Q4 2011

For the three months ended December 31, 2011

CANFOR CORPORATION
2011 FOURTH QUARTER
INTERIM REPORT

To Our Shareholders

Canfor Corporation reported a net loss attributable to shareholders ("shareholder net loss") of $44.1 million, or $0.31 per share, for the fourth quarter of 2011, compared to a shareholder net loss of $21.6 million, or $0.15 per share, for the third quarter of 2011 and shareholder net income of $32.9 million, or $0.23 per share, for the fourth quarter of 2010. For the year ended December 31, 2011, the Company's shareholder net loss was $56.6 million, or $0.40 per share, compared to shareholder net income of $81.4 million, or $0.57 per share, for 2010.

The shareholder net loss for the fourth quarter of 2011 included various items affecting comparability with prior periods, which had an overall net negative impact of $12.0 million, or $0.09 per share. After adjusting for such items, the Company's adjusted shareholder net loss for the fourth quarter of 2011 was $32.1 million, or $0.22 per share, compared to an adjusted shareholder net loss of $1.8 million, or $0.01 per share, for the third quarter of 2011, and adjusted shareholder net income of $15.1 million, or $0.11 per share, for the fourth quarter of 2010. For the year ended December 31, 2011, the adjusted shareholder net loss was $31.7 million, or $0.22 per share, compared to adjusted shareholder net income of $74.1 million, or $0.52 per share, for 2010.

The Company reported an operating loss of $64.0 million for the fourth quarter of 2011, an adverse variance of $78.5 million from operating income of $14.5 million in the third quarter of 2011. Included in this variance are restructuring costs of $22.5 million related to the announced closures of the Company's Rustad sawmill and Tackama plywood plant in the BC Interior, and asset impairment charges of $9.2 million relating to certain lumber and panels assets. Excluding these items, and the impact of inventory valuation adjustments, Canfor's operating loss was $21.4 million, an adverse variance of $36.0 million compared to similarly adjusted operating earnings for the previous quarter, reflecting lower prices and higher log costs in the lumber segment, as well as lower prices in the pulp and paper segment.

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

(millions of dollars, except for per share amounts)	**Q4 2011**	Q3 2011	**Year 2011**	Q4 2010	Year 2010
Sales	**$ 576.2**	$ 602.1	**$ 2,421.4**	$ 629.1	$ 2,430.4
EBITDA	**$ (16.4)**	$ 54.4	**$ 177.7**	$ 83.5	$ 354.4
Operating income (loss)	**$ (64.0)**	$ 14.5	**$ 8.4**	$ 41.7	$ 186.7
Net income (loss) attributable to equity shareholders of Company	**$ (44.1)**	$ (21.6)	**$ (56.6)**	$ 32.9	$ 81.4
Net income (loss) per share attributable to equity shareholders of Company, basic and diluted	**$ (0.31)**	$ (0.15)	**$ (0.40)**	$ 0.23	$ 0.57
Adjusted shareholder net income (loss)	**$ (32.1)**	$ (1.8)	**$ (31.7)**	$ 15.1	$ 74.1
Adjusted shareholder net income (loss) per share	**$ (0.22)**	$ (0.01)	**$ (0.22)**	$ 0.11	$ 0.52

U.S. housing activity saw a modest improvement in the fourth quarter of 2011, aided by unseasonably mild weather and a slight improvement in the U.S. economy. U.S. housing starts for the quarter averaged 657,000 units (seasonally adjusted annual rate), up 8% from the previous quarter, though much of the increase related to multifamily units, which use a lower proportion of lumber than single family units. While the Company's offshore lumber shipments remained at high levels in the quarter, sales realizations were adversely impacted by softer demand, particularly for lower lumber grades.

The average North America benchmark Western SPF 2x4 #2&Btr price showed a modest decline from the previous quarter. Prices for lower grade product, however, fell sharply during the quarter, with #3 lumber prices down almost 25%, in part reflecting slowing Chinese consumption ahead of the Lunar New Year. Prices for SYP products fared slightly better, with the benchmark SYP 2x4 price essentially unchanged compared to the previous quarter. Northern Bleached Softwood Kraft ("NBSK") pulp markets continued to weaken during the quarter. The average North America list price was US$920 per tonne, down 7% from the previous quarter, while further price erosion was seen in prices to China. Canadian dollar sales realizations for all products were positively impacted by a weaker Canadian dollar (down over 4 cents, or 4%, from the previous quarter), which somewhat mitigated the effects of lower US-dollar pricing.

Lumber shipments were in line with the previous quarter at just under one billion board feet. Production was down 7%, for the most part reflecting downtime taken over the Christmas period, which pushed up unit cash conversion costs, along with seasonally higher energy consumption. Higher unit log costs in the period reflected a shortage of log truckers in parts of the BC Interior in the quarter, along with unseasonably mild weather and higher diesel prices. These increases were partially mitigated by continuing improved productivity at operations upgraded during the year.

Shipment volumes for pulp products were down 5%, reflecting the weaker pulp markets, though production levels were up from third quarter levels with less downtime taken at Canfor Pulp's Northwood pulp mill for its recovery boiler and precipitator upgrade, which was completed early in the fourth quarter. Total pulp unit cash manufacturing costs were down from the previous quarter, mostly due to the higher production levels and lower fibre costs.

The Company continued to make progress on the $300 million, three-year strategic capital investment program at its lumber operations during the quarter, completing new energy systems at its Plateau and Chetwynd sawmills, planer and logyard upgrades at its Grande Prairie mill, and a planer upgrade at its Prince George sawmill. The Company's recently upgraded Vavenby sawmill, which restarted in September on one shift, transitioned to two shifts in December.

Looking ahead, the acquisition of Tembec Industries Ltd.'s southern British Columbia Interior wood products assets is currently scheduled to close towards the end of the first quarter of 2012, subject to customary closing conditions including regulatory approval.

The North American lumber market is forecast to improve modestly as the U.S. economy continues on its slow road to recovery, while the Canadian housing market is projected to remain steady. Strong offshore demand is anticipated to continue into 2012. Shipments to China have picked up in early 2012 after slowing in advance of the Lunar New Year, although prices for lower grade lumber are forecast to remain at low levels through the first quarter. The global softwood pulp market is forecast to remain soft through the first quarter of 2012.

Ronald L. Cliff
Chairman

Don B. Kayne
President and Chief Executive Officer

Canfor Corporation
Fourth Quarter 2011
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, 2011 relative to the quarters ended September 30, 2011 and December 31, 2010, and the financial position of the Company at December 31, 2011. It should be read in conjunction with Canfor's unaudited interim consolidated financial statements and accompanying notes for the quarters ended December 31, 2011 and 2010, as well as the 2010 annual MD&A and the 2010 audited consolidated financial statements and notes thereto, which are included in Canfor's Annual Report for the year ended December 31, 2010 (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 as of January 1, 2011 is the required reporting framework for Canadian publicly accountable enterprises.

Throughout this discussion, reference is made to EBITDA (calculated as 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). EBITDA, 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 EBITDA, 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 EBITDA 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.

2010 prior period comparative financial information throughout this report has been restated, and is shown in accordance with IFRS. All financial references are in millions of Canadian dollars unless otherwise noted. The information in this report is as at February 8, 2012.

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 2011 EARNINGS OVERVIEW

Selected Financial Information and Statistics[1]

(millions of dollars, except for per share amounts)	Q4 2011	Q3 2011	Year 2011	Q4 2010	Year 2010
Sales	**$ 576.2**	$ 602.1	**$ 2,421.4**	$ 629.1	$ 2,430.4
EBITDA	**$ (16.4)**	$ 54.4	**$ 177.7**	$ 83.5	$ 354.4
Operating income (loss)	**$ (64.0)**	$ 14.5	**$ 8.4**	$ 41.7	$ 186.7
Foreign exchange gain (loss) on long-term debt and investments, net	**$ 4.9**	$ (16.6)	**$ (5.0)**	$ 9.8	$ 14.7
Gain (loss) on derivative financial instruments[2]	**$ 9.6**	$ (12.1)	**$ 3.5**	$ 1.8	$ 0.1
Net income (loss)	**$ (38.1)**	$ (9.6)	**$ 10.8**	$ 56.9	$ 173.3
Net income (loss) attributable to equity shareholders of Company	**$ (44.1)**	$ (21.6)	**$ (56.6)**	$ 32.9	$ 81.4
Net income (loss) per share attributable to equity shareholders of Company, basic and diluted	**$ (0.31)**	$ (0.15)	**$ (0.40)**	$ 0.23	$ 0.57
Average exchange rate (US$ per C$1.00)[3]	**$ 0.977**	$ 1.020	**$ 1.011**	$ 0.987	$ 0.971

[1] Prior year amounts have been restated, and are shown in accordance with International Financial Reporting Standards ("IFRS").
[2] Includes gains (losses) from natural gas, diesel, foreign exchange and lumber future derivative financial instruments (see "Unallocated and Other" section for more details).
[3] Source – Bank of Canada (average noon rate for the period).

