Ainsworth®

# REPORT TO SHAREHOLDERS
# FOR THE THREE MONTHS AND YEAR ENDED
# DECEMBER 31, 2012

## LETTER TO SHAREHOLDERS

March 7, 2013

Dear Fellow Shareholders:

I am pleased to report that Ainsworth's adjusted EBITDA for the year was $106.7 million in 2012, compared to $12.5 million in 2011. These are our best operating results since 2005. Adjusted EBITDA margins were 26 percent on shipment volumes of 1.62 billion square feet (3/8" basis) and sales of $409.1 million. These impressive results not only reflect improving market conditions but were also made possible by our unrelenting focus on superior operational performance and our strategic commitment to value-added products and markets.

In 2012, the recovery in the U.S. housing market gained momentum particularly in the second half of the year. We started the year with cautious optimism about the gradual return of U.S. residential construction activity and improving North American demand for structural panels. As the year unfolded, demand conditions continued to steadily improve, with the U.S. housing recovery well-established by the end of the year. U.S. housing starts were 780,000 in 2012, up 28 percent from 608,800 starts in 2011 and ahead of industry forecasts. Housing starts were up in all regions and most notably in the West, a region that accounts for a significant share of our shipments.

As a result of these positive market conditions, OSB market prices increased significantly during the year. The higher prices reflected lean and committed inventories throughout the supply chain and the inability of manufacturers to keep pace with demand. The North Central price indicator for the benchmark 7/16" OSB averaged U.S.$271/msf in 2012 (a 46 percent increase over 2011) with the Western Canadian price indicator for the benchmark 7/16" OSB very close behind at U.S.$269/msf (a 75 percent increase over 2011). During the fourth quarter, the North Central and Western Canada price indicators averaged U.S.$332 and U.S.$331/msf, respectively.

We increased shipments in 2012 and were able to benefit from the higher OSB prices. Shipment volumes increased 5 percent from the same period a year ago, reflecting efficiency gains at each of our three operating mills. At 1.62 billion square feet, we exceeded our previous record annual combined production for these mills by 4%.

Costs of products sold were $287.2 million for the year, compared to $264.6 million in 2011. While the majority of these increases related to the increase in shipment volumes, we also experienced increases in resin and wax prices company-wide, as well as higher wood costs at some of our operations. Offsetting higher raw material costs during the year, we were able to achieve close to $9 million in cost reduction initiatives by the end of the year.

Turning to Japan, our principal overseas market, the housing industry there showed signs of improvement in 2012. Year over year total starts increased 5.8 percent to finish at 882,797 units, spurred in part by looming consumption tax increases and renewed economic confidence. Wooden housing averaged 55 percent of the overall market in 2012 and experienced a 4.7 percent increase relative to 2011. However, our ability to take advantage of the positive market conditions was limited primarily by domestic plywood producers, whose production volumes returned to levels achieved prior to the tsunami in March 2011. Despite lower shipments to Japan in 2012 compared to 2011, we continue to be the principal OSB provider to Japanese builders and are fully engaged in an action plan that is focused on demand creation and product line expansion.

*Comprehensive Refinancing*

During the fourth quarter of 2012, we successfully completed a comprehensive refinancing via a $175 million rights offering of common shares and a U.S.$350 million debt offering. The proceeds from the rights offering and the debt offering were used to repay substantially all of our existing debt. The refinancing resulted in a 30 percent reduction in total debt, a $25 million reduction in annual borrowing costs and effectively the extension of our debt maturity profile into 2017.

Our improved balance sheet, in combination with cash generated from operations, provides us with the flexibility to pursue our business plan and capitalize on the ongoing market recovery.

*Outlook*
At the time of writing this letter, all indicators regarding market conditions are positive. U.S. Foreclosures and existing home inventories are trending down, home prices and builder confidence are improving and housing forecasts are being upgraded. At the same time, OSB inventories in the supply chain are lean, mill order files are long and structural panel prices are at the highest levels since May 2004. Against this backdrop of optimism with respect to market demand, structural panel producers are making some plans to bring idle capacity back on line. However, we are of the view that supply will come on gradually and lag demand growth in the near-term.

We are actively working towards restarting our High Level mill in the second half of this year. The mill is one of the largest production facilities in the industry and will be an efficient producer with strong access to high quality, low cost fiber. High Level will enable us to continue to meet the growing requirements of our existing customer base while allowing us to service new market segments, both in terms of geography and technical innovation. The unique characteristics of the High Level press and equipment will also enable us to expand our reach into industrial applications as well as markets such as China where we have identified and are developing significant opportunities for innovative and proprietary products. These diversification efforts are strategic to our Company as we establish a sustainable business throughout the cycle.

*Safety*
As you all know, safety has been a major area of focus throughout the organization and significant improvements have been made, with contributions from all employees. Unfortunately, I regret to report that Ainsworth experienced a fatality at our Grande Prairie OSB operation in February 2013. The entire Ainsworth team is deeply saddened by this tragedy. Safe practices and policies are fundamental to our operations and the well-being of our employees. An incident like this reminds us that it is imperative to remain diligently focused on our commitment to safety and the continuous improvement of work practices as an essential guiding principle for our Company.

As always, I appreciate the continued trust and support of our shareholders, our valued customers and our great employees.

Sincerely,

/s/ Jim Lake

President and Chief Executive Officer

# MANAGEMENT'S DISCUSSION AND ANALYSIS
# OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
# For the Three Months and Year Ended December 31, 2012

This management's discussion and analysis is presented as at March 7, 2013. Financial references are in Canadian dollars unless otherwise indicated. Additional information relating to Ainsworth Lumber Co. Ltd. (also referred to as Ainsworth, the Company, or we, or our), including our annual information form, is available on SEDAR at www.sedar.com. Our financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS").

## Overview

Ainsworth is a leading manufacturer and marketer of oriented strand board ("OSB") with a focus on value-added specialty products for markets in North America and Asia.

Our strategy is to be sustainable and profitable throughout the business cycle by diversifying sales geographically, expanding our value-added product offerings and leveraging a proven track record of operational excellence, innovation and technical product development. We remain focused on prudent balance sheet management and maximizing shareholder value.

The Company has a production capacity of 2.5 billion square feet per year (3/8-inch basis) and has four wholly-owned OSB manufacturing facilities located in Grande Prairie, Alberta; High Level, Alberta; 100 Mile House, British Columbia; and, Barwick, Ontario. All four mills are strategically located in terms of wood supply and access to markets in North America and Asia. The Company's active facilities have a current production capacity of 1.7 billion square feet (3/8-inch basis).

The table below summarizes the estimated annual production capacity for each of our mills (in millions of square feet "mmsf", 3/8-inch basis):

| | |
|---|---|
| 100 Mile House, BC | 440 |
| Grande Prairie, AB | 730 |
| Barwick, ON | 510 |
| High Level, AB (currently curtailed) [1] | 860 |
| Total capacity | 2,540 |
| Current operating capacity | 1,680 |

(1) The Company holds a 100% interest in the High Level mill ("High Level") as a result of the acquisition of the remaining 50% interest from Grant Forest Products Inc. in 2011, and has implemented plans to resume production in 2013.

To meet increases in customer demand for OSB, incremental capacity will come from restarting the High Level mill. This mill has been on care and maintenance since December 2007 and has the capability of manufacturing products for Ainsworth's markets in both North America and Asia. Ainsworth has implemented plans to restart the High Level mill in the second half of 2013 in order to meet customer orders and enquiries from both North American and export markets.

In addition, the Company continues to assess the timing and the remaining costs to complete the second production line at the Grande Prairie mill, which would further increase capacity by approximately 600 mmsf (3/8-inch basis) to over 3 billion square feet per year (3/8-inch basis).

All of our facilities utilize flexible mill technology and can manufacture products for domestic and overseas markets. Our facilities have access to low cost fibre sources, are energy efficient and have low sustaining capital requirements. Ainsworth employs an experienced, reliable workforce of approximately 600 workers. Safety and environmental responsibility is emphasized as a key value at all levels.

## Advisory Regarding Forward-Looking Statements

This document contains forward looking statements concerning future events or expectations of Ainsworth's future performance, OSB demand and pricing, financial conditions, and other expectations, beliefs, intentions and plans that are not historical fact. These forward-looking statements appear under the heading "Outlook" and in a number of other places in this report and can be identified by words such as "may", "estimates", "projects", "expects", "intends", "believes", "plans", "anticipates", "continue", "growing", "expanding", or their negatives or other comparable words. Investors are cautioned that such forward-looking statements are not promises or guarantees of future performance but are only predictions that relate to future events, conditions or circumstances or our future results, performance, achievements or developments and are subject to substantial known and unknown risks, assumptions, uncertainties and other factors that could cause our actual results, performance or developments in our business or in our industry to differ materially from those expressed, anticipated or implied by such forward-looking statements. Factors that could cause actual results to differ materially from those expressed or implied by such forward looking statements include, without limitation, the future demand for, and sales volumes of, Ainsworth's products, future production volumes, efficiencies and operating costs, increases or decreases in the prices of Ainsworth's products, Ainsworth's future stability and growth prospects, Ainsworth's future profitability and capital needs, including capital expenditures, and the outlook for and other future developments in Ainsworth's affairs or in the industries in which Ainsworth participates and factors detailed from time to time in Ainsworth's periodic reports filed with the Canadian Securities Administrators and other regulatory authorities. These periodic reports are available to the public at www.sedar.com. Many of these factors are beyond Ainsworth's control.

Ainsworth believes that the expectations reflected in its forward-looking information are reasonable but no assurance can be given that these expectations will prove to be correct and therefore any forward-looking statements included in this report should not be unduly relied upon. These statements speak only as of the date of this report. Ainsworth has no intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required under applicable securities laws. The forward-looking statements contained in this document are expressly qualified by this cautionary statement.

## Non-IFRS Measures

In addition to IFRS measures, Ainsworth uses the non-IFRS measures "adjusted EBITDA", "adjusted EBITDA margin" "adjusted working capital" and "gross profit" to make strategic decisions and to provide investors with a basis to evaluate operating performance and ability to incur and service debt. Non-IFRS measures do not have a standardized meaning prescribed by IFRS and may not be comparable to similar measures used by other companies. Included in this report are tables calculating adjusted EBITDA, adjusted EBITDA margin, adjusted working capital, and narrative disclosures defining gross profit.

## Summary of Operating and Financial Results from Continuing Operations

| | 2012 | Q4-12 | Q3-12 | Q2-12 | Q1-12 | 2011 | Q4-11 | Q3-11 | Q2-11 | Q1-11 |
|---|---|---|---|---|---|---|---|---|---|---|
| *(in millions, except volume, unless otherwise noted)* | | | | | | | | | | |
| Sales | $ 409.1 | $ 117.9 | $ 115.6 | $ 90.5 | $ 85.1 | $ 293.3 | $ 69.5 | $ 71.8 | $ 80.5 | $ 71.5 |
| Adjusted EBITDA (1) | 106.7 | 42.3 | 37.3 | 17.1 | 10.0 | 12.5 | 2.7 | 0.7 | 2.7 | 6.4 |
| Adjusted EBITDA margin (2) | 26.1% | 35.9% | 32.3% | 18.9% | 11.8% | 4.3% | 3.9% | 1.0% | 3.4% | 9.0% |
| Shipment volume (mmsf 3/8") | 1,620.0 | 398.2 | 422.9 | 393.8 | 405.1 | 1,540.5 | 374.3 | 393.4 | 422.0 | 350.8 |
| Production volume (mmsf 3/8") | 1,624.3 | 406.4 | 419.1 | 398.0 | 400.8 | 1,541.0 | 368.3 | 394.9 | 388.9 | 388.9 |

(1) Adjusted EBITDA, a non-IFRS financial measure, is defined as net income (loss) from continuing operations before amortization, gain on disposal of property, plant and equipment, cost of curtailed operations, stock option expense (recovery), finance expense, foreign exchange (gain) loss on long-term debt, other foreign exchange loss (gain), income tax (recovery) expense and non-recurring items. See the detailed calculation of adjusted EBITDA by quarter on page 10.

(2) Adjusted EBITDA margin, a non-IFRS financial measure, is defined as adjusted EBITDA divided by sales.

## Review of Financial Results

| | | Q4-12 | | Q4-11 | | 2012 | | 2011 |
|---|---|---|---|---|---|---|---|---|
| *(in millions)* | | | | | | | | |
| Sales | **$** | **117.9** | $ | 69.5 | **$** | **409.1** | $ | 293.3 |
| Cost of products sold | | **72.0** | | 62.7 | | **287.2** | | 264.6 |
| Net income from continuing operations | | **6.7** | | 1.7 | | **28.8** | | 7.6 |
| Net income | | **6.7** | | 2.8 | | **28.4** | | 8.3 |
| Adjusted EBITDA | | **42.3** | | 2.7 | | **106.7** | | 12.5 |
| Adjusted EBITDA margin | | **35.9%** | | 3.9% | | **26.1%** | | 4.3% |

The table below shows the calculation of adjusted EBITDA:

| | | Q4-12 | | Q4-11 | | 2012 | | 2011 |
|---|---|---|---|---|---|---|---|---|
| *(in millions)* | | | | | | | | |
| Net income from continuing operations | **$** | **6.7** | $ | 1.7 | **$** | **28.8** | $ | 7.6 |
| Add (deduct): | | | | | | | | |
| Amortization of property, plant and equipment | | **6.9** | | 5.9 | | **25.6** | | 23.9 |
| Loss (gain) on disposal of property, plant and equipment | | **0.2** | | (0.2) | | **0.1** | | (0.9) |
| Write-down of property, plant and equipment, intangibles and other | | **1.5** | | - | | **1.5** | | 0.9 |
| Cost of curtailed operations | | **1.1** | | 1.0 | | **3.7** | | 3.3 |
| Stock option expense | | **0.5** | | (0.2) | | **0.8** | | 0.4 |
| Finance expense | | **11.3** | | 13.1 | | **50.8** | | 49.8 |
| Loss on early repayment of long-term debt | | **22.9** | | - | | **22.9** | | - |
| Income tax expense (recovery) | | **2.5** | | (2.4) | | **5.9** | | (16.7) |
| Foreign exchange loss (gain) on long-term debt | | **7.6** | | (16.4) | | **(10.3)** | | 11.4 |
| (Gain) loss on derivative financial instrument | | **(18.3)** | | - | | **(23.9)** | | 6.2 |
| Gain on High Level acquisition | | **-** | | - | | **-** | | (72.5) |
| Other | | **(0.6)** | | 0.2 | | **0.8** | | (0.9) |
| Adjusted EBITDA | **$** | **42.3** | $ | 2.7 | **$** | **106.7** | $ | 12.5 |

Net income from continuing operations in the fourth quarter of 2012 was $6.7 million compared to $1.7 million in the fourth quarter of 2011. The $5.0 million increase in net income included a $39.1 million increase in gross profit (sales less cost of products sold (exclusive of amortization)), an $18.3 million variation in gain/loss on derivative financial instrument, and a $1.8 million decrease in finance expense. The increases were partially offset by a $24.1 million variation in foreign exchange gain/loss on long-term debt, a $22.9 million loss on early repayment of long-term debt, and a total $7.2 million reduction related to items including income tax expense, write-downs, and amortization expense.

On an annual basis, net income from continuing operations was $28.8 million in 2012, compared to $7.6 million in 2011. The $21.2 million increase in net income included a $93.2 million increase in gross profit, a $30.2 million variation in gain/loss on derivative financial instrument, and a $21.6 million variation in foreign exchange gain/loss on long-term debt. The increases were partially offset by a one-time gain on the High Level acquisition of $72.5 million in 2011, a $22.9 million loss on early repayment of long-term debt in 2012, a $22.8 million variation in income tax expense, and a total $5.6 million reduction related to various items including amortization expense, write-downs, disposal of property, plant and equipment, foreign exchange loss from operations, and interest on long-term debt.

## Adjusted EBITDA

In the fourth quarter of 2012, adjusted EBITDA was $42.3 million compared to $2.7 million in the fourth quarter of 2011. Adjusted EBITDA margin on sales was 35.9% compared to 3.9% in the same period of 2011. The increase was primarily the result of a $39.1 million increase in gross profit.

Adjusted EBITDA on an annual basis was $106.7 million in 2012, compared to $12.5 million in 2011. Adjusted EBITDA margin on sales was 26.1% compared to 4.3% in 2011. The increase was primarily the result of a $93.2 million increase in gross profit.

### Sales

Sales of $117.9 million in the fourth quarter of 2012 were $48.4 million higher than sales of $69.5 million for the same period in 2011. The increase in sales was mainly due to a 59.4% increase in realized pricing. During the fourth quarter of 2012, the average benchmark price for the North Central region was U.S.$332 per msf (7/16-inch basis), an increase of U.S.$142 per msf (7/16-inch basis) compared to the same period in 2011. The average benchmark price for the Western Canada region increased by U.S.$182 per msf (7/16-inch basis) in the fourth quarter of 2012 compared to the same period in 2011. Sales revenue was further improved by a 6.4% increase in sales volumes as the Company responded to increased demand from customers.

Sales of $409.1 million in 2012 were $115.8 million higher than sales of $293.3 million in 2011. The increase in sales was the result of a 32.6% increase in realized pricing and a 5.2% increase in sales volume. Production volumes increased 5.4% from 2011 to 2012.

The average benchmark F.O.B. mill prices reported by Random Lengths for each quarter of 2012 and 2011, as well as the annual averages for 2012 and 2011, are shown in the table below:

| U.S. dollars | 2012 | Q4-12 | Q3-12 | Q2-12 | Q1-12 | 2011 | Q4-11 | Q3-11 | Q2-11 | Q1-11 |
|---|---|---|---|---|---|---|---|---|---|---|
| North Central (7/16" basis) | $ 271 | $ 332 | $ 313 | $ 235 | $ 203 | $ 186 | $ 190 | $ 184 | $ 174 | $ 199 |
| Western Canada (7/16" basis) | 269 | 331 | 310 | 232 | 201 | 154 | 149 | 137 | 151 | 182 |

### Costs of Products Sold (Exclusive of Amortization)

In the fourth quarter of 2012, cost of products sold was $72.0 million, a $9.3 million increase over the same period in 2011. On an annual basis, cost of products sold was $287.2 million in 2012, a $22.6 million increase compared to 2011. The increase in cost of products sold on a quarterly and annual basis was primarily the result of increased sales volumes. We also experienced increases in resin and wax prices company-wide, as well as higher wood costs at some of our operations. Offsetting higher raw material costs, our cost reduction initiatives in 2012 generated approximately $9 million in savings.

