

Q3 2006

FOR

THE THREE MONTHS ENDED SEPTEMBER 30, 2006

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To Our Shareholders

Canfor Corporation reported a net loss of \$51.6 million for the third quarter of 2006, or \$0.36 per share. Net income for the year to date was \$6.5 million, or \$0.05 per share.

Operating income before amortization (EBITDA)¹ was \$3.3 million in the third quarter, compared to EBITDA of \$26.9 million in the previous quarter and EBITDA of \$31.3 million in the same quarter last year. The decline in profitability over the comparable periods was mainly as a result of lower prices for lumber and OSB. US dollar SPF lumber prices averaged 12% lower than in the second quarter and 15% lower than the same period last year, while OSB prices declined by 24% and 38% respectively. The Canadian dollar remained flat over the previous quarter, but appreciated by 7% compared to the third quarter of 2005. These factors were partially offset by stronger pulp prices, which averaged 6% higher than the previous quarter and 21% higher than the same period in 2005, and earnings from the New South operations acquired in March of this year.

The market prices for Canfor's lumber and panel products are extremely low due to the slowdown in new home construction in our core US markets. With the Canadian dollar remaining relatively strong, we are in a very difficult business environment. Despite the challenges of the mountain pine beetle affected wood, we are not satisfied with the overall performance of our operations. Our efforts are being directed to their improvement and to meet the high expectations we have established. With the Softwood Lumber Agreement now in effect, Canfor can serve its customers in the US within a framework of greater certainty. We will continue to develop global markets for our products. Over the coming months, Canfor will receive approximately US \$730 million. Considerations for the use of these funds will be reviewed going forward.

We are pleased with the success of the Canfor Pulp Limited Partnership as it reported strong results again this quarter and continues to add value for Canfor shareholders.



Peter J.G. Bentley
Chairman



James A. Shepherd
President and Chief Executive Officer

¹ EBITDA is a non-GAAP earnings measure, as described on page 2.

Canfor Corporation
Third Quarter 2006 – Report to Shareholders
Management’s Discussion and Analysis

This interim Management’s Discussion and Analysis (MD&A) provides a review of the significant developments that have impacted Canfor’s performance during the third quarter of 2006 relative to the previous quarter and the last published annual results as at December 31, 2005 and relative to the comparative quarter in 2005. This MD&A should be read in conjunction with the interim consolidated financial statements and accompanying notes as well as the annual MD&A and audited consolidated financial statements and notes, which are included in Canfor’s Annual Report for the year ended December 31, 2005 (available at www.canfor.com).

Factors that could impact future operations are also discussed. These factors may be influenced by 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; exchange rates; changes in law and public policy; rulings on countervailing and anti-dumping duties; and opportunities available to or pursued by Canfor.

Throughout this discussion, reference is made to EBITDA (operating income before amortization), which Canfor considers to be an important indicator for identifying trends in the performance of each operating segment and of the Company’s ability to generate funds to meet its debt repayment and capital expenditure requirements. EBITDA is not a generally accepted earnings measure and should not be considered as an alternative to net income or cash flows as determined in accordance with Canadian generally accepted accounting principles (GAAP). As there is no standardized method of calculating EBITDA, Canfor’s use of the term may not be directly comparable with similarly titled measures used by other companies. The final page of this MD&A contains a reconciliation of EBITDA to net income from continuing operations, as reported in accordance with GAAP.

Certain prior year comparative information throughout this report has been restated for consistency with the presentation in the current year.

The information in this report is as at October 27, 2006.

All financial references are in millions of Canadian dollars unless otherwise noted.

SUMMARY OF SELECTED RESULTS

(millions of dollars, except for per share amounts)	Q3 2006	Q2 2006	YTD 2006²	Q3 2005	YTD 2005
Sales ³	\$ 927.7	\$ 1,059.9	\$ 2,950.3	\$ 934.1	\$ 2,933.3
Countervailing & anti-dumping duties expensed	\$ 24.3	\$ 32.1	\$ 86.6	\$ 58.5	\$ 184.9
EBITDA	\$ 3.3	\$ 26.9	\$ 113.5	\$ 31.3	\$ 270.3
Operating income (loss)	\$ (44.8)	\$ (15.3)	\$ (21.6)	\$ (5.8)	\$ 157.1
Foreign exchange gain (loss) on long-term debt	\$ (6.7)	\$ 24.4	\$ 16.7	\$ 30.0	\$ 14.7
Net income (loss) from continuing operations, after tax	\$ (51.6)	\$ 39.2	\$ 8.8	\$ 20.7	\$ 112.4
Net loss from discontinued operations	\$ -	\$ -	\$ (2.3)	\$ (3.3)	\$ (4.1)
Net income (loss)	\$ (51.6)	\$ 39.2	\$ 6.5	\$ 17.4	\$ 108.3
Per share, diluted					
Net income (loss) from continuing operations	\$ (0.36)	\$ 0.28	\$ 0.05	\$ 0.14	\$ 0.78
Net income (loss)	\$ (0.36)	\$ 0.28	\$ 0.05	\$ 0.12	\$ 0.75
Average Canadian/US exchange rate ⁴	\$ 0.892	\$ 0.891	\$ 0.883	\$ 0.832	\$ 0.817

² Includes the results of New South from March 6, 2006.

³ Prior year sales figures in the Lumber segment, as presented in the Quarterly Financial Information in the 2005 Annual Report, have been restated for comparability with the presentation in the current year.

⁴ Source – Bank of Canada (average noon rate for the period)

Operating income declined by \$29.5 million over the previous quarter, and was \$39.0 million lower than in the same quarter in 2005. Although the value of the Canadian dollar against the US dollar was flat compared with the previous quarter, it was 7% stronger than in the third quarter of 2005, which, along with the sharp decline in lumber and OSB prices and lower production volumes, contributed to the declining profitability. The benchmark US dollar SPF lumber price declined by 12% from the second quarter and by 15% from the same time last year and SYP prices also weakened by 20% in the quarter. The decline in US dollar OSB prices was even more significant, falling by 24% from the second quarter and by 38% from the same period last year. These factors were partially offset by the continuing strength of pulp prices, which averaged 6% higher than the previous quarter and 21% higher than the same period last year, and earnings from New South, which was acquired in March of this year.

Completion of Spinout of the Pulp Income Fund

On July 1, 2006, Canfor completed the transfer of its NBSK pulp and paper business⁵ (the Pulp Business) to the Canfor Pulp Limited Partnership (CPLP) in exchange for a \$125 million promissory note, 14.254 million Class A Limited Partnership Units and 57.016 million Class B Exchangeable Limited Partnership Units (the Spinout). Canfor then exchanged its Class A Limited Partnership Units for an equal number of Units of Canfor Pulp Income Fund (CPIF). Upon the completion of the Spinout, the existing Common Shares of Canfor were cancelled and Canfor shareholders were entitled to receive one New Common Share of Canfor and 0.1 of a Unit of CPIF, with the distribution of the Fund Units being structured as a return of capital on the Canfor Shares. As a result, on the date of the Spinout Canfor Shareholders owned all of the issued and outstanding New Common Shares and all of the issued and outstanding Fund Units, with the outstanding Fund Units representing a 20% indirect interest in CPLP. Through its interest in CPLP, which is indirectly exchangeable for Fund Units, Canfor owns the remaining 80% interest in the Pulp Business. CPLP is managed by Canfor Pulp Holdings Inc. (the general partner) on behalf of the limited partners.

Canfor and the CPLP have entered into a long-term fibre supply agreement under which Canfor will continue to provide CPLP with residual wood chips and hog fuel produced at certain of its sawmills at market prices. CPLP also purchases, at cost, a number of administrative, accounting, legal and management services from Canfor under a partnership services agreement, which can be terminated, in whole or in part, on 12 months notice. CPLP continues to provide marketing services to Canfor, acting as a selling representative on behalf of Howe Sound Limited Partnership and Canfor's Taylor Pulp operation.

This transaction furthers Canfor's strategy of focusing on the profitability and growth of the wood products business, while still participating in the improved business fundamentals for the pulp and paper mills.

Acquisition of New South

On March 6, 2006, Canfor completed its acquisition of New South Companies Inc. (New South). Headquartered in South Carolina, New South operates three sawmills with an annual capacity of 425 million board feet of southern yellow pine (SYP), two treating plants, a finger joint plant and an international lumber import business. The transaction was valued at US \$181.6 million (US \$205.0 million, less assumed debt of US \$39.4 million and adjustments for working capital and transaction costs), or Cdn \$206.1 million.