The Company's shareholder net income (loss) and adjusted shareholder net income (loss), together with the related adjustments, are detailed in the table below:

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 2011	Q3 2011	Year 2011	Q4 2010	Year 2010
Shareholder Net Income (Loss)	**$ (44.1)**	$ (21.6)	**$ (56.6)**	$ 32.9	$ 81.4
Foreign exchange (gain) loss on long-term debt and investments, net	**$ (3.3)**	$ 11.0	**$ 3.3**	$ (6.9)	$ (10.4)
(Gain) loss on derivative financial instruments	**$ (6.7)**	$ 7.0	**$ (3.3)**	$ (0.5)	$ 0.5
Decrease (increase) in fair value of asset-backed commercial paper	**$ (0.5)**	$ 1.8	**$ (0.2)**	$ (5.5)	$ (5.5)
Mill closure provisions	**$ 17.0**	$ -	**$ 17.0**	$ -	$ 13.0
Asset impairment charges	**$ 5.5**	$ -	**$ 5.5**	$ -	$ -
Restructuring costs related to changes in management group	**$ -**	$ -	**$ 2.6**	$ -	$ -
Gain on sale of operating assets of Howe Sound Pulp and Paper Limited Partnership	**$ -**	$ -	**$ -**	$ (4.9)	$ (4.9)
Net impact of above items	**$ 12.0**	$ 19.8	**$ 24.9**	$ (17.8)	$ (7.3)
Adjusted Shareholder Net Income (Loss)	**$ (32.1)**	$ (1.8)	**$ (31.7)**	$ 15.1	$ 74.1
Shareholder Net Income (Loss) per share (EPS), as reported	**$ (0.31)**	**$** (0.15)	**$ (0.40)**	$ 0.23	$ 0.57
Net impact of above items per share	**$ 0.09**	**$** 0.14	**$ 0.18**	$ (0.12)	$ (0.05)
Adjusted Shareholder Net Income (Loss) per share	**$ (0.22)**	**$** (0.01)	**$ (0.22)**	$ 0.11	$ 0.52

EBITDA

The following table reconciles the Company's net income (loss), as reported in accordance with IFRS, to EBITDA:

(millions of dollars)		Q4 2011		Q3 2011		Year 2011		Q4 2010		Year 2010
Net income (loss), as reported	**$**	**(38.1)**	$	(9.6)	**$**	**10.8**	$	56.9	$	173.3
Add (subtract):										
Amortization	**$**	**47.6**	$	39.9	**$**	**169.3**	$	41.8	$	167.7
Finance expense, net	**$**	**4.3**	$	7.0	**$**	**22.5**	$	4.6	$	26.8
Foreign exchange (gain) loss on long-term debt and investments, net	**$**	**(4.9)**	$	16.6	**$**	**5.0**	$	(9.8)	$	(14.7)
(Gain) loss on derivative financial instruments	**$**	**(9.6)**	$	12.1	**$**	**(3.5)**	$	(1.8)	$	(0.1)
Other (income) expense	**$**	**(1.3)**	$	(5.2)	**$**	**(5.9)**	$	(11.0)	$	(8.1)
Income tax (recovery) expense	**$**	**(14.4)**	$	(6.4)	**$**	**(20.5)**	$	2.8	$	9.5
EBITDA, as reported	**$**	**(16.4)**	$	54.4	**$**	**177.7**	$	83.5	$	354.4
Included in above:										
Negative (positive) impact of inventory valuation adjustments[4]	**$**	**10.9**	$	0.1	**$**	**12.3**	$	(0.1)	$	(20.2)
Mill closure provisions	**$**	**22.5**	$	-	**$**	**22.5**	$	-	$	17.3
Asset impairment charges	**$**	**9.2**	$	-	**$**	**9.2**	$	-	$	-
EBITDA excluding inventory valuation adjustments, closure provisions and impairment charges	**$**	**26.2**	$	54.5	**$**	**221.7**	$	83.4	$	351.5

[4] 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 write-downs required at each year end.

Reported EBITDA for the fourth quarter of 2011 was negative $16.4 million, down $70.8 million from the third quarter. This movement relates in part to restructuring costs of $22.5 million recorded due to the announcement of the closures of the Rustad sawmill and Tackama Plywood plant, asset impairment charges of $9.2 million on certain lumber and panels assets and an adverse variance relating to inventory valuation adjustments of $10.8 million. In addition to these items, operating results were also negatively impacted by lower prices and higher log costs in the lumber segment, as well as lower prices in the pulp and paper segment.

U.S. housing activity saw a modest improvement in the fourth quarter of 2011, aided by unseasonably mild weather and a slight improvement in the U.S. economy. U.S. housing starts for the quarter averaged 657,000 units (seasonally adjusted annual rate), up 8% from the previous quarter, though much of the increase related to multifamily units, which use a lower proportion of lumber than single family units. While the Company's offshore lumber shipments remained at high levels in the quarter, sales realizations were adversely impacted by softer demand, particularly for lower lumber grades.

The average North America benchmark Western Spruce/Pine/Fir ("SPF") 2x4 #2&Btr price showed a modest decline from the previous quarter. Prices for lower grade product, however, fell sharply during the quarter, with #3 lumber prices down almost 25%, in part reflecting slowing Chinese consumption ahead of the Lunar New Year. Prices for Southern Yellow Pine ("SYP") products fared slightly better, with the benchmark SYP 2x4 price essentially unchanged compared to the previous quarter. Northern Bleached Softwood Kraft ("NBSK") pulp markets continued to weaken during the quarter. The average North American list price was US$920 per tonne, down 7% from the previous quarter, while further price erosion was seen in prices to China. Canadian dollar sales realizations for all products were positively impacted by a weaker Canadian dollar (down over 4 cents, or 4%, from the previous quarter), which somewhat mitigated the effects of lower US-dollar pricing.

Lumber shipments were in line with the previous quarter at just under one billion board feet. Production was down 7%, for the most part reflecting downtime taken over the Christmas period, which pushed up unit cash conversion costs, along with seasonally higher energy consumption. Higher unit log costs in the period reflected a shortage of log truckers in parts of the BC Interior in the quarter, along with unseasonably mild weather and higher diesel prices. These increases were partially mitigated by continuing improved productivity at operations upgraded during the year.

Shipment volumes for pulp products were down 5%, reflecting the weaker pulp markets, though production levels were up from third quarter levels with less downtime taken at Canfor Pulp's Northwood pulp mill for its recovery boiler and precipitator upgrade (the "Northwood upgrade"), which was completed early in the fourth quarter. Total pulp unit cash manufacturing costs were down from the previous quarter, mostly due to the higher production levels and lower fibre costs.

Compared to the fourth quarter of 2010, EBITDA excluding the noted unusual items, was down $57.2 million. Of this, $26.3 million was in the lumber segment where lower prices and higher log costs, partly offset by the positive effects of higher lumber recoveries and productivity, accounted for most of the variance. In addition, pulp and paper EBITDA was down $27.2 million, reflecting lower market prices for pulp products and lower shipment volumes.

OPERATING RESULTS BY BUSINESS SEGMENT

Lumber

Selected Financial Information and Statistics - Lumber

(millions of dollars unless otherwise noted)	Q4 2011	Q3 2011	Year 2011	Q4 2010	Year 2010
Sales	**$ 325.9**	$ 331.4	**$ 1,317.1**	$ 318.0	$ 1,255.2
Operating income (loss)	**$ (55.6)**	$ (11.7)	**$ (80.7)**	$ 0.7	$ 23.9
EBITDA, as reported	**$ (34.1)**	$ 9.7	**$ 3.2**	$ 21.7	$ 106.7
Negative (positive) impact of inventory valuation adjustments	**$ 9.7**	$ 1.5	**$ 12.4**	$ (0.7)	$ (21.4)
Mill closure provisions	**$ 11.9**	$ -	**$ 11.9**	$ -	$ 17.3
Asset impairment charges	**$ 7.2**	$ -	**$ 7.2**	$ -	$ -
EBITDA excluding impact of inventory valuation adjustments, closure provisions and impairment charges	**$ (5.3)**	$ 11.2	**$ 34.7**	$ 21.0	$ 102.6
Average SPF 2x4 #2&Btr lumber price in US$[5]	**$ 238**	$ 246	**$ 255**	$ 269	$ 256
Average SPF price in Cdn$	**$ 244**	$ 241	**$ 252**	$ 273	$ 264
Average SYP 2x4 #2 lumber price in US$[6]	**$ 260**	$ 259	**$ 268**	$ 256	$ 301
Average SYP price in Cdn$	**$ 266**	$ 254	**$ 265**	$ 259	$ 310
U.S. housing starts (thousand units SAAR)[7]	**657**	610	**607**	539	587
Production – SPF lumber (MMfbm)	**760.8**	813.6	**3,134.3**	725.1	2,886.7
Production – SYP lumber (MMfbm)	**106.4**	117.3	**431.3**	82.9	355.0
Shipments – SPF lumber (MMfbm)[8]	**833.9**	812.0	**3,182.8**	760.1	2,906.0
Shipments – SYP lumber (MMfbm)[8]	**112.7**	122.7	**449.9**	93.4	378.9
Shipments – wholesale lumber (MMfbm)	**27.4**	34.1	**140.5**	31.4	115.2

[5] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)
[6] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)
[7] Source – U.S. Census Bureau, seasonally adjusted annual rate ("SAAR")
[8] Canfor-produced lumber, including lumber purchased for remanufacture.

Overview

The operating loss for the lumber segment was $55.6 million for the fourth quarter of 2011, a $43.9 million higher loss than the previous quarter, and an adverse variance of $56.3 million compared to the fourth quarter of 2010. For the 2011 year, the operating loss was $80.7 million, compared to operating income of $23.9 million for the previous year.

Reported EBITDA for the lumber segment was negative $34.1 million, compared to positive EBITDA of $9.7 million for the previous quarter and $21.7 million for the fourth quarter of 2010. Results in the lumber segment for the fourth quarter of 2011 were impacted by various unusual items including an inventory devaluation expense of $9.7 million related to lower average market prices and higher log costs, an expense of $11.9 million related to the announced closure of manufacturing operations at the Rustad sawmill and asset impairments of $7.2 million.

Excluding the impact of these unusual items, EBITDA for the fourth quarter of 2011 was negative $5.3 million, compared to positive EBITDA of $11.2 million in the third quarter. Sales realizations were down in the fourth quarter, and while the benchmark Western SPF 2x4 #2&Btr price was down by around 3%, certain other products, particularly low grade lumber, saw much larger declines with #3 grade prices down approximately 25%. Prices for SYP products fared slightly better, with the benchmark 2x4 #2 price remaining flat while some wider dimensions saw modest increases. Canadian dollar sales realizations benefitted from the weaker average Canadian dollar which was down 4 cents against the US dollar compared to the third quarter.

