

Q2 2007

For the three months
ended June 30, 2007



CANFOR
CORPORATION
2007 SECOND
QUARTER
INTERIM REPORT

Canfor Corporation
Second Quarter 2007
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 second quarter of 2007 relative to the previous quarter and the last published annual results as at December 31, 2006 and relative to the comparative quarter in 2006. 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, 2006 (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; foreign exchange rates; changes in law and public policy; the outcome of trade disputes; and opportunities available to or pursued by Canfor.

Throughout this discussion, reference is made to EBITDA, 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. A reconciliation of EBITDA to net income reported in accordance with GAAP is included at the end of this MD&A.

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 July 27, 2007.

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

SUMMARY OF SELECTED RESULTS FOR THE QUARTER

(millions of dollars, except for per share amounts)	Q2 2007	Q1 2007	YTD 2007	Q2 2006	YTD 2006 ¹
Sales	\$ 876.6	\$ 850.6	\$ 1,727.2	\$ 1,059.9	\$ 2,022.6
EBITDA	\$ 5.1	\$ (10.0)	\$ (4.9)	\$ 26.9	\$ 110.2
Operating income (loss)	\$ (38.4)	\$ (57.8)	\$ (96.2)	\$ (15.3)	\$ 23.2
Foreign exchange gain (loss) on long-term debt and temporary investments	\$ 16.8	\$ (6.0)	\$ 10.8	\$ 24.4	\$ 23.4
Gain (loss) on derivative financial instruments	\$ (7.7)	\$ 8.6	\$ 0.9	\$ -	\$ -
Net income (loss)	\$ (38.8)	\$ (42.7)	\$ (81.5)	\$ 39.2	\$ 58.1
Net income (loss) per share, diluted	\$ (0.27)	\$ (0.30)	\$ (0.57)	\$ 0.28	\$ 0.41
Average Canadian/US exchange rate ²	\$ 0.911	\$ 0.854	\$ 0.881	\$ 0.891	\$ 0.878

A net loss of \$38.8 million was recorded in the current quarter, which was a \$3.9 million improvement over the previous quarter, but \$78.0 million worse than in the same quarter in 2006.

In addition to the impact of the strengthening in the Canadian dollar in the current quarter, factors contributing to the decrease in net earnings compared to the same quarter last year include the decline in lumber and OSB markets and the backing out of the 49.8% non-controlling interest (\$18.1 million) in Canfor Pulp Limited Partnership (CPLP), following the spinout of the business on July 1, 2006, partially offset by significant increases in pulp prices. The

¹ Includes the results of New South from March 6, 2006

² Source – Bank of Canada (average noon rate for the period)

second quarter 2006 results were favourably impacted by several one-time items, primarily resulting from corporate income tax rate reductions and a foreign exchange gain on long-term debt, which had a favourable impact of \$61.9 million, or \$0.43 per share.

The 7% strengthening in the Canadian dollar compared to the first quarter of 2007 more than offset the benefit of higher US dollar lumber, OSB and pulp prices in the second quarter. Market prices for lumber improved slightly over the previous quarter, with SPF Random Length 2x4 #2&Btr prices averaging US \$258 per thousand board feet, or 2% higher than in the first quarter. SYP Random Length 2x4 #2&Btr prices averaged US \$292 per thousand board feet, or 5% higher than in the first quarter. However, US dollar prices averaged 18% and 23% lower, for SPF and SYP respectively, than in the same period last year. OSB prices increased by 8% over the first quarter, averaging US \$156 per thousand square feet in the second quarter, but were 34% lower than in the second quarter of 2006. The plywood market took a slight downward turn, with prices averaging Cdn \$357 per thousand square feet (3/8" delivered to Toronto), or 6% lower than in the first quarter and 1% lower than in the same quarter last year. NBSK pulp prices remained strong, averaging US \$783 per tonne in the quarter, which was 3% higher than the previous quarter and 18% higher than the same quarter last year.

The following summarizes the significant factors that affected the second quarter 2007 after-tax loss:

(millions of dollars after tax and non-controlling interests)	
Loss on derivative financial instruments as a result of adopting new accounting standards for financial instruments	\$ (3.7)
Foreign exchange gain on long-term debt and temporary investments	10.2
Restructuring costs	(5.8)
Reversal of first quarter short-term incentive plan accrual	2.3
Impact of corporate general income tax rate change	1.0
Net favourable impact of above items on net income	\$ 4.0
Net impact of above items on earnings per share	\$ 0.03

OPERATING RESULTS BY BUSINESS SEGMENT

Lumber

(millions of dollars unless otherwise noted)	Q2 2007	Q1 2007	YTD 2007	Q2 2006	YTD 2006 ¹
Sales	\$ 528.6	\$ 511.6	\$ 1,040.2	\$ 736.1	\$ 1,372.4
EBITDA	\$ (27.7)	\$ (46.3)	\$ (74.0)	\$ 12.3	\$ 58.7
EBITDA margin	(5)%	(9)%	(7)%	2%	4%
Operating income (loss)	\$ (51.2)	\$ (74.6)	\$ (125.8)	\$ (10.3)	\$ 11.5
Average SPF 2x4 #2 & Better lumber price in US \$ ³	\$ 258	\$ 253	\$ 255	\$ 316	\$ 329
Average SPF price in Cdn \$	\$ 283	\$ 296	\$ 289	\$ 355	\$ 375
Average SYP 2x4 #2 lumber price in US \$ ⁴	\$ 292	\$ 279	\$ 286	\$ 380	\$ 407
Average SYP price in Cdn \$	\$ 321	\$ 327	\$ 325	\$ 426	\$ 464

³ Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)

⁴ Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)

(millions of dollars unless otherwise noted)	Q2 2007	Q1 2007	YTD 2007	Q2 2006	YTD 2006 ¹
Production – SPF lumber (MMfbm)	1,080.1	1,114.4	2,194.5	1,141.2	2,358.9
Production – SYP lumber (MMfbm)	100.7	99.1	199.8	111.4	141.3
Shipments – Canfor-produced SPF lumber (MMfbm) ⁵	1,122.0	1,002.0	2,124.0	1,198.1	2,323.3
Shipments – Canfor-produced SYP lumber (MMfbm) ⁵	126.1	108.1	234.2	126.6	164.0
Shipments – wholesale lumber (MMfbm)	96.4	102.6	199.0	272.4	422.4

The Lumber segment reported an operating loss of \$51.2 million in the second quarter of 2007, compared to an operating loss of \$74.6 million in the previous quarter and an operating loss of \$10.3 million in the second quarter of 2006. The improvement over the first quarter is mainly attributable to the relative impact on the two quarters of adjustments required to reduce the carrying value of closing lumber inventories to market value. The adjustment to market at the end of June was significantly less than that required at the end of March, and this resulted in an improvement in the current quarter of \$32.1 million relative to the first quarter. Partially offsetting this improvement was the impact of lower Canadian dollar prices and a \$4.1 million expense for restructuring costs. When compared to the same quarter in 2006, lower prices and shipment volumes were the primary reasons for the higher operating loss.

