<b>E. LAWRENCE SAUDER</b> <sup>(3)</sup> Vancouver, BC, Canada	April 1984	Non-Executive Chairman International Forest Products Limited	2008	Present
		Non-Executive Chairman Hardwoods Distribution Income Fund	2008	Present
		Non-Executive Vice Chairman International Forest Products Limited	2004	2008
		President Sauder Industries Limited	1988	2004
<b>JOHN P. SULLIVAN</b> <sup>(1)(2)(4)</sup> Vancouver, BC, Canada	May 2001	Corporate Director	2003	Present
		Vice President International Forest Products Limited	2001	2003
<b>DOUGLAS W.G. WHITEHEAD</b> <sup>(2)(3)</sup> North Vancouver, BC, Canada	April 2007	Non-Executive Chairman Finning International Inc.	2008	Present
		President and Chief Executive Officer Finning International Inc.	2000	2008

- (1) Member of the Audit Committee
- (2) Member of the Corporate Governance and Nominating Committee
- (3) Member of the Management Resources and Compensation Committee
- (4) Member of the Environment and Safety Committee
- (5) Lead Director

The Company currently has 4 Committees of the Board of Directors: Audit Committee, the Corporate Governance and Nominating Committee, the Management Resources and Compensation Committee and the Environment and Safety Committee. The members of each Committee are indicated by footnote in the list of directors above.

The term of office for all current directors will end on the day of the next Annual General Meeting of the Company's shareholders.

### Officers as of February 12, 2009

The following table sets out the Company's officers as of February 12, 2009, their respective municipalities of residence and their principal occupations within the last five years:

<b>Name and Municipality of Residence</b>	<b>Positions Held</b>	<b>From</b>	<b>To</b>
<b>DUNCAN K. DAVIES</b> Vancouver, BC, Canada	President and Chief Executive Officer International Forest Products Limited	2000	Present
	President and Chief Operating Officer International Forest Products Limited	1998	2000
<b>JOHN A. HORNING</b> West Vancouver, BC, Canada	Senior Vice President, Chief Financial Officer and Corporate Secretary International Forest Products Limited	2007	Present
	Senior Vice President and Chief Financial Officer International Forest Products Limited	2002	2007
	Vice President Finance and Corporate Development International Forest Products Limited	2000	2002
<b>SANDY M. FULTON</b> Blaine, Washington, USA	Senior Vice President and Chief Operating Officer International Forest Products Limited	2007	Present
	Senior Vice President, U.S. Operations International Forest Products Limited	2004	2007
	Management Consultant Various companies in the forest and financial services industries	2000	2004
	Executive Vice President, Operations Crown Pacific Limited Partnership (Forest Products)	1998	2000
<b>OTTO F. SCHULTE</b> Black Creek, BC, Canada	Vice President, Coastal Woodlands International Forest Products Limited	2000	Present
<b>RICHARD J. SLACO</b> Delta, BC, Canada	Vice President and Chief Forester International Forest Products Limited	2002	Present
<b>STEPHEN D.A. WILLIAMS</b> North Vancouver, BC, Canada	Vice President and Corporate Treasurer International Forest Products Limited	2006	Present
	Corporate Treasurer International Forest Products Limited	2000	2006

## **SHAREHOLDINGS OF DIRECTORS AND OFFICERS**

As at December 31, 2008, the directors and officers of the Company as a group owned, directly or indirectly, or exercised control of or direction over 2,036,807 Subordinate Voting Shares representing approximately 4.42% of the outstanding Subordinate Voting Shares and 1,011,735 Multiple Voting Shares representing approximately 99.6% of the outstanding Multiple Voting Shares. In respect of the foregoing, the outstanding Multiple Voting Shares are owned by Sauder Industries Limited. All the issued shares of Sauder Industries Limited are owned by members of the late W.L. Sauder's immediate family, their descendents and controlled companies, including E. Lawrence Sauder, the non-executive Chairman of the Company. E. Lawrence Sauder controls or directs the exercise of the voting rights attached to the voting securities of the Company held by Sauder Industries Limited with respect to routine matters such as the election of directors and appointment of auditors.