### Selling and Administration

Selling and administration expense increased from $4.1 million in the fourth quarter of 2011 to $4.3 million in the fourth quarter of 2012. For the full twelve months of 2012, selling and administration expense decreased by $1.0 million from $17.4 million in 2011 as a result of reductions in salaries and benefits expense and lower professional fees.

### Amortization of Property, Plant and Equipment and Intangible Assets

Amortization expense in the fourth quarter of 2012 was $6.9 million compared to $5.9 million in the fourth quarter of 2011. Full year amortization expense was $25.6 million in 2012 compared to $23.9 million in 2011. The increase quarter over quarter and year over year was the result of higher shipment volumes in 2012 compared to 2011 since our OSB panel mills are amortized using the units-of-production method.

### Costs of Curtailed Operations

Costs of curtailed operations are primarily comprised of costs directly attributable to our High Level, Alberta mill.

### Finance Expense

Finance expense in the fourth quarter of 2012 was $11.3 million, a decrease of $1.8 million compared to $13.1 million in the fourth quarter of 2011. This reduction was due to a lower principal balance and interest rate on long-term debt following the refinancing transactions in late 2012, whereby the Company repaid the 11% Senior Unsecured Notes and Senior Secured term loan using net proceeds from the issuance of 7.5% Senior Secured Notes and from the issuance of common shares via the rights offering. The reduction was partially offset by the foreign exchange effect of a weaker Canadian dollar, on average, relative to the U.S. dollar.

Finance expense for the full year was $50.8 million in 2012, an increase of $1.0 million compared to $49.8 million in 2011. The increase for the twelve months ended 2012 compared to 2011 was the result of a higher principal balance of 11% Senior Unsecured Notes outstanding for the majority of 2012 due to the issue of new notes as payment-in-kind interest, in combination with the foreign exchange effect of a weaker Canadian dollar, on average, relative to the U.S. dollar.

### Loss on Early Repayment of Long-Term Debt

During the fourth quarter of 2012, we repaid our Senior Unsecured Notes and Senior Secured term loan. The call option embedded in the Senior Unsecured Notes was revalued and subsequently extinguished at the time of repayment. The increase in value was recorded as a gain on derivative financial instrument, while the value of $17.2 million was written off as a loss on early repayment of long-term debt. The total loss on early repayment of long-term debt of $22.9 million also includes a $6.0 million write-off of unamortized transaction costs and bond premium, $1.0 million legal and consent fees on tender, and was partly offset by a $1.3 million realized foreign exchange gain on repayment.

### Foreign Exchange Gain (Loss) on Long-Term Debt

The unrealized foreign exchange loss on long-term debt in the fourth quarter of 2012 was $7.6 million compared to a gain of $16.4 million in the fourth quarter of 2011. For the full year, the unrealized foreign exchange gain on long-term debt was $10.3 million in 2012 compared with a loss of $11.4 million in 2011.

The majority of our debt is denominated in U.S. currency and is therefore subject to fluctuations in the exchange rate. A strengthening of the Canadian dollar, relative to the U.S. dollar, results in a foreign exchange gain, whereas a weakening of the Canadian dollar, relative to the U.S. dollar, results in a foreign exchange loss.

Management estimates that a one cent change of the Canadian dollar results in an after tax increase/decrease in foreign exchange loss/gain on our U.S. dollar debt of $2.6 million on an annual basis.

### Gain (Loss) on Derivative Financial Instrument

During the fourth quarter of 2012, the derivative financial instrument related to the call option embedded in the Senior Unsecured Notes was extinguished with the repayment of our Senior Unsecured Notes. The value was written off as a loss on early repayment of debt. Prior to extinguishment, the derivative financial asset was revalued based on current interest rates and the credit spread. The call options embedded in the Senior Secured Notes issued during the fourth quarter were recorded at fair value on issuance and were revalued at December 31, 2012, based on current interest rates and the credit spread. Changes in the risk-free rate, the credit spread and the cash interest rate resulted in total gains on the derivative financial assets of $18.3 million in the fourth quarter of 2012 (fourth quarter of 2011: $nil).

A gain of $23.9 million was recorded for the twelve months ended December 31, 2012 (twelve months ended December 31, 2011: $6.2 million loss).

The derivative financial asset is revalued quarterly (see “Financial Instrument”) and changes in the value of this derivative financial asset are reflected in operations.

### Gain on Acquisition of High Level

The curtailed OSB facility located in High Level, Alberta is wholly-owned by the Company as a result of the acquisition of the remaining 50% interest from Grant Forest Products Inc. for $20 million. The acquisition was completed with regulatory approval granted by the Court in respect of Grant Forest Products’ proceedings under the Companies’ Creditors Arrangement Act (CCAA) on February 17, 2011. We recognized a bargain purchase gain of $49.7 million, resulting from the excess fair value of the net assets acquired over the cash consideration paid. Following this transaction, we revalued our existing 50% interest in the assets and liabilities of High Level held prior to this transaction to their fair values, recognizing a gain of $22.8 million. The total $72.5 million gain net of tax was presented on the consolidated statement of operations at December 31, 2011.

### Other Items

Other income of $145 thousand in the fourth quarter of 2012 was not significantly different than $360 thousand in the fourth quarter of 2011. On an annual basis, other income was $480 thousand in 2012 compared to $1.5 million in 2011, primarily due to lower interest income on short-term investments.

During the fourth quarter of 2012, certain non-core property located in Savona, British Columbia was written down to fair market value of $1.0 million. Subsequent to the end of the year, the Company sold this property for cash consideration approximating the carrying value.

### Income Taxes

Income tax expense in the fourth quarter of 2012 was $2.5 million on income before income taxes of $9.2 million compared with an income tax recovery of $2.4 million on a loss before income taxes of $0.6 million in the fourth quarter of 2011. Income tax expense was $5.9 million for the year 2012 compared with an income tax recovery of $16.7 million for the year 2011. Certain permanent differences, such as the non-taxable portion of the foreign exchange gain on our debt and expenses not deductible for tax purposes, impacted the resulting income tax expense.

As a result of the discontinuation of our U.S. OSB operations, U.S. tax losses and the resulting valuation allowance are excluded from the temporary timing differences disclosed in the financial statements.

Tax filings are subject to the review, audit and assessment of applicable taxation authorities in Canada and the United States. Tax laws and regulations are subject to interpretation and inherent uncertainty; therefore, our assessments involve judgments, estimates and assumptions about current and future events. Although we believe these estimates and assumptions are reasonable and appropriate, the final determination could be materially different than that which is reflected in our provision for income taxes and recorded tax assets and liabilities.

### Net Income (Loss) from Discontinued Operations

Net loss from discontinued operations includes expenses, such as pension and actuarial costs, associated with the OSB mills in Minnesota, as well as from the plywood and veneer operations in Lillooet and Savona that were disposed in 2009.

### Capital Resources and Liquidity

As of December 31, 2012, our adjusted working capital was $136.6 million, compared to $90.1 million as at December 31, 2011. We have presented adjusted working capital as we believe that it provides investors with a basis to evaluate our ability to fund operations and capital expenditures. Adjusted working capital, a non-IFRS measure, is calculated as follows:

| | | **December 31 2012** | | **December 31 2011** |
|---|---|---|---|---|
| *(in millions)* | | | | |
| Current assets | **$** | **181.4** | $ | 123.8 |
| Restricted cash not related to current liabilities | | **(5.6)** | | (4.9) |
| Current liabilities | | **(39.2)** | | (28.8) |
| Adjusted working capital | **$** | **136.6** | $ | 90.1 |
| Adjusted working capital, discontinued operations | | **(0.5)** | | (0.2) |
| Adjusted working capital, continuing operations | **$** | **137.1** | $ | 90.3 |

Our working capital requirements in the short term are to fund any potential future shortfalls from operations, interest payments, debt principal repayments and essential capital expenditures.

During the fourth quarter of 2012, the Company completed a private placement of U.S.$350 million of Senior Secured Notes and a fully backstopped equity rights offering for gross proceeds of $175 million. The net proceeds from the Senior Secured Notes issuance and the rights offering were used to repay the Company's Senior Secured term loan and Senior Unsecured Notes, which were otherwise due in 2014 and 2015. The Senior Secured Notes are secured by substantially all of the Company's assets on a first priority basis. These refinancing transactions have increased our financial flexibility by reducing our debt levels, lowering our borrowing costs, and extending our debt maturity profile substantially to 2017.

At December 31, 2012, Ainsworth's available liquidity, consisting of cash and cash equivalents, was $106.8 million, an improvement of $20.2 million from September 30, 2012, and $49.1 million since December 31, 2011 resulting from our stronger operating results. Ainsworth is also permitted under the terms of the Senior Secured Notes to borrow at least an additional U.S.$170 million of senior secured and unsecured debt subject to the limitations set forth in the indenture.

Capital spending of $6.0 million in 2012 was primarily limited to maintaining our current capacity. We anticipate capital expenditures will increase in 2013 primarily as a result of our planned restart of the High Level mill. We expect capital expenditures to total approximately $25.0 million in 2013.

Our cash flows for the fourth quarter and years ended December 31, 2012 and 2011 were as follows:

| | Q4-12 | Q4-11 | 2012 | 2011 |
|---|---|---|---|---|
| *(in millions)* | | | | |
| Cash provided by (used in) operating activities before interest and working capital | **$ 40.3** | $ (0.7) | **$ 100.0** | $ 6.1 |
| Cash used for interest payments | **(11.8)** | (14.1) | **(28.6)** | (30.6) |
| Cash provided by (used in) working capital | **4.2** | (4.2) | **(3.3)** | (2.5) |
| Cash provided by (used in) operating activities | **32.7** | (19.0) | **68.1** | (27.0) |
| Cash used in financing activities | **(9.2)** | (1.6) | **(12.0)** | (11.3) |
| Cash used in investing activities (1) | **(3.2)** | (1.1) | **(6.3)** | (20.2) |

(1) Cash used in investing activities for 2011 has been restated from what was previously reported as a result of the reclassification of items included in cash and cash equivalents (see Note 2(b) of the consolidated financial statements). Cash used in investing activities of $20.2 million in 2011 was restated from $12.2 million, as previously reported, after excluding a $13.9 million redemption of short-term investments and including $5.9 million transferred in from restricted cash. Cash used in investing activities of $1.1 million in the fourth quarter of 2011 was restated from cash provided by investing activities of $4.1 million, as previously reported, after excluding a $5.0 million redemption of short-term investments and including $0.2 million transferred out to restricted cash.

In the fourth quarter of 2012 we had a cash inflow of $40.3 million from operating activities before interest paid and working capital requirements compared to $0.7 million cash used in the fourth quarter of 2011. For the full year, cash provided by operating activities before interest and working capital increased to $100.0 million in 2012 from $6.1 million in 2011. Increases in pricing and margins resulted in higher cash generated by operations quarter over quarter and year over year.

Cash used in financing activities for all periods presented includes repayment of equipment financing loans and capital lease obligations. Cash used in financing activities for the fourth quarter and full year of 2012 includes cash proceeds from the issuance of Senior Secured Notes and the rights offering, with offsetting cash outflows used to repay our Senior Unsecured Notes and Senior Secured term loan. The increase for all periods in 2012 compared to 2011 was mainly related to the costs associated with the refinancing and rights offering. Our debt principal repayments are scheduled to total $6.3 million in 2013.

The increase in cash used by investing activities was due to an increase in capital spending in the fourth quarter of 2012 compared with the same period in 2011. For the full year, cash used in investing activities decreased in 2012 due to the High Level acquisition in 2011 that used cash of $20.0 million, combined with lower capital spending and in 2012 compared to 2011. Additions to property, plant and equipment in 2012 were primarily limited to essential projects or projects where costs will be recovered by estimated benefits in a short timeframe.

## Contractual Obligations

The following table summarizes the timing of payments for which we have contractual obligations as at December 31, 2012.

| | 2013 | 2014 to 2015 | 2016 to 2017 | Thereafter | Total |
|---|---|---|---|---|---|
| *(In millions)* | | | | | |
| Senior Secured Notes [(1)] | $ 27.4 | $ 52.2 | $ 400.4 | $ - | $ 480.0 |
| Equipment loan [(2)] | 3.0 | 7.5 | - | - | 10.5 |
| Deutsche Bank equipment loan [(3)] | 3.2 | 1.6 | - | - | 4.8 |
| Capital lease obligations [(4)] | 0.6 | 0.5 | - | - | 1.1 |
| Operating lease obligations | 0.9 | 1.3 | - | - | 2.2 |
| Purchase commitments [(5)] | 4.4 | 2.4 | 2.4 | 3.2 | 12.4 |
| | $ 39.5 | $ 65.5 | $ 402.8 | $ 3.2 | $ 511.0 |

(1) Under the indentures governing our outstanding Senior Secured Notes, we are required to make cash interest payments at 7.5% per annum on June 15 and December 15. Our Senior Secured Notes mature on December 15, 2017.

(2) Under the equipment loan agreement, we are required to pay interest at a rate per annum, reset monthly, equal to LIBOR plus 3.50%, payable monthly. For the purpose of the above table we have calculated the interest rate at the December 31, 2012 month-end LIBOR rate of 0.305%. Principal payments are made monthly.

(3) The terms of the Deutsche Bank equipment loan agreement were amended during the fourth quarter of 2012, increasing the interest rate from EURIBOR plus 0.65% to EURIBOR plus 1.65% per annum, reset semi-annually. The semi-annual repayment amount of €630,855 was increased to €1,193,919, payable June 20 and December 20. For the purpose of the above table we have calculated the interest rate at the December 31, 2012 month-end EURIBOR rate of 0.187%.

(4) Capital lease obligations are payable monthly.

(5) Purchase commitments consist of long-term purchase contracts with annual minimum fixed payments and agreements to purchase certain equipment (including $3.1 million with respect to certain equipment for our High Level mill).

(6) Contractual obligations denominated in $U.S. are converted to Canadian dollars at the December 31, 2012 exchange rate posted by the Bank of Canada of $1.00 = U.S. $0.9949.

(7) Contractual obligations denominated in € are converted to Canadian dollars at the December 31, 2012 exchange rate posted by the Bank of Canada of $1.00 = €1.3118.

## Outstanding Share Data

The issued share capital of the Company at December 31, 2012 is as follows:

| | Shares | Warrants | Value (in millions) |
|---|---|---|---|
| Common shares | **240,833,888** | **-** | **$ 583** |
| Shareholder warrants | **-** | **8,695,634** | **-** |
| | **240,833,888** | **8,695,634** | **$ 583** |

The Company issued 140 million common shares on December 27, 2012 in connection with a rights offering that raised gross proceeds of $175 million.

The Company issued 8,695,634 warrants on July 28, 2008. Upon exercise, the warrants will be converted into common shares without additional consideration. For accounting purposes, nominal value has been allocated to these warrants as the fair value is not readily determinable due to their contingent nature.

The number of shares that may be issued to warrant holders is dependent on the market price of the Company's common shares. If the Company's common share price exceeds a barrier price of U.S. $7.89 per share (2011: $12.00 per share) on or before July 29, 2013, each warrant will be converted into 1.52 (2011: 1.0) common shares. If the Company's common share price does not exceed the barrier price on or before July 29, 2013, each warrant will be converted into 0.0035 (2011: 0.0023) common shares.

## Outstanding Stock Options

The following table presents the exercise prices and expiry dates for the 1,588,676 stock options outstanding at December 31, 2012:

| Grant Date | Number of Options Outstanding | Original Exercise Price | Adjusted Exercise Price (1) | Expiry Date |
|---|---|---|---|---|
| November 14, 2008 (2) | 400,000 | 1.74 | 1.16 | November 14, 2018 |
| March 5, 2010 | 200,000 | 2.30 | 1.53 | March 5, 2020 |
| March 15, 2010 | 25,000 | 2.45 | 1.63 | March 15, 2020 |
| May 13, 2010 | 72,376 | 4.48 | 2.99 | May 13, 2020 |
| May 21, 2010 | 50,000 | 4.14 | 2.76 | May 21, 2020 |
| June 14, 2010 | 100,000 | 3.28 | 2.19 | June 14, 2020 |
| August 5, 2010 | 6,300 | 2.89 | 1.93 | August 5, 2020 |
| August 13, 2010 | 25,000 | 2.71 | 1.81 | August 13, 2020 |
| March 4, 2011 | 275,000 | 3.28 | 2.19 | March 4, 2021 |
| September 9, 2011 | 200,000 | 1.93 | 1.29 | September 9, 2021 |
| March 9, 2012 | 100,000 | 1.55 | 1.03 | March 9, 2022 |
| March 13, 2012 | 135,000 | 1.55 | 1.03 | March 13, 2022 |

(1) Effective December 27, 2012, the exercise price of all options outstanding prior to the rights offering was adjusted to reflect the dilutive effect of the 140 million shares issued in connection with the rights offering.

(2) These stock options were deemed to be granted on May 13, 2009 when the stock option plan was approved by the shareholders.

