Canfor Corporation **Second Quarter Interim Report** For the three months ended June 30, 2004

SUMMARY INFORMATION FOR THE EIGHT MOST RECENTLY COMPLETED QUARTERS

	2nd QTR 2004	1st QTR 2004	4th QTR 2003	3rd QTR 2003	2nd QTR 2003	1st QTR 2003	4th QTR 2002	3rd QTR 2002
SALES AND INCOME (millions of dollars)								
Gross sales	**$ 1,277.5**	$ 685.6	$ 656.3	$ 685.1	$ 639.4	$ 681.8	$ 610.0	$ 706.1
Net income (loss) from continuing operations	**$ 143.6**	$ 32.0	$ 34.6	$ 17.8	$ (3.7)	$ 37.1	$ (60.1)	$ (14.6)
Net income (loss)	**$ 143.6**	$ 32.0	$ 34.1	$ 80.1	$ (1.1)	$ 40.2	$ (58.0)	$ (11.8)
PER COMMON SHARE (dollars)								
Net income (loss) from continuing operations								
Basic	**$ 1.08**	$ 0.37	$ 0.41	$ 0.20	$ (0.06)	$ 0.44	$ (0.76)	$ (0.20)
Diluted	**$ 1.00**	$ 0.34	$ 0.37	$ 0.19	$ (0.06)	$ 0.40	$ (0.76)	$ (0.20)
Net income (loss)								
Basic	**$ 1.08**	$ 0.37	$ 0.40	$ 0.97	$ (0.03)	$ 0.48	$ (0.73)	$ (0.16)
Diluted	**$ 1.00**	$ 0.34	$ 0.37	$ 0.86	$ (0.03)	$ 0.43	$ (0.73)	$ (0.16)

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To Our Shareholders,

Canfor Corporation reported net income of $143.6 million for the second quarter of 2004, or $1.00 per share on a diluted basis, compared to net income of $32.0 million, or $0.34 per share, in the previous quarter and a net loss of $1.1 million, or $0.03 per share, in the same quarter of 2003. Net income of $175.6 million, or $1.48 per share, was earned for the year-to-date compared with net income of $39.1 million, or $0.42 per share in the same period in 2003.

These very strong earnings were in spite of $30.3 million of one-time charges ($24.0 million after tax), which included $7.2 million for incentive payments related to the CRMI program, $17.2 million of restructuring costs related to the combination with Slocan, discussed below, and $5.9 million of closure costs for the Taylor sawmill. In addition, countervailing and anti-dumping duties of $100.2 million were expensed in the quarter. These duties reduced operating earnings in the Lumber segment by approximately 40% in the quarter.

Operating income in the second quarter was $225.2 million, which is a $162.8 million increase over the first quarter and $272.7 million higher than the same quarter in 2003. The main factors in the improved results were the inclusion of the legacy Slocan operations in our results from April 1, 2004 and the exceptionally strong prices for all of our major products. Lumber prices increased by 78%, OSB by 98%, plywood by 64% and pulp prices by 18% in comparison with the same quarter in 2003.

The combination of Canfor and Slocan Forest Products Ltd. was successfully concluded on April 1st. Initiatives to integrate the two companies are proceeding successfully and nearing completion. Through the process of integration, annual synergies of approximately $85 million have been identified to date, with the expectation that these will all be fully realized by mid year 2005. In order to comply with an order from the Competition Bureau which directed the sale of assets as a condition of the Bureau's consent to the combination with Slocan, the Fort St James mill, together with associated tenures, are in the process of being divested. It is expected that this sale will be completed prior to the end of the year.

The softwood lumber dispute continues to be without any clear resolution at this time. The recent rulings by the US Department of Commerce on rates of duty and by the NAFTA on threat of injury have resulted in a strengthened Canadian position in any potential settlement. However, it continues to be our belief that the most suitable way to ultimately settle the dispute is through a process of meaningful negotiation.

The outlook for the balance of the year, and particularly for the third quarter, is for continuing strength in demand and pricing for all of our major products. However, we believe that prices, particularly for lumber and panels, will moderate somewhat in the coming months.

Management has identified several significant capital opportunities. In light of this, the Board of Directors has determined not to declare a dividend at this time.

Peter J.G. Bentley
Chairman

James A. Shepherd
President and Chief Executive Officer

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 second 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. Further information about Slocan Forest Products Ltd. may be obtained by referring to the Management's Discussion and Analysis and Financial Statements included in their Management Information Circular dated February 25, 2004, which is available at www.sedar.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; 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 July 22, 2004.