## **INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS**

Since the commencement of our most recently completed financial year, and for the three most recently completed financial years, no director or executive officer of the Company, no person or company that is the direct or indirect beneficial owner of, or who exercises control or direction over, more than 10% of the Company's voting securities or any associate or affiliate of such persons, has had any material interest in any transaction involving the Company.

## **MATERIAL CONTRACT**

In early 2008, the Company entered into an agreement, subject to certain approvals, to acquire a timber tenure in the Kamloops region currently owned by Weyerhaeuser Company Limited. During the fourth quarter of 2008, the parties agreed to a reduced volume of approximately 275,000 m<sup>3</sup>. The parties are currently working toward a revised contract to reflect the reduced volume. The transaction is the subject of a lengthy regulatory review. That process has recently been challenged by a First Nations band. Presently, there is no certainty of the timing of completion.

## **LEGAL PROCEEDINGS**

We are not a party to, and our property is not the subject of, any material legal proceedings which are currently in place or which we know to be contemplated.

## **INTEREST OF EXPERTS**

KPMG LLP are the external auditors of the Company and have confirmed that they are independent with respect to the Company within the meaning of the Rules of Professional Conduct of Institute of Chartered Accountants of British Columbia and the applicable rules and regulations thereunder.

## **AUDIT COMMITTEE INFORMATION**

### **The Audit Committee Terms of Reference**

The Audit Committee (the "Committee") is appointed by the Board to assist the Board in fulfilling its oversight responsibility relating to:

- a. the integrity of the Company's financial statements,
- b. the financial reporting process,
- c. the systems of internal accounting and financial controls,
- d. the professional qualifications and independence of the external auditors,
- e. the performance of the external auditors, risk management processes,
- f. financial plans,
- g. pension plans, and

- h. compliance by the Company with ethics and legal and regulatory requirements.

The Committee's Terms of Reference, attached as Appendix "A" to this Annual Information Form, sets out its responsibilities and duties.

The Committee met 4 times in 2008 in conjunction with regularly scheduled Board meetings.

### **Composition of the Audit Committee**

The Committee consists of 4 directors: Harold C. Kalke (Chair), Gordon H. MacDougall, J. Eddie McMillan and John P. Sullivan. Each Committee member is independent and financially literate in compliance with *Multilateral Instrument 52-110 – Audit Committees*.

### **Relevant Education and Experience**

The following is a brief summary of the education and experience of each member of the Committee that is relevant to the performance of his responsibilities as a member of the Committee, including any education or experience that has provided the member with an understanding of the accounting principles used by the Company to prepare its annual and interim financial statements.

#### *Mr. Harold Kalke*

Mr. Kalke is the Chairman of the Committee. He is the President of Kalico Developments Ltd., a real estate development and management company. He has founded and operated several companies in the real estate development business and oil and gas sector. Mr. Kalke has served as Chairman of the Board of Governors of the University of British Columbia.

He has a Bachelor of Science degree in Engineering and a Masters in Business Administration degree from the University of Western Ontario.

Mr. Kalke has served on the Committee since July 2000 and chaired the Committee since April 2006.

#### *Mr. Gordon MacDougall*

Mr. MacDougall is Vice Chairman and Partner of Connor, Clark & Lunn Investment Management Ltd., an asset management firm. From 1996 to 2006, he was a Partner at Connor, Clark & Lunn Investment Management Partnership and Director, Head of Portfolio Strategy Team and Head of Client Solutions Team of Connor, Clark & Lunn Investment Management Ltd. He previously served as lead director for Intrawest Corporation. Mr. MacDougall currently is Chairman of the Investment Committee and Director of Vancouver Foundation.

He holds a CFA from the University of Virginia, a Master of Business Administration degree from the University of Pittsburgh and a Bachelor of Commerce degree in Finance from Sir George Williams University (now Concordia University).

