QUARTER 4

FOR THE THREE MONTHS ENDED DECEMBER 31, 2012

CANFOR

CANFOR CORPORATION
2012 FOURTH QUARTER
INTERIM REPORT

2012

To Our Shareholders

Canfor Corporation reported net income attributable to shareholders ("shareholder net income") of $21.6 million, or $0.15 per share, for the fourth quarter of 2012, compared to $22.2 million, or $0.16 per share, for the third quarter of 2012 and a shareholder net loss of $44.1 million, or $0.31 per share, for the fourth quarter of 2011. For the year ended December 31, 2012, the shareholder net income was $32.1 million, or $0.22 per share, compared to a net loss of $56.6 million, or $0.40 per share, for 2011.

The shareholder net income for the fourth quarter of 2012 included various items affecting comparability with prior periods, which had an overall positive impact on the Company's results of $1.2 million, or $0.01 per share. After adjusting for such items, the Company's adjusted shareholder net income for the fourth quarter of 2012 was $22.8 million, or $0.16 per share, up $7.5 million, or $0.05 per share, from an adjusted shareholder net income of $15.3 million, or $0.11 per share, for the third quarter of 2012, and an adjusted shareholder net loss of $32.1 million, or $0.22 per share, for the fourth quarter of 2011. For the year ended December 31, 2012, the Company's adjusted shareholder net income was $26.9 million, or $0.18 per share, in contrast to an adjusted shareholder net loss of $31.7 million, or $0.22 per share, for 2011.

The Company reported operating income of $50.1 million for the fourth quarter of 2012, an improvement of $27.8 million from $22.3 million reported for the third quarter of 2012. The increase was mostly attributable to the continuing recovery in the U.S. housing market and improved operational performance at Canfor Pulp's Northern Bleached Softwood Kraft ("NBSK") pulp mills. North American #2&Btr dimension lumber prices showed strong gains, particularly in December. Pricing to offshore markets, much of which is negotiated monthly or quarterly in advance, showed solid gains but lagged those in North America. Results also reflected higher market stumpage and seasonally higher manufacturing costs, as well as an accounting gain related to the Company's salaried post retirement benefit plans.

The following table summarizes selected financial information for the Company for the comparative periods:

(millions of dollars, except for per share amounts)	**Q4 2012**	Q3 2012	**YTD 2012**	Q4 2011	YTD 2011
Sales	**$ 721.8**	$ 683.8	**$ 2,714.1**	$ 576.2	$ 2,421.4
Operating income (loss)	**$ 50.1**	$ 22.3	**$ 76.9**	$ (63.2)	$ 11.9
Net income (loss) attributable to equity shareholders of the Company	**$ 21.6**	$ 22.2	**$ 32.1**	$ (44.1)	$ (56.6)
Net income (loss) per share attributable to equity shareholders of the Company, basic and diluted	**$ 0.15**	$ 0.16	**$ 0.22**	$ (0.31)	$ (0.40)
Adjusted shareholder net income (loss)	**$ 22.8**	$ 15.3	**$ 26.9**	$ (32.1)	$ (31.7)
Adjusted shareholder net income (loss) per share	**$ 0.16**	$ 0.11	**$ 0.18**	$ (0.22)	$ (0.22)

Lumber markets ended the year with one of the strongest price rallies in recent years supported by an improved U.S. housing market combined with strong demand from offshore markets. Building off the positive trend experienced earlier in the year, the U.S. housing market continued to strengthen through the fourth quarter. Total U.S. housing starts averaged 898,000 units SAAR (seasonally adjusted annual rate), up 16% from the previous quarter, ending the year at 954,000 units SAAR in December, the highest monthly starts since mid-2008. Canadian housing starts decreased 8% from the third quarter of 2012 to 204,000 units SAAR reflecting seasonally slower activity and recent tightening of Canadian mortgage lending rules. Solid demand in China and Japan supported increases in offshore shipments in the final quarter of 2012, particularly China, where the Company's shipments for 2012 reached a new record-high. Global softwood pulp markets improved slightly through the fourth quarter of 2012, with increased softwood pulp purchases from China helping to offset weaker shipments to North America and Europe.

The average North American benchmark Western Spruce/Pine/Fir ("SPF") 2x4 #2&Btr price rose sharply in the latter part of the quarter. On average, Western SPF 2X4 #2&Btr prices moved up 12% to US$335 per Mfbm, with strong increases seen in other dimensions during the quarter, while lower grades saw more modest price increases and in the case of machine stress rated ("MSR") and stud grades, prices weakened slightly quarter-over-quarter. Prices for Southern Yellow Pine ("SYP") products also showed strong gains, with the benchmark SYP 2x4 price averaging US$386 per Mfbm, up 20% from the previous quarter of 2012. North American sales realizations in the quarter lagged benchmark levels due largely to a steep increase in prices close to year end. Sales realizations for offshore

Western SPF lumber products saw solid gains in the current quarter, but lagged North American pricing gains, reflecting the nature of pricing, much of which is negotiated monthly or quarterly in advance.

Lumber production, at just over 1.1 billion board feet, was broadly in line with the previous quarter. Lumber unit manufacturing costs were up compared to the previous quarter reflecting both unit log and production cost increases. Increased log costs primarily reflected increased market stumpage and hauling costs while increased unit production costs resulted primarily from seasonal cost increases and the restart of the Company's Radium sawmill.

NBSK pulp list prices showed a modest improvement in the fourth quarter. The average list price for North America was up US$10 to US$863 per tonne, with slightly higher prices seen in other regions. Overall, however, pulp sales realizations moved up only marginally in the fourth quarter of 2012 as a result of increased volumes to lower-margin regions, principally China.

Increased pulp shipments and production for the fourth quarter of 2012 reflected improved operating rates after the operational challenges faced in the previous quarter. Pulp unit manufacturing costs were down from the previous quarter in part reflecting the higher production volumes and lower fibre costs, partially offset by the impact of one-time costs associated with new collective labour agreements in the third quarter of 2012.

The Company continued to preserve its strong financial position, ending the year with net debt to capitalization of 19.9% and $413 million available under its operating loans. During the fourth quarter of 2012, Canfor Pulp obtained a new $110 million operating loan facility replacing its previous $40 million operating loan facility.

Looking ahead, the U.S. market is projected to continue its gradual recovery. Rising housing prices, an improved job market, and an increase in household formations will support an improved housing market. Repair and remodel markets will also be significantly impacted by the same fundamentals. Canadian markets are anticipated to be flat through 2013, with softness projected in multi-family urban markets, but stable demand from other sectors. Offshore markets are forecast to also improve in 2013. NBSK pulp prices are projected to show a modest improvement through the first half of 2013, but the outlook for the balance of the year is more uncertain given the economic challenges in Europe and new hardwood and softwood pulp capacity currently projected to come online the second half of 2013. Canfor Pulp announced an increase in the North American NBSK pulp list price of US$30 per tonne in January 2013.

Ronald L. Cliff
Chairman

Don B. Kayne
President and Chief Executive Officer

Canfor Corporation
Fourth Quarter 2012
Management's Discussion and Analysis

This interim Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the quarter ended December 31, 2012 relative to the quarters ended September 30, 2012 and December 31, 2011, and the financial position of the Company at December 31, 2012. It should be read in conjunction with Canfor's unaudited interim consolidated financial statements and accompanying notes for the quarters ended December 31, 2012 and 2011, as well as the 2011 annual MD&A and the 2011 audited consolidated financial statements and notes thereto, which are included in Canfor's Annual Report for the year ended December 31, 2011 (available at www.canfor.com). The financial information in this interim MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which is the required reporting framework for Canadian publicly accountable enterprises.

Throughout this discussion, reference is made to Operating Income before Amortization which Canfor considers to be a relevant indicator for measuring trends in the performance of each of its operating segments and the Company's ability to generate funds to meet its debt repayment and capital expenditure requirements. Reference is also made to Adjusted Shareholder Net Income (Loss) (calculated as Shareholder Net income (loss) less specific items affecting comparability with prior periods – for the full calculation, see reconciliation included in the section "Analysis of Specific Material Items Affecting Comparability of Shareholder Net Income (Loss)") and Adjusted Shareholder Net Income (Loss) per Share (calculated as Adjusted Shareholder Net Income (Loss) divided by the weighted average number of shares outstanding during the period). Operating Income before Amortization and Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share are not generally accepted earnings measures and should not be considered as an alternative to net income or cash flows as determined in accordance with IFRS. As there is no standardized method of calculating these measures, Canfor's Operating Income before Amortization, Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of Operating Income before Amortization to operating income (loss) and Adjusted Shareholder Net Income (Loss) to net income (loss) reported in accordance with IFRS are included in this MD&A.

Factors that could impact future operations are also discussed. These factors may be influenced by both known and unknown risks and uncertainties that could cause the actual results to be materially different from those stated in this discussion. Factors that could have a material impact on any future oriented statements made herein include, but are not limited to: general economic, market and business conditions; product selling prices; raw material and operating costs; currency exchange rates; interest rates; changes in law and public policy; the outcome of labour and trade disputes; and opportunities available to or pursued by Canfor.

All financial references are in millions of Canadian dollars unless otherwise noted. The information in this report is as at February 14, 2013.

Forward Looking Statements

Certain statements in this MD&A constitute "forward-looking statements" which involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from any future results, performance or achievements expressed or implied by such statements. Words such as "expects", "anticipates", "projects", "intends", "plans", "will", "believes", "seeks", "estimates", "should", "may", "could", and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are based on management's current expectations and beliefs and actual events or results may differ materially. There are many factors that could cause such actual events or results expressed or implied by such forward-looking statements to differ materially from any future results expressed or implied by such statements. Forward-looking statements are based on current expectations and the Company assumes no obligation to update such information to reflect later events or developments, except as required by law.