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

Summarized Results [1]

(millions of dollars, except for per share amounts)	**2nd Quarter 2004**	1st Quarter 2004	**6 months ended June 30, 2004**	2nd Quarter 2003	6 months ended June 30, 2003
Gross sales	**$ 1,277.5**	$ 685.6	**$ 1,963.1**	$ 639.4	$ 1,321.2
Countervailing & anti-dumping duties expensed	**$ (100.2)**	$ (37.4)	**$ (137.6)**	$ (46.8)	$ (80.7)
Restructuring costs	**$ (23.1)**	$ -	**$ (23.1)**	$ -	$ -
EBITDA	**$ 264.1**	$ 92.4	**$ 356.5**	$ (22.1)	$ 11.4
Operating income (loss)	**$ 225.2**	$ 62.4	**$ 287.6**	$ (47.5)	$ (44.4)
Foreign exchange gain (loss) on long-term debt	**$ (21.9)**	$ (6.0)	**$ (27.9)**	$ 43.6	$ 87.9
Net income (loss) from continuing operations	**$ 143.6**	$ 32.0	**$ 175.6**	$ (3.7)	$ 33.4
Discontinued operation, net of tax	**$ -**	$ -	**$ -**	$ 2.6	$ 5.7
Net income (loss)	**$ 143.6**	$ 32.0	**$ 175.6**	$ (1.1)	$ 39.1
Per share (diluted)					
Net income (loss) from continuing operations	**$ 1.00**	$ 0.34	**$ 1.48**	$ (0.06)	$ 0.36
Net income (loss)	**$ 1.00**	$ 0.34	**$ 1.48**	$ (0.03)	$ 0.42

Operating income in the second quarter improved significantly over the previous quarter, mainly because of the impact of the combination with Slocan, higher product prices and a more favourable exchange rate. The legacy Slocan operations contributed $108.7 million towards the $225.2 million of operating income in the quarter. Compared to the same period last year, US dollar lumber prices averaged 78% higher, pulp prices averaged 18% higher, plywood prices were 64% higher and OSB prices experienced the most dramatic increase, at 98% over the second quarter in 2003. The weaker Canadian dollar (US 2.3¢ lower than in the first quarter) also contributed to the increase in Canadian dollar revenues and operating results in the quarter. When compared to 2003, the Canadian dollar was US 2.1¢ stronger in the quarter and US 5.9¢ stronger in the first six months of the year, with the corresponding negative impact on sales more than offset by higher product prices.

There were a number of one-time expenses recorded in the current quarter that had a significant impact on operating income. These included $7.2 million for incentive payments related to the CRMI program and $23.1 million of restructuring costs, $17.2 million of which are integration costs associated with the combination with Slocan, as discussed below, and $5.9 million for closure costs for the Taylor sawmill.

On April 1, 2004, Canfor and Slocan Forest Products Ltd. (Slocan) completed the combination of their businesses. Under the arrangement, Canfor acquired all of the issued and outstanding shares of Slocan in exchange for the issuance to Slocan shareholders of 49,333,571 Canfor shares. The value of the Canfor shares issued was $452.9 million. Slocan was amalgamated with Canadian Forest Products Ltd., Canfor's principal operating subsidiary, on the same day.

[1] All figures quoted in this report reflect the results of the former Slocan operations since April 1, 2004.

As discussed below, under "Changes in Financial Position", Canfor refinanced Slocan's existing long-term debt of US $160 million on the combination date with new private placement financing of US $185 million. The net cash outflow for the combination was $37.9 million, which is comprised of a $28.6 million make-whole penalty on Slocan's debt and $29.8 million of transaction costs, partially offset by Slocan's cash balance of $20.5 million. As a result of the combination, Canfor recorded a $17.2 million charge for severance and other restructuring costs, the majority of which were recorded in corporate costs ($14.8 million), with the balance ($2.4 million) recorded in the lumber segment.

OPERATING RESULTS

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

With the integration of Slocan's operations as of April 1, 2004, the business segments previously reported by Canfor have been changed to better reflect the combined company's business. Canfor's lumber, plywood and panel and fibre operations were formerly reported in the "Wood Products" segment, which has now been separated into "Lumber" and "Panels". The Lumber segment includes the Company's sawmill and remanufacturing operations and the "Panels" segment includes the OSB, plywood and panel and fibre operations. The Pulp and Paper segment now includes the Taylor pulp operation and the Coastal Operations segment is unchanged. The first quarter 2004 and the 2003 comparative figures have been restated to reflect the new reporting structure.

Lumber

(millions of dollars unless otherwise noted)		**2nd Quarter 2004**		1st Quarter 2004		**6 months ended June 30, 2004**		2nd Quarter 2003		6 months ended June 30, 2003
Gross sales	**$**	**819.9**	$	418.0	**$**	**1,237.9**	$	375.2	$	763.2
EBITDA	**$**	**174.7**	$	67.9	**$**	**242.6**	$	(29.2)	$	(21.9)
EBITDA margin		**21%**		16%		**20%**		(8%)		(3%)
Operating income (loss)	**$**	**153.7**	$	51.9	**$**	**205.6**	$	(39.7)	$	(47.3)
Average 2"x4" #2 & Better lumber price -										
US $ per thousand board feet *(source: Random Lengths)*	**$**	**437**	$	370	**$**	**401**	$	245	$	245
Average price in Cdn $	**$**	**594**	$	488	**$**	**537**	$	343	$	356

The Lumber segment earned operating income of $153.7 million in the quarter, or $101.8 million more than in the previous quarter and $193.4 million more than in the same quarter last year. The legacy Slocan operations generated $56.0 million of the current period's operating income. Higher lumber prices accounted for the majority of the balance of the increase over the prior periods.