Mr. MacDougall has served on the Committee since April 2007.

#### *Mr. Eddie McMillan*

Mr. McMillan is an Independent Business Consultant. From 1998 to 2002, he was Executive Vice President – Wood Products Group of Willamette Industries Inc. Over the years, he has served as a director of Forest Express, Inc. and has been associated with numerous industry association boards including the American Plywood Association, National Particleboard Association, Particleboard and MDF Institute, Southern Forest Products Association, Western Wood Products Association, National Association of Lumber Wholesalers and the American Forest and Paper Association.

He has a Bachelor of Science in Accounting/Business Administration from Louisiana Tech University.

Mr. McMillan has served on the Committee since April 2007.

*Mr. John Sullivan*

Mr. Sullivan is a Corporate Director. From 2001 to 2003, he was Vice President of the Company. He joined the Company following the acquisition of Primex Forest Products Ltd. ("Primex"), where he was Vice President, Corporate Development from 1987 to 2001. Prior to 1987, he held various management positions at Primex. Over the past years, he has served on many boards including the Board of Primex, as well as several federal crown and private companies.

Mr. Sullivan has served on the Committee since April 2007.

**AUDIT FEES**

The Committee annually recommends the appointment of the Company's external auditors and approves the annual audit plan and compensation of the external auditors for all audit, audit related and non-audit services. In the case of non-audit services, the services and compensation is approved by the Committee before the services commence.

KPMG LLP, Chartered Accountants, Vancouver, are the independent auditors of the Company. Fees paid or accrued to KPMG LLP for audit and other services for the years ended December 31, 2008 and December 31, 2007 were as follows:

	<b>2008 Fees</b>	<b>2007 Fees</b>
Audit and audit-related fees:		
Audit of the consolidated financial statements .....	\$ 350,000	\$ 337,000
Quarterly reviews .....	96,000	96,000
Business acquisition related audits.....	250,000	-
Audit-related fees (1) .....	<u>51,725</u>	<u>79,700</u>
Total audit and audit-related fees .....	747,725	512,700
Tax fees (2) .....	41,613	223,981
All other fees - forestry certification audits .....	67,200	60,800
- internal control over financial reporting advisory fees	24,281	1,913
- due diligence advisory fees .....	<u>-</u>	<u>8,250</u>
<b>TOTAL .....</b>	<b><u>\$ 880,819</u></b>	<b><u>\$ 807,644</u></b>

(1) Audit-related fees consist principally of fees for professional services rendered with respect to audits of a defined benefit pension plan, subsidiary companies, and advice and assistance related to accounting issues.

(2) Tax fees consist of fees for tax compliance services, professional services related to U.S. cross border transfer pricing and sales tax.

**CODE OF ETHICS**

We have adopted a code of ethics that applies to our directors, officers and employees. A copy of the code, entitled "Code of Conduct", can be found on our website at [www.interfor.com](http://www.interfor.com).



**ADDITIONAL INFORMATION**

Additional information relating to the Company, including directors' and officers' remuneration and indebtedness, principal holders of the Company's securities and securities authorized for issuance under equity compensation plans, is contained in the Company's Information Circular.

Additional financial information about the Company is provided in the Company's financial statements and Management's Discussion and Analysis for the year ended December 31, 2008.

Copies of the documents referred to above are available on the SEDAR website at [www.sedar.com](http://www.sedar.com) and may also be obtained upon request from:

International Forest Products Limited  
Corporate Secretary  
3500-1055 Dunsmuir Street  
Vancouver, British Columbia,  
Canada, V7X 1H7  
Telephone: 604 689 6800  
Facsimile: 604 689 6825  
E-mail: [info@interfor.com](mailto:info@interfor.com)

Additional information relating to the Company may be found on the SEDAR website at [www.sedar.com](http://www.sedar.com).

