



## International Forest Products Limited

Vancouver, B.C.

August 2, 2012

### **Higher Volumes and Prices Boost Interfor's Q2 Results EBITDA Increases to \$16.5 Million; Grand Forks Project Ahead of Schedule; Project Scope Expanded**

**INTERNATIONAL FOREST PRODUCTS LIMITED** ("Interfor" or the "Company") (TSX: IFP.A) reported net earnings of \$0.3 million or \$0.01 per share in the second quarter of 2012.

Excluding restructuring costs and other one-time items, the Company's net earnings in the second quarter were \$0.9 million or \$0.02 per share compared with a net loss of \$5.2 million or \$0.09 per share in the first quarter of 2012 and a net loss of \$3.2 million or \$0.06 per share in the second quarter of 2011.

Key factors impacting the Company's results in the current quarter were higher lumber sales volumes and prices which increased 13% and 7% respectively versus the immediately preceding quarter.

EBITDA for the quarter (adjusted to exclude one-time items and other income) was \$16.5 million, up \$10.7 million versus the first quarter of 2012 and \$5.2 million higher than the same quarter last year.

Lumber production in the quarter was 333 million board feet, up 10 million board feet or 3 percent compared to the immediately preceding quarter. Sales volume, including wholesale activities, was 363 million board feet, compared with 320 million board feet in the first quarter.

Capacity utilization in the second quarter was 80%, up from 78% in the first quarter, in spite of a week curtailment at Adams Lake to facilitate repairs to one of that mill's kilns.

In the quarter, SPF 2x4 in the U.S. market averaged US\$295 per mfbm, up US\$29 per mfbm versus the first quarter, and Hem-Fir studs were \$US337 per mfbm, up US\$43 per mfbm. MSR was particularly strong with prices of SPF 1650f up US\$58 per mfbm in the quarter. Activity levels in China remained firm in the second quarter although prices lagged those in North America. In Japan, prices for traditional products were impacted by changes in currency rates with green hemlock squares off US\$18 per mfbm quarter-over-quarter while J Grade dimension was flat. Cedar prices were up 2-3% in the quarter.

Export taxes on shipments to the U.S. fell to 10% in June in response to higher lumber prices resulting in a tax saving of approximately \$0.4 million or \$0.01 per share in the quarter.

In the quarter, Interfor generated \$12.0 million in cash from operations after changes in working capital were considered. Capital spending amounted to \$14.4 million, including \$6.2 million on the Grand Forks and Castlegar upgrades that are now underway.

Net debt closed the quarter at \$119.4 million or 24 percent of invested capital.

The near-term outlook for recovery in the U.S. housing sector remains uncertain and concerns over sustainability continue. Export taxes have declined to 5% for July but will increase to 10% in August due to recent decreases in the relevant market benchmark. Canadian housing starts are expected to slow slightly over the balance of 2012.

Compared to recent years, the economic outlook for China has softened as the Chinese government scales back economic growth targets and real estate markets weaken under government restrictions designed to stabilize housing prices.

Activity levels in Japan should improve as the year progresses as reconstruction in the areas impacted by the March 2011 earthquake and tsunami gains momentum.

The Canadian dollar is projected to trade near parity relative to its U.S. counterpart through 2012.

Considerable attention continues to be devoted to the capital projects at Grand Forks and Castlegar with timelines on track for completion in the first quarter, 2013. The Company recently introduced a number of scope changes to the Grand Forks project including plans to upgrade the mill's log and lumber storage yards that had originally been planned for the third and fourth quarter, 2013 and for 2014. The additional capital authorized totals \$8.9 million and will be funded from internally-generated cash flow and, if necessary, from the Company's credit lines.

As always, Interfor will maintain a disciplined approach to managing its business by focusing on items that will position the Company to deliver above average returns on capital invested in the years ahead.

### **FORWARD-LOOKING STATEMENTS**

This release contains information and statements that are forward-looking in nature, including, but not limited to, statements containing the words "will" and "is expected" and similar expressions. Such 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 Annual Report and Management Information Circular 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.

### **ABOUT INTERFOR**

Interfor is a leading global supplier, with one of the most diverse lines of lumber products in the world. The Company has operations in British Columbia, Washington and Oregon, including two sawmills in the Coastal region of British Columbia, three in the B.C. Interior, two in Washington and two in Oregon. For more information about Interfor, visit our website at [www.interfor.com](http://www.interfor.com).

There will be a conference call on Friday, August 3 2012 at 8:00 AM (Pacific Time) hosted by **INTERNATIONAL FOREST PRODUCTS LIMITED** for the purpose of reviewing the Company's release of its Second Quarter, 2012 Financial Results.

The dial-in number is **1-866-323-8540**. The conference call will also be recorded for those unable to join in for the live discussion, and will be available until August 17, 2012. The number to call is **1-866-245-6755**  
**Passcode 621635**.

For further information:

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# International Forest Products Limited

## Second Quarter Report

### For the three and six months ended June 30, 2012

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## Management's Discussion and Analysis

Dated as of August 2, 2012

This Management's Discussion and Analysis ("MD&A") provides a review of Interfor's financial performance for the three and six months ended June 30, 2012 relative to 2011, the Company's financial condition and future prospects. The MD&A should be read in conjunction with the interim Condensed Consolidated Financial Statements for the three and six months ended June 30, 2012 and 2011, and Interfor's Annual Information Form, Consolidated Financial Statements and Annual MD&A for the years ended December 31, 2011 and 2010 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 IAS 34 *Interim Financial Reporting* and International Financial Reporting Standards ("IFRS") except as noted herein. In this MD&A, reference is made to EBITDA and Adjusted EBITDA. EBITDA represents earnings before finance costs, taxes, depreciation, depletion, amortization, restructuring costs, other foreign exchange gains and losses, and write-downs of property, plant, equipment ("asset write-downs"). Adjusted EBITDA represents EBITDA adjusted for other income (expense) and other income of an associate company. The Company discloses EBITDA as it is a measure used by analysts and Interfor's management to evaluate the Company's performance. As EBITDA is not a defined term under IFRS, 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 Statements

This report contains forward-looking statements. Forward-looking statements are statements that address or discuss activities, events or developments that the Company expects or anticipates may occur in the future. Forward-looking statements are included in the description of areas which are likely to be impacted by the description of future cash flows and liquidity under the headings "Overview", "Income Taxes" and "Cash Flow and Financial Position"; changes in accounting policy under the heading "Accounting Policy Changes"; in the description of economic conditions under the headings "Sales" and "Outlook"; and in the description of risks and uncertainties under the headings "Softwood Lumber Agreement Disputes" and "WorkSafeBC Orders Safety Reviews". These forward-looking statements reflect management's current expectations and beliefs and are based on certain assumptions including assumptions as to general business and economic conditions in the U.S. and Canada, as well as other factors management believes are appropriate in the circumstances including, among others: product selling prices, raw material and operating costs, changes in foreign currency exchange rates, and other factors referenced herein. Such forward-looking statements are subject to risks and uncertainties and no assurance can be given that any of the events anticipated by such statements will occur or, if they do occur, what benefit the Company will derive from them. A number of factors could cause actual results, performance or developments to differ materially from those expressed or implied by such forward-looking statements, including those matters described herein and in Interfor's current Annual Information Form available on [www.sedar.com](http://www.sedar.com). Accordingly, readers should exercise caution in relying upon forward-looking statements and the Company undertakes no obligation to publicly revise them to reflect subsequent events or circumstance, except as required by law.

### Review of Operating Results

#### Overview

Interfor recorded net earnings of \$0.3 million, or \$0.01 per share for the second quarter of 2012 as compared to a net loss of \$5.3 million, or \$0.10 per share for the second quarter of 2011. For the first six months, 2012, the Company recorded a net loss of \$6.2 million, or \$0.11 per share as compared to a net loss of \$7.0 million, or \$0.14 per share for the first six months, 2011.