## Financial Instruments

Ainsworth does not use derivatives or participate in hedging activities. However, our Senior Secured Notes include a call option which has been identified as an embedded derivative whereby we have the right to repurchase the Notes. A derivative financial asset was recorded at fair value at issuance of the Senior Secured Notes and is revalued at each reporting period based on current interest rates and the credit spread. As the risk-free interest rate and the credit spread increase, the value of the derivative financial asset decreases. Conversely, a decrease in the risk-free interest rate and the credit spread increases the value of the derivative financial asset. Changes in the value of this derivative financial asset are reflected in operations as "Gain (loss) on derivative financial instrument". Management estimates that had interest rates been 1% higher and all other variables were constant, the value of the derivative financial asset would have increased by $3.0 million. At December 31, 2012, the derivative financial asset had a value of $13.4 million (value of derivative embedded in the Senior Unsecured Notes at December 31, 2011: $6 thousand).

## Off-Balance Sheet Arrangements

The Company does not have any significant off-balance sheet arrangements other than letters of credit in the amount of $5.6 million ($4.9 million at December 31, 2011), for which restricted cash is held as collateral. Further, there are no off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on the Company's financial condition, results of operations, liquidity, capital expenditures or resources.

## Related Party Transactions

The Company is controlled by Brookfield Capital Partners Ltd. ("BCP"), which beneficially owns or exercises control or direction over approximately 54.5% of the issued and outstanding common shares (54.2% prior to their acquisition of additional common shares pursuant to the rights offering).

In the normal course of operations, the Company made interest payments on its Senior Unsecured Notes held by BCP. On December 27, 2012, the Company repaid the principal, plus accrued interest on the Senior Unsecured Notes held by BCP, net of amounts owed to the Company for subscription of common shares.

During the fourth quarter of 2012, the Company paid a backstop fee of $4.4 million to BCP for their role as a standby purchaser of the rights offering. Since all rights were exercised by right-holders under the basic and additional subscription privileges, including BCP, it was not necessary for BCP to purchase shares pursuant to the terms of the standby purchase agreement.

The Company also periodically sells goods to BCP affiliates. During the three months ended December 31, 2012, these sales were approximately $0.4 million (three months ended December 31, 2011: $0.8 million). During the twelve months ended December 31, 2012, these sales were approximately $3.8 million (twelve months ended December 31, 2011: $3.2 million).

The following table includes amounts that were paid to other related parties:

| | **Q4-12** | Q4-11 | **2012** | 2011 |
|---|---|---|---|---|
| *(in thousands)* | | | | |
| Legal fees [(1)] | **$ 741** | $ 26 | **$ 749** | $ 100 |
| Other services [(2)] | **105** | 5 | **239** | 140 |
| Key management compensation [(3)] | **1,249** | 1,320 | **4,082** | 4,686 |

(1) Legal fees were paid to a law firm of which one of the Company's directors is also a partner.

(2) Includes amounts paid to BCP and its affiliates for services provided to the Company.

(3) Key management compensation includes total compensation for the Board of Directors and the executive management team. No person on the Board of Directors or the executive management team had any material interest during the period in a contract of significance (except as disclosed above with respect to a service contract for legal services rendered) with the Company or any subsidiary company.

Sales to overseas markets are handled by Interex Forest Products Ltd. ("Interex"), a cooperative sales company over which Ainsworth, as a shareholder, has significant influence. At December 31, 2012, $2.8 million was included in trade accounts receivable with respect to Interex.

All transactions with related parties were measured and recorded at the exchange amount which is equivalent to fair value. Fair value is defined as the transaction amount with unrelated parties under similar terms and conditions.

## Selected Annual and Quarterly Financial Information

| | 2012 | Q4-12 | Q3-12 | Q2-12 | Q1-12 | 2011 | Q4-11 | Q3-11 | Q2-11 | Q1-11 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *(in millions, except per share data, unless otherwise noted)* | | | | | | | | | | | |
| **Sales and earnings (loss)** | | | | | | | | | | | |
| Sales | $ 409.1 | $ 117.9 | $ 115.6 | $ 90.5 | $ 85.1 | $ 293.3 | $ 69.5 | $ 71.8 | $ 80.5 | $ 71.5 | $ 329.5 |
| Operating income (loss) | 78.8 | 33.7 | 30.7 | 11.0 | 3.4 | (12.8) | (3.3) | (6.0) | (3.8) | 0.3 | 27.6 |
| Foreign exchange gain (loss) on long-term debt | 10.3 | (7.6) | 18.4 | (10.5) | 10.0 | (11.4) | 16.4 | (42.8) | 2.5 | 12.5 | 30.4 |
| Net income (loss) from continuing operations | 28.7 | 6.7 | 32.6 | (11.3) | 0.7 | 7.6 | 1.7 | (58.9) | (12.9) | 77.7 | 12.7 |
| Net (loss) income from discontinued operations | (0.3) | - | - | (0.2) | (0.1) | 0.7 | 1.1 | (0.3) | (0.1) | - | (0.9) |
| Net income (loss) | 28.4 | 6.7 | 32.6 | (11.5) | 0.6 | 8.3 | 2.8 | (59.2) | (13.0) | 77.7 | 11.9 |
| Adjusted EBITDA | 106.7 | 42.3 | 37.3 | 17.1 | 10.0 | 12.5 | 2.7 | 0.7 | 2.7 | 6.4 | 59.3 |
| **Basic and diluted earnings (loss) per common share** | | | | | | | | | | | |
| Net income (loss) continuing operations (1) | 0.28 | 0.06 | 0.32 | (0.11) | 0.01 | 0.07 | 0.02 | (0.59) | (0.13) | 0.77 | 0.13 |
| Net income (loss) (1) | 0.28 | 0.06 | 0.32 | (0.11) | 0.01 | 0.08 | 0.03 | (0.59) | (0.13) | 0.77 | 0.12 |
| **Balance sheet** | | | | | | | | | | | |
| Total assets | 835.2 | 835.2 | 812.7 | 781.1 | 790.1 | 786.3 | 786.3 | 809.9 | 833.4 | 863.1 | 762.2 |
| Total long-term debt (2) | 361.4 | 361.4 | 519.0 | 532.3 | 517.9 | 523.2 | 523.2 | 535.8 | 497.1 | 498.6 | 507.9 |

(1) Basic and diluted net income (loss) per share. As at December 31, 2012, the Company had 240,833,888 issued common shares outstanding. For all periods presented the Company has not paid or declared any cash dividends.

(2) Total long-term debt includes the current portion of long-term debt.

OSB demand and product pricing were the main factors causing fluctuations in our sales and EBITDA over the past eight quarters. North American OSB prices declined in the second quarter of 2011, particularly in the Western region, however demand from overseas increased in the second quarter of 2011 as a result of the earthquake and tsunami in Japan in March 2011. Starting in the third quarter of 2011, North American OSB prices have increased steadily, nearly doubling in the Western region. OSB shipment volumes have varied in the past eight quarters depending on production disruptions, maintenance requirements and product mix.

Net income (loss) fluctuated as a result of unrealized foreign exchange gain (loss) on long-term debt caused by changes in the strength of the Canadian dollar relative to the U.S. dollar, gain (loss) on derivative financial asset related to changes in the value of the call option embedded in our Senior Notes, and loss of $22.9 million on early repayment of debt in the fourth quarter of 2012. In the first quarter of 2011, net income was increased by the acquisition of the remaining 50% in the curtailed High Level OSB facility that resulted in a $72.5 million gain, net of tax.

## Segmented Information

Our geographic distribution of sales was as follows:

| | | Q4 | | Q3 | | Q2 | | Q1 | | Annual |
|---|---|---|---|---|---|---|---|---|---|---|
| *(in millions)* | | | | | | | | | | |
| 2012 | | | | | | | | | | |
| United States | $ | **85.1** | $ | **82.5** | $ | **65.8** | $ | **61.4** | $ | **294.8** |
| Canada | | **21.7** | | **23.4** | | **12.9** | | **13.4** | | **71.4** |
| Japan | | **9.4** | | **9.2** | | **10.5** | | **8.6** | | **37.7** |
| Overseas - other | | **1.7** | | **0.5** | | **1.3** | | **1.7** | | **5.2** |
| | $ | **117.9** | $ | **115.6** | $ | **90.5** | $ | **85.1** | $ | **409.1** |
| 2011 | | | | | | | | | | |
| United States | $ | 49.0 | $ | 47.0 | $ | 45.4 | $ | 49.4 | $ | 190.8 |
| Canada | | 10.5 | | 12.1 | | 11.4 | | 9.9 | | 43.9 |
| Japan | | 8.7 | | 11.2 | | 22.4 | | 9.9 | | 52.2 |
| Overseas - other | | 1.3 | | 1.5 | | 1.3 | | 2.3 | | 6.4 |
| | $ | 69.5 | $ | 71.8 | $ | 80.5 | $ | 71.5 | $ | 293.3 |

Canadian sales increased in the second half of 2012 as a result of supply and demand conditions. Property, plant and equipment, intangible assets and other assets are located within Canada.

## Risks and Uncertainties

### *Economic Uncertainty*

Our results of operations and financial position could be affected by adverse changes in the global capital and credit markets, and the economy in general. Economic downturns characterized by higher unemployment, lower family income, lower corporate earnings, lower business investment and lower consumer spending typically result in decreased demand for our products. These conditions are beyond our control and may have a significant impact on our business, results of operations, cash flows and financial position.

Our core OSB business relies heavily on new home and renovation construction in North America which, have yet to show signs of a sustained recovery. Volatility in new home and renovation construction levels is influenced by a number of factors, including the supply of new and existing homes on the market, longer-term interest rates and mortgage foreclosure rates. A significant increase in long-term interest rates, a prolonged decline in the availability of mortgage financing, or the occurrence of other events that reduce levels of residential construction activity could adversely affect our results.

### *Liquidity*

We are subject to liquidity risk to the extent that our current assets and available sources of funds may not be sufficient to meet current liabilities. Our main sources of liquidity have been cash flow from our current operations and borrowings from third parties. Notwithstanding recent improved results and the comprehensive refinancing that took place in 2012, we continue to monitor discretionary capital expenditures carefully as global debt and equity markets, as well as operating results, can be volatile. Under the terms of the Company's senior note indenture, we are permitted to borrow at least an additional U.S.$170 million of senior secured and unsecured debt subject to the limitations set forth in the indenture. The availability of this funding, or other sources of capital, is dependent on capital markets at the time and may not be available on acceptable terms.

### *Competition*

We face competition from numerous domestic and foreign competitors in the wood-based panels industry. We also compete less directly with firms that manufacture substitutes for wood building products. Our ability to compete in these and other markets is dependent on a variety of factors such as the entry of new competitors, our competitors' pricing strategies, manufacturing costs, availability of key production inputs, access to markets, our ability to anticipate and respond to changing customer preferences, product quality, financial resources and currency exchange rates. Some of our competitors may have greater financial and other resources and greater manufacturing economies of scale compared to our Company. Should our competitors open new mills or reopen curtailed mills this could increase market supply causing downward pressure on product prices and could result in an erosion of our profit margins.

### Product Prices

Our financial performance is dependent on the selling prices of our products. The markets for most structural panel products are cyclical and are influenced by a variety of factors outside of our control. We have limited influence over the timing and extent of price changes, which are often volatile. These factors include periods of excess product supply due to industry capacity additions, periods of decreased demand due to weak general economic activity and inventory de-stocking by customers. During periods of low prices, our operations are subject to reduced revenues and margins, resulting in substantial declines in profitability and possible net losses. Prices are also impacted by seasonal factors such as weather and building activity. Market demand varies seasonally, as homebuilding activity and repair and renovation work, the principal end use for panel products, is generally stronger in the spring and summer months. Management estimates the annualized impact of a U.S. $10 per msf (3/8-inch basis) change in the North American OSB price on adjusted EBITDA when operating at current capacity (before inclusion of High Level) is approximately U.S. $17 million. Our strategy is to mitigate price volatility by maintaining low cost, high-quality flexible production facilities; establishing and developing long-term relationships with customers; geographic diversification through overseas sales; and developing specialty niche products where possible.

### Customer Dependence and Concentration

The Company sells its products primarily to major distributors, contractor supply yards, and wholesale distributors and faces strong competition for the business of significant customers. In 2012, we had one customer whose total purchases from both its distribution business and its engineered wood manufacturing business represented 20% of our total net sales. The loss of a significant customer or any significant customer order cancellations could negatively affect sales and earnings.

### Product Concentration

We manufacture a single product, OSB, and, as such, fluctuations in demand or prices for OSB will have an impact on our revenues and profitability. This product concentration increases our exposure to variability in demand for and/or prices of OSB and a decline in demand for and/or prices of OSB may adversely affect our business, financial condition and results of operations.

### International Sales

A significant portion of our sales are made to customers outside of Canada and the United States. Our international sales present us with a number of risks and challenges, including but not limited to the effective marketing of our products in other countries, collectability of accounts receivable, tariffs and other barriers to trade and recessionary environments in foreign economies.

### Foreign Exchange

All of our sales, including products sold in Canada and overseas, are denominated in U.S. dollars. As a result, any decrease in the value of the U.S. dollar relative to the Canadian dollar reduces the amount of revenue we realize and conversely, any increase in the U.S. dollar relative to the Canadian dollar increases the amount of revenue we realize. The impact of the foreign exchange sensitivity on sales is partially offset by our U.S. dollar denominated debt as well as U.S. dollar purchases of raw materials, supplies, and services such as resin, wax and transportation. At December 31, 2012 and December 31, 2011, we did not hold any foreign exchange contracts.

### Wood Fibre

Wood fibre represents the major raw material in the production of panels. In Canada, wood fibre is sourced primarily by agreements with provincial governments. The agreements are granted for various terms from five to twenty-five years and are generally subject to regular renewals every five years. As the agreements come due, we rely on the assumption that we will be able to renew or replace the agreements. The agreements incorporate commitments with respect to sustainable forest management, silvicultural work, forest and soil renewal, and cooperation with other forest users. The government reserves the right to revoke a forest management license for any mills that are not operating for greater than twelve months, as is the case with our mill at High Level, Alberta. We have not received any notice to this effect from the government at this time. Our wood fibre supply could also be influenced by natural events, such as forest fires, severe weather conditions and other natural disasters, which may increase wood fibre costs or restrict our access to wood fibre. Aboriginal groups have claimed substantial portions of land in various provinces over which they claim aboriginal title or in which they have a traditional interest and for which they are seeking compensation from various levels of government. The results of these claims may adversely affect the supply of wood fibre and the commercial terms of supply agreements with provincial governments.

### Other Input Costs

In addition to wood fibre, we use various resins in our manufacturing process. Resin costs are influenced by changes in the prices or availability of petroleum products, as well as demand for and availability of resin products. Rising petroleum prices can also reduce our profitability due to increased domestic and international transportation rates or fuel surcharges.

### Energy Costs

We are a consumer of energy, including predominantly electrical power. In recent years, BC Hydro and Power Authority has sought, and to some extent received, rate increases above historical levels. BC Hydro rates may increase significantly in response to a new B.C. energy policy mandating self-sufficiency by 2016 and reflecting the higher cost of marginal resources. In Alberta, energy markets are deregulated which may result in greater price volatility.

### Capital Intensity

The production of wood-based panels is capital intensive and it is likely that key pieces of equipment will need to be repaired or replaced. In certain circumstances, the costs of repairing or replacing equipment and the associated downtime of the affected production line may not be an insurable event. In addition, significant amounts of capital could be required to modify our equipment to produce alternative or additional products or to make significant changes in the characteristics of our current products.

### Labour Relations and Employee Retention

The Grande Prairie mill employees are non-unionized, while the Barwick and 100 Mile House mills are unionized. During 2010, new union contracts were negotiated for 100 Mile House, due to expire on June 30, 2013, and Barwick, due to expire on July 31, 2013. We could experience strikes or work interruptions if we are unable to negotiate acceptable contracts with its various trade unions upon expiry, which could reduce our sales and profitability.

The Company’s success depends, to a significant extent, upon its ability to attract and retain key senior management and operations personnel, and to have sufficient skilled labour available. The Company’s failure to recruit and maintain key personnel, and market conditions which cause shortages of skilled labour, could have an adverse impact on our business, financial position and results of operations.

### Regulatory

Government regulations relating to forest management practices may adversely affect us and could increase our costs of doing business. Legislation in British Columbia, Alberta and Ontario empowers provincial regulatory agencies to develop regulations, set policies and establish and maintain all aspects of sustainable forest management. Changes to these regulations and policies could adversely affect our access to wood fiber for our OSB operations or could increase the cost of our wood fibre. Changes to these laws or regulations, or the implementation of new laws or regulations, could result in additional expenses, capital expenditures or impediments to our operations, which could impair our competitive position and adversely affect our business.

We are also subject to a wide range of general and industry specific product, environmental, health and safety laws, regulations and standards imposed by federal, provincial, and local authorities in Canada and other countries where we market our products. Changes to these laws, regulations, and standards could adversely affect our ability to sell products to certain jurisdictions or operate within certain jurisdictions. Such changes could adversely affect our business, financial condition, results of operations and cash flows.

### Environmental

Our operations are subject to a range of general and industry-specific environmental laws and regulations relating to air emissions, wastewater discharges, solid and hazardous waste management, plant and wildlife protection, and site remediation. Failure to comply with applicable environmental laws and regulations could result in fines, penalties or other enforcement actions that could impact production capacity or increase production costs. No assurance can be given that changes to these laws and regulations or their application will not adversely affect the

Company's business, operations, financial condition and operational results. Additionally, the Company may discover currently unknown environmental issues, contamination or conditions in relation to past or present operations in or at its current or former facilities, or may be faced with unforeseen environmental liabilities in the future. This may require site or other remediation costs to maintain compliance or correct violations or result in government or private claims for damage to persons, property or the environment.

### *Periodic Litigation*

The Company may from time to time become party to claims and litigation proceedings that arise in the ordinary course of business. Such matters are subject to many uncertainties and the Company cannot predict with assurances the outcomes and ultimate financial impacts of them. There can be no guarantees that actions that may be brought against the Company in the future will be resolved in its favour or that the insurance the Company carries will be available or paid to cover any litigation exposure. Any losses from settlements or unfavorable judgments arising out of these claims could be adverse to the Company.