Operations

Canfor's Canadian and US lumber mills showed operational improvements in the second quarter. A 5% decrease in conversion costs was achieved over the prior quarter, as a result of productivity improvements and a focus on spending reductions. Production of premium products improved by 8% over the prior quarter. However, lumber market conditions triggered a number of curtailments, which, along with a fire at the Mackenzie operation and a washed out road at the Radium operation, reduced production by approximately 72 million board feet (compared to market curtailments of approximately 52 million board feet in the first quarter). As a result, SPF production was 5% lower than in the same quarter last year and 3% lower than in the first quarter. Further downtime has been announced for July and August, which is expected to reduce production by approximately 66 million board feet in the third quarter.

Markets – see below, following Panels section

Panels

(millions of dollars unless otherwise noted)	Q2 2007	Q1 2007	YTD 2007	Q2 2006	YTD 2006
Sales	\$ 81.6	\$ 71.7	\$ 153.3	\$ 100.8	\$ 200.1
EBITDA	\$ (10.2)	\$ (12.5)	\$ (22.7)	\$ (3.6)	\$ 3.3
EBITDA margin	(13)%	(17)%	(15)%	(4)%	2%
Operating loss	\$ (16.3)	\$ (18.5)	\$ (34.8)	\$ (10.6)	\$ (9.5)
Average plywood price in Cdn \$ ⁶	\$ 357	\$ 379	\$ 368	\$ 360	\$ 368
Average OSB price in US \$ ⁷	\$ 156	\$ 145	\$ 150	\$ 238	\$ 261
Average OSB price in Cdn \$	\$ 171	\$ 170	\$ 170	\$ 267	\$ 297
Production – plywood (MMsf 3/8")	101.2	100.9	202.1	115.5	229.5
Production – OSB (MMsf 3/8")	166.9	179.9	346.8	176.1	348.8
Shipments – plywood (MMsf 3/8")	118.7	86.9	205.6	118.1	228.4
Shipments – OSB (MMsf 3/8")	168.0	173.8	341.8	187.8	345.0

⁵ Includes shipments of lumber purchased for remanufacture.

⁶ Canadian softwood plywood, per Msf 3/8" basis, delivered to Toronto (Source – C.C. Crowe Publications, Inc.)

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

The Panels segment recorded an operating loss of \$16.3 million in the second quarter, compared to a loss of \$18.5 million in the previous quarter and a loss of \$10.6 million in the same quarter in 2006. While OSB prices increased slightly compared to the prior quarter, weak OSB markets continued to adversely impact the results of the Panels segment.

Operations

Plywood production was slightly higher than in the previous quarter, but 12% lower than the same period last year, due primarily to the Tackama facility moving from a 7-day to a 5-day per week operating schedule at the beginning of 2007. OSB production decreased by 7% from the previous quarter and 5% compared to the same quarter last year, primarily as a result of the PolarBoard plant moving to a 5-day per week operating schedule, partially offset by increased production at the Peace Valley joint venture, which is continuing through its ramp up. Despite the reduced shifting, productivity at the panel operations increased slightly over the previous quarter.

As a result of continuing weak market conditions, further downtime has been announced for the Tackama plywood facility and the PolarBoard OSB plant, which will reduce production by 8.5 million square feet of plywood and 14.0 million square feet of OSB in the third quarter.

Markets – Lumber and Panels

Demand for solid wood products has remained largely unchanged from the first quarter of 2007. US housing starts were 1.462 million units⁸ for the second quarter of 2007, down by 21% from the second quarter of 2006, and almost unchanged from the first quarter of 2007. Canadian housing starts were 226,533 units⁹ for the second quarter, down by half of a percent from the same period in 2006.

Lumber prices maintained their low levels during the first half of the second quarter. However, the price of 2x4 #2 & Btr. began to increase from the middle of May as industry curtailments were announced. The Random Lengths Framing Lumber Composite price that determines the export tax level payable by Canadian producers averaged US \$293 per Mfbm during the second quarter of 2007. This was 16% below the second quarter 2006 average of US \$347. Although the composite price increased during the second quarter, it is still below the threshold price of US \$316 per Mfbm required to reduce the export tax rate. Consequently, Canfor paid a 15% export tax on all US bound shipments for the quarter.

The North American repair and remodeling sector remained strong during the second quarter. Canfor's lumber shipments to Home Center customers increased by 6% for the second quarter of 2007, compared with the second quarter of 2006.

New home construction has started to decline in Japan from the levels experienced a year ago. Total housing starts from January to May averaged 4.1% below the same period last year and 2x4 housing starts were 1.1% lower. Canfor's offshore lumber shipments increased by 22% in the second quarter of 2007, compared to the second quarter of 2006.

OSB prices have remained relatively flat through much of the quarter. Substantial price gains occurred only in the latter half of June as a result of announced mill closures and downtime throughout the industry, as well the onset of summer construction. However, prices remain low by historical standards.

Outlook – Lumber and Panel Markets

The market for solid wood products is expected to remain near current levels for most of the second half of the year. US housing starts are predicted to remain unchanged for the remainder of the year, as the industry attempts to reduce the inventory of unsold homes. Canadian plywood prices are expected to remain at current levels as

⁸ US Census Bureau (seasonally adjusted annual rate)

⁹ Canadian Mortgage Housing Corporation (seasonally adjusted annual rate)

Canadian new home construction continues to be strong in 2007. However, Canadian housing starts are not expected to increase significantly through the balance of the year.

Pulp and Paper¹⁰

(millions of dollars unless otherwise noted)	Q2 2007	Q1 2007	YTD 2007	Q2 2006	YTD 2006
Sales	\$ 266.4	\$ 267.3	\$ 533.7	\$ 223.0	\$ 450.1
EBITDA	\$ 52.2	\$ 60.9	\$ 113.1	\$ 28.2	\$ 62.8
EBITDA margin	20%	23%	21%	13%	14%
Operating income	\$ 39.6	\$ 48.6	\$ 88.2	\$ 17.3	\$ 39.7
Average pulp price – US \$ ¹¹	\$ 783	\$ 757	\$ 770	\$ 665	\$ 642
Average price in Cdn \$	\$ 859	\$ 886	\$ 874	\$ 746	\$ 731
Production – pulp (000 mt)	308.8	305.4	614.2	272.5	590.6
Production – paper (000 mt)	33.9	31.6	65.5	30.1	63.2
Shipments – Canfor-produced pulp (000 mt)	309.3	304.3	613.6	293.1	606.4
<i>Marketed on behalf of HSLP¹² (000 mt)</i>	102.5	81.4	183.9	98.3	186.9
Shipments – paper (000 mt)	35.9	30.4	66.3	31.3	62.4

The Pulp and Paper segment reported operating income of \$39.6 million in the second quarter of 2007, which was \$9.0 million lower than the previous quarter, but \$22.3 million higher than in the same quarter last year. When compared to the prior quarter, the impact of the strengthening Canadian dollar and higher fibre costs was partially offset by improved NBSK prices and higher sales volumes. Fibre costs increased by 7% when compared to the prior quarter due to higher prices paid for residual chips driven by the lower chip production from sawmills in the BC Interior. When compared to the prior year, the benefit of a 15% increase in Canadian dollar realized prices, along with higher sales and production volumes, was partially offset by higher fibre costs.