EBITDA and Adjusted EBITDA for the second quarter of 2012 were \$16.5 million, compared to \$11.3 million for the second quarter, 2011. EBITDA and Adjusted EBITDA for the first half of 2012 were \$22.5 million and \$22.3 million, respectively, compared to \$22.9 million and \$22.9 million for the same period in 2011.

For the second quarter, 2012 the Company's net earnings before restructuring costs, certain foreign exchange gains

(losses), certain other one-time items and the effect of unrecognized tax assets was \$0.9 million, or \$0.02 per share as compared to a net loss of \$3.2 million, or \$0.06 per share for the second quarter of 2011. The Company recorded share-based incentive compensation expense of 0.2 million, or \$0.00 per share in the second quarter, 2012 as compared to a recovery of \$3.1 million, or \$0.06 per share for the same period, 2011.

For the first six months, 2012 the Company's net loss before restructuring costs, certain foreign exchange gains (losses), certain other one-time items and the effect of unrecognized tax assets was \$4.4 million, or \$0.08 per share as compared to a net loss of \$4.8 million, or \$0.09 per share for the first half, 2011. The Company recorded share-based incentive compensation expense of \$1.5 million, or \$0.03 per share for the first six months, 2012 as compared to \$0.5 million, or \$0.01 per share for the same period, 2011.

The first quarter of 2012 saw modest increases in domestic demand partially as a result of milder weather across North America. Industry-wide, domestic lumber supply was impacted by North American mills destroyed by fire and by several large competitor mills being exclusively dedicated to export market production late in the quarter. In the second quarter, 2012 a mill in northern B.C. was destroyed by fire, further reducing supply. The reduced supply has been a key factor in the price improvements as production levels have fallen short of end-use demand, particularly with an increase of 26% in seasonally adjusted U.S. housing starts, on average for the first half, 2012 as compared to the same period, 2011. As a result, prices reported by Random Lengths for Western SPF 2x4 #2&Btr in June 2012 averaged US\$298 per mfbm, up by US\$50 per mfbm over December, 2011 average prices and US\$63 per mfbm over June, 2011 average prices.

As a result of the lift in commodity lumber prices in the second quarter, 2012, the export tax paid under the Softwood Lumber Agreement ("SLA") declined from 15% to 10% on June 1, 2012, only the fourth time since the SLA was signed in 2006 that it has been less than 15%. The tax rate declined even further from 10% to 5% on July 1, 2012, but will rise to 10% on August 1, 2012.

Slowing Chinese demand through the second half of 2011 firmed in the first quarter, 2012, as Chinese distributors reduced the backlog of lumber inventories that existed in the fourth quarter, 2011. Towards the end of the first quarter, 2012, Chinese lumber demand and prices began to show moderate improvement but the construction market remains sluggish, impacted by current government fiscal policies.

Log inventories in China were relatively high through most of the first quarter, 2012, resulting in a decline in log export sales from the Company's B.C. Coastal logging operations, but also providing less competition for log purchases in the U.S. Pacific Northwest. Log inventories in China have decreased, but local sawmills are operating at reduced rates reflecting the slowdown in material required for concrete forming.

Lumber markets in Japan experienced downward pressure on selling prices as Japanese purchasers looked to mitigate the impacts of a depreciating yen against North American currencies.

The mild winter across much of the U.S. resulted in stronger than expected demand in the cedar markets in the first quarter, 2012 and continued growth in home improvement sector in the second quarter, 2012 generated higher sales realizations. Log availability has been tight, limiting the cedar lumber supply and enabling some price increases.

Results quarter-over-quarter have also been impacted by a weakened Canadian dollar which, relative to its U.S. counterpart depreciated by four percent on average for the second quarter, 2012 and by three percent on average for the first half, 2012, as compared to the same periods of 2011.

### Sales

The Company recorded its highest quarterly sales revenue since the third quarter, 2004.

Lumber shipments improved by 28 million board feet to 363 million board feet for the second quarter, 2012, up 9% over the same quarter, 2011 and by 35 million board feet to 682 million board feet for the first half, 2012, up 5% over the first half, 2011. Reduced North American supply in the first half, 2012 combined with stronger U.S. housing starts created a supply-demand imbalance with a resultant lift in lumber shipments and prices. Compared to the same periods in 2011, lumber shipments to the U.S. markets increased 42% for the second quarter, 2012, and 29% for the first half, 2012.

Average unit lumber sales values improved in the second quarter, 2012, climbing \$47 per mfbm, or 12% and \$24 per mfbm, or 6% year-to-date, over the respective periods of 2011. A weaker average Canadian dollar quarter-over-quarter and for the first half of 2012 had a positive impact on sales returns as compared to the same periods of 2011.

Compared to the same period, 2011, log sales improved by 24% or \$7.0 million and by 26% or \$13.1 million for the second quarter and first half, 2012 respectively. The majority of log sales originate in Interfor's Canadian operations, which showed a volume increase of 21% for the second quarter, 2012, and 20% for the first half, 2012 compared to 2011.

Average B.C. Coastal log sales prices declined 5% to \$79 per cubic metre in the second quarter, 2012 and by 9% to

\$75 per cubic metre year-to-date vis-à-vis the same periods in 2011. Compared to the same periods in 2011, overall Canadian log sales prices decreased by 8% to \$75 per cubic metre for the second quarter, 2012 and by 3% to \$70 per cubic metre for the first half, 2012 partially as a result of a shift in sales mix to smaller, lower value logs sold in the B.C. Interior.

Increased timber sales activity in the U.S., targeted specifically for domestic and export log markets, also contributed to the overall improvement in sales for the first half of 2012, as both volume and per unit sales realizations improved over 2011.

Pulp chip and other by-product revenues improved by 6% or \$1.1 million for the second quarter of 2012 and \$2.8 million or 9% for the first half, 2012, compared to the respective periods in 2011, largely driven by higher operating rates on the B.C. Coast and Interior, marginally offset by reduced volume from the U.S. Pacific Northwest sawmills. Declines in U.S. pulp prices in late 2011 did not impact chip prices until the second quarter, 2012 when sales contracts negotiated when pulp markets were stronger came up for renewal. U.S. chip prices in the U.S. Pacific Northwest were also affected by the decreases in logs destined for export markets which increased the availability of fibre used in whole log chipping.

#### Operating Costs

Production costs for the second quarter of 2012 increased \$28.2 million, or 16%, and \$43.8 million, or 13%, for the first half of 2012, compared to the same periods in 2011.

Lumber production increased by 7.6 million board feet, or 2% in the second quarter, 2012 vis-à-vis the same period, 2011 and was marginally lower by 1.6 million board feet for the first half, 2012 compared to the first half, 2011. Modest production gains in B.C. operations, particularly on the B.C. Coast, were driven by improved log availability compared to the first half of 2011 when storm damage in late 2010 negatively impacted logging activity. Reduced operating hours in the U.S. Pacific Northwest sawmills for the second quarter and first six months, 2012 compared to the same periods in 2011, offset production gains on the B.C. Coast. Availability of economic fibre supply challenged the Olympic Peninsula sawmills but supply and pricing improved in the second quarter, 2012.

Unit cash conversion costs for the second quarter and first half, 2012 were stable as compared to the same periods of 2011.

Unit costs of logs consumed increased 14% quarter-over-quarter and 9% year-over-year for 2012 as compared to the same periods, 2011 resulting from a number of factors including difficult weather conditions in the B.C. Interior; an increase in heli-logging activity on the B.C. Coast; higher log prices in parts of the Pacific Northwest and a weaker Canadian dollar.

