West Fraser Timber Co. Ltd.

Consolidated Financial Statements

December 31, 2018 and 2017

RESPONSIBILITY OF MANAGEMENT

The management of West Fraser Timber Co. Ltd. (“West Fraser”, “we”, “us” or “our”) is responsible for the preparation, integrity, objectivity and reliability of the consolidated financial statements. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and necessarily include amounts that represent the best estimates and judgments of management.

We maintain a system of internal controls over financial reporting that encompasses policies, procedures and controls to provide reasonable assurance that assets are safeguarded against loss or unauthorized use, transactions are executed and recorded with appropriate authorization and financial records are accurate and reliable.

Our independent auditor, which is appointed by the shareholders upon the recommendation of the Audit Committee and the Board of Directors, has completed its audit of the consolidated financial statements in accordance with generally accepted auditing standards in Canada and its report follows.

The Board of Directors provides oversight to the financial reporting process through its Audit Committee, which is comprised of four Directors, none of whom is an officer or employee of West Fraser. The Audit Committee meets regularly with representatives of management and of the auditor to review the consolidated financial statements and matters relating to the audit. The auditor has 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.

Ted Seraphim
Chief Executive Officer

Chris Virostek
Vice-President, Finance
and Chief Financial Officer

February 12, 2019

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of West Fraser Timber Co. Ltd.

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of West Fraser Timber Co. Ltd. and its subsidiaries (together, the Company) as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

What we have audited

The Company's consolidated financial statements comprise:

- the consolidated balance sheets as at December 31, 2018 and 2017;
- the consolidated statements of earnings and comprehensive earnings for the years then ended;
- the consolidated statements of changes in shareholders' equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report.

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

Independence

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis, which we obtained prior to the date of this auditor's report and the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, which is expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express an opinion or any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard. When we read the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.
In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are

responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is John Bunting.

PricewaterhouseCoopers LLP

Chartered Professional Accountants
Vancouver, British Columbia
February 12, 2019

West Fraser Timber Co. Ltd.
Consolidated Balance Sheets
As at December 31, 2018 and 2017
(in millions of Canadian dollars, except where indicated)

		2018		2017
Assets				
Current assets				
Cash and short-term investments	**$**	**160**	$	258
Receivables (note 24)		**332**		352
Income taxes receivable		**48**		-
Inventories (note 6)		**791**		670
Prepaid expenses		**14**		11
		1,345		1,291
Property, plant and equipment (note 7)		**2,056**		1,892
Timber licences (note 8)		**513**		533
Goodwill and other intangibles (note 9)		**767**		731
Export duty deposits (note 27)		**75**		37
Other assets (note 10)		**32**		27
Deferred income tax assets (note 19)		**3**		6
	$	**4,791**	$	4,517
Liabilities				
Current liabilities				
Cheques issued in excess of funds on deposit	**$**	**13**	$	-
Operating loans (note 13)		**61**		-
Payables and accrued liabilities (note 11)		**448**		441
Income taxes payable		**34**		104
Reforestation and decommissioning obligations (note 12)		**39**		38
		595		583
Long-term debt (note 13)		**692**		636
Other liabilities (note 12)		**316**		347
Deferred income tax liabilities (note 19)		**292**		225
		1,895		1,791
Shareholders' Equity				
Share capital (note 15)		**491**		549
Accumulated other comprehensive earnings		**170**		108
Retained earnings		**2,235**		2,069
		2,896		2,726
	$	**4,791**	$	4,517

Approved by the Board of Directors

Reid Carter
Director

Robert L. Phillips
Lead Director

West Fraser Timber Co. Ltd.
Consolidated Statements of Earnings and Comprehensive Earnings
For the years ended December 31, 2018 and 2017
(in millions of Canadian dollars, except where indicated)

	2018	2017
Sales	**$ 6,118**	$ 5,134
Costs and expenses		
Cost of products sold	**3,617**	3,124
Freight and other distribution costs	**732**	633
Export duties (note 27)	**202**	48
Amortization	**257**	210
Selling, general and administration	**231**	217
Equity-based compensation (note 16)	**7**	32
	5,046	4,264
Operating earnings	**1,072**	870
Finance expense (note 17)	**(37)**	(31)
Other (note 18)	**37**	7
Earnings before tax	**1,072**	846
Tax provision (note 19)	**(262)**	(250)
Earnings	**$ 810**	$ 596
Earnings per share (dollars) (note 21)		
Basic	**$ 10.88**	$ 7.63
Diluted	**$ 10.62**	$ 7.63
Comprehensive earnings		
Earnings	**$ 810**	$ 596
Other comprehensive earnings		
Translation gain (loss) on foreign operations[1]	**62**	(42)
Actuarial gain (loss) on post-retirement benefits[2]	**24**	(26)
Comprehensive earnings	**$ 896**	$ 528

1. Recycled through earnings in the event of a disposal in net investment in foreign operations.
2. Adjusted through retained earnings. Net of tax provision of $9 million (2017 - $7 million recovery).

West Fraser Timber Co. Ltd.
Consolidated Statements of Changes in Shareholders' Equity
For the years ended December 31, 2018 and 2017
(in millions of Canadian dollars, except where indicated)

	Share capital		Translation		
	Number of shares	Amount	of foreign operations	Retained earnings	Total equity
Balance - December 31, 2016	78,162,568	$ 549	$ 150	$ 1,542	$ 2,241
Changes in Shareholders' Equity for 2017					
Translation loss on foreign operations	-	-	(42)	-	(42)
Actuarial loss on post-retirement benefits	-	-	-	(26)	(26)
Issuance of Common shares	29,113	2	-	-	2
Repurchase of Common shares	(245,645)	(2)	-	(15)	(17)
Earnings for the year	-	-	-	596	596
Dividends[1]	-	-	-	(28)	(28)
Balance - December 31, 2017	77,946,036	$ 549	$ 108	$ 2,069	$ 2,726
Changes in Shareholders' Equity for 2018					
Translation gain on foreign operations	**-**	**-**	**62**	**-**	**62**
Actuarial gain on post-retirement benefits	**-**	**-**	**-**	**24**	**24**
Issuance of Common shares	**8,598**	**1**	**-**	**-**	**1**
Repurchase of Common shares	**(8,135,796)**	**(59)**	**-**	**(617)**	**(676)**
Earnings for the year	**-**	**-**	**-**	**810**	**810**
Dividends[1]	**-**	**-**	**-**	**(51)**	**(51)**
Balance - December 31, 2018	**69,818,838**	**$ 491**	**$ 170**	**$ 2,235**	**$ 2,896**

1. Represents dividends declared of $0.70 per share for 2018 and $0.36 per share for 2017.

West Fraser Timber Co. Ltd.
Consolidated Statements of Cash Flows
For the years ended December 31, 2018 and 2017
(in millions of Canadian dollars, except where indicated)

	2018	2017
Cash provided by operations		
Earnings	**$ 810**	$ 596
Adjustments		
Amortization	**257**	210
Finance expense	**37**	31
Foreign exchange gain on long-term financing	**(10)**	(10)
Foreign exchange gain on long-term duty deposits	**(5)**	(1)
Export duty deposits (note 27)	**(31)**	(36)
Post-retirement expense	**84**	82
Contributions to post-retirement benefit plans	**(103)**	(69)
Tax provision	**262**	250
Income taxes paid	**(316)**	(73)
Other	**(2)**	(16)
Changes in non-cash working capital		
Receivables	**39**	(34)
Inventories	**(105)**	(64)
Prepaid expenses	**(3)**	(1)
Payables and accrued liabilities	**(5)**	37
	909	902
Cash provided by (used for) financing		
Proceeds from long-term debt	**-**	250
Proceeds from operating loans	**63**	-
Finance expense paid	**(32)**	(23)
Dividends	**(37)**	(28)
Repurchase of Common shares	**(675)**	(17)
Other	**-**	(1)
	(681)	181
Cash used for investing		
Acquisition (note 5)	**-**	(526)
Additions to capital assets	**(370)**	(336)
Government assistance (note 23)	**6**	3
Other	**10**	5
	(354)	(854)
Change in cash	**(126)**	229
Foreign exchange effect on cash	**15**	(6)
Cash - beginning of year	**258**	35
Cash - end of year	**$ 147**	$ 258
Cash consists of		
Cash and short-term investments	**$ 160**	$ 258
Cheques issued in excess of funds on deposit	**(13)**	-
	$ 147	$ 258

West Fraser Timber Co. Ltd.
Notes to Consolidated Financial Statements
For the years ended December 31, 2018 and 2017
(figures are in millions of Canadian dollars, except where indicated)

1. Nature of operations

West Fraser Timber Co. Ltd. ("West Fraser", "we", "us" or "our") is a diversified wood products company producing lumber, LVL, MDF, plywood, pulp, newsprint, wood chips and energy with facilities in western Canada and the southern United States. Our executive office is located at 858 Beatty Street, Suite 501, Vancouver, British Columbia. West Fraser was formed by articles of amalgamation under the *Business Corporations Act* (British Columbia) and is registered in British Columbia, Canada. Our Common shares are listed for trading on the Toronto Stock Exchange under the symbol WFT.