Operations

NBSK production during the second quarter was 600 tonnes below the first quarter and 30,500 tonnes higher than the second quarter of 2006. Scheduled maintenance downtime was taken at the Intercon and Northwood pulp mills in the quarter. Production tonnes lost as a result of the downtime were similar to the prior quarter. The large increase in production over the prior year quarter was attributable to shorter scheduled maintenance downtime and a 4% improvement in operating rates. Scheduled maintenance downtime in the second quarter of 2006 resulted in lost production of approximately 30,900 tonnes compared to only 8,500 tonnes in the current quarter.

Paper production during the second quarter was up by 2,300 tonnes over the prior quarter and up 3,800 tonnes when compared to the same period in 2006. Increased production volumes were the result of the differences in scheduled maintenance downtime taken. No maintenance downtime was taken during the current quarter. Productivity rates were also higher in the second quarter of 2007 when compared to the first quarter and to the same quarter in 2006.

The Taylor BCTMP mill achieved improved production rates and pulp quality in the quarter, with production volumes 9% higher than in the previous quarter and 13% higher than in the same quarter last year.

Howe Sound Limited Partnership, which Canfor does not consolidate in its results, earned EBITDA of \$7.0 million in

¹⁰ Includes the Taylor Pulp Mill and 100% of Canfor Pulp Limited Partnership (CPLP), which is being consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both northern bleached softwood kraft (NBSK) and bleached chemi-thermo mechanical pulp (BCTMP).

¹¹ Per tonne, Northern Europe delivered price (RISI World Pulp Monthly, table #5)

¹² Howe Sound Pulp and Paper Limited Partnership

the second quarter and \$10.6 million for the year to date. EBITDA improved by \$3.4 million over the previous quarter, primarily as a result of higher pulp prices and shipment volumes. Shipment volumes in the first quarter were lower than normal due to late vessel departures and the impact of the kraft mill's annual maintenance shutdown. As further discussed in the "Risks and Uncertainties" section below, the Coastal BC forestry workers' strike that is currently underway could potentially jeopardize the continuity of operations at Howe Sound.

Markets

Market conditions for the second quarter of 2007 remained strong. At just 24 days of supply, inventories for softwood market pulp decreased by one day from the level at the end of the first quarter of 2007. Generally, a supply of 30 days is considered a level indicative of a well-balanced market. The supply side of the industry continues to remain tight due to earlier closures of Canadian mills. Fibre supply issues in Canada and in Europe, and the impact of the strengthening Canadian dollar on Canadian producers, may result in additional curtailments. The market concerns over further reductions in supply are currently tempered by a small drop in demand from the printing and writing paper sector. The benchmark list price for delivery into Northern Europe stood at US \$760 per tonne at the end of March 2007 and finished the second quarter at US \$800 per tonne, compared to the second quarter of 2006, when the list price into Northern Europe averaged US \$665 per tonne.

Outlook – Pulp Markets

It is expected that NBSK supply and demand will continue to be in balance to the end of 2007, allowing the market price of northern softwood pulp to remain strong. During 2008, there may be some downward pressure on prices as new South American softwood and hardwood capacity impacts the market. Although CPLP does not compete directly with South American pulps, the increased capacity could be expected to cause downward pressure on all pulp prices. As the pricing differential between hardwood and softwood increases, substitution becomes more economically viable. This situation will be tempered by the possibility that the strong Canadian dollar, high fibre costs and low fibre availability could further reduce NBSK production from producers in Canada and Scandinavia.

Non-Segmented Items

(millions of dollars)	Q2 2007	Q1 2007	YTD 2007	Q2 2006	YTD 2006
Corporate costs	\$ (10.5)	\$ (13.3)	\$ (23.8)	\$ (11.7)	\$ (18.5)
Net interest income (expense)	\$ (3.3)	\$ 0.6	\$ (2.7)	\$ (11.8)	\$ (21.6)
Foreign exchange gain (loss) on long-term debt and temporary investments	\$ 16.8	\$ (6.0)	\$ 10.8	\$ 24.4	\$ 23.4
Gain (loss) on derivative financial instruments	\$ (7.7)	\$ 8.6	\$ 0.9	\$ -	\$ -
Equity income and other income (expense), net	\$ (13.7)	\$ 10.2	\$ (3.5)	\$ (3.5)	\$ (2.6)

Corporate Costs

Corporate costs, at \$10.5 million were \$2.8 million lower than in the previous quarter, primarily due to a reversal of the year-to-date accrual for the short-term incentive plan. \$4.6 million of severance costs were recorded in the current quarter, as a result of implementing a cost-reduction program. The previous quarter included a \$4.6 million charge for the CEO's remuneration on resignation, including \$1.9 million of pension costs. Corporate costs in the second quarter of 2006 included a \$1.8 million insurance deductible for a fire at the PolarBoard operation.

Net Interest Income (Expense)

Net interest expense of \$3.3 million in the quarter was comprised of \$11.1 million of interest on long and short-term debt, partially offset by \$7.8 million of interest income on short-term investments. Net interest income of \$0.6 million in the previous quarter was comprised of \$11.3 million of interest income on short-term investments and \$2.2 million of additional interest income on the countervailing and anti-dumping duty refund, which was almost entirely offset by \$12.9 million of interest on long and short-term debt. Net interest expense of \$11.8 million in the second quarter of

2006 was comprised of \$12.6 million of interest on long and short-term debt, partially offset by interest income of \$0.8 million.

Gain on Derivative Financial Instruments

On January 1, 2007, Canfor adopted the Canadian Institute of Chartered Accountants' new standards for financial instruments, comprehensive income and hedging. Canfor elected not to apply hedge accounting to its derivative financial instruments that were outstanding at December 31, 2006. As a result, these derivatives, which were previously not recorded in the financial statements until they were exercised, were recorded at their fair value on January 1, 2007 as an adjustment to opening "Accumulated Other Comprehensive Income". The derivatives were revalued to fair market value at June 30, 2007, resulting in a loss of \$7.7 million being recorded in the second quarter (year to date – gain of \$0.9 million).