Compared to the same period in 2011, B.C. log production grew by 6% to 840,000 cubic metres from 796,000 cubic metres in the second quarter, 2012 and by 7% to 1.7 million cubic metres from 1.6 million cubic metres for the first half, 2012. Difficult harvesting conditions due to harsh weather on the B.C. Coast in the spring, 2012 contributed to declines in log production of 9% in the second quarter, 2012 and 5% for the first six months, 2012 as compared to the same periods in 2011 when the Company sought to take advantage of strong export markets and to catch up on lost production due to storm related reductions in late 2010. These reductions were offset by a 25% increase in logging activity in the B.C. Interior for the first half, 2012 and 63% for the second quarter, 2012 vis-à-vis the same periods, 2011 as extended cold weather prior to spring break up enabled greater activity.

In the first quarter, 2012, the Company commenced demolition of the remaining structures of the former Adams Lake sawmill site not previously addressed during the rebuild of the mill completed in 2009. In addition, in the second quarter, 2012, the Company engaged an environmental consultant to undertake groundwater and other testing at a landfill at its Castlegar sawmill site in the B.C. Interior to update its assessment of potential remediation costs. Based on the results of the testing the Company reduced its estimate of the environmental provision recorded on acquisition of the site from Pope and Talbot, Inc. in 2008. The resultant net impact on production costs was a recovery of \$0.4 million for the second quarter, 2012 and \$0.1 million for the first half, 2012.

The Company finalized an insurance claim in the first half, 2011, as compensation for lost profits and reimbursement of costs resulting from storm damage on the B.C. Coast which occurred in the late fall, 2010. The Company recorded insurance proceeds of \$0.5 million in the second quarter, 2011 and \$2.7 million for the first half, 2011 which were netted against production costs.

Higher commodity lumber prices in the second quarter, 2012 drove export tax rates from 15% to 10% on June 1, 2012. Export taxes for the second quarter, 2012 increased by \$0.7 million, or 43% over the same quarter, 2011, in keeping with a 43% increase in Canadian shipment volumes to the U.S. For the first half, 2012, export taxes increased \$0.9 million, or 22% as compared to the same period, 2011, in line with a 20% increase in Canadian shipment volumes to the U.S.

Relative to the same periods in 2011, selling and administrative costs increased by \$0.1 million and \$0.4 million for the

second quarter and first half, 2012 respectively. Increases in selling and export market administration in the latter half of 2011 contributed to the increases.

Long-term incentive compensation ("LTIC") expense of \$0.2 million for the second quarter, 2012 (Quarter 2, 2011 – recovery of \$3.1 million), and an expense of \$1.5 million for the first half, 2012 (first half, 2011 - \$0.5 million expense) reflect changes in the estimated fair value of the share-based compensation plans. Fair value is estimated based on a number of components including current market price of the underlying shares, strike price, expected volatility, vesting periods and the expected life of the awards. The movement in the Company's share price has the greatest impact on expense.

Second quarter and first half, 2012 depreciation of plant and equipment was 4% higher and 1% lower respectively, over the corresponding periods in 2011. The increase in the second quarter, 2012 was largely driven by increased operating rates in the B.C. sawmills, while accelerated depreciation on a number of assets with shortened useful lives in early 2011 contributed to the overall decrease year-over-year.

Road amortization and depletion expense decreased \$0.3 million and \$0.2 million for the second quarter and first half, 2012 as compared to the same periods in 2011. This corresponds to reduced logging activity on the B.C. Coast combined with a shift from conventional logging to heli-logging.

Second quarter and year-to-date, 2012 restructuring costs of \$0.1 million arose on cancellation of a cutting permit offset by the related impairment of road infrastructure and severance costs for early retirement of hourly workers. Restructuring costs in the comparative periods, 2011 of \$0.2 million in the second quarter and \$1.0 million for the first half, comprised primarily of payments in relation to the buyout of logging contractor's Bill 13 entitlements and severance costs for early retirement of hourly workers.

#### Finance Costs, Other Foreign Exchange Gain (loss), Other Income (Expense)

Finance costs decreased by \$0.2 million for the second quarter and \$1.0 million for the first half, compared to the same periods, 2011, resulting from an overall decrease in average debt levels compared to the same period in the prior year. Debt was reduced in the second quarter, 2011 when net proceeds of \$54.9 million received from a public offering of Class A Subordinate Voting shares on April 8, 2011 were used to repay drawings.

In 2012, the Company changed its accounting policy to recognize realized trading gains and losses and changes in fair value of its derivative forward foreign exchange contracts in Other foreign exchange gain (loss). Previously these gains and losses were recognized as an adjustment to Sales. The policy was adopted in order to better align the Company's presentation on the Statement of Earnings with those adopted by Interfor's peer group. The policy was adopted on a retrospective basis, and had no effect on Net earnings or the Statement of Financial Position for any of the periods presented.

Other foreign exchange loss at \$0.5 million for the second quarter and \$0.1 million for the first half, 2012 compared to gains of \$0.2 million and \$1.3 million for the respective periods, 2011 is impacted by the volatility of the Canadian dollar and the timing and amount of derivative forward foreign exchange contracts.

Other income for the second quarter and first half of 2012 and 2011 was negligible, consisting of sales of minor surplus equipment and scrap.

#### Income Taxes

In the second quarter of 2012, the Company recorded an income tax expense of \$0.3 million (Quarter 2, 2011 - \$1.2 million) which excludes the benefit of \$0.0 million of certain deferred income tax assets arising from loss carry-forwards available to reduce future taxable income which were not recognized (Quarter 2, 2011 - \$2.2 million). For the first six months, 2012, the income tax expense of \$0.4 million excluded the benefit of \$1.8 million of deferred tax assets (first half, 2011 - \$2.5 million). Although the Company expects to realize the full benefit of the loss carry-forwards and other deferred tax assets, due to the cyclical nature of the wood products industry and the economic conditions over the last several years, the Company has not recognized the benefit of its deferred tax assets in excess of its deferred tax liabilities.

#### Cash Flow and Financial Position

The Company generated \$22.3 million from operations, before changes in working capital during the first half, 2012 as compared to \$24.5 million for the first half, 2011.

Year-over-year, cash flows declined slightly as higher costs offset the rise in North American sales values and improved domestic demand in the first half, 2012; in the same period, 2011, higher export sales volumes partially offset by lower overall sales realizations drove cash earnings.

Cash generated by the Company from operations, after changes in working capital, was \$8.7 million for the six months ended June 30, 2012 compared to \$15.5 million in the first half, 2011.

Improvements in overall sales volumes, North American sales values and the shift away from export markets were reflected in a cash utilization of \$14.8 million for accounts receivable partially offset by a \$4.8 million increase in accounts payable in the first half, 2012. Cash of \$3.6 million utilized for prepayments reflected increased deposits made in the U.S. operations to secure timber rights.

In the first half, 2011, significant increases in lumber production to meet export demand as well as weather-related and other logistical issues causing shipping delays resulted in an inventory build-up of \$11.1 million. The increase in accounts receivable of \$8.9 million, offset by a \$10.9 million rise in accounts payable was the result of the higher operating rates and export shipments in the first half, 2011.

Cash capital expenditures for the first half of 2012 totalled \$25.3 million (first half, 2011 - \$19.6 million) with \$8.6 million spent on the capital upgrades for the Grand Forks and Castlegar mills, \$1.5 million on other high-return discretionary projects, \$4.8 million on business maintenance expenditures and \$10.4 million on road construction. These expenditures were funded by net drawings of \$20.0 million on the Company's Revolving Term Line during the first half, 2012.

On January 3, 2011 the Seaboard General Partnership ("SGP") declared an income distribution to its partners. Interfor's share was \$15.7 million and was settled with the Company by way of setoff against the promissory note payable to the SGP. On January 5, 2011 by virtue of the withdrawal of all other partners in SGP, Interfor acquired control of its net assets. Cash generated from investments includes cash received on acquisition of SGP of \$4.8 million.

In the second quarter, 2011 the Company also settled an insurance claim in respect of severe storm damage to logging roads and bridges in the fall, 2010. Net cash proceeds of \$4.8 million were received in June 2011.

