



**focus and grow**

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## To Our Shareholders,

Canfor Corporation reported net income of \$32.0 million for the first quarter of 2004, or \$0.34 per share on a diluted basis, compared to income of \$34.1 million, or \$0.37 per share, in the previous quarter and income of \$40.2 million, or \$0.43 per share, in the same quarter of 2003.

The first quarter net income was \$2.1 million lower than the previous quarter, and \$8.2 million lower than the same quarter in 2003, mainly due to the \$6.0 million unrealized foreign exchange loss on long-term debt in the current quarter, compared with gains of \$36.2 million and \$20.7 million in the first and fourth quarters of 2003 (all after tax). Also, the fourth quarter 2003 results included a \$19.5 million after-tax gain on the sale of non-core assets.

Operating income was \$62.4 million, significantly higher than in the previous quarter, mainly because of higher prices for lumber and pulp, and the realization of benefits from the various cost reduction/margin improvement initiatives. Lumber prices averaged 24% higher than the previous quarter and 51% higher than the same period in 2003, while pulp prices averaged 6% higher than the previous quarter and 23% higher than the same period in 2003. However, the impact of the higher prices was lessened by the stronger dollar, which averaged almost 10 cents, or 15%, higher than the first quarter of 2003, resulting in an estimated \$80 million negative impact on gross sales in the quarter.

In the past six years, the Company has more than realized its growth objectives and, with over 5 billion board feet of lumber capacity, is now the largest SPF lumber producer in the world. The cost structure needed to come down, and the latest Cost Reduction/Margin Improvement results clearly indicate that Canfor has become a highly efficient, low cost forest products company. Canfor is now well positioned to compete in its core businesses with the very best in the world.

The Board of Directors would like to thank and acknowledge the enormous efforts and hard work of all the people of Canfor and congratulate them for their accomplishments.

The Board of Directors will continue to assess the Company's requirements for capital expenditures, market conditions and other factors affecting its sources and uses of cash before determining an appropriate dividend policy for the future.



Peter J.G. Bentley  
Chairman



David L. Emerson  
Chief Executive Officer



James A. Shepherd  
President

## Management's Discussion and Analysis

The Management's Discussion and Analysis provides a review of the significant developments that have impacted Canfor's performance during the first quarter of 2004 relative to the previous quarter and the last published annual results as at December 31, 2003 and relative to the comparative quarter in 2003. The following unaudited financial results along with Management's Discussion and Analysis should be read in conjunction with the consolidated financial statements and notes thereto included in Canfor's Annual Report for the year ended December 31, 2003.

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; 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 a key 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 GAAP. As there is no standardized method of calculating EBITDA, the Company's use of the term may not be directly comparable with similarly titled measures used by other companies.

The information in this report is as at April 23, 2004.

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

### Summarized Results for the Quarter

(millions of dollars, except for per share amounts)	1st Quarter 2004	4th Quarter 2003	1st Quarter 2003
Gross sales	\$ 685.6	\$ 656.4	\$ 681.8
Countervailing & anti-dumping duties expensed	\$ (37.4)	\$ (33.3)	\$ (33.9)
EBITDA	\$ 92.4	\$ 27.2	\$ 33.5
Operating income (loss)	\$ 62.4	\$ (0.3)	\$ 3.1
Foreign exchange gain (loss) on long-term debt	\$ (6.0)	\$ 25.4	\$ 44.3
Income from continuing operations, after tax	\$ 32.0	\$ 34.6	\$ 37.1
Discontinued operation, net of tax	\$ -	\$ (0.5)	\$ 3.1
Net income	\$ 32.0	\$ 34.1	\$ 40.2
Per share (diluted)			
Income from continuing operations	\$ 0.34	\$ 0.37	\$ 0.40
Net income	\$ 0.34	\$ 0.37	\$ 0.43

First quarter net income of \$32.0 million was \$2.1 million lower than the previous quarter, and \$8.2 million lower than the same quarter in 2003, mainly due to the \$6.0 million unrealized foreign exchange loss on long-term debt in the current quarter, compared with the large gains in the first and fourth quarters of 2003. Also, the fourth quarter 2003 results included a \$19.5 million after-tax gain on the sale of non-core assets.

Operating income improved significantly in the quarter, mainly because of higher prices for lumber and pulp, but also because the benefits from the various cost reduction/margin improvement initiatives from 2003 are starting to be realized. US dollar lumber prices averaged 24% higher than the previous quarter and 51% higher than the same period in 2003, while pulp prices averaged 6% higher than the previous quarter and 23% higher than the same period in 2003. However, the impact of the higher prices was lessened by the stronger Canadian dollar, which averaged almost 10 cents, or 15%, higher than in the first quarter of 2003.

**OPERATING RESULTS**

The following discussion relates to the operating segments, as presented in the Statements of Segmented Information in the Financial Statements.

**Wood Products**

(millions of dollars unless otherwise noted)	1st Quarter 2004	4th Quarter 2003	1st Quarter 2003
Gross sales	\$ 450.0	\$ 414.2	\$ 415.3
EBITDA	\$ 74.1	\$ 16.6	\$ 7.6
Operating income (loss)	\$ 57.6	\$ 2.4	\$ (8.0)
Average 2"x4" #2 & Better lumber price - US \$ per thousand board feet (source: <i>Random Lengths</i> )	\$ 370	\$ 298	\$ 245
Average price in Cdn \$	\$ 488	\$ 392	\$ 370

The Wood Products segment earned operating income of \$57.6 million in the quarter, which represents a \$55.2 million increase over the previous quarter and a \$65.6 million increase over the same quarter in 2003. Improved earnings are mainly the result of the sharp increase in lumber prices in the quarter, which, after adjusting for the effect of exchange, averaged 24% higher than the previous quarter and 32% higher than the first quarter of 2003. High plywood prices also contributed to the improved results, with Canfor's plywood operation achieving record earnings of \$6.8 million in the quarter, or \$5.7 million more than the same period last year.