2. Basis of presentation

These consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") and were approved by our Board of Directors on February 12, 2019.

Our consolidated financial statements have been prepared under the historical cost basis, except for certain items as discussed in the applicable accounting policies.

Accounting policies that relate to the consolidated financial statements as a whole are incorporated in this note. Where an accounting policy is applicable to a specific note disclosure, the policy is described within the respective note.

We have reclassified certain prior-year amounts to conform to current-year's presentation.

Accounting policies

Basis of consolidation

These consolidated financial statements include the accounts of West Fraser and its wholly-owned subsidiaries after the elimination of intercompany transactions and balances. Principal operating subsidiaries are West Fraser Mills Ltd., West Fraser, Inc., West Fraser Wood Products Inc., West Fraser Southeast, Inc., Blue Ridge Lumber Inc., Sundre Forest Products Inc., Manning Forest Products Ltd. and West Fraser Newsprint Ltd.

Our 50% owned joint operations, Alberta Newsprint Company and Cariboo Pulp & Paper Company, are accounted for by the proportionate consolidation method.

Use of estimates and judgments

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. It also requires management to exercise judgment in the process of applying accounting policies. Significant areas requiring estimates include recoverability of long-lived assets and goodwill, duty deposits related to the softwood lumber dispute, fair value of derivatives, reforestation and decommissioning obligations, employee future benefits, equity-based compensation, income taxes and litigation. Actual amounts could differ materially from these and other estimates, the impact of which would be recorded in future periods. Management uses judgments and assumptions in assessing potential indicators of impairment, determining the appropriate cash generating unit level used in impairment testing and determining the accounting treatment for certain investments where we own less than 100% of the entity.

Revenue recognition

Revenue is derived primarily from product sales and is recognized when a customer obtains control over the goods. For most of our sales, control is obtained when the product is loaded on a common carrier at our mill. Some of our revenue is recognized when the product is delivered to the customer or when it is loaded on an ocean carrier. The amount of revenue recognized is net of our estimate for early payment discounts and volume rebates.

Revenue includes charges for freight, handling, countervailing and antidumping duties. The costs related to these revenues are recorded in freight and other distribution costs and export duties.

Foreign currency translation

Our functional and presentation currency is Canadian dollars.

U.S. operations

Assets and liabilities of our U.S. operations have a functional currency of U.S. dollars and are translated at the period-end exchange rate. Revenues and expenses are translated at average exchange rates during the reporting period. The resulting unrealized translation gains or losses are included in other comprehensive earnings.

Translation of other foreign currency balances and transactions

Monetary assets and liabilities denominated in foreign currencies, including long-term financing, are translated at the period-end exchange rate. Income and expense items are translated at the average or transaction date exchange rates during the reporting period. The resulting translation gains or losses are included in other income.

Cash and short-term investments

Cash and short-term investments consist of cash on deposit and short-term interest-bearing securities maturing within three months of the date of purchase.

Impairment of long-lived assets

We review property, plant, equipment, timber licences, goodwill and other intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. For the purpose of impairment testing, assets are separated into cash generating units (“CGUs”). We have identified each of our mills as a CGU for impairment testing of property, plant, equipment and other intangibles unless there is economic interdependence of CGUs, in which case they are grouped for impairment testing. Timber licences and goodwill are tested for impairment by combining CGUs within the economic area of the related assets. We perform an annual test for goodwill impairment.

Recoverability is assessed by comparing the carrying amount of the CGU or grouped CGUs to the discounted estimated net future cash flows the assets are expected to generate. If the carrying amount exceeds the discounted estimated net future cash flows, the assets are written down to the higher of fair value less costs to sell and value-in-use (being the present value of the estimated net future cash flows of the relevant asset or CGU).

Goodwill impairment is assessed by comparing the fair value of its CGU to the underlying carrying amount of the CGU’s net assets, including goodwill. When the carrying amount of the CGU exceeds its fair value, the fair value of the CGU’s goodwill is compared with its carrying amount. An impairment loss is recognized for any excess of the carrying value of goodwill over its fair value.

Estimated net future cash flows are based on several assumptions concerning future circumstances including selling prices of products, U.S./Canadian dollar exchange rates, production rates, input costs and capital requirements. The estimated net future cash flows are discounted at rates reflective of market risk.

Where an impairment loss for long-lived assets, other than goodwill, subsequently reverses, the carrying amount of the asset or CGU is increased to the lesser of the revised estimate of its recoverable amount and the carrying amount that would have been recorded had no impairment loss been previously recognized. Goodwill impairment losses cannot be reversed.

Fair value measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. For financial reporting purposes, fair value measurements are categorized into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurement are observable and the significance of the inputs. Our fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value.

The three levels of the fair value hierarchy are:

Level 1

Values based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2

Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.

Level 3

Values based on prices or valuation techniques that require inputs which are both unobservable and significant to the overall fair value measurement.

3. Changes in accounting standards

IFRS 9 - Financial Instruments

We have adopted IFRS 9 effective January 1, 2018 using the full retrospective method. The new standard for financial instruments, IFRS 9, replaces IAS 39 - Financial Instruments: Recognition and Measurement. It makes changes to the previous guidance on the classification and measurement of financial assets and introduces an ‘expected credit loss’ model for the impairment of financial assets. IFRS 9 also contains new requirements on the application of hedge accounting.

The adoption of this standard had no significant impact on our consolidated financial statements and no retrospective adjustments were necessary.

IFRS 15 - Revenue from Contracts with Customers

We have adopted IFRS 15 effective January 1, 2018 using the full retrospective method. The new revenue standard, IFRS 15, replaces IAS 18 - Revenue, IAS 11 - Construction Contracts and the related interpretations. This standard addresses revenue recognition and establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity’s contracts with customers. IFRS 15 requires that revenue is recognized at the ‘transaction price’ when certain contractual obligations are met but with any ‘variable consideration’ elements of the price recognized when it is ‘highly probable’ that there will be no reversal of that revenue.

The adoption of this standard had no significant impact on our consolidated financial statements and no retrospective adjustments were necessary.

4. Accounting standards, amendments and interpretations issued but not yet applied

IFRS 16 - Leases

IFRS 16 was issued in January 2016. This standard is effective for annual periods beginning on or after January 1, 2019 with earlier application permitted. The new standard replaces IAS 17 - Leases and the related interpretations.

IFRS 16 eliminates the classification of leases as either operating leases or finance leases for a lessee. This standard establishes a single, on-balance sheet accounting model for all leases which will result in the recognition of a right-of-use asset and a lease obligation. The nature of expenses related to those leases will change as IFRS 16 replaces the straight-line operating lease expense, currently reported under cost of products sold on our consolidated statements of earnings, with a depreciation charge for the right-of-use asset and an interest expense on the lease liability which will be reported under finance expense. Although the depreciation charge is typically even, the interest expense reduces over the life of the lease as lease payments are made. This results in a reducing total expense as an individual lease matures.

IFRS 16 allows two exemptions for short-term and low-value leases for which the payments will be recognized as an expense, typically on a straight-line basis over the lease term.

We will apply IFRS 16 initially on January 1, 2019, using the modified retrospective approach. Under this method, the right-of-use asset is recognized at the date of the initial application at an amount equal to the lease liability, using the company's incremental borrowing rate. Comparative figures are not restated.

We completed the assessment for the potential impact on our consolidated financial statements and anticipate that IFRS 16 will not have a significant impact our consolidated financial statements. The most significant impact identified is that we will recognize approximatively $17 million in right-of-use assets under property, plant and equipment on our consolidated balance sheets and approximatively $17 million long-term liabilities for the leases related to some of our office spaces and vehicles with minimal impact on our consolidated statements of earnings.

IAS 19 - Amendments, Employee Benefits

In February 2018, IAS 19 was amended. The amendments specify how companies should calculate pension expenses when changes to a defined benefit pension plan occur. The standard requires updated actuarial assumptions after a plan amendment, curtailment or settlement. The amendments also require a company to recognize through earnings any reduction in a surplus, even if that surplus was not previously recognized due to an asset ceiling limitation.