⁵ Comprised of two NBSK pulp mills and one NBSK pulp and paper mill located in Prince George, British Columbia and a marketing group based in Vancouver, British Columbia.

OPERATING RESULTS BY BUSINESS SEGMENT

Lumber ²

(millions of dollars unless otherwise noted)	Q3 2006	Q2 2006	YTD 2006	Q3 2005	YTD 2005
Sales ³	\$ 593.4	\$ 736.1	\$ 1,965.8	\$ 622.6	\$ 2,001.8
EBITDA	\$ (44.7)	\$ 12.3	\$ 14.0	\$ 22.1	\$ 210.9
EBITDA margin	(8)%	2%	1%	4%	11%
Operating income (loss)	\$ (71.5)	\$ (10.3)	\$ (60.0)	\$ 1.2	\$ 144.6
Average SPF 2x4 #2 & Better lumber price in US \$ ⁶	\$ 278	\$ 316	\$ 312	\$ 327	\$ 362
Average SPF price in Cdn \$	\$ 312	\$ 355	\$ 353	\$ 392	\$ 443
Average SYP 2x4 #2 lumber price in US \$ ⁷	\$ 304	\$ 380	\$ 373	\$ 457	\$ 449
Average SYP price in Cdn \$	\$ 341	\$ 426	\$ 422	\$ 549	\$ 550
Production – SPF lumber (MMfbm)	1,072.2	1,141.2	3,431.1	1,126.4	3,574.5
Production – SYP lumber (MMfbm)	107.7	111.4	249.0	-	-
Shipments – Canfor-produced SPF lumber (MMfbm)	1,058.1	1,198.1	3,381.4	1,219.9	3,627.8
Shipments – Canfor-produced SYP lumber (MMfbm)	113.0	126.6	277.0	-	-
Shipments – wholesale lumber (MMfbm)	244.9	272.4	667.3	114.4	293.0

Operating earnings in the Lumber segment decreased by \$61.2 million from the previous quarter and were \$72.7 million lower than in the same period last year. Although the US/Cdn exchange rate stabilized, the downward trend of the market accelerated, accounting for the majority of the decline in profitability. The decrease in SPF and SYP prices reduced earnings by \$45.5 million and \$9.6 million respectively compared to the previous quarter. The current quarter's results were also negatively impacted by a \$20.0 million adjustment to lumber inventories. Inventories are required to be valued at the lower of cost and net realizable value, and, in the current poor markets, anticipated sales proceeds for these inventories are less than cost.

As a result of the US Department of Commerce lowering the deposit rates for the countervailing and anti-dumping duties from 18.20% to 10.05% on December 12, 2005, combined with the stronger Canadian dollar, the duty expense of \$24.3 million in the current period was \$34.2 million lower than in the third quarter of 2005. An update of the current duty situation follows in the "Risks and Uncertainties" section of this MD&A.

Operations

In response to the unfavourable market realities of the high Canadian dollar and depressed lumber prices, downtime was taken at some mills in the quarter, accounting for a 6% decline in total lumber production from the previous quarter. Some mills experienced operational challenges in the quarter with production negatively impacted by a 1% drop in productivity compared to the last quarter and a 5% decline from the same period last year. Cash conversion costs were up marginally over the previous quarter and were 6% unfavorable relative to the same quarter in 2005. Product recoveries were flat compared to the previous quarter and down 2% from 2005. The Plateau mill's productivity is improving quarter over quarter but is behind original start up expectations. Revised plans are to have the mill operating at capacity by late 2007. Planer mill improvements, particularly in the ramp-up of capital implementations at the Mackenzie, Chetwynd and Radium operations, yielded gains in value-added product growth. The segment improved prime product production by 2% over the prior period, with ongoing gains expected to continue through the end of the year.

Lumber inventories grew by 7% over the previous quarter, which is a reflection of the slowdown in demand in the North American market.

⁶ Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)

⁷ Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)

The Houston Pellet Plant commenced production in the quarter, and the energy plant phase of the project is anticipated to be operational by mid-2007.

Stumpage Rates

The Government of British Columbia has recently announced two significant policy changes related to pricing of Crown timber in the Interior Region of the Province.

In the first policy change, the Grade 3 (dead and dry) sawlogs category was eliminated effective April 1, 2006. This quality of log will now generally be categorized as sawlogs, with a minor amount categorized as pulpwood or dead and dry sawlogs depending on their quality. If they are deemed to be pulpwood, they will continue to sell for 25 cents per cubic metre. If they qualify as sawlogs, they will be priced, on average, at \$10 per cubic metre less than green sawlogs. The change in log grades is intended to be revenue neutral to the Crown, meaning that the stumpage rate for green sawlogs will decline somewhat. Consequently, for operations in areas with high proportions of sawlogs currently classified as dead and dry, the stumpage cost for fibre is anticipated to increase and operations harvesting largely green timber expect to see stumpage rates decline.

The second change announced is the replacement of the current Comparative Value Pricing System (CVP) with a market-based system driven by prices for timber sold in open auctions through the BC Timber Sales Program effective July 1, 2006. In the former CVP system, the declining value of trees killed by the Mountain Pine Beetle (MPB) would not be recognized and this is one of the reasons for the change. The Province of BC recently announced that a market-based system had been agreed upon by both government and industry and the original implementation date of September 1, 2006 was accelerated to July 1, 2006. Canfor's current analysis of the new system suggests a slight increase in log prices in the near term, but the expanding MPB epidemic across the Interior coupled with the declining value of the beetle-killed trees as they degrade, is expected, over time, to gradually reduce stumpage to reflect that market price.

The impact of these changes is not expected to have a material impact on Canfor's log costs in the near term.

The US specifically acknowledges the Interior market pricing system introduced by the BC Government and it is protected under the Softwood Lumber Agreement (SLA). The SLA was finalized in the quarter and an impact assessment is ongoing in preparation for fourth quarter implementation. A more detailed discussion of the SLA is contained in the "Risks and Uncertainties" section of this MD&A.

Markets – see below, following Panels section

Panels

(millions of dollars unless otherwise noted)	Q3 2006	Q2 2006	YTD 2006	Q3 2005	YTD 2005
Sales	\$ 85.5	\$ 100.8	\$ 285.6	\$ 94.3	\$ 276.7
EBITDA	\$ (10.4)	\$ (3.6)	\$ (7.1)	\$ 3.7	\$ 36.1
EBITDA margin	(12)%	(4)%	(2)%	4%	13%
Operating income (loss)	\$ (17.3)	\$ (10.6)	\$ (26.8)	\$ 1.3	\$ 28.1
Average plywood price in Cdn \$ ⁸	\$ 364	\$ 360	\$ 367	\$ 362	\$ 387
Average OSB price in US \$ ⁹	\$ 181	\$ 238	\$ 234	\$ 291	\$ 320
Average OSB price in Cdn \$	\$ 203	\$ 267	\$ 265	\$ 350	\$ 392
Production – plywood (MMsf 3/8")	104.0	115.5	333.5	104.2	323.4
Production – OSB (MMsf 3/8")	200.8	176.1	549.6	129.8	365.3
Shipments – plywood (MMsf 3/8")	103.2	118.1	331.6	124.3	337.4
Shipments – OSB (MMsf 3/8")	193.4	187.8	538.4	131.7	351.3

Operating earnings in the Panels segment decreased by \$6.7 million from the prior quarter and by \$18.6 million from the third quarter of 2005, mainly due to the decline in OSB prices. The impact of the lower OSB prices in the quarter was approximately \$12.0 million, which was partially offset by higher OSB production and slightly higher plywood prices.

The quarter's results include a \$5.1 million operating loss from the Peace Valley OSB joint venture, which was \$2.0 million worse than in the previous quarter, mainly due to the lower OSB prices. The plant, which is in its start-up phase, commenced operations at the end of the fourth quarter of 2005. The ramp up continued into the current period, with productivity increasing to 78% of annual capacity in the quarter.

Operations

Plywood

Despite the marginal change in market prices, the plywood group showed continuous improvement in operational performance and increased earnings by 42% over the prior quarter. A 10% improvement in prime product outturns was realized in the quarter, which contributed to a 9% improvement in the average market value. Total cash conversion costs were up 5% over the second quarter level, and 3% over the third quarter of 2005. Plywood production was 10% lower than in the second quarter as a result of maintenance downtime taken at both plywood operations.