Equity Income and Other Income (Expense), Net

Equity income and other expenses netted to an expense of \$13.7 million in the second quarter, which was comprised of \$0.1 million of income from equity investees and \$13.8 million of foreign exchange translation losses on cash, trade receivables and payables. The first quarter's net equity and other income of \$10.2 million was comprised of \$0.1 million of losses from equity investees offset by \$10.3 million of foreign exchange translation gains, while the second quarter 2006 net expense of \$3.5 million was comprised of \$3.6 million of project costs related to the pulp business and \$0.4 million of other expenses, partially offset by equity income of \$0.5 million.

LIQUIDITY AND CAPITAL RESOURCES

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

(millions of dollars)	Q2 2007	Q1 2007	YTD 2007	Q2 2006	YTD 2006
Ratio of current assets to current liabilities			3.7 : 1		2.3 : 1
Ratio of net debt to capitalization ¹³			5%		23%
Increase (decrease) in cash and cash equivalents	\$ 26.0	\$ (585.8)	\$ (559.8)	\$ 17.1	\$ (299.8)
from:					
Operating activities	\$ 22.2	\$ (561.7)	\$ (539.5)	\$ 98.7	\$ (40.5)
Financing activities	\$ (30.7)	\$ (61.6)	\$ (92.3)	\$ (65.1)	\$ (37.7)
Investing activities	\$ 34.5	\$ 37.5	\$ 72.0	\$ (16.5)	\$ (238.2)
Discontinued operations	\$ -	\$ -	\$ -	\$ -	\$ 16.6

Operating activities generated \$22.2 million of cash in the second quarter of 2007, compared to \$561.7 million consumed in the previous quarter and \$98.7 million generated in the second quarter of 2006. The improvement in cash flow from operations over the previous quarter is mainly due to the draw down of log inventories, which typically increase in the first quarter because of the seasonality of logging activity, and also because of an income tax instalment of \$206.3 million and a US \$164.0 million special lumber export charge that were both paid in the first quarter of 2007. Cash generated from operations decreased by \$76.2 million from the same quarter last year, primarily due to the lower operating income.

Financing activities consumed \$30.7 million of cash in the second quarter of 2007 as a result of long-term debt repayments of \$11.7 million, net operating bank loan repayments of \$2.7 million and \$16.3 million of distributions paid by CPLP to non-controlling interests. In the previous quarter, \$41.6 million of long-term debt repayments were made and \$22.7 million of distributions were paid by CPLP to non-controlling interests, partially offset by \$2.6 million of net proceeds from operating bank loans. Cash used for financing activities of \$65.1 million in the second quarter of 2006

¹³ Net debt (total debt less cash and temporary investments) divided by net debt plus shareholders' equity.

was comprised of \$12.7 million of long-term debt repayments and \$52.3 million of repayments on operating bank loans.

The \$34.5 million of cash generated from investing activities in the second quarter primarily resulted from the redemption of temporary investments of \$61.7 million, partially offset by \$23.5 million of capital expenditures. In the previous quarter, \$53.7 million of temporary investments were redeemed and \$18.3 million of capital expenditures were made. In the second quarter of 2006, \$4.7 million of temporary investments were redeemed and \$24.4 million of capital expenditures were made.

At June 30, 2007, Canfor had \$449.4 million of bank operating lines of credit available, of which \$1.0 million was drawn down and an additional \$51.7 million was reserved for several standby letters of credit.

RISKS AND UNCERTAINTIES

A comprehensive discussion of Risks and Uncertainties was included in the Company's 2006 Annual Report. An update of that discussion is included below.

Howe Sound Limited Partnership (Howe Sound)

BC's unionized Coastal logging and sawmill workers commenced strike action at midnight, Friday July 20th. The strike action will likely exacerbate fibre cost inflation and availability issues on the Coast. Howe Sound relies on wood chips supplied by Coastal sawmills. Depending on the length of the strike, Howe Sound may be forced to partially or fully curtail its operations.

At June 30th, Canfor had unsecured receivable balances outstanding with Howe Sound of \$14.5 million.

Surge Tax

The Softwood Lumber Agreement (SLA), which was implemented in the fourth quarter of 2006, includes a surge mechanism that increases the export tax by 50% when the monthly volume of exports from a region exceeds a certain trigger volume, as defined in the SLA. The US Coalition for Fair Lumber Imports has alleged that the US consumption figures that are used in calculating the allowable exports in a month should not be the estimated or expected consumption but should be the actual consumption based on a 12-month rolling average. Canada maintains that the US is wrongly interpreting the point at which the surge clause is triggered. Consultations between Canadian and US government officials took place on April 19th, without a resolution being reached. The US can request binding arbitration that would be heard by panelists from non-involved countries. Although the Government of Canada is committed to defending its position, there is some potential that Canfor will have an additional export tax liability of approximately \$20 million for the period under dispute. The arbitration, if it occurs, would likely not be complete until early 2008.

SELECTED QUARTERLY FINANCIAL INFORMATION

	Q2 2007	Q1 2007	Q4 2006	Q3 2006	Q2 2006	Q1 2006	Q4 2005	Q3 2005
Sales and Income (millions of dollars)								
Sales	\$ 876.6	\$ 850.6	\$ 892.0	\$ 927.7	\$ 1,059.9	\$ 962.7	\$ 853.8	\$ 934.1
Operating income (loss)	\$ (38.4)	\$ (57.8)	\$ 656.1	\$ (44.8)	\$ (15.3)	\$ 38.5	\$ (14.7)	\$ (5.8)
Net income (loss) from continuing operations	\$ (38.8)	\$ (42.7)	\$ 466.9	\$ (51.6)	\$ 39.2	\$ 21.2	\$ (10.6)	\$ 20.7
Net income (loss)	\$ (38.8)	\$ (42.7)	\$ 465.3	\$ (51.6)	\$ 39.2	\$ 18.9	\$ (12.3)	\$ 17.4
Per common share (dollars)								
Net income (loss) from continuing operations								
Basic	\$ (0.27)	\$ (0.30)	\$ 3.28	\$ (0.36)	\$ 0.28	\$ 0.15	\$ (0.07)	\$ 0.14
Diluted	\$ (0.27)	\$ (0.30)	\$ 3.27	\$ (0.36)	\$ 0.28	\$ 0.15	\$ (0.07)	\$ 0.14
Net income (loss)								
Basic and diluted	\$ (0.27)	\$ (0.30)	\$ 3.26	\$ (0.36)	\$ 0.28	\$ 0.13	\$ (0.09)	\$ 0.12
Statistics								
Lumber shipments (MMfbm)	1,345	1,213	1,352	1,416	1,597	1,313	1,176	1,334
Plywood shipments (MMsf 3/8")	119	87	110	103	118	110	98	124
OSB shipments (MMsf 3/8")	168	174	184	193	188	157	118	132
Pulp shipments (000 mt)	309	304	292	308	293	313	312	310
Average exchange rate (Cdn\$/US\$)								
	\$ 0.911	\$ 0.854	\$ 0.878	\$ 0.892	\$ 0.891	\$ 0.866	\$ 0.852	\$ 0.832
Average Western SPF 2x4 #2&Btr lumber price (US \$)								
	\$ 258	\$ 253	\$ 245	\$ 278	\$ 316	\$ 343	\$ 328	\$ 327
Average SYP (East) 2x4 #2 lumber price (US \$)								
	\$ 292	\$ 279	\$ 272	\$ 304	\$ 380	\$ 435	\$ 439	\$ 457
Average plywood price—Toronto (Cdn \$)								
	\$ 357	\$ 379	\$ 366	\$ 364	\$ 360	\$ 375	\$ 387	\$ 362
Average OSB price—North Central (US \$)								
	\$ 156	\$ 145	\$ 166	\$ 181	\$ 238	\$ 285	\$ 317	\$ 291
Average NBSK pulp list price delivered to Northern Europe (US \$)								
	\$ 783	\$ 757	\$ 730	\$ 710	\$ 665	\$ 618	\$ 600	\$ 587