The amendments to IAS 19 must be applied prospectively to plan amendments, curtailments or settlements occurring on or after January 1, 2019. We do not expect these amendments to have a significant effect on our consolidated financial statements.

There are no other standards or amendments or interpretations to existing standards issued but not yet effective which are expected to have a material impact on our consolidated financial statements.

5. Acquisition

On August 31, 2017, we completed the acquisition of six sawmills that produce southern yellow pine lumber and a finger-joint mill in Florida and Georgia as well as an administrative office in Georgia (the "Gilman Acquisition"). The consideration paid, net of cash acquired, was $526 million (US$419 million) and the transaction was an acquisition of shares. The acquisition was financed with cash on hand, borrowings on our revolving credit facility and a $250 million (US$200 million) term loan. In December 2018, we ceased operations at the finger-joint mill.

The transaction has been accounted for as an acquisition of a business and the purchase price has been allocated over the estimated fair value of the assets purchased and liabilities assumed. We have allocated the purchase price as follows:

		December 31, 2017
Net assets acquired	$	607
Less: cash acquired		(81)
Net non-cash assets acquired		526
Allocation:		
Current assets		58
Current liabilities		(12)
Property, plant and equipment		91
Goodwill		355
Employee future benefits		(11)
Deferred income tax asset, net		45
	$	526

Factors contributing to goodwill include the Gilman workforce, assets that are geographically complementary to our existing facilities and offer close access to large markets, the available timber basket and multiple markets for residuals. This transaction strengthens our core lumber business and gives us increased scale and geographic diversification. This was a rare opportunity to acquire a U.S. lumber producer with meaningful capacity, high quality facilities and a culture similar to our own. The goodwill of $355 million is not deductible for tax purposes.

6. Inventories

Accounting policies

Inventories of manufactured products, logs and other raw materials are valued at the lower of average cost and net realizable value. Processing materials and supplies are valued at the lower of average cost and replacement cost.

Supporting information

		2018		2017
Manufactured products	**$**	**421**	$	358
Logs and other raw materials		**218**		167
Processing materials and supplies		**152**		145
	$	**791**	$	670

Inventories at December 31, 2018 were written down by $30 million (December 31, 2017 - $9 million) to reflect net realizable value being lower than cost.

The carrying amount of inventory recorded at net realizable value was $149 million at December 31, 2018 (December 31, 2017 - $33 million), with the remaining inventory recorded at cost.

7. Property, plant and equipment

Accounting policies

Property, plant and equipment are stated at historical cost, less accumulated amortization and impairment losses. Expenditures for additions and improvements are capitalized. Borrowing costs are capitalized when the asset construction period exceeds 12 months and the borrowing costs are directly attributable to the asset. Expenditures for maintenance and repairs are charged to earnings. Upon retirement, disposal or destruction of an asset, the cost and related amortization are removed from the accounts and any gain or loss is included in earnings.

Property, plant and equipment are amortized on a straight-line basis over their estimated useful lives as follows:

Buildings	10 - 30 years
Manufacturing equipment and machinery	6 - 20 years
Fixtures, mobile and other equipment	3 - 10 years
Roads and bridges	Not exceeding 40 years
Major maintenance shutdowns	12 to 36 months

Supporting information

	Manufacturing plant, equipment & machinery	Construction-in-progress	Roads & bridges	Other	Total
As at December 31, 2016	$ 1,444	$ 160	$ 41	$ 40	$ 1,685
Additions	164	165	17	1	347
Acquisition	85	3	-	3	91
Amortization[1]	(175)	-	(14)	-	(189)
Foreign exchange	(35)	(2)	-	(2)	(39)
Disposals	(1)	-	-	-	(1)
Transfers	128	(131)	1	-	(2)
As at December 31, 2017	$ 1,610	$ 195	$ 45	$ 42	$ 1,892
As at December 31, 2017					
Cost	$ 4,047	$ 195	$ 138	$ 49	$ 4,429
Accumulated amortization	(2,437)	-	(93)	(7)	(2,537)
Net	$ 1,610	$ 195	$ 45	$ 42	$ 1,892
As at December 31, 2017	$ 1,610	$ 195	$ 45	$ 42	$ 1,892
Additions	**168**	**151**	**17**	**1**	**337**
Amortization[1]	**(218)**	**-**	**(15)**	**-**	**(233)**
Foreign exchange	**54**	**10**	**-**	**1**	**65**
Disposals	**(5)**	**-**	**-**	**-**	**(5)**
Transfers	**169**	**(169)**	**-**	**-**	**-**
As at December 31, 2018	**$ 1,778**	**$ 187**	**$ 47**	**$ 44**	**$ 2,056**
As at December 31, 2018					
Cost	**$ 4,444**	**$ 187**	**$ 148**	**$ 51**	**$ 4,830**
Accumulated amortization	**(2,666)**	**-**	**(101)**	**(7)**	**(2,774)**
Net	**$ 1,778**	**$ 187**	**$ 47**	**$ 44**	**$ 2,056**

1. Amortization of $230 million relates to cost of products sold and $3 million relates to selling, general and administration expense (2017 - $186 million and $3 million, respectively).

8. Timber licences

Accounting policies

Timber licences, which are renewable or replaceable, are stated at historical cost, less accumulated amortization and impairment losses. Amortization is provided on a straight-line basis over their estimated useful lives of 40 years.

Supporting information

		Timber licences
As at December 31, 2016	$	551
Amortization[1]		(19)
Acquisition		1
As at December 31, 2017	$	533
As at December 31, 2017		
Cost	$	800
Accumulated amortization		(267)
Net	$	533
As at December 31, 2017	$	533
Amortization[1]		**(20)**
As at December 31, 2018	**$**	**513**
As at December 31, 2018		
Cost	**$**	**800**
Accumulated amortization		**(287)**
Net	**$**	**513**

1. Amortization relates to cost of products sold.

9. Goodwill and other intangibles

Accounting policies

Goodwill represents the excess of the purchase price paid for an acquisition over the fair value of the net assets acquired. Goodwill is not amortized but is subject to an annual impairment test. An additional impairment test is conducted if events or circumstances indicate that goodwill may be impaired.

Other intangibles are stated at historical cost less accumulated amortization and impairments. Other intangibles include software which is amortized over periods of up to 10 years and non-replaceable finite term timber rights which are amortized as the related timber is logged.

Supporting information

	Goodwill	Other	Total
As at December 31, 2016	$ 356	$ 15	$ 371
Additions	-	11	11
Acquisition	355	-	355
Transfers	-	2	2
Amortization[1]	-	(2)	(2)
Foreign exchange	(6)	-	(6)
As at December 31, 2017	$ 705	$ 26	$ 731
As at December 31, 2017			
Cost	$ 705	$ 47	$ 752
Accumulated amortization	-	(21)	(21)
Net	$ 705	$ 26	$ 731
As at December 31, 2017	$ 705	$ 26	$ 731
Additions	**-**	**6**	**6**
Amortization[1]	**-**	**(4)**	**(4)**
Foreign exchange	**38**	**-**	**38**
Disposals	**-**	**(4)**	**(4)**
As at December 31, 2018	**$ 743**	**$ 24**	**$ 767**
As at December 31, 2018			
Cost	**$ 743**	**$ 48**	**$ 791**
Accumulated amortization	**-**	**(24)**	**(24)**
Net	**$ 743**	**$ 24**	**$ 767**

1. Amortization of $2 million relates to cost of products sold and $2 million relates to selling, general and administration expense (2017 - $1 million and $1 million, respectively).

Goodwill

We have attributed $218 million of goodwill to a CGU made up of our Canadian lumber operations, $479 million of goodwill to a CGU made up of our U.S. lumber operations and $46 million of goodwill to a CGU made up of our plywood and LVL operations.

For the purpose of the 2018 impairment test of goodwill, the fair value of CGUs has been determined based on value-in-use calculations using a discount rate of 8.5%. These calculations are approved by management and use cash flow projections based on the 2019 operating plan, a forecast of 2020 and 2021 and trend level earnings for subsequent years. Assumptions were developed by management based on industry sources after taking into account management's best estimates. No impairment on goodwill has been recognized.