The extreme cold weather in January caused some start-up delays at the Houston, Prince George and Fort St John sawmills following their recent capital installations. However, the Houston mill was achieving performance targets by March and Prince George and Fort St John are continuing to improve on their performance as they incorporate their third shifts. The other sawmills exceeded target performance levels in the quarter. By the end of the first quarter, overall productivity was 20% higher and conversion costs were down by 23% in comparison with the fourth quarter of 2003.

During the quarter, Canfor reassessed its anti-dumping duty (ADD) rate for the second period of review, which began in May 2003, based on updated sales and cost data. As a result, a retroactive adjustment was made to reduce the expense for the period from May to December 2003 to 2.86% and the effective rate for the current quarter was estimated at 1.88%. As of March 10, 2004, countervailing duty (CVD) is being paid at the reduced deposit rate of 12.24%, but, as discussed under "Risks and Uncertainties" below, Canfor will continue to record the expense at the original rate of 18.79%. The net CVD/ADD adjustment recorded in the first quarter increased operating income by \$5.3 million (of which \$1.3 million is the retroactive adjustment for 2003).

**Markets:**

During the quarter, lumber prices reached their highest level since June 2002. Prices for Western SPF 2"x4" lumber averaged US \$370 per thousand board feet, or 51% higher than the same period in 2003. The continuing low mortgage rates spurred housing construction and repair and renovation activity through a period in which demand typically slows down. Lumber demand was also strong in offshore markets, particularly in Japan and Korea. Lumber supply and shipments were affected by severe winter weather early in the quarter and by transportation difficulties from railcar and truck shortages. Railcar supply was further reduced because of the CN strike, which raised supply concerns in the marketplace.

Plywood demand was also very strong during the quarter and outstripped available supply. Despite experiencing the same transportation issues as described above, plywood sales volumes were 13% higher than the same period in 2003. The average price of Canadian Softwood Plywood (CSP) sheathing delivered to Toronto was Cdn \$528<sup>1</sup>, or 31% higher than the same period last year.

**Outlook:**

The mills are expected to operate at full capacity in the second quarter, with the exception of the Taylor planer mill, which will be permanently shut down in April. Lumber transportation is steadily returning to normal after the resolution of the rail strike. Exceptionally strong demand for lumber is expected to continue for the next few months, as interest rates remain low and inventories are rebuilt. Although both lumber and plywood prices are expected to retreat from current highs, they are anticipated to remain relatively strong for the first half of the year. Possible interest rate increases during the second half of 2004 may negatively affect housing construction and prices may fall further.

<sup>1</sup> Per MSF, 3/8" basis (Source: C.C. Crow Publications, Inc.)

## Management's Discussion and Analysis

### Pulp and Paper

(millions of dollars unless otherwise noted)	1st Quarter 2004	4th Quarter 2003	1st Quarter 2003
Gross sales	\$ 218.4	\$ 217.0	\$ 228.4
EBITDA	\$ 23.3	\$ 19.6	\$ 19.5
Operating income (loss)	\$ 12.5	\$ 9.2	\$ 8.0
Average pulp price delivered to Northern Europe - US\$ per tonne (source: Pulp & Paper Week)	\$ 590	\$ 555	\$ 480
Average price in Cdn \$	\$ 778	\$ 730	\$ 725

The increase in pulp prices in the quarter was the main factor in the improved results. However, shipment volumes were down by 7% from the previous quarter and were 12% lower than the same quarter in 2003, mainly as a result of railcar shortages due to the CN strike and offshore shipping capacity constraints.

Despite experiencing some weather-related and mechanical problems early in the quarter, overall productivity at the pulp mills averaged near target levels. Lower chip prices and lower labour and maintenance costs also contributed to the improved earnings, although the impact was partially offset by a significant increase in energy costs, which was partly weather-related.

#### Markets:

Demand for market pulp in the first quarter was strong, as a result of solid global economic growth and robust paper markets in Asia. Prices in the northern European market were at US \$560 per tonne at the beginning of the year, and with neither suppliers nor customers holding excess inventories, a small increase in demand quickly led to very tight market conditions. Low inventories and the weaker US dollar in relation to the Canadian dollar and the Euro resulted in pulp producers raising prices. Prices increased in February and March, ending the quarter at US \$620 per tonne in northern Europe.

#### Outlook:

Canfor has announced April 1<sup>st</sup> pulp price increases of US \$20 in northern Europe (to US \$640 per tonne), US \$30 in North America (to US \$650 per tonne) and US \$35-50 in Asia (to US \$625-640 per tonne). Supply is expected to continue to be tight over the next two to three months, as spring is traditionally the time when pulp mills take their maintenance shutdowns. The remainder of 2004 is expected to be characterized by strong demand as all world economies, led by the US and China, are exhibiting economic growth. There is little new softwood pulp capacity planned for 2004 or 2005, which should keep the supply situation for softwood pulp very tight and result in further price increases.

### Coastal Operations

(millions of dollars)	1st Quarter 2004	4th Quarter 2003	1st Quarter 2003
Gross sales	\$ 17.2	\$ 25.2	\$ 38.1
EBITDA	1.7	(2.0)	10.2
Operating income (loss)	0.6	(3.3)	8.2

The Coastal Operations segment earned operating income of \$0.6 million, despite being shut down for the majority of the quarter, which is a significant improvement over the previous quarter's loss of \$3.3 million. In comparison, operating income of \$8.2 million was earned in the first quarter of 2003, when the segment operated at full capacity and experienced strong market demand due to reduced activity by other coastal operators.