FOURTH QUARTER 2012 OVERVIEW

Selected Financial Information and Statistics[1]

(millions of dollars, except for per share amounts)	Q4 2012	Q3 2012	YTD 2012	Q4 2011	YTD 2011
Operating income (loss) by segment:					
Lumber	**$ 41.7**	$ 34.9	**$ 75.4**	$ (55.8)	$ (81.5)
Pulp and Paper	**$ 10.8**	$ (7.2)	**$ 26.6**	$ 18.2	$ 152.9
Unallocated and Other	**$ (2.4)**	$ (5.4)	**$ (25.1)**	$ (25.6)	$ (59.5)
Total operating income (loss)	**$ 50.1**	$ 22.3	**$ 76.9**	$ (63.2)	$ 11.9
Add: Amortization	**$ 50.4**	$ 45.7	**$ 187.2**	$ 47.6	$ 169.3
Total operating income (loss) before amortization	**$ 100.5**	$ 68.0	**$ 264.1**	$ (15.6)	$ 181.2
Add (deduct):					
Working capital movements	**$ (50.5)**	$ (14.0)	**$ (75.3)**	$ 30.4	$ (5.6)
Salary pension plan contributions	**$ (8.7)**	$ (9.0)	**$ (35.7)**	$ (8.1)	$ (37.3)
Other operating cash flows, net[2]	**$ (7.9)**	$ (11.1)	**$ (21.9)**	$ 31.6	$ 24.7
Cash from operating activities	**$ 33.4**	$ 33.9	**$ 131.2**	$ 38.3	$ 163.0
Add (deduct):					
Finance expenses paid	**$ (7.6)**	$ (1.4)	**$ (19.5)**	$ (6.2)	$ (18.9)
Distributions paid to non-controlling interests	**$ (0.4)**	$ (3.0)	**$ (15.9)**	$ (11.4)	$ (91.0)
Capital additions, net[3]	**$ (47.0)**	$ (44.1)	**$ (245.7)**	$ (91.0)	$ (236.7)
Proceeds from sale of asset-backed commercial paper ("ABCP")	**$ -**	$ -	**$ 12.9**	$ -	$ 29.8
Drawdown (repayment) of long-term debt	**$ -**	$ -	**$ 50.1**	$ -	$ (81.9)
Other, net	**$ 4.0**	$ 1.5	**$ 16.3**	$ (2.1)	$ 4.3
Change in cash / operating loans	**$ (17.6)**	$ (13.1)	**$ (70.6)**	$ (72.4)	$ (231.4)
ROIC – Consolidated[4]	**2.4%**	1.6%	**3.7%**	(4.1)%	(3.4)%
Average exchange rate (US$ per C$1.00)[5]	**$ 1.009**	$ 1.005	**$ 1.001**	$ 0.977	$ 1.011

[1] Certain prior period amounts have been restated due to a change in accounting policy for treatment of net interest expense for defined benefit post-retirement plans. Further details can be found in the Company's unaudited interim consolidated financial statements.

[2] Further information on operating cash flows can be found in the Company's unaudited interim consolidated financial statements.

[3] Additions to property, plant and equipment include the acquisition of assets from Tembec Industries Ltd. ("Tembec") in the first quarter of 2012, and are shown net of amount received under Government funding initiatives in the pulp and paper segment.

[4] Consolidated Return on Invested Capital ("ROIC") is equal to operating income/loss, plus realized gains/losses on derivatives and other income/expense, all net of minority interest, divided by the average invested capital during the year. Invested capital is equal to capital assets, plus long-term investments and net non-cash working capital, all excluding minority interest components.

[5] Source – Bank of Canada (average noon rate for the period).

Analysis of Specific Material Items Affecting Comparability of Shareholder Net Income (Loss)

After-tax impact, net of non-controlling interests (millions of dollars, except for per share amounts)	Q4 2012	Q3 2012	YTD 2012	Q4 2011	YTD 2011
Shareholder Net Income (Loss)	**$ 21.6**	$ 22.2	**$ 32.1**	$ (44.1)	$ (56.6)
Foreign exchange (gain) loss on long-term debt and investments, net	**$ 1.2**	$ (4.0)	**$ (3.1)**	$ (3.3)	$ 3.3
(Gain) loss on derivative financial instruments	**$ 6.5**	$ (4.4)	**$ 1.2**	$ (6.7)	$ (3.3)
Asset impairment charges	**$ 0.6**	$ -	**$ 0.6**	$ 5.5	$ 5.5
Net gain on post retirement and pension plan amendments	**$ (7.1)**	$ -	**$ (7.1)**	$ -	$ -
Restructuring charges for management changes	**$ -**	$ 1.5	**$ 1.5**	$ -	$ 2.6
Increase in fair value of ABCP	**$ -**	$ -	**$ (1.1)**	$ (0.5)	$ (0.2)
Costs related to Tembec acquisition	**$ -**	$ -	**$ 2.8**	$ -	$ -
Mill closure provisions	**$ -**	$ -	**$ -**	$ 17.0	$ 17.0
Net impact of above items	**$ 1.2**	$ (6.9)	**$ (5.2)**	$ 12.0	$ 24.9
Adjusted Shareholder Net Income (Loss)	**$ 22.8**	$ 15.3	**$ 26.9**	$ (32.1)	$ (31.7)
Shareholder Net Income (Loss) per share (EPS), as reported	**$ 0.15**	$ 0.16	**$ 0.22**	$ (0.31)	$ (0.40)
Net impact of above items per share	**$ 0.01**	$ (0.05)	**$ (0.04)**	$ 0.09	$ 0.18
Adjusted Shareholder Net Income (Loss) per share	**$ 0.16**	$ 0.11	**$ 0.18**	$ (0.22)	$ (0.22)

The Company reported operating income of $50.1 million for the fourth quarter of 2012, an improvement of $27.8 million from $22.3 million reported for the third quarter of 2012. The increase was mostly attributable to the continuing recovery in the U.S. housing market and improved operational performance at Canfor Pulp's Northern Bleached Softwood Kraft ("NBSK") pulp mills. North American #2&Btr dimension lumber prices showed strong gains, particularly in December. Pricing to offshore markets, much of which is negotiated monthly or quarterly in advance, showed solid gains but lagged those in North America. Results also reflected higher market stumpage and seasonally higher manufacturing costs, as well as an accounting gain related to the Company's salaried post retirement benefit plans.

Lumber markets ended the year with one of the strongest price rallies in recent years supported by an improved U.S. housing market combined with strong demand from offshore markets. Building off the positive trend experienced earlier in the year, the U.S. housing market continued to strengthen through the fourth quarter. Total U.S. housing starts averaged 898,000 units SAAR (seasonally adjusted annual rate), up 16% from the previous quarter, ending the year at 954,000 units SAAR in December, the highest monthly starts since mid-2008. Canadian housing starts decreased 8% from the third quarter of 2012 to 204,000 units SAAR reflecting seasonally slower activity and recent tightening of Canadian mortgage lending rules. Solid demand in China and Japan supported increases in offshore shipments in the final quarter of 2012, particularly China, where the Company's shipments for 2012 reached a new record-high. Global softwood pulp markets improved slightly through the fourth quarter of 2012, with increased softwood pulp purchases from China helping to offset weaker shipments to North America and Europe.

The average North American benchmark Western Spruce/Pine/Fir ("SPF") 2x4 #2&Btr price rose sharply in the latter part of the quarter. On average, Western SPF 2X4 #2&Btr prices moved up 12% to US$335 per Mfbm, with strong increases seen in other dimensions during the quarter, while lower grades saw more modest price increases and in the case of machine stress rated ("MSR") and stud grades, prices weakened slightly quarter-over-quarter. Prices for Southern Yellow Pine ("SYP") products also showed strong gains, with the benchmark SYP 2x4 price averaging US$386 per Mfbm, up 20% from the previous quarter of 2012. North American sales realizations in the quarter lagged benchmark levels due largely to a steep increase in prices close to year end. Sales realizations for offshore Western SPF lumber products saw solid gains in the current quarter, but lagged North American pricing gains, reflecting the nature of pricing, much of which is negotiated monthly or quarterly in advance.

Lumber production, at just over 1.1 billion board feet, was broadly in line with the previous quarter. Lumber unit manufacturing costs were up compared to the previous quarter reflecting both unit log and production cost increases. Increased log costs primarily reflected increased market stumpage and hauling costs while increased unit production costs resulted primarily from seasonal cost increases and the restart of the Company's Radium sawmill.

NBSK pulp list prices showed a modest improvement in the fourth quarter. The average list price for North America was up US$10 to US$863 per tonne, with slightly higher prices seen in other regions. Overall, however, pulp sales realizations moved up only marginally in the fourth quarter of 2012 as a result of increased volumes to lower-margin regions, principally China.

Increased pulp shipments and production for the fourth quarter of 2012 reflected improved operating rates after the operational challenges faced in the previous quarter. Pulp unit manufacturing costs were down from the previous quarter in part reflecting the higher production volumes and lower fibre costs, partially offset by the impact of one-time costs associated with new collective labour agreements in the third quarter of 2012.

Compared to the fourth quarter of 2011, operating income was up $113.3 million, driven by increases of $97.5 million in the lumber segment and $21.7 million in the Company's panel operations, reflecting improved markets, partially offset by a decrease in the pulp and paper segment results of $7.4 million, principally reflecting significantly lower prices for NBSK pulp products.

OPERATING RESULTS BY BUSINESS SEGMENT

Lumber

Selected Financial Information and Statistics – Lumber

(millions of dollars unless otherwise noted)	Q4 2012	Q3 2012	YTD 2012	Q4 2011	YTD 2011
Sales	**$ 469.9**	$ 454.7	**$ 1,711.8**	$ 325.9	$ 1,317.1
Operating income (loss) before amortization	**$ 68.3**	$ 60.4	**$ 177.2**	$ (34.3)	$ 2.4
Operating income (loss)	**$ 41.7**	$ 34.9	**$ 75.4**	$ (55.8)	$ (81.5)
Negative (positive) impact of inventory valuation adjustments[6]	**$ (0.4)**	$ -	**$ (13.5)**	$ 9.7	$ 12.4
Costs related to Tembec acquisition	**$ -**	$ -	**$ 2.5**	$ -	$ -
Mill Closure provisions	**$ -**	$ -	**$ -**	$ 11.9	$ 11.9
Asset impairment charges	**$ -**	$ -	**$ -**	$ 7.2	$ 7.2
Operating income (loss) excluding impact of inventory valuation adjustments and unusual items	**$ 41.3**	$ 34.9	**$ 64.4**	$ (27.0)	$ (50.0)
Average SPF 2x4 #2&Btr lumber price in US$[7]	**$ 335**	$ 300	**$ 299**	$ 238	$ 255
Average SPF price in Cdn$	**$ 332**	$ 299	**$ 299**	$ 244	$ 252
Average SYP 2x4 #2 lumber price in US$[8]	**$ 386**	$ 322	**$ 333**	$ 260	$ 268
Average SYP price in Cdn$	**$ 383**	$ 320	**$ 333**	$ 266	$ 265
U.S. housing starts (thousand units SAAR) [9]	**898**	774	**780**	678	609
Production – SPF lumber (MMfbm)	**985.5**	973.9	**3,857.5**	760.8	3,134.3
Production – SYP lumber (MMfbm)	**121.8**	118.6	**479.1**	106.4	431.3
Shipments – SPF lumber (MMfbm)[10]	**1,007.9**	996.8	**3,867.5**	833.9	3,182.8
Shipments – SYP lumber (MMfbm)[10]	**133.5**	127.9	**511.8**	112.7	449.9
Shipments – wholesale lumber (MMfbm)	**8.0**	7.9	**54.7**	27.4	140.5

[6] In accordance with IFRS, Canfor records its log and finished product inventories at the lower of cost and net realizable value ("NRV"). Changes in inventory volumes, market prices, foreign exchange rates and costs over the respective reporting periods can all affect inventory valuation adjustments, if any, required at each period end.

[7] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)

[8] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)

[9] Source – U.S. Census Bureau, seasonally adjusted annual rate ("SAAR")

[10] Canfor-produced lumber, including lumber purchased for remanufacture.