10. Other assets

	2018	2017
Post-retirement (note 14)	**$ 12**	$ 13
Deferred financing costs on lines of credit (note 13)	**-**	2
Other	**20**	12
	$ 32	$ 27

11. Payables and accrued liabilities

		2018		2017
Trade accounts	**$**	**260**	$	244
Equity-based compensation		**51**		79
Compensation		**78**		74
Export duties		**17**		8
Dividends		**14**		8
Interest		**5**		5
Other		**23**		23
	$	**448**	$	441

12. Other liabilities

		2018		2017
Post-retirement (note 14)	**$**	**189**	$	231
Reforestation		**76**		70
Decommissioning		**29**		25
Other		**22**		21
	$	**316**	$	347

Reforestation and decommissioning obligations

Reforestation and decommissioning obligations relate to our responsibility for reforestation under various timber licences and our obligations related to landfill closures and other site remediation costs.

Accounting policies

Reforestation obligations are measured at the present value of the expenditures expected to be required to settle the obligations and are accrued and charged to earnings when timber is harvested. The reforestation obligation is reviewed periodically and changes to estimates are credited or charged to earnings.

We record the present value of a liability for decommissioning obligations in the period that a reasonable estimate can be made. The present value of the liability is added to the carrying amount of the associated asset and amortized over its useful life or, if there is no associated asset, it is expensed. Decommissioning obligations are reviewed annually and changes to estimates result in an adjustment of the carrying amount of the associated asset or, where there is no asset, they are credited or charged to earnings.

Reforestation and decommissioning obligations are discounted at the risk-free rate at the balance sheet date and accreted over time through periodic charges to earnings. The liabilities are reduced by actual costs of settlement.

Supporting information

	Reforestation				Decommissioning			
		2018		2017		**2018**		2017
Beginning of year	**$**	**108**	$	113	**$**	**25**	$	25
Liabilities recognized		**46**		47		**-**		-
Liabilities settled		**(46)**		(45)		**-**		-
Change in estimates		**7**		(7)		**4**		-
End of year		**115**		108		**29**		25
Less: current portion		**(39)**		(38)		**-**		-
	$	**76**	$	70	**$**	**29**	$	25

The total undiscounted amount of the estimated cash flows required to satisfy these obligations is $158 million (2017 - $147 million). The cash flows have been discounted using interest rates ranging from 1.86% to 1.88% (2017 - 1.68% to 1.86%).

The timing of the reforestation payments is based on the estimated period required to attain free to grow status in a given area, which is generally between 12 to 15 years. Payments relating to landfill closures and site remediation are expected to occur over periods ranging up to 47 years.

13. Long-term debt and operating loans

Accounting policies

Transaction costs related to debt financing or refinancing are deferred and amortized over the life of the associated debt. When our operating loan is undrawn, the related deferred financing costs are recorded in other assets.

Supporting information

Long-term debt

		2018		2017
US$300 million senior notes due October 2024; interest at 4.35%	**$**	**409**	$	376
US$200 million term loan due August 2022; floating interest rate		**273**		251
US$8 million note payable due October 2020; interest at 2%		**10**		10
Notes payable		**4**		4
		696		641
Deferred financing costs		**(4)**		(5)
	$	**692**	$	636

Required principal repayments are disclosed in note 24.

Operating loans

Our revolving lines of credit consist of a $500 million committed revolving credit facility which matures August 25, 2022, a $34 million (US$25 million) demand line of credit dedicated to our U.S. operations and an $8 million demand line of credit dedicated to our jointly owned newsprint operation. In addition, we have demand lines of credit totalling $70 million dedicated to letters of credit, of which US$15 million is dedicated to our U.S. operations.

At December 31, 2018, $61 million (net of deferred financing costs of $2 million) was drawn under our revolving credit facility. Letters of credit in the amount of $58 million were also supported by our facilities, leaving $491 million of credit available for further use. At December 31, 2017, our revolving credit facility was undrawn, deferred financing costs of $2 million were recorded in other assets and our outstanding letters of credit were $47 million.

Interest on the facilities is payable at floating rates based on Prime, Base Rate Advances, Bankers' Acceptances or LIBOR Advances at our option.

All debt is unsecured except the $8 million joint operation demand line of credit, which is secured by that joint operation's current assets.

14. Post-retirement benefits

We maintain defined benefit and defined contribution pension plans covering a majority of our employees. The defined benefit plans generally do not require employee contributions and provide a guaranteed level of pension payable for life based either on length of service or on earnings and length of service, and in most cases do not increase after commencement of retirement.

The defined benefit pension plans are operated in Canada and the U.S. under broadly similar regulatory frameworks. The majority are funded arrangements where benefit payments are made from plan assets which are held in trust. Responsibility for the governance of the plans, including investment and contribution decisions, resides with our Retirement Committees which report to the Human Resources & Compensation Committee of the Board of Directors. For the registered defined benefit pension plans, regulations set minimum requirements for contributions for benefit accruals and the funding of deficits.

Accounting policies

We record a post-retirement asset or liability for our employee defined benefit pension and other retirement benefit plans by netting our plan assets with our plan obligations, on a plan-by-plan basis.

The cost of defined benefit pensions and other retirement benefits earned by employees is actuarially determined using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using market yields from high quality corporate bonds with cash flows that approximate expected benefit payments at the balance sheet date. Plan assets are valued at fair value at each balance sheet date.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive earnings in the period in which they arise.

Past service costs arising from plan amendments are recognized immediately.

The finance amount on net post-retirement balances is classified as finance expense.

For defined contribution plans, pension expense is the amount of contributions we are required to make in respect of services rendered by employees.

Supporting information

The actual return on plan assets for 2018 is a loss of $4 million (2017 - $123 million gain). The total pension expense for the defined benefit plans is $73 million (2017 - $72 million). In 2018, we made contributions of $86 million (2017 - $52 million). We expect to contribute approximately $69 million to our defined benefit pension plans during 2019 based on the most recent valuation report for each pension plan. We also provide group life insurance, medical and extended health benefits to certain employee groups, for which we contributed $2 million in 2018 (2017 - $3 million).

The total pension expense and funding contributions for the defined contribution pension plans is $15 million (2017 - $14 million).

In 2018, we entered into annuity purchase agreements to settle approximately $480 million of our defined benefit obligations by purchasing annuities using our plan assets. These agreements transferred the pension obligations of retired employees under certain pension plans to financial institutions. The difference between the cost of the annuity purchase and the liabilities held for these pension plans is reflected as a settlement cost. As part of the annuity purchase, we contributed $5 million to these plans.

The status of the defined benefit pension plans and other retirement benefit plans, in aggregate, is as follows:

	Defined benefit pension plans				Other retirement benefit plans			
		2018		2017		**2018**		2017
Accrued benefit obligations								
Benefit obligations – opening	**$**	**1,821**	$	1,598	**$**	**43**	$	51
Acquisition		**-**		68		**-**		-
Service cost		**66**		67		**3**		1
Finance cost on obligation		**61**		61		**2**		2
Benefits paid		**(66)**		(66)		**(2)**		(3)
Actuarial loss (gain) due to change in financial assumptions		**(83)**		73		**(5)**		(8)
Actuarial loss (gain) due to demography/experience		**16**		36		**(7)**		-
Settlement		**(480)**		(10)		**-**		-
Other		**12**		(6)		**-**		-
Benefit obligations - ending	**$**	**1,347**	$	1,821	**$**	**34**	$	43
Plan assets								
Fair value - opening	**$**	**1,658**	$	1,507	**$**	**-**	$	-
Acquisition		**-**		57		**-**		-
Finance income on plan assets		**54**		56		**-**		-
Actuarial gain (loss) on plan assets		**(58)**		67		**-**		-
Employer contributions		**86**		52		**2**		3
Benefits paid		**(66)**		(66)		**(2)**		(3)
Settlement		**(479)**		(11)		**-**		-
Other		**9**		(4)		**-**		-
Fair value - ending	**$**	**1,204**	$	1,658	**$**	**-**	$	-
Funded status[1]								
Post-retirement assets	**$**	**12**	$	25	**$**	**-**	$	-
Impact of minimum funding requirement [2]		**-**		(12)		**-**		-
Post-retirement assets (note 10)		**12**		13		**-**		-
Post-retirement liabilities (note 12)		**(155)**		(188)		**(34)**		(43)
	$	**(143)**	$	(175)	**$**	**(34)**	$	(43)

1. Plans in a surplus position are classified as assets and plans in a deficit position are shown as liabilities on the consolidated balance sheets. Other retirement benefit plans continue to be unfunded.
2. Some of our plans have a surplus that is not recognized on the basis that future economic benefits may not be available to us in the form of a reduction in future contributions or a cash refund.