Coastal logging operations continued their seasonal shutdown into the beginning of 2004 as a result of the extreme winter weather conditions. In mid-January, the Government of British Columbia announced the launch of the new market-based timber pricing system, effective February 29, 2004. In order to take advantage of the expected \$9 per cubic metre decrease in stumpage fees under the new system, the start-up of logging operations was delayed until late February. As a result, production, sales and operating income were all significantly lower than the same period in 2003. However, as the majority of other coastal operators also delayed start up, lower than normal winter inventories resulted in strengthened demand and prices in the quarter.

**Non-Segmented Items**

(millions of dollars)	1st Quarter 2004	4th Quarter 2003	1st Quarter 2003
Corporate costs	\$ (8.3)	\$ (8.6)	\$ (5.1)
Equity income (loss) of affiliated companies	0.6	0.8	0.2
Net interest expense	(12.4)	(11.1)	(12.7)
Foreign exchange gain (loss) on long-term debt	(6.0)	25.4	44.3
Other income (expense)	0.3	24.2	1.9

Corporate costs for the quarter, at \$8.3 million, were \$3.2 million higher than the same period last year, mainly due to the expensing of incentive awards and higher consulting and legal fees.

Other income in the previous quarter included a gain of \$23.8 million (before tax) realized on the sale of non-core assets.

Although Canfor no longer consolidates Howe Sound Pulp and Paper Limited Partnership (HSLP) into its financial results, the operation reported a net loss of \$18.0 million for the quarter, compared to a net loss of \$9.0 million in the same period in 2003. The results for the quarter were impacted by low newsprint prices, as well as by the same exchange-related issues that have affected Canfor's results. Based on a separate prepayment agreement between Canfor and Oji Paper Co., Ltd., the partners of HSLP, at the end of the first quarter, Canfor had prepaid \$44.5 million to HSLP in advance of the due date of receivables for pulp marketed and collected on their behalf (\$33.5 million had been prepaid at December 31, 2003).

**SUMMARY OF FINANCIAL POSITION**

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

(millions of dollars)	1st Quarter 2004	4th Quarter 2003	1st Quarter 2003
Ratio of current assets to current liabilities	1.8:1	1.5:1	1.5:1
Ratio of net debt to common shareholders' equity	35:65	35:65	43:57
Decrease (increase) in net short-term indebtedness	\$ 51.8	\$ (39.8)	\$ (110.5)
- comprised of cash flow from (used in):			
Operating activities	\$ (6.4)	\$ (9.6)	\$ (93.4)
Financing activities	\$ 71.8	\$ (10.9)	\$ (5.4)
Investing activities	\$ (13.6)	\$ (19.0)	\$ (15.3)
Discontinued operation	\$ -	\$ (0.3)	\$ 3.6

**Changes in Financial Position**

The changes in the components of these ratios during the quarter are detailed in the Consolidated Cash Flow Statement of the Financial Statements. Significant changes in the quarter are discussed below.

Cash flow from operations was still negative in the quarter, but improved by \$3.2 million over the previous quarter and by \$87.0 million over the same quarter in 2003, mainly as a result of the significant increase in EBITDA, as discussed above. Inventories increased by \$138.9 million from the end of the year, mainly because of the seasonal build-up of log inventories, while trade receivables increased by \$36.8 million as a result of higher prices for lumber and pulp. Interest paid in the quarter amounted to \$18.6 million, which was \$2.3 million lower than the same period last year largely due to the effect of the stronger Canadian dollar on US dollar interest payments.

Cash flow from financing activities was \$71.8 million, of which \$66.9 million is proceeds from new long-term financing of US \$50 million that was drawn down in February and \$5.8 million of which is proceeds from the exercise of stock options.

Cash used in investing activities of \$13.6 million is mainly comprised of capital expenditures made by the Wood Products and Pulp and Paper segments.

## Management's Discussion and Analysis

### Liquidity and Financial Requirements

At the end of the quarter, Canfor was in a net short-term indebtedness position of \$5.6 million and had \$225.2 million of unused operating bank lines of credit available, as compared to the December 31, 2003 net short-term indebtedness position of \$57.4 million and \$96.1 million of unused operating lines of credit.

Provisions contained in Canfor's long-term borrowing agreements limit both the amount of indebtedness the Company can incur and the amount of dividends it may pay on its common shares. The amount of dividends the Company is permitted to pay under its long-term borrowing agreements is \$197.0 million or \$2.40 per share. The Company can incur an additional \$536.5 million of long-term debt under these borrowing arrangements.

### Outstanding Shares

At April 23, 2004, there were 131,318,708 common shares outstanding.

### COST REDUCTION/MARGIN IMPROVEMENT (CRMI) PROGRAM

In October 2002, Canfor announced a company-wide Cost Reduction/Margin Improvement program to achieve \$150 million in net structural improvements on an annualized basis by the fourth quarter of 2003. To compensate for the rise in the Canadian dollar and other negative cost pressures, the goal was subsequently raised to \$230 million.

On an annualized basis, structural savings achieved at the end of 2003 from Interior Fibre, Pulp and Paper, Coastal Operations, Centralized Services and Corporate projects totaled \$131 million. Wood Products had completed initiatives by the end of the year which management estimated would generate annual savings of \$100 million in 2004, and Pulp and Paper estimated that a further \$14 million of savings would be achieved in 2004, for a total of \$245 million.

A number of challenges were faced in the first quarter of 2004, including stretches of very cold weather in January, and the start-up of the sawmill upgrades. However, by the end of February, these issues were substantially resolved, and in the month of March the Company's operations were achieving CRMI benefits in line with previously announced goals. As mentioned in the Wood Products section above, conversion costs have been declining steadily as a result of the CRMI initiatives. Conversion costs for the first quarter of 2004 were \$110 per thousand board feet, 10% lower than the average for 2003. However, these cost improvements have accelerated during the quarter as the impacts of CRMI initiatives have been realized. Average monthly cash conversion costs per thousand board feet have continued to decline in the quarter, moving from \$119 in January to \$109 in February and \$102 in March.