Overview

Operating income for the lumber segment was $41.7 million for the fourth quarter of 2012, an increase of $6.8 million compared to operating income of $34.9 million in the immediately preceding quarter, and a $97.5 million improvement from the operating loss of $55.8 million reported for the fourth quarter of 2011. Results for the fourth quarter of 2011 were adversely impacted by inventory valuation adjustments of $9.7 million and certain mill closure provisions and asset impairment charges which totaled $19.1 million. For the 2012 year, operating income was $75.4 million compared to an operating loss of $81.5 million for the previous year.

The stronger results compared to the third quarter of 2012 reflected improved sales realizations, with higher prices received for most products in both North American and offshore markets. Sales realizations lagged benchmark levels due largely to the sharp increase in prices close to year end as well as the nature of offshore pricing, much of which is negotiated monthly or quarterly in advance. Unit manufacturing costs were up over the prior quarter reflecting increases in log and production costs. Log cost increases were predominantly related to market-price stumpage and increased hauling costs, while higher production costs reflected the re-start of the Company's Radium sawmill operation, as well as seasonally higher costs. Other contributing factors were lower sawmill residual chip realizations and an accounting gain of $5.6 million related to certain amendments to the Company's salaried post retirement plans.

The improvement in operating income compared to the fourth quarter of 2011 reflected significantly improved market prices and sales realizations, and increased lumber shipments as a result of increased production at the two south-east Kootenay region operations acquired at the end of the first quarter of 2012. Partially offsetting these gains was a 3% stronger Canadian dollar, an increase in unit log costs, largely attributable to market-price related stumpage increases and a small increase in average unit production costs related to the restart of the Radium sawmill and the acquired Kootenay mills. Other contributing factors included sawmill residual chip prices which were well down compared to the same quarter of 2011, consistent with the decline in NBSK pulp sales realizations over the period, as well as the aforementioned amendments to the Company's salaried post retirement plans.

Markets

During the fourth quarter of 2012, the lumber market experienced one of its strongest price rallies in recent years, primarily due to improving fundamentals in the U.S. housing market and continued robust offshore demand. Total U.S. housing starts averaged 898,000 units[11] SAAR, an increase of 16% from the previous quarter and up 32% from the fourth quarter of 2011, with starts averaging 954,000 units SAAR in December providing further evidence that a housing recovery is now underway. For the full year of 2012, total U.S. housing starts were 780,000 units, up 28% from 2011. Single-family starts, which consume a larger proportion of lumber, were 592,000 units SAAR in the fourth quarter of 2012, the highest level since late 2008. Repair and remodeling activity was steady and also trended higher than a year ago.

Canadian housing starts were at 204,000 units[12] SAAR for the current quarter, down 18,000 units, or 8%, compared to the third quarter of 2012. The decrease reflected seasonal factors as well as a recent tightening of Canadian residential mortgage lending rules. Compared to the fourth quarter of 2011, housing starts were up 1%.

Canfor's offshore lumber shipments continued an overall growth trend and were up 15% compared to the previous quarter and 11% higher than the fourth quarter of 2011. The rise in shipments was due to solid demand in key markets, including China and Japan. Shipments to China, in particular, were well up compared to the previous quarter.

Sales

Lumber sales revenue for the fourth quarter of 2012 was $469.9 million, compared to $454.7 million for the previous quarter and $325.9 million in the fourth quarter of 2011. Increases from both comparative periods reflected the impact of improved pricing, with the improvement from the fourth quarter of 2011 also reflecting increased shipments. Total shipments in the fourth quarter of 2012, at just over 1.1 billion board feet, were consistent with the previous quarter, and were up 18% from the fourth quarter of 2011, reflecting higher production following various capital upgrades and other efficiency improvements, as well as additional production from the Kootenay mill operations.

Overall sales realizations saw positive gains in all markets in the current quarter, with North American sales realizations benefiting from the continued upward trend in pricing and lower export taxes. For sales to North America, the Random Lengths Western SPF 2x4 #2&Btr price was up 12% to US$335 per Mfbm, with strong increases seen in other dimensions during the quarter. More modest increases were seen in lower grade products, and in the case of machine stress rate ("MSR") and stud grades, prices weakened slightly quarter-over-quarter. Sales realizations for SYP products showed solid gains, with the benchmark SYP 2x4 #2 price averaging US$386 per Mfbm, up 20% from the previous quarter. North American sales realizations in the current quarter lagged benchmark levels primarily as a result of the sharp price increase in December. Sales realizations for offshore Western SPF lumber products also saw solid gains in the current quarter but lagged North American pricing gains largely due to the nature of pricing, much of which is negotiated monthly or quarterly in advance. The average value of the Canadian dollar was in line with the previous quarter.

[11] U.S. Census Bureau
[12] CMHC – Canada Mortgage and Housing Corporation

Compared to the fourth quarter of 2011, the benchmark North American Random Lengths Western SPF 2x4 #2&Btr price was up US$97 per Mfbm, or 41%, with strong gains seen in other widths and dimensions. SYP products followed a similar trend, with the benchmark SYP 2x4 #2 price up 48%. Solid increases were also seen for offshore sales realizations. Sales realizations also reflected the positive impact of the higher proportion of high-value prime product produced at the Kootenay operations and lower export taxes, partly offset by the 3% stronger Canadian dollar.

The Random Lengths Framing Lumber Composite price averaged US$347 per Mfbm for the fourth quarter of 2012, resulting in an average 8% export tax rate on all U.S. bound shipments. This compared to a similar rate in the third quarter of 2012 and 15% for the fourth quarter of 2011.

Total residual fibre revenue was down from the third quarter of 2012, primarily reflecting lower sawmill residual chip prices, partly due to the effect of lagging price formulas for residual chips as well as seasonal factors. Compared to the fourth quarter of 2011, total residual fibre revenue was well up, with higher shipments of sawmill residual chips offsetting lower residual prices resulting from weaker NBSK market pulp prices.

Operations

Lumber production, at just over 1.1 billion board feet, was in line with the previous quarter and up 28% from the fourth quarter of 2011. The increase compared to the comparable period in 2011 largely reflected the recent Kootenay mills acquisition, the Radium start-up and increased productivity following various capital improvement projects in 2011 and early 2012.

Overall lumber unit manufacturing costs were up compared to the previous quarter reflecting both unit log and production cost increases. Increased log costs primarily reflected increased stumpage and hauling costs, while increased unit production costs resulted primarily from the restart of the Radium sawmill operation and seasonal cost increases normally experienced in the fourth quarter.

Compared to the fourth quarter of 2011, unit manufacturing costs showed a slight increase, reflecting higher unit log costs impacted by market-price related stumpage increases and higher hauling costs coupled with slightly higher unit cash conversion costs attributable largely to the Radium start-up and the acquired Kootenay sawmills.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[13]

(millions of dollars unless otherwise noted)	Q4 2012	Q3 2012	YTD 2012	Q4 2011	YTD 2011
Sales	**$ 228.4**	$ 206.3	**$ 923.5**	$ 237.0	$ 1,057.5
Operating income before amortization	**$ 31.3**	$ 8.5	**$ 95.6**	$ 39.9	$ 220.9
Operating income (loss)	**$ 10.8**	$ (7.2)	**$ 26.6**	$ 18.2	$ 152.9
Average pulp price delivered to U.S. – US$[14]	**$ 863**	$ 853	**$ 872**	$ 920	$ 977
Average price in Cdn$	**$ 855**	$ 849	**$ 871**	$ 942	$ 966
Production – pulp (000 mt)	**314.1**	276.8	**1,169.9**	294.5	1,200.0
Production – paper (000 mt)	**35.4**	31.9	**130.2**	33.5	136.5
Shipments –pulp (000 mt)	**297.8**	268.9	**1,176.6**	275.4	1,188.7
Shipments – paper (000 mt)	**32.1**	30.6	**129.1**	30.2	127.6

[13] Includes the Taylor pulp mill and 100% of Canfor Pulp Products Inc., which is consolidated in Canfor's results. Pulp production and shipment volumes presented are for both northern bleached softwood kraft ("NBSK") and bleached chemi-thermo mechanical pulp ("BCTMP").
[14] Per tonne, NBSK pulp list price delivered to U.S. (Resource Information Systems, Inc.).

Overview

Operating income for the pulp and paper segment was $10.8 million for the fourth quarter of 2012, an improvement of $18.0 million from an operating loss of $7.2 million for the previous quarter, but down $7.4 million from the fourth quarter of 2011. For the 2012 year, operating income was $26.6 million, down $126.3 million from $152.9 million in 2011.

Results in the current quarter were impacted by lower unit manufacturing costs and higher shipment volumes, both reflecting improved operations in the quarter. Market pulp production increased approximately 37,000 tonnes compared to the previous quarter due to increased operating days and higher overall operating rates following the extended scheduled outage and subsequent ramp ups experienced at the Prince George Pulp Mill in the previous quarter. Both quarters' results were impacted by certain one-time costs, including an accounting gain of $4.0 million related to post retirement plan adjustments in the current quarter and costs of $3.2 million associated with new five year collective labour agreements in the third quarter of 2012.

NBSK pulp list prices showed a small improvement in all regions in the fourth quarter of 2012, with prices to North America up US$10 to US$863 per tonne, but this was largely offset by a lower-value regional sales mix.

Lower operating earnings compared to the fourth quarter of 2011 reflected lower global market pulp prices, as NBSK pulp list prices were down in all regions, with prices to North America declining US$57, or 6%, per tonne and similar decreases were seen for Europe and China. Sales realizations were also negatively impacted by a 3% stronger Canadian dollar compared to the fourth quarter of 2011. Higher shipment volumes and a 5% reduction in unit manufacturing costs, reflecting lower fibre costs and the impact of higher production volumes, helped to mitigate the impact of reduced sales realizations. Other contributing factors included the aforementioned post retirement benefit accounting gain in the current quarter.

Markets

Global softwood pulp demand increased 7% compared to the third quarter of 2012 and was up 3% for the full year 2012 compared to 2011[15]. The increase in softwood shipments was primarily due to increased purchasing from China, partially offset by reductions in shipments to North America and Europe, particularly the latter region. At the end of December 2012, World 20[16] softwood pulp producer inventories increased 2 days from the end of the third quarter, to 29 days of supply, but were down 7 days compared to December 2011 inventories. Global demand for printing and writing papers decreased 2% in 2012 as compared to 2011[15].

Sales

The Company's pulp shipments in the fourth quarter of 2012 were 298,000 tonnes, an increase of approximately 29,000 tonnes, or 11%, from the previous quarter. Compared to the fourth quarter of 2011, shipments were up 23,000 tonnes, or 8%. For the most part, the increased shipments relative to both comparative periods reflected higher production volumes coupled with higher levels of purchases by Chinese consumers.

Global softwood pulp pricing saw a small increase through the current quarter. The North America NBSK pulp list price averaged US$863 per tonne for the quarter, up US$10, or 1%, from the third quarter of 2012, while CPPI's average list price to China and price to Europe were up US$30 and US$23, respectively, over the same period. Overall, however, pulp sales realizations moved up only marginally in the fourth quarter mostly as a result of increased volumes to lower-margin regions, principally China. The BCTMP market weakened slightly through the fourth quarter of 2012, with the average sales realization down compared to the previous quarter, reflecting a slight decrease in prices in the last month of 2012.