Additionally, we acquired the Barwick facility through a share transaction in 2004. As a result, there is a potential that we may have acquired undisclosed or unknown liabilities or other undisclosed detrimental issues concerning the Barwick facility. The existence of such undisclosed liabilities or other detrimental issues related to the Barwick facility could adversely affect our business, financial condition, results of operations and cash flows.

### *Tax Exposures*

As a normal course of business the Company takes various tax filing positions without the assurance that tax authorities will accept and not challenge such filing positions. In addition, the Company is subject to further uncertainties concerning the interpretation and application of tax laws in various operating jurisdictions. Ainsworth maintains reserves for known estimated tax exposures in all jurisdictions. These exposures are settled primarily through the closure of audits with the jurisdictional taxing authorities.

### *Defined Benefit Pension Plan Funding*

We maintain two defined benefit pension plans. In British Columbia, the defined benefit pension plan provides pension accruals for all union employees at the 100 Mile House facility and a group of non-union employees, but is closed to any new non-union employees. In Minnesota, the defined benefit pension plan is closed to new members and there are no current service pension accruals. In both cases, plans continue to be subject to market risk on the plan assets and to changes in discount rates. The latest funding valuations indicate that the British Columbia defined benefit pension plan is in a solvency deficit position and therefore we are required to make accelerated cash funding contributions. If actual experience differs from these assumptions or any of these assumptions change such that the solvency deficit increases, we would be required to increase cash funding contributions, reducing the availability of such funds for other corporate purposes. The U.S. defined benefit pension plan is underfunded and we continue to make contributions to the plan.

## Significant Accounting Estimates and Judgments

Management has made certain estimates and judgments that affect the reported amounts and other disclosures in our financial statements. These estimates and judgments are described below.

### *Valuation of Inventory*

We closely monitor conditions that could impact valuation of inventories or otherwise impair our assets. Inventories of logs and panel products are valued at the lower of average cost and net realizable value. The net realizable value of logs is determined based on estimated OSB selling prices less estimated costs of conversion. We base our estimate of selling price on sales orders that exist at balance sheet reporting dates and management's estimate for forecasted sales prices based on supply, demand and industry trends. Prices fluctuate over time and it is probable that market values at the time of eventual sale will differ from our estimates.

### *Loss Contingencies*

Our estimates of loss contingencies for legal proceedings and product warranty claims are based on various judgments and assumptions regarding the potential resolution or disposition of the underlying claims and associated costs.

### *Valuation of Long-Lived Assets*

Where changes, events or circumstances indicate that the assets may be impaired, we review the long-lived assets held and used by us (primarily property, plant and equipment, construction in progress, intangible assets and timber and logging roads) for impairment. Assessing the valuation of the affected assets requires us to make judgments, assumptions and estimates. In general, write-downs for impairment are recognized when the book values exceed our estimate of the discounted future net cash flows associated with the related assets.

Management currently believes we have adequate support for the carrying value of our long-lived assets based on the anticipated cash flows that result from our estimates of future demand, pricing and production costs, and assuming certain levels of planned capital expenditures. However, should the markets for our products deteriorate to levels significantly below current forecasts or should capital not be available to fund operations or expenditures, it is possible that we will be required to record further impairment charges. From time to time we also review possible dispositions of various capital assets in light of current and anticipated economic and industry conditions, our financing and strategic plan and other relevant factors. As a result, we may be required to record further impairment charges in connection with any decision to close or dispose of such assets.

### *Amortization*

Amortization of property, plant and equipment is principally based on the units of production method where the cost of equipment is amortized over the estimated units that will be produced during a conservative estimate of its useful life.

### *Employee Benefit Plans*

Many of our B.C. employees participate in defined benefit pension plans sponsored by the Company. We account for the consequences of our sponsorship of these plans in accordance with IFRS, which require us to make actuarial assumptions that are used to calculate the related assets, liabilities and expenses recorded in our financial statements. While we believe we have a reasonable basis for these assumptions, which include assumptions regarding long-term rates of return on plan assets, life expectancies, rates of increase in salary levels, rates at which future values should be discounted to determine present values and other matters, the amounts of our pension related assets, liabilities and expenses recorded in our financial statements would differ if we used other assumptions.

### *Reforestation Obligation*

Timber is harvested under various licenses issued by the Provinces of British Columbia and Alberta, which include future requirements for reforestation. The future estimated reforestation obligation is accrued and charged to earnings on the basis of the volume of timber cut. The estimates of reforestation obligation are based upon various judgments, assumptions. Both the precision and reliability of such estimates are subject to uncertainties and, as additional information becomes known, these estimates are subject to change.

### *Valuation of Derivative Financial Instruments*

Derivative financial instruments are measured at their fair value upon initial recognition and on each subsequent reporting date. If a market value is not available, the fair value is calculated using standard financial valuation models, such as discounted cash flow or option pricing models. Derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. Embedded derivatives are separated from the host contract when the analysis shows that the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract.

### *Deferred Income Tax Assets and Liabilities*

We record future income tax assets including the potential tax benefit of operating loss carry-forwards and future income tax liabilities. The amounts that we record for these assets and liabilities are based upon various judgments, assumptions and estimates, including judgments regarding the tax rates that will be applicable to the future income tax amounts, the likelihood that we will generate sufficient taxable income or gain to utilize future income tax assets. Due to the numerous variables associated with our judgments, assumptions and estimates relating to the valuation of our future income tax assets and liabilities, and the effects of changes in circumstances affecting these valuations, both the precision and reliability of the resulting estimates are subject to uncertainties and, as additional information becomes known, we may change our estimates.

### *Share-Based Payments*

We account for stock options using the fair value method. Under this method, compensation expense for options is measured at the grant date using the Black-Scholes option pricing model based on certain estimates and assumptions and is recognized over the vesting period. If estimates or assumptions change in the future, we could be required to reduce or increase contributed surplus, resulting in compensation expense or recovery.

### *Determination of Fair Value on Purchased Business Combinations*

Fair value on purchased business combinations is determined based on valuations performed by independent third party specialists. Details related to forecast cash flows, discount rates, capital expenditures and other assumptions used in developing these valuations require considerable use of judgments, assumptions and estimates by management. As a result, we may be required to record impairment charges should the markets for our products deteriorate to levels significantly below current forecasts or should capital not be available to fund operations or expenditures.

## Accounting Standards Developments

*a)* *IFRS 9 Financial instruments* ("IFRS 9")

*This standard, as issued in November 2009 and amended in October 2010,* will replace *IAS 39 Financial Instruments: Recognition and Measurement*. IFRS 9 provides guidance for the classification and subsequent measurement of financial assets at amortized cost or at fair value based on the Company's business model for managing financial assets and the contractual cash flow characteristics of the financial assets. Financial liabilities are classified as subsequently measured at amortized cost except for financial liabilities classified at fair value through profit or loss ("FVTPL"), financial guarantees and certain other exceptions. The new standard also requires a single impairment model to be used, replacing the multiple impairment models in IAS 39. The effective date of IFRS 9 was deferred to annual periods beginning on or after January 1, 2015. The Company does not expect this pronouncement to have a significant impact on its results and financial position.

*b)* *Consolidation*

In May 2011, the ISAB issued the following new standards:

*(i)* *IFRS 10 Consolidated Financial Statements* ("IFRS 10")

IFRS 10 will replace parts of IAS 27, Consolidated and Separate Financial Statements, and SIC-12, Consolidation – Special Purpose Entities. IFRS 10 uses control as the single basis for consolidation, irrespective of the nature of the investee, and requires continuous assessment of control over an investee.

*(ii)* *IFRS 11 Joint Ventures ("IFRS 11")*

IFRS 11 will replace IAS 31 Interests in Joint Ventures, and SIC-13 Jointly Controlled Entities – Non-monetary Contributions by Venturers. IFRS 11 classifies joint arrangements as either joint operations or joint ventures based on the rights and obligations of the parties to the joint arrangements. IFRS 11 requires a joint operator to recognize its portion of assets, liabilities, revenues and expenses of a joint arrangement, while a joint venture is recognized as an investment in a joint arrangement using the equity method.

*(iii)* *IFRS 12, Disclosures of Involvement with Other Entities*

The above standards are effective for annual periods beginning on or after January 1, 2013. The Company does not expect these pronouncements to have a significant impact on its results and financial position.

*(c)* *IFRS 13 Fair value measurements and disclosure* ("IFRS 13")

IFRS 13 was issued by the IASB in May 2011. This standard provides a definition of fair value and a framework for the measurement and disclosure of fair values to be applied when required or permitted by other IFRS standards. IFRS 13 is effective for annual periods beginning on or after January 1, 2013. The Company does not expect this pronouncement to have a significant impact on its results and financial position.

(d) *IAS 19 Employee benefits* ("IAS 19")

*IAS 19* was amended by the IASB in June 2011. This amendment includes: the requirement to recognize gains and losses relating to defined benefit plans in other comprehensive income in the period they occur; the replacement of interest cost and expected return on plan assets with a calculation of interest income or cost on net asset or liability based on the plan's discount rate; clarification of guidance on measurement issues; and expanded disclosure regarding the characteristics of and risks associated with defined benefit plans will also be required. The amendment is effective for annual periods beginning on or after January 1, 2013. The Company is still assessing the impact of this amendment on its results and financial position.

## Disclosure Controls and Procedures and Internal Control over Financial Reporting

As required by National Instrument 52-109 Certification of Disclosure in Issuer's Annual and Interim Filings, the Company's management, including the President and Chief Operating Officer ("COO"), and the Vice President, Finance and Chief Financial Officer ("CFO") have evaluated the effectiveness of disclosure controls and procedures as at December 31, 2012. Disclosure controls and procedures are designed to provide reasonable assurance that all necessary information is reported to the COO and CFO on a timely basis to ensure that the necessary decisions can be made regarding annual and interim financial statement disclosure.

The certifying officers have evaluated the effectiveness of our disclosure controls and procedures as at December 31, 2012, and have concluded that such controls and procedures are adequate and effective to ensure accurate and complete disclosures in the annual filings.

Management has also designed internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS. There has been no material change in the design of the Company's internal control over financial reporting for the quarter and year ended December 31, 2012 that would materially affect, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Management of the Company, including the COO and CFO, has performed an assessment of the effectiveness of the Company's internal control over financial reporting as at December 31, 2012 based on the provisions of Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this assessment, management has concluded that its internal controls over financial reporting are operating effectively as at December 31, 2012. Management determined that there were no material weaknesses in the Company's internal control over financial reporting as at December 31, 2012.

While the officers of the Company have designed the Company's disclosure controls and procedures and internal control over financial reporting, they expect that these controls and procedures may not prevent all errors and fraud. A control system, no matter how well conceived or operated, can only provide reasonable, not absolute, assurance that the objectives of the control system are met.

## AINSWORTH LUMBER CO. LTD.
## Other Information

| Selected Financial Data ($000's) | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Cash, cash equivalents | $ 106,777 | $ 57,696 |
| Restricted cash | 5,560 | 4,861 |
| Adjusted working capital (Note 1) | 136,651 | 90,147 |
| Total assets | 835,183 | 786,263 |
| Total long-term debt | 361,436 | 523,166 |
| Shareholders' equity | 385,274 | 190,060 |

**Reconciliation of Net Income (Loss) to Adjusted EBITDA**

| (in millions) | 2012 | Q4-12 | Q3-12 | Q2-12 | Q1-12 | 2011 | Q4-11 | Q3-11 | Q2-11 | Q1-11 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Net Income (loss) from Continuing Operations** | $ 28.7 | $ 6.7 | $ 32.6 | $ (11.3) | $ 0.7 | $ 7.6 | $ 1.7 | $ (58.9) | $ (12.9) | $ 77.7 |
| Add (deduct): | | | | | | | | | | |
| Amortization of property, plant and equipment | 25.6 | 6.9 | 6.4 | 6.1 | 6.2 | 23.9 | 5.9 | 6.1 | 6.3 | 5.6 |
| Loss (gain) on disposal of property, plant and equipment | 0.1 | 0.2 | (0.1) | - | - | (0.9) | (0.2) | (0.5) | (0.5) | 0.3 |
| Write-down of property, plant and equipment, intangibles and other | 1.5 | 1.5 | - | - | - | 0.9 | - | - | - | 0.9 |
| Cost of curtailed operations | 3.8 | 1.1 | 0.9 | 0.7 | 1.1 | 3.3 | 1.0 | 0.9 | 0.9 | 0.5 |
| Stock option expense (recovery) | 0.8 | 0.5 | 0.1 | - | 0.2 | 0.4 | (0.2) | 0.2 | 0.2 | 0.2 |
| Finance expense | 50.8 | 11.3 | 13.3 | 13.1 | 13.1 | 49.8 | 13.1 | 12.5 | 11.8 | 12.4 |
| Loss on early repayment of long-term debt | 22.9 | 22.9 | - | - | - | - | - | - | - | - |
| Income tax expense (recovery) | 5.9 | 2.5 | 7.0 | (2.0) | (1.6) | (16.7) | (2.4) | (8.3) | (3.8) | (2.2) |
| Foreign exchange (gain) loss on long-term debt | (10.3) | 7.6 | (18.4) | 10.5 | (10.0) | 11.4 | (16.4) | 42.8 | (2.5) | (12.5) |
| (Gain) loss on derivative financial instrument | (23.9) | (18.3) | (5.4) | (0.2) | - | 6.2 | - | 7.0 | 3.7 | (4.5) |
| Gain on High Level acquisition | - | - | - | - | - | (72.5) | - | - | - | (72.5) |
| Other | 0.8 | (0.6) | 0.9 | 0.2 | 0.3 | (0.9) | 0.2 | (1.1) | (0.5) | 0.5 |
| **Adjusted EBITDA** (Note 2) | $ 106.7 | $ 42.3 | $ 37.3 | $ 17.1 | $ 10.0 | $ 12.5 | $ 2.7 | $ 0.7 | $ 2.7 | $ 6.4 |

*Note 1: Adjusted working capital is a non-IFRS financial measure defined as working capital excluding future income taxes and restricted cash.*

*Note 2: Adjusted EBITDA, a non-IFRS financial measure, is defined as sales less costs of products sold (exclusive of amortization) and selling and administrative expense (exclusive of share-based compensation) plus other income.*

## About Ainsworth

Ainsworth Lumber Co. Ltd. is a leading Canadian forest products company, with a 50-year reputation for quality products and unsurpassed customer service. In Alberta, the Company's facilities include OSB plants at Grande Prairie and High Level. In British Columbia, the Company's facilities include an OSB plant at 100 Mile House. In Ontario, the Company's facilities include an OSB plant at Barwick. The Company's facilities have a total annual capacity of 2.5 billion square feet (3/8-inch basis) of OSB.

**Ainsworth Lumber Co. Ltd.**
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Common shares of
Ainsworth Lumber Co. Ltd.
are traded on the
Toronto Stock Exchange
under the symbol: ANS

Visit our web-site: www.ainsworthengineered.com

*Auditors' Report and Consolidated Financial Statements of*

# AINSWORTH LUMBER CO. LTD.

*December 31, 2012 and December 31, 2011*

**INDEPENDENT AUDITOR'S REPORT**

To the Shareholders of Ainsworth Lumber Co. Ltd.

We have audited the accompanying consolidated financial statements of Ainsworth Lumber Co. Ltd., which comprise the consolidated statements of financial position as at December 31, 2012 and 2011 and the consolidated statements of income and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended and a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Ainsworth Lumber Co. Ltd. as at December 31, 2012 and 2011 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

/s/ Deloitte LLP

Chartered Accountants
March 7, 2013
Vancouver, British Columbia

# AINSWORTH LUMBER CO. LTD.

## Consolidated Statements of Financial Position

(In thousands of Canadian dollars)

| | | December 31 2012 | | December 31 2011 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Current Assets** | | | | |
| Cash and cash equivalents | **$** | **106,777** | $ | 57,696 |
| Restricted cash | | **5,560** | | 4,861 |
| Trade and other receivables (Note 4) | | **25,608** | | 17,802 |
| Inventories (Note 5) | | **38,140** | | 36,408 |
| Prepaid expenses | | **5,312** | | 6,553 |
| Assets held for disposal (Note 6) | | **-** | | 509 |
| **Total Current Assets** | | **181,397** | | 123,829 |
| **Property, Plant and Equipment (Note 7)** | | **628,694** | | 648,766 |
| **Intangible Assets (Note 8)** | | **9,905** | | 11,678 |
| **Other Assets (Note 21)** | | **15,187** | | 1,990 |
| **Total Assets** | **$** | **835,183** | $ | 786,263 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | | |
| **Current Liabilities** | | | | |
| Trade and other payables (Note 9) | **$** | **30,257** | $ | 21,686 |
| Income taxes payable | | **2,140** | | 1,521 |
| Current portion of long-term debt (Note 12) | | **6,313** | | 4,895 |
| Liabilities related to discontinued operations (Note 6) | | **476** | | 719 |
| **Total Current Liabilities** | | **39,186** | | 28,821 |
| **Accrued Pension Benefit Liability (Note 10)** | | **17,006** | | 13,103 |
| **Reforestation Obligation (Note 11)** | | **3,781** | | 2,936 |
| **Long-term Debt (Note 12)** | | **355,123** | | 518,271 |
| **Deferred Income Tax Liabilities (Note 25)** | | **32,344** | | 31,194 |
| **Liabilities Related to Discontinued Operations (Note 6)** | | **2,469** | | 1,878 |
| **Total Liabilities** | | **449,909** | | 596,203 |
| **SHAREHOLDERS' EQUITY** | | | | |
| **Capital Stock (Note 15)** | | **582,626** | | 411,509 |
| **Contributed Surplus** | | **1,808** | | 1,484 |
| **Deficit** | | **(199,160)** | | (222,933) |
| **Total Shareholders' Equity** | | **385,274** | | 190,060 |
| **Total Liabilities and Shareholders' Equity** | **$** | **835,183** | $ | 786,263 |

The accompanying Notes to the Consolidated Financial Statements are an integral part of these statements.