OSB

Some operational progress in the quarter was overshadowed by heavy downward pressure on OSB markets. The PolarBoard plant achieved significant gains in daily production, a 10% reduction in cash conversion costs and a 6% improvement in recovery in the quarter. A screen failure caused 6.5 days of lost production late in the quarter, but the problem has since been rectified and the operation is running well again.

OSB production was 200.8 million square feet in the quarter, including Canfor's 50% share of Peace Valley OSB's production. The 14% increase in production from the previous quarter was the result of gains in productivity at both PolarBoard and Peace Valley OSB.

The segment also includes the Panel and Fibre operation, which incurred a small operating loss in the quarter as a result of a decrease in customer demand for decorative wall panels and baled fibre, as well as higher fuel prices and the negative impact of the strong Canadian dollar.

⁸ Canadian softwood plywood, per Msf 3/8" basis, delivered to Toronto (Source – C.C. Crowe Publications, Inc.)

⁹ Oriented strand board, per Msf 7/16" North Central (Source – Random Lengths Publications, Inc.)

Markets – Lumber and Panels

US GDP growth declined to 2.6% in the second quarter of 2006 from 5.6% in the first quarter ¹⁰, largely as a result of weaker US housing demand. US housing starts were 1.735 million units (seasonally adjusted annual rate) ¹¹ for the third quarter of 2006, down 17% compared with the third quarter level of 2.101 million units in 2005. The reduction in new housing demand has occurred as speculators have exited the new housing market and also because of declining affordability for regular consumers. The rate of new home sales in the US has decreased by 10% ¹¹ from January to August of 2006.

Repair and remodeling demand has remained strong throughout 2006. Canfor shipments to Home Center customers increased by 6% for the third quarter of 2006 compared to the third quarter of 2005.

Lumber

Lumber prices have steadily decreased throughout 2006. Reduced demand, coupled with increasing supply, particularly during the last weeks of the quarter, resulted in SPF 2x4 #2& Better prices declining to US \$248 at the end of the quarter, which is a three-year low. The Random Lengths Framing Lumber Composite price that determines the export tax level payable by Canadian producers averaged US \$300 per Mfbm during the third quarter of 2006, which is 21% below the 2005 third quarter average of US \$380, and 14% lower than the second quarter average of US \$347. Based on these prices, Canfor will be starting the SLA under the highest tax bracket of 15%. A more detailed discussion of the SLA is contained in the "Risks and Uncertainties" section of this MD&A.

Offshore shipments have remained strong in 2006. Total shipments increased by 13% in the third quarter of 2006 compared to the same quarter in 2005, and, at 318.9 million board feet, were 15% higher on a year-to-date basis. While shipments to Japan declined slightly compared with the third quarter 2005 shipments, sales to China, Taiwan, and other South Asian emerging markets increased significantly.

Panels

OSB prices have also been affected by the reduction in new home construction and increases in supply. As considerable new capacity has come on stream during the past 12 months, inventories have remained high and buyers have not been required to cover more than their current needs. Plywood prices have remained flat from the third quarter of 2006 compared to last year because of continued strong demand in the Canadian market and no increases in supply.

Outlook – Lumber and Panel Markets

US housing starts are expected to remain near current low levels into the first half of 2007 because of the existing high inventories of unsold new homes. In contrast, repair and remodeling markets are expected to remain relatively strong for the next several months. The current low prices for lumber have resulted in several announcements of production curtailment, which are expected to significantly reduce supply into the first quarter of 2007. With additional OSB plants coming on stream in the fourth quarter of 2004, OSB prices are expected to remain low well into 2007. Plywood prices are expected to drift lower as a result of continued substitution of plywood sheathing for lower-priced OSB.

As a result of the unfavourable market realities of the high Canadian dollar and depressed lumber and OSB prices, on October 20th Canfor announced the indefinite closure of the finger joint lumber line at its Grande Prairie, Alberta operation and downtime at its sawmill in Mackenzie BC and at its PolarBoard OSB plant in Fort Nelson, BC. The Grande Prairie finger joint line, which has an annual capacity of 9 million board feet, is expected to close in the week of November 13th. The Mackenzie sawmill will be down in the last week of October and in the first week of November, resulting in a production curtailment of approximately 19 million board feet of lumber. The PolarBoard mill will be down for the last two weeks of November and the last two weeks of December, which represents approximately 44 million square feet of OSB production.

¹⁰ US Bureau of Economic Analysis

¹¹ US Census Bureau

Pulp and Paper ¹²

(millions of dollars unless otherwise noted)	Q3 2006	Q2 2006	YTD 2006	Q3 2005	YTD 2005
Sales	\$ 248.8	\$ 223.0	\$ 698.9	\$ 217.2	\$ 654.8
EBITDA	\$ 65.1	\$ 28.2	\$ 127.9	\$ 9.9	\$ 39.5
EBITDA margin	26%	13%	18%	5%	6%
Operating income (loss)	\$ 52.1	\$ 17.3	\$ 91.8	\$ (2.1)	\$ 5.4
Average pulp price – US \$ ¹³	\$ 711	\$ 670	\$ 668	\$ 588	\$ 614
Average price in Cdn \$	\$ 797	\$ 752	\$ 757	\$ 706	\$ 752
Production – pulp (000 mt) ¹⁴	308.4	272.5	899.0	298.8	884.4
Production – paper (000 mt)	32.0	30.1	95.2	31.7	95.9
Shipments – Canfor-produced pulp (000 mt) ¹⁴	307.7	293.1	914.1	309.6	876.7
<i>Marketed on behalf of HSLP (000 mt)</i> ¹⁵	101.1	98.3	288.6	90.9	275.5
Shipments – paper (000 mt)	32.5	31.3	94.9	31.1	96.6

Operating income in the Pulp and Paper segment improved by \$34.8 million from the previous quarter and \$54.2 million when compared to the same quarter last year. The increase from the prior quarter is mainly due to improved NBSK pricing and higher production volumes as a result of the annual maintenance shutdowns at all facilities in the prior quarter. When compared to the third quarter of 2005, improved NBSK prices, higher production and the beneficial impact of lower chip prices were partially offset by the negative effects of a stronger Canadian dollar.

Operations

NBSK production improved by 13% over the prior quarter and by 5% over the same quarter in 2005. Operations at the Northwood and Prince George pulp mills were impacted by the direct and residual effects of several lightning strikes resulting in major power failures. This resulted in a loss of approximately 7,700 tonnes of production during the quarter. In the prior period, scheduled annual maintenance and other downtime reduced production by 37,700 tonnes and in the third quarter of 2005 scheduled maintenance downtime and a slow-back of the Prince George Pulp Mill due to precipitator performance issues resulted in lost production of 16,000 tonnes.

The co-generation facility at the Prince George Pulp Mill averaged 968 megawatt hours per day compared to 973 in the prior quarter and 880 in the same period last year. This represents 88% of the target rate and planned improvements with hog fuel feed and ash handling systems are expected to improve performance over the next several quarters.

Paper production during the third quarter was 6% higher than the prior quarter and 1% higher than the same quarter in 2005. The increase over the prior quarter is primarily the result of maintenance downtime taken in the second quarter. Operations continue to focus on higher margin bleached paper production, which averaged 72% in the quarter compared to 71% in the prior quarter and 74% for the same period in 2005.

Production at the Taylor Pulp Mill was 14% higher than in the second quarter due to the maintenance downtime that was taken in June, but was 3% lower than in the third quarter of 2005 as a result of poor chip quality.

Markets

The chemical market pulp industry continued to experience strong demand during the third quarter of 2006. This was partly driven by modest demand growth in the printing and writing paper segment ¹⁶, but was mostly due to the large

¹² Includes 100% of CPLP and the Taylor Pulp Mill, which was excluded from the spinout transaction.

¹³ Per tonne, delivered to Northern Europe

¹⁴ Includes Northern Bleached Softwood Kraft (NBSK) pulp produced by CPLP and Bleached Chemi-Thermo Mechanical pulp (BCTMP) produced by Canfor's Taylor Pulp Mill.