In addition to exposure to foreign exchange and changes in product prices, 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. In the first quarter of 2007, strike action at CN resulted in shortages in railcar supply, which had an adverse impact on shipment volumes in the quarter. A container truckers' strike at the Port of Vancouver impacted offshore shipments in the third quarter of 2005.

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 reversed on the income statement beginning in the third quarter of 2006, and a further 29.8% at the end of November 2006, which affects comparability of net income of prior periods. The results from the New South operations, which were acquired in March 2006, also impact the comparability of the quarterly results.

Other factors that impact the comparability of the quarters are noted below:

(millions of dollars, after tax)	Q2 2007	Q1 2007	Q4 2006	Q3 2006	Q2 2006	Q1 2006	Q4 2005	Q3 2005
Foreign exchange gain (loss) on long-term debt and temporary investments	\$ 10.2	\$ (5.3)	\$ (9.9)	\$ (5.6)	\$ 20.2	\$ (0.8)	\$ (3.8)	\$ 24.7
Gain (loss) on derivative financial instruments	(3.7)	4.9	-	-	-	-	-	-
Duty refund and interest ¹⁴	-	1.4	551.2	-	-	-	-	-
Mill closure and severance costs	(5.8)	-	(4.3)	-	-	-	-	(2.5)
CEO remuneration on resignation	-	(3.0)	-	-	-	-	-	-
Gain (loss) on timber take back	-	-	-	-	-	-	2.7	(8.9)
Insurance deductible on fire at PolarBoard OSB plant	-	-	-	-	(1.4)	-	-	-
Corporate development costs related to segregation of pulp and paper business	-	-	-	-	(2.4)	-	-	-
Spinout costs incurred directly by CPLP	-	-	-	(3.1)	-	-	-	-
Change in accounting practice for pulp maintenance costs	-	-	-	-	2.6	-	-	-
Adjustment to prior period's incentive costs	2.3	-	-	-	-	1.1	(2.6)	-
Write down of equity and other investments	-	-	(16.2)	-	-	-	-	-
Distribution from Seaboard General Partnership arising from asset sales	-	-	-	-	-	-	8.9	-
Corporate income tax rate reductions	1.0	-	-	-	43.9	-	-	21.0
Prior year tax reassessments and other tax adjustments	-	-	0.5	-	(1.0)	-	-	-
Net income (loss) from discontinued operations	-	-	(1.6)	-	-	(2.3)	(1.7)	(3.3)
Net favourable (unfavourable) impact on quarterly earnings	\$ 4.0	\$ (2.0)	\$ 519.7	\$ (8.7)	\$ 61.9	\$ (2.0)	\$ 3.5	\$ 31.0

OUTSTANDING SHARES

At July 27, 2007, there were 142,582,267 common shares outstanding.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ending June 30, 2007, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

¹⁴ The refund of \$717.7 million was included in the Lumber segment's operating income in the fourth quarter of 2006 and the interest income of \$97.7 million is offset against the interest expense line on the income statement. Additional interest of \$2.2 million was received in the first quarter of 2007.

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)	Q2 2007	Q1 2007	YTD 2007	Q2 2006	YTD 2006
Net income (loss) from continuing operations	\$ (38.8)	\$ (42.7)	\$ (81.5)	\$ 39.2	\$ 60.4
Add (subtract):					
Non-controlling interests	18.1	24.3	42.4	-	-
Income tax recovery	(25.6)	(26.0)	(51.6)	(45.4)	(38.0)
Other (income) expense	13.8	(10.3)	3.5	4.0	3.7
(Gain) loss on derivative financial instruments	7.7	(8.6)	(0.9)	-	-
Foreign exchange (gain) loss on long-term debt and temporary investments	(16.8)	6.0	(10.8)	(24.4)	(23.4)
Interest (income) expense	3.3	(0.6)	2.7	11.8	21.6
Equity (income) loss of affiliated companies	(0.1)	0.1	-	(0.5)	(1.1)
Amortization	43.5	47.8	91.3	42.2	87.0
EBITDA (operating income (loss) before amortization)	\$ 5.1	\$ (10.0)	\$ (4.9)	\$ 26.9	\$ 110.2

Consolidated Income Statements

(millions of dollars, unaudited)	3 months ended June 30,		6 months ended June 30,	
	2007	2006	2007	2006
Sales	\$ 876.6	\$ 1,059.9	\$ 1,727.2	\$ 2,022.6
Costs and expenses				
Manufacturing and product costs	662.0	814.6	1,324.1	1,496.0
Freight and other distribution costs	152.7	163.4	296.0	315.8
Export tax / countervailing and anti-dumping duties	29.2	32.1	57.9	62.3
Amortization	43.5	42.2	91.3	87.0
Selling and administration costs	18.9	22.9	45.4	38.3
Restructuring costs (Note 4)	8.7	-	8.7	-
	915.0	1,075.2	1,823.4	1,999.4
Operating income (loss) from continuing operations	(38.4)	(15.3)	(96.2)	23.2
Equity income of affiliated companies	0.1	0.5	-	1.1
Interest expense	(3.3)	(11.8)	(2.7)	(21.6)
Foreign exchange gain on long-term debt and temporary investments	16.8	24.4	10.8	23.4
Gain (loss) on derivative financial instruments (Note 6)	(7.7)	-	0.9	-
Other expense	(13.8)	(4.0)	(3.5)	(3.7)
Net income (loss) from continuing operations before income taxes	(46.3)	(6.2)	(90.7)	22.4
Income tax recovery (Note 7)	25.6	45.4	51.6	38.0
Non-controlling interests	(18.1)	-	(42.4)	-
Net income (loss) from continuing operations	(38.8)	39.2	(81.5)	60.4
Net loss from discontinued operations	-	-	-	(2.3)
Net income (loss)	\$ (38.8)	\$ 39.2	\$ (81.5)	\$ 58.1
Per common share (in dollars) (Note 8)				
Net income (loss) from continuing operations				
Basic & diluted	\$ (0.27)	\$ 0.28	\$ (0.57)	\$ 0.42
Net income (loss)				
Basic & diluted	\$ (0.27)	\$ 0.28	\$ (0.57)	\$ 0.41