The operations are expected to continue to achieve these benefits and more in future quarters. With the integration of the former Slocan operations, new performance targets are being developed.

### **RISKS AND UNCERTAINTIES**

A comprehensive discussion of Risks and Uncertainties was included in the 2003 Annual Report. An update of that discussion is included below.

#### **Canada/US Softwood Lumber Dispute**

In November 2003, the US Department of Commerce (DOC) responded to Canfor's request in March 2003 for an expedited review by issuing a preliminary CVD deposit rate of 12.24%. In early March 2004, the DOC confirmed this finding and Canfor's CVD cash deposit rate was reduced from 18.79% to 12.24% for shipments to the US effective from March 10, 2004. Canfor has made no retroactive adjustment for this and is still expensing at the original rate of 18.79% until there is more certainty over whether a company-specific administrative review will be granted.

As a result of a NAFTA Panel ruling in September 2003 rejecting the use of cross-border benchmarks, the DOC announced that the national CVD rate would be reduced to 13.23% from 18.79%. This revision is being reviewed by the NAFTA Panel, and a decision, either to approve the revised rate or to require further revisions is expected in mid- May. If the rate is confirmed it will be prospective only. Cash refunds would not be received until the completion of an administrative review and a final rate determination leading to the liquidation of entries.

On March 15, 2004 a NAFTA Panel was also scheduled to publish its ruling on the US International Trade Commission (ITC)'s remand decision regarding threat of injury to the US softwood lumber industry. This ruling has been delayed and is not expected until the end of April. This same NAFTA Panel previously ruled the ITC's original injury determination to be unlawful. A World Trade Organization (WTO) ruling released on March 22 further supported the NAFTA Panel in that it also rejected the finding that a threat to injure US producers existed.

Following an earlier order by a NAFTA Panel, on April 13, 2004 the DOC released the results of the second remand determination on dumping margins. Canfor's dumping margin was reduced from 5.96% to 5.74%. The Panel can approve this within weeks but the US can challenge and delay for up to six months.

Also with respect to the dumping issue, a WTO Panel issued a report on April 13, 2004 that found in favour of Canada on the issue of "zeroing", which is an important issue for Canfor. Zeroing is the practice of preventing the negative margin for one category of goods from offsetting a margin of dumping for another category of goods, thus inflating the overall margin. This decision would result in a lower ADD rate for Canfor, but the US is expected to challenge the WTO's finding.

#### **Labour Agreements**

The labour agreement with the IWA (Industrial, Wood and Allied Workers of Canada) covering their BC Interior certified solid wood operations that expired in June 2003 was ratified by seven of Canfor's sawmills in the first quarter. One sawmill has not held its ratification vote yet. The agreement provides for wage increases totalling 11% over a six-year term, expiring June 30, 2009. The IWA contract with the Hines Creek, Alberta operation expired at the end of February 2004 and a new contract patterned after the one in the BC Interior was ratified in the first quarter. The CEP (Communications, Energy and Paperworkers Union) contract with the Grande Prairie, Alberta operation also expired at the end of February and negotiations are underway. Negotiations are continuing with the PPWC (Pulp, Paper and Woodworkers of Canada) for the agreement representing the plywood production and maintenance employees at Canfor's North Central Plywood operation.

On April 16, 2004, the Canadian Merchant Service Guild initiated strike action for the Masters, Mates and Engineers workers. The strike affects approximately 75% of the marine shipping, tugboat and barge services on the BC Coast. It will potentially affect the movement of logs, woodchips, pulp and lumber. At this time, it is not possible to determine the impact on Canfor's operations. A mediator has been appointed by the Federal Government in an effort to resolve the dispute as quickly as possible.

## Management's Discussion and Analysis

### **SUBSEQUENT EVENT - ACQUISITION OF SLOCAN FOREST PRODUCTS LTD.**

On April 1, 2004, Canfor and Slocan Forest Products Ltd. (Slocan) announced that they had completed the combination of their businesses pursuant to a plan of arrangement that was approved by Slocan's shareholders on March 25, 2004. Under the arrangement, Canfor acquired all of the issued and outstanding shares of Slocan in exchange for the issuance to Slocan shareholders of 1.3147 Canfor shares for each Slocan share held by them, representing 49,333,581 Canfor shares.

The effective date of the acquisition for accounting purposes is April 1, 2004. Therefore, the purchase price allocation and post-acquisition operating results of Slocan will be included in Canfor's second quarter results. On the effective date, Canfor received proceeds of US \$185 million from new private placement financings, which were utilized to repay Slocan's existing long-term debt of US \$160 million and a make-whole penalty of US \$22 million.

The following selected results for the combined company are presented for information only and do not reflect any costs of acquisition or other pro forma adjustments:

(millions of dollars, except for statistical information)	First Quarter 2004		
	Canfor	Slocan	Combined
Gross sales	\$ 685.6	\$ 306.6	\$ 992.2
EBITDA	92.4	67.3	159.7
Net Income	32.0	29.6	61.6
Net Income per Share, Diluted	0.34	0.78	0.43
Working Capital	403.9	195.9	599.8
Total Assets	2,552.7	839.9	3,392.6
Ratio of Net Debt to Equity	35:65	38:62	36:64
Lumber (MMfbm)			
Production	827.0	402.8	1,229.8
Shipments	727.2	364.1	1,091.3
Oriented Strand Board (000 Msf 3/8")			
Production	-	129.6	129.6
Shipments	-	127.5	127.5
Plywood (000 Msf 3/8")			
Production	44.0	63.7	107.7
Shipments	45.4	63.5	108.9
Pulp (000 mt)			
Production	249.0	51.9	300.9
Shipments	241.7	52.1	293.8

### **Commentary on Slocan's First Quarter 2004 Results:**

Slocan Forest Products Ltd. had net earnings for the first quarter of 2004 of \$29.6 million or \$0.79 per share (\$0.78 on a diluted basis) and generated EBITDA of \$67.3 million. Cash flow from operations after reforestation expenditures and before changes in non-cash working capital during the quarter was \$52.3 million. Cash on hand at the end of the quarter was \$20.5 million. Strong markets for the Company's lumber and panel products contributed to these results. As discussed earlier in Canfor's Wood Products segment, high lumber prices compensated for a strong Canadian dollar. OSB and plywood prices were also very strong during the quarter with OSB achieving record price levels. Pulp prices increased in the latter part of the quarter enabling the Pulp segment to be a positive contributor.