In addition, results in the current quarter were adversely impacted by a modest increase in unit manufacturing costs, reflecting both higher unit conversion and unit log costs compared to the previous quarter, and lower sawmill residual chip prices related to a decline in NBSK pulp sales realizations. The fourth quarter of 2011 also included a deferred reforestation obligation fair value charge, while costs in the previous quarter reflected costs incurred in advance of the restart of the Vavenby sawmill in September.

Compared to the fourth quarter of 2010, EBITDA for the lumber segment, excluding the unusual items, was down $26.3 million. A significant part of the decrease related to lower market prices, as evidenced by a US$31 per thousand board feet ("Mfbm") fall in the benchmark Western SPF price and weaker low grade prices. In addition, unit manufacturing costs were up compared to the fourth quarter of 2010, with higher log costs more than offsetting a reduction in unit conversion costs resulting from improved operational performance. The current quarter deferred reforestation obligation fair value charge was a further contributing factor to the variance.

Markets

During the fourth quarter of 2011, unseasonably mild weather and a slight improvement in the U.S. economy contributed to a modest improvement in housing activity into the end of the year. Total U.S. housing starts averaged 657,000 units[9] SAAR for the quarter, an increase of 8% from the previous quarter and up 22% from the same quarter in 2010. Multifamily starts continued to gain momentum, rising 9% from the previous quarter, reflecting the better homeownership affordability of this residential structure. Starts for single family units, which consume a larger proportion of lumber saw a 7% rise, the first significant rise in 2011 as inventories of homes for sale are slowly depleting.

In Canada, lumber consumption decreased moderately reflecting lower seasonal housing activity. Housing starts averaged 200,000 units[10] SAAR for the quarter, down 5,000 units, or 3%, compared to the third quarter of 2011, but were well up from the comparable quarter in 2010 when starts were at 180,000 units SAAR.

Canfor's offshore lumber shipments increased by 2% from the previous quarter, and were 15% higher than the same quarter in 2010. Shipments to China eased later in the quarter as customers looked to avoid any disruption in receiving product around the Lunar New Year festivities in early 2012, and construction activity eased as the Chinese government sought to control overall economic growth. Sales volumes to Japan and Korea saw increases over the previous quarter of 6% and 12%, respectively.

Sales

Sales for the lumber segment for the fourth quarter of 2011 were $325.9 million, down slightly from the previous quarter and up slightly from the fourth quarter of 2010. Total shipments for the fourth quarter of 2011 were 974 million board feet, in line with the previous quarter, and up 10% from the fourth quarter of 2010.

The average North American Random Lengths Western SPF 2x4 #2&Btr lumber price was down US$8 per Mfbm from the previous quarter at US$238 per Mfbm. Larger reductions were seen for other grades, including MSR (machine stress rated) product, and some wider dimensions. Prices for #3 and Economy SPF grades in particular saw significant price erosion, with the Random Length 2x4 #3 price falling almost 25%, in part attributable to the lower demand from China. Prices for SYP products fared slightly better, with the benchmark SYP 2x4 price of US$260 per Mfbm in line with the previous quarter, while certain wider dimensions saw modest price increases.

Compared to the fourth quarter of 2010, the benchmark Random Lengths Western SPF 2x4 #2&Btr price was down US$31 per Mfbm, or 12%. Certain other SPF products saw higher price decreases, with 2x10 product down 19% and 2x4 #3 down 29%, though declines were more modest for studs and MSR (machine stress rated) products. SYP price movements were less pronounced, with the benchmark 2x4 price up US$4 per Mfbm compared to the fourth quarter of 2010, while certain wider dimensions saw modest decreases.

[9] U.S. Census Bureau
[10] CMHC – Canada Mortgage and Housing Corporation

The average value of the Canadian dollar compared to the US dollar in the fourth quarter was down more than 4 cents, or 4%, from the previous quarter, and down 1 cent, or 1%, compared to the fourth quarter of 2010, partly offsetting the effects of weaker US dollar prices.

The Random Lengths Framing Lumber Composite price averaged US$261 per Mfbm for the fourth quarter of 2011, down US$5, or 2%, compared to the previous quarter, and still well below the trigger price of US$315 that is required to reduce the export tax rate on all U.S. bound shipments below the current rate of 15%.

Total residual fibre revenue was up compared to both the previous quarter and the fourth quarter of 2010, with higher volumes of sawmill residual chips sold offsetting lower prices resulting from lower NBSK market pulp prices.

Operations

Lumber production was down 7% from the previous quarter, at 867 million board feet, with the reduction principally reflecting Christmas shutdowns taken at the Company's operations, offset in part by increased production at the Vavenby sawmill, which continued to ramp up after its restart in September, and other recently upgraded mills. Lumber production was up 7% compared to the fourth quarter of 2010, for the most part resulting from solid productivity improvements and the Vavenby restart, offset in part by the closure of the Clear Lake sawmill in early 2011.

Overall, the Company's unit lumber manufacturing costs were up modestly from the previous quarter, reflecting higher unit conversion and log costs for Western SPF mills. The increase in unit cash conversion costs largely reflected the impact of the Christmas shutdowns and seasonally higher energy consumption. The Vavenby sawmill ramp up also contributed to the higher costs, but this impact was partly offset by increased productivity at other recently upgraded facilities. The increase in unit log costs at Western SPF operations resulted largely from higher hauling costs, reflecting increased trucking rates stemming from tight trucker availability, and higher diesel costs, as well as the adverse impact of the milder than expected weather conditions on log volumes harvested in the current period.

Compared to the fourth quarter of 2010, unit manufacturing costs showed a small increase, with lower unit conversion costs being more than offset by increases in unit log costs at Western SPF operations. The lower unit conversion costs reflected the impact of productivity improvements in the current quarter as well as the closure of the higher cost Clear Lake sawmill operation. The higher unit log costs were principally due to higher diesel and hauling costs and challenges presented by milder weather in the current period.

Total restructuring, mill closure and severance costs for the lumber segment were $10.9 million in the current quarter, largely due to an $11.9 million provision for the announced closure of manufacturing operations at the Rustad sawmill. Restructuring costs in the third quarter of 2011 were $4.9 million, which included costs incurred prior to the restart of the Vavenby sawmill, and were $1.9 million in the fourth quarter of 2010, reflecting ongoing costs for mills idled at that time.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[11]

(millions of dollars unless otherwise noted)	Q4 2011	Q3 2011	Year 2011	Q4 2010	Year 2010
Sales	**$ 237.0**	$ 260.5	**$ 1,057.5**	$ 300.8	$ 1,119.6
Operating income	**$ 17.5**	$ 37.3	**$ 150.1**	$ 50.0	$ 192.7
EBITDA	**$ 39.2**	$ 51.5	**$ 218.1**	$ 66.4	$ 260.0
Average pulp price delivered to U.S. – US$[12]	**$ 920**	$ 993	**$ 977**	$ 967	$ 960
Average price in Cdn$	**$ 942**	$ 974	**$ 966**	$ 980	$ 989
Production – pulp (000 mt)	**294.5**	273.9	**1,200.0**	320.6	1,229.0
Production – paper (000 mt)	**33.5**	36.7	**136.5**	34.7	136.7
Shipments – Canfor-produced pulp (000 mt)	**275.4**	291.2	**1,188.7**	331.1	1,225.0
Pulp marketed on behalf of HSLP (000 mt)[13]	**-**	-	**-**	-	271.9
Shipments – paper (000 mt)	**30.2**	32.1	**127.6**	39.0	144.7

[11] Includes the Taylor pulp mill and 100% of Canfor Pulp Limited Partnership ("CPLP"), 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").
[12] Per tonne, NBSK pulp list price delivered to U.S. (Resource Information Systems, Inc.).
[13] Howe Sound Pulp and Paper Limited Partnership pulp mill.

Overview

Operating income for the pulp and paper segment was $17.5 million for the fourth quarter of 2011, down $19.8 million from the previous quarter and down $32.5 million from the fourth quarter of 2010. For the 2011 year, operating income was $150.1 million, down $42.6 million from $192.7 million in 2010.

EBITDA for the pulp and paper segment for the fourth quarter of 2011 was $39.2 million, down $12.3 million from the prior quarter and down $27.2 million from the fourth quarter of 2010. For the year ended December 31, 2011 EBITDA was $218.1 million, down $41.9 million from 2010.

US dollar pulp prices saw significant declines in the fourth quarter, reflecting softening global demand, though this was offset in part by the 4% weaker average Canadian dollar. Compared to the previous quarter, pulp production was up 8%, mostly due to longer downtime in the prior period for the Northwood upgrade, with the increased production contributing to a reduction in unit cash manufacturing costs. In addition, results for the pulp and paper segment include accelerated amortization related to assets replaced during Canfor Pulp's Northwood upgrade.

The lower earnings compared to the fourth quarter of 2010 were primarily attributable to lower market NBSK pulp prices, as well as lower shipment levels. Unit manufacturing costs were flat compared to the fourth quarter of 2010, as a small increase in unit conversion costs relating to lower production volumes, mostly reflecting downtime related to the Northwood upgrade, was offset by lower fibre costs, reflecting a drop in the cost of sawmill residual chips (linked to the NBSK market pulp price). In addition, results were negatively impacted in the current quarter by the previously mentioned accelerated amortization.

Markets

Global softwood pulp markets remained weak in the fourth quarter of 2011. Producer inventory levels increased through the period resulting in successive price decreases. According to the latest published World 20[14] report, global bleached softwood pulp shipments for December were unchanged compared to the same period in 2010.

PPPC[15] statistics reported increased global demand for printing and writing papers and tissue of 1% for 2011 compared to 2010. PPPC reported an increase in shipments of bleached softwood sulphate pulp of 3% for 2011 compared to 2010 with increased shipments to Asia offset by reduction in Europe and North America.