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

Consolidated Cash Flow Statements

(millions of dollars, unaudited)	3 months ended June 30,		6 months ended June 30,	
	2007	2006	2007	2006
Cash generated from (used in)				
Operating activities				
Net income (loss) from continuing operations	\$ (38.8)	\$ 39.2	\$ (81.5)	\$ 60.4
Items not affecting cash:				
Amortization	43.5	42.2	91.3	87.0
Income taxes	3.0	(41.2)	(9.8)	(41.4)
Long-term portion of deferred reforestation	(10.6)	(10.9)	5.8	10.9
Employee future benefits	(1.2)	3.7	(3.4)	7.6
Foreign exchange gain on long-term debt	(47.8)	(24.4)	(54.3)	(23.4)
Loss (gain) on derivative financial instruments	7.7	-	(0.9)	-
Non-controlling interests	18.1	-	42.4	-
Other	0.5	2.6	3.0	(1.1)
Changes in non-cash working capital (Note 9)	47.8	87.5	(532.1)	(140.5)
	22.2	98.7	(539.5)	(40.5)
Financing activities				
Proceeds from long-term debt	-	-	-	1.0
Repayment of long-term debt	(11.7)	(12.7)	(53.3)	(48.2)
Changes in operating bank loans	(2.7)	(52.3)	(0.1)	9.6
Cash distributions paid to non-controlling interests	(16.3)	-	(39.0)	-
Other	-	(0.1)	0.1	(0.1)
	(30.7)	(65.1)	(92.3)	(37.7)
Investing activities				
Changes in temporary investments	61.7	4.7	115.4	7.0
Acquisition of New South Companies, Inc.	-	-	-	(206.1)
Property, plant, equipment and timber	(23.5)	(24.4)	(41.8)	(39.4)
Proceeds from sale of property, plant and equipment	0.1	1.2	0.6	1.8
Other	(3.8)	2.0	(2.2)	(1.5)
	34.5	(16.5)	72.0	(238.2)
Increase (decrease) in cash and cash equivalents from continuing operations	26.0	17.1	(559.8)	(316.4)
Increase in cash from discontinued operations	-	-	-	16.6
Increase (decrease) in cash and cash equivalents	26.0	17.1	(559.8)	(299.8)
Cash and cash equivalents at beginning of period	438.0	(18.0)	1,023.8	298.9
Cash and cash equivalents at end of period	\$ 464.0	\$ (0.9)	\$ 464.0	\$ (0.9)
Cash payments in the period				
Interest, net	\$ 0.3	\$ 3.4	\$ 2.9	\$ 22.6
Income taxes	\$ 36.7	\$ 2.2	\$ 243.0	\$ 6.7

Consolidated Balance Sheets

(millions of dollars)	As at June 30, 2007	As at December 31, 2006
	(unaudited)	(audited)
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 464.0	\$ 1,023.8
Temporary investments	8.8	126.0
Accounts receivable		
Trade	264.4	223.9
Other	51.6	72.8
Income taxes recoverable	47.3	-
Future income taxes	21.4	15.7
Inventories	585.3	635.7
Prepaid expenses	50.2	37.7
Total current assets	1,493.0	2,135.6
Long-term investments and other assets	112.2	115.3
Property, plant, equipment and timber	2,199.0	2,254.9
Goodwill	74.4	81.6
Deferred charges	86.6	91.8
	\$ 3,965.2	\$ 4,679.2
LIABILITIES		
Current Liabilities		
Operating bank loans	\$ 1.0	\$ 1.1
Accounts payable and accrued liabilities	310.9	579.0
Current portion of long-term debt	50.1	87.5
Current portion of deferred reforestation	40.6	39.6
Income taxes payable	-	235.4
Future income taxes	15.4	20.7
Total current liabilities	418.0	963.3
Long-term debt (Note 2)	531.7	602.8
Other accruals and provisions (Note 3)	188.2	173.3
Future income taxes, net	407.3	415.4
Non-controlling interests	309.0	296.7
	\$ 1,854.2	\$ 2,451.5
SHAREHOLDERS' EQUITY		
Share capital – 142,582,267 common shares outstanding	\$ 1,124.6	\$ 1,124.3
Contributed surplus	31.9	31.9
Retained earnings	971.6	1,068.5
Accumulated other comprehensive income (loss)	(17.1)	3.0
	\$ 2,111.0	\$ 2,227.7
	\$ 3,965.2	\$ 4,679.2

Subsequent Event (Note 11)

R. L. Cliff

Director, R.L. Cliff

J. F. Shepard

Director, J.F. Shepard

Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Loss

(millions of dollars, unaudited)	3 months ended June 30,		6 months ended June 30,	
	2007	2006	2007	2006
Consolidated Statements of Changes in Shareholders' Equity				
Share capital				
Balance at beginning of period	\$ 1,124.5	\$ 1,268.9	\$ 1,124.3	\$ 1,268.7
Common shares issued on exercise of stock options	0.1	-	0.3	0.2
Balance at end of period	\$ 1,124.6	\$ 1,268.9	\$ 1,124.6	\$ 1,268.9
Contributed surplus				
Balance at beginning of period	\$ 31.9	\$ -	\$ 31.9	\$ -
Balance at end of period	\$ 31.9	\$ -	\$ 31.9	\$ -
Retained earnings				
Balance at beginning of period	\$ 1,010.4	\$ 798.4	\$ 1,068.5	\$ 779.5
Implementation of financial instruments standards (Note 1)	-	-	(13.2)	-
Change in accounting for CPLP's pension liability (Note 5)	-	-	(2.2)	-
Net income (loss)	(38.8)	39.2	(81.5)	58.1
Balance at end of period	\$ 971.6	\$ 837.6	\$ 971.6	\$ 837.6
Accumulated other comprehensive income (loss)				
Balance at beginning of period	\$ 0.2	-	\$ -	-
Implementation of financial instruments standards (Note 1)	-	-	(1.9)	-
Reclassification from foreign exchange translation adjustment	-	-	3.0	-
Net change in foreign exchange translation adjustment	(17.8)	-	(20.4)	-
Reclassification to income of losses on derivatives designated as cash flow hedges in prior periods	0.5	-	2.2	-
Balance at end of period	\$ (17.1)	-	\$ (17.1)	-
Foreign exchange translation adjustment				
Balance at beginning of period	\$ -	\$ 1.9	\$ 3.0	\$ (1.6)
Reclassification to accumulated other comprehensive income (loss)	-	-	(3.0)	-
Unrealized foreign exchange translation gain	-	(9.8)	-	(6.3)
Balance at end of period	\$ -	\$ (7.9)	\$ -	\$ (7.9)
Shareholders' equity at end of period	\$ 2,111.0	\$ 2,098.6	\$ 2,111.0	\$ 2,098.6
Consolidated Statement of Comprehensive Loss				
Net loss	\$ (38.8)	-	\$ (81.5)	-
Other comprehensive income (loss)				
Exchange translation adjustment on self-sustaining foreign subsidiaries	(17.8)	-	(20.4)	-
Reclassification to income of losses on derivatives designated as cash flow hedges in prior periods, net of taxes and non-controlling interests	0.5	-	2.2	-
Other comprehensive loss	(17.3)	-	(18.2)	-
Total comprehensive loss	\$ (56.1)	-	\$ (99.7)	-

Notes to the Consolidated Interim Financial Statements

(unaudited, millions of dollars unless otherwise noted)

1. Significant Accounting Policies and Change in Accounting Policy

Basis of Presentation

These 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, 2006. These interim financial statements follow the same accounting policies and methods of computation as used in the 2006 consolidated financial statements, except as noted below.