	Defined benefit pension plans				Other retirement benefit plans			
		2018		2017		**2018**		2017
Expense								
Service cost	**$**	**66**	$	67	**$**	**3**	$	1
Net finance expense		**7**		5		**2**		2
	$	**73**	$	72	**$**	**5**	$	3

Assumptions and sensitivities

The weighted average duration of the defined benefit pension obligations is 19 years, which increased by approximatively two years compared to 2017. The projected future benefit payments for the defined benefit pension plans at December 31, 2018 are as follows:

	2019	2020	2021 to 2023	Thereafter	Total
Defined benefit pension plans	$ 34	$ 38	$ 139	$ 2,457	$ 2,668

The estimation of post-retirement benefit obligations involves a high degree of judgment for matters such as discount rate, employee service periods, compensation escalation rates, expected retirement ages of employees, mortality rates, expected health-care costs and other variable factors. These estimates are reviewed annually with independent actuaries. The significant actuarial assumptions used to determine our balance sheet date post-retirement assets and liabilities and our post-retirement benefit plan expenses are as follows:

	Defined benefit pension plans		**Other retirement benefit plans**	
	2018	2017	**2018**	2017
Benefit obligations:				
Discount rate	**3.75%**	3.50%	**3.75%**	3.50%
Future compensation rate increase	**3.50%**	3.50%	**n/a**	n/a
Benefit expense:				
Discount rate - beginning of year	**3.50%**	3.75%	**3.50%**	3.75%
Future compensation rate increase	**3.50%**	3.50%	**n/a**	n/a

Health-care benefit costs, shown under other retirement benefit plans, are funded on a pay-as-you-go basis. The actuarial assumptions for extended health-care costs are estimated to increase 7.0% in year one, grading down 0.25% per year for years two to ten, to 4.5% per year thereafter.

The impact of a change in these assumptions on our post-retirement obligations as at December 31, 2018 is as follows:

	Obligations
Discount rate	
Decrease in assumption from 3.75% to 3.25%	$ 125
Increase in assumption from 3.75% to 4.25%	$ (106)
Rate of increase in future compensation	
Decrease in assumption from 3.50% to 3.00%	$ (20)
Increase in assumption from 3.50% to 4.00%	$ 20
Health-care cost trend rates	
Increase in assumption by 1.00%	$ 1
Decrease in assumption by 1.00%	$ (2)

The sensitivities have been calculated on the basis that all other variables remain constant. When calculating the sensitivity of the defined benefit obligation, the same methodology is applied as was used to generate the financial statement asset/liability.

Assets

The assets of the pension plans are invested predominantly in a diversified range of equities and bonds. The weighted average asset allocations of the defined benefit plans at December 31, by asset category, are as follows:

	Target range[1]	**2018**	2017
Canadian equities	**9% - 25%**	**10%**	14%
Foreign equities	**12% - 52%**	**24%**	27%
Fixed income investments	**35% - 45%**	**44%**	48%
Other investments	**5% - 32%**	**22%**	11%
		100%	100%

1. The target range applies to our open plans comprising the majority of our pension assets. Our closed plans target a more conservative asset mix with a greater percentage of fixed income investments.

Risk management practices

We are exposed to various risks related to our defined benefit pension and other post-retirement benefit plans:

- Uncertainty in benefit payments: The value of the liability for post-retirement benefits will ultimately depend on the amount of benefits paid and this in turn will depend on the level of future compensation increase and how long individuals live.

- Volatility in asset value: We are exposed to changes in the market value of pension plan investments which are required to fund future benefit payments.

- Uncertainty in cash funding: Movement in the value of the assets and obligations may result in increased levels of cash funding, although changes in the level of cash funding required can be spread over a number of years. We are also exposed to changes in pension regulation and legislation.

Our retirement committees manage these risks in accordance with a Statement of Investment Policies and Procedures for each pension plan or group of plans administered under master trust agreements. The following are some specific risk management practices employed:

- Retaining and monitoring professional advisors including an outsourced chief investment officer (“OCIO”);

- Monitoring our OCIO’s adherence to asset allocation guidelines and permitted categories of investments; and

- Monitoring investment decisions and performance of the OCIO and asset performance against benchmarks.

15. **Share capital**

Authorized

400,000,000 Common shares, without par value
20,000,000 Class B Common shares, without par value
10,000,000 Preferred shares, issuable in series, without par value

Issued

	2018			2017		
	Number		**Amount**	Number		Amount
Common	**67,537,360**	**$**	**491**	75,664,558	$	549
Class B Common	**2,281,478**		**-**	2,281,478		-
Total Common	**69,818,838**	**$**	**491**	77,946,036	$	549

In 2018 we repurchased 8,135,796 Common shares for $676 million and in 2017 we repurchased 245,645 Common shares for $17 million.

On September 17, 2018, our Board of Directors authorized the renewal of our normal course issuer bid ("NCIB") program to repurchase for cancellation up to 5,524,048 Common shares or approximately 10% of the public float as at September 11, 2018. The NCIB will expire on September 18, 2019 and our previous NCIB expired on September 18, 2018.

Rights and restrictions of Common shares

Common shares and Class B Common shares are equal in all respects except that each Class B Common share may at any time be exchanged for one Common share. Certain circumstances or corporate transactions may require the approval of the holders of our Common shares and Class B Common shares on a separate class-by-class basis.

16. **Equity-based compensation**

We have share option, phantom share unit ("PSU") and directors' deferred share unit ("DSU") plans. We have partially hedged our exposure under these plans with an equity derivative contract. The equity-based compensation expense included in the consolidated statement of earnings is $7 million (2017 - $32 million).

Accounting policies

We estimate the fair value of outstanding share options using the Black-Scholes valuation model and the fair value of our PSU plan and directors' DSU plan using an intrinsic valuation model at each balance sheet date. We record the resulting expense or recovery, over the related vesting period, through a charge to earnings.

From time to time, we enter into equity derivative contracts to provide a partial offset to our exposure to fluctuations in equity-based compensation from our stock option, PSU and DSU plans. These derivatives are fair valued at each balance sheet date using an intrinsic valuation model and the resulting expense or recovery is offset against the related equity-based compensation.

If a share option holder elects to acquire Common shares, both the exercise price and the accrued liability are credited to shareholders' equity.

Supporting information

Share option plan

Under our share option plan, officers and employees may be granted options to purchase up to 7,295,940 Common shares, of which 483,705 remain available for issuance. The exercise price of a share option is the closing price of a Common share on the trading day immediately preceding the grant date. Our share option plan gives share option holders the right to elect to receive a cash payment in lieu of exercising an option to purchase Common shares. Options vest at the earlier of the date of retirement or death and 20% per year from the grant date and expire after 10 years. We have recorded a recovery of $9 million (2017 - expense of $52 million) related to the share option plan.

A summary of the activity in the share option plan is presented below:

	2018			2017		
	Number		**Weighted average price** (dollars)	Number		Weighted average price (dollars)
Outstanding - beginning of year	**1,435,938**	**$**	**37.19**	2,119,886	$	29.83
Granted	**112,715**	**$**	**85.40**	192,255	$	53.11
Exercised	**(335,306)**	**$**	**25.16**	(872,973)	$	22.77
Expired / Cancelled	**(8,899)**	**$**	**51.88**	(3,230)	$	55.13
Outstanding - end of year	**1,204,448**	**$**	**44.94**	1,435,938	$	37.19
Exercisable - end of year	**809,740**	**$**	**37.37**	978,341	$	30.68

The following table summarizes information about the share options outstanding and exercisable at December 31, 2018:

Exercise price range (dollars)	**Number of outstanding options** (number)	**Weighted average remaining contractual life** (years)		**Weighted average exercise price** (dollars)	**Number of exercisable options** (number)		**Weighted average exercise price** (dollars)
$12.36	128,500	0.1	$	12.36	128,500	$	12.36
$23.65 - $25.75	235,466	2.7	$	24.62	235,466	$	24.62
$40.82 - $55.62	615,128	6.4	$	46.79	360,413	$	45.74
$73.99 - $85.40	225,354	7.6	$	79.66	85,361	$	74.82
	1,204,448	5.2	$	44.94	809,740	$	37.37

The weighted average share price at the date of exercise for share options exercised during the year was $83.43 per share (2017 - $67.80 per share).

The accrued liability related to the share option plan based on a Black-Scholes valuation model is $36 million at December 31, 2018 (December 31, 2017 - $63 million). The weighted average fair value of the options used in the calculation was $30.15 per option at December 31, 2018 (December 31, 2017 - $43.79 per option).