Compared to the fourth quarter of 2011, NBSK pulp sales realizations decreased 12% reflecting lower NBSK pulp list pricing in all regions and a 3% stronger Canadian dollar. The North America NBSK pulp list price decreased US$57 per tonne, or 6%. NBSK pulp list prices to China and Europe also decreased compared to the same period in 2011, with the average price down US$51 and US$65, respectively. Also contributing to the lower sales realizations in the current quarter were a higher proportion of shipments to China. Compared to the fourth quarter of 2011, BCTMP sales realizations were down in the current quarter, reflecting the declining prices in the latter half of 2012 and the strengthening Canadian dollar.

[15] As reported by Pulp and Paper Products Council ("PPPC") statistics.
[16] World 20 data is based on twenty producing countries representing 80% of world chemical market pulp capacity and is based on information compiled and prepared by the PPPC.

Operations

Pulp production in the fourth quarter of 2012 was 314,000 tonnes, up approximately 37,000 tonnes, or 13%, from the previous quarter and up 20,000 tonnes, or 7%, compared to the fourth quarter of 2011. The increase in production compared to the third quarter of 2012 reflected a reduction in scheduled outages and improved operating rates following the aforementioned outage at the Prince George Pulp Mill in the previous quarter along with improved operating rates at other facilities.

Pulp unit manufacturing costs decreased 7% from the previous quarter of 2012, with higher production volumes coupled with lower fibre and chemical costs, partially offset by higher maintenance expense and a seasonal increase in energy costs. Lower fibre costs were in part due to lower-cost sawmill residual chips reflecting the effects of lagging price formulas for residual chips as well as seasonal factors. The previous quarter's costs also included one-time costs associated with the new five year collective labour agreements.

Compared to the fourth quarter of 2011, unit manufacturing costs decreased 5%, principally reflecting the favourable impact of higher production volumes, reduced chemical usage and lower fibre costs, partially offset by timing of maintenance spending. Lower fibre costs in the current quarter reflected lower-cost sawmill residual chips, where prices are linked to NBSK pulp sales realizations, as well as a reduction in higher-cost whole log chips.

Unallocated and Other Items

(millions of dollars)	**Q4 2012**	Q3 2012	**YTD 2012**	Q4 2011	YTD 2011
Operating income (loss) of Panels operations[17]	**$ 2.7**	$ 2.1	**$ 2.0**	$ (19.0)	$ (33.8)
Corporate costs	**$ (5.1)**	$ (7.5)	**$ (27.1)**	$ (6.6)	$ (25.7)
Finance expense, net	**$ (6.5)**	$ (5.8)	**$ (24.7)**	$ (5.1)	$ (26.0)
Foreign exchange gain (loss) on long-term debt and investments, net	**$ (2.0)**	$ 6.5	**$ 4.7**	$ 4.9	$ (5.0)
Gain (loss) on derivative financial instruments	**$ (8.7)**	$ 6.8	**$ (0.8)**	$ 9.6	$ 3.5
Other income (expense), net	**$ (0.2)**	$ (2.6)	**$ (0.4)**	$ 1.3	$ 5.9

[17] The Panels operations include the Peace Valley OSB (Oriented Strand Board) joint venture, the only facility currently operating, and the Company's Tackama plywood plant, which was closed in January 2012, and its PolarBoard OSB plant, which is currently indefinitely idled.

The panels operations reported operating income of $2.7 million for the fourth quarter of 2012, compared to $2.1 million for the previous quarter. Operating results for the fourth quarter of 2012 included $0.8 million in impairment charges related to a damaged asset held by the operation. Excluding the impact of this impairment charge, the operating income of panels operations increased $1.6 million, with the improvement in operating income in the current period reflecting continued improvement in OSB markets, driven primarily by increased housing activity and damage caused by Hurricane Sandy, as evidenced by a US$20 per thousand square feet ("msf") increase in the benchmark OSB price to US$332 per msf[18]. Results for the fourth quarter of 2011 included an expense of $10.6 million relating to the announced closure of the Tackama plywood plant, as well as an asset impairment charge of $2.0 million relating to other idled panels assets. Compared to the fourth quarter of 2011, excluding the impact of these items and inventory valuation adjustments, results for the panel operations improved by $8.7 million, largely reflecting considerably stronger market prices, with the benchmark OSB price up by US$142 per msf, or 75%, partially offset by an increase in costs due in part to higher log costs.

Corporate costs were $5.1 million for the fourth quarter of 2012, down $2.4 million from the previous quarter, in part reflecting restructuring costs associated with the integration of Canfor Pulp recorded in the previous quarter. Corporate costs were lower by $1.5 million compared to the fourth quarter of 2011. Corporate costs in the fourth quarter of 2011 reflected restructuring costs and costs related to the announced acquisition of the Kootenay sawmills and tenure. The decrease from both comparative periods also reflected a portion of the aforementioned gain due to amendments to the Company's salaried post retirement benefit plans offset in part by higher share-based compensation expense.

[18] Oriented Strand Board, North Central price, 7/16" (Source – Random Lengths Publications, Inc.)

Net finance expense for the fourth quarter of 2012 was $6.5 million, up $0.7 million from the previous quarter, primarily reflecting costs associated with a new operating loan facility entered into by Canfor Pulp in the fourth quarter of 2012. Compared to the fourth quarter of 2011, finance expense was up $1.4 million, again reflecting the costs associated with the new Canfor Pulp operating loan facility coupled with the effect of a positive accretion adjustment related to the Company's reforestation obligation recorded in the fourth quarter of 2011.

The Company recorded a foreign exchange translation loss on its US dollar denominated debt of $2.0 million for the fourth quarter of 2012, as a result of the weakening of the Canadian dollar against the US dollar, which fell by just over 1% between the respective quarter ends. The $6.5 million gain in the third quarter of 2012 and $4.9 million gain in the fourth quarter of 2011, resulted from a strengthening of the Canadian dollar in the previous periods.

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs, lumber prices and interest rates. For the fourth quarter of 2012, the Company recorded a net loss of $8.7 million related to its derivative financial instruments, largely reflecting realized and unrealized losses on lumber futures as a result of rising lumber prices, as well as realized and unrealized losses on the US dollar forward contracts and collars, related to the weakening of the Canadian dollar.

The following table summarizes the gains (losses) on derivative financial instruments for the comparable periods:

(millions of dollars)	Q4 2012	Q3 2012	YTD 2012	Q4 2011	YTD 2011
Foreign exchange collars and forward contracts	**$ (1.0)**	$ 3.8	**$ 3.2**	$ 9.3	$ (2.7)
Energy derivatives	**$ (0.3)**	$ 1.5	**$ 0.6**	$ 0.9	$ 0.6
Lumber futures	**$ (7.5)**	$ 1.3	**$ (3.6)**	$ (0.6)	$ 5.6
Interest rate swaps	**$ 0.1**	$ 0.2	**$ (1.0)**	$ -	$ -
	$ (8.7)	$ 6.8	**$ (0.8)**	$ 9.6	$ 3.5

Other expense, net of $0.2 million reflected a small adverse fair value adjustment related to a royalty agreement associated with the sale in late 2010 of the operating assets of Howe Sound Pulp and Paper Limited Partnership compared to a positive fair value adjustment of $2.2 million in the fourth quarter of 2011. Further contributing to the other expense was a $0.6 million loss recorded on the sale of land and timber in the fourth quarter of 2012. Partially offsetting these charges in the fourth quarter of 2012 were favourable exchange movements on US dollar denominated cash, receivables and payables of Canadian operations of $0.7 million, compared to a loss in the previous quarter of $2.6 million and a loss of $2.1 million in the fourth quarter of 2011 resulting from the effect of the strengthening of the Canadian dollar during those periods.

Other Comprehensive Income (Loss)

The following table summarizes Canfor's Other Comprehensive Income (Loss) for the comparable periods:

(millions of dollars)	Q4 2012	Q3 2012	YTD 2012	Q4 2011	YTD 2011
Foreign exchange translation differences for foreign operations	**$ 1.9**	$ (7.0)	**$ (4.6)**	$ (4.3)	$ 4.4
Defined benefit actuarial loss, net of tax	**$ (5.7)**	$ (16.7)	**$ (50.4)**	$ 10.7	$ (50.3)
Other comprehensive income (loss), net of tax	**$ (3.8)**	$ (23.7)	**$ (55.0)**	$ 6.4	$ (45.9)

In the fourth quarter of 2012, the Company recorded an after-tax charge to the statements of other comprehensive income (loss) of $5.7 million in relation to changes in the valuation of its defined benefit post-employment compensation plans. The charge reflects a reduction in the discount rate used to value the plans offset in part by a slightly higher than expected rate of return on plan assets for the period. In the previous quarter a charge of $16.7 million was recorded, reflecting a reduction in discount rates offset slightly by a higher than expected rate of return on plan assets for the period. An after-tax credit of $10.7 million was recorded in the fourth quarter of 2011.

In addition, the Company recorded $1.9 million of other comprehensive income in the quarter for foreign exchange differences for foreign operations, reflecting the weakening of the Canadian dollar by over 1% over the quarter. This compared to other comprehensive loss of $7.0 million in the previous quarter and $4.3 million in the fourth quarter of 2011, when the Canadian dollar strengthened over both comparative periods.

SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's cash flow and selected ratios for and as at the end of the following periods:

(millions of dollars, except for ratios)	**Q4 2012**	Q3 2012	**YTD 2012**	Q4 2011	YTD 2011
Increase (decrease) in cash and cash equivalents	**$ (7.6)**	$ (13.1)	**$ (43.6)**	$ (72.4)	$ (231.4)
Operating activities	**$ 33.4**	$ 33.9	**$ 131.2**	$ 38.3	$ 163.0
Financing activities	**$ 2.0**	$ (4.4)	**$ 42.0**	$ (17.6)	$ (191.4)
Investing activities	**$ (43.0)**	$ (42.6)	**$ (216.8)**	$ (93.1)	$ (203.0)
Ratio of current assets to current liabilities			**1.3 : 1**		1.5 : 1
Net debt to capitalization			**19.9%**		13.4%
ROIC – Consolidated	**2.4%**	1.6%	**3.7%**	(4.1)%	(3.4)%
ROCE - Canfor solid wood business[19]	**1.8%**	2.5%	**2.9%**	(5.5)%	(10.1)%

[19] Return on Capital Employed ("ROCE") for the Canfor solid wood business represents consolidated ROCE adjusted to remove the Company's interest in the Peace Valley OSB Joint Venture and pulp and paper operations, including Canfor Pulp and the Taylor pulp mill. Consolidated ROCE is equal to shareholder net income for the period plus finance expense, after tax, divided by the average capital employed during the period (which consists of current and long-term debt and operating loans, and shareholders' equity, less cash and temporary investments).