**Commitments and Guarantees (Note 13)**
**Contingencies (Note 14)**

Approved by the Board on March 7, 2013:

| | |
|---|---|
| /s/ Peter Gordon | /s/ Gordon Lancaster |
| **DIRECTOR** | **DIRECTOR** |

# AINSWORTH LUMBER CO. LTD.

## Consolidated Statements of Income and Comprehensive Income

(In thousands of Canadian dollars, except share and per share data)

| | | Year Ended December 31 2012 | | Year Ended December 31 2011 |
|---|---|---|---|---|
| **Sales (Note 27)** | **$** | **409,071** | $ | 293,266 |
| **Costs and Expenses** | | | | |
| Costs of products sold (Note 17) | | **287,232** | | 264,619 |
| Selling and administration (Note 17) | | **16,441** | | 17,441 |
| Amortization of property, plant and equipment and intangible assets | | **25,626** | | 23,987 |
| Costs of curtailed operations (Note 22) | | **3,703** | | 3,313 |
| **Total Costs and Expenses** | | **333,002** | | 309,360 |
| **Income (Loss) from Operations** | | **76,069** | | (16,094) |
| **Finance Expense (Note 18)** | | **(50,781)** | | (49,776) |
| **Loss on Early Repayment of Long-Term Debt (Note 19)** | | **(22,879)** | | - |
| **Foreign Exchange Gain (Loss) (Note 20)** | | **9,429** | | (11,122) |
| **Gain (Loss) on Derivative Financial Instrument (Note 21)** | | **23,993** | | (6,227) |
| **Gain on Acquisition of High Level (Note 23)** | | **-** | | 72,544 |
| **Other Items (Note 24)** | | **(1,163)** | | 1,563 |
| **Income (Loss) Before Income Taxes** | | **34,668** | | (9,112) |
| **Income Tax (Expense) Recovery (Note 25)** | | **(5,898)** | | 16,739 |
| **Income from Continuing Operations** | | **28,770** | | 7,627 |
| **Net (Loss) Income from Discontinued Operations (Note 6)** | | **(398)** | | 666 |
| **Net Income** | **$** | **28,372** | $ | 8,293 |
| **Other Comprehensive Income** | | | | |
| Actuarial losses, net of tax (Note 10) | | **(4,599)** | | (4,881) |
| **Total Comprehensive Income** | **$** | **23,773** | $ | 3,412 |
| Basic and diluted net income per common share (Note 15) | | | | |
| Continuing operations | **$** | **0.28** | $ | 0.08 |
| Discontinued operations | | **0.00** | | 0.01 |
| Basic and diluted net income per common share | **$** | **0.28** | $ | 0.09 |
| Weighted average number of common shares outstanding - basic | | **102,330,910** | | 100,646,514 |
| Effect of dilutive stock options on continuing operations | | **236,225** | | 260,580 |
| Weighted average number of common shares outstanding - diluted | | **102,567,135** | | 100,907,094 |

The accompanying Notes to the Consolidated Financial Statements are an integral part of these statements.

# AINSWORTH LUMBER CO. LTD.

## Consolidated Statements of Changes in Shareholders' Equity

(In thousands of Canadian dollars)

| | Capital Stock | Contributed Surplus | Deficit | Total Shareholders' Equity |
|---|---|---|---|---|
| Balance, January 1, 2011 | $ 410,950 | $ 1,350 | $ (226,345) | $ 185,955 |
| Net income and total comprehensive income | - | - | 3,412 | 3,412 |
| Share-based payments (Note 16) | - | 369 | - | 369 |
| Stock options exercised (Note 16) | 559 | (235) | - | 324 |
| Balance, December 31, 2011 | **$ 411,509** | **$ 1,484** | **$ (222,933)** | **$ 190,060** |

| | Capital Stock | Contributed Surplus | Deficit | Total Shareholders' Equity |
|---|---|---|---|---|
| Balance, January 1, 2012 | $ 411,509 | $ 1,484 | $ (222,933) | $ 190,060 |
| Net income and total comprehensive income | - | - | 23,773 | 23,773 |
| Share-based payments (Note 16) | - | 391 | - | 391 |
| Stock options exercised (Note 16) | 168 | (67) | - | 101 |
| Shares issued in rights offering (Note 15) | 170,949 | - | - | 170,949 |
| Balance, December 31, 2012 | **$ 582,626** | **$ 1,808** | **$ (199,160)** | **$ 385,274** |

The accompanying Notes to the Consolidated Financial Statements are an integral part of these statements.

# AINSWORTH LUMBER CO. LTD.

## Consolidated Statements of Cash Flows

(In thousands of Canadian dollars)

| | | **Year Ended December 31 2012** | | Year Ended December 31 2011 |
|---|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | |
| Net Income | **$** | **28,372** | $ | 8,293 |
| Items not affecting cash | | | | |
| Amortization of property, plant and equipment and intangible assets | | **25,626** | | 23,987 |
| Finance expense (Note 18) | | **50,781** | | 49,776 |
| Loss on early repayment of long-term debt (Note 19) | | **22,879** | | - |
| Share-based payments (Note 16) | | **830** | | 416 |
| Foreign exchange (gain) loss on long-term debt (Note 20) | | **(10,269)** | | 11,353 |
| (Gain) loss on derivative financial instrument (Note 21) | | **(23,993)** | | 6,227 |
| Loss (gain) on disposal of property, plant and equipment (Note 24) | | **155** | | (1,509) |
| Write-down of property, plant and equipment and intangible assets (Note 24) | | **1,316** | | 1,614 |
| Change in non-current reforestation obligation | | **845** | | (513) |
| Deferred taxes | | **2,704** | | (20,195) |
| Gain on acquisition of High Level (Note 23) | | **-** | | (72,544) |
| Other | | **805** | | (685) |
| Cash flows from operating activities before working capital, interest and income taxes | | **100,051** | | 6,220 |
| Change in non-cash operating working capital (Note 26) | | **(3,298)** | | (2,490) |
| Interest paid | | **(28,642)** | | (30,648) |
| Income taxes paid | | **(26)** | | (85) |
| Cash provided by (used in) operating activities | | **68,085** | | (27,003) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | | |
| Repayment of long-term debt (Note 12) | | **(522,886)** | | (23,335) |
| Issue of long-term debt (Note 12) | | **348,145** | | 14,089 |
| Refinancing costs | | **(12,126)** | | - |
| Proceeds from issue of shares (Note 15, 16) | | **175,101** | | 324 |
| Increase (reduction) in finance lease obligations (Note 12) | | **(235)** | | (2,337) |
| Cash used in financing activities | | **(12,001)** | | (11,259) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | |
| (Increase) decrease in restricted cash | | **(699)** | | 5,980 |
| Acquisition of High Level (Note 23) | | **-** | | (20,000) |
| Additions to property, plant and equipment and intangible assets (Note 7, 8) | | **(5,960)** | | (7,847) |
| Proceeds on disposal of property, plant and equipment and intangible assets | | **345** | | 2,028 |
| Increase in other assets | | **(31)** | | (315) |
| Cash used in investing activities | | **(6,345)** | | (20,154) |
| Effect of foreign exchange rate changes on cash and cash equivalents | | **(658)** | | (37) |
| **NET CASH INFLOW (OUTFLOW)** | | **49,081** | | (58,453) |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR** | | **57,696** | | 116,149 |
| **CASH AND CASH EQUIVALENTS, END OF YEAR** | **$** | **106,777** | $ | 57,696 |
| Cash | | **55,847** | | 6,951 |
| Cash equivalents | | **50,930** | | 50,745 |
| **CASH AND CASH EQUIVALENTS, END OF YEAR** | **$** | **106,777** | $ | 57,696 |

The accompanying Notes to the Consolidated Financial Statements are an integral part of these statements.

## 1. CORPORATE INFORMATION

Ainsworth Lumber Co. Ltd. ("the Company") is a manufacturer and marketer of oriented strand board ("OSB") with a focus on value-added specialty products for markets in North America and Asia. The Company owns four Canadian OSB manufacturing facilities in Alberta, British Columbia, and Ontario. The Company's OSB facility located in High Level, Alberta has been curtailed since December of 2007; however, the Company has implemented plans to resume production of the High Level mill in 2013. The Company's registered address is 1055 Dunsmuir Street, Suite 3194, Bentall 4, P.O. Box 49307, Vancouver, British Columbia, Canada, V7X 1L3.

Ainsworth Lumber Co. Ltd. is a publicly listed company incorporated under the laws of Canada. The Company's shares are listed on the Toronto Stock Exchange.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### a) *Statement of compliance*

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The policies set out below were consistently applied to all periods presented.

These consolidated financial statements were authorized for issuance by the Board of Directors of the Company on March 7, 2013.

### b) *Basis of consolidation*

The consolidated financial statements of the Company for the year ended December 31, 2012 include the accounts of the Company and all of its wholly-owned subsidiaries, which are the entities over which the Company has control. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The Company's principal subsidiaries include Ainsworth Corp. and Ainsworth Engineered Canada Limited Partnership. Intercompany balances, transactions, revenues, and expenses, between subsidiaries are eliminated upon consolidation.

The accounting policies of its subsidiaries are consistent with the policies adopted by the Company.

Certain prior period balances have been changed in the current period presentation.

(i) Short-term investments of $45.5 million as at December 31, 2011 ($59.4 million as at December 31, 2010) have been reclassified to cash and cash equivalents as they are readily convertible to cash and subject to insignificant changes in value.

(ii) Restricted cash of $4.7 million, previously included in cash and cash equivalents as at December 31, 2011 ($10.8 million as at December 31, 2010) has been disclosed separately.

(iii) On the consolidated statements of cash flows for the year ended December 31, 2011, cash and cash equivalents of $116.1 million at the beginning of the year reflects an increase of $48.6 million as a result of the reclassification of short-term investments and restricted cash as at December 31, 2010.

(iv) Costs of curtailed operations of $3.3 million have been presented within income (loss) from operations, resulting in a decrease in income from operations of $3.3 million.

### c) *Business combination*

The acquisition of businesses is accounted for using the acquisition method. The consideration of each acquisition is measured at the aggregate of the fair values, at the date of acquisition, of

**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

assets obtained, liabilities incurred or assumed, and equity instruments issued by the Company in exchange for control of the acquired business. The acquired business' identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3, *Business Combinations* ("IFRS 3") are recognized at their fair values at the acquisition date, except for non-current assets that are classified as held-for-sale in accordance with IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations* which are recognized and measured at fair value, less costs to sell. The non-controlling interest in the acquiree is initially measured at the non-controlling interest's proportion of the net fair value of the identifiable assets, liabilities and contingent liabilities recognized.

To the extent the fair value of consideration paid exceeds the fair value of the net identifiable assets, goodwill is recognized. To the extent the fair value of consideration paid is less than the fair value of net identifiable assets, the excess is recognized in income immediately.

Where a business combination is achieved in stages with the Company holding a pre-existing equity interest in the acquired entity, its previously held interests in the acquired entity are re-measured to fair value at the acquisition date, which is the date control is obtained, and the resulting gain or loss, if any, is recognized in income or loss. Once control is obtained, as long as control is not lost, all changes to ownership interests are treated as equity transactions and reported within equity.

*d) Functional and presentational currency*

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency. All financial information presented in Canadian dollars has been rounded to the nearest thousand.

Transactions in currencies other than the functional currency are recorded at the rates of exchange prevailing on dates of transactions. At each financial position reporting date, monetary assets and liabilities that are denominated in foreign currencies are translated using rate at the end of the reporting period. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction and are not retranslated.

The individual financial statements of each of the Company's subsidiaries are presented in the currency of the primary economic environment in which the entity operates. In preparing the financial statements of the individual subsidiaries, transactions in currencies other than the subsidiary's functional currency are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items that are denominated in currencies other than the functional currency are translated at the period end exchange rates. Non-monetary assets and liabilities are translated using the historical rate on the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities not denominated in the functional currency of an entity are recognized in profit or loss in the period.

*e) Use of estimates and judgment*

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions at the financial position date that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses.

The most significant estimates relate to the determination of the useful life and value in use of its property, plant and equipment and intangible assets; units-of-production for amortization of the

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

OSB facilities; accounting for business combinations; measurement of deferred income tax assets and liabilities; valuation of inventory; loss contingencies; other assets; reforestation obligations; measurement of future employee benefits; and management's estimates of capital requirements and liquidity.

Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis and are based on historical experiences and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

The most significant judgments relate to timing of revenue recognition; determination of functional currency; determination of cash generating units; purchase price allocation under the acquisition method; lease classification; and classification of financial instruments.

f) *Cash and cash equivalents*

Cash and cash equivalents generally consist of cash balances with banks, investments with original maturities of three months or less at the time of purchase, and investments that are both readily convertible to cash and subject to insignificant risk of changes in value.

The Company had an unutilized U.S.$2.5 million future foreign exchange contract credit facility at December 31, 2012 which, if utilized, would be secured by cash collateral.

g) *Restricted cash*

Restricted cash is held in a separate account as collateral for the $5.6 million (December 31, 2011: $4.9 million) outstanding letters of credit to support the Company's ongoing business operations.

h) *Inventories*

Inventory is valued at the lower of cost and net realizable value. Inventory cost is determined using the three month weighted average cost of production. Cost of panel products is defined as all costs that relate to bringing the inventory to its present location and condition under normal operating conditions and includes manufacturing costs, such as raw materials, labour and production overhead and amortization costs. Cost of logs is defined as all costs that relate to purchasing, harvesting and delivery of the logs to their present location, including labour, overhead and amortization.

Materials, supplies and consumable spares are valued at the lower of cost and replacement cost, which approximates net realizable value, and are expensed when introduced into the production process.

Inventory write-downs may be reversed (to the extent of the original write-down) if circumstances change in subsequent periods.

i) *Property, plant and equipment*

Items of property, plant and equipment are measured at cost less accumulated amortization and accumulated impairment losses. Cost includes expenditures that are directly attributable to acquiring and bringing the assets to a working condition for their intended use. The Company also capitalizes borrowing costs which are directly attributable to the acquisition, construction or

**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

production of qualifying assets, unless development activities on these qualifying assets are suspended, in which case borrowing costs are expensed.

The cost of replacing significant parts of an item of property, plant and equipment is recognized in the carrying amount of the asset if it is probable that the future economic benefits embodied within the part will flow to the Company, and its costs can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in the Statement of Operations and Comprehensive Income as incurred.

When significant parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

OSB facilities are amortized on the units-of-production method based on the estimated useful life of the assets at normal production levels over 25 years. Other assets are amortized on the declining balance basis at annual rates based on the estimated useful lives of the assets as follows:

| Assets | Rates |
|---|---|
| Building | 5% |
| Machinery and equipment | 15-20% |
| Office equipment | 15% |

Assets under finance leases are amortized on a straight line basis over the term of the lease (one to four years). Logging roads are stated at cost and are amortized on the basis of the volume of timber cut. Assets under construction are not depreciated until they are ready for their intended use. Land is not depreciated.

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate. Property, plant and equipment are reviewed for impairment and accounted for as discussed in Note 2(k).

*j) Intangible assets*

Intangible assets consist of timber rights. The assets are measured at cost less accumulated amortization. Non-renewable pulpwood agreements and wood deposits are amortized over the life of the agreement, and the remaining assets are amortized on the basis of the volume of timber cut. Amortization methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate. If the Company identifies events or changes in circumstances which may indicate that their carrying amount may not be recoverable, the intangible assets would be reviewed for impairment and accounted as discussed in Note 2(k).

*k) Asset impairment*

The carrying amounts of property, plant and equipment and intangible assets are reviewed for impairment at each reporting period and whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable.

An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows ("cash generating units" or "CGUs"). The recoverable amount is the higher of an asset's fair value less cost to sell or its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time

**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the CGUs (as defined above) to which the asset belongs.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

*l) Other assets*

Other assets consist of long-term advances and deposits which are recorded at cost and a derivative financial instrument measured at fair value upon initial recognition and at each subsequent reporting date. If a market value is not available, the fair value is calculated using standard financial valuation models, such as discounted cash flow or option pricing models. Derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. Changes in their fair values are recognized in the Statement of Comprehensive Income.

*m) Disposal of assets and discontinued operations*

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through sale rather than continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale and it should be expected to be completed within one year from the date of classification. Non-current assets (and disposal groups) classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

*n) Reforestation obligations*

Timber is harvested under various licenses issued by the Provinces of British Columbia and Alberta, which include future requirements for reforestation. The fair value of the future estimated reforestation obligation is accrued and charged to operations in cost of products sold on the basis of the volume of timber cut, fair value being the present value of estimated future cash flows using a credit adjusted risk free rate. Subsequent changes to fair value resulting from the passage of time and revisions to fair value calculations are recognized into income as they occur.

*o) Revenue recognition*

Revenue is measured at the fair value of the consideration received or receivable, excluding any intercompany sales which have been eliminated upon consolidation. Revenue from the sale of goods and services is recognized when the risks and rewards of ownership, including managerial involvement, have transferred to the buyer; the amount of revenue can be measured reliably; the receipt of economic benefits is probable; and costs incurred or to be incurred can be measured reliably. Freight costs are included in cost of products sold.

**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*p) Finance expense*

The Company's long-term debt is recorded net of premiums and consent fees, which are deferred at inception and subsequently amortized over the term of the debt using the effective interest rate method.

The Company accounts for transaction costs that are directly attributable to the issuance of long-term debt by deducting such costs from the carrying value of the long-term debt. The capitalized transaction costs are amortized to earnings using the effective interest rate method.

*q) Taxation*

Tax expense is comprised of current and deferred tax components. Tax is recognized in the statement of operations except to the extent that it relates to items recognized directly in equity or other comprehensive income, in which case the related tax is recognized in equity or other comprehensive income.

Current tax expense is based on the results for the period as adjusted for items that are not currently taxable or not deductible for tax purposes. Current tax is calculated using tax rates and laws that were enacted or substantively enacted at the financial position date.