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

As at June 30, 2012, the Revolving Term Line was drawn by US\$30.2 million (revalued at the quarter-end exchange rate to \$30.7 million) and \$100.0 million for total drawings of \$130.7 million, leaving an unused available line of \$69.3 million. The Company's Operating Line of \$65.0 million had no borrowings other than outstanding letters of credit of \$5.3 million, leaving an unused available line of \$59.7 million. Including cash of \$11.3 million, the Company had available resources of \$140.3 million as at June 30, 2012.

These resources, together with cash generated from operations, will be used to support Interfor's working capital requirements, capital expenditures including the Kootenay optimization projects, and debt servicing commitments.

Interfor continues to monitor discretionary capital expenditures. Based on current pricing and cash flow projections and existing credit lines the Company believes it has sufficient liquidity to meet all of its financial obligations.

At June 30, 2012, the Company had cash of \$11.3 million. After deducting the Company's drawings under its Revolving Term Line, the Company ended the first half, 2012, with net debt of \$119.4 million or 24% of invested capital as compared to 19% as at June 30, 2011, primarily as a result of the sawmill rebuild at Grand Forks.

## Selected Quarterly Financial Information<sup>1</sup>

Quarterly Earnings Summary	2012		2011			2010		
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
	(millions of dollars except share and per share amounts)							
Sales – Lumber <sup>2</sup>	162.4	133.6	133.6	139.6	133.7	131.4	136.3	112.2
– Logs	35.6	27.0	22.9	36.0	28.6	20.8	20.6	21.9
– Wood chips and other residual products	17.8	18.2	17.5	17.6	16.8	16.4	15.7	14.0
– Other	9.6	7.9	14.6	9.9	8.7	10.0	2.4	2.4
Total Sales	225.4	186.7	188.7	203.1	187.9	178.6	175.0	150.6
Operating earnings (loss) before restructuring costs <sup>2</sup>	2.9	(5.5)	(6.2)	3.9	(2.3)	(0.1)	0.3	(3.0)
Operating earnings (loss) <sup>2</sup>	2.8	(5.5)	(6.1)	4.2	(2.4)	(1.0)	0.3	(3.4)
Net earnings (loss)	0.3	(6.5)	(6.5)	0.0	(5.3)	(1.7)	0.8	1.4
Net earnings (loss) per share – basic and diluted	0.01	(0.12)	(0.12)	0.00	(0.10)	(0.04)	0.02	0.03
Net earnings (loss), adjusted for certain one-time and other items <sup>2,4,6</sup>	0.9	(5.2)	(3.7)	2.4	(3.2)	(1.7)	(0.8)	(2.0)
Net earnings (loss), adjusted for certain one-time and other items – per share <sup>2,4</sup>	0.02	(0.09)	(0.07)	0.04	(0.06)	(0.03)	(0.02)	(0.04)
EBITDA <sup>7</sup>	16.5	6.0	6.7	17.6	11.3	11.6	13.3	14.4
Adjusted EBITDA <sup>7</sup>	16.5	5.8	6.7	17.3	11.3	11.6	13.2	9.7
Cash flow from operations per share <sup>5</sup>	0.24	0.15	0.08	0.26	0.22	0.27	0.22	0.18
Shares outstanding – end of period (millions) <sup>3</sup>	55.9	55.9	55.9	55.9	55.9	47.5	47.4	47.1
– weighted average (millions)	55.9	55.9	55.9	55.9	55.2	47.4	47.2	47.1
Average foreign exchange rate per US\$1.00	1.0104	1.0010	1.0230	0.9808	0.9680	0.9856	1.0131	1.0395
Closing foreign exchange rate per US\$1.00	1.0181	0.9975	1.0170	1.0482	0.9645	0.9696	0.9946	1.0290

1 Tables may not add due to rounding.

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

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

3 As at August 2, 2012, the numbers of shares outstanding by class are: Class A Subordinate Voting shares – 54,847,176, Class B Common shares – 1,015,779, Total – 55,862,955.

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

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

6 Net earnings (loss), adjusted for certain one-time and other items is not a defined term under IFRS, and may not be comparable to adjusted earnings (loss) calculated by others. Net earnings (loss), adjusted for certain one-time and other items may be calculated as follows<sup>3</sup>:

	2012		2011			2010		
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
	(millions of dollars)							
Net earnings (loss)	0.3	(6.5)	(6.5)	0.0	(5.3)	(1.7)	0.8	1.4
Add (deduct):								
Other (income) expense	(0.0)	(0.1)	-	(0.4)	(0.0)	-	0.3	0.1
Other (income) expense of associate company	-	-	-	-	-	-	(0.4)	(4.8)
Other foreign exchange (gains) losses	0.5	(0.4)	(1.1)	2.5	(0.2)	(1.1)	(1.1)	(0.8)
Restructuring costs (recovery)	0.1	-	(0.1)	(0.3)	0.1	0.8	-	0.5
Deferred tax assets not recognized (recognized)	0.0	1.8	3.9	0.6	2.2	0.3	(0.3)	1.6
Net earnings (loss) adjusted for certain one-time and other items <sup>3</sup>	0.9	(5.2)	(3.7)	2.4	(3.2)	(1.7)	(0.8)	(2.0)

7 EBITDA represents earnings before finance costs, taxes, depreciation, depletion, amortization, restructuring costs, other foreign exchange gains and losses, and asset write-downs. 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 not a defined term under IFRS, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance. Adjusted EBITDA represents EBITDA adjusted for other income and other income of the associate company.

EBITDA and Adjusted EBITDA may be calculated from the Statements of Operations as follows<sup>3</sup>:

	2012			2011			2010	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
	(millions of dollars)							
Net earnings (loss)	0.3	(6.5)	(6.5)	0.0	(5.3)	(1.7)	0.8	1.4
Add: Income taxes (recovery)	0.3	-	0.2	0.5	1.2	(0.4)	(0.5)	(0.2)
Finance costs	1.7	1.5	1.3	1.7	1.9	2.3	2.5	2.6
Depreciation, depletion and amortization	13.6	11.3	13.0	13.3	13.6	11.7	11.7	11.0
Other foreign exchange (gains) losses	0.5	(0.4)	(1.1)	2.5	(0.2)	(1.1)	(1.1)	(0.8)
Restructuring costs (recovery)	0.1	-	(0.1)	(0.3)	0.1	0.8	-	0.5
EBITDA	16.5	6.0	6.7	17.6	11.3	11.6	13.3	14.4
Deduct:								
Other income (expense)	(0.0)	0.1	-	0.4	-	-	(0.3)	(0.1)
Other income of associate company	-	-	-	-	-	-	0.4	4.8
Adjusted EBITDA <sup>3</sup>	16.5	5.8	6.7	17.3	11.3	11.6	13.2	9.7

### Volume and Price Statistics

		2012			2011			2010	
		Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Lumber sales	(million fbm)	363	320	318	336	334	313	321	277
Lumber production	(million fbm)	333	323	294	313	325	332	303	272
Log sales <sup>1</sup>	(thousand cubic metres)	379	361	310	430	314	301	292	289
Log production <sup>1</sup>	(thousand cubic metres)	840	892	795	1,002	796	816	794	595
Average selling price – lumber <sup>2</sup>	(\$/thousand fbm)	\$448	\$418	\$420	\$415	\$400	\$419	\$424	\$405
Average selling price – logs <sup>1</sup>	(\$/cubic metre)	\$75	\$64	\$69	\$74	\$82	\$61	\$64	\$73
Average selling price – pulp chips	(\$/thousand fbm)	\$46	\$48	\$51	\$48	\$44	\$40	\$42	\$40

1 B.C. operations

2 Gross sales before export taxes

3 Tables may not add due to rounding

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

Operating rates increased in early 2010, as lumber prices rose in response to increased North American demand and a temporary supply/demand imbalance. During the same period off-shore demand increased, particularly from China, with rapid export market growth through the last half of 2010 and the first half, 2011, levelling off for the balance of 2011. Export markets slowed further in the first two quarters, 2012, but were more than offset by strong North American demand resulting in higher sales prices and a reduction in export tax rates in the second quarter, 2012.