**CANFOR CORPORATION**  
**Consolidated Statements of Income and Retained Earnings**

(unaudited) (millions of dollars)	3 months ended March 31,	
	2004	2003
<b>Gross sales</b>	<b>\$ 685.6</b>	<b>\$ 681.8</b>
<b>Costs and expenses</b>		
Manufacturing and product costs	431.8	480.6
Freight and other distribution costs	108.7	120.5
Countervailing and anti-dumping duties (Note 5)	37.4	33.9
Amortization	30.0	30.4
Selling and administration	15.3	13.3
	<b>623.2</b>	<b>678.7</b>
<b>Operating income from continuing operations</b>	<b>62.4</b>	<b>3.1</b>
Equity income of affiliated companies	0.6	0.2
Interest expense	(12.4)	(12.7)
Foreign exchange gain (loss) on long-term debt	(6.0)	44.3
Other income	0.3	1.9
Income from continuing operations before income taxes	44.9	36.8
Income tax recovery (expense) (Note 6)	(12.9)	0.3
<b>Income from continuing operations</b>	<b>32.0</b>	<b>37.1</b>
Income from discontinued operation	-	3.1
<b>Net income</b>	<b>\$ 32.0</b>	<b>\$ 40.2</b>
<b>Per common share (in dollars) (Note 7)</b>		
Income from continuing operations		
Basic	\$ 0.37	\$ 0.44
Diluted	\$ 0.34	\$ 0.40
Net income		
Basic	\$ 0.37	\$ 0.48
Diluted	\$ 0.34	\$ 0.43
Retained earnings, beginning of year – as reported	\$ 273.4	\$ 136.7
Cumulative effect of change in accounting policy (Note 2)	3.6	3.6
<b>Retained earnings, beginning of year – as restated</b>	<b>\$ 277.0</b>	<b>\$ 140.3</b>
Net income for the year to date	32.0	40.2
Common share dividends	-	(5.3)
Interest on equity component of convertible subordinated debentures, net of taxes	(1.6)	(1.5)
<b>Retained earnings, end of current period</b>	<b>\$ 307.4</b>	<b>\$ 173.7</b>

## Consolidated Cash Flow Statements

(unaudited) (millions of dollars)	3 months ended March 31,	
	2004	2003
<b>Cash generated from (used in)</b>		
<b>Operating activities</b>		
Income from continuing operations	\$ 32.0	\$ 37.1
Items not affecting cash:		
Amortization	30.0	30.4
Long-term portion of deferred reforestation	20.2	14.9
Income taxes	8.9	(0.3)
Unrealized foreign exchange loss (gain) on long-term debt	6.0	(44.3)
Reversal of accrued duties (Note 5)	(5.3)	(7.4)
Gain on disposal of assets	(0.5)	(0.6)
Other	4.9	(0.2)
Changes in non-cash working capital	(102.6)	(123.0)
	(6.4)	(93.4)
<b>Financing activities</b>		
Proceeds from long-term debt (Note 3)	66.9	-
Repayment of long-term debt	(0.8)	-
Net proceeds on issuance of common shares (Note 8)	5.8	-
Dividends paid to common shareholders	-	(5.3)
Other	(0.1)	(0.1)
	71.8	(5.4)
<b>Investing activities</b>		
Property, plant, equipment and timber	(15.4)	(13.3)
Proceeds on disposal of property, plant and equipment	0.6	0.8
Other	1.2	(2.8)
	(13.6)	(15.3)
Decrease in net short-term indebtedness / (decrease in net cash) from continuing operations	51.8	(114.1)
Cash generated by discontinued operation	-	3.6
<b>Decrease in net short-term indebtedness / (decrease in net cash)</b>	<b>51.8</b>	<b>(110.5)</b>
<b>Net cash (short-term indebtedness) at beginning of period</b>	<b>(57.4)</b>	<b>22.9</b>
<b>Net short-term indebtedness at end of period</b>	<b>\$ (5.6)</b>	<b>\$ (87.6)</b>
<b>Net short-term indebtedness comprises</b>		
Cash	\$ 7.4	\$ 6.7
Operating bank loans	(13.0)	(94.3)
	\$ (5.6)	\$ (87.6)
<b>Changes in non-cash working capital</b>		
Accounts receivable	\$ (8.1)	\$ (72.9)
Inventories	(138.9)	(168.3)
Prepaid expenses	6.7	11.4
Accounts payable, accrued liabilities and current portion of deferred reforestation	35.4	105.4
Income taxes	2.3	1.4
	\$ (102.6)	\$ (123.0)

Interest paid for the three months ended March 31, 2004 was \$18.6 million (2003 – \$20.9 million) and income taxes paid were \$0.5 million (2003 – \$0.6 million).