Deferred tax is recorded using the asset and liability method. Under this method, the Company calculates all temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the period end date. Deferred tax is calculated based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates that are expected to apply to the year of realization or settlement based on tax rates and laws enacted or substantively enacted at the period end date.

Deferred tax assets are recognized to the extent it is probable that taxable profits will be available against which the deductible temporary differences and unused tax losses and tax credits can be utilized. The carrying amount of deferred tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

In a business combination, temporary differences arise as a result of differences in the fair values of identifiable assets and liabilities acquired and their respective tax bases. Deferred income tax assets and liabilities are recognized for the tax effects of these differences. Deferred income tax assets and liabilities are not recognized for temporary differences arising from goodwill or from the initial recognition of assets and liabilities acquired in a transaction other than a business combination which do not affect either accounting or taxable income or loss.

*r) Net income (loss) per share*

Basic earnings (loss) per share is calculated by dividing net income (loss) by the weighted average number of voting common shares outstanding during the period. Diluted earnings (loss) per share is based on the weighted average number of voting common shares and exchangeable shares and stock options outstanding at the beginning of or granted during the period, calculated using the treasury stock method. Under this method, the proceeds from the exercise of the

**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

options are assumed to be used to repurchase the Company's shares on the open market. The difference between the number of shares assumed purchased and the number of options assumed exercised is added to the actual number of shares outstanding to determine diluted shares outstanding for purposes of calculating diluted earnings per share. Therefore, the number of shares in the diluted earnings per share calculation will increase as the average share price increases.

*s) Employee benefits*

The costs of retirement benefits for defined benefit plans are recognized as the benefits are earned by employees. The Projected Unit Credit Method is used along with management's best estimate assumptions to value pension and other post-retirement benefits. Pension assets are valued at fair value for the purpose of calculating the expected return on plan assets. The Company recognizes all actuarial gains and losses arising from defined benefit plans in other comprehensive income, and reports them in retained earnings (deficit). Any asset resulting from this calculation is limited to unrecognized actuarial losses and past service cost, plus the present value of available refunds and reductions in future contributions to the plan. Payments to the defined contribution pension plan are expensed as incurred, when the related employee service is rendered.

*t) Share-based payments*

The Company offers both equity-settled and cash-settled share-based payment plans for eligible directors, officers and employees. Both plans are accounted for using the fair value method. Under the fair value method, compensation expense for these share-based payments is determined based on the fair value at the grant date using the Black-Scholes option-pricing model and is charged to income over the vesting period. For equity-settled share-based payments that vest over more than a single period, each tranche of the award is considered to be a separate grant and the fair value of each is calculated on the grant date. Management estimates a forfeiture rate for the purpose of determining the compensation expense over the vesting period.

Equity-settled awards relate to stock options. When stock options are exercised, any consideration paid by employees, as well as the related share-based compensation are credited to capital stock. Equity-settled awards are not re-measured subsequent to the initial grant date.

Cash-settled awards relate to deferred share units ("DSUs"). The awards are initially measured at fair value at the grant date, and subsequently re-measured to fair value at each reporting date until settlement. The related cost of a cash-settled award is credited to liabilities until settled.

*u) Financial instruments*

All financial instruments are initially recorded at fair value including transaction costs except for transaction costs related to financial instruments classified as fair value through profit or loss ("FVTPL") which are expensed as incurred. Subsequent measurement of financial instruments is determined based on its classification.

The Company classifies its cash and cash equivalents, and short-term investments as FVTPL which are measured at fair value with gains and losses included in net income in the period in which they arise. Trade and other receivables are classified as loans and receivables which are accounted for at amortized cost. Trade and other payables, income taxes payable, and long-term debt are measured at amortized cost. The Company measures derivatives and embedded derivatives at fair value with changes in fair value recognized in net income and has not elected to use hedge accounting.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Company has not designated any financial instruments as held to maturity.

Financial instruments recognized at fair value are classified in fair value hierarchy levels as follows:

- Level 1 – valuation based on quoted prices (unadjusted) in active market for identical assets or liabilities;

- Level 2 – valuation techniques based on inputs that are other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (prices) or indirectly (derived from prices);

- Level 3 – valuation techniques with unobservable market inputs (involves assumptions and estimates by management of how market participants would price the assets or liabilities.)

*v)* *Provisions*

Provisions represent liabilities of the Company for which the amount or timing is uncertain. A provision is recognized when, as a result of a past event, the Company has a present obligation (legal or constructive) that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where appropriate, the future cash flow estimates are adjusted to reflect risks specific to the liability.

## 3. ACCOUNTING STANDARDS DEVELOPMENTS

*c)* *IFRS 9 Financial instruments* (“IFRS 9”)

*This standard, as issued in November 2009 and amended in October 2010,* will replace *IAS 39 Financial Instruments: Recognition and Measurement*. IFRS 9 provides guidance for the classification and subsequent measurement of financial assets at amortized cost or at fair value based on the Company’s business model for managing financial assets and the contractual cash flow characteristics of the financial assets. Financial liabilities are classified as subsequently measured at amortized cost except for financial liabilities classified at fair value through profit or loss (“FVTPL”), financial guarantees and certain other exceptions. The new standard also requires a single impairment model to be used, replacing the multiple impairment models in IAS 39. The effective date of IFRS 9 was deferred to annual periods beginning on or after January 1, 2015. The Company does not expect this pronouncement to have a significant impact on its results and financial position.

*d)* *Consolidation*

In May 2011, the ISAB issued the following new standards:

*(iv) IFRS 10 Consolidated Financial Statements* (“IFRS 10”)
IFRS 10 will replace parts of IAS 27, Consolidated and Separate Financial Statements, and SIC-12, Consolidation – Special Purpose Entities. IFRS 10 uses control as the single basis for consolidation, irrespective of the nature of the investee, and requires continuous assessment of control over an investee.

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 3. ACCOUNTING STANDARDS DEVELOPMENT (Continued)

(v) *IFRS 11 Joint Ventures ("IFRS 11")*
IFRS 11 will replace IAS 31 Interests in Joint Ventures, and SIC-13 Jointly Controlled Entities – Non-monetary Contributions by Venturers. IFRS 11 classifies joint arrangements as either joint operations or joint ventures based on the rights and obligations of the parties to the joint arrangements. IFRS 11 requires a joint operator to recognize its portion of assets, liabilities, revenues and expenses of a joint arrangement, while a joint venture is recognized as an investment in a joint arrangement using the equity method.

(vi) *IFRS 12, Disclosures of Involvement with Other Entities*

The above standards are effective for annual periods beginning on or after January 1, 2013. The Company does not expect these pronouncements to have a significant impact on its results and financial position.

(c) *IFRS 13 Fair value measurements and disclosure* ("IFRS 13")

IFRS 13 was issued by the IASB in May 2011. This standard provides a definition of fair value and a framework for the measurement and disclosure of fair values to be applied when required or permitted by other IFRS standards. IFRS 13 is effective for annual periods beginning on or after January 1, 2013. The Company does not expect this pronouncement to have a significant impact on its results and financial position.

(d) *IAS 19 Employee benefits* ("IAS 19")

*IAS 19* was amended by the IASB in June 2011. This amendment includes: the requirement to recognize gains and losses relating to defined benefit plans in other comprehensive income in the period they occur; the replacement of interest cost and expected return on plan assets with a calculation of interest income or cost on the net asset or liability based on the plan's discount rate; clarification of guidance on measurement issues; and expanded disclosure regarding the characteristics of and risks associated with defined benefit plans will also be required. The amendment is effective for annual periods beginning on or after January 1, 2013. The Company is still assessing the impact of this amendment on its results and financial position.

## 4. TRADE AND OTHER RECEIVABLES

All trade and other receivables are pledged as security for the Senior Secured Notes and are comprised of the following:

| | | **2012** | | 2011 |
|---|---|---|---|---|
| Trade receivables | **$** | **22,305** | $ | 13,978 |
| Other receivables | | **3,403** | | 3,924 |
| | | **25,708** | | 17,902 |
| Less: allowance for doubtful accounts | | **(100)** | | (100) |
| | **$** | **25,608** | $ | 17,802 |

(Figures are in thousands of Canadian dollars unless indicated otherwise)

**4. TRADE AND OTHER RECEIVABLES (Continued)**

Changes in the allowance for doubtful accounts are as follows:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Balance, January 1 | $ | **100** | $ | 100 |
| Receivables written off during the year | | **-** | | - |
| Balance, December 31 | $ | **100** | $ | 100 |

The aging of trade receivables is as follows:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| < 30 days | $ | **22,126** | $ | 13,748 |
| 30 - 60 days | | **179** | | 225 |
| > 60 days | | **-** | | 5 |
| | $ | **22,305** | $ | 13,978 |

The Company did not have any impaired trade receivables for the year ended December 31, 2012 (December 31, 2011: $nil).

**5. INVENTORIES**

The carrying value of logs and panel products, valued at lower of cost and net realizable value, and materials, supplies and spares, valued at lower of cost and replacement cost, is set out in the following table:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Logs | $ | **8,739** | $ | 8,734 |
| Panel products | | **12,502** | | 10,627 |
| Materials, supplies and spares | | **16,899** | | 17,047 |
| | $ | **38,140** | $ | 36,408 |

A recovery of inventory previously written down was recorded as follows:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Log inventory | $ | **-** | $ | 123 |
| Panel inventory | | **-** | | 288 |
| | $ | **-** | $ | 411 |

All inventories are pledged as security for the Senior Secured Notes.

**6. LONG-LIVED ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS**

During 2009, the Company completed sales of its Minnesota OSB mills and its specialty plywood business. Liabilities relate to costs associated with terminating the Minnesota defined benefit pension plan and settling outstanding employee claims.

In 2011, the Company sold its aircraft for proceeds of U.S.$5.75 million ($5.5 million). Concurrent with the sale, the Company repaid the related financing lease of $7.1 million.

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 6. LONG-LIVED ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS (Continued)

The following table presents selected financial information related to discontinued operations:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| ASSETS | | | | |
| Current Assets of Discontinued Operations | | | | |
| Trade and other receivables | $ | - | $ | 509 |
| Total Assets Held for Disposal | $ | - | $ | 509 |
| LIABILITIES | | | | |
| Current Liabilities of Discontinued Operations | | | | |
| Trade and other payables | $ | 476 | $ | 719 |
| Accrued Pension Benefit Liability (1) | | 2,469 | | 1,878 |
| Total Liabilities Held for Disposal | $ | 2,945 | $ | 2,597 |

(1) During 2010, the Company issued a letter of credit in the amount of U.S.$1.1 million to in respect of its potential obligations related to the Minnesota defined benefit plan upon termination of the defined benefit pension plan.

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Impairment of Other Assets | $ | - | $ | (112) |
| Gain on Disposal of Property, Plant and Equipment | | - | | 1,030 |
| (Loss) Income Before Income Taxes | | (397) | | 632 |
| Income Tax (Expense) Recovery | | (1) | | 34 |
| (Loss) Income from Discontinued Operations | $ | (398) | $ | 666 |

There have been no significant investing or financing activities related to the discontinued operations since fiscal 2010. The cash outflows from discontinued operations relate primarily to the U.S. pension plan and settlement of miscellaneous general accounts, offset by cash inflows related to the sale of certain equipment.

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 7. PROPERTY, PLANT AND EQUIPMENT

| **Cost** | **Land** | **Building** | **Machinery and Equipment** | **Assets under Finance Lease** | **Other Assets** (2) | **Construction in Progress** (3) | **Total** (1) |
|---|---|---|---|---|---|---|---|
| Cost, December 31, 2011 | $4,334 | $223,118 | $ 442,252 | $ 1,818 | $ 8,057 | $ 55,513 | $ 735,092 |
| Additions | - | - | 53 | - | 132 | 4,604 | 4,789 |
| Disposals | - | (5) | (228) | - | (182) | (138) | (553) |
| Investment tax credits on capital expenditures | - | - | (203) | - | - | - | (203) |
| Transfers | - | - | 3,907 | 333 | 273 | (4,668) | (155) |
| Write-downs (4) | (1,199) | - | - | - | - | - | (1,199) |
| Cost, December 31, 2012 | $3,135 | $223,113 | $ 445,781 | $ 2,151 | $ 8,280 | $ 55,311 | $ 737,771 |
| **Accumulated Amortization** | | | | | | | |
| Accumulated amortization, December 31, 2011 | $ - | $ (19,493) | $ (64,389) | $ (449) | $ (1,995) | $ - | $ (86,326) |
| Amortization for the period | - | (7,169) | (14,409) | (625) | (663) | - | (22,866) |
| Disposals | - | - | 48 | - | 67 | - | 115 |
| Accumulated amortization, December 31, 2012 | $ - | $ (26,662) | $ (78,750) | $ (1,074) | $ (2,591) | $ - | $ (109,077) |
| **Carrying amount** | | | | | | | |
| Balance, Dec. 31, 2011 | $4,334 | $203,625 | $ 377,863 | $ 1,369 | $ 6,062 | $ 55,513 | $ 648,766 |
| Balance, Dec. 31, 2012 | 3,135 | 196,451 | 367,031 | 1,077 | 5,689 | 55,311 | 628,694 |

(1) All property, plant and equipment are pledged as security for the Senior Secured Notes.

(2) Other assets includes office equipment, computer hardware, computer software, vehicles, forklifts, loaders and skidders, roads and storage, prepaid roads, leasehold improvements and plantations.

(3) No interest has been capitalized in construction in progress for the periods presented as construction has been put on hold indefinitely. Included in construction in progress is $52,101 related to our second production line at Grande Prairie, which is currently curtailed.

(4) During the quarter, certain non-core property located in Savona, British Columbia was written down to fair market value of $1.0 million. Subsequent to the end of the year, the Company sold this property for cash consideration approximating the carrying value.

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 8. INTANGIBLE ASSETS

Intangible assets consist of timber rights.

| **Cost** | | |
|---|---|---|
| Cost at December 31, 2011 | $ | 25,469 |
| Additions | | 1,327 |
| Disposals | | (62) |
| Write-downs | | (172) |
| Cost, December 31, 2012 | $ | 26,562 |

| **Accumulated Amortization** | | |
|---|---|---|
| Accumulated amortization at December 31, 2011 | $ | (13,791) |
| Amortization for the period | | (2,921) |
| Write-downs | | 55 |
| Accumulated amortization, December 31, 2012 | $ | (16,657) |

| **Carrying Amount** | | |
|---|---|---|
| Balance, December 31, 2011 | $ | 11,678 |
| Balance, December 31, 2012 (1) | | 9,905 |

(1) Intangible assets are pledged as security for the Senior Secured Notes.

## 9. TRADE AND OTHER PAYABLES

| | | **2012** | | 2011 |
|---|---|---|---|---|
| Trade payables | **$** | **11,456** | $ | 8,759 |
| Other payables and accruals (1) | | **18,801** | | 12,927 |
| | **$** | **30,257** | $ | 21,686 |

(1) Other payables and accruals include wages and benefits, severance payable, sundry payables, current reforestation liabilities and accrued interest. At December 31, 2012, $100 is payable to Brookfield Capital Partners Ltd. ("BCP") for services provided to the Company.

## 10. ACCRUED PENSION BENEFIT LIABILITY

The Company maintains two defined benefit pension plans for certain salaried and certain hourly employees in British Columbia and Minnesota. Pension benefits are dependent on a member's salary throughout their career and years of service with the company. The pension liability of the Minnesota plan was reclassified to discontinued operations (Note 6).

***Defined benefit plans:***

The Company measures its accrued pension benefit obligations and the fair value of plan assets of its defined benefit pension plans for accounting purposes as at December 31 of each year. The most recent actuarial valuation of the British Columbia pension plan for funding purposes was as of December 31, 2009. The date of the next required valuation is December 31, 2012. The most recent actuarial valuation of the Minnesota pension plan was as of January 1, 2012. The next valuation will be prepared as of January 1, 2013 The net accrued benefit liability related to the Company's U.S. operations has been classified separately as a result of the decision to discontinue these operations. Actuarial gains and losses are recognized in other comprehensive income in the period within which they occur.

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 10. ACCRUED PENSION BENEFIT LIABILITY (Continued)

Information about the Company's defined benefit pension plan is as follows:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| PLAN ASSETS | | | | |
| Fair value at beginning of year | $ | **41,487** | $ | 39,222 |
| Expected return on plan assets | | **2,566** | | 2,708 |
| Employer contributions (1) | | **3,497** | | 5,236 |
| Benefits paid | | **(4,358)** | | (3,449) |
| Actuarial gain (loss) | | **736** | | (2,230) |
| Fair value at end of year | $ | **43,928** | $ | 41,487 |
| ACCRUED BENEFIT OBLIGATION | | | | |
| Balance at beginning of year | | **54,590** | | 49,667 |
| Current service cost | | **2,012** | | 1,778 |
| Interest cost | | **2,721** | | 2,735 |
| Benefits paid | | **(4,358)** | | (3,449) |
| Actuarial loss | | **5,969** | | 3,859 |
| Balance at end of year (2) | | **60,934** | | 54,590 |
| NET PLAN DEFICIT AT END OF YEAR | $ | **(17,006)** | $ | (13,103) |
| Fair value of plan assets at end of year, discontinued operations | $ | **4,097** | $ | 4,433 |
| Accrued benefit obligation at end of year, discontinued operations | $ | **6,566** | $ | 6,311 |
| Net plan deficit at end of year, discontinued operations | $ | **(2,469)** | $ | (1,878) |

(1) Employer contributions for the year ended December 31, 2013 are estimated at $3,497, not considering the effect of the next actuarial valuation which may increase contributions.

(2) Accrued benefit obligation includes liabilities of $2.2 million (December 31, 2011: $2.1 million) related to the Lillooet and Savona discontinued operations.