¹⁵ Howe Sound Pulp and Paper Limited Partnership

reduction in Canadian NBSK production capacity (approximately 1 million tonnes or 16% of Canadian capacity has shut down in 2006)¹⁶. The capacity reduction is driven primarily by mill closures in Eastern Canada due to high fibre and energy costs and the strengthening Canadian dollar.

Historically, the industry experiences increases in inventories during the third quarter as demand is normally below average and pulp mills run at full production rates during the summer months. However, inventory levels for NBSK pulp, the grade manufactured and sold by CPLP, rose by just one day, to 26 days of supply¹⁶. An inventory level of 30 days of supply is considered a balanced market.

These market dynamics have translated into a very positive pricing environment for NBSK pulp. The benchmark price into Northern Europe stood at US \$690 per tonne at the end of June 2006, rose to US \$710 during the quarter and going into the fourth quarter Canfor's list price into Northern Europe was US \$730 per tonne. Prices for delivery to the United States and Asia increased at a faster pace than those in Europe. The current list price for delivery to the US is US \$770 per tonne and US \$690-730 in Asia (increases of US \$50 and \$60, respectively, since the end of the second quarter).

Outlook – Pulp Markets

The outlook for the fourth quarter is generally positive, as NBSK pulp inventories are low and prices remain strong around the world, with a price increase announced for European and Asian deliveries. This will allow the market to carry its current momentum into next year.

Non-Segmented Items

(millions of dollars)	Q3 2006	Q2 2006	YTD 2006	Q3 2005	YTD 2005
Corporate costs	\$ (8.1)	\$ (11.7)	\$ (26.6)	\$ (6.2)	\$ (21.0)
Net interest expense	\$ (10.8)	\$ (11.8)	\$ (32.4)	\$ (10.0)	\$ (32.9)
Foreign exchange gain (loss) on long-term debt	\$ (6.7)	\$ 24.4	\$ 16.7	\$ 30.0	\$ 14.7
Equity and other income (expense)	\$ (6.2)	\$ (3.5)	\$ (8.8)	\$ (9.8)	\$ (6.2)

Corporate Costs

Corporate costs were \$1.9 million higher in the third quarter than in the same period last year, mainly due to higher consulting, insurance and aircraft maintenance costs. Corporate costs of \$11.7 million in the second quarter were higher than usual, primarily due to a \$1.8 million insurance deductible on the fire at PolarBoard.

Interest Expense

Net interest expense of \$10.8 million was \$0.8 million higher than in the third quarter of 2005, as a result of reduced income from temporary investments, an increase in short-term borrowings, and the inclusion of New South's interest payments on their revolving and long-term debt, partially offset by long-term debt reductions and the impact of the stronger Canadian dollar on US dollar denominated interest.

Equity Income and Other

Equity and other income and expenses amounted to \$(6.2) million in the current quarter, compared to \$(3.5) million in the previous quarter and \$(9.8) million in the same quarter last year. The majority of the current quarter's expense is costs associated with the initial organization of CPLP, principally comprised of legal, accounting, audit and consulting fees. The previous quarter's expense included \$3.6 million of project costs incurred by Canfor prior to the spinout of the Pulp Business. The third quarter 2005 expense included an \$11.1 million write-down of Canfor's timber licenses, which was reduced to \$8.8 million in the fourth quarter after the agreement with the Province of British Columbia was finalized.

¹⁶ Pulp and Paper Products Council

Discontinued Operations

Coastal Operations

On March 20, 2006, Canfor completed the transfer of its Englewood logging operation and associated timber licences to a new limited partnership, Coastal Fibre Limited Partnership (CFLP), jointly owned with Oji Paper Canada Ltd., which contributed assets of equal value. In consideration of the transfer, Canfor received a partnership interest valued at \$45.0 million, which approximates book value of the assets transferred. On the same day, CFLP transferred these assets to Western Forest Products Ltd. (WFP) in return for a long-term agreement with WFP to supply CFLP with fibre, and CFLP will supply this fibre to Howe Sound Limited Partnership (HSLP). Canfor's 50% interest in CFLP has been proportionately consolidated in these financial statements, and the long-term fibre agreement with WFP, valued at \$40.0 million, has been recorded as a long-term asset, which will be amortized as the fibre is supplied to CFLP.

Coastal logging operations had been curtailed as of December 15, 2005. A net loss of \$2.3 million from discontinued operations was recognized in the first quarter of 2006, which was comprised of a \$4.3 million loss from the Coastal operations up to March 20th and a \$2.8 million loss on the assets transferred, including a \$2.4 million accrual for road deactivation and other closure costs. These amounts were partially offset by a \$4.8 million tax recovery. Coastal operations incurred an after-tax loss of \$3.3 million in the third quarter of 2005 (year-to-date net loss in 2005 – \$3.4 million).

Sawmills

The sale of the Fort St James, Slocan and Valemount sawmills was completed during the second quarter of 2005. The year-to-date net loss from these operations amounted to \$0.7 million in 2005.

SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's financial position as at the end of the following periods:

(millions of dollars, except for ratios)	Q3 2006	Q2 2006	YTD 2006	Q3 2005	YTD 2005
Ratio of current assets to current liabilities			2.0 : 1		2.6 : 1
Ratio of net debt to common shareholders' equity			23 : 77		14 : 86
Increase (decrease) in net cash	\$ 16.2	\$ 12.4	\$ (290.6)	\$ (81.0)	\$ (126.4)
– comprised of cash flow from (used in):					
Operating activities	\$ 78.8	\$ 98.7	\$ 38.3	\$ 51.6	\$ 149.2
Financing activities	\$ (40.1)	\$ (65.1)	\$ (77.8)	\$ (54.7)	\$ (66.1)
Investing activities	\$ (22.5)	\$ (21.2)	\$ (267.7)	\$ (80.6)	\$ (217.0)
Discontinued operations	\$ -	\$ -	\$ 16.6	\$ 2.7	\$ 7.5

Changes in Financial Position

Operating activities generated \$78.8 million in cash in the third quarter, which was a \$19.9 million decline from the second quarter, mainly because of lower operating earnings resulting from lower lumber and OSB prices, as discussed earlier. Operating activities generated \$27.2 million more cash than in the third quarter of 2005, primarily due to the reduction in log inventories in the current quarter.

Cash used in financing activities of \$40.1 million in the current quarter was primarily comprised of scheduled long-term debt repayments of \$36.2 million and \$3.4 million of distributions paid by CPLP to non-controlling interests. In the previous quarter financing activities included long-term debt repayments of \$12.7 million and \$52.3 million of net repayments on revolving lines of credit. In the third quarter of 2005, financing activities were mainly comprised of debt repayments of \$42.0 million and \$13.8 million to repurchase the Company's shares for cancellation.

The \$22.5 million of cash used in investing activities in the quarter was comprised of capital expenditures of \$34.0 million, partially offset by an \$11.4 million final incentive payment received from BC Hydro for the Prince George Pulp Mill's co-generation project. Investing activities of \$21.2 million and \$80.6 million in the second quarter of 2006 and third quarter of 2005, respectively, were mainly comprised of capital expenditures.

Liquidity and Financial Requirements

At September 30, 2006, Canfor had \$374.8 million of bank operating lines of credit available, of which \$33.2 million was drawn down and an additional \$55.8 million was reserved for several standby letters of credit.

OUTSTANDING SHARES

With the completion of the Pulp spinout transaction on July 1, 2006, the existing common shares of Canfor Corporation were cancelled and each shareholder received one new Canfor share and 0.1 of a unit of the Canfor Pulp Income Fund in exchange for each Canfor share held prior to July 1.

At October 27, 2006, there were 142,543,778 common shares of Canfor outstanding.

RISKS AND UNCERTAINTIES

A comprehensive discussion of Risks and Uncertainties was included in the 2005 Annual Report. An update of that discussion is included below.

Canada/US Softwood Lumber Dispute

In the third quarter Canfor expensed duties at the same rate at which deposits were being paid. Since December 12, 2005, this rate has been 8.70% for countervailing duty (CVD) and 1.36% for anti-dumping duty (ADD), which was subsequently amended by the US Department of Commerce (DOC) to 1.35% on January 21, 2006. The cumulative additional CVD accrued in excess of the cash deposits made at September 30, 2006 is \$64.4 million and is included in "other accruals and provisions" (Note 6). The cumulative ADD cash deposits in excess of the calculated expense accrued at September 30, 2006 is \$108.8 million and is being carried as a receivable under "long-term investments and other assets".