## Appendix "A"

**AUDIT COMMITTEE  
Terms of Reference****PURPOSE**

The Audit Committee has been established by the Board and under powers delegated to it by the Board is mandated to oversee the accounting and financial reporting processes of the Company and audits of its financial statements in accordance with the Board's objectives.

**COMPOSITION AND TERM OF OFFICE**

1. The Audit Committee shall consist of four or more Directors.
2. All members of the Audit Committee shall be independent within the meaning of *Multilateral Instrument 52-110-Audit Committees*.
3. All members must be financially literate or become financially literate within a reasonable period following appointment and at least one member should have accounting or related expertise.
4. The Chairman of the Audit Committee along with other Audit Committee members will be appointed annually by the Board following the AGM to hold office until the next AGM, unless the member becomes unable to serve or is removed by the Board. A casual vacancy may be filled and additional members may be appointed at any time by the Board to hold office until the next AGM.
5. A quorum shall consist of a simple majority.

**DUTIES AND RESPONSIBILITIES**

The Audit Committee shall perform the following functions, as well as any other functions specifically authorized by the Board:

**General**

1. Schedule regular meetings and meet, at a minimum, four times per year. Extraordinary meetings may be called by any member of the Audit Committee or at the request of the Chairman of the Board.
2. Appoint a Secretary who shall record the proceedings of the Audit Committee's meetings.
3. Report to the Board activities and recommendations, if any, requiring Board approval.

**Financial Disclosure, Risk Management and Internal Controls**

4. Review the following documents before the public disclosure of same by the Company, and, if appropriate, recommend approval by the Board of the Company's:
  - (a) annual and quarterly financial statements;
  - (b) Management's Discussion and Analysis; and
  - (c) annual and interim earnings press releases.

The review will involve direct discussions with Management and the Company's external auditor (the "Auditor"), including an opportunity for an in-camera meeting with the Auditor independent of Management.

Review and approve the disclosures required by applicable securities laws to be included in the Company's Annual Information Form and Management Information Circular relating to the Audit Committee and audit and non-audit services and fees.

5. Review the process for certification of the interim and annual financial statements by the CEO and Chief Financial Officer ("CFO") and the certification made by the CEO and CFO.
6. Review all news releases announcing financial results, containing financial information based on unreleased financial results or non-GAAP financial measures or providing earnings guidance, forward-looking financial information and future-oriented financial information or financial outlooks before the public disclosure of same by the Company.
7. Review financial information contained in any prospectus, take-over bid circular, issuer bid circular, rights offering circular and any other document that the Audit Committee is to review before the public disclosure of same by the Company, and, if appropriate, recommend approval by the Board.
8. Review matters related to internal controls over financial reporting of the Company and ensure the Company has adequate procedures in place in respect thereof. Ensure that the necessary measures are taken to follow up suggestions from the Auditor's reports.
9. Review the principal risks of the Company and ensure that an effective risk management strategy is in place.
10. Review the Company's derivatives policies and activities, including details of exposures to banks and other counterparties.

#### **External Auditor**

11. Review and recommend to the Board the appointment of the Auditor to be nominated for the purposes of preparing or issuing an Auditor's report and performing other audit, review or attest services for the Company.
12. Establish the mandate of the Auditor, including the annual engagement, audit plan, audit scope and compensation for the audit services, subject to shareholder approval.
13. Oversee the activities of the Auditor. The Auditor shall report directly to the Audit Committee.
14. Directly communicate and meet with the Auditor, with and without Management present, to discuss the results of their examinations.
15. Review the independence of the Auditor, any rotation of the partners assigned to the audit in accordance with applicable laws and professional standards, the internal quality control findings of the Auditor's firm and peer reviews.
16. Review the performance of the Auditor, including the relationship between the Auditor and Management and the evaluation of the lead partner of the Auditor.
17. Resolve disagreements between Management and the Auditor regarding financial reporting.
18. Review material written communications between the Auditor and Management.