## Consolidated Balance Sheets

(millions of dollars)	as at March 31, 2004 (unaudited)	as at December 31, 2003 (audited)
<b>ASSETS</b>		
<b>Current assets</b>		
Cash	\$ 7.4	\$ 24.7
Accounts receivable		
Trade	210.0	173.2
Other	49.6	78.3
Income taxes recoverable	0.1	1.4
Future income taxes	19.5	21.9
Inventories	583.9	445.0
Prepaid expenses	17.5	24.1
<b>Total current assets</b>	<b>888.0</b>	<b>768.6</b>
<b>Long-term investments and other</b>	<b>110.7</b>	<b>100.5</b>
<b>Property, plant, equipment and timber</b>	<b>1,429.6</b>	<b>1,443.5</b>
<b>Deferred charges</b>	<b>124.4</b>	<b>126.8</b>
	<b>\$ 2,552.7</b>	<b>\$ 2,439.4</b>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Operating bank loans (Note 3)	\$ 13.0	\$ 82.1
Accounts payable and accrued liabilities	379.0	335.5
Current portion of long-term debt	58.0	57.2
Current portion of deferred reforestation	34.1	39.6
<b>Total current liabilities</b>	<b>484.1</b>	<b>514.4</b>
<b>Long-term debt (Note 3)</b>	<b>549.2</b>	<b>478.0</b>
<b>Other accruals and provisions (Note 4)</b>	<b>112.7</b>	<b>83.0</b>
<b>Future income taxes, net</b>	<b>188.9</b>	<b>175.7</b>
<b>Deferred credit</b>	<b>88.9</b>	<b>95.7</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital - 81,933,794 shares outstanding (Note 8)	665.0	659.2
Convertible subordinated debentures	155.0	155.0
Retained earnings	307.4	277.0
Foreign exchange translation adjustment	1.5	1.4
<b>Total shareholders' equity</b>	<b>1,128.9</b>	<b>1,092.6</b>
	<b>\$ 2,552.7</b>	<b>\$ 2,439.4</b>
<b>Contingencies (Note 10)</b>		
<b>Subsequent event (Note 11)</b>		

APPROVED BY THE BOARD



Director, R.L. Cliff



Director, J.A. Shepherd

## Statements of Segmented Information

(unaudited) (millions of dollars)	Wood Products (Note c)	Pulp and Paper	Coastal Operations	Corporate and Other	Consolidated
3 months ended March 31, 2004					
Gross sales to external customers	\$ 450.0	218.4	17.2	-	\$ 685.6
Gross sales to other segments (Note b)	\$ 25.3	-	0.9	-	\$ 26.2
Operating income (loss)	\$ 57.6	12.5	0.6	(8.3)	\$ 62.4
Amortization	\$ 16.5	10.8	1.1	1.6	\$ 30.0
Capital expenditures	\$ 7.4	7.0	1.0	-	\$ 15.4
Identifiable assets	\$ 1,268.0	823.4	74.9	386.4	\$ 2,552.7
3 months ended March 31, 2003					
Gross sales to external customers	\$ 415.3	228.4	38.1	-	\$ 681.8
Gross sales to other segments (Note b)	\$ 20.2	-	2.4	-	\$ 22.6
Operating income (loss)	\$ (8.0)	8.0	8.2	(5.1)	\$ 3.1
Amortization	\$ 15.6	11.5	2.0	1.3	\$ 30.4
Capital expenditures	\$ 9.0	2.7	1.4	0.2	\$ 13.3
Identifiable assets	\$ 1,164.8	837.7	81.7	449.5	\$ 2,533.7

## Statements of Consolidated Production and Shipments

3 months ended March 31, (unaudited)	Production		Shipments	
	2004	2003	2004	2003
Coastal Logs - 000 m3	230.2	427.2	187.7	339.9
Lumber - MMfbm				
Canfor produced	827.0	751.9	727.2	719.6
Purchased from other wholesale producers			61.5	70.4
Total Lumber			788.7	790.0
Plywood - 000 Msf 3/8"	44.0	45.3	45.4	40.0
Pulp - 000 mt				
Canfor produced	249.0	262.6	241.7	273.9
Marketed on behalf of HSLP (Note d)			73.6	92.3
Total Pulp			315.3	366.2
Kraft paper - 000 mt	34.0	31.1	35.3	33.2

- a. Operations are presented by product lines. Operations are considered to be in one geographic area, Canada, since the subsidiary in the United States is not significant to the total.
- b. Sales to other segments are accounted for at prices which approximate market value.
- c. Wood Products' sales for the quarter include sales of Canfor produced lumber of \$323.6 million (2003 – \$248.2 million) and sales of hardboard and refined fibre and fibremat of \$5.6 million and \$3.9 million respectively (2003 – \$4.8 million and \$3.9 million)
- d. Canfor is responsible for marketing, on a commission basis, the pulp production of Howe Sound Pulp and Paper Limited Partnership.
- e. Certain prior year figures have been reclassified to conform to the current year's presentation.

## Notes to the Consolidated Financial Statements

1. 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, 2003. These interim financial statements follow the same accounting policies and methods of computation as used in the 2003 consolidated financial statements, except as described in Note 2.

The quarterly results are not necessarily indicative of results to be expected for an entire year.

### 2. Changes in Accounting Policies and Presentation

#### *Asset Retirement Obligations*

Effective January 1, 2004, Canfor retroactively adopted the new recommendations of the Canadian Institute of Chartered Accountants (CICA) for asset retirement obligations, which require that such obligations be measured at fair value. As a result of adopting these new recommendations, Canfor's deferred reforestation liability decreased by \$5.6 million, the net future income tax liability increased by \$2.0 million and retained earnings increased by \$3.6 million at December 31, 2003. The change in accounting for deferred reforestation did not have an impact on 2003 earnings. The new recommendations were not applied to retirement obligations for assets with indeterminate useful lives because sufficient information is not presently available to estimate a range of potential settlement dates for the obligations.