As at September 30, 2006, Canfor had paid combined duty deposits of US \$802.6 million since the inception of CVD and ADD in May 2002.

On September 12, 2006, a Softwood Lumber Agreement (SLA) was signed by David Emerson, Canada's Minister of International Trade and Susan Schwab, the US Trade Representative. On implementation, the SLA requires the DOC to revoke all existing ADD and CVD orders on softwood lumber shipped to the US from Canada. The existing combined duty rate is replaced with an export tax in the case of BC and Alberta, while a quota mechanism will apply to Ontario and Quebec. The export tax is to be administered by the Canadian government. The rate of this tax is determined with reference to a Random Length lumber composite price index, which represents a basket of lumber grades. The tax rate can be 15%, 10%, 5% or zero depending on the composite price level. The lower the composite price, the higher the tax rate applicable. At current price levels, the maximum rate of 15% is applicable. A surge tax of an additional 50% on top of the export tax may be applied to all producers in a region, depending on the monthly volume shipped from that region. The surge tax is retroactive in that it is not known until the shipments have already been made in a particular month. The surge trigger volume is calculated by a series of formulas based on monthly US lumber consumption in the prior year. However, because the surge volume is calculated based on a pool of exporters for a particular region, it is very difficult for an individual producer to gauge how much they can ship in the month without triggering the surge tax for the entire region.

The SLA includes two key requirements to be met as a condition to coming into force. Firstly, all parties (governments, trade associations, companies) were required to agree to terminate litigation underway at the World Trade Organization, NAFTA or the US Court of International Trade (CIT). Secondly, Canadian importers of record

accounting for at least 95% of all cash deposits had to agree to assign approximately 19% of their deposits to make up the US \$1 billion that the SLA required to be retained in the US.

The plan at signing of the SLA was to implement it on October 1, 2006. However, the consent to terminate legal cases and associated issues was not completed by October 1, and the respective governments agreed to delay implementation by up to one month (November 1).

On October 6, 2006 the Governments of the US and Canada announced an agreement to amend the SLA to formally deal with the issue of the requirement for importers totaling 95% of the deposits signing agreements to leave deposits in the US and to resolve the legal consent dilemma. Further, they announced that the SLA would come into force on October 12, 2006. The legal consent question has been resolved by the two countries agreeing to jointly ask the CIT to terminate the Section 129 case (this is the "threat of injury" case in which the two countries are the principal litigants). When the Court agrees, all other litigation will become moot. Canfor agreed to terminate its Chapter 11 case on October 12.

On October 12 the US revoked the CVD and ADD orders and the border tax (or quota) came into effect. The US industry has signed "no injury" letters in enough quantity to prevent new litigation during the term of the SLA unless one of the countries exercises the termination clause in the agreement.

Canfor is prepared for implementation and expects a seamless transition as the SLA takes effect.

Canfor expects to recognize the return of duties paid in the fourth quarter financial statements. At current exchange rates, the refund, including interest, is expected to have a net after-tax beneficial impact of approximately Cdn \$520 million on the fourth quarter 2006 results. The cash amount of the refund will be approximately US \$730 million, including interest, before tax, and is expected to be received in the latter part of the fourth quarter or early in the first quarter of 2007.

SELECTED QUARTERLY FINANCIAL INFORMATION

	Q3 2006	Q2 2006	Q1 2006	Q4 2005	Q3 2005	Q2 2005	Q1 2005	Q4 2004
Sales and Income (millions of dollars)								
Sales	\$ 927.7	\$ 1,059.9	\$ 962.7	\$ 853.8	\$ 934.1	\$ 1,035.7	\$ 963.5	\$ 1,037.7
Operating income (loss)	\$ (44.8)	\$ (15.3)	\$ 38.5	\$ (14.7)	\$ (5.8)	\$ 66.0	\$ 96.9	\$ 20.3
Net income (loss) from continuing operations	\$ (51.6)	\$ 39.2	\$ 21.2	\$ (10.6)	\$ 20.7	\$ 28.2	\$ 63.5	\$ 45.4
Net income (loss)	\$ (51.6)	\$ 39.2	\$ 18.9	\$ (12.3)	\$ 17.4	\$ 25.3	\$ 65.6	\$ 43.0
Per common share (dollars)								
Net income (loss) from continuing operations								
Basic	\$ (0.36)	\$ 0.28	\$ 0.15	\$ (0.07)	\$ 0.14	\$ 0.20	\$ 0.44	\$ 0.34
Diluted	\$ (0.36)	\$ 0.28	\$ 0.15	\$ (0.07)	\$ 0.14	\$ 0.20	\$ 0.44	\$ 0.32
Net income (loss)								
Basic	\$ (0.36)	\$ 0.28	\$ 0.13	\$ (0.09)	\$ 0.12	\$ 0.18	\$ 0.46	\$ 0.31
Diluted	\$ (0.36)	\$ 0.28	\$ 0.13	\$ (0.09)	\$ 0.12	\$ 0.18	\$ 0.46	\$ 0.30
Statistics								
Lumber shipments (MMfbm)	1,416	1,597	1,313	1,176	1,334	1,393	1,193	1,345
Pulp shipments (000 mt)	308	293	313	312	310	299	268	313
Plywood shipments (MMsf 3/8")	103	118	110	98	124	107	106	96
OSB shipments (MMsf 3/8")	193	188	157	118	132	117	103	127
Average exchange rate (Cdn\$/US\$)	\$ 0.892	\$ 0.891	\$ 0.866	\$ 0.852	\$ 0.832	\$ 0.804	\$ 0.815	\$ 0.819
Average Western SPF 2x4 #2&Btr lumber price (US \$)	\$ 278	\$ 316	\$ 343	\$ 328	\$ 327	\$ 365	\$ 398	\$ 338
Average SYP (East) 2x4 #2 lumber price (US \$)	\$ 304	\$ 380	\$ 435	\$ 439	\$ 457	\$ 458	\$ 433	\$ 410
Average NBSK final pulp price delivered to Northern Europe (US \$)	\$ 711	\$ 670	\$ 622	\$ 600	\$ 588	\$ 613	\$ 642	\$ 609
Average plywood price—Toronto (Cdn \$)	\$ 364	\$ 360	\$ 375	\$ 387	\$ 362	\$ 361	\$ 439	\$ 444
Average OSB price—North Central (US \$)	\$ 181	\$ 238	\$ 285	\$ 317	\$ 291	\$ 305	\$ 364	\$ 260

The main factors affecting the comparability of the results over the last eight quarters are changes in the value of the Canadian dollar against the US dollar, which, as the majority of Canfor's revenues are invoiced in US dollars, has had a significant impact on Canadian dollar revenues and the translation of US dollar denominated long-term debt, and changes in lumber, pulp, plywood and OSB prices.

One-time items that had a significant impact on quarterly results include restructuring and mill closure provisions of \$10.2 million in the fourth quarter of 2004 and \$1.6 million and \$2.5 million in the second and third quarters of 2005 respectively (all figures are after tax). The second quarter 2005 results were reduced by a \$4.0 million after-tax loss on the sale of the Fort St James, Slocan and Valemout sawmills and the third quarter 2005 results were reduced by an \$8.9 million after-tax write-down of timber licences, which was subsequently reduced to \$6.2 million in the fourth quarter of 2005. In the third quarter of 2005, the BC Corporate income tax rate was reduced by 1.5%, which resulted in a \$21.0 million favourable adjustment to the current and future income tax liability being recorded in the period. This was partially offset by \$7.7 million of other tax adjustments related to the availability of capital losses and

reassessments of prior tax years. The fourth quarter 2005 results include a \$5.2 million after-tax accrual for long-term incentive plan payments, which was reduced by \$1.1 million after tax in the first quarter of 2006. Favourable items affecting the fourth quarter 2005 results include \$8.9 million of income from the Seaboard General Partnership, resulting from asset sales, and \$2.0 million of scientific research and development tax credits claimed. The second quarter 2006 earnings include a \$43.9 million favourable adjustment to the current and future income tax liability to reflect the corporate income tax rate reductions that were substantially enacted in the 2006 Federal Budget. Non-recurring expenses in the second quarter of 2006 included a \$1.4 million after-tax insurance deductible for the fire at PolarBoard, \$2.8 million of after-tax project costs related to the pulp spinout and a \$1.0 million tax expense arising from a reassessment of Slocan's 2003 and 2004 tax years. These expenses were partially offset by a \$3.2 million favourable after-tax adjustment to pulp maintenance costs as a result of a change in accounting policy. The results from the New South operations, which were acquired in March 2006, also impact comparability with prior periods. Following the spinout of the Pulp Business on July 1, 2006, Canfor is continuing to consolidate 100% of the earnings from CPLP; however, the 20% non-controlling interest is backed out on the income statement beginning in the third quarter of 2006, which affects comparability of net income after tax of prior periods. \$3.8 million of additional costs (after tax and non-controlling interests) associated with the pulp spinout were expensed by CPLP in the third quarter of 2006.