The volatility of the Canadian dollar also impacted results, given that historically over 75% of the Canadian operations' lumber sales are to export markets and priced in U.S. dollars. A strong Canadian dollar reduces the lumber sales realizations in Canada, but reduces the impact of losses in U.S. operations when converted to Canadian dollars. No deferred tax assets arising from loss carry-forwards were recognized during 2010 through the first half of 2012.

In the first quarter, 2011 the Company acquired 100% control of SGP. It was wound up in early January, 2011 but continued operations as Seaboard and its accounts were consolidated from the date of change in control on January 5, 2011. Other sales revenues include the ocean freight revenues of Seaboard.

## **Softwood Lumber Agreement Disputes**

On January 18, 2011 the U.S. Trade Representative's ("USTR") office filed for arbitration under the provisions of the SLA over its concern that the Province of British Columbia ("B.C.") is charging too low a price for certain timber harvested on public lands in the B.C. Interior.

On July 18, 2012 the London Court of International Arbitration ("LCIA"), which has jurisdiction over disputes under the SLA, dismissed the U.S. claim in its entirety. The ruling of the LCIA is final and not subject to appeal.

In April, 2012 the U.S. Lumber Coalition approached the USTR alleging that the B.C. government is undercharging B.C. Coastal forest companies for timber harvested on Crown lands. As this second complaint is in the very preliminary stages of investigation and the existence of any potential claim has not been determined, no provision has been recorded in the financial statements as at June 30, 2012.

## **WorkSafeBC Orders Safety Reviews**

On April 24, 2012, as a result of the explosion and destruction of two sawmills in the B.C. Interior in 2012, WorkSafeBC, the workers' compensation insurer in B.C., ordered province-wide sawmill safety reviews, including full hazard identification and risk assessment with particular focus on combustible dust, dust accumulation and potential ignition sources. In May, 2012 WorkSafeBC officers conducted reviews to confirm that the ordered actions had been taken and sawmills were in compliance with the Workers Compensation Act and Occupational Health and Safety Regulation in regard to combustible dust and potential safety hazards. No deficiencies of any significance were identified in the WorkSafeBC reviews of the Company's Canadian sawmill sites.

In early 2012, the Company engaged a consultant to assist in the evaluation of safety standards at each of its sawmills and as at May 3, 2012 reviews were completed at the Canadian sawmill sites. The Company believes that it maintains high standards of safe work practices and provides a safe work environment.

## **Accounting Policy Changes**

The Company uses derivative forward foreign exchange contracts which are designated as held for trading and are carried on the Statement of Financial Position at fair value. Previously, changes in fair value were recorded as an adjustment to Sales in Net earnings. Effective January 1, 2012 the Company changed its accounting policy to align with the presentation adopted by companies in its peer group and changes in fair value are now recorded in Other foreign exchange gain (loss) in Net earnings. There is no effect on Net earnings or on the Statement of financial position.

The policy has been applied on a retrospective basis and comparative information has been restated.

### *IFRS Future Changes*

IFRS 9, Financial Instruments, replaces the multiple classification and measurement models in IAS 39, Financial Instruments: Recognition and Measurement, with a single model that has only two classification categories: amortized cost and fair value. This standard is in effect for accounting periods beginning on or after January 1, 2015, with earlier adoption permitted.

IAS 19, Employee Benefits, was revised to eliminate the option to defer recognition of gains and losses, known as the "corridor method", and to enhance disclosure requirements for defined benefit plans. As the Company did not choose the corridor method in accounting for its defined benefit plans, there is no impact on its financial statements as a result of the elimination of this option. This standard is in effect for accounting periods beginning on or after January 1, 2013, with earlier adoption permitted.

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

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

## **Controls and Procedures**

There were no changes in the Company's internal controls over financial reporting ("ICFR") during the quarter ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect, the Company's ICFR.

## **Critical Accounting Estimates**

There were no material changes to the Company's critical accounting estimates during the quarter ended June 30, 2012. For a full discussion of critical accounting estimates, please refer to the Company's discussion in its MD&A for the year ended December 31, 2011 as filed on SEDAR at [www.sedar.com](http://www.sedar.com).

## **Outlook**

The near-term outlook for recovery in the U.S. housing sector remains uncertain and concerns over sustainability continue. Export taxes have declined to 5% for July but will increase to 10% in August due to recent decreases in the relevant benchmark prices. Canadian housing starts are expected to slow slightly over the balance of 2012.

Compared to recent years, the economic outlook for China has softened, as the Chinese government scales back economic growth targets, and the real estate market weakens under government restrictions to stabilize housing prices. We still expect China to remain an important and growing end market for the Company's lumber products.

Activity levels in Japan are expected to improve as reconstruction in the areas impacted by the March 2011 earthquake and tsunami gains momentum.

Expectations are that the Canadian dollar will continue to trade near parity relative to its U.S. counterpart through 2012.

Considerable attention continues to be devoted to the Grand Forks and Castlegar capital projects, with project timelines remain on track for completion in the first quarter, 2013.

With the recent economic turmoil in Europe, slower growth in China, and cautious optimism over U.S. housing starts, Interfor continues its disciplined approach to production, inventory management and capital spending to help position the Company to deliver above average returns on capital invested as markets improve.

## **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), 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.



Lawrence Sauder  
Chairman



Duncan K. Davies  
President and Chief Executive Officer



## CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)

For the three and six months ended June 30, 2012 and 2011 (unaudited)

(thousands of Canadian dollars except loss per share)

	3 Months June 30, 2012	3 Months June 30, 2011	6 Months June 30, 2012	6 Months June 30, 2011
<b>Sales (note 3(a))</b>	\$ 225,424	\$ 187,886	\$ 412,084	\$ 366,468
<b>Costs and expenses:</b>				
Production	200,893	172,661	372,563	328,785
Selling and administration	5,327	5,269	10,632	10,240
Long term incentive compensation expense (recovery)	205	(3,081)	1,522	460
Export taxes	2,491	1,742	5,024	4,106
Depreciation of plant and equipment (note 9)	6,923	6,625	13,715	13,911
Depletion and amortization of timber, roads and other (note 9)	6,663	6,943	11,188	11,357
	222,502	190,159	414,644	368,859
<b>Operating earnings (loss) before restructuring costs</b>	2,922	(2,273)	(2,560)	(2,391)
Restructuring costs (note 10)	(146)	(139)	(146)	(989)
<b>Operating earnings (loss)</b>	2,776	(2,412)	(2,706)	(3,380)
Finance costs (note 11)	(1,668)	(1,895)	(3,210)	(4,169)
Other foreign exchange gain (loss)	(493)	213	(61)	1,301
Other income (note 12)	6	28	128	57
	(2,155)	(1,654)	(3,143)	(2,811)
<b>Earnings (loss) before income taxes</b>	621	(4,066)	(5,849)	(6,191)
<b>Income tax expense:</b>				
Current	243	352	357	390
Deferred	78	844	4	411
	321	1,196	361	801
<b>Net earnings (loss)</b>	\$ 300	\$ (5,262)	\$ (6,210)	\$ (6,992)
<b>Net earnings (loss) per share, basic and diluted (note 13)</b>	\$ 0.01	\$ (0.10)	\$ (0.11)	\$ (0.14)

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

For the three and six months ended June 30, 2012 and 2011 (unaudited)