At the end of December 2011, World 20 producers of bleached softwood pulp inventories were at 36 days of supply. By comparison December 2010 inventories were at 25 days of supply and September 2011 was at 32 days of supply. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

Sales

Shipments of Canfor-produced pulp in the fourth quarter of 2011 were 275,000 tonnes, down 16,000 tonnes, or 5%, from the previous quarter, and down 56,000 tonnes, or 17%, from the fourth quarter of 2010, reflecting softening global demand.

During the quarter, downward pressure on NBSK pulp list prices due to rising producer inventories resulted in lower average NBSK pulp list prices, with prices to the U.S. down US$73 to US$920 per tonne, and prices to Europe down US$112 to US$868 per tonne. CPLP's list price to China fell US$120 per tonne from the prior quarter to US$730 per tonne. The price reductions were partially offset by the weaker Canadian dollar. BCTMP sales realizations fared better than for NBSK pulp products, seeing a moderate increase compared to the previous quarter, partly reflecting the positive impact of the weaker Canadian dollar.

The NBSK pulp list prices in the fourth quarter of 2011 were also well down from the fourth quarter of 2010, with prices to the U.S. down US$47 per tonne and prices to Europe down almost US$90 per tonne. CPLP's China list price was also down significantly, dropping just over US$100 per tonne from the comparative period. The slightly weaker Canadian dollar went a small way to offsetting some of these pricing losses. BCTMP sales realizations showed a modest improvement, reflecting higher market prices for this product, as well as the weaker Canadian dollar.

[14] 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.

[15] Pulp and Paper Products Council ("PPPC").

Operations

Pulp production in the fourth quarter of 2011 was 295,000 tonnes, up 21,000 tonnes, or 8%, from the previous quarter reflecting less downtime for the Northwood upgrade in the current quarter, with the mill restarting early in the fourth quarter. Compared to the fourth quarter of 2010, production was down 26,000 tonnes, mostly reflecting the downtime for the Northwood upgrade early in the period.

Pulp unit cash manufacturing costs were down slightly compared to the previous quarter, reflecting the higher production levels in the current quarter, as well as lower maintenance and operating costs. Unit fibre costs were in line with the prior period. In addition, results in the current quarter were negatively impacted by accelerated amortization related to assets replaced during the Northwood upgrade.

Compared to the fourth quarter of 2010, unit cash manufacturing costs were substantially unchanged, with an increase in conversion costs, reflecting lower production levels and higher chemical costs, offset by a reduction in unit fibre costs. The decrease in fibre costs reflected in part lower prices for sawmill residual chips. Higher overall costs in the current quarter also reflected the increased amortization, while the comparative quarter included higher short-term incentive compensation costs and expenses relating to the conversion of Canfor Pulp Income Fund to a public corporation (Canfor Pulp Products Inc.) on January 1, 2011.

Unallocated and Other Items

(millions of dollars)	Q4 2011	Q3 2011	Year 2011	Q4 2010	Year 2010
Operating loss of Panels operations[16]	**$ (19.0)**	$ (4.9)	**$ (33.8)**	$ (2.8)	$ (7.9)
Corporate costs	**$ (6.9)**	$ (6.2)	**$ (27.2)**	$ (6.2)	$ (22.0)
Finance expense, net	**$ (4.3)**	$ (7.0)	**$ (22.5)**	$ (4.6)	$ (26.8)
Foreign exchange gain (loss) on long-term debt and investments, net	**$ 4.9**	$ (16.6)	**$ (5.0)**	$ 9.8	$ 14.7
Gain (loss) on derivative financial instruments	**$ 9.6**	$ (12.1)	**$ 3.5**	$ 1.8	$ 0.1
Other income (expense), net	**$ 1.3**	$ 5.2	**$ 5.9**	$ 11.0	$ 8.1

[16] 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 2010, and its PolarBoard OSB plant, which is currently indefinitely idled.

The panels operations reported an operating loss of $19.0 million for the fourth quarter of 2011, compared to a loss of $4.9 million for the previous quarter. 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. Excluding the impact of these items, and inventory valuation adjustments in the respective periods, the operating loss of panels operations was $5.2 million in the fourth quarter of 2011, which was largely unchanged from the previous quarter. In the fourth quarter of 2010, the panels operating loss of $2.8 million included a gain on sale of non-core assets and other positive one-time adjustments. Excluding these items, and inventory valuation adjustments, the operating loss was $4.7 million.

Excluding the above one-time items, the slight improvement in operating results from the previous quarter reflected a small increase in OSB market prices, which were up US$6 per thousand square foot ("msf") to US$190 per msf[17]. Compared to the fourth quarter of 2010, the decline in results reflected weaker market conditions and pricing for OSB products.

Corporate costs were $6.9 million for the fourth quarter of 2011, up $0.7 million from the previous quarter and fourth quarter of 2010. The current quarter expense reflected further restructuring costs and costs relating to the pending acquisition of two sawmills and timber tenure from Tembec which was announced in the quarter.

Net finance expense for the fourth quarter of 2011 was $4.3 million, down $2.7 million from the previous quarter, with the prior period including costs relating to the extension of the Company's main operating line of credit. Compared to the fourth quarter of 2010, finance expense was down $0.3 million, with lower interest costs on long term debt being partially offset by a positive accretion expense adjustment related to the Company's reforestation obligation in the comparative quarter.

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

The Company recorded a foreign exchange translation gain on its US dollar denominated debt, net of investments, of $4.9 million for the fourth quarter of 2011, as a result of the strengthening of the Canadian dollar against the US dollar, which rose 2% between the respective quarter ends. In the third quarter of 2011, the Company recorded a translation loss of $16.6 million, which reflected a 7% weakening of the Canadian dollar over the period, while the fourth quarter of 2010 showed a $9.8 million gain, due to the Canadian dollar rising 4%.

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs and lumber prices. During the third and fourth quarters of 2011, the Company entered into various additional financial instrument contracts, including significant new foreign exchange collars. As at December 31, 2011, these collars had a total notional amount of $257 million and weighted average protection and topside rates of $0.97 and $1.08 per US dollar, respectively. The contracts cover a period from January to December, 2012.

For the fourth quarter of 2011, the Company recorded a net gain of $9.6 million related to its derivative financial instruments, principally reflecting unrealized gains attributable to the stronger Canadian dollar during the quarter. The following table summarizes the gains (losses) on derivative financial instruments for the comparable periods:

(millions of dollars)	Q4 2011	Q3 2011	Year 2011	Q4 2010	Year 2010
Foreign exchange collars and forward contracts	**$ 9.3**	$ (14.9)	**$ (2.7)**	$ 3.3	$ 4.0
Natural gas swaps	**$ -**	$ -	**$ (0.2)**	$ -	$ (5.2)
Diesel collars and swaps	**$ 0.9**	$ (0.9)	**$ 0.8**	$ 0.6	$ 0.8
Lumber futures	**$ (0.6)**	$ 3.7	**$ 5.6**	$ (2.1)	$ 0.5
	$ 9.6	$ (12.1)	**$ 3.5**	$ 1.8	$ 0.1

Other income, net of $1.3 million for the fourth quarter of 2011 includes a $2.2 million positive fair value adjustment related to a royalty agreement associated with the sale of the operating assets of Howe Sound Pulp and Paper Limited Partnership ("HSPP"), which occurred in late 2010. This gain was mostly offset by unfavourable foreign exchange movements on US dollar denominated cash, receivables and payables of Canadian operations of $2.1 million, compared to a gain in the previous quarter of $7.2 million and a loss of $3.7 million in the fourth quarter of 2010.

In addition, in the fourth quarter of 2011, there was also a $0.5 million gain relating to the change in fair value of the Company's investment in asset-backed commercial paper ("ABCP"). This compares to an ABCP-related expense of $2.0 million in the previous quarter and a $6.3 million gain in the fourth quarter of 2010. In addition, a gain of $5.5 million was recorded in the fourth quarter of 2010 relating to the HSPP asset sale.

Other Comprehensive Income (Loss)

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

(millions of dollars)	Q4 2011	Q3 2011	Year 2011	Q4 2010	Year 2010
Foreign exchange translation differences for foreign operations	**$ (4.3)**	$ 14.6	**$ 4.4**	$ (5.3)	$ (10.3)
Defined benefit actuarial gain (loss), net of tax	**$ 10.7**	$ (56.6)	**$ (50.3)**	$ 25.8	$ (48.0)
Other comprehensive income (loss), net of tax	**$ 6.4**	$ (42.0)	**$ (45.9)**	$ 20.5	$ (58.3)

In the fourth quarter of 2011, the Company recorded an after-tax credit to other comprehensive income of $10.7 million in relation to changes in the valuation of its defined benefit post-employment compensation plans. The credit reflects a gain on plan assets that is higher than the expected gain for the quarter, offset in part by losses on non-pension retirement benefit plan liabilities due to a reduction in the discount rate and changes to other assumptions. In the previous quarter an after-tax charge of $56.6 million was recorded reflecting an actual loss on the plan assets, compared to an expected gain, as well as reductions in the discount rates used to value the accrued benefit obligations. An after-tax gain of $25.8 million in the fourth quarter of 2010 primarily reflected an increase in the discount rate used at the end of the period compared to the end of the previous quarter, as well as higher-than-expected returns on assets.

In addition, the Company recorded a charge of $4.3 million to other comprehensive income in the fourth quarter for foreign exchange differences for foreign operations, reflecting the 2% strengthening of the Canadian dollar over the quarter. This compared to a $14.6 million credit in the previous quarter due to a 7% weakening of the Canadian dollar over that period, and a $5.3 million charge in the fourth quarter of 2010, when the Canadian dollar strengthened.