Changes in Financial Position

Cash generated from operating activities was $33.4 million in the fourth quarter of 2012 in line with the previous quarter and down slightly compared to the fourth quarter of 2011. Higher cash operating earnings in the current quarter were offset by an increase in working capital which in part reflected higher log inventories at the end of 2012. The increase in working capital compared to the same quarter of 2011 reflected higher production and shipments, unseasonably wet weather in late 2011 which hampered log harvesting activity, as well as restructuring provisions at the end of 2011.

Financing activities generated cash of $2.0 million in the current quarter, compared to cash used of $4.4 million in the previous quarter and $17.6 million in the fourth quarter of 2011. The current quarter's cash flows included an additional draw of $10.0 million on the Company's operating loans and reduced cash distributions to non-controlling interests of $0.4 million (Q3 2012: $3.0 million; Q4 2011: $11.4 million). Finance expenses paid in the current quarter were $7.6 million, up $6.2 million from the previous quarter and up $1.4 million from the fourth quarter of 2011, principally reflecting timing of scheduled interest payments.

Investing activities used cash of $43.0 million in the fourth quarter of 2012, in line with the third quarter of 2012 and down $50.1 million compared to the fourth quarter of 2011. Cash used for capital additions was $47.7 million, down $6.4 million from the third quarter of 2012, and down $68.5 million from the fourth quarter of 2011. Capital additions for lumber operations in the current quarter included the upgrade at the Company's Radium sawmill which restarted in the fourth quarter. In the pulp segment, current quarter capital expenditures were $12.8 million, principally related to equipment received related to the scheduled 2013 turbine upgrades at the Company's Northwood Pulp Mill as well as major maintenance expenditures related to outages and payments related to previous period projects. Investing cash flows in the current quarter also included $5.5 million in net proceeds realized on the sale of certain non-core assets, including the Company's remanufacturing facility in Washington, U.S.

Liquidity and Financial Requirements

At December 31, 2012, the Company on a consolidated basis had cheques issued in excess of cash on hand of $14.7 million, $27.0 million drawn on its operating loans, and an additional $27.2 million reserved for several standby letters of credit. Total remaining available operating loans were $413.3 million. The Company and Canfor Pulp remained in compliance with the covenants relating to their operating loans and long-term debt during the quarter, and expect to remain so for the foreseeable future.

During the third quarter of 2012, Canfor Pulp obtained a new $110.0 million operating loan facility replacing its previous $40.0 million operating loan facility. No amounts were drawn on the new bank facility, except for amounts reserved for several standby letters of credit.

During the first quarter of 2012, the Company issued new term debt of $100.0 million to fund a US$50.0 million term debt repayment on February 1, 2012 and the acquisition of assets from Tembec. The new debt is in the form of an unsecured non-revolving term loan, with a maturity date of February 13, 2017. Interest rates are floating based on the lenders' Canadian prime rate or bankers acceptances.

Canfor has US$75.0 million of term debt that is scheduled for repayment on April 1, 2013, and Canfor Pulp has US$110.0 million of term debt that is scheduled for repayment on November 30, 2013.

The Company's consolidated net debt to total capitalization at the end of the fourth quarter of 2012 was 19.9%. For Canfor, excluding Canfor Pulp, net debt to capitalization at the end of the fourth quarter was 18.9%.

Softwood Lumber Agreement ("SLA") Update

On January 18, 2011, the U.S. triggered the arbitration provision of the 2006 Softwood Lumber Agreement ("SLA") by delivering a Request for Arbitration. The U.S. claimed that the province of British Columbia ("BC") had not properly applied the timber pricing system grandparented in the SLA. The U.S. also claimed that subsequent to 2006, BC made additional changes to the timber pricing system which had the effect of reducing timber prices. The claim focused on substantial increases in Grade 4 (non sawlog or low grade) volumes commencing in 2007. It was alleged that timber was scaled and graded as Grade 4 that did not meet the criteria for that grade, and was accordingly priced too low.

As the arbitration is a state-to-state international dispute under the SLA, Canada prepared a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. After numerous representations from both sides, a hearing was held before the arbitration panel in the first quarter of 2012.

On July 18, 2012 the arbitration panel ruled in favour of Canada and dismissed the claims of the U.S. in their entirety.

CPPI Share Exchange

On March 2, 2012, Canadian Forest Products Ltd. ("CFP"), a wholly owned subsidiary of Canfor, acquired 35,776,483 common shares of Canfor Pulp Products, Inc. ("CPPI") in exchange for its 35,776,483 Class B Exchangeable LP Units of Canfor Pulp Limited Partnership ("CPLP") and 35,776,483 common shares of Canfor Pulp Holding Inc. ("Canfor Holding"), pursuant to the terms of an Exchange Agreement made as of January 1, 2011 among CFP, CPPI, Canfor Holding and CPLP.

Prior to the share exchange, CFP and CPPI entered into a one-time dividend waiver agreement, waiving CFP's right to the first $7.8 million of future dividends declared by CPPI. The full $7.8 million dividend was paid by CPPI during the second quarter of 2012.

Sale of interest in Peace Valley OSB Joint Venture

In November 2012, the Company entered into a Letter of Intent with Louisiana-Pacific Corporation to sell Canfor's 50% share in Peace Valley Orientated OSB joint venture in Fort St. John, B.C. By completing this sale, Louisiana-Pacific Corporation will become the sole owner of the Peace Valley OSB mill. As at December 31, 2012, the assets and liabilities related to the sale are classified as held for sale in the Company's consolidated balance sheet. As part of the sale, Canfor may receive additional annual consideration over a 3 year period based on Peace Valley OSB's annual adjusted earnings before interest, tax, depreciation and amortization. The transaction is subject to various customary closing conditions and is currently scheduled to close in the first half of 2013.

OUTLOOK

Lumber

For 2013, the U.S. market is projected to continue its gradual recovery. Rising housing prices, an improved job market, and an increase in household formations will support an improved housing market. Repair and remodel markets will also be significantly impacted by the same fundamentals. Canadian markets are anticipated to be flat through 2013, with softness projected in multi-family urban markets, but stable demand from other sectors. Offshore markets are forecast to also improve in 2013. After a slight slowdown in 2013, exports to China are anticipated to rise. Demand in Japan will be buoyant for 2013, in advance of an increase in the value-added tax in 2014.

Pulp and Paper

NBSK pulp prices are projected to show a modest improvement through the first half of 2013, but the outlook for the balance of the year is more uncertain given the economic challenges in Europe and new hardwood and softwood pulp capacity currently projected to come online the second half of 2013. For the month of January, CPPI announced an increase in the North American NBSK pulp list price of US$30 per tonne to US$900 per tonne.

Canfor Corporation
Condensed Consolidated Balance Sheets

(millions of Canadian dollars, unaudited)		**As at December 31, 2012**		As at December 31, 2011
ASSETS				
Current assets				
Cash and cash equivalents	**$**	**-**	$	28.9
Accounts receivable - Trade		**102.7**		105.1
- Other		**52.2**		65.7
Inventories (Note 2)		**431.3**		348.3
Prepaid expenses		**23.4**		20.4
Assets held for sale (Note 3)		**77.3**		-
Total current assets		**686.9**		568.4
Property, plant and equipment		**1,081.7**		1,139.2
Timber licenses		**554.6**		530.1
Goodwill and other intangible assets		**80.4**		83.0
Long-term investments and other (Note 4)		**44.6**		62.8
Deferred income taxes, net		**39.7**		18.1
Total assets	**$**	**2,487.9**	$	2,401.6
LIABILITIES				
Current liabilities				
Cheques issued in excess of cash on hand	**$**	**14.7**	$	-
Operating loans (Note 5(a))		**27.0**		-
Accounts payable and accrued liabilities		**255.7**		290.5
Current portion of long-term debt (Note 5(b))		**184.1**		50.9
Current portion of deferred reforestation obligations		**37.3**		31.6
Liabilities held for sale (Note 3)		**2.0**		-
Total current liabilities		**520.8**		373.0
Long-term debt (Note 5(b))		**100.0**		188.1
Retirement benefit obligations		**314.5**		298.3
Deferred reforestation obligations		**78.4**		65.0
Other long-term liabilities		**13.6**		13.8
Deferred income taxes, net		**150.8**		103.3
Total liabilities	**$**	**1,178.1**	$	1,041.5
EQUITY				
Share capital	**$**	**1,126.2**	$	1,125.9
Contributed surplus		**31.9**		31.9
Retained earnings (deficit)		**(36.7)**		(24.6)
Accumulated foreign exchange translation differences		**(10.5)**		(5.9)
Total equity attributable to equity holders of the Company		**1,110.9**		1,127.3
Non-controlling interests		**198.9**		232.8
Total equity	**$**	**1,309.8**	$	1,360.1
Total liabilities and equity	**$**	**2,487.9**	$	2,401.6

The accompanying notes are an integral part of these condensed consolidated financial statements.

APPROVED BY THE BOARD

Director, R.S. Smith

Director, R.L. Cliff

Canfor Corporation
Condensed Consolidated Statements of Income (Loss)

(millions of Canadian dollars, unaudited)	3 months ended December 31, **2012**	3 months ended December 31, 2011	12 months ended December 31, **2012**	12 months ended December 31, 2011
Sales	**$ 721.8**	$ 576.2	**$ 2,714.1**	$ 2,421.4
Costs and expenses				
Manufacturing and product costs	**465.7**	421.0	**1,820.2**	1,627.5
Freight and other distribution costs	**125.0**	113.6	**503.7**	467.9
Export taxes	**9.8**	9.6	**45.5**	39.9
Amortization	**50.4**	47.6	**187.2**	169.3
Selling and administration costs	**15.2**	15.6	**61.3**	57.4
Asset impairments	**0.8**	9.2	**0.8**	9.2
Restructuring, mill closure and severance costs	**4.8**	22.8	**18.5**	38.3
	671.7	639.4	**2,637.2**	2,409.5
Operating income (loss)	**50.1**	(63.2)	**76.9**	11.9
Finance expense, net	**(6.5)**	(5.1)	**(24.7)**	(26.0)
Foreign exchange gain (loss) on long-term debt and investments, net	**(2.0)**	4.9	**4.7**	(5.0)
Gain (loss) on derivative financial instruments (Note 7)	**(8.7)**	9.6	**(0.8)**	3.5
Other income (expense), net	**(0.2)**	1.3	**(0.4)**	5.9
Net income (loss) before income taxes	**32.7**	(52.5)	**55.7**	(9.7)
Income tax recovery (expense) (Note 8)	**(8.1)**	14.4	**(14.3)**	20.5
Net income (loss)	**$ 24.6**	$ (38.1)	**$ 41.4**	$ 10.8
Net income (loss) attributable to:				
Equity shareholders of the Company	**$ 21.6**	$ (44.1)	**$ 32.1**	$ (56.6)
Non-controlling interests	**3.0**	6.0	**9.3**	67.4
Net income (loss)	**$ 24.6**	$ (38.1)	**$ 41.4**	$ 10.8
Net income (loss) per common share: (in dollars)				
Attributable to equity shareholders of the Company				
- Basic and diluted (Note 9)	**$ 0.15**	$ (0.31)	**$ 0.22**	$ (0.40)

The accompanying notes are an integral part of these condensed consolidated financial statements.