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, plywood and OSB plants, and pulp mills. Market demand also varies seasonally to some degree. For example, building activity and repair and renovation work, which affects demand for lumber and panel products, is generally stronger in the spring and summer months. Shipment volumes are affected by these factors as well as by global supply and demand conditions. Shortages in railcar supply had an adverse impact on shipment volumes in the first quarter of 2005 and a container truckers' strike at the Port of Vancouver impacted offshore shipments in the third quarter of 2005.

DISCLOSURE CONTROLS

The Company has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Board and the Audit Committee.

EBITDA RECONCILIATION

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

(millions of dollars, except for per share amounts)	Q3 2006	Q2 2006	YTD 2006	Q3 2005	YTD 2005
Net income (loss) from continuing operations	\$ (51.6)	\$ 39.2	\$ 8.8	\$ 20.7	\$ 112.4
Add:					
Non-controlling interests	8.4	-	8.4	-	-
Income tax (recovery) expense	(25.3)	(45.4)	(63.3)	(16.3)	20.3
Unusual expense	-	-	-	11.1	11.1
Other (income) expense	5.8	4.0	9.5	(1.3)	(0.9)
Foreign exchange (gain) loss on long-term debt	6.7	(24.4)	(16.7)	(30.0)	(14.7)
Interest expense	10.8	11.8	32.4	10.0	32.9
Equity (income) loss of affiliated companies	0.4	(0.5)	(0.7)	-	(4.0)
Amortization	48.1	42.2	135.1	37.1	113.2
EBITDA (operating income before amortization)	\$ 3.3	\$ 26.9	\$ 113.5	\$ 31.3	\$ 270.3

Consolidated Statements of Income and Retained Earnings

(millions of dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2006	2005	2006	2005
Sales	\$ 927.7	\$ 934.1	\$ 2,950.3	\$ 2,933.3
Costs and expenses				
Manufacturing and product costs	743.7	668.8	2,239.7	1,975.7
Freight and other distribution costs	135.7	157.6	451.5	448.2
Countervailing and anti-dumping duties (Note 7)	24.3	58.5	86.6	184.9
Amortization	48.1	37.1	135.1	113.2
Selling and administration costs	20.7	14.9	59.0	49.0
	972.5	936.9	2,971.9	2,771.0
Restructuring, mill closure and other severance costs	-	3.0	-	5.2
Operating income (loss) from continuing operations	(44.8)	(5.8)	(21.6)	157.1
Equity income (loss) of affiliated companies	(0.4)	-	0.7	4.0
Interest expense	(10.8)	(10.0)	(32.4)	(32.9)
Foreign exchange gain (loss) on long-term debt	(6.7)	30.0	16.7	14.7
Other income (expense)	(5.8)	1.3	(9.5)	0.9
Unusual expense	-	(11.1)	-	(11.1)
Net income (loss) from continuing operations before income taxes and non-controlling interests	(68.5)	4.4	(46.1)	132.7
Income tax recovery (expense) (Note 9)	25.3	16.3	63.3	(20.3)
Non-controlling interests (Note 2)	(8.4)	-	(8.4)	-
Net income (loss) from continuing operations	(51.6)	20.7	8.8	112.4
Net loss from discontinued operations (Note 4)	-	(3.3)	(2.3)	(4.1)
Net income (loss)	\$ (51.6)	\$ 17.4	\$ 6.5	\$ 108.3
Per common share (in dollars) (Note 10)				
Net income (loss) from continuing operations				
Basic	\$ (0.36)	\$ 0.14	\$ 0.06	\$ 0.78
Diluted	\$ (0.36)	\$ 0.14	\$ 0.06	\$ 0.78
Net income (loss)				
Basic	\$ (0.36)	\$ 0.12	\$ 0.05	\$ 0.76
Diluted	\$ (0.36)	\$ 0.12	\$ 0.05	\$ 0.75
Retained earnings, beginning of year			\$ 779.5	\$ 691.9
Net income for the period			6.5	108.3
Premium paid on common shares purchased for cancellation			-	(4.9)
Retained earnings, end of period			\$ 786.0	\$ 795.3

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

Consolidated Cash Flow Statements

(millions of dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2006	2005	2006	2005
Cash generated from (used in)				
Operating activities				
Net income (loss) from continuing operations	\$ (51.6)	\$ 20.7	\$ 8.8	\$ 112.4
Items not affecting cash:				
Amortization	48.1	37.1	135.1	113.2
Income taxes	(24.8)	(20.8)	(66.2)	10.1
Long-term portion of deferred reforestation	(13.9)	(13.8)	(3.0)	(5.9)
Employee future benefits	1.9	3.4	9.5	11.5
Foreign exchange loss (gain) on long-term debt	6.7	(30.0)	(16.7)	(14.7)
Adjustment to accrued duties (Note 7)	-	2.8	2.1	(4.7)
Non-controlling interests	8.4	-	8.4	-
Other	(0.1)	10.3	(3.3)	4.1
Changes in non-cash working capital (Note 12)	104.1	41.9	(36.4)	(76.8)
	78.8	51.6	38.3	149.2
Financing activities				
Proceeds from long-term debt	-	-	1.0	0.6
Repayment of long-term debt	(36.2)	(42.0)	(84.4)	(56.6)
Changes in operating bank loans (Note 5)	(0.3)	1.1	9.3	2.1
Common shares purchased for cancellation	-	(13.8)	-	(13.8)
Distributions paid to non-controlling interests (Note 2)	(3.4)	-	(3.4)	-
Other	(0.2)	-	(0.3)	1.6
	(40.1)	(54.7)	(77.8)	(66.1)
Investing activities				
Business acquisition (Note 3)	-	-	(206.1)	-
Net proceeds from sale of discontinued operations	-	-	-	59.0
Property, plant, equipment and timber	(34.0)	(83.7)	(73.4)	(238.6)
Electrical co-generation incentive payments	11.4	-	11.4	8.3
Howe Sound Pulp and Paper Limited Partnership	-	-	-	(50.0)
Proceeds from sale of property, plant and equipment	0.8	4.0	2.6	5.0
Other	(0.7)	(0.9)	(2.2)	(0.7)
	(22.5)	(80.6)	(267.7)	(217.0)
Increase (decrease) in net cash from continuing operations	16.2	(83.7)	(307.2)	(133.9)
Increase in net cash from discontinued operations (Note 4)	-	2.7	16.6	7.5
Increase (decrease) in net cash *	16.2	(81.0)	(290.6)	(126.4)
Net cash at beginning of period (Note 5)	(0.9)	392.9	305.9	438.3
Net cash at end of period	\$ 15.3	\$ 311.9	\$ 15.3	\$ 311.9
Cash payments (recoveries) in the period				
Interest, net	\$ 12.7	\$ 14.5	\$ 35.3	\$ 36.6
Income taxes	\$ (0.2)	\$ 0.8	\$ 6.5	\$ 3.0

* Net cash is comprised of cash and temporary investments.