**Non-Audit Services**

19. Pre-approve non-audit services. The Audit Committee may delegate to one or more of its members the authority to pre-approve non-audit services. The pre-approval of non-audit services by any member to whom authority has been delegated shall be presented to the Committee at its first scheduled meeting following such pre-approval.

**Company Policies**

20. Satisfy itself that adequate procedures are in place for the review of the public disclosure of financial information extracted or derived from the Company's financial statements and periodically assess the adequacy of those procedures.
21. Establish and periodically review the policies and procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submissions by the employees of the Company regarding questionable accounting or auditing matters.
22. Review and approve the Company's hiring policies regarding partners, employees and former partners and employees of the former and present Auditor.

**Insurance**

23. Review the Company's insurance programs, including the Company's directors' and officers' insurance coverage, and make recommendations for their renewal or replacement.

**AUTHORITY**

1. The Audit Committee is authorized to engage any outside advisor it deems necessary to carry out its duties and responsibilities and to arrange payment of the advisor's compensation by the Company.
2. The Audit Committee may, at the request of the Board or at its own initiative, investigate such other matters as it considers appropriate in furtherance of the Audit Committee's purpose.

## GLOSSARY

**"Adjusted EBITDA"** EBITDA less U.S. duty refunds, net and other income.

**"Allowable Annual Cut (AAC)"** The average annual volume of timber which the holder of a licence from the Province of British Columbia may harvest on Crown land under the licence in a five-year control period.

**"Bone Dry Unit (BDU)"** A unit of measurement for wood chips and other sawmill by-products, being equal to 2,400 pounds.

**"Cash flow from operations"** Cash generated from operations before considering changes in operating working capital.

**"Custom cutting"** An arrangement under which a mill contracts to cut logs owned by a customer into products of specifications defined by the customer.

**"EBITDA"** Earnings before interest, income taxes, depletion, amortization, restructuring costs, other foreign exchange gains and losses, and write-downs of property, plant, equipment and timber.

**"Forest Licence"** Replaceable, volume-based timber cutting rights for a specific volume of Crown timber within a Timber Supply area.

**"Invested Capital"** The total of bank indebtedness, short term advances from the Seaboard partnership, long-term debt and shareholders' equity.

**"Invested Capital, adjusted"** Invested Capital less cash, deposits and short term advances from the Seaboard partnership.

**"m<sup>3</sup>"** A measure of one cubic metre of solid wood, British Columbia metric scale, as determined under the Forest Act, equal to 35.3 cubic feet of solid wood.

**"Mfbm" or "Mbf"** One thousand foot board measure equal to one thousand square feet of lumber, one inch thick.

**"Net debt"** Total Debt less cash, deposits and short term advances from the Seaboard partnership.

**"Pre-tax return on total assets"** Earnings (loss) before taxes, restructuring costs, other foreign exchange gains and losses, and write-downs of property, plant, equipment and timber, U.S. duty refunds, net and Other income divided by closing total assets.

**"Return on average Invested Capital, adjusted"** Net earnings (loss) plus after tax interest cost (excluding interest income on U.S. duty refund, net of special charge) divided by the average of opening and closing Invested Capital, adjusted.

**"Return on average shareholders' equity"** Net earnings (loss) divided by the average of opening and closing shareholders' equity.

**"Silviculture"** The art and science of controlling the establishment, growth, composition, health and quality of forests.

**"Stumpage"** A charge assessed by the provincial government on all Crown timber harvested.

**"Sustained yield (sustainable log supply)"** The yield that a forest area can produce on an ongoing basis without impairment of the long-term productivity of the land.

**"Timber Licence"** Non-replaceable, area based, Crown timber cutting rights.

**"Total Debt"** The total of bank indebtedness, short-term advances from the Seaboard partnership, long-term debt.

**"Tree Farm Licence"** A renewable 25-year licence to manage a forest area to yield an annual harvest on a sustainable basis.