#### *Shipping and Handling Costs*

Effective January 1, 2004, the CICA introduced new recommendations for the application of generally accepted accounting principles (GAAP), which, among other things, provides guidance on alternate sources to consult with when an issue is not specifically addressed by Canadian GAAP. Prior to January 1, 2004, Canfor, along with other companies in the forest industry, presented sales net of shipping and handling costs. As a result of applying this new standard, effective January 1, 2004, Canfor has presented shipping and handling costs in accordance with the US EITF 00-10 Accounting for Shipping and Handling Fees and Costs. EITF 00-10 specifies that shipping and handling costs recovered from customers should be included in sales, while shipping and handling costs incurred should be included in cost of sales. Countervailing and anti-dumping duties, which previously were presented as a deduction to gross sales, have also been reclassified to cost of sales in accordance with the new GAAP standard. The prior period has been reclassified for comparability.

### 3. Bank Indebtedness and Long-Term Debt

At March 31, 2004 Canfor had \$260.5 million of bank operating lines of credit available, of which \$13.0 million was drawn down and an additional \$22.3 million was utilized for several standby letters of credit.

In December 2003, Canfor negotiated a new private placement financing, which was structured to allow for the draw down of US \$50 million in February 2004 and the remaining US \$110 million upon the closing of the Slocan acquisition (Note 11). The US \$50 million drawn down on February 2, 2004 was utilized for general operating purposes and capital expenditures. The remaining US \$110 million was drawn down on April 1, 2004, along with an additional private placement financing of US \$75 million that was obtained during the quarter. These funds were utilized to refinance Slocan's existing debt, as discussed in Note 11. The debt is in the form of unsecured senior notes, which have the following interest rates and maturities: US \$50 million at 6.33% (2012), US \$60 million at 5.66% (2009), US \$50 million at 6.18% (2011) and US \$75 million at 5.42% (2013).

The agreements relative to Canfor's privately placed senior notes contain provisions limiting the amount of indebtedness that Canfor and its designated subsidiaries can incur and the amount of dividends payable on its common shares. Under these agreements, Canfor and its designated subsidiaries can presently incur \$536.5 million in additional long-term debt and pay up to \$197.0 million, or \$2.40 per share, in dividends on its common shares.

At March 31, 2004, the fair value of Canfor's long-term debt was \$649.6 million and the fair value of the convertible subordinated debentures was equal to their carrying value.

### 4. Other Accruals and Provisions

(millions of dollars)	March 31, 2004	December 31, 2003
Deferred reforestation	\$ 54.2	\$ 34.0
Post employment benefits	36.9	33.3
Other liabilities	21.6	15.7
Total other accruals and provisions	\$ 112.7	\$ 83.0

## Notes to the Consolidated Financial Statements

### 5. Countervailing and Anti-dumping Duties

The US International Trade Commission (ITC) imposed an 18.79% countervailing duty (CVD) on Canadian lumber producers on May 16, 2002. On March 5, 2004, Canfor's company-specific rate was reduced to 12.24%, effective prospectively from March 10, 2004. Although cash deposits are now being made at the 12.24% rate, Canfor will continue to record the expense at 18.79% until there is more certainty over whether Canfor will be granted a company-specific administrative review. The difference between the expensed amount and the cash paid since March 10th was \$3.7 million and is included in "other liabilities".

The ITC also imposed anti-dumping duties (ADD) on Canadian lumber producers on May 16, 2002 and Canfor's company-specific rate was assessed at 5.96%. While the cash payments for the anti-dumping duty are being made at the assessed rate, the expense has been accrued at an effective rate of 1.88% for the quarter. The expense in the same quarter of 2003 was accrued at 4.85%. Canfor reassesses its estimate of the ADD rate on a regular basis, by applying the DOC's methodology to updated sales and cost data as it becomes available. The cumulative difference between the assessed rate and the effective rate at March 31, 2004 is \$41.7 million, and is being carried as a receivable under "long-term investments and other".

Canfor and other Canadian forest product companies, the Federal Government and Canadian provincial governments (Canadian Interests) categorically deny the US allegations and strongly disagree with the countervailing and dumping determinations made by the ITC and DOC. Canadian Interests continue to aggressively defend the Canadian industry in this US trade dispute and are appealing the decision of these administrative agencies to the appropriate courts, NAFTA panels and the WTO. Notwithstanding the rates established in the investigations and the posting of cash deposits, the final liability for the assessment of countervailing and anti-dumping duties will not be determined until the DOC's administrative review process is complete. The first administrative review, covering the period from May 22, 2002 to April 30, 2003, is currently underway. With the finalization of any appeals, completion of the first administrative review could extend beyond 2004.

### 6. Income Tax Recovery (Expense)

(millions of dollars)	3 months ended March 31, 2004	3 months ended March 31, 2003
Current	\$ (26.6)	\$ (9.8)
Future	5.9	9.5
Tax benefit of current Howe Sound Pulp and Paper Limited Partnership losses	1.1	0.6
Affiliates	(0.1)	-
	(19.7)	0.3
Amortization of deferred credit on utilization of acquired tax losses	6.8	-
	\$ (12.9)	\$ 0.3

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 March 31, 2004	3 months ended March 31, 2003
Income tax expense at statutory tax rate	\$ (16.0)	\$ (13.4)
Large corporation tax	(1.3)	(1.3)
Tax benefit of current Howe Sound Pulp and Paper Limited Partnership losses	1.1	0.6
Deferred income tax credit amortized	6.8	-
Permanent difference from foreign exchange gains and losses on long-term debt	(2.1)	13.4
Other permanent differences and tax adjustments	(1.4)	1.0
	\$ (12.9)	\$ 0.3