Consolidated Balance Sheets

(millions of dollars, unaudited)	As at September 30, 2006	As at December 31, 2005
ASSETS		
Current Assets		
Cash and temporary investments	\$ 15.3	\$ 305.9
Accounts receivable		
Trade	265.0	205.4
Other	70.4	79.8
Income taxes recoverable	1.7	-
Future income taxes	20.3	23.9
Inventories	626.5	600.9
Prepaid expenses	51.5	36.2
Current assets of discontinued operations (Note 4)	-	39.8
Total current assets	1,050.7	1,291.9
Long-term investments and other assets		
Property, plant, equipment and timber	2,255.1	2,211.1
Goodwill (Note 3)	79.1	-
Deferred charges	81.2	96.9
Non-current assets of discontinued operations (Note 4)	-	43.7
	\$ 3,713.5	\$ 3,830.1
LIABILITIES		
Current Liabilities		
Operating bank loans (Note 5)	\$ 33.2	\$ 3.0
Accounts payable and accrued liabilities	353.0	380.3
Current portion of long-term debt	98.3	95.7
Current portion of deferred reforestation	44.8	43.3
Income taxes payable	-	4.1
Current liabilities of discontinued operations (Note 4)	-	9.3
Total current liabilities	529.3	535.7
Long-term debt (Note 5)	455.6	544.5
Other accruals and provisions (Note 6)	229.1	220.5
Long-term liabilities of discontinued operations (Note 4)	-	0.4
Future income taxes, net	430.6	468.3
Deferred credit	14.1	14.1
Non-controlling interests (Note 2)	121.6	-
	1,780.3	1,783.5
SHAREHOLDERS' EQUITY		
Share capital – 142,543,778 shares outstanding (Note 2)	1,124.3	1,268.7
Contributed surplus (Note 2)	30.0	-
Retained earnings	786.0	779.5
Foreign exchange translation adjustment	(7.1)	(1.6)
	1,933.2	2,046.6
	\$ 3,713.5	\$ 3,830.1

Subsequent event (Note 7)

APPROVED BY THE BOARD



Director, R.L. Cliff



Director, J.A. Shepherd

Notes to the Consolidated Financial Statements (unaudited)

1. These unaudited interim financial statements do not include all of the disclosures required by Canadian generally accepted accounting principles for annual financial statements and, accordingly, should be read in conjunction with the financial statements and notes included in Canfor's Annual Report for the year ended December 31, 2005. These interim financial statements follow the same accounting policies and methods of computation as used in the 2005 consolidated financial statements.

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, plywood and OSB plants, and pulp mills. Market demand also varies seasonally to some degree. For example, building activity and repair and renovation work, which affects demand for lumber and panel products, is generally stronger in the spring and summer months. Shipment volumes are affected by these factors as well as by global supply and demand conditions. Therefore, the quarterly results are not necessarily indicative of results to be expected for an entire year.

2. Pulp Income Fund Transaction

On July 1, 2006, Canfor completed the transfer of its NBSK pulp and paper business (the Pulp Business) to the Canfor Pulp Limited Partnership (CPLP) in exchange for a \$125 million promissory note, 14.254 million Class A Limited Partnership Units and 57.016 million Class B Exchangeable Limited Partnership Units (the Spinout). Canfor exchanged its Class A Limited Partnership Units for an equal number of Units of Canfor Pulp Income Fund (CPIF). Upon the completion of the Spinout, the existing Common Shares of Canfor were cancelled and Canfor shareholders were entitled to receive one New Common Share of Canfor and 0.1 of a Unit of CPIF, with the distribution of the Fund Units being structured as a return of capital on the Canfor Shares. As a result, on the date of the Spinout Canfor Shareholders owned all of the issued and outstanding New Common Shares and all of the issued and outstanding Fund Units, with the outstanding Fund Units representing a 20% indirect interest in the Pulp Business. Through its interest in CPLP, which is indirectly exchangeable for Fund Units, Canfor owns the remaining 80% interest in the Pulp Business. CPLP is managed by Canfor Pulp Holdings Inc. (the general partner) on behalf of the limited partners.

Canfor and the CPLP have entered into a long-term fibre supply agreement under which Canfor will continue to provide CPLP with residual wood chips and hog fuel produced at certain of its sawmills at market prices. CPLP also purchases, at cost, a number of administrative, accounting, legal and management services from Canfor under a partnership services agreement, which can be terminated, in whole or in part, on 12 months notice. CPLP continues to provide marketing services to Canfor, acting as a selling representative on behalf of Howe Sound Limited Partnership and Canfor's Taylor Pulp operation.

Canfor is continuing to consolidate CPLP in these financial statements, with a provision for non-controlling interests. All intercompany balances and transactions have been eliminated.

3. Business Acquisition

On March 6, 2006, Canfor completed its acquisition of New South Companies, Inc. (New South) at a cost of US \$181.6 million, net of assumed debt and including transaction costs.

New South operates three sawmills with an annual capacity of 425 million board feet of southern yellow pine, one remanufacturing facility and two lumber treating plants located in North and South Carolina and an international lumber import business. New South also operates a lumber-trucking fleet of 55 trucks on the US East Coast.

The acquisition has been accounted for using the purchase method, in which the purchase consideration was allocated to the fair values of the assets and liabilities assumed on March 6, 2006. In the second quarter, following the completion of an independent valuation of the assets acquired, the following adjustments were made to the original allocation: a \$1.8 million increase to non-cash working capital, a \$0.6 million decrease to goodwill, a \$1.9 million decrease to other assets and a \$0.7 million decrease to the future income tax liability.

(millions of dollars)

Net assets acquired at March 6, 2006	
Non-cash working capital	\$ 85.2
Property, plant and equipment	96.3
Goodwill	80.6
Other assets	29.4
Long-term debt	(44.6)
Future income taxes, net	(38.3)
Other liabilities	(2.5)
	\$ 206.1

New South is financially and operationally self-sustaining and, accordingly, the current rate method is used for the translation of their financial statements to Canadian dollars on consolidation. Under this method, assets and liabilities, including any excess of purchase price over book value arising on acquisition, are translated at the exchange rate in effect at the balance sheet date. Revenue and expense items are translated at the average exchange rate in effect during the period. Exchange gains or losses arising from the current rate method of translation are deferred in a separate component of shareholders' equity.

4. Discontinued Operations

On March 20, 2006, Canfor completed the transfer of its Englewood logging operation and associated timber licences to a new limited partnership, Coastal Fibre Limited Partnership (CFLP), jointly owned with Oji Paper Canada Ltd., which contributed assets of equal value. In consideration of the transfer Canfor received a partnership interest valued at \$45.0 million, which approximates book value of the assets transferred. On the same day, CFLP transferred these assets to Western Forest Products Ltd. (WFP) in return for a long-term agreement with WFP to supply CFLP with fibre, and CFLP will supply this fibre to Howe Sound Pulp and Paper Limited Partnership (HSLP). Canfor's 50% interest in CFLP has been proportionately consolidated and the long-term fibre agreement with WFP, which is valued at \$40.0 million, has been recorded in "long-term investments and other assets" on the balance sheet, and will be amortized as the fibre is supplied to CFLP.

The following table presents selected financial information related to discontinued operations for the current and comparative periods:

(millions of dollars)	3 months ended September 30,					
	2006			2005		
	Coastal Operations	Sawmills	Total	Coastal Operations	Sawmills	Total
Sales to external customers	\$ -	\$ -	\$ -	\$ 12.2	\$ -	\$ 12.2
Operating loss before income taxes	\$ -	\$ -	\$ -	\$ (5.0)	\$ -	\$ (5.0)
Income tax recovery	-	-	-	1.7	-	1.7
Net loss	\$ -	\$ -	\$ -	\$ (3.3)	\$ -	\$ (3.3)
Net loss per share - diluted			\$ -			\$ (0.02)

9 months ended September 30,

(millions of dollars)	2006			2005		
	Coastal Operations	Sawmills	Total	Coastal Operations	Sawmills	Total
Sales to external customers	\$ 9.5	\$ -	\$ 9.5	\$ 47.1	\$ 61.7	\$ 108.8
Operating income (loss) before income taxes	\$ (4.3)	\$ -	\$ (4.3)	\$ (5.2)	\$ 5.1	\$ (0.1)
Loss on disposal before income taxes	(2.8)	-	(2.8)	-	(6.2)	(6.2)
Income tax recovery	4.8	-	4.8	1.8	0.4	2.2
Net loss	\$ (2.3)	\$ -	\$ (2.3)	\$ (3.4)	\$ (0.7)	\$ (4.1)
Net loss per share - diluted			\$ (0.01)			\$ (0.03)

5. Bank Indebtedness, Operating Bank Loans and Long-Term Debt

At September 30, 2006, Canfor had \$374.8 million of bank operating lines of credit available, of which \$33.2 million was drawn down and an additional \$55.8 million was reserved for several standby letters of credit.

These credit facilities, which are presented as "operating bank loans" on the Consolidated Balance Sheet, were previously included as a component of "net cash (short-term indebtedness)" on the Consolidated Cash Flow Statement. In the second quarter of 2006, the cash flow presentation was restated to include changes in these balances as financing activities. Prior periods have been restated for comparability.