The components of pension expense that have been charged to the statement of operations for the period, within selling and administration and cost of products sold, are set out below:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Accrual for current services | $ | **2,012** | $ | 1,778 |
| Interest on accrued benefits | | **2,721** | | 2,735 |
| Expected return on pension fund assets | | **(2,566)** | | (2,708) |
| Pension expense, continuing operations | $ | **2,167** | $ | 1,805 |
| Pension expense, discontinued operations | $ | **274** | $ | 181 |

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 10. ACCRUED PENSION BENEFIT LIABILITY (Continued)

Net actuarial losses have been charged to other comprehensive income and immediately recognized in retained earnings (deficit) as follows:

| | **2012** | 2011 |
|---|---|---|
| Actuarial losses in other comprehensive income, January 1 | **$ 14,295** | $ 9,414 |
| Actuarial (gain) loss on plan assets, continuing operations | **(736)** | 2,230 |
| Actuarial loss on plan liabilities, continuing operations | **5,970** | 3,859 |
| Net actuarial loss, discontinued operations | **673** | 315 |
| Income tax recovery on actuarial loss | **(1,308)** | (1,523) |
| Total loss charged to other comprehensive income for the year | **4,599** | 4,881 |
| Actuarial losses in other comprehensive income, December 31 | **$ 18,894** | $ 14,295 |

The significant weighted-average actuarial assumptions adopted in measuring the Company's accrued benefit obligations and benefit costs included the following:

| | **2012** | 2011 |
|---|---|---|
| Discount rate on accrued benefit obligation at end of year | **4.40%** | 5.00% |
| Discount rate on benefit costs | **5.00%** | 5.50% |
| Expected long-term rate of return on plan assets | **6.25%** | 6.75% |
| Actual return on plan assets | **9.89%** | 1.76% |
| Rate of compensation increase | **3.00%** | 3.00% |

The expected rate of return considers the allocation of the assets in which the pension fund is invested and the individual best estimate rates of return on those asset classes in order to establish an overall rate of return for the entire fund. This rate is assumed to be net of administration and investment management fees charged to the plan.

The plan assets in the defined benefit pension plans, which fall within the allowable range of the corresponding assets category as set out in the Statement of Investment Policies and Procedures, are as follows:

| **PLAN ASSETS** | **2012** | 2011 |
|---|---|---|
| Cash | **0.2%** | 0.1% |
| Canadian short-term investments | **0.0%** | 3.5% |
| Canadian bonds and debentures | **44.7%** | 36.8% |
| Canadian common shares | **0.0%** | 25.9% |
| Canadian pooled equity funds | **35.2%** | 2.1% |
| Global bonds and debentures | **0.0%** | 0.7% |
| Global pooled equity funds | **0.0%** | 14.4% |
| U.S. common shares | **0.0%** | 16.5% |
| U.S. pooled equity funds | **19.9%** | 0.0% |
| | **100.0%** | 100.0% |

At December 31, 2012, there were no shares of the Company held in the pension and other benefit trusts administered by the Company.

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 10. ACCRUED PENSION BENEFIT LIABILITY (Continued)

***Defined contribution plan and other plans:***

Beginning in the second quarter of 2010, new salaried employees in British Columbia were enrolled into a new Canadian defined contribution pension plan. The plan is funded by payments from the employees and the Company. Payments are charged to the statement of operations for the period as incurred.

The Company also sponsors a Group Registered Retirement Savings Plan (RRSP) at three of its Canadian operations, including the curtailed High Level operation.

Contributions to these plans were as follows:

| | | **2012** | | 2011 |
|---|---|---|---|---|
| Group RRSP | **$** | **590** | $ | 782 |
| Defined contribution pension plan | | **289** | | 185 |
| 401(k) savings plans | | **26** | | 18 |

## 11. REFORESTATION OBLIGATION

Reforestation obligations relate to timber that is harvested under various licenses issued by the Provinces of British Columbia and Alberta. The future estimated reforestation obligation is accrued and charged to operations in cost of products sold on the basis of the volume of timber cut.

| | | **2012** | | 2011 |
|---|---|---|---|---|
| Balance, January 1 | **$** | **3,405** | $ | 2,502 |
| Expense | | **1,518** | | 620 |
| Paid during the year | | **(371)** | | (477) |
| High Level purchase price adjustment[1] | | **-** | | 1,201 |
| Unwinding of discount | | **(283)** | | (441) |
| Balance, December 31 | **$** | **4,269** | $ | 3,405 |
| | | | | |
| Current portion, included in trade and other payables | **$** | **488** | $ | 469 |
| Non-current portion | | **3,781** | | 2,936 |
| | **$** | **4,269** | $ | 3,405 |

(1) Includes the acquisition of the remaining 50% interest in High Level reforestation obligation, plus a fair value adjustment on the existing 50% interest held prior to the transaction.

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 12. LONG-TERM DEBT

| | Note | Par Value | Maturity | | 2012 | | 2011 |
|---|---|---|---|---|---|---|---|
| Bank and other loans | | | | | | | |
| Senior unsecured notes | (a) | US $398,252 | July 29, 2015 | $ | **-** | $ | 405,022 |
| Senior secured notes | (b) | US $350,000 | Dec. 15, 2017 | | **348,215** | | - |
| Senior secured term loan | (c) | US $102,637 | June 26, 2014 | | **-** | | 104,382 |
| Equipment financing loan | (d) | US $10,081 | Sept. 30, 2014 | | **10,030** | | 12,987 |
| Equipment financing loan | (e) | Euro 3,582 | June 20, 2014 | | **4,698** | | 7,491 |
| Finance leases | (f) | | 2013 - 2015 | | **995** | | 1,231 |
| | | | | | **363,938** | | 531,113 |
| Consent fees | | | | | **-** | | (691) |
| Unamortized transaction costs | | | | | **(9,025)** | | (12,955) |
| Unamortized deferred debt premium | | | | | **6,523** | | 5,699 |
| | | | | **$** | **361,436** | $ | 523,166 |
| Current | | | | **$** | **6,313** | $ | 4,895 |
| Non-current | | | | | **355,123** | | 518,271 |
| | | | | **$** | **361,436** | $ | 523,166 |

a) During the fourth quarter of 2012, the Senior Unsecured Notes, bearing cash interest payable semi-annually at 6.0% per annum and 5.0% payment-in-kind interest per annum due at maturity, were redeemed and cancelled by the Company using proceeds from the issue of Senior Secured Notes (see (b)) and proceeds from the rights offering (Note 15).

b) On November 27, 2012, the Company completed a private placement of U.S.$350 million of Senior Secured Notes. These notes bear interest at an annual rate of 7.5%, payable semi-annually in cash in arrears, and are secured by substantially all of the Company's assets on a first priority basis, subject to certain exceptions and permitted liens.

c) On November 27, 2012, the Company repaid the Senior Secured Term Loan in full using proceeds from the issue of Senior Secured Notes (see (b)).

d) The equipment loan is secured by certain property, plant and equipment, and requires maintenance of working capital of not less than $50.0 million. Principal and interest payable monthly at LIBOR plus 3.5% per annum.

e) Effective November 27, 2012, the terms of this equipment loan were amended to increase semi-annual interest payable of EURIBOR plus 0.65% per annum to EURIBOR plus 1.65%. The maturity of this loan was amended from December 20, 2016 to June 20, 2014.

f) Secured by certain property, plant and equipment.

Anticipated requirements to meet long-term debt principal repayments, including finance lease obligations, during each of the five years ending December 31 are as follows:

| | |
|---|---|
| 2013 | $ 6,324 |
| 2014 | 9,323 |
| 2015 | 76 |
| 2016 | - |
| 2017 | 348,215 |
| And thereafter | - |
| | $ 363,938 |

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 13. COMMITMENTS AND GUARANTEES

The Company is committed to operating lease payments in respect of premises and finance lease payments in respect of machinery and equipment as follows:

| | Operating Leases | Finance Leases |
|---|---|---|
| No later than one year | $ 866 | $ 596 |
| Later than one year, but no later than five years | 1,300 | 502 |
| Later than five years | - | - |
| | 2,166 | 1,098 |
| Less: future finance charges | - | (103) |
| Present value of minimum lease payments | $ 2,166 | $ 995 |

The Company's obligations under finance leases are secured by the lessors' title to the leased assets. The fair value of the finance lease obligations approximate their carrying value.

The Company had a contractual commitment to purchase property, plant and equipment at December 31, 2012 of approximately $3.1 million (December 31, 2011: $nil). The Company has certain long-term purchase contracts with minimum fixed payment commitments. All contracts are at market prices and on normal business terms.

The Company provides a limited product warranty to purchasers of its products. The Company cannot estimate the amount of future payments, if any, under its product warranties unless and until events arise that could result in a claim.

## 14. CONTINGENCIES

In the normal course of its business activities, the Company is subject to claims and legal actions that may be made against its customers, suppliers and others. While the final outcome with respect to actions outstanding or pending as at December 31, 2012 cannot be predicted with certainty, the Company believes the resolution will not have a material effect on the Company's financial position, financial performance, or cash flows.

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 15. CAPITAL STOCK AND WARRANTS

a. The authorized capital of the Company consists of an unlimited number of common shares without par value and an unlimited number of Preferred Shares issuable in series, 5,000,000 of which are designated as Series 1 Preferred Shares.

The Company's issued and outstanding share capital is as follows:

| | **2012** | | | 2011 | | |
|---|---|---|---|---|---|---|
| | **Shares** | **Warrants (1)** | **Amount** | **Shares** | **Warrants (1)** | **Amount** |
| Balance, January 1 | **100,768,888** | **8,695,634** | **$411,509** | 100,502,222 | 8,695,634 | $410,950 |
| Stock options exercised (Note 16) | **65,000** | **-** | **168** | 266,666 | - | 559 |
| Shares issued in rights offering (2) | **140,000,000** | **-** | **175,000** | - | - | - |
| Transaction costs on rights offering (3) | **-** | **-** | **(4,051)** | - | - | - |
| Balance, December 31 | **240,833,888** | **8,695,634** | **$582,626** | 100,768,888 | 8,695,634 | $411,509 |

(1) The Company issued 8,695,634 warrants on July 28, 2008. Upon exercise, warrants will be converted into common shares without additional consideration. For accounting purposes, nominal value has been allocated to these warrants as the fair value is not reliably determinable due to their contingent nature.
The number of shares that may be issued to warrant holders is dependent on the market price of the Company's common shares. If the Company's common share price exceeds a barrier price of U.S.$7.89 per share (2011: U.S.$12.00 per share) on or before July 29, 2013, each warrant will be converted into 1.52 (2011: 1.0) common shares. If the Company's common share price does not exceed the barrier price on or before July 29, 2013, each warrant will be converted into 0.0035 (2011: 0.0023) common shares on July 29, 2013.

(2) On December 27, 2012, the Company completed its fully backstopped rights offering raising gross proceeds of $175 million. A total of 140 million common shares were purchased under the rights offering. The net proceeds from the rights offering, along with the U.S.$350 million from the issuance of Senior Secured Notes, were used to repay the Company's 11% Senior Unsecured Notes and the Senior Secured Term Loan (Note 12).

(3) Transaction costs are net of tax and include legal, regulatory and other professional fees related to the rights offering, and fees of $4.4 million paid to BCP for its role as standby purchaser of the rights offering (Note 29).

b. Net income per share

The shareholder warrants were not included in the computation of diluted earnings per share because the Company's share price did not exceed the barrier price of U.S.$7.89 per share.

At December 31, 2012 there were 514,010 (December 31, 2011: 1,128,678) stock options which were not taken into account in the calculation of diluted earnings per share for each period presented because their effect was anti-dilutive.

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 16. SHARE-BASED PAYMENTS

The Company has a single stock option plan designed to provide equity-based compensation to directors, executives and key senior management. The stock options granted vest evenly over a three to five year period. The plan provides for the issuance of options to acquire a maximum of 9,000,000 common shares with terms of up to 10 years. The fair value of options granted is calculated using the Black-Scholes model on the date of grant. Adoption of the plan was approved by the Company's shareholders on May 13, 2009.

Effective December 27, 2012, the Company reduced the exercise price of all options that were outstanding prior to the rights offering, to reflect the dilutive effect of the 140 million common shares that were issued in connection with the rights offering. The modification did not result in an incremental increase in fair value.

The table below outlines the significant assumptions used during the period to estimate the fair value of options granted:

| | **2012** | 2011 |
|---|---|---|
| Risk-free interest rate | **1.41%** | 1.93% |
| Expected volatility[1] | **54.00%** | 50.77% |
| Dividend yield | **0%** | 0% |
| Expected option life (years) | **4.00** | 4.00 |
| Share price | **$1.51** | $2.96 |

[1] Expected volatility is based on the historical share price volatility over the past four years, taking into consideration the volatility of similar entities over a comparable period.

The table below outlines the status of the Company's stock option plan:

| | **2012** | | 2011 | |
|---|---|---|---|---|
| | **Number of Share Options** | **Weighted Average Exercise Price** | Number of Share Options | Weighted Average Exercise Price |
| Outstanding at beginning of period | **1,753,676** | **$ 2.52** | 1,978,676 | $ 2.13 |
| Granted during the period | **300,000** | **1.55** | 800,000 | 2.94 |
| Exercised during the period [1] | **(65,000)** | **1.56** | (266,666) | 1.22 |
| Forfeited during the period [2] | **(400,000)** | **2.41** | (758,334) | 2.40 |
| | **1,588,676** | **2.40** | 1,753,676 | 2.52 |
| Effect of exercise price reduction | | **(0.80)** | | - |
| Outstanding at end of period | **1,588,676** | **$ 1.60** | 1,753,676 | $ 2.52 |
| Options exercisable at end of period | **840,336** | | 703,672 | |
| Weighted average fair value per option granted during the period | **$ 1.55** | | $ 1.22 | |

[1] During the year ended December 31, 2012, $168 was credited to capital stock with respect to options that were exercised. This includes $101 consideration received on exercise, plus $67 representing the vested fair value of the stock options. During the year ended December 31, 2011, $559 was credited to capital stock with respect to stock options that were exercised. This includes $324 consideration received on exercise, plus $235 representing the vested fair value of the stock options.

[2] During the year ended December 31, 2012, $135 (December 31, 2011: $413) was reversed from contributed surplus with respect to unvested options forfeited.

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 16. SHARE-BASED PAYMENTS (Continued)

The following table summarizes the weighted average exercise prices and weighted average remaining contractual life of the stock options outstanding at December 31, 2012:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| **Range of Exercise Prices** | **Number of Options** | **Weighted Average Remaining Contractual Life (yrs)** | **Weighted Average Exercise Price** | **Number of Options** | **Weighted Average Exercise Price** |
| $0 - 2 | 1,091,300 | 7.43 | $ 1.25 | 612,962 | $ 1.29 |
| 2.01 - 4 | 497,376 | 7.84 | 2.36 | 227,374 | 2.53 |
| | 1,588,676 | 7.56 | $ 1.60 | 840,336 | $ 1.62 |

The following table outlines the Company's share-based compensation expense with respect to the stock option plan:

| | **2012** | 2011 |
|---|---|---|
| Share-based compensation expense | **$ 391** | $ 369 |

Effective May 13, 2011, the Company implemented a Deferred Share Units ("DSU") plan for directors. Under the DSU plan, directors may elect to receive up to 100% of their fees in the form of DSUs. The number of DSUs awarded is determined by dividing the dollar portion of the fees by the weighted average price of the Company's common shares for the five business days prior to the grant date. DSUs must be retained until the director leaves the Board, at which time the cash value of the DSUs is paid out.

The initial fair value of the liability is calculated as of the grant date using the Black-Scholes option-pricing model and is recognized immediately. The liability is subsequently re-measured to fair value at each reporting period until settlement. The initial fair value of amounts granted and any subsequent changes in fair value are recorded within compensation expense in the period.

The table below outlines the significant assumptions used as at December 31 to estimate the fair value of DSUs:

| | **2012** | 2011 |
|---|---|---|
| Weighted average assumptions: | | |
| Risk-free interest rate | **1.30%** | 1.13% |
| Expected volatility | **52.00%** | 54.00% |
| Dividend yield | **0%** | 0% |
| Expected life (years) | **4.00** | 4.00 |
| Share price | **$2.53** | $0.95 |

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 16. SHARE-BASED PAYMENTS (Continued)

The table below outlines the status of the Company's DSU plan:

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Number of DSUs | | Fair Value | Number of DSUs | | Fair Value |
| Outstanding at beginning of period | 114,264 | $ | 47 | - | $ | - |
| Granted during the period | 301,694 | | 211 | 114,264 | | 94 |
| Change in value | | | 227 | | | (47) |
| Outstanding at end of period | 415,958 | $ | 485 | 114,264 | $ | 47 |

## 17. EMPLOYEE BENEFITS

The table below summarizes the employee benefits included in cost of products sold, and selling and administration expenses:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Short-term employee benefits | $ | 50,173 | $ | 49,965 |
| Long-term employee benefits | | 10,008 | | 9,373 |
| Share-based payments | | 829 | | 417 |
| | $ | 61,010 | $ | 59,755 |

## 18. FINANCE EXPENSE

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Cash interest | $ | (30,224) | $ | (28,296) |
| Payment-in-kind interest | | (18,510) | | (18,990) |
| Interest on finance leases | | (129) | | (437) |
| Amortization of bond premium, transaction costs and consent fees | | (1,918) | | (2,053) |
| | $ | (50,781) | $ | (49,776) |

## 19. LOSS ON EARLY REPAYMENT OF LONG-TERM DEBT

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Extinguishment of derivative embedded in Senior Unsecured Notes | $ | (17,200) | $ | - |
| Write off transaction costs and bond premium | | (5,956) | | - |
| Net consent fees on tender | | (884) | | - |
| Legal fees and other | | (160) | | - |
| Realized foreign exchange gain | | 1,321 | | - |
| | $ | (22,879) | $ | - |

## 20. FOREIGN EXCHANGE GAIN (LOSS)

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Foreign exchange gain (loss) on long-term debt | $ | 10,269 | $ | (11,353) |
| Other foreign exchange (loss) gain | | (840) | | 231 |
| | $ | 9,429 | $ | (11,122) |

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 21. GAIN (LOSS) ON DERIVATIVE FINANCIAL INSTRUMENT

On November 26, 2012, the derivative financial instrument related to the call option embedded in the Senior Unsecured Notes was revalued based on current interest rates and the credit spread. Changes in the risk-free rate, the credit spread and the cash interest rate resulted in gains on the derivative financial asset of $17.2 million. This derivative financial instrument was extinguished on November 27, 2012 when the Senior Unsecured Notes were redeemed (see Note 19).