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)	Q4 2011	Q3 2011	Year 2011	Q4 2010	Year 2010
Increase (decrease) in cash and cash equivalents	**$ (72.4)**	$ (28.7)	**$ (231.4)**	$ 37.2	$ 126.9
Operating activities	**$ 38.0**	$ 60.9	**$ 163.0**	$ 100.3	$ 381.6
Financing activities	**$ (17.6)**	$ (18.7)	**$ (191.4)**	$ (37.1)	$ (139.3)
Investing activities	**$ (92.8)**	$ (70.9)	**$ (202.7)**	$ (25.5)	$ (114.3)
Ratio of current assets to current liabilities			**1.5 : 1**		2.0 : 1
Net debt to capitalization			**13.4%**		3.8%
ROCE – Consolidated[18]	**(3.2)%**	(1.3)%	**(3.3)%**	2.8%	7.2%
ROCE - Canfor solid wood business[19]	**(5.5)%**	(3.0)%	**(10.1)%**	1.3%	1.7%

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

Changes in Financial Position

Cash generated from operating activities was $38.0 million for the fourth quarter of 2011, compared to cash generated of $60.9 million in the previous quarter. Cash earnings were lower in the current quarter, but this was offset in part by more favourable working capital movements, with a significant reduction in accounts receivable more than offsetting lower accounts payable and higher inventories. Compared to the fourth quarter of 2010, cash earnings were lower, while working capital movements in the comparative period benefited from cash received in relation to the sale of the operating assets of Howe Sound Pulp and Paper Limited Partnership. Partially offsetting this were lower cash payments made in relation to the salary pension plan in the current quarter.

Financing activities used cash of $17.6 million in the current quarter, compared to $18.7 million used in the previous quarter and $37.1 million used in the fourth quarter of 2010. The current quarter's cash flows included reduced cash distributions to non-controlling interests of $11.4 million (Q3 2011: $15.7 million; Q4 2010 $28.2 million). Finance expenses paid in the current quarter were $6.2 million, up from $3.1 million in the third quarter, reflecting timing of interest payments, and down $1.7 million from $7.9 million in the fourth quarter of 2010.

Investing activities used cash of $92.8 million in the fourth quarter of 2011, compared to $70.9 million in the third quarter and $25.5 million in the fourth quarter of 2010. Cash used for capital additions in the current quarter was $116.2 million, up significantly from both comparable periods. Capital additions of $49.3 million for lumber operations in the current quarter included a biomass energy generation facility in Grande Prairie, a planer upgrade at the Prince George sawmill, planer and logyard upgrades at Grande Prairie and the completion of new biomass-fueled energy systems at Chetwynd and Plateau.

Capital expenditures for the pulp and paper segment for the fourth quarter of 2011 were $66.9 million, with $25.2 million received under the Green Transformation Program (the "Program"). As of December 31, 2011, CPLP had incurred its full Program allocation of $122.2 million. At December 31, 2011 the Partnership had received reimbursements totaling $102.5 million, with the balance of $19.7 million receivable as at that date.

Liquidity and Financial Requirements

At December 31, 2011, the Company on a consolidated basis had cash and cash equivalents of $28.9 million and $443.3 million of bank operating lines of credit, which were undrawn, with $28.1 million reserved for several standby letters of credit. The Company and CPLP remained in compliance with the covenants relating to their operating lines of credit and long-term debt during the quarter, and expect to remain so for the foreseeable future.

The Company's consolidated net debt to total capitalization at the end of the fourth quarter of 2011 was 13.4%. For Canfor, excluding Canfor Pulp, net debt to capitalization at the end of 2011 was 7.8%.

Scheduled debt repayments in 2011 included US$32.3 million, which was paid on March 1, and US$50.0 million, paid on April 1. On February 2, 2012, the Company repaid $49.9 million (US$50 million) of 6.33% interest rate privately placed senior notes. No further debt repayments are scheduled in 2012.

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. claims that the province of British Columbia ("BC") has not properly applied the timber pricing system grandparented in the SLA. The U.S. also claims that subsequent to 2006, BC made additional changes to the timber pricing system which had the effect of reducing timber prices. The claim focuses on substantial increases in Grade 4 (non sawlog or low grade) volumes commencing in 2007. It is 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 is preparing a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. In August 2011, the U.S. filed a detailed statement of claim with the arbitration panel, which Canada responded to in November 2011. The U.S. subsequently filed a reply, to which Canada filed a response in early February 2012. A hearing before the arbitration panel is currently expected before the end of the first quarter of 2012. It is not possible at this time to predict the outcome or the value of any final claim, and accordingly no provision has been recorded by the Company.

Acquisition of Tembec Assets

In November 2011, the Company signed an agreement to acquire Tembec Industries Ltd.'s southern British Columbia Interior wood products assets, for a purchase price including normal working capital of $60 million. The purchase will include Tembec's Elko and Canal Flats sawmills, approximately 1.1 million cubic metres of combined Crown, private land and contract allowable cut, and a long-term agreement to provide residual fibre supply for Tembec's Skookumchuck pulp mill. The transaction is subject to various customary closing conditions including regulatory approval and is currently scheduled to close at the end of the first quarter of 2012.

OUTLOOK

Lumber

The North American lumber market is forecast to improve modestly as the U.S. economy continues on its slow road to recovery. The residential construction market is projected to trend higher with historically low mortgage rates and improved job markets contributing to record levels of housing affordability and attracting potential homebuyers into the market. The repair and remodeling segment is also projected to show a modest pick up following the recent improvement in housing activity. The Canadian housing market is projected to remain steady.

Strong offshore demand is anticipated to continue into 2012. Shipments to China have picked up in early 2012 after slowing in advance of the Lunar New Year, although prices for lower grade lumber are forecast to remain at low levels through the first quarter. Demand from Japan is forecast to remain stable through early 2012.

Pulp and Paper

The global softwood pulp market is forecast to remain soft through the first quarter of 2012. There is ample supply as historically there is minimal scheduled maintenance downtime at pulp mills during the winter months. However, current pricing at or below cash costs for some NBSK producers may reduce the risk of further price erosion. Global softwood pulp demand is projected to remain flat in 2012 on slowed growth from China and declining production of graphic papers in mature markets. European demand may be somewhat influenced by the ability of Europe to manage through the current debt crisis in certain countries.

Canfor Corporation
Condensed Consolidated Balance Sheets

(millions of dollars, unaudited)	**As at December 31, 2011**	As at December 31, 2010
ASSETS		
Current assets		
Cash and cash equivalents	**$ 28.9**	$ 260.3
Accounts receivable - Trade	**105.1**	146.9
- Other	**65.7**	54.2
Inventories (Note 2)	**348.3**	325.8
Prepaid expenses	**20.4**	28.1
Total current assets	**568.4**	815.3
Property, plant and equipment	**1,139.2**	1,049.1
Timber licenses	**530.1**	546.7
Goodwill and other intangible assets	**83.0**	84.5
Long-term investments and other (Note 3)	**62.8**	89.1
Deferred income taxes, net	**18.1**	9.4
Total assets	**$ 2,401.6**	$ 2,594.1
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	**$ 290.5**	$ 292.9
Current portion of long-term debt (Note 4(b))	**50.9**	82.5
Current portion of deferred reforestation obligations	**31.6**	31.6
Total current liabilities	**373.0**	407.0
Long-term debt (Note 4(b))	**188.1**	235.6
Retirement benefit obligations	**298.3**	272.2
Deferred reforestation obligations	**65.0**	60.6
Other long-term liabilities	**13.8**	17.5
Deferred income taxes, net	**103.3**	131.2
Total liabilities	**$ 1,041.5**	$ 1,124.1
EQUITY		
Share capital	**$ 1,125.9**	$ 1,125.4
Contributed surplus	**31.9**	31.9
Retained earnings	**(24.6)**	73.5
Accumulated foreign exchange translation differences	**(5.9)**	(10.3)
Total equity attributable to equity holders of the Company	**1,127.3**	1,220.5
Non-controlling interests	**232.8**	249.5
Total equity	**$ 1,360.1**	$ 1,470.0
Total liabilities and equity	**$ 2,401.6**	$ 2,594.1

Commitment and Contingency (Note 11)

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 dollars, unaudited)	3 months ended December 31, **2011**	2010	12 months ended December 31, **2011**	2010
Sales	**$ 576.2**	$ 629.1	**$ 2,421.4**	$ 2,430.4
Costs and expenses				
Manufacturing and product costs	**421.5**	407.4	**1,629.8**	1,514.3
Freight and other distribution costs	**113.6**	113.7	**467.9**	428.0
Export taxes	**9.6**	10.3	**39.9**	40.0
Amortization	**47.6**	41.8	**169.3**	167.7
Selling and administration costs	**15.9**	13.2	**58.6**	61.3
Asset impairments	**9.2**	-	**9.2**	-
Restructuring, mill closure and severance costs	**22.8**	1.0	**38.3**	32.4
	640.2	587.4	**2,413.0**	2,243.7
Operating income (loss)	**(64.0)**	41.7	**8.4**	186.7
Finance expense, net	**(4.3)**	(4.6)	**(22.5)**	(26.8)
Foreign exchange gain (loss) on long-term debt and investments, net	**4.9**	9.8	**(5.0)**	14.7
Gain (loss) on derivative financial instruments (Note 6)	**9.6**	1.8	**3.5**	0.1
Other income, net	**1.3**	11.0	**5.9**	8.1
Net income (loss) before income taxes	**(52.5)**	59.7	**(9.7)**	182.8
Income tax recovery (expense) (Note 7)	**14.4**	(2.8)	**20.5**	(9.5)
Net income (loss)	**$ (38.1)**	$ 56.9	**$ 10.8**	$ 173.3
Net income (loss) attributable to:				
Equity shareholders of the Company	**$ (44.1)**	$ 32.9	**$ (56.6)**	$ 81.4
Non-controlling interests	**6.0**	24.0	**67.4**	91.9
Net income (loss)	**$ (38.1)**	$ 56.9	**$ 10.8**	$ 173.3
Net income (loss) per common share: (in dollars)				
Attributable to equity shareholders of the Company				
- Basic and diluted (Note 8)	**$ (0.31)**	$ 0.23	**$ (0.40)**	$ 0.57