Change in Accounting Policy

Effective January 1, 2007, Canfor adopted the Canadian Institute of Chartered Accountants' new Handbook Section 3855 "Financial Instruments", Section 3861 "Financial Instruments – Disclosure and Presentation", Section 3865 "Hedges", and Section 1530 "Comprehensive Income". Section 3855 prescribes when a financial instrument should be recognized on the balance sheet and at what amount. It also specifies how to present financial instrument gains and losses. Section 3865, which is optional, provides alternative treatments to Section 3855 for when qualifying transactions are designated as hedges for accounting purposes. Section 1530 introduces new requirements for situations when certain gains and losses ("other comprehensive income", or "OCI") must be temporarily presented outside of net income in a new Statement of Comprehensive Income (Loss). Cumulative changes in OCI are included in Accumulated Other Comprehensive Income ("AOCI"), which is presented as a new category of Shareholders' Equity on the Consolidated Balance Sheet. The adoption of these new standards at January 1, 2007 resulted in adjustments to opening retained earnings and AOCI, as described below. Comparative amounts for prior periods have not been restated.

Under Section 3855, all financial instruments are classified into one of these five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives are measured in the Consolidated Balance Sheet at fair value on initial recognition except for certain related party transactions. Subsequent measurement depends on the initial classification of the instrument. Held-for-trading financial assets are measured at fair value, with changes in fair value recognized in net income. Available-for-sale financial instruments are measured at fair value, with changes in fair value recorded in OCI until the instrument is derecognized or impaired. Loans and receivables, held-to-maturity investments and other financial liabilities are measured at amortized cost. All derivative instruments, including embedded derivatives, are recorded in the Consolidated Balance Sheet at fair value unless they qualify for the normal sales and purchases exemption. Changes in the fair value of derivatives that are not exempt are recorded in income unless hedge accounting is used, in which case changes in fair value are recorded in OCI.

As a result of adopting these new standards, Canfor has classified its cash as held-for-trading and its temporary investments as held-to-maturity. Accounts receivable are classified as loans and receivables. Long-term investments are classified as available for sale, and notes and other advances are classified as loans and receivables. Bank indebtedness, operating bank loans, accounts payable and accrued charges, and long-term debt, including interest payable, are classified as other liabilities, all of which are measured at amortized cost. Derivative instruments are recorded in the balance sheet at fair value, including those derivatives that are embedded in financial or non-financial contracts that are not closely related to the host contract.

Canfor has elected to not utilize hedge accounting on its existing derivative financial instruments. As a result, these instruments, which were previously not recognized in the financial statements until they were exercised, were classified as held-for-trading and were measured at fair value through opening AOCI at January 1, 2007. The opening adjustments to AOCI were a reduction of \$3.9 million to record the fair value of hedging relationships existing prior to adopting Section 3855, partially offset by adjustments for future income taxes and non-controlling interests amounting to \$2.0 million, and a credit of \$3.0 million to reclassify the "Foreign Exchange Translation Adjustment" that was previously presented as a separate line item within Shareholders' Equity.

Opening retained earnings was reduced by \$13.2 million as a result of the implementation of these new standards. This amount was comprised of a \$14.2 million deferred unrealized foreign exchange loss on long-term debt arising from a previous hedging relationship and \$2.8 million of deferred financing costs that were written off, partially offset by a \$3.8 million adjustment to the associated liabilities for future income taxes and non-controlling interests.

2. Bank Indebtedness and Long-Term Debt

At June 30, 2007, Canfor had \$449.4 million of bank operating lines of credit available, of which \$1.0 million was drawn down and an additional \$51.7 million was reserved for several standby letters of credit.

At June 30, 2007, the fair value of Canfor's long-term debt, which was measured at its amortized cost of \$581.8 million, was \$582.8 million. The fair value of long-term debt was determined based on prevailing market rates for long-term debt with similar characteristics and risk profiles.

3. Other Accruals and Provisions

	June 30, 2007	December 31, 2006
Deferred reforestation	\$ 76.7	\$ 70.9
Accrued pension obligations	25.9	22.7
Post employment benefits	81.1	75.1
Other long-term liabilities	4.5	4.6
Total other accruals and provisions	\$ 188.2	\$ 173.3

4. Restructuring Costs

Restructuring costs of \$8.7 million, primarily comprised of severance, were recorded in the second quarter of 2007, \$4.1 million in the Lumber segment and \$4.6 million in corporate costs, as a result of implementing a cost-reduction program in the period. An additional liability will be recorded in subsequent periods as the affected positions are identified.

5. Employee Future Benefits

Canfor's total benefit costs were as follows:

	3 months ended June 30,		6 months ended June 30,	
	2007	2006	2007	2006
Defined benefit pension plans	\$ 3.9	\$ 4.6	\$ 7.7	\$ 9.2
Other employee future benefit plans	4.2	4.2	8.5	8.3
Defined contribution pension plans and 401(k) plans	1.1	0.9	2.0	1.6
Contributions to forest industry union plans	6.1	6.4	12.6	13.0
	\$ 15.3	\$ 16.1	\$ 30.8	\$ 32.1

At December 31, 2006, Canfor had recorded a prepaid pension benefit of \$64.8 million. In the first quarter of 2007, an actuarial calculation was performed to identify and segregate the pension asset applicable to Canfor Pulp Limited Partnership (CPLP). At December 31, 2006, CPLP had accounted for their employee future benefit plans as a multi-employer plan, and adopted defined-benefit accounting in the current period on a retroactive basis, without restatement. As a result, Canfor recorded an opening adjustment of \$2.2 million to retained earnings to reflect the non-controlling interest, net of tax, applicable to CPLP's opening adjustment to equity.

6. Gain (Loss) on Derivative Financial Instruments

Canfor 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 June 30, 2007, the fair value of outstanding derivative commodity contracts was \$1.5 million. The fair value of these contracts was determined based on prevailing market rates for instruments with similar characteristics.