## Notes to the Consolidated Financial Statements

### 7. Earnings Per Share

(millions of dollars, except for number of shares and per share amounts)	3 months ended March 31, 2004	3 months ended March 31, 2003
<b>Basic Earnings</b>		
Income from continuing operations	\$ 32.0	\$ 37.1
Less interest on equity component of convertible debentures, net of taxes	(1.6)	(1.5)
Income from continuing operations available to common shareholders	30.4	35.6
Income from discontinued operations	-	3.1
Net income available to common shareholders	30.4	38.7
<b>Diluted Earnings</b>		
Add back interest on equity component of convertible debentures	1.6	1.5
Income from continuing operations available to common shareholders	32.0	37.1
Net income available to common shareholders	\$ 32.0	\$ 40.2
Weighted average number of common shares	81,598,283	81,156,010
Incremental shares from stock options	244,184	86,881
Shares issuable upon conversion of convertible debentures	11,742,424	11,742,424
Diluted number of common shares	93,584,891	92,985,315
<b>Per common share</b>		
Income from continuing operations		
Basic	\$ 0.37	\$ 0.44
Diluted	\$ 0.34	\$ 0.40
Net income		
Basic	\$ 0.37	\$ 0.48
Diluted	\$ 0.34	\$ 0.43

### 8. Stock-Based Compensation

During the quarter, proceeds of \$5.8 million were received from the exercise of 666,513 stock options at a weighted-average exercise price of \$8.70.

No new stock options were granted in the current quarter or the same quarter in 2003. The following pro forma disclosures present the effect, on the current and prior period's reported net income and earnings per share, of stock options granted in 2002, prior to the adoption of the fair-value based method of accounting.

(millions of dollars, except for per share amounts)	3 months ended March 31, 2004	3 months ended March 31, 2003
Net income		
As reported	\$ 32.0	\$ 40.2
Pro forma	\$ 31.9	\$ 40.0
Net income per common share		
As reported - basic	\$ 0.37	\$ 0.48
As reported - diluted	\$ 0.34	\$ 0.43
Pro forma - basic	\$ 0.37	\$ 0.47
Pro forma - diluted	\$ 0.34	\$ 0.43

The fair value of the stock options granted in 2002 was estimated on each grant date using a Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield of 2.6%; expected volatility of 44%; risk-free interest rate of 3.75%; and an expected life of 4 years. The weighted average fair value of each option was \$3.10.

## Notes to the Consolidated Financial Statements

### 9. Financial Instruments

A significant portion of Canfor's income from operations is generated from sales denominated in US dollars. In order to manage some of the risk associated with fluctuating exchange rates, Canfor enters into forward exchange contracts from time to time. At March 31, 2004, Canfor had US \$6 million of forward exchange contracts outstanding (2003 - US \$120 million). These contracts were fixed at an average rate of 1.4545 and have option periods that are spread through October 2004. Contracts totaling US \$15 million were exercised in the current quarter and the realized gain of \$1.5 million is reflected in net sales (first quarter 2003 - \$2.2 million gain on contracts of US \$20 million). At March 31, 2004 there was an unrecognized gain of \$0.9 million on the remaining contracts.

The Company also uses financial instruments to reduce its exposure to price risk associated with energy costs. Commodity swaps hedging future natural gas purchases of 1.1 million Gigajoules were outstanding at the end of the current quarter. There was an unrealized gain of \$0.2 million on these swaps at March 31, 2004.

### 10. Contingencies

#### *The Forestry Revitalization Plan*

In March 2003, the Government of British Columbia (the Crown) introduced the Forestry Revitalization Plan (the Plan) that provides for significant changes to Crown forest policy and to the existing allocation of Crown timber tenures to licensees. The changes prescribed in the Plan include the elimination of minimum cut control regulations, the elimination of existing timber processing regulations, and the elimination of restrictions limiting the transfer and subdivision of existing licenses. As well, through legislation, licensees, including Canfor, are required to return 20% of their replaceable tenure to the Crown. The Plan states that approximately half of this volume will be redistributed to open up opportunities for woodlots, community forests and First Nations and the other half will be available for public auction. The Crown has acknowledged that licensees will be fairly compensated for the return of tenure and related infrastructure costs such as roads and bridges.

The effect of the timber take-back will result in a reduction of approximately 1.5 million cubic metres to Canfor's existing allowable annual cut on its replaceable tenures. The effect of the Plan on Canfor's financial position and results of operations cannot be determined at this time. Canfor will record the effects of the Plan at the time that the amounts to be recorded are estimable.

### 11. Subsequent Event

On April 1, 2004, Canfor and Slocan Forest Products (Slocan) completed the combination of their businesses after having obtained the approval of Slocan shareholders on March 25, 2004 and of the Supreme Court of British Columbia on March 30, 2004. Under the plan of arrangement, Canfor acquired all of the issued and outstanding shares of Slocan in exchange for the issuance to Slocan shareholders of 1.3147 Canfor shares for each Slocan share held by them, representing 49,333,581 Canfor shares. The value of the Canfor shares issued is \$452.9 million, based on a market price of Canfor shares of \$9.18 per share. Slocan was amalgamated with Canadian Forest Products Ltd., Canfor's principal operating subsidiary, on April 1, 2004.

On the closing date, Canfor repaid Slocan's existing long-term debt of US \$160 million and also paid US \$22 million in make-whole penalties to the note-holders. These payments were financed with new private placement debt, as discussed in Note 3.

The transaction was subject to the satisfaction of certain other conditions specified in the Combination Agreement, including compliance with the Forest Act (British Columbia) and approval under the Competition Act (Canada). Canfor believes that the Minister of Forests will not cancel any of Slocan's forest tenures, reduce the cut under the tenures or impose terms and conditions that would have a materially adverse effect on Canfor. In order to address the concerns of the federal Commissioner of Competition under the Competition Act (Canada) regarding the impact of the combination on competition, Canfor entered into a Consent Agreement, as required by the Commissioner, pursuant to which she directed the Company to divest the Canfor sawmill located at Fort St James, British Columbia and certain associated harvesting rights.

12. Certain comparative figures have been reclassified to conform to the current quarter's presentation.



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