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 dollars, unaudited)	3 months ended December 31, 2011	3 months ended December 31, 2010	12 months ended December 31, 2011	12 months ended December 31, 2010
Net income (loss)	**$ (38.1)**	$ 56.9	**$ 10.8**	$ 173.3
Other comprehensive income (loss)				
Foreign exchange translation differences for foreign operations	**(4.3)**	(5.3)	**4.4**	(10.3)
Defined benefit plan actuarial gains (losses) (Note 5)	**14.9**	33.5	**(64.5)**	(61.6)
Income tax recovery (expense) on defined benefit plan actuarial gains (losses) (Note 7)	**(4.2)**	(7.7)	**14.2**	13.6
Other comprehensive income (loss), net of tax	**6.4**	20.5	**(45.9)**	(58.3)
Total comprehensive income (loss)	**$ (31.7)**	$ 77.4	**$ (35.1)**	$ 115.0
Total comprehensive income (loss) attributable to:				
Equity shareholders of the Company	**$ (35.2)**	$ 50.8	**$ (93.7)**	$ 30.1
Non-controlling interests	**3.5**	26.6	**58.6**	84.9
Total comprehensive income (loss)	**$ (31.7)**	$ 77.4	**$ (35.1)**	$ 115.0

Condensed Consolidated Statements of Changes in Equity

(millions of dollars, unaudited)	3 months ended December 31, 2011	3 months ended December 31, 2010	12 months ended December 31, 2011	12 months ended December 31, 2010
Share capital				
Balance at beginning of period	**$ 1,125.7**	$ 1,125.0	**$ 1,125.4**	$ 1,124.7
Common shares issued on exercise of stock options	**0.2**	0.4	**0.5**	0.7
Balance at end of period	**$ 1,125.9**	$ 1,125.4	**$ 1,125.9**	$ 1,125.4
Contributed surplus				
Balance at beginning and end of period	**$ 31.9**	$ 31.9	**$ 31.9**	$ 31.9
Retained earnings				
Balance at beginning of period	**$ 6.3**	$ 17.4	**$ 73.5**	$ 33.1
Net income (loss) attributable to equity shareholders of Company	**(44.1)**	32.9	**(56.6)**	81.4
Defined benefit plan actuarial gains (losses), net of tax	**13.2**	23.2	**(41.5)**	(41.0)
Balance at end of period	**$ (24.6)**	$ 73.5	**$ (24.6)**	$ 73.5
Accumulated foreign exchange translation differences				
Balance at beginning of period	**$ (1.6)**	$ (5.0)	**$ (10.3)**	$ -
Foreign exchange translation differences for foreign operations	**(4.3)**	(5.3)	**4.4**	(10.3)
Balance at end of period	**$ (5.9)**	$ (10.3)	**$ (5.9)**	$ (10.3)
Total equity attributable to equity holders of Company	**$ 1,127.3**	$ 1,220.5	**$ 1,127.3**	$ 1,220.5
Non-controlling interests				
Balance at beginning of period	**$ 241.0**	$ 261.7	**$ 249.5**	$ 259.3
Net income attributable to non-controlling interests	**6.0**	24.0	**67.4**	91.9
Defined benefit plan actuarial gains (losses) attributable to non-controlling interests	**(2.5)**	2.6	**(8.8)**	(7.0)
Distributions to non-controlling interests	**(11.7)**	(38.8)	**(75.3)**	(94.7)
Balance at end of period	**$ 232.8**	$ 249.5	**$ 232.8**	$ 249.5
Total equity	**$ 1,360.1**	$ 1,470.0	**$ 1,360.1**	$ 1,470.0

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

Canfor Corporation
Condensed Consolidated Statements of Cash Flows

(millions of dollars, unaudited)	3 months ended December 31, 2011	3 months ended December 31, 2010	12 months ended December 31, 2011	12 months ended December 31, 2010
Cash generated from (used in):				
Operating activities				
Net income (loss)	**$ (38.1)**	$ 56.9	**$ 10.8**	$ 173.3
Items not affecting cash:				
Amortization	**47.6**	41.8	**169.3**	167.7
Income tax (recovery) expense	**(14.4)**	2.8	**(20.5)**	9.5
Long-term portion of deferred reforestation obligation	**6.3**	0.3	**3.1**	(6.7)
Change in fair value of long-term investment	**(0.5)**	(6.3)	**(0.2)**	(6.3)
Foreign exchange (gain) loss on long-term debt and investments, net	**(4.9)**	(9.8)	**5.0**	(14.7)
Changes in mark-to-market value of derivative financial instruments	**(11.1)**	(4.3)	**(3.9)**	(1.7)
Employee future benefits	**(3.9)**	1.7	**(1.9)**	6.4
Net finance expense	**4.3**	4.6	**22.5**	26.8
Asset impairments	**9.2**	-	**9.2**	-
Mill closure provisions	**22.5**	-	**22.5**	17.3
Other, net	**(1.3)**	(10.8)	**(9.7)**	(10.4)
Salary pension plan contributions	**(8.1)**	(24.7)	**(37.3)**	(29.9)
Income taxes recovered (paid), net	**-**	0.3	**(0.3)**	45.9
Net change in non-cash working capital (Note 9)	**30.4**	47.8	**(5.6)**	4.4
	38.0	100.3	**163.0**	381.6
Financing activities				
Repayment of long-term debt (Note 4(b))	**-**	(1.4)	**(81.9)**	(35.1)
Finance expenses paid	**(6.2)**	(7.9)	**(18.9)**	(25.1)
Cash distributions paid to non-controlling interests	**(11.4)**	(28.2)	**(91.0)**	(79.0)
Other, net	**-**	0.4	**0.4**	(0.1)
	(17.6)	(37.1)	**(191.4)**	(139.3)
Investing activities				
Additions to property, plant and equipment	**(116.2)**	(47.3)	**(312.3)**	(142.2)
Reimbursements from Government under Green Transformation Program	**25.2**	19.1	**75.6**	20.2
Proceeds from redemption of asset-backed commercial paper (Note 3)	**-**	0.7	**29.8**	4.6
Other, net	**(1.8)**	2.0	**4.2**	3.1
	(92.8)	(25.5)	**(202.7)**	(114.3)
Foreign exchange gain (loss) on cash and cash equivalents of subsidiaries with different functional currency	**-**	(0.5)	**(0.3)**	(1.1)
Increase (decrease) in cash and cash equivalents	**(72.4)**	37.2	**(231.4)**	126.9
Cash and cash equivalents at beginning of period	**101.3**	223.1	**260.3**	133.4
Cash and cash equivalents at end of period	**$ 28.9**	$ 260.3	**$ 28.9**	$ 260.3

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

1. Basis of preparation and transition to International Financial Reporting Standards ("IFRS")

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".

Canfor's transition date to IFRS was January 1, 2010. Various reconciliations between previous Canadian generally accepted accounting principles ("previous GAAP") and IFRS related to the transition and subsequent reporting periods are set out in note 12, together with explanatory notes.

These interim financial statements do not include all of the disclosures required by 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 first quarter 2011 interim financial statements and notes, with further relevant information also in the Company's Annual Report for the year ended December 31, 2010, prepared in accordance with previous GAAP, 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.

Accounting standards issued and not applied

Unless otherwise noted, the following new or revised standards and amendments as adopted by the International Accounting Standards Board ("IASB") are effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. Canfor has completed an initial review of the potential impact of these new standards on the Company, and is currently considering whether or not to adopt any of these in advance of the mandatory date.

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,* introduces a new single control model and single consolidation model built on a revised definition of control and criteria for assessment of consolidation. The new Standard 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. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. 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. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interest in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures,* and SIC-13, *Jointly Controlled Entities – Non-monetary Contributions by Venturers.* Canfor is in the process of assessing the full impact of IFRS 11 on amounts recorded in the financial statements.
- IFRS 12, *Disclosure of Interests in Other Entities,* establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The Standard carries forward existing disclosures and also introduces significant 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; the principal impact will be in the form of additional disclosures.
- 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, as well as associates, once the assessment of the arrangement has been made under IFRS 11. The amendments to IAS 27 are not expected to have a material impact on amounts recorded in the financial statements of the Company. Canfor is in the process of assessing the full impact of the amendments to IAS 28, which is dependent upon the assessment of the Company's joint arrangements under IFRS 11.

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. A number of other amendments have been made to recognition, measurement and classification including redefining short-term and other long-term benefits, guidance on the treatment of taxes related to benefit plans, guidance on risk/cost sharing features, and expanded disclosures. Canfor is in the process of assessing the full impact of IAS 19 on amounts recorded in the financial statements and related disclosures.

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 Standard replaces the multiple category and measurement models in IAS 39, *Financial Instruments – Recognition and Measurement*. The new Standard limits the number of categories for classification of financial assets to two: amortized cost and fair value through profit or loss. The requirements for financial liabilities are largely in line with IAS 39. 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. The ability to recognize unquoted equity instruments at cost under IAS 39 is eliminated. IFRS 9 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- IFRS 13, *Fair Value Measurement,* is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard 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. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures. IFRS 13 is not expected to have 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. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately. 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 dollars)		**As at December 31, 2011**		As at December 31, 2010
Logs	**$**	**55.9**	$	53.9
Finished products		**186.3**		169.7
Residual fibre		**17.3**		17.4
Processing materials and supplies		**88.8**		84.8
	$	**348.3**	$	325.8

The above inventory balances are stated after inventory write-downs from cost to net realizable value. Write-downs at December 31, 2011 totaled $15.5 million (December 31, 2010 - $3.2 million).