The loss of \$7.7 million recorded in the second quarter was comprised of the change in the fair value of derivative financial instruments in the period of \$6.7 million and the reclassification, from accumulated other comprehensive income, of unrealized losses of \$1.0 million on derivatives formerly designated as cash flow hedges that were exercised in the current period.

7. Income Tax Recovery

	3 months ended June 30,		6 months ended June 30,	
	2007	2006	2007	2006
Current	\$ 40.2	\$ 3.6	\$ 40.4	\$ (2.4)
Future	(14.6)	46.1	11.2	40.8
Tax on equity earnings	-	(0.2)	-	(0.4)
	25.6	49.5	51.6	38.0
Amortization of deferred credit on utilization of acquired tax losses	-	(4.1)	-	-
	\$ 25.6	\$ 45.4	\$ 51.6	\$ 38.0

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

	3 months ended June 30,		6 months ended June 30,	
	2007	2006	2007	2006
Income tax recovery (expense) at statutory tax rate	\$ 15.8	\$ 2.2	\$ 31.0	\$ (7.7)
Large corporation tax	-	0.9	-	-
Amortization of deferred credit on utilization of acquired tax losses	-	(4.1)	-	-
Permanent difference from capital gains and losses	1.3	4.2	2.2	4.0
Non-controlling interests	6.2	-	14.5	-
Change in federal general corporate income tax rate	1.0	42.4	1.0	42.4
Other permanent differences and adjustments	1.3	(0.2)	2.9	(0.7)
Income tax recovery	\$ 25.6	\$ 45.4	\$ 51.6	\$ 38.0

8. 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 June 30,		6 months ended June 30,	
	2007	2006	2007	2006
Weighted average number of common shares	142,571,037	142,540,062	142,565,876	142,529,128
Incremental shares from stock options	58,684	81,474	53,881	84,839
Diluted number of common shares	142,629,721	142,621,536	142,619,757	142,613,967

9. Changes in Non-Cash Working Capital

	3 months ended June 30,		6 months ended June 30,	
	2007	2006	2007	2006
Accounts receivable	\$ 10.0	\$ 30.9	\$ (25.6)	\$ (0.1)
Income taxes	(76.6)	(5.5)	(282.7)	(6.3)
Future income taxes	9.3	-	(5.3)	-
Inventories	216.7	248.5	50.4	(4.4)
Prepaid expenses	(13.6)	(41.3)	(13.4)	(29.8)
Accounts payable, accrued liabilities and current portion of deferred reforestation	(98.0)	(145.1)	(255.5)	(99.9)
	\$ 47.8	\$ 87.5	\$ (532.1)	\$ (140.5)

10. Segmented Information ^(a)

	Lumber ^(b)	Panels	Pulp & Paper ^(d)	Corporate & Other	Consolidated
3 months ended June 30, 2007					
Sales to external customers	\$ 528.6	81.6	266.4	-	\$ 876.6
Sales to other segments ^(c)	\$ 29.9	1.2	-	-	\$ 31.1
Operating income (loss)	\$ (51.2)	(16.3)	39.6	(10.5)	\$ (38.4)
Amortization	\$ 23.5	6.1	12.6	1.3	\$ 43.5
Capital expenditures	\$ 14.4	0.9	7.5	0.7	\$ 23.5
3 months ended June 30, 2006					
Sales to external customers	\$ 736.1	100.8	223.0	-	\$ 1,059.9
Sales to other segments ^(c)	\$ 22.0	0.9	-	-	\$ 22.9
Operating income (loss)	\$ (10.3)	(10.6)	17.3	(11.7)	\$ (15.3)
Amortization	\$ 22.6	7.0	10.9	1.7	\$ 42.2
Capital expenditures	\$ 19.1	1.9	3.2	0.2	\$ 24.4
6 months ended June 30, 2007					
Sales to external customers	\$ 1,040.2	153.3	533.7	-	\$ 1,727.2
Sales to other segments ^(c)	\$ 58.8	2.1	-	-	\$ 60.9
Operating income (loss)	\$ (125.8)	(34.8)	88.2	(23.8)	\$ (96.2)
Amortization	\$ 51.8	12.1	24.9	2.5	\$ 91.3
Capital expenditures	\$ 26.6	3.5	10.7	1.0	\$ 41.8
Identifiable assets ^(e)	\$ 1,762.5	335.6	973.5	893.6	\$ 3,965.2
6 months ended June 30, 2006					
Sales to external customers	\$ 1,372.4	200.1	450.1	-	\$ 2,022.6
Sales to other segments ^(c)	\$ 38.6	1.6	-	-	\$ 40.2
Operating income (loss)	\$ 11.5	(9.5)	39.7	(18.5)	\$ 23.2
Amortization	\$ 47.2	12.8	23.1	3.9	\$ 87.0
Capital expenditures	\$ 27.8	4.5	7.0	0.1	\$ 39.4
Identifiable assets ^(e)	\$ 2,011.5	364.6	877.6	529.3	\$ 3,783.0

- (a) Operations are presented by product line.
- (b) Sales for the quarter include sales of Canfor-produced lumber of \$454.9 million (2006 – \$566.0 million) and \$874.4 million for the year-to-date (2006 – \$1,085.8 million).
- (c) Sales to other segments are accounted for at prices that approximate market value.
- (d) Includes 100% of Canfor Pulp Limited Partnership and the Taylor Pulp Mill, which was excluded from the spinout of the pulp and paper business in 2006.
- (e) Identifiable assets of the Lumber segment include goodwill of \$74.4 million (2006 – \$79.1 million), which resulted from the acquisition of New South Companies Inc. in March 2006.

Geographic Information

	3 months ended June 30,		6 months ended June 30,	
	2007	2006	2007	2006
Sales by location of customer				
Canada	\$ 156.4	\$ 144.0	\$ 300.8	\$ 290.1
United States	507.7	745.5	1,022.7	1,383.2
Europe	42.6	43.9	87.7	83.9
Far East and Other	169.9	126.5	316.0	265.4
	\$ 876.6	\$ 1,059.9	\$ 1,727.2	\$ 2,022.6
Capital assets, goodwill and other intangible assets by location				
Canada			\$ 2,116.7	\$ 2,169.4
United States			179.8	203.7
Europe			0.1	0.1
Far East and Other			0.7	0.1
			\$ 2,297.3	\$ 2,373.3

11. Subsequent Event

Howe Sound Limited Partnership (Howe Sound)

BC's unionized Coastal logging and sawmill workers commenced strike action at midnight, Friday July 20th. The strike action will likely exacerbate fibre cost inflation and availability issues on the Coast. Howe Sound relies on wood chips supplied by Coastal sawmills. Depending on the length of the strike, Howe Sound may be forced to partially or fully curtail its operations.

At June 30th, Canfor had unsecured receivable balances outstanding with Howe Sound of \$14.5 million.

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



www.canfor.com