Canfor Corporation
Condensed Consolidated Statements of Other Comprehensive Income (Loss)

(millions of Canadian dollars, unaudited)	3 months ended December 31, 2012	3 months ended December 31, 2011	12 months ended December 31, 2012	12 months ended December 31, 2011
Net income (loss)	**$ 24.6**	$ (38.1)	**$ 41.4**	$ 10.8
Other comprehensive income (loss)				
Foreign exchange translation differences for foreign operations	**1.9**	(4.3)	**(4.6)**	4.4
Defined benefit plan actuarial gains (losses) (Note 6)	**(7.6)**	14.9	**(67.4)**	(64.5)
Income tax recovery (expense) on defined benefit plan actuarial gains (losses) (Note 8)	**1.9**	(4.2)	**17.0**	14.2
Other comprehensive income (loss), net of tax	**(3.8)**	6.4	**(55.0)**	(45.9)
Total comprehensive income (loss)	**$ 20.8**	$ (31.7)	**$ (13.6)**	$ (35.1)
Total comprehensive income (loss) attributable to:				
Equity shareholders of the Company	**$ 18.7**	$ (35.2)	**$ (16.7)**	$ (93.7)
Non-controlling interests	**2.1**	3.5	**3.1**	58.6
Total comprehensive income (loss)	**$ 20.8**	$ (31.7)	**$ (13.6)**	$ (35.1)

Condensed Consolidated Statements of Changes in Equity

(millions of Canadian dollars, unaudited)	3 months ended December 31, 2012	3 months ended December 31, 2011	12 months ended December 31, 2012	12 months ended December 31, 2011
Share capital				
Balance at beginning of period	**$ 1,126.2**	$ 1,125.7	**$ 1,125.9**	$ 1,125.4
Common shares issued on exercise of stock options	**-**	0.2	**0.3**	0.5
Balance at end of period	**$ 1,126.2**	$ 1,125.9	**$ 1,126.2**	$ 1,125.9
Contributed surplus				
Balance at beginning and end of period	**$ 31.9**	$ 31.9	**$ 31.9**	$ 31.9
Retained earnings (deficit)				
Balance at beginning of period	**$ (53.5)**	$ 6.3	**$ (24.6)**	$ 73.5
Net income (loss) attributable to equity shareholders of the Company	**21.6**	(44.1)	**32.1**	(56.6)
Defined benefit plan actuarial gains (losses), net of tax	**(4.8)**	13.2	**(44.2)**	(41.5)
Balance at end of period	**$ (36.7)**	$ (24.6)	**$ (36.7)**	$ (24.6)
Accumulated foreign exchange translation differences				
Balance at beginning of period	**$ (12.4)**	$ (1.6)	**$ (5.9)**	$ (10.3)
Foreign exchange translation differences for foreign operations	**1.9**	(4.3)	**(4.6)**	4.4
Balance at end of period	**$ (10.5)**	$ (5.9)	**$ (10.5)**	$ (5.9)
Total equity attributable to equity holders of the Company	**$ 1,110.9**	$ 1,127.3	**$ 1,110.9**	$ 1,127.3
Non-controlling interests				
Balance at beginning of period	**$ 197.2**	$ 241.0	**$ 232.8**	$ 249.5
Net income attributable to non-controlling interests	**3.0**	6.0	**9.3**	67.4
Defined benefit plan actuarial losses attributable to non-controlling interests	**(0.9)**	(2.5)	**(6.2)**	(8.8)
Distributions to non-controlling interests	**(0.4)**	(11.7)	**(12.0)**	(75.3)
Share exchange (Note 14)	**-**	-	**(25.0)**	-
Balance at end of period	**$ 198.9**	$ 232.8	**$ 198.9**	$ 232.8
Total equity	**$ 1,309.8**	$ 1,360.1	**$ 1,309.8**	$ 1,360.1

The accompanying notes are an integral part of these condensed consolidated financial statements.

Canfor Corporation
Condensed Consolidated Statements of Cash Flows

(millions of Canadian dollars, unaudited)	3 months ended December 31, **2012**	3 months ended December 31, 2011	12 months ended December 31, **2012**	12 months ended December 31, 2011
Cash generated from (used in):				
Operating activities				
Net income (loss)	**$ 24.6**	$ (38.1)	**$ 41.4**	$ 10.8
Items not affecting cash:				
Amortization	**50.4**	47.6	**187.2**	169.3
Income tax (recovery) expense	**8.1**	(14.4)	**14.3**	(20.5)
Long-term portion of deferred reforestation obligations	**8.9**	6.3	**2.5**	3.1
Change in fair value of long-term investment	**-**	(0.4)	**(1.3)**	(0.2)
Foreign exchange (gain) loss on long-term debt and investments, net	**2.0**	(4.9)	**(4.7)**	5.0
Changes in mark-to-market value of derivative financial instruments	**5.8**	(11.1)	**3.9**	(3.9)
Employee future benefits (Note 6)	**(13.6)**	(4.7)	**(18.5)**	(5.4)
Net finance expense	**6.5**	5.1	**24.7**	26.0
Asset impairments	**0.8**	9.2	**0.8**	9.2
Mill closure provisions	**-**	22.5	**-**	22.5
Other, net	**1.8**	(1.1)	**-**	(9.7)
Salary pension plan contributions	**(8.7)**	(8.1)	**(35.7)**	(37.3)
Income taxes recovered (paid), net	**(2.7)**	-	**(8.1)**	(0.3)
Net change in non-cash working capital (Note 10)	**(50.5)**	30.4	**(75.3)**	(5.6)
	33.4	38.3	**131.2**	163.0
Financing activities				
Change in operating bank loans (Note 5(a))	**10.0**	-	**27.0**	-
Proceeds from long-term debt (Note 5(b))	**-**	-	**100.0**	-
Repayment of long-term debt (Note 5(b))	**-**	-	**(49.9)**	(81.9)
Finance expenses paid	**(7.6)**	(6.2)	**(19.5)**	(18.9)
Cash distributions paid to non-controlling interests	**(0.4)**	(11.4)	**(15.9)**	(91.0)
Other, net	**-**	-	**0.3**	0.4
	2.0	(17.6)	**42.0**	(191.4)
Investing activities				
Additions to property, plant and equipment	**(47.7)**	(116.2)	**(199.8)**	(312.3)
Reimbursements from Federal Government under Green Transformation Program	**0.7**	25.2	**19.7**	75.6
Proceeds from disposal of property, plant and equipment	**5.5**	0.7	**6.1**	1.4
Acquisition of Tembec assets (Note 13)	**-**	-	**(65.6)**	-
Share exchange (Note 14)	**-**	-	**6.8**	-
Proceeds from redemption of asset-backed commercial paper (Note 4)	**-**	-	**12.9**	29.8
Other, net	**(1.5)**	(2.8)	**3.1**	2.5
	(43.0)	(93.1)	**(216.8)**	(203.0)
Increase (decrease) in cash and cash equivalents*	**(7.6)**	(72.4)	**(43.6)**	(231.4)
Cash and cash equivalents at beginning of period*	**(7.1)**	101.3	**28.9**	260.3
Cash and cash equivalents at end of period*	**$ (14.7)**	$ 28.9	**$ (14.7)**	$ 28.9

*Cash and cash equivalents include cash on hand less unpresented cheques.

The accompanying notes are an integral part of these condensed consolidated financial statements.

Canfor Corporation
Notes to the Condensed Consolidated Financial Statements
(unaudited, millions of Canadian dollars unless otherwise noted)

1. Basis of Preparation

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting*, and include the accounts of Canfor Corporation and its subsidiary entities, hereinafter referred to as "Canfor" or "the Company".

These interim financial statements do not include all of the disclosures required by International Financial Reporting Standards ("IFRS") for annual financial statements. Additional disclosures relevant to the understanding of these interim financial statements, including the accounting policies applied, can be found in Canfor's Annual Report for the year ended December 31, 2011, available at www.canfor.com or www.sedar.com.

Canfor's financial results are impacted by seasonal factors such as weather and building activity. Adverse weather conditions can cause logging curtailments, which can affect the supply of raw materials to sawmills and pulp mills. Market demand also varies seasonally to some degree. For example, building activity and repair and renovation work, which affects demand for solid wood products, are generally stronger in the spring and summer months. Shipment volumes are affected by these factors as well as by global supply and demand conditions.

The currency of presentation for these financial statements is the Canadian dollar.

Change in Accounting Policy

Effective January 1, 2012, the Company retroactively changed its accounting policy for the presentation of interest expense and expected rate of return on assets of defined benefit post-retirement plans. The net expense has been reclassified from operating income, where it was included in manufacturing and product costs and in selling and administration costs, to net finance expense. Management considers the classification of net pension interest expense as a finance expense more accurately reflects the nature of this cost. The effect on the three months ended December 31, 2011 and twelve months ended December 31, 2011 is an increase in operating income, and net finance expense, of $0.8 million and $3.5 million, respectively. There is no impact on amounts recorded in the consolidated balance sheet or opening equity as at January 1, 2012.

Accounting standards issued and not applied

Unless otherwise noted, the following new or revised standards and amendments as adopted by the IASB are effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. These new and revised accounting standards have not yet been adopted by Canfor and the Company does not plan to early adopt any of the standards.

Consolidation and interests in other entities

In May 2011, as part of its consolidation project, the IASB issued the following new suite of consolidation and related standards. The suite is intended to cover all aspects of interests in other entities from determination of how to account for interests in other entities to required disclosure of the interest in those entities. Early adoption is permitted provided that the entire suite of consolidation standards is adopted at the same time.

- IFRS 10, *Consolidated Financial Statements,* requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvements with the investee and has the ability to affect those returns through its power over the investee. IFRS 10 replaces SIC-12, *Consolidation – Special Purpose Entities,* and parts of IAS 27, *Consolidated and Separate Financial Statements.* IFRS 10 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- IFRS 11, *Joint Arrangements,* redefines joint operations and joint ventures with a focus on the rights and obligations of an arrangement, rather than its legal form. The new Standard requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting, whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures,* and SIC-13, *Jointly Controlled Entities – Non-monetary Contributions by Venturers.*

Under IFRS 11, Canfor's 50% interest in Canfor-LP OSB Limited Partnership is classified as a joint venture and will be accounted for using the equity method of accounting until completion of the sale (note 3). The Company currently proportionately consolidates Canfor-LP OSB Limited Partnership in accordance with IAS 31.

- IFRS 12, *Disclosure of Interests in Other Entities,* carries forward existing disclosure requirements and introduces additional disclosures that address the nature of, and risks associated with, an entity's interests in other entities. IFRS 12 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- There have been amendments to existing standards, including IAS 27 (2011), *Separate Financial Statements,* and IAS 28 (2011), *Investments in Associates and Joint Ventures.* IAS 27 (2011) addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 (2011) sets out the equity accounting for joint ventures and associates, once the assessment of the arrangement has been made under IFRS 11. Canfor's interest in Canfor-LP OSB Limited Partnership will be accounted for in accordance with IAS 28 (2011). The amendments to IAS 27 are not expected to have a material impact on amounts recorded in the financial statements of the Company.