3. Long-term Investments and Other

(millions of dollars)		**As at December 31, 2011**		As at December 31, 2010
Asset-backed commercial paper ("ABCP")	**$**	**11.8**	$	40.9
Other investments		**24.3**		26.5
Investment tax credits		**8.6**		6.4
Defined benefit plan assets		**3.0**		3.4
Other deposits, loans and advances		**15.1**		11.9
	$	**62.8**	$	89.1

During the fourth quarter of 2011, a pre-tax gain of $0.5 million was recorded to "Other income, net" due to an increase in the fair value of the ABCP assets. In addition, during the first half of 2011, net proceeds of $29.8 million were received from the redemption/sale of certain ABCP assets. The remaining movement in this balance over the period relates to foreign exchange and previous fair value adjustments.

4. Operating Lines and Long-Term Debt

(a) Available Operating Lines

(millions of dollars)		**As at December 31, 2011**		As at December 31, 2010
Canfor (excluding CPLP)				
Principal operating lines	**$**	**350.0**	$	350.0
Facility A		**12.9**		12.7
Facility B		**-**		29.7
Other		**-**		1.1
Total operating lines - Canfor (excluding CPLP)		**362.9**		393.5
Letters of credit (principally unregistered pension plans)		**(17.2)**		(17.3)
Total available operating lines – Canfor (excluding CPLP)	**$**	**345.7**	$	376.2
CPLP				
Main bank loan facility	**$**	**40.0**	$	40.0
Bridge loan credit facility		**30.0**		-
Facility for BC Hydro letter of credit		**10.4**		13.2
Total operating lines - CPLP		**80.4**		53.2
Letters of credit (for general business purposes)		**(0.5)**		(0.5)
BC Hydro letter of credit		**(10.4)**		(13.2)
Total available operating lines - CPLP	**$**	**69.5**	$	39.5
Consolidated:				
Total operating lines	**$**	**443.3**	$	446.7
Total available operating lines	**$**	**415.2**	$	415.7

For Canfor, excluding CPLP, the principal operating lines 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, and was non-recourse to the Company under normal circumstances, except for an amount of US$6.7 million. The ABCP assets of the Company had been pledged as security to support this credit facility which had similar terms to the other operating lines, except that the interest rate was plus or minus a margin.

The terms of CPLP's principal bank 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. The maturity date of this facility is November 30, 2013.

CPLP also has a $30.0 million bridge loan credit facility with a maturity date of December 31, 2012 to fund timing differences between expenditures and reimbursements for projects funded under the Canadian Federal Government Green Transformation Program. The bridge facility terms are similar to CPLP's main facility, with interest and other costs at prevailing market rates. CPLP also has a separate facility with a maturity date of November 30, 2013 to cover a $10.4 million standby letter of credit issued to BC Hydro.

As at December 31, 2011, the Company and CPLP were in compliance with all covenants relating to their operating lines of credit and no amounts were drawn on the Company's or CPLP's available operating lines.

All borrowings of CPLP (operating lines and long-term debt) are non-recourse to other entities within the Company.

(b) Long-Term Debt

In the first half of 2011, the Company repaid $31.5 million (US$32.3 million) of 8.03% interest rate privately placed senior notes and $48.1 million (US$50.0 million) of 6.18% interest rate privately placed senior notes, as well as $2.3 million of other long-term debt obligations.

At December 31, 2011, the fair value of the Company's long-term debt, which was measured at its amortized cost of $239.0 million, was $246.6 million. The fair value of long-term debt was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

On February 2, 2012, the Company repaid $49.9 million (US$50.0 million) of 6.33% interest rate privately placed senior notes.

5. 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 three months ended December 31, 2011, $14.9 million (before tax) was credited to other comprehensive income. The credit reflects a gain on plan assets that was higher than the expected gain, offset in part by losses on non-pension retirement benefit plan liabilities due to a reduction in the discount rate and changes to other assumptions. 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, 2010, a pre-tax amount of $33.5 million was credited to other comprehensive income, primarily reflecting an increase in the discount rate used at the end of the period compared to the end of the previous quarter, as well as gains on assets which were higher than the expected gain. For the twelve months ended December 31, 2010, the pre-tax charge was $61.6 million.

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

Pension Benefit Plans	
Discount rate	
December 31, 2011	**5.00%**
September 30, 2011	5.00%
December 31, 2010	5.50%
September 30, 2010	5.25%
January 1, 2010	6.25%
Rate of return on plan assets	
12 months ended December 31, 2011	**2.50%**
9 months ended September 30, 2011	(2.50)%
12 months ended December 31, 2010	11.60%
9 months ended September 30, 2010	5.30%
Other Benefit Plans	
Discount rate	
December 31, 2011	**5.30%**
September 30, 2011	5.40%
December 31, 2010	5.75%
September 30, 2010	5.50%
January 1, 2010	6.75%

6. 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, lumber prices and energy costs. At December 31, 2011, the fair value of derivative financial instruments was a net liability of $0.2 million (December 31, 2010 – net liability of $4.1 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, 2011 and 2010:

(millions of dollars)	3 months ended December 31, **2011**	2010	12 months ended December 31, **2011**	2010
Foreign exchange collars and forward contracts	**$ 9.3**	$ 3.3	**$ (2.7)**	$ 4.0
Natural gas swaps	**-**	-	**(0.2)**	(5.2)
Diesel options and swaps	**0.9**	0.6	**0.8**	0.8
Lumber futures	**(0.6)**	(2.1)	**5.6**	0.5
	$ 9.6	$ 1.8	**$ 3.5**	$ 0.1

The following table summarizes the fair value of the derivative financial instruments included in the balance sheet at December 31, 2011 and December 31, 2010:

(millions of dollars)	**As at December 31, 2011**	As at December 31, 2010
Foreign exchange collars and forward contracts	**$ (0.4)**	$ 1.6
Natural gas swaps	**-**	(4.7)
Diesel options and swaps	**(0.2)**	1.0
Lumber futures	**0.4**	(2.0)
Total asset (liability)	**(0.2)**	(4.1)
Less: current portion	**(0.2)**	(4.1)
Long-term portion	**$ -**	$ -

7. Income Taxes

(millions of dollars)	3 months ended December 31, **2011**	2010	12 months ended December 31, **2011**	2010
Current	**$ (1.4)**	$ 1.6	**$ (1.7)**	$ 2.2
Deferred	**15.8**	(4.4)	**22.2**	(11.7)
Income tax recovery (expense)	**$ 14.4**	$ (2.8)	**$ 20.5**	$ (9.5)

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

(millions of dollars)	3 months ended December 31, **2011**	2010	12 months ended December 31, **2011**	2010
Income tax recovery (expense) at statutory rate 2011 – 26.5% (2010 – 28.5%)	**$ 13.9**	$ (17.0)	**$ 2.6**	$ (52.1)
Add (deduct):				
Non-taxable income related to non-controlling interests in limited partnerships	**1.6**	6.7	**17.9**	26.1
Entities with different income tax rates and other tax adjustments	**(0.1)**	1.0	**1.0**	1.4
Tax recovery (expense) at rates other than statutory rate	**(0.8)**	1.4	**(0.9)**	3.4
Permanent difference from capital gains and losses and other non-deductible items	**(0.2)**	5.1	**(0.1)**	11.7
Income tax recovery (expense)	**$ 14.4**	$ (2.8)	**$ 20.5**	$ (9.5)

In addition to the amounts recorded to net income, a tax expense of $4.2 million was recorded to other comprehensive income for the three month period ended December 31, 2011 (three months ended December 31, 2010 – expense of $7.7 million) in relation to the actuarial gains on defined benefit employee compensation plans. For the twelve months ended December 31, 2011 the related tax recovery was $14.2 million (twelve months ended December 31, 2010 – recovery of $13.6 million).

8. 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.

	3 months ended December 31,		12 months ended December 31,	
	2011	2010	**2011**	2010
Weighted average number of common shares	**142,705,764**	142,636,749	**142,698,624**	142,613,920
Incremental shares from potential exercise of options [a]	**653**	2,405	**4,023**	573
Diluted number of common shares [a]	**142,705,764**	142,639,154	**142,698,624**	142,614,493

[a] 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.

9. Net Change in Non-Cash Working Capital

	3 months ended December 31,		12 months ended December 31,	
(millions of dollars)	**2011**	2010	**2011**	2010
Accounts receivable	**$ 71.1**	$ 34.6	**$ 36.6**	$ (3.7)
Inventories	**(21.8)**	5.8	**(22.6)**	(16.8)
Prepaid expenses	**18.4**	7.5	**6.1**	(7.1)
Accounts payable, accrued liabilities and current portion of deferred reforestation obligations	**(37.3)**	(0.1)	**(25.7)**	32.0
Net decrease (increase) in non-cash working capital	**$ 30.4**	$ 47.8	**$ (5.6)**	$ 4.4

10. Segment Information

Canfor has two reportable segments, as described below, which offer different products and are managed separately because they require different production processes and marketing strategies. The following summary describes the operations of each of the Company's reportable segments:

- *Lumber* - Includes logging operations, and manufacture and sale of various grades, widths and lengths of lumber products.
- *Pulp and paper* – Includes purchase of residual fibre, and production and sale of pulp and paper products, including northern bleached softwood kraft ("NBSK") and bleached chemi-thermo mechanical pulp ("BCTMP"). This segment includes 100% of Canfor Pulp Limited Partnership and the Taylor Pulp mill.

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. Sales for panels operations for the three months ended December 31, 2011 were $13.3 million (three months ended December 31, 2010 - $10.3 million) and $46.8 million for the twelve months ended December 31, 2011 (twelve months ended December 31, 2010 - $55.6 million).