	3 Months June 30, 2012	3 Months June 30, 2011	6 Months June 30, 2012	6 Months June 30, 2011
<b>Net earnings (loss)</b>	\$ 300	\$ (5,262)	\$ (6,210)	\$ (6,992)
<b>Other comprehensive income (loss):</b>				
Foreign currency translation differences – foreign operations	2,563	(654)	105	(3,857)
Defined benefit plan actuarial losses	(2,810)	(782)	(3,419)	(658)
Gain (loss) in fair value of interest rate swaps (note 15)	(353)	-	213	-
Income tax expense on other comprehensive income	78	175	4	50
	(522)	(1,261)	(3,097)	(4,465)
<b>Total comprehensive loss for the period</b>	\$ (222)	\$ (6,523)	\$ (9,307)	\$ (11,457)

See accompanying notes to consolidated financial statements



## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the six months ended June 30, 2012 and 2011 (unaudited)

(thousands of Canadian dollars)

	6 Months June 30, 2012	6 Months June 30, 2011
<b>Cash provided by (used in):</b>		
<b>Operating activities:</b>		
Net loss	\$ (6,210)	\$ (6,992)
<b>Items not involving cash:</b>		
Depreciation of plant and equipment	13,715	13,911
Depletion and amortization of timber, roads and other	11,188	11,357
Deferred income tax expense	4	411
Current income tax expense	357	390
Finance costs	3,210	4,169
Other assets	-	3
Reforestation liability	1,109	1,789
Other liabilities and provisions	(1,231)	(623)
Write-down of plant and equipment	128	-
Unrealized foreign exchange losses	85	152
Other (note 12)	(102)	(57)
	22,253	24,510
<b>Cash generated from (used in) operating working capital:</b>		
Trade accounts receivable and other	(14,754)	(8,929)
Inventories	983	(11,074)
Prepayments	(3,558)	648
Trade accounts payable and accrued liabilities	4,740	10,923
Income taxes paid	(924)	(530)
	8,740	15,548
<b>Investing activities:</b>		
Additions to property, plant and equipment	(14,862)	(9,844)
Additions to logging roads	(10,408)	(9,726)
Additions to timber and other intangible assets	-	(50)
Proceeds on disposal of property, plant, and equipment	179	86
Cash received on acquisition of subsidiary	-	4,846
Investments and other assets	(122)	(954)
	(25,213)	(15,642)
<b>Financing activities:</b>		
Issuance of capital stock, net of share issue expenses	-	56,260
Interest payments	(2,687)	(3,320)
Increase in bank indebtedness (note 6(a))	-	1,295
Additions to long-term debt (note 6(b))	50,000	40,000
Repayments of long-term debt (note 6(b))	(30,000)	(96,000)
	17,313	(1,765)
<b>Foreign exchange gain (loss) on cash and cash equivalents held in a foreign currency</b>	<b>25</b>	<b>(134)</b>
<b>Increase (decrease) in cash</b>	<b>865</b>	<b>(1,993)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>10,435</b>	<b>9,301</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 11,300</b>	<b>\$ 7,308</b>

See accompanying notes to consolidated financial statements



**CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**  
**June 30, 2012 and December 31, 2011 (unaudited)**

(thousands of Canadian dollars)

	June 30, 2012	Dec. 31, 2011
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 11,300	\$ 10,435
Trade accounts receivable and other	58,669	44,000
Inventories (note 5)	96,768	97,645
Prepayments	14,284	10,757
	<b>181,021</b>	<b>162,837</b>
<b>Investment in associate company</b>	-	-
<b>Employee future benefits</b>	609	1,256
<b>Other investments and assets</b>	2,566	2,836
<b>Property, plant and equipment</b>	343,687	340,034
<b>Logging roads and bridges</b>	17,806	16,753
<b>Timber licences</b>	75,138	76,792
<b>Other intangible assets</b>	943	1,250
<b>Goodwill</b>	13,078	13,078
	<b>\$ 634,848</b>	<b>\$ 614,836</b>
<b>Liabilities and Equity</b>		
<b>Current liabilities:</b>		
Trade accounts payable and accrued liabilities	\$ 69,275	\$ 60,692
Reforestation liability	12,543	14,121
Income taxes payable	491	1,058
	<b>82,309</b>	<b>75,871</b>
<b>Reforestation liability</b>	19,081	17,777
<b>Long-term debt (note 6(b))</b>	130,747	110,713
<b>Employee future benefits</b>	9,988	8,186
<b>Other liabilities and provisions (note 7)</b>	11,208	11,467
<b>Equity:</b>		
Share capital (note 8)		
Class A subordinate voting shares	342,285	342,285
Class B common shares	4,080	4,080
Contributed surplus	7,476	7,476
Reserves	(5,110)	(5,432)
Retained earnings	32,784	42,413
	<b>381,515</b>	<b>390,822</b>
	<b>\$ 634,848</b>	<b>\$ 614,836</b>

**Contingencies (note 16)**  
**Subsequent event (note 17)**

See accompanying notes to consolidated financial statements

On behalf of the Board:

L. Sauder  
Director

D. Whitehead  
Director



**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

For the six months ended June 30, 2012 and 2011 (unaudited)

(thousands of Canadian dollars)

	Class A Share Capital	Class B Share Capital	Contributed Surplus	Translation Reserve	Hedging Reserve	Retained Earnings	Total
<b>Balance at December 31, 2011</b>	\$ 342,285	\$ 4,080	\$ 7,476	\$ (4,929)	\$ (503)	\$ 42,413	\$ 390,822
<b>Net loss for the period:</b>	-	-	-	-	-	(6,210)	(6,210)
<b>Other comprehensive loss:</b>							
Foreign currency translation differences, net of tax	-	-	-	109	-	-	109
Defined benefit plan actuarial losses, net of tax	-	-	-	-	-	(3,419)	(3,419)
Gain in fair value of interest rate swaps	-	-	-	-	213	-	213
<b>Balance at June 30, 2012</b>	\$ 342,285	\$ 4,080	\$ 7,476	\$ (4,820)	\$ (290)	\$ 32,784	\$ 381,515
<b>Balance at December 31, 2010</b>	\$ 285,362	\$ 4,080	\$ 5,408	\$ (7,646)	\$ -	\$ 60,246	\$ 347,450
<b>Net loss for the period:</b>	-	-	-	-	-	(6,992)	(6,992)
<b>Other comprehensive earnings (loss):</b>							
Foreign currency translation differences, net of tax	-	-	-	(3,972)	-	-	(3,972)
Defined benefit plan actuarial losses, net of tax	-	-	-	-	-	(493)	(493)
<b>Contributions:</b>							
Share options exercised	1,370	-	-	-	-	-	1,370
Share issuance, net of share issue expenses	55,557	-	-	-	-	-	55,557
<b>Changes in ownership interests in investee:</b>							
Acquisition of subsidiary	-	-	2,068	-	-	(4)	2,064
<b>Balance at June 30, 2011</b>	\$ 342,289	\$ 4,080	\$ 7,476	\$ (11,618)	\$ -	\$ 52,757	\$ 394,984

See accompanying notes to consolidated financial statements.

## INTERNATIONAL FOREST PRODUCTS LIMITED

### Notes to Unaudited Condensed Consolidated Interim Financial Statements

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

Three and six months ended June 30, 2012 and 2011 (unaudited)

#### 1. Nature of operations:

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

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

The condensed consolidated interim financial statements of the Company as at and for the three and six months ended June 30, 2012 comprise the Company and its subsidiaries. The consolidated financial statements of the Company as at and for the year ended December 31, 2011 are available on [www.sedar.com](http://www.sedar.com).

#### 2. Statement of Compliance:

##### (a) Statement of compliance:

These condensed consolidated interim financial statements, including comparatives, have been prepared in accordance with IAS 34 *Interim Financial Reporting* using accounting policies consistent with the International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). These condensed consolidated interim financial statements were approved by the Board of Directors on August 2, 2012.

##### (b) Basis of measurement:

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

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

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

#### 3. Significant accounting policies:

These condensed consolidated interim financial statements have been prepared using the significant accounting policies and methods of computation consistent with those applied in the Company's December 31, 2011 annual consolidated financial statements, except for the accounting policy adopted subsequent to that date, as discussed below.