The inputs to the option model are as follows:

	2018	2017
Share price on balance sheet date	**$67.30**	$77.33
Weighted average exercise price	**$44.93**	$37.19
Expected dividend	**$0.80**	$0.44
Expected volatility	**35.19%**	33.34%
Weighted average interest rate	**1.87%**	1.76%
Weighted average expected remaining life in years	**3.4**	3.5

The expected dividend on our shares was based on the annualized dividend rate at each period end. Expected volatility was based on five years of historical data. The interest rate for the life of the options was based on the implied yield available on government bonds with an equivalent remaining term at each period-end. Historical data was used to estimate the expected life of the options and forfeiture rates.

The intrinsic value of options issued under the share option plan at December 31, 2018 was $29 million (December 31, 2017 - $56 million). The intrinsic value is determined based on the difference between the period end share price and the exercise price, multiplied by the sum of the related vested options plus unvested options for those holders eligible to retire.

Phantom share unit plan

Our PSU plan is intended to supplement, in whole or in part, or replace the granting of share options as long-term incentives for officers and employees. The plan provides for two types of units which vest on the third anniversary of the grant date. A restricted share unit pays out based on the Common share price over the 20 trading days immediately preceding its vesting date (the "vesting date value"). A performance share unit pays out at a value between 0% and 200% of its vesting date value contingent upon our performance relative to a peer group of companies over the three-year performance period. Officers and employees granted units under the plan are also entitled to additional units to reflect cash dividends paid on Common shares from the applicable grant date until payout.

We have recorded an expense of $5 million (2017 - $6 million) related to the PSU plan. The number of units outstanding as at December 31, 2018 was 155,595 (December 31, 2017 - 109,414), including performance share units totalling 84,966 (December 31, 2017 - 48,268).

Directors' deferred share unit plan

We have a DSU plan which provides a structure for non-employee directors to accumulate an equity-like holding in West Fraser. The DSU plan allows directors to participate in the growth of West Fraser by providing a deferred payment based on the value of a Common share at the time of redemption. Each director receives deferred share units ("Units") in payment of an annual equity retainer until a minimum equity holding is reached and may elect to receive Units in payment of up to 100% of other fees earned. After a minimum equity holding is reached, directors may elect to receive the equity retainer in Units or cash. The Units are issued based on our Common share price at the time of issue. Additional Units are issued to take into account the value of dividends paid on Common shares from the date of issue to the date of redemption. Units are redeemable only after a director retires, resigns or otherwise leaves the board. The redemption value is equal to the Common share price at the date of redemption. A holder of Units may elect to redeem Units in cash or receive Common shares having an equivalent value.

We have recorded an expense of nil (2017 - $4 million) related to the DSU plan. The number of Units outstanding as at December 31, 2018 was 52,930 (December 31, 2017 - 102,757).

Equity-based compensation hedge

During this year, we terminated our equity derivative contract under which we hedged 1,000,000 Common share equivalent units at a $46.02 share price. The contract was closed at a $66.46 per share. At the same time, a new equity derivative contract to hedge 1,000,000 Common share equivalent units at a $66.46 per share was initiated. An expense of $10 million (2017 - recovery of $30 million) is included in equity-based compensation related to these contracts.

17. **Finance expense, net**

		2018		2017
Interest expense	**$**	**(34)**	$	(25)
Interest income on short-term investments		**5**		1
Interest income on long-term duty deposits receivable (note 27)		**2**		-
Finance expense on employee future benefits		**(9)**		(7)
Accretion on long-term liabilities		**(1)**		-
	$	**(37)**	$	(31)

18. **Other**

		2018		2017
Foreign exchange gain (loss) on working capital	**$**	**13**	$	(11)
Foreign exchange gain (loss) on intercompany financing[1]		**65**		(15)
Foreign exchange gain (loss) on long-term debt (note 27)		**(55)**		25
Insurance gain on disposal of equipment[2]		**-**		7
Foreign exchange gain on export duty deposits receivable (note 27)		**5**		1
Other[3]		**9**		-
	$	**37**	$	7

1. Relates to US$600 million from January to mid-December and US$550 million thereafter (2017 - US$600 million) of financing provided to our U.S. operations. IAS 21 requires that the exchange gain or loss be recognized through earnings as the financing is not considered part of our permanent investment in our U.S. subsidiaries. The balance sheet amounts and related financing expense are eliminated in these consolidated financial statements.
2. Represents the insurance gain of $7 million recognized in 2017 related to equipment damaged at our jointly-owned NBSK plant in Quesnel. Estimated insurance proceeds for equipment replacement are accounted for as proceeds on disposition, and the resulting gain is included in other income.
3. Other includes gain on disposal of intangible assets and gain on sale of lumber futures.

19. **Tax provision**

Accounting policies

The tax expense for the period is comprised of current and deferred tax. Tax is recognized in the consolidated statement of earnings, except to the extent that it relates to items recognized in other comprehensive earnings in which case it is recognized in other comprehensive earnings.

Deferred taxes are provided for using the liability method. Under this method, deferred taxes are recognized for temporary differences between the tax and financial statement basis of assets, liabilities and certain carry-forward items.

Deferred tax assets are recognized only to the extent that it is probable that they will be realized. Deferred income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of substantive enactment.

Supporting information

The major components of income tax included in comprehensive earnings are as follows:

		2018		2017[1]
Earnings				
Current tax	**$**	**(207)**	$	(158)
Deferred tax		**(55)**		(92)
Tax provision on earnings	**$**	**(262)**	$	(250)
Other comprehensive earnings				
Deferred tax (expense) recovery on post-retirement actuarial losses	**$**	**(9)**	$	7
Tax provision on comprehensive earnings	**$**	**(271)**	$	(243)

1. Includes the impact of the 2017 statutory changes for British Columbia and the United States.

The tax provision differs from the amount that would have resulted from applying the British Columbia statutory income tax rate to earnings before tax is as follows:

		2018		2017
Income tax expense at statutory rate of 27% (2017 - 26%)	**$**	**(289)**	$	(220)
Non-taxable amounts		**2**		(6)
Rate differentials between jurisdictions and on specified activities		**20**		(20)
Unrecognized capital losses		**1**		1
Impact of statutory tax changes[1]		**-**		(6)
Other		**4**		1
Tax provision	**$**	**(262)**	$	(250)

1. Represents the re-measurement of deferred income tax assets and liabilities for the British Columbia tax rate change from 11% to 12% and the impact of United States tax reform, both of which were substantively enacted as at December 31, 2017.

Deferred income taxes are made up of the following components:

		2018		2017
Property, plant, equipment and intangibles	**$**	**402**	$	371
Reforestation and decommissioning obligations		**(33)**		(30)
Employee future benefits		**(50)**		(61)
Tax loss carry-forwards[1]		**(38)**		(58)
Other		**8**		(3)
	$	**289**	$	219
Represented by:				
Deferred income tax assets	**$**	**(3)**	$	(6)
Deferred income tax liabilities		**292**		225
	$	**289**	$	219

1. Includes federal net operating loss ("NOL") carry-forwards of $116 million expiring from 2025 to 2030. A portion of these NOL's are subject to restrictions on use.

20. Employee compensation

Our employee compensation expense includes salaries and wages, employee future benefits, termination costs and bonuses. Total compensation expense is $933 million (2017 - $872 million).

Key management includes directors and officers and their compensation expense and balance sheet date payables are as follows:

		2018		2017
Expense				
Salary and short-term employee benefits	**$**	**10**	$	10
Post-retirement benefits		**1**		1
Equity-based compensation[1]		**(3)**		48
	$	**8**	$	59
Payables and accrued liabilities				
Compensation	**$**	**4**	$	4
Equity-based compensation[1]		**42**		64
	$	**46**	$	68

1. Amounts do not necessarily represent the actual value which will ultimately be paid.

21. Earnings per share

Basic earnings per share is calculated based on earnings available to Common shareholders, as set out below, using the weighted average number of Common shares and Class B Common shares outstanding.

Diluted earnings per share is calculated based on earnings available to Common shareholders adjusted to remove the actual share option (recovery) expense charged to earnings and after deducting a notional charge for share option expense assuming the use of the equity-settled method, as set out below. The diluted weighted average number of shares is calculated using the treasury stock method. When earnings available to Common shareholders for diluted earnings per share are greater than earnings available to Common shareholders for basic earnings per share, the calculation is anti-dilutive and diluted earnings per share are deemed to be the same as basic earnings per share.