(millions of dollars)		Lumber	Pulp & Paper	Unallocated & Other	Elimination Adjustment		Consolidated
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)	**$**	**(55.6)**	**17.5**	**(25.9)**	**-**	**$**	**(64.0)**
Amortization	**$**	**21.5**	**21.7**	**4.4**	**-**	**$**	**47.6**
Capital expenditures[1]	**$**	**49.3**	**66.9**	**-**	**-**	**$**	**116.2**
3 months ended December 31, 2010							
Sales to external customers	$	318.0	300.8	10.3	-	$	629.1
Sales to other segments	$	28.1	-	-	(28.1)	$	-
Operating income (loss)	$	0.7	50.0	(9.0)	-	$	41.7
Amortization	$	21.0	16.4	4.4	-	$	41.8
Capital expenditures	$	26.8	20.4	0.1	-	$	47.3
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)	**$**	**(80.7)**	**150.1**	**(61.0)**	**-**	**$**	**8.4**
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**
12 months ended December 31, 2010							
Sales to external customers	$	1,255.2	1,119.6	55.6	-	$	2,430.4
Sales to other segments	$	129.8	-	-	(129.8)	$	-
Operating income (loss)	$	23.9	192.7	(29.9)	-	$	186.7
Amortization	$	82.8	67.3	17.6	-	$	167.7
Capital expenditures	$	88.1	53.9	0.2	-	$	142.2
Identifiable assets	$	1,343.4	878.9	371.8	-	$	2,594.1

[1]Capital expenditures represent cash paid for capital assets during the period. Pulp & Paper includes capital expenditures by CPLP that are financed by the government-funded Green Transformation Program.

11. Commitment and Contingency

(a) Acquisition of Tembec assets

In November 2011, the Company signed an agreement to acquire Tembec Industries Ltd.'s ("Tembec") southern British Columbia Interior wood products assets, for a purchase price including normal working capital of $60 million. The purchase will include Tembec's Elko and Canal Flats sawmills, approximately 1.1 million cubic metres of combined Crown, private land and contract allowable cut, and a long-term agreement to provide residual fibre supply for Tembec's Skookumchuck pulp mill. The transaction is subject to various customary closing conditions including regulatory approval and is currently scheduled to close at the end of the first quarter of 2012.

(b) Softwood Lumber Agreement ("SLA")

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. claims that the province of British Columbia ("BC") has not properly applied the timber pricing system grandparented in the SLA. The U.S. also claims that subsequent to 2006, BC made additional changes to the timber pricing system which had the effect of reducing timber prices. The claim focuses on substantial increases in Grade 4 (non sawlog or low grade) volumes commencing in 2007. It is 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 is preparing a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. In August 2011, the U.S. filed a detailed statement of claim with the arbitration panel, which Canada responded to in November 2011. The U.S. subsequently filed a reply, to which Canada filed a response in early February 2012. A hearing before the arbitration panel is currently expected before the end of the first quarter of 2012. It is not possible at this time to predict the outcome or the value of any final claim, and accordingly no provision has been recorded by the Company.

12. Transition to International Financial Reporting Standards ("IFRS")

For 2011, the Company is preparing its financial statements in accordance with IFRS for the first time. In preparing comparative information for 2010, the Company has adjusted amounts previously reported in financial statements prepared in accordance with previous Canadian GAAP ("previous GAAP").

The Company's transition date to IFRS was January 1, 2010 and a provisional opening IFRS balance sheet was prepared as at that date. A full reconciliation of the opening balance sheet to amounts reported under previous GAAP can be found in the Company's condensed consolidated interim financial statements for the first quarter of 2011, along with the balance sheet as at December 31, 2010. Subsequent to the disclosures presented in the first quarter of 2011, the Company adjusted the preliminary opening balance sheet in relation to measurement of provisions using a risk-free rate as discussed below.

Certain of the differences are also summarized in the following sections, which include reconciliations of total comprehensive income from previous GAAP to IFRS for the three month and twelve month periods ending December 31, 2010, and a reconciliation of equity as at December 31, 2010.

The accounting changes resulting from the transition to IFRS do not impact the Company's compliance with any of its financial covenants with respect to its debt obligations.

(i) Reconciliation of comprehensive income for three and twelve month periods ended December 31, 2010

(millions of dollars, unaudited)	Note (section iii)		3 months ended December 31, 2010		12 months ended December 31, 2010
Net income					
Previous GAAP		$	54.9	$	161.3
Lower amortization of property, plant and equipment and timber licenses in period, net of tax	a		1.5		5.2
Lower pension expense for period, net of tax	b		1.0		7.3
Higher accretion expense, net of tax	c		(0.5)		(0.5)
Net income under IFRS		$	**56.9**	$	**173.3**
Other comprehensive income (loss)					
Previous GAAP		$	(5.3)	$	(10.3)
Actuarial gains (losses) on defined benefit plans during the period, net of tax	b		25.8		(48.0)
Other comprehensive income (loss) under IFRS		$	**20.5**	$	**(58.3)**

(ii) Reconciliation of equity at December 31, 2010

(millions of dollars, unaudited)	Note (section iii)		As at December 31, 2010
Previous GAAP – Total equity		$	1,717.1
Recognition of impairment provisions at date of transition	a		(42.6)
Lower amortization of property, plant and equipment and timber licenses for twelve months ended December 31, 2010, net of tax	a		5.2
Recognition of unamortized actuarial losses at date of transition	b		(162.4)
Lower pension expense for twelve months ended December 31, 2010, net of tax	b		7.3
Actuarial gains (losses) on defined benefit plans for twelve months ended December 31, 2010, net of tax	b		(48.0)
Effect of change in discount rate for provisions recognized on transition	c		(6.1)
Higher accretion expense for twelve months ended December 31, 2010, net of tax	c		(0.5)
IFRS – Total equity		$	**1,470.0**

(iii) Explanatory notes for reconciliations

The following explanations are referenced in the reconciliations in sections (i) and (ii) of this note:

(a) Recognition of impairment provisions against property, plant and equipment and timber licenses

There are differences in the methodology used to determine if an asset should be impaired under IFRS compared to that under previous GAAP. The previous GAAP rules provided for a two-step test, with no impairment being required if the undiscounted future expected cash flows relating to an asset exceeded the carrying value of that asset. Under IFRS, the undiscounted cash flows are not considered and an impairment is recorded where the recoverable amount (defined as the higher of 'value in use' and 'fair value less costs to sell') is below the asset's carrying value. As a result, impairments were required for certain assets under IFRS that were not recorded under previous GAAP.

The effect at the date of transition was to decrease the book value of certain sawmill assets included within property, plant and equipment by $9.4 million and timber licenses by $46.6 million. An impairment of $0.8 million was also recorded against capital spares inventory. A corresponding adjustment to deferred income taxes of $14.2 million was also recorded, with the net amount of $42.6 million being charged to opening equity.

These impairments had the impact of reducing the overall amortization expense after-tax by $1.5 million for the three months ended December 31, 2010, and $5.2 million for the twelve months ended December 31, 2010.

(b) Recognition of unamortized actuarial losses at date of transition to IFRS into equity

Under IFRS, the Company's accounting policy is to recognize all actuarial gains and losses, arising on its defined benefit pension and other non-pension post retirement plans, immediately in other comprehensive income. At the date of transition, all previously unrecognized cumulative actuarial gains and losses were recognized in retained earnings.

This resulted in a charge to retained earnings in the opening balance sheet of $148.4 million, and a charge to non-controlling interests of $14.0 million reflecting non-controlling interests in CPLP. Pension assets recorded under previous GAAP of $110.6 million were removed, and liabilities of $101.3 million were recorded to reflect the actual funding position of the defined benefit pension plans. The long-term deferred income tax liability was reduced by $49.5 million as a result of these adjustments.

Under previous GAAP, actuarial gains and losses were deferred and taken through the income statement over a number of years. As Canfor has elected to recognize these immediately through other comprehensive income under IFRS, the defined benefit expense in the income statement is reduced by $1.0 million after-tax for the fourth quarter of 2010 and $7.3 million after-tax for the year to date. The after-tax gain through other comprehensive income was $25.8 million in the fourth quarter of 2010, and an after-tax charge of $48.0 million for the year to date.

(c) Change in discount rate for provisions

Under previous GAAP, long-term provisions were discounted at the credit-adjusted risk-free rate in effect at the date the liability was recorded, whereas under IFRS these are discounted at the risk-free rate in effect at the balance sheet date. This results in a lower discount rate being used to value the Company's deferred reforestation and asset retirement obligations, with increases of $7.1 million and $1.0 million, respectively, to these provisions at January 1, 2010 ($5.3 million and $0.8 million, after tax).

During 2010, the difference in discount rates used resulted in an after-tax expense that was higher by $0.4 million and $0.1 million, respectively, for the deferred reforestation and the asset retirement obligations. In addition, the expense related to the unwinding over time of the discount on the Company's deferred reforestation obligation was reclassified from manufacturing and product costs into finance expense.

At December 31, 2010, the deferred reforestation obligation under previous GAAP of $53.0 million was increased by $7.6 million ($5.7 million after-tax) due to different discount rates being used, and the asset retirement obligation was increased by $1.1 million ($0.9 million after-tax).

These adjustments represent a change from the preliminary January 1, 2010 and December 31, 2010 balance sheets as previously disclosed.

(iv) Explanation of material adjustments to the statement of cash flows

The impact of the transition to IFRS on the statement of cash flows is to reclassify certain items between cash flow categories. One of the main reclassifications relates to interest payments and receipts which were classified as operating activities under previous GAAP, but are shown as financing and investing activities, respectively, under IFRS.

In addition, the reclassification of certain of CPLP's major maintenance costs to property, plant and equipment under IFRS has an impact on the statement of cash flows. Under previous GAAP, these costs were shown under operating activities as deferred maintenance spending, whereas under IFRS they are included in additions to property, plant and equipment under investing activities.