##### (a) Change in accounting policy:

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

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

	As previously reported	Adjustment	Restated
For the three months ended June 30, 2011			
Sales	\$ 188,154	\$ (268)	\$ 187,886
Other foreign exchange gain (loss)	(55)	268	213
For the six months ended June 30, 2011			
Sales	\$ 367,899	\$ (1,431)	\$ 366,468
Other foreign exchange gain (loss)	(130)	1,431	1,301

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

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

The IASB periodically issues new standards and amendments or interpretations to existing standards. The following new pronouncements are those that the Company considers most significant and are not intended to be a complete list of new pronouncements that may affect the financial statements.

IFRS 9, *Financial Instruments*, replaces the multiple classification and measurement models in IAS 39, *Financial Instruments: Recognition and Measurement*, with a single model that has only two classification categories: amortized cost and fair value. This standard is in effect for accounting periods beginning on or after January 1, 2015, with earlier adoption permitted. The Company does not expect this standard to have a significant effect on its financial statements.

## INTERNATIONAL FOREST PRODUCTS LIMITED

Notes to Unaudited Condensed Consolidated Interim Financial Statements

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

Three and six months ended June 30, 2012 and 2011 (unaudited)

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

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

IAS 19, *Employee Benefits*, was revised to eliminate the option to defer recognition of gains and losses, known as the "corridor method", and to enhance disclosure requirements for defined benefit plans. As the Company did not choose the corridor method in accounting for its defined benefit plans, there is no impact on its financial statements as a result of the elimination of this option. This standard is in effect for accounting periods beginning on or after January 1, 2013, with earlier adoption permitted.

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

### 4. Seasonality of operating results:

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 B.C. Coastal logging divisions experience higher production levels in the latter half of the first quarter, throughout the second and third quarters and in the first half of the fourth quarter. Logging activity in the B.C. Interior is generally higher in the first half of the first quarter, slows during spring thaw and increases in the third and fourth quarters. Sawmill operations are less seasonal than logging operations but are dependent on the availability of logs from logging operations, including those from suppliers. In addition, the market demand for lumber and related products is generally lower in the winter due to reduced construction activity, which increases during the spring, summer and fall.

### 5. Inventories:

	June 30, 2012	Dec. 31, 2011
Logs	\$ 52,955	\$ 59,412
Lumber	35,702	31,729
Other	8,111	6,504
	<u>\$ 96,768</u>	<u>\$ 97,645</u>

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 in order to record inventory at the lower of cost and net realizable value at June 30, 2012 was \$9,229,000 (December 31, 2011 - \$10,006,000).

### 6. Cash and borrowings:

	Operating Line	Revolving Term Line	Total
<b>June 30, 2012</b>			
Available line of credit	\$ 65,000	\$ 200,000	\$ 265,000
Maximum borrowing available	65,000	200,000	265,000
Drawings	-	130,747	130,747
Outstanding letters of credit included in line utilization	5,276	-	5,276
Unused portion of line	59,724	69,253	128,977
<b>December 31, 2011</b>			
Available line of credit	\$ 65,000	\$ 200,000	\$ 265,000
Maximum borrowing available	65,000	200,000	265,000
Drawings	-	110,713	110,713
Outstanding letters of credit included in line utilization	5,062	-	5,062
Unused portion of line	59,938	89,287	149,225

#### (a) Operating Line:

The Canadian operating line of credit ("Operating Line") may be drawn in either CAD\$ or US\$ advances, and bears interest at bank prime plus a margin or, at the Company's option, at rates for Bankers' Acceptances or LIBOR based loans plus a margin, and in all cases dependent upon a financial ratio of total debt divided by twelve months' trailing EBITDA<sup>1</sup>. Borrowing levels under the Operating Line are subject to a borrowing base calculation dependent on certain accounts receivable and inventories.

The Operating Line is secured by a general security agreement which includes a security interest in all accounts receivable and inventories, charges against timber tenures, and mortgage security on sawmills. The Operating Line is subject to certain financial covenants including a minimum working capital requirement, a maximum ratio of total debt to total capitalization and a minimum net worth calculation. As at June 30, 2012 other than outstanding letters of credit included in the line utilization the Operating Line was undrawn (December 31, 2011 - \$nil).

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

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

## INTERNATIONAL FOREST PRODUCTS LIMITED

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

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

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

The Revolving Term Line is available to a maximum of \$200,000,000 and 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 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 maturity date of the Revolving Term Line is July 28, 2015.

As at June 30, 2012, the Revolving Term Line was drawn by US\$30,200,000 (December 31, 2011 – US\$30,200,000) revalued at the quarter-end exchange rate to \$30,747,000 (December 31, 2011 - \$30,713,000), and \$100,000,000 (December 31, 2011 - \$80,000,000) for total drawings of \$130,747,000 (December 31, 2011 - \$110,713,000).

The US\$30,200,000 drawing under the Revolving Term Line has been designated as a hedge against the Company's investment in its U.S. operations and unrealized foreign exchange loss of \$33,000 for the six months ended June 30, 2012 (June 30, 2011 - \$909,000 gain) arising on revaluation of the Non-Revolving Term Line were recognized in Foreign exchange translation differences in Other comprehensive income. For the second quarter, 2012 the unrealized foreign exchange loss of \$622,000 (Quarter 2, 2011 - \$154,000 gain) was recognized in Other comprehensive income.

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

Twelve months ending	
June 30, 2013	\$ -
June 30, 2014	-
June 30, 2015	-
June 30, 2016	130,747
June 30, 2017	-
	<u>\$ 130,747</u>

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

### 7. Other liabilities and provisions:

In the second quarter, 2012, the Company engaged an environmental consultant to undertake groundwater and other testing at a landfill at its Castlegar sawmill site in the B.C. Interior to update its assessment of potential remediation costs. Based on the results of the testing undertaken the Company revised its estimate of the environmental provision recorded on acquisition of the site from Pope and Talbot, Inc. in 2008 and recorded a recovery of \$1,000,000 in Production costs, increasing Net earnings. Further testing and monitoring of the site and a final assessment is expected in the third quarter, 2012.

### 8. Share capital:

The transactions in share capital are described below:

	Number			Amount
	Class A	Class B	Total	
Balance, December 31, 2010	46,337,676	1,015,779	47,353,455	\$ 289,442
Shares issued on exercise of options	287,000	-	287,000	1,370
Share issuance, net of share issue costs and income tax benefit	8,222,500	-	8,222,500	55,553
Balance, December 31, 2011 and June 30, 2012	<u>54,847,176</u>	<u>1,015,779</u>	<u>55,862,955</u>	<u>\$ 346,365</u>

On April 8, 2011 the Company closed a public offering of 8,222,500 Class A Subordinate Voting shares at a price of \$7.00 per share for net cash proceeds of \$54,890,000.

### 9. Depreciation, depletion and amortization:

Depreciation, depletion and amortization can be allocated by function as follows:

	3 Months	3 Months	6 Months	6 Months
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Production	\$ 13,359	\$ 13,361	\$ 24,468	\$ 24,814
Selling and administration	227	207	435	454
	<u>\$ 13,586</u>	<u>\$ 13,568</u>	<u>\$ 24,903</u>	<u>\$ 25,268</u>

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### 10. Restructuring costs:

	3 Months June 30, 2012	3 Months June 30, 2011	6 Months June 30, 2012	6 Months June 30, 2011
Severance costs	\$ 285	\$ 66	\$ 285	\$ 251
Asset impairments	128	-	128	-
Contractor buyout	-	175	-	840
Other recovery	(267)	(102)	(267)	(102)
	\$ 146	\$ 139	\$ 146	\$ 989

Restructuring costs of \$285,000 in the second quarter, 2012 resulted from severance costs related to early retirement of hourly workers. In addition, the cancellation of a cutting permit gave rise to a recovery of previously accrued restructuring of \$267,000, partially offsetting a \$128,000 impairment of related road infrastructure.