At September 30, 2006, the fair value of Canfor's long-term debt was \$574.0 million.

6. Other Accruals and Provisions

(millions of dollars)	September 30, 2006	December 31, 2005
Deferred reforestation	\$ 65.6	\$ 67.7
Countervailing duty provision (Note 7)	64.4	67.4
Accrued pension obligations	22.0	20.8
Post employment benefits	72.4	63.1
Other long-term liabilities	4.7	1.5
Total other accruals and provisions	\$ 229.1	\$ 220.5

7. Countervailing and Anti-dumping Duties

In the third quarter, Canfor expensed duties at the same rate at which deposits were being paid. Since December 12, 2005, this rate has been 8.70% for countervailing duty (CVD) and 1.36% for anti-dumping duty (ADD), which was subsequently amended by the US Department of Commerce (DOC) to 1.35% on January 21, 2006. The cumulative additional CVD accrued in excess of the cash deposits made at September 30, 2006 is \$64.4 million and is included in "other accruals and provisions" (Note 6). The cumulative ADD cash deposits in excess of the calculated expense accrued at September 30, 2006 is \$108.8 million and is being carried as a receivable under "long-term investments and other assets".

As at September 30, 2006, Canfor had paid combined duty deposits of US \$802.6 million since the inception of CVD and ADD in May 2002.

Effective October 12, 2006, the governments of Canada and the United States implemented an agreement for the settlement of the softwood lumber dispute. The Softwood Lumber Agreement (SLA) requires that an export tax be collected by the government of Canada, which is based on the price and volume of lumber shipped. The SLA had an effective date of October 12, 2006, at which time the DOC revoked all existing ADD and CVD orders on softwood lumber shipped to the US from Canada. Subject to receiving formal approval by the Canadian Parliament, the SLA will result in a return of approximately 81% of duties paid, together with accumulated interest.

8. Employee Future Benefits

Total employee future benefit costs were as follows:

(millions of dollars)	3 months ended September 30,		9 months ended September 30,	
	2006	2005	2006	2005
Defined benefit pension plans	\$ 4.1	\$ 4.0	\$ 12.1	\$ 12.1
Other employee future benefit plans	3.9	2.1	12.3	6.3
Defined contribution pension plans and 401(k) plans	1.4	0.5	3.1	1.3
Contributions to forest industry union plans	5.6	7.6	18.3	22.8
	\$ 15.0	\$ 14.2	\$ 45.8	\$ 42.5

9. Income Tax Recovery (Expense)

(millions of dollars)	3 months ended September 30,		9 months ended September 30,	
	2006	2005	2006	2005
Current	\$ 1.3	\$ (5.3)	\$ (1.1)	\$ (10.4)
Future	23.8	27.2	64.6	(23.6)
Tax on equity earnings	0.2	-	(0.2)	(1.5)
	25.3	21.9	63.3	(35.5)
Amortization of deferred credit on utilization of acquired tax losses	-	(5.6)	-	15.2
	\$ 25.3	\$ 16.3	\$ 63.3	\$ (20.3)

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 September 30,		9 months ended September 30,	
	2006	2005	2006	2005
Income tax expense at statutory tax rate	\$ 23.4	\$ (1.5)	\$ 15.7	\$ (46.1)
Large corporation tax	-	(1.3)	-	(3.8)
Amortization of deferred credit on utilization of acquired tax losses	-	(5.6)	-	15.2
Permanent difference from capital gains and losses	(1.1)	7.9	2.9	3.0
Change in estimate of available capital losses	-	(4.8)	-	(8.7)
Change in corporate income tax rates	-	21.0	42.4	21.0
Non-controlling interests	2.9	-	2.9	-
Other permanent differences and adjustments	0.1	0.6	(0.6)	(0.9)
Income tax recovery (expense)	\$ 25.3	\$ 16.3	\$ 63.3	\$ (20.3)

10. Earnings Per Share

Basic earnings per share is calculated by dividing the net earnings available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing the net earnings 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.

	3 months ended September 30,		9 months ended September 30,	
	2006	2005	2006	2005
Weighted average number of common shares	142,541,176	142,966,325	142,533,188	143,288,208
Incremental shares from stock options	49,920	130,846	73,199	184,430
Diluted number of common shares	142,591,096	143,097,171	142,606,387	143,472,638

11. Financial Instruments

Canfor uses a variety of financial instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, lumber and pulp prices and energy costs.

At September 30, 2006, Canfor had entered into pulp swaps to hedge 15,000 tonnes of future pulp sales at an average price of \$683 per tonne, along with matching US dollar forward exchange contracts for US \$10.2 million at an average rate of 1.1107. There was a combined unrealized loss of \$1.5 million on the pulp swaps and forward contracts at the end of the period.

At September 30, 2006, Canfor had entered into commodity swaps hedging future natural gas purchases of 8.2 million gigajoules and diesel purchases of 3.0 million gallons. There were unrealized losses of \$4.6 million and \$0.1 million on these contracts, respectively, at the end of the period.

12. Changes in Non-Cash Working Capital

(millions of dollars)	3 months ended September 30,		9 months ended September 30,	
	2006	2005	2006	2005
Accounts receivable	\$ (10.5)	\$ 0.1	\$ (10.6)	\$ (26.2)
Income taxes	(0.8)	4.6	(7.1)	3.8
Inventories	40.0	23.0	35.6	(0.3)
Prepaid expenses	16.0	11.5	(13.8)	(4.0)
Accounts payable, accrued liabilities and deferred reforestation	59.4	2.7	(40.5)	(50.1)
	\$ 104.1	\$ 41.9	\$ (36.4)	\$ (76.8)

13. Segmented Information ^(a)

(millions of dollars)	Lumber ^(b)	Panels	Pulp & Paper ^(c)	Corporate & Other ^(d)	Consolidated
3 months ended September 30, 2006					
Sales to external customers	\$ 593.4	85.5	248.8	-	927.7
Sales to other segments ^(c)	\$ 19.6	1.0	-	-	20.6
Operating income (loss)	\$ (71.5)	(17.3)	52.1	(8.1)	(44.8)
Amortization	\$ 26.8	6.9	13.0	1.4	48.1
Capital expenditures	\$ 24.5	3.4	6.0	0.1	34.0
3 months ended September 30, 2005					
Sales to external customers	\$ 622.6	94.3	217.2	-	934.1
Sales to other segments ^(c)	\$ 17.8	1.0	-	-	18.8
Operating income (loss)	\$ 1.2	1.3	(2.1)	(6.2)	(5.8)
Amortization	\$ 20.9	2.4	12.0	1.8	37.1
Capital expenditures	\$ 49.9	21.9	5.8	6.1	83.7
9 months ended September 30, 2006					
Sales to external customers	\$ 1,965.8	285.6	698.9	-	2,950.3
Sales to other segments ^(c)	\$ 58.2	2.6	-	-	60.8
Operating income (loss)	\$ (60.0)	(26.8)	91.8	(26.6)	(21.6)
Amortization	\$ 74.0	19.7	36.1	5.3	135.1
Capital expenditures	\$ 56.9	7.9	14.7	(6.1)	73.4
Identifiable assets	\$ 1,958.0	346.5	932.4	476.6	3,713.5
9 months ended September 30, 2005					
Sales to external customers	\$ 2,001.8	276.7	654.8	-	2,933.3
Sales to other segments ^(c)	\$ 88.8	3.7	-	-	92.5
Operating income (loss)	\$ 144.6	28.1	5.4	(21.0)	157.1
Amortization	\$ 66.3	8.0	34.1	4.8	113.2
Capital expenditures	\$ 84.6	86.2	58.3	9.5	238.6
Identifiable assets	\$ 1,723.7	320.4	906.6	886.5	3,837.2

(a) Operations are presented by product line.

(b) Sales for the quarter include sales of Canfor-produced lumber of \$461.2 million (2005 – \$534.3 million) and \$1,546.6 million for the year to date (2005 – \$1,758.2 million).

(c) Includes 100% of CPLP (Note 2) and the Taylor Pulp Mill, which was excluded from the spinout transaction.

(d) Corporate & Other includes discontinued operations (Note 3).

(e) Sales to other segments are accounted for at prices that approximate market value.

14. Certain comparative information has been reclassified to conform to the presentation in the current period.



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