**"Value-added product"** A commodity or other product that has been further processed to increase financial value.

**"Volumetric unit"** A unit of measurement for wood chips and other sawmill by-products, being equal to 200 cubic feet. A volumetric unit represents between 60% and 85% of the chips in a Bone Dry Unit, depending on the species.

**"Whitewood"** Includes the Coastal species Hemlock, Balsam Fir, Douglas Fir and Spruce; the term whitewood is used on British Columbia Coast to differentiate the above species from Red Cedar and Yellow Cedar.

**DIRECTORS**

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**Lead Director****L.I. Bell**

Vernon, BC

**D.K. Davies**

Vancouver, BC

**H.C. Kalke**

West Vancouver, BC

**P.M. Lynch**

Toronto, ON

**G.H. MacDougall**

West Vancouver, BC

**J.E. McMillan**

Perdido Key, Florida

**Chairman of the Board****E.L. Sauder**

Vancouver, BC

**J.P. Sullivan**

Vancouver, BC

**D.W.G. Whitehead**

North Vancouver, BC

**OFFICERS**

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**E.L. Sauder**

Chairman

**S.M. Fulton**Senior Vice President and  
Chief Operating Officer**R.J. Slaco**

Vice President and Chief Forester

**D.K. Davies**

President and Chief Executive Officer

**S.D.A. Williams**Vice President and  
Corporate Treasurer**J.A. Horning**Senior Vice President, Chief Financial  
Officer and Corporate Secretary**O.F. Schulte**

Vice President, Coastal Woodlands

**MANUFACTURING OPERATIONS**

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**Acorn**604-581-0494  
9355 Alaska Way  
Delta, BC V4C 4R7**Adams Lake**250-679-3234  
9200 Holding Road, R.R.2  
Chase, BC V0E 1M0**Beaver**360-327-3377  
200673 Highway 101  
Beaver, WA 98305**Castlegar**250-365-4400  
2705 Arrow Lakes Drive  
Castlegar, BC V1N 4G4**Forks**360-374-4347  
143 Sitkum Solduc Road  
PO Box 2299  
Forks, WA 98331**Gilchrist**541-433-2222  
#1 Sawmill Road  
Gilchrist, OR 97737**Grand Forks**250-443-2400  
570 68<sup>th</sup> Ave.  
PO Box 39  
Grand Forks, BC V0H 1H0**Hammond Cedar**604-465-5401  
20580 Maple Crescent  
Maple Ridge, BC V2X 1B1**Molalla**503-829-9131  
15555 South Highway 211  
Molalla, OR 97038**Port Angeles**360-457-6266  
243701 Hwy 101 W.  
Port Angeles, WA 98363**CORPORATE INFORMATION**

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**Head Office**604-689-6800  
P.O. Box 49114, Bentall Four  
3500 – 1055 Dunsmuir St.  
Vancouver, BC V7X 1H7**Sales and Marketing****North American Dimension  
Products**  
360-788-2200  
Bellingham, WA**Coastal Woodlands**250-286-5000  
1250-A Ironwood Street  
Campbell River, BC V9W 6H5  
Campbell River 250-286-1881  
Sechelt 604-740-8220**Interfor Pacific Inc.**360-788-2299  
2211 Rimland Drive, Suite 220  
Bellingham, WA 98226**Export Whitewood Group**Delta, BC 604-587-4552  
Tokyo, Japan 011-81-3-5641-2351**Interior Woodlands**Nakusp, BC 250-265-3741  
Grand Forks, BC 250-443-2400  
Adams Lake, BC 250-679-3234**Reman Operations**

CEDARPRIME Inc. 360-988-2120

**Cedar Group**

Maple Ridge, BC 604-465-5401

**Auditors**

KPMG LLP, Vancouver, BC

**Stock Exchange**Class "A" shares listed on  
The Toronto Stock Exchange  
Symbol: IFP.A**Log Marketing**604-422-3452  
600 2700 Production Way,  
Burnaby, BC**Transfer Agent**Computershare Investor Services Inc.  
Vancouver, BC and Toronto, ON