		2018		2017
Earnings				
Basic	**$**	**810**	$	596
Share option expense (recovery)		**(9)**		52
Equity settled share option adjustment		**(3)**		(4)
Diluted	**$**	**798**	$	644
Weighted average number of shares (thousands)				
Basic		**74,451**		78,097
Share options		**652**		858
Diluted		**75,103**		78,955
Earnings per share (dollars)				
Basic	**$**	**10.88**	$	7.63
Diluted	**$**	**10.62**	$	7.63

22. Commitments

Operating leases

We are committed to make payments under certain operating leases for equipment, land, building and office space. Operating lease costs expensed during the year were $6 million (2017 - $6 million). The future payments required under operating leases are as follows:

2019	$	5
2020		4
2021		4
2022		3
Thereafter		3
	$	19

Product purchase and sale commitments

We have long-term purchase and sale contracts with minimum annual volume commitments. All contracts are at market prices and on normal business terms.

Capital commitments

Capital commitments at December 31, 2018 are $108 million.

23. Government assistance

Accounting policies

Government assistance received that relates to the construction of manufacturing assets is applied to reduce the cost of those assets. Government assistance received that relates to operational expenses is applied to reduce the amount charged to earnings for the operating item.

Supporting information

Government assistance of $16 million (2017 - $3 million) was recorded as a reduction to property, plant and equipment. The majority of this relates to a grant for an energy reduction project.

Government assistance of $5 million (2017 - $14 million) was recorded as a reduction to cost of products sold. The government assistance related primarily to research and development and apprentice tax credits

24. Financial instruments

Accounting policies

All financial assets and liabilities, except for derivatives, are initially measured at fair value and subsequently measured at amortized cost using the effective interest rate method. Derivatives are measured at fair value through profit or loss (“FVTPL”).

Supporting information

The following tables provide the carrying and fair values of our financial instruments by category, as well as the associated fair value hierarchy levels as defined in note 2 under *"Fair value measurements"*:

2018	**Level**	**Amortized cost**	**FVTPL**	**Other financial liabilities**	**Carrying value**	**Fair value**
Financial assets						
Cash and short-term investments	1	**$ 160**	**$ -**	**$ -**	**$ 160**	**$ 160**
Receivables[1]	3	**331**	**1**	**-**	**332**	**332**
Export duty deposits (note 27)	3	**75**	-	-	**75**	**75**
		$ 566	**$ 1**	**$ -**	**$ 567**	**$ 567**
Financial liabilities						
Cheques issued in excess of funds on deposit	1	**$ -**	**$ -**	**$ 13**	**$ 13**	**$ 13**
Operating loans (note 13)	1	**-**	**-**	**63**	**63**	**63**
Payables and accrued liabilities	2	**-**	**-**	**448**	**448**	**448**
Long-term debt (note 13)[2]	2	**-**	**-**	**696**	**696**	**689**
		$ -	**$ -**	**$ 1,220**	**$ 1,220**	**$ 1,213**

1. Receivables include our equity derivative receivable of $1 million.
2. The fair value of the long-term debt is based on rates available to us at December 31, 2018 for long-term debt with similar terms and remaining maturities.

2017	Level	Amortized cost	FVTPL	Other financial liabilities	Carrying value	Fair value
Financial assets						
Cash and short-term investments	1	$ 258	$ -	$ -	$ 258	$ 258
Receivables[1]	3	351	1	-	352	352
Export duty deposits (note 27)	3	37	-	-	37	37
		$ 646	$ 1	$ -	$ 647	$ 647
Financial liabilities						
Payables and accrued liabilities	2	$ -	$ -	$ 441	$ 441	$ 441
Long-term debt (note 13)[2]	2	-	-	641	641	634
		$ -	$ -	$ 1,082	$ 1,082	$ 1,075

1. Receivables include our equity derivative receivable of $1 million.
2. The fair value of the long-term debt is based on rates available to us at December 31, 2017 for long-term debt with similar terms and remaining maturities.

Financial risk management

Our activities result in exposure to a variety of financial risks including risks related to derivative contracts, currency fluctuation, credit, liquidity and interest rates.

The sensitivities provided give the effect of possible changes in the relevant prices and rates on earnings. The sensitivities are hypothetical and should not be considered to be predictive of future performance or earnings.

Changes in fair values or cash flows based on market variable fluctuations cannot be extrapolated since the relationship between the change in the market variable and the change in fair value or cash flows may not be linear.

Derivative contracts

From time to time, we use derivatives to manage our exposure to U.S. dollar exchange fluctuations, commodity prices and equity-based compensation. Commodity contracts used by West Fraser include lumber futures and energy related agreements.

Based on the equity contract as at December 31, 2018 and holding all other variables constant, a $1.00 change in our share price would change its fair value by $1 million, which would partially offset the movement in our equity-based compensation.

No energy related derivatives were outstanding at December 31, 2018 or 2017.

No material lumber futures or foreign exchange contracts were outstanding at December 31, 2018 or 2017.

Currency fluctuation

Our Canadian operations sell most of their products at prices denominated in U.S. dollars or based on prevailing U.S. dollar prices. A significant portion of their operational costs and expenses are incurred in Canadian dollars. Therefore, an increase in the value of the Canadian dollar relative to the U.S. dollar reduces the revenue in Canadian dollar terms realized by our Canadian operations from sales made in U.S. dollars, which reduces operating margin and the cash flow available to fund operations.

Our U.S. operations transact and report in U.S. dollars, but their results are translated into Canadian dollars for financial statement purposes with the resulting translation gains or losses being reported in other comprehensive earnings.

Impact of U.S. dollar currency fluctuation

The U.S. dollar foreign currency balance sheet exposure at December 31, 2018 is as follows:

Canadian operations		**2018**
Net working capital	**US$**	**83**
Export duty deposits		**55**
Intercompany financing[1]		**550**
Long-term debt		**(500)**
	US$	**188**

U.S. operations		**2018**
Net investment	**US$**	**1,164**

1. IAS 21 requires that the exchange gain or loss be recognized through earnings as the financing is not considered part of our permanent investment in our U.S. subsidiaries. The balance sheet amounts and related financing expense are eliminated in these consolidated financial statements.

Based on these balances, with other variables unchanged, a $0.01 increase (decrease) in the exchange rate for one U.S. dollar into Canadian currency would result in a $3 million decrease (increase) in earnings and an increase (decrease) of $21 million in the translation gain on foreign operations included in other comprehensive earnings.

Credit

Credit risk arises from the non-performance by counterparties of contractual financial obligations. Investments in cash and short-term investments are primarily made using major banks and only made with counterparties meeting certain

credit-worthiness criteria. Credit risk for trade and other receivables is managed through established credit monitoring activities such as:

- Customer credit limits are established and monitored;
- Ongoing evaluations of key customer financial conditions are performed; and
- In certain market areas, we have undertaken additional measures to reduce credit risk including credit insurance, letters of credit and prepayments. At December 31, 2018, approximately 45% of trade accounts receivable was covered by at least some of these additional measures.

Given our credit monitoring activities, the low percentage of overdue accounts and our low customer defaults with no bad debts in 2018 or 2017, we have recorded minimal expected credit losses. We consider the credit quality of the trade accounts receivable at December 31, 2018 to be high. The aging analysis of trade accounts receivable is presented below:

	2018	2017
Trade accounts receivable – gross		
Current	**$ 260**	$ 290
Past due 1 to 30 days	**7**	3
Past due 31 to 60 days	**1**	2
Past due over 60 days	**-**	1
	268	296
Allowance for doubtful accounts	**-**	-
Trade accounts receivable – net	**268**	296
Insurance receivable	**14**	20
Government assistance	**10**	-
Other	**40**	36
Receivables	**$ 332**	$ 352

Liquidity

We manage liquidity by maintaining adequate cash and short-term investment balances and by having appropriate lines of credit available. In addition, we regularly monitor and review both actual and forecasted cash flows. Refinancing risks are managed by ensuring debt has a balanced maturity schedule where possible.

The following table summarizes the aggregate amount of contractual future cash outflows for long-term debt:

	2019	2020	2021	2022	Thereafter	Total
Long-term debt (note 13)	$ -	$ 10	$ -	$ 273	$ 413	$ 696
Interest on long-debt[1,2]	31	30	30	26	32	149
	$ 31	$ 40	$ 30	$ 299	$ 445	$ 845

1. Assumes debt level, foreign exchange rate and interest rates remain at December 31, 2018 levels and rates.
2. At December 31, 2018, we had drawn $63 million under our revolving credit facility. The potential interest payable on this loan has not been included in the above table.

Interest rates

Interest rate risk relates mainly to floating rate debt.