Employee benefits

- IAS 19, *Employee Benefits,* has been amended to make changes to the recognition and measurement of defined benefit pension expense and termination benefits and to enhance the disclosure of all employee benefits. Pension benefit cost will be split between (i) the cost of benefits accrued in the current period (service cost) and benefit changes (past-service costs (including plan amendments, settlements and curtailments)); and (ii) finance expense or income. Interest cost and expected return on plan assets, which currently reflect different rates, will be replaced with a net interest amount that is calculated by applying one discount rate to the net defined benefit liability (asset). The principal impact on the Company of this portion of the amended Standard is expected to be an increase in net finance cost as the Company's return on plan assets will effectively be estimated at a lower rate.

  The amended Standard also requires immediate recognition of actuarial gains and losses in other comprehensive income as they arise, without subsequent recycling to net income. This is consistent with the Company's current accounting policy.

  In addition, under the amended Standard, the impact of plan amendments related to past service will no longer be recognized over a vesting period but instead will be recognized immediately in the period of a plan amendment.

  The amended Standard will result in an increase in operating income of approximately $1.5 million offset by an increase in finance expense of approximately $9.2 million in the 2012 comparative financial statements.

Other standards and amendments

- IFRS 9, *Financial Instruments,* addresses classification and measurement of financial assets and financial liabilities, and is effective January 1, 2015, with earlier adoption permitted. The new Standard limits the number of categories for classification of financial assets to two: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Equity instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. IFRS 9 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- IFRS 13, *Fair Value Measurement,* clarifies that fair value is the price that would be received on sale of an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. IFRS 13 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- IAS 1, *Presentation of Financial Statements,* has been amended to require entities to separate items presented in other comprehensive income ("OCI") into two groups, based on whether or not items may be recycled to net income in the future. The amendment is effective for annual periods beginning on or after July 1, 2012, with earlier application permitted. IAS 1 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.

2. Inventories

(millions of Canadian dollars)		**As at December 31, 2012**		As at December 31, 2011
Logs	**$**	**119.4**	$	55.9
Finished products		**205.8**		186.3
Residual fibre		**11.5**		17.3
Processing materials and supplies		**94.6**		88.8
	$	**431.3**	$	348.3

The above inventory balances are stated after inventory write-downs from cost to net realizable value. No write-downs were included in inventory at December 31, 2012 (December 31, 2011 - $15.5 million). At December 31, 2012, an amount of $4.3 million was reclassified from inventories to assets held for sale.

3. Assets and Liabilities Held for Sale

On November 28, 2012, the Company entered into a Letter of Intent with Louisiana-Pacific to sell its 50% share in Canfor-LP OSB Limited Partnership ("Canfor-LP OSB") for a price of $70.0 million plus working capital. As part of the sale, Canfor may receive additional annual consideration over a 3 year period based on Peace Valley OSB's annual adjusted earnings before interest, tax, depreciation and amortization. On completion of the sale, Louisiana-Pacific will become the sole owner of the Peace Valley OSB mill. At December 31, 2012, the assets and liabilities to be sold have been reclassified as held for sale and the non-current assets have been measured at the lower of the carrying amount and the fair value less cost to sell. No impairment was recorded on reclassification as the fair value less cost to sell exceeded the carrying amount. The transaction is currently scheduled to close in the first half of 2013.

At December 31, 2012, the following assets and liabilities are classified as held for sale:

(millions of Canadian dollars)		**As at December 31, 2012**
Accounts receivable	**$**	**3.9**
Inventories		**4.3**
Prepaid expenses		**0.3**
Property, plant and equipment		**68.8**
Assets held for sale	**$**	**77.3**
Accounts payable and accrued liabilities	**$**	**2.0**
Liabilities held for sale	**$**	**2.0**

There are no cumulative income or expenses included in other comprehensive income (loss) relating to the assets and liabilities held for sale.

4. Long-term Investments and Other

(millions of Canadian dollars)		**As at December 31, 2012**		As at December 31, 2011
Asset-backed commercial paper ("ABCP")	**$**	**-**	$	11.8
Other investments		**23.7**		24.3
Investment tax credits		**8.6**		8.6
Defined benefit plan assets		**1.4**		3.0
Other deposits, loans and advances		**10.9**		15.1
	$	**44.6**	$	62.8

During the second quarter of 2012, the Company sold all remaining ABCP assets for net proceeds of $12.9 million.

5. Operating Loans and Long-Term Debt

(a) Available Operating Loans

(millions of Canadian dollars)		**As at December 31, 2012**		As at December 31, 2011
Canfor (excluding CPLP)				
Principal operating loans	**$**	**350.0**	$	350.0
Facility A		**-**		12.9
Total operating loans - Canfor (excluding CPLP)		**350.0**		362.9
Drawn		**(27.0)**		-
Letters of credit (principally unregistered pension plans)		**(18.0)**		(17.2)
Total available operating loans - Canfor (excluding CPLP)	**$**	**305.0**	$	345.7
CPLP				
Operating loan facility	**$**	**110.0**	$	40.0
Bridge loan credit facility (maximum $30.0 million)		**-**		19.7
Facility for BC Hydro letter of credit		**7.5**		10.4
Total operating loans - CPLP		**117.5**		70.1
Drawn		**-**		-
Letters of credit (for general business purposes)		**(1.7)**		(0.5)
BC Hydro letter of credit		**(7.5)**		(10.4)
Total available operating loans - CPLP	**$**	**108.3**	$	59.2
Consolidated:				
Total operating loans	**$**	**467.5**	$	433.0
Total available operating loans	**$**	**413.3**	$	404.9

For Canfor, excluding Canfor Pulp Limited Partnership ("CPLP"), the principal operating loans mature on October 31, 2015. Interest is payable at floating rates based on lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin that varies with the Company's net debt to total capitalization ratio. Facility A, which was for US$12.7 million at December 31, 2011, expired in January 2012.

The terms of CPLP's operating loan facility include interest payable at floating rates that vary depending on the ratio of net debt to operating earnings before interest, taxes, depreciation, amortization and certain other non-cash items, and is based on lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin. In the fourth quarter of 2012, CPLP entered into a new $110.0 million operating loan facility replacing its previous $40.0 million operating loan facility. The new facility has certain financial covenants that stipulate maximum net debt to total capitalization ratios and minimum net worth amounts based on shareholders' equity. The maturity date of the new facility is November 13, 2016.

During the third quarter of 2012, CPLP terminated its $30.0 million bridge loan credit facility in conjunction with the completion of the Canadian Federal Government Green Transformation Program ("Program"). The facility was used to fund timing differences between expenditures and reimbursements for projects funded by the Program. The Company has a separate facility with a maturity date of November 30, 2013 to cover a $7.5 million standby letter of credit issued to BC Hydro.

As at December 31, 2012, the Company and CPLP were in compliance with all covenants relating to their operating loans. Substantially all borrowings of CPLP (operating loans and long-term debt) are non-recourse to other entities within the Company.

(b) Long-Term Debt

During the first quarter of 2012, the Company repaid $49.9 million (US$50.0 million) of 6.33% interest rate privately placed senior notes. The Company also issued new term debt totaling $100.0 million which was used to fund the above debt repayment and the acquisition of assets from Tembec Industries Ltd. ("Tembec") (Note 13). The new debt is in the form of an unsecured non-revolving term loan, with a maturity date of February 13, 2017. Interest rates are floating based on the lenders' Canadian prime rate or bankers acceptances. In addition, during the first half of 2012 the Company put in place $100.0 million of floating to fixed interest rate swaps.

At December 31, 2012, the fair value of the long-term debt, measured at its amortized cost of $284.1 million, was $288.8 million. The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

6. Employee Future Benefits

Canfor measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. At the end of each interim reporting period, the Company estimates movements in its accrued benefit liabilities based upon movements in discount rates and the rates of return on plan assets, as well as any significant changes to the plans. Adjustments are also made for payments made and current service and interest costs.

For the twelve months ended December 31, 2012, $67.4 million (before tax) was charged to other comprehensive income. The charge reflects a reduction in the discount rate used to value the plans offset slightly by a higher than expected rate of return for the period. For the three months ended December 31, 2012, the charge was $7.6 million (before tax). For the twelve months ended December 31, 2011, a pre-tax amount of $64.5 million was charged to other comprehensive income principally reflecting a decrease in the discount rate over the period. For the three months ended December 31, 2011 the pre-tax credit was $14.9 million.

During the fourth quarter of 2012, the Company amended the salaried post retirement benefit plans for certain employees and retirees. The amendments reduced the Company's retirement benefit obligation by $15.7 million (before tax). As a result of the plan amendments, Canfor recognized an accounting gain of $12.9 million (before tax) for vested past-service costs and deferred a gain of $2.8 million (before tax) for unvested past-service costs.

For the Company's single largest pension plan, a one percentage point increase in the rate of return on plan assets over the year would reduce the funded deficit by an estimated $4.1 million. A one percentage point increase in the discount rate used in calculating the actuarial estimate of future liabilities would reduce the funded deficit by an estimated $58.3 million.

The assumptions used to estimate the changes in net accrued benefit liabilities were as follows:

Pension Benefit Plans	
Discount rate	
December 31, 2012	**4.20%**
September 30, 2012	4.30%
December 31, 2011	5.00%
September 30, 2011	5.00%
December 31, 2010	5.50%
Rate of return on plan assets	
12 months ended December 31, 2012	**9.40%**
9 months ended September 30, 2012	6.60%
12 months ended December 31, 2011	2.50%
9 months ended September 30, 2011	(2.50)%
Other Benefit Plans	
Discount rate	
December 31, 2012	**4.40%**
September 30, 2012	4.50%
December 31, 2011	5.30%
September 30, 2011	5.40%
December 31, 2010	5.75%

7. Derivative Financial Instruments

The Company uses a variety of derivative financial instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, interest rates, lumber prices, energy costs, electricity sales and floating interest rates on certain long-term debt. At December 31, 2012, the fair value of derivative financial instruments was a net liability of $4.1 million (December 31, 2011 – net liability of $0.2 million). The fair value of these financial instruments was determined based on prevailing market rates for instruments with similar characteristics.