During the first quarter of 2011 the Company recorded \$850,000, resulting from the buyout of a logging contractor's Bill 13 entitlements and severance costs related to early retirement of hourly workers.

In the second quarter, 2011, further hourly worker early retirements were slightly offset by revisions to previously accrued severances resulting in restructuring costs of \$66,000. Additional payments of \$175,000 for the buyout of Bill 13 entitlements and a revision of an estimate for other accrued restructuring resulting in a recovery of \$102,000 were recorded as restructuring in the second quarter, 2011.

### 11. Finance costs:

	3 Months June 30, 2012	3 Months June 30, 2011	6 Months June 30, 2012	6 Months June 30, 2011
Interest on borrowing	\$ 1,377	\$ 1,455	\$ 2,653	\$ 3,315
Accretion expense	138	203	251	381
Amortization of prepaid finance costs	153	237	306	473
	\$ 1,668	\$ 1,895	\$ 3,210	\$ 4,169

### 12. Other income:

The trading of lumber futures together with minor disposals of surplus equipment and scrap resulted in proceeds of \$179,000 and a gain of \$128,000 in the first and second quarters, 2012.

In the first and second quarters, 2011, the Company disposed of surplus equipment which generated \$86,000 in proceeds and a gain of \$57,000.

### 13. Net earnings (loss) per share:

	3 Months June 30, 2012			3 Months June 30, 2011		
	Net earnings (loss)	Weighted Average Number of Shares	Per share	Net earnings (loss)	Weighted Average Number of Shares	Per share
Basic and diluted earnings (loss) per share	\$ 300	55,863	\$ 0.01	\$ (5,262)	55,212	\$ (0.10)

  

	6 Months June 30, 2012			6 Months June 30, 2011		
	Net earnings (loss)	Weighted Average Number of Shares	Per share	Net earnings (loss)	Weighted Average Number of Shares	Per share
Basic and diluted earnings (loss) per share	\$ (6,210)	55,863	\$ (0.11)	\$ (6,992)	51,322	\$ (0.14)

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### 14. Segmented information:

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

The Company's sales to both foreign and domestic markets are as follows:

	3 Months June 30, 2012	3 Months June 30, 2011	6 Months June 30, 2012	6 Months June 30, 2011
Canada	\$ 64,550	\$ 48,981	\$ 124,966	\$ 100,096
United States	91,756	57,395	162,321	121,114
China/Taiwan	31,280	46,010	51,827	77,334
Japan	27,276	23,443	53,064	44,110
Other export	10,562	12,057	19,906	23,814
	\$ 225,424	\$ 187,886	\$ 412,084	\$ 366,468

Sales by product line are as follows:

	3 Months June 30, 2012	3 Months June 30, 2011	6 Months June 30, 2012	6 Months June 30, 2011
Lumber	\$ 162,369	\$ 133,750	\$ 295,991	\$ 265,115
Logs	35,650	28,645	62,600	49,494
Wood chips and other by products	17,845	16,780	36,008	33,193
Ocean freight and other	9,560	8,711	17,485	18,666
	\$ 225,424	\$ 187,886	\$ 412,084	\$ 366,468

### 15. Financial instruments:

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

As at June 30, 2012, the Company has outstanding obligations to sell a maximum of US\$20,500,000 at an average rate of CAD\$1.02783 to the US\$1.00 during 2012. All foreign currency gains or losses to June 30, 2012 have been recognized in Other foreign exchange gain (loss) in Net earnings and the fair value of these foreign currency contracts, being an asset of \$198,000 (measured based on Level 2 of the fair value hierarchy), has been recorded in Trade accounts receivable and other (December 31, 2011 - \$283,000 asset recorded in Trade accounts receivable and other measured based on Level 2 of the fair value hierarchy).

On August 25, 2011, the Company entered into two interest rate swaps, each with notional value of \$25,000,000 and maturing July 28, 2015. Under the terms of the swaps the Company pays an amount based on a fixed annual interest rate of 1.56% and receives a 90 day BA CDOR which is recalculated at set interval dates. The intent of these swaps is to convert floating-rate interest expense to fixed-rate interest expense. As these interest rate swaps have been designated as cash flow hedges the fair value of these interest rate swaps at June 30, 2012, being a liability of \$290,000 (measured based on Level 2 of the fair value hierarchy), has been recorded in Trade accounts payable and accrued liabilities (December 31, 2011 - \$503,000 liability recorded in Trade accounts payable and accrued liabilities measured based on Level 2 of the fair value hierarchy) and a gain of \$213,000 (June 30, 2011 - \$nil) has been recognized in Other comprehensive income for the six months ending June 30, 2012. For the second quarter, 2012 a loss of \$353,000 (Quarter 2, 2011 - \$nil) was recognized in Other comprehensive income.

The Company also traded lumber futures to manage price risk and which were designated as held for trading with changes in fair value recorded in Other income (expense) in net earnings. At June 30, 2012 there were no outstanding lumber futures contracts and a gain of \$26,000 was recognized in Other income (expense) on completed contracts for the six months ended June 30, 2012 (June 30, 2011 - \$nil). There were no lumber futures traded in the second quarter, 2012 (Quarter 2, 2011 - \$nil).

### 16. Contingencies:

#### (a) Softwood Lumber Agreement:

On January 18, 2011, the U.S. Trade Representative's ("USTR") office filed for arbitration under the provisions of the Softwood Lumber Agreement ("SLA") over its concern that the Province of British Columbia ("B.C.") is charging too low a price for certain timber harvested on public lands in the B.C. Interior. The arbitration was conducted by the London Court of International Arbitration ("LCIA").

In August, 2011 the USTR filed a detailed statement of claim with the LCIA and Canada delivered its initial response in November, 2011. Final submissions to the arbitration panel were submitted on May 24, 2012.

On July 18, 2012, the LCIA ruled that Canada had not circumvented the SLA (see Subsequent event, note 17).

In April, 2012 the U.S. Lumber Coalition approached the USTR alleging that the B.C. government is undercharging B.C. Coastal forest companies for timber harvested on Crown lands. As this second complaint is in the very preliminary stages of investigation, the existence of any potential claim has not been determined and no provision has been recorded in the financial statements as at June 30, 2012.

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### 16. Contingencies (continued):

#### (b) Significant customer in creditor protection:

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

The Court has granted Interfor a security interest as a critical supplier on all current and future products purchased from Interfor. Catalyst continues to meet its obligations to Interfor during the restructuring process.

In June, 2012, Catalyst trade accounts receivable of \$150,000 related to pre-CCAA filing was written off.

A restructuring plan was approved by Catalyst's creditors in June, 2012 and approved by the B.C. Supreme Court in July, 2012. Catalyst is expected to emerge from creditor protection in September, 2012. The final outcome of Catalyst's restructuring and any potential long term impact to the Company cannot be determined at this point.

#### (c) WorkSafeBC Orders Safety Reviews:

On April 24, 2012, as a result of a second explosion and destruction of a sawmill in B.C. in early 2012, WorkSafeBC, the workers' compensation insurer in B.C., conducted province-wide sawmill safety reviews, including full hazard identification and risk assessment with particular focus on combustible dust, dust accumulation and potential ignition sources. No deficiencies of any significance were identified in the WorkSafeBC reviews of the Company's Canadian sawmill sites.

In addition, in early 2012, the Company engaged a consultant to assist in the evaluation of safety standards at each of its sawmills and as at May 3, 2012 reviews have been completed at the Canadian sawmill sites. The Company believes that it maintains high standards of safe work practices and provides a safe work environment.

### 17. Subsequent event:

On July 18, 2012 a tribunal of the LCIA convened under the SLA ruled that Canada had not circumvented the agreement in the pricing of timber in the B.C. Interior, as alleged by the United States.



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