At December 31, 2018, a 100 basis point increase (decrease) in interest rates on floating rate debt would result in a $2 million decrease (increase) in earnings. This analysis assumes that all other variables remain constant.

25. **Capital disclosures**

Our business is cyclical and is subject to significant changes in cash flow over the business cycle. In addition, financial performance can be materially influenced by changes in product prices and the relative values of the Canadian and U.S. dollars. Our objective in managing capital is to ensure adequate liquidity and financial flexibility at all times, particularly at the bottom of the business cycle.

Our main policy relating to capital management is to maintain a strong balance sheet and otherwise meet financial tests that are commonly applied by rating agencies for investment grade issuers of public debt. Our debt is currently rated as investment grade by three major rating agencies.

We monitor and assess our financial performance in order to ensure that net debt levels are prudent taking into account the anticipated direction of the business cycle. When financing acquisitions, we combine debt and equity financing in a proportion that is intended to maintain an investment grade rating for debt throughout the cycle. Debt repayments are arranged, where possible, on a staggered basis that takes into account the uneven nature of anticipated cash flows. We have established committed revolving lines of credit that provide liquidity and flexibility when capital markets are restricted.

One key measurement used to monitor our capital position is net debt to total capital, calculated as follows at December 31:

	2018	2017
Net debt		
Cash and short-term investments	**$ (160)**	$ (258)
Deferred financing costs[1]	**(6)**	(7)
Cheques issued in excess of funds on deposit	**13**	-
Operating loans	**63**	-
Long-term debt	**696**	641
	606	376
Shareholders' equity	**2,896**	2,726
Total capital	**$ 3,502**	$ 3,102
Net debt to total capital	**17%**	12%

1. For our balance sheet presentation, these costs are applied to reduce the associated debt or, in instances when the operating loan is undrawn, these costs are included in other assets.

26. **Segment and geographical information**

The segmentation of manufacturing operations into lumber, panels and pulp and paper is based on a number of factors, including similarities in products, production processes and economic characteristics. Transactions between segments are at market prices and on normal business terms. The segments follow the accounting policies as described in these consolidated financial statement notes, where applicable.

	Lumber		Panels		Pulp & Paper		Corporate & Other		Total
2018									
Sales									
To external customers	**$**	**4,291**	**$**	**664**	**$**	**1,163**	**$**	**-**	**$ 6,118**
To other segments		**165**		**12**		**-**		**-**	
	$	**4,456**	**$**	**676**	**$**	**1,163**	**$**	**-**	
Operating earnings before amortization	**$**	**954**	**$**	**127**	**$**	**258**	**$**	**(10)**	**$ 1,329**
Amortization		**(196)**		**(15)**		**(44)**		**(2)**	**(257)**
Operating earnings		**758**		**112**		**214**		**(12)**	**1,072**
Finance expense		**(25)**		**(2)**		**(10)**		**-**	**(37)**
Other		**20**		**-**		**11**		**6**	**37**
Earnings before tax	**$**	**753**	**$**	**110**	**$**	**215**	**$**	**(6)**	**$ 1,072**
Total assets	**$**	**3,739**	**$**	**320**	**$**	**659**	**$**	**73**	**$ 4,791**
Total liabilities	**$**	**701**	**$**	**62**	**$**	**156**	**$**	**976**	**$ 1,895**
Capital expenditures	**$**	**284**	**$**	**16**	**$**	**60**	**$**	**10**	**$ 370**

	Lumber		Panels		Pulp & Paper		Corporate & Other		Total
2017									
Sales									
To external customers	$	3,554	$	592	$	988	$	-	$ 5,134
To other segments		117		8		-		-	
	$	3,671	$	600	$	988	$	-	
Operating earnings before amortization	$	836	$	113	$	172	$	(41)	$ 1,080
Amortization		(155)		(13)		(40)		(2)	(210)
Operating earnings		681		100		132		(43)	870
Finance expense		(20)		(3)		(8)		-	(31)
Other		(1)		-		2		6	7
Earnings before tax	$	660	$	97	$	126	$	(37)	$ 846
Total assets	$	3,404	$	314	$	627	$	172	$ 4,517
Total liabilities	$	467	$	57	$	156	$	1,111	$ 1,791
Capital expenditures	$	247	$	22	$	58	$	9	$ 336
Acquisition	$	526	$	-	$	-	$	-	$ 526

The geographic distribution of non-current assets and external sales is as follows:

	Non-current assets				Sales by geographic area[1]			
		2018		2017		**2018**		2017
Canada	**$**	**2,121**	$	2,096	**$**	**1,239**	$	1,129
United States		**1,325**		1,130		**3,661**		2,973
China		**-**		-		**734**		627
Other Asia		**-**		-		**442**		357
Other		**-**		-		**42**		48
	$	**3,446**	$	3,226	**$**	**6,118**	$	5,134

1. Sales distribution is based on the location of product delivery.

27. **Countervailing ("CVD") and antidumping ("ADD") duty dispute**

On November 25, 2016, a coalition of U.S. lumber producers petitioned the U.S. Department of Commerce ("USDOC") and the U.S. International Trade Commission ("USITC") to investigate alleged subsidies to Canadian softwood lumber producers and levy countervailing and antidumping duties against Canadian softwood lumber imports. We were chosen by the USDOC as a "mandatory respondent" to both the countervailing and antidumping investigations and as a result have received unique company specific rates.

On April 24, 2017, the USDOC issued its preliminary determination in the countervailing duty ("CVD") investigation and imposed a company specific preliminary rate of 24.12% to be posted by cash deposits on the exports from Canada of softwood lumber to the U.S. on or after April 28, 2017. On June 26, 2017, the USDOC issued its preliminary determination in the antidumping duty ("ADD") investigation and imposed a company specific preliminary rate of 6.76% to be posted by cash deposits on the exports from Canada of softwood lumber to the U.S. on or after June 30, 2017. The requirement that we deposit CVD was suspended on August 24, 2017 until final determination was published by the USITC. On December 4, 2017, the USDOC amended our CVD rate to 17.99% and our ADD rate to 5.57%. Effective December 28, 2017, we began posting cash deposits for CVD and effective December 4, 2017, we began posting cash deposits for ADD at the revised rates. The CVD and ADD rates are subject to further adjustment through administrative reviews to be completed by the USDOC. The administrative reviews for each of CVD and ADD are expected to commence in the spring of 2019 and cover the periods from April 28, 2017 to December 31, 2018 for CVD and June 30, 2017 to December 31, 2018 for ADD. The reviews may not be finalized until mid-2020 and the results are subject to appeals.

During the year ended December 31, 2018, our lumber segment posted cash deposits for CVD at a 17.99% rate and for ADD at a 5.57% rate. We recalculate the ADD rate for the current period of review using our reported results and the same calculation methodology as the USDOC. Based on our current data, we determined that the expected ADD rate will be 1.46% which is lower than the ADD deposit rate of 5.57%.

For the year ended December 31, 2018 we incurred duty deposits of $178 million related to CVD (2017 - $52 million) and $55 million related to ADD (2017 - $32 million) as follows:

Export duties incurred in the period		**2018**		2017
Export duties recognized as expense in consolidated statements of earnings	**$**	**202**	$	48
Export duties recognized as long-term duty deposits receivable in consolidated balance sheets		**31**		36
Total	**$**	**233**	$	84

We have recorded long-term duty deposits receivable related to CVD of $11 million representing the excess of deposits made at the preliminary rate of 24.12% compared to the final rate of 17.99%. In addition, we have recorded long-term duty deposits receivable related to ADD of $62 million for the difference between the 5.57% deposit rate and our

1.46% estimated rate. Lastly, we have recognized interest of $2 million on the long-term duty deposits receivable related to both CVD and ADD. The details are as follows:

Export duty deposits receivable		**2018**		2017
Beginning of year	**$**	**37**	$	-
Export duties recognized as long-term duty deposits receivable in consolidated balance sheets		**31**		36
Interest recognized on the long-term duty deposits receivable		**2**		-
Foreign exchange on the long-term duty deposits		**5**		1
End of year	**$**	**75**	$	37

As at December 31, 2018, duties paid and payable that are on deposit with the USDOC total US$244 million.

The duty rates are subject to change based on administrative reviews and appeals available to us. In addition, we will update our ADD rate at each reporting date considering our actual results for each period of review. Changes to estimated rates may be material and any changes will be reflected through earnings in the period of the change. Notwithstanding the deposit rates assigned under the investigations, our final liability for the assessment of CVD and ADD will not be determined until each annual administrative review process is complete and related appeal processes are concluded.