The Senior Secured Notes issued on November 27, 2012, have embedded call options, whereby the Company has the right to repurchase 10% of the original principal of the Senior Secured Notes, each year, in the first two years, and the right to redeem the Senior Secured Notes after two years. The Company recorded the fair value of the new derivative financial asset related to these call options at the time the Senior Secured Notes were issued. A revaluation was done at December 31, 2012 based on current interest rates and the credit spread resulting in a gain of $6.8 million. Total gains on derivative financial instruments for the year ended December 31, 2012 were $24.0 million (year ended December 31, 2011: $6.2 million loss).

Changes in the value of this derivative financial asset are reflected in operations and within other assets on the statement of financial position.

## 22. COSTS OF CURTAILED OPERATIONS

Costs of curtailed operations primarily include costs associated with the High Level OSB facility.

## 23. GAIN ON ACQUISITION OF HIGH LEVEL

Effective February 17, 2011, the Company acquired the remaining 50% interest in Footner Forest Products Inc. ("High Level") from Grant Forest Products Inc. for $20 million, thereby increasing the Company's interest to 100%. The excess fair value of the net assets acquired over the cash consideration paid of $20 million resulted in a bargain purchase gain of $49,687. The existing 50% interest in the assets and liabilities of High Level held prior to this transaction was revalued to their fair values of $74,160, resulting in a gain of $22,857. The total gain of $72,544 is recorded in the consolidated statement of operations and comprehensive income for the year ended December 31, 2011.

## 24. OTHER ITEMS

| | | **2012** | | 2011 |
|---|---|---|---|---|
| (Loss) gain on disposal of property, plant and equipment | **$** | **(155)** | $ | 972 |
| Write-down of property, plant and equipment, intangibles and other | | **(1,488)** | | (942) |
| Other income | | **480** | | 1,533 |
| | **$** | **(1,163)** | $ | 1,563 |

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 25. TAXATION

Certain permanent differences, such as the non-taxable portion of the foreign exchange gain on debt and expenses not deductible for tax purposes, impact the resulting income tax expense (recovery).

Tax filings are subject to the review, audit and assessment of applicable taxation authorities in Canada and the United States. Tax laws and regulations are subject to interpretation and inherent uncertainty; therefore, management's assessments involve judgments, estimates and assumptions about current and future events. Although management believes these estimates and assumptions are reasonable and appropriate, the final determination could be materially different than that which is reflected in the Company's provision for income taxes and recorded current and deferred income tax assets and liabilities.

### 1. Reconciliation of the effective tax rate:

The following table provides a reconciliation of the Canadian statutory corporation rate to the effective tax rate of the Company:

| | **2012** | | 2011 | |
|---|---|---|---|---|
| | **Amount** | **%** | Amount | % |
| Income tax expense (recovery) at statutory rate | **$ 8,666** | **25** | $ (2,415) | 27 |
| Non-taxable foreign exchange loss (gain) on long-term debt | **(1,461)** | **(4)** | 1,651 | (18) |
| Gain on acquisition of High Level | **-** | | (19,224) | 211 |
| Change in statutory income tax rates | **-** | | 748 | (8) |
| Other | **(1,307)** | **(4)** | 2,501 | (28) |
| Tax expense (recovery) | **$ 5,898** | **17** | $(16,739) | 184 |
| Comprised of: | | | | |
| Current taxes | **$ 649** | | $ 351 | |
| Deferred income taxes | **5,249** | | (17,090) | |
| Tax expense (recovery) | **$ 5,898** | | $(16,739) | |

**2.** Temporary differences and tax loss carry forwards which give rise to the net deferred income tax liability are as follows:

| | **2012** | 2011 |
|---|---|---|
| Deferred income tax assets: | | |
| Accruals not currently deductible | **$ 1,688** | $ 1,705 |
| Deferred pension costs | **4,073** | 2,953 |
| Financing costs | **2,308** | (380) |
| Foreign exchange loss on long-term debt | **-** | 707 |
| Investment tax credits | **12,005** | 10,622 |
| Tax loss carryforwards | **59,761** | 63,477 |
| Other tax credits | **918** | 918 |
| | **$ 80,753** | $ 80,002 |
| Deferred income tax liabilities: | | |
| Depreciable capital assets | **(111,302)** | (110,983) |
| Derivative gain on financial instrument | **(1,671)** | - |
| Land | **(63)** | (213) |
| Foreign exchange gain on long-term debt | **(61)** | - |
| | **$ (113,097)** | $ (111,196) |
| Deferred income tax liability, net | **$ (32,344)** | $ (31,194) |

(Figures are in thousands of Canadian dollars unless indicated otherwise)

**25. TAXATION (Continued)**

**3. Unrecognized deferred tax assets:**

The Company has U.S. non-capital tax loss carry-forwards of $359,154 that expire between 2026 and 2032, which may be restricted.

The movement in deferred income tax assets and liabilities during the year was all charged to the statement of operations, with the exception of $1.3 million charged to other comprehensive income related to the movement in deferred pension costs (2011: $1.5 million), and $1.4 million charged to share capital related to the movement in financing costs (2011: $nil).

## 26. CHANGES IN NON-CASH OPERATING WORKING CAPITAL

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Trade and other receivables | $ | (7,297) | $ | (2,612) |
| Inventories | | (1,570) | | 2,310 |
| Income taxes payable | | 645 | | 304 |
| Prepaid expenses | | 779 | | 202 |
| Trade and other payables | | 4,145 | | (2,694) |
| | $ | (3,298) | $ | (2,490) |

## 27. SEGMENTED REPORTING

The Company operates principally in Canada and the United States in one business segment, oriented strand board. Sales from continuing operations attributed to geographic areas based on location of customer are as follows:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| United States | $ | 294,847 | $ | 190,801 |
| Canada | | 71,374 | | 43,888 |
| Japan | | 37,751 | | 52,284 |
| Overseas - other | | 5,099 | | 6,293 |
| | $ | 409,071 | $ | 293,266 |

Property, plant and equipment, intangible assets and other assets are located in Canada.

## 28. FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS

**Management of capital**

The Company's objectives for managing capital (defined as working capital, long-term debt and equity excluding accumulated other comprehensive income) are to safeguard its ability to continue as a going concern in order to provide returns to shareholders and benefits for other stakeholders. The Company manages capital by adjusting the amount of dividends paid to shareholders, purchasing shares for cancellation pursuant to normal issuer bids, issuing new shares and warrants, issuing new debt, and/or issuing new debt to replace existing debt with different characteristics. Under its existing debt indentures, the Company is restricted in managing capital and must conform to the indentures' provisions, which govern capital components such as dividends, asset sales and debt incurrence. At December 31, 2012, the Company is in compliance with the provisions of these indentures.

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 28. FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (Continued)

The accounting classification of each category of financial instruments, and the level within the fair value hierarchy in which they have been classified are set out below:

| | Fair Value Hierarchy Level | | **2012** | | 2011 |
|---|---|---|---|---|---|
| FINANCIAL ASSETS | | | | | |
| Held for trading | | | | | |
| Cash and cash equivalents | Level 1 | **$** | **106,777** | $ | 57,696 |
| Loans and receivables | | | | | |
| Trade and other receivables [(1)] | n/a | | **25,608** | | 17,802 |
| Derivative financial assets | Level 2 | | **13,371** | | 6 |
| | | **$** | **145,756** | $ | 75,504 |
| FINANCIAL LIABILITIES | | | | | |
| Other financial liabilities | | | | | |
| Trade and other payables [(1)] | n/a | **$** | **30,257** | $ | 21,686 |
| Long-term debt, including current portion | n/a | | **360,441** | | 521,935 |
| | | **$** | **390,698** | $ | 543,621 |

[(1)] The carrying value of trade and other receivables and trade and other payables approximates fair value due to the short-term nature of these items.

**Financial risk factors**

The Company's activities result in exposure to a number of financial risks, including credit risk, liquidity risk and market risk. The Company's objectives, policies and processes for measuring and managing these risks are described below.

***Credit risk***

Credit risk is the risk that a contracting entity will not complete its obligations under a financial instrument and cause a financial loss. The Company is exposed to credit risk on trade and other receivables, cash and cash equivalents. The Company's maximum exposure to credit risk is the gross carrying amount of these assets net of any allowance for doubtful accounts or impairment loss as reflected in these consolidated financial statements. At December 31, 2012, the amount of accounts receivable past due was nominal and no accounts were impaired.

Credit risk associated with cash equivalents is minimized by ensuring that the Company only invests in liquid securities and with counterparties that have a high credit rating. Credit risk associated with trade receivables is minimized through the use of pre-determined credit limits, continuous monitoring of payments, and credit insurance. The Company uses credit ratings and internal financial evaluations of counterparties to determine credit-worthiness and to set credit limits. Concentration of credit risk with respect to trade receivables is limited due to the dispersion of a large number of customers across many geographic areas as well as the use of credit insurance.

(Figures are in thousands of Canadian dollars unless indicated otherwise)

**28. FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (Continued)**

***Liquidity risk***

Liquidity risk is the risk that the Company encounters difficulty in meeting its financial obligations as they come due. Liquidity risk includes the risk that, as a result of operational liquidity requirements, the Company will not have sufficient funds to settle a transaction on the due date; will be forced to sell financial assets at a value which is less than what they are worth; or may be unable to settle or recover a financial asset at all. Liquidity risk arises from trade and other payables, long-term debt, commitments and financial guarantees. The Company continues to focus on maintaining adequate liquidity to meet cash interest and principal repayments, operating working capital requirements including seasonal log inventory builds in the first and fourth quarters, and capital expenditures.

We continue to monitor discretionary capital expenditures carefully as global debt and equity markets, as well as operating results, can be volatile. Under the terms of the Company's senior note indenture, we are permitted to borrow at least an additional U.S.$170 million of senior secured and unsecured debt subject to the limitations set forth in the indenture. The availability of this funding, or other sources of capital, is dependent on capital markets at the time and may not be available on acceptable terms.

The contractual maturity of the Company's liabilities, long-term debt and commitments for the next five years are shown in the following table. These amounts represent the future undiscounted principal and interest cash flows and therefore do not equate to the carrying values shown in the statement of financial position.

| | Less than 1 month | 1 to 3 months | Less than 1 year | 1 to 5 years | More than 5 years |
|---|---|---|---|---|---|
| Senior Secured Notes | $ - | $ - | $ 27,422 | $452,680 | $ - |
| HSBC Equipment loan | 255 | 507 | 2,248 | 7,540 | - |
| Deutsche Bank equipment loan | - | - | 3,204 | 1,581 | - |
| Finance lease obligations | 69 | 96 | 431 | 502 | - |
| Operating lease obligations | 72 | 144 | 650 | 1,300 | - |
| Trade payable and accrued liabilities | 28,492 | 112 | 2,129 | - | - |
| Reforestation obligation | - | - | - | 2,627 | 1,154 |
| Purchase commitments | 415 | 1,144 | 2,797 | 4,888 | 3,157 |
| | $ 29,303 | $ 2,003 | $ 38,881 | $471,118 | $ 4,311 |

***Market risk***

*Interest rate risk*

Interest rate risk refers to the risk that the value of a financial instrument or cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Company is exposed to interest risk on its floating rate debt. Unfavourable changes in the applicable interest rates may result in an increase in interest expense. The Company manages its exposure to interest rate risk by maintaining a combination of floating rate debt and fixed rate debt. The Company does not use derivative instruments to reduce its exposure to interest rate risk.

At December 31, 2012, if interest rates had been 50 basis points higher/lower and all other variables were held constant, the Company's after-tax net income would decrease/increase by approximately $55 on an annual basis (December 31, 2011: $0.5 million).

The Company is also exposed to interest risk on the derivative financial instrument that arises from the call option embedded in the Senior Secured Notes. As the risk-free interest rate and the credit spread increase, the value of the derivative financial asset decreases. Conversely, a decrease in the risk-free interest rate and the credit spread increases the value of the derivative financial asset. Changes in the value of this derivative financial asset are reflected in operations. The value of the derivative financial

(Figures are in thousands of Canadian dollars unless indicated otherwise)

**28. FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (Continued)**

instrument as at December 31, 2012 was $13.4 million (value of derivative embedded in the Senior Unsecured Notes as at December 31, 2011: $6.0) and was included in other assets. At December 31, 2012, if interest rates had been 1% higher and all other variables were constant, the value of the derivative financial asset would increase by approximately $3.0 million.

*Currency risk*
Currency risk refers to the risk that the value of a financial commitment, recognized asset or liability will fluctuate due to changes in foreign currency rates. The Company's functional currency is the Canadian dollar, but it is exposed to foreign currency risk primarily arising from U.S. dollar denominated long-term debt, cash, trade and other receivables and trade and other payables. In addition, the majority of the Company's sales are transacted in U.S. dollars.

The U.S. dollar is the only foreign currency to which the Company has significant exposure. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

At December 31, 2012, the impact on the after tax net income of a one cent weakening/strengthening of the Canadian dollar, all other variables remaining constant, on the revaluation of the Company's monetary assets and liabilities would be would have been $2.3 million higher/lower on an annual basis (December 31, 2011: $3.8 million).

*Commodity price risk*
The Company's financial performance is principally dependent on the demand for and selling prices of its products. Both are subject to significant fluctuations. The markets for panel products are cyclical and are affected by factors such as global economic conditions including the strength of the U.S. and Japanese housing market, changes in industry production capacity, changes in world inventory levels and other factors beyond the Company's control. The Company reduces its exposure to commodity price risk through product and geographic diversification.

**Fair value of financial instruments**
The fair value of financial instruments, with the exception of the Senior Secured Notes, is estimated to approximate their carrying value at December 31, 2012 due to the immediate or short-term maturity of these financial instruments.

The carrying values and fair values of the long- term debt are as follows:

| | **2012** | | 2011 | |
|---|---|---|---|---|
| | **Carrying Value** | **Fair Value** | Carrying Value | Fair Value |
| Senior Secured Notes (1) | **$ 345,802** | **$ 356,690** | $ - | $ - |
| Senior Unsecured Notes | **-** | **-** | 398,019 | 232,170 |
| Term loan | **-** | **-** | 103,574 | 87,134 |
| Equipment financing (2) | **14,639** | **14,639** | 20,342 | 20,342 |
| | **$ 360,441** | **$ 371,329** | $ 521,935 | $ 339,646 |

(1) Fair value is determined using quoted ask prices for the Company's Senior Secured Notes. The estimated fair value may differ from the amount which could be realized in an immediate settlement.
(2) Carrying value approximates fair value as the equipment financing bears floating interest rates that approximate market rates.

The fair value of the call option embedded in the Senior Secured Notes as at December 31, 2012 was $13.4 million (fair value of call option embedded in Senior Unsecured Notes as at December 31, 2011: $6.0).

(Figures are in thousands of Canadian dollars unless indicated otherwise)

## 29. RELATED PARTY TRANSACTIONS

***Brookfield Capital Partners***

The Company is controlled by BCP, which beneficially owns or exercises control or direction over approximately 54.5% of the issued and outstanding common shares (54.2% prior to their acquisition of additional common shares pursuant to the rights offering).

In the normal course of operations, the Company made interest payments on its Senior Unsecured Notes held by BCP. On December 27, 2012, the Company repaid the principal, plus accrued interest on the Senior Unsecured Notes held by BCP, net of amounts owed to the Company for subscription of common shares.

The Company also paid a backstop fee of $4.4 million to BCP for their role as a standby purchaser of the rights offering. Since all rights were exercised by right-holders under the basic and additional subscription privileges, including BCP, it was not necessary for BCP to purchase shares pursuant to the terms of the standby purchase agreement.

The Company also periodically sells goods to BCP affiliates. During the year ended December 31, 2012, these sales were approximately $3.8 million (year ended December 31, 2011: $3.2 million).

***Subsidiaries***

Transactions with subsidiaries (listed in Note 2(b)), which have been eliminated on consolidation, are carried out in the normal course of business on an arm's length basis and are not disclosed in this note. Outstanding balances are placed on inter-company accounts with no specified credit period. Long-term loans owed to the Company by subsidiary undertakings are non-interest bearing in accordance with the inter-company loan agreements.

***Compensation of the executive management team and directors***

No person on the Board of Directors of Ainsworth Lumber Co. Ltd. or its executive management team had any material interest during the period in a contract of significance (except as disclosed below with respect to a service contract for legal services rendered) with the Company or any subsidiary company. The total compensation for the Board of Directors and the executive management team is as follows:

| | | **2012** | | 2011 |
|---|---|---|---|---|
| Short-term employee benefits | **$** | **3,323** | $ | 3,743 |
| Long-term employee benefits | | **81** | | 126 |
| Share-based payments | | **678** | | 817 |
| | **$** | **4,082** | $ | 4,686 |

***Other***

| | | **2012** | | 2011 |
|---|---|---|---|---|
| Legal fees (1) | **$** | **749** | $ | 100 |
| Other services (2) | | **239** | | 140 |
| | **$** | **988** | $ | 240 |

(1) Legal fees were paid to a law firm of which one of the Company's directors is also a partner.
(2) Includes amounts paid to BCP and its affiliates for services provided to the Company.

Sales to overseas markets are handled by Interex Forest Products Ltd. ("Interex"), a cooperative sales company over which Ainsworth, as a shareholder, has significant influence. At December 31, 2012, $2.8 million was included in trade receivables with respect to Interex.

All transactions with related parties were measured and recorded at fair value. Fair value is defined as the transaction amount with unrelated parties under similar terms and conditions.