The following table summarizes the gain (loss) on derivative financial instruments for the three and twelve month periods ended December 31, 2012 and 2011:

(millions of Canadian dollars)	3 months ended December 31, 2012	3 months ended December 31, 2011	12 months ended December 30, 2012	12 months ended December 30, 2011
Foreign exchange collars and forward contracts	**$ (1.0)**	$ 9.3	**$ 3.2**	$ (2.7)
Energy derivatives	**(0.3)**	0.9	**0.6**	0.6
Lumber futures	**(7.5)**	(0.6)	**(3.6)**	5.6
Interest rate swaps	**0.1**	-	**(1.0)**	-
	$ (8.7)	$ 9.6	**$ (0.8)**	$ 3.5

The following table summarizes the fair value of the derivative financial instruments included in the balance sheet at December 31, 2012 and December 31, 2011:

(millions of Canadian dollars)	**As at December 31, 2012**	As at December 31, 2011
Foreign exchange collars and forward contracts	**$ 0.3**	$ (0.4)
Energy derivatives	**0.3**	(0.2)
Lumber futures	**(4.1)**	0.4
Interest rate swaps	**(0.6)**	-
Total asset (liability), net	**(4.1)**	(0.2)
Less: current portion asset (liability), net	**(3.5)**	(0.2)
Long-term portion asset (liability), net	**$ (0.6)**	$ -

8. Income Taxes

(millions of Canadian dollars)	3 months ended December 31, 2012	3 months ended December 31, 2011	12 months ended December 31, 2012	12 months ended December 31, 2011
Current	**$ (2.2)**	$ (1.4)	**$ (2.9)**	$ (1.7)
Deferred	**(5.9)**	15.8	**(11.4)**	22.2
Income tax recovery (expense)	**$ (8.1)**	$ 14.4	**$ (14.3)**	$ 20.5

The reconciliation of income taxes calculated at the statutory rate to the actual income tax provision is as follows:

(millions of Canadian dollars)	3 months ended December 31, 2012	3 months ended December 31, 2011	12 months ended December 31, 2012	12 months ended December 31, 2011
Income tax recovery (expense) at statutory rate 2012 – 25.0% (2011 – 26.5%)	**$ (8.2)**	$ 13.9	**$ (13.9)**	$ 2.6
Add (deduct):				
Non-taxable income related to non-controlling interests in limited partnerships	**0.2**	1.6	**1.7**	17.9
Entities with different income tax rates and other tax adjustments	**0.3**	(0.1)	**(2.4)**	1.0
Tax recovery (expense) at rates other than statutory rate	**-**	(0.8)	**0.1**	(0.9)
Permanent difference from capital gains and losses and other non-deductible items	**(0.4)**	(0.2)	**0.2**	(0.1)
Income tax recovery (expense)	**$ (8.1)**	$ 14.4	**$ (14.3)**	$ 20.5

In addition to the amounts recorded to net income, a tax recovery of $1.9 million was recorded to other comprehensive income for the three month period ended December 31, 2012 (three months ended December 31, 2011 – tax expense of $4.2 million) in relation to the actuarial losses on defined benefit employee compensation plans. For the twelve months ended December 31, 2012, the tax recovery was $17.0 million (twelve months ended December 31, 2011 - $14.2 million).

9. Earnings Per Share

Basic net income (loss) per share is calculated by dividing the net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is calculated by dividing the net income (loss) available to common shareholders by the weighted average number of common shares during the period using the treasury stock method. Under this method, proceeds from the potential exercise of stock options are assumed to be used to purchase the Company's common shares. When there is a net loss, the exercise of stock options would result in a calculated diluted net loss per share that is anti-dilutive. As at December 31, 2012, there were no outstanding stock options.

	3 months ended December 31,		12 months ended December 31,	
	2012	2011	**2012**	2011
Weighted average number of common shares	**142,752,431**	142,705,764	**142,749,096**	142,698,624
Incremental shares from potential exercise of options[1]	**-**	653	**-**	4,023
Diluted number of common shares[1]	**142,752,431**	142,705,764	**142,749,096**	142,698,624

[1]Where the addition of share options to the total shares outstanding has an anti-dilutive impact on the diluted net income (loss) per share calculation, those share options have not been included in the total common shares outstanding for purposes of the calculation of diluted net income (loss) per share.

10. Net Change in Non-Cash Working Capital

(millions of Canadian dollars)	3 months ended December 31, **2012**	2011	12 months ended December 31, **2012**	2011
Accounts receivable	**$ 12.2**	$ 71.1	**$ 0.4**	$ 36.6
Inventories	**(41.3)**	(21.8)	**(60.8)**	(22.6)
Prepaid expenses	**9.9**	18.4	**(1.4)**	6.1
Accounts payable, accrued liabilities and current portion of deferred reforestation obligations	**(31.3)**	(37.3)	**(13.5)**	(25.7)
Net decrease (increase) in non-cash working capital	**$ (50.5)**	$ 30.4	**$ (75.3)**	$ (5.6)

11. Segment Information

Canfor has two reportable segments which offer different products and are managed separately because they require different production processes and marketing strategies.

Sales between segments are accounted for at prices that approximate fair value. These include sales of residual fibre from the lumber segment to the pulp and paper segment for use in the pulp production process.

The Company's panels business does not meet the criteria to be reported fully as a separate segment and is included in Unallocated & Other below. Sales for panels operations for the three months ended December 31, 2012 were $23.5 million (three months ended December 31, 2011 - $13.3 million) and $78.8 million for the twelve months ended December 31, 2012 (twelve months ended December 31, 2011 - $46.8 million).

(millions of Canadian dollars)		Lumber	Pulp & Paper	Unallocated & Other	Elimination Adjustment		Consolidated
3 months ended December 31, 2012							
Sales to external customers	**$**	**469.9**	**228.4**	**23.5**	**-**	**$**	**721.8**
Sales to other segments	**$**	**26.1**	**-**	**-**	**(26.1)**	**$**	**-**
Operating income (loss)	**$**	**41.7**	**10.8**	**(2.4)**	**-**	**$**	**50.1**
Amortization	**$**	**26.6**	**20.5**	**3.3**	**-**	**$**	**50.4**
Capital expenditures[1]	**$**	**34.7**	**12.8**	**0.2**	**-**	**$**	**47.7**
3 months ended December 31, 2011							
Sales to external customers	$	325.9	237.0	13.3	-	$	576.2
Sales to other segments	$	30.8	-	-	(30.8)	$	-
Operating income (loss)	$	(55.8)	18.2	(25.6)	-	$	(63.2)
Amortization	$	21.5	21.7	4.4	-	$	47.6
Capital expenditures[1]	$	49.3	66.9	-	-	$	116.2
12 months ended December 31, 2012							
Sales to external customers	**$**	**1,711.8**	**923.5**	**78.8**	**-**	**$**	**2,714.1**
Sales to other segments	**$**	**111.9**	**-**	**-**	**(111.9)**	**$**	**-**
Operating income (loss)	**$**	**75.4**	**26.6**	**(25.1)**	**-**	**$**	**76.9**
Amortization	**$**	**101.8**	**69.0**	**16.4**	**-**	**$**	**187.2**
Capital expenditures[1]	**$**	**110.9**	**88.7**	**0.2**	**-**	**$**	**199.8**
Identifiable assets	**$**	**1,553.7**	**774.6**	**159.6**	**-**	**$**	**2,487.9**
12 months ended December 31, 2011							
Sales to external customers	$	1,317.1	1,057.5	46.8	-	$	2,421.4
Sales to other segments	$	127.1	-	-	(127.1)	$	-
Operating income (loss)	$	(81.5)	152.9	(59.5)	-	$	11.9
Amortization	$	83.9	68.0	17.4	-	$	169.3
Capital expenditures[1]	$	155.3	156.2	0.8	-	$	312.3
Identifiable assets	$	1,413.8	812.3	175.5	-	$	2,401.6

[1] Capital expenditures represent cash paid for capital assets, excluding acquisition of Tembec assets, during the period. Pulp & Paper includes capital expenditures by CPPI that are financed by the federal government-funded Green Transformation Program.

12. Softwood Lumber Agreement

On January 18, 2011, the U.S. triggered the arbitration provision of the 2006 Softwood Lumber Agreement ("SLA") by delivering a Request for Arbitration. The U.S. claimed that the province of British Columbia ("BC") had not properly applied the timber pricing system grandparented in the SLA. The U.S. also claimed that subsequent to 2006, BC made additional changes to the timber pricing system which had the effect of reducing timber prices. The claim focused on substantial increases in Grade 4 (non sawlog or low grade) volumes commencing in 2007. It was alleged that timber was scaled and graded as Grade 4 that did not meet the criteria for that grade, and was accordingly priced too low.

As the arbitration was a state-to-state international dispute under the SLA, Canada prepared a defense to the claim with the assistance of the BC provincial government and the BC lumber industry. After numerous representations from both sides, a hearing was held before the arbitration panel in the first quarter of 2012.

On July 18, 2012 the arbitration panel ruled in favour of Canada and dismissed the claims of the U.S. in their entirety.

13. Acquisition of Tembec Assets

On March 23, 2012, the Company completed the acquisition of Tembec's southern British Columbia Interior wood products assets for cash consideration of $65.6 million, including a payment on account of net working capital, excluding certain liabilities retained by Tembec. The acquisition has been accounted for in accordance with IFRS 3 Business Combinations.

The acquisition included Tembec's Elko and Canal Flats sawmills and approximately 1.1 million cubic metres of combined Crown, private land and contract annual allowable cut. The transaction also included a long-term agreement to provide residual fibre supply for Tembec's Skookumchuck pulp mill. The assets acquired increase the Company's fibre availability and production capacity.

The following summarizes the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

(millions of Canadian dollars)		
Land	$	3.0
Buildings, equipment and mobile		6.5
Timber licenses		43.5
Deferred reforestation obligations		(16.5)
Non-cash working capital, net		29.1
Total net identifiable assets	$	65.6

If the acquisition had occurred on January 1, 2012, consolidated sales would have increased by approximately $37.0 million, with no material change to consolidated income. In determining these amounts, the fair value adjustments that arose on the acquisition date have been assumed to be the same as if the acquisition had occurred on January 1, 2012.

The Company incurred acquisition-related costs of $1.3 million, principally relating to external legal fees and due diligence costs, which have been included in selling and administration costs, and severance costs of $2.5 million related to restructuring of the acquired assets. These amounts are recorded in the Company's consolidated statement of income (loss) for the year ended December 31, 2012.

14. Share Exchange

On March 2, 2012, Canadian Forest Products Ltd. ("CFP"), a wholly owned subsidiary of Canfor, acquired 35,776,483 common shares of Canfor Pulp Products Inc. ("CPPI") in exchange for its 35,776,483 Class B Exchangeable LP Units of CPLP and 35,776,483 common shares of Canfor Pulp Holding Inc. ("Canfor Holding"), pursuant to the terms of an Exchange Agreement made as of January 1, 2011 among CFP, CPPI, Canfor Holding and CPLP.

As of the date of exchange, the Company consolidated the balances of CPPI and Canfor Holding, including an additional deferred income tax liability of $31.4 million and cash of $6.8 million. The non-controlling interest in consolidated equity increased by $25.0 million on the date of exchange, representing the additional non-controlling interest balances in CPPI and Canfor Holding.

Prior to the share exchange, CFP and CPPI entered into a one-time dividend waiver agreement, waiving CFP's right to the first $7.8 million of future dividends declared by CPPI. As such, $7.8 million was included in non-controlling interests to account for future distributions which the Company had waived its entitlement to. The full $7.8 million dividend was paid by CPPI during the second quarter of 2012.