Operationally, the segment continued to run at or near capacities as strong market conditions and inventories dictated operating levels. Transportation equipment shortages continue to be the biggest challenge to the group as inventory levels grew at certain locations. Supply Chain initiatives to address the logistic issues continue. Performance of the mills as measured by margin was excellent during the quarter as Isle Pierre, Radium, Grande Prairie, Rustad, and Vavenby had strong quarters. Houston, Prince George Sawmill, and Quesnel continue to improve margin as they ramp up from their major expansions. Conversion costs increased slightly over the first quarter as spring maintenance programs and inventory conversion accelerated during the quarter. The integration of the two organizations has gone well as implementation of continuous improvement initiatives along with the reallocation of key personnel has laid the groundwork for smooth transition. The Lumber segment incurred one-time charges totalling $11.2 million related to incentive awards, restructuring and the Taylor sawmill closure.

A charge to income of $25.1 million in excess of the cash deposit amounts for duties was recorded in the second quarter. This adjustment is comprised of additional countervailing duty (CVD) of $28.7 million, which is being expensed at the originally assessed rate of 18.79% despite the cash deposit rate having been lowered to 12.24% in March. Offsetting this amount is a favourable anti-dumping duty (ADD) adjustment of $3.6 million, which mainly relates to an adjustment to legacy Slocan's expense for the period from May 22, 2002 to April 30, 2003, resulting from the Department of Commerce's revised rates announced in June, and to adjust the combined company's expense to 3.13% in April, which is Canfor's estimated rate for the second period of review (May 1, 2003 to April 30, 2004). The May and June ADD expense has been recorded at the cash deposit rate, which will be adjusted once enough data has been accumulated to determine what rate to use for the third period of review. The effective ADD rate for the second quarter was approximately 5%, compared to 1.88% in the first quarter and 8.3% in the second quarter of 2003. A more comprehensive discussion of the duty situation follows under "Risks and Uncertainties" below.

Markets:
Lumber markets strengthened through most of the second quarter. The western SFP 2"x4" #2 and Better price broke through the US $400 per Mfbm level in April for the first time in five years and continued to increase before peaking in mid-May at US $462. The average price for the quarter was US $437, which is a 51% increase from the previous quarter and 78% higher than in the second quarter of 2003. Strong housing demand resulting from low interest rates, improved job markets and higher consumer confidence continues to drive US housing starts. Existing home sales also reached record levels, which resulted in increased repair and renovation activity. During this period of strong demand for lumber, market supply was negatively impacted by railcar and truck shortages. Although transportation constraints have eased slightly, they are adversely affecting our ability to ship our products on a timely basis.

Offshore lumber demand was also strong during the second quarter. Canfor's total offshore lumber sales were 25% higher than the combined volumes of the two legacy companies were in the second quarter last year. The improving Japanese economy and the effect of new home incentives has resulted in increased levels of new home construction, and particularly of 2"x4" housing construction. As a result of the strong demand, Canfor's sales to Japan increased by 25% during the quarter in comparison with the same quarter in 2003. Shipments to other offshore markets, including Korea and China, also improved substantially.

Outlook:
Economists are generally predicting that interest rates will rise during the second half of the year. Higher interest rates will likely result in reduced housing construction, but not to a significant degree. Overall fundamentals for the housing market will remain strong, as increased employment, household income and improved consumer confidence offset the impact of higher interest rates.

Panels

(millions of dollars unless otherwise noted)		**2nd Quarter 2004**		1st Quarter 2004		**6 months ended June 30, 2004**		2nd Quarter 2003		6 months ended June 30, 2003
Gross sales	**$**	**136.8**	$	32.0	**$**	**168.8**	$	29.7	$	57.0
EBITDA	**$**	**62.2**	$	6.2	**$**	**68.4**	$	2.2	$	2.5
EBITDA margin		**45%**		19%		**41%**		7%		4%
Operating income	**$**	**59.5**	$	5.7	**$**	**65.2**	$	1.5	$	1.1
Average plywood price [2] - in Cdn $	**$**	**592**	$	528	**$**	**560**	$	361	$	359
Average OSB price in US $ [3]	**$**	**437**	$	444	**$**	**441**	$	221	$	199
Average OSB price in Cdn $	**$**	**594**	$	550	**$**	**573**	$	309	$	290

When comparing the current quarter's operating income of $59.5 million to the prior periods presented above, the main factor in the increase is the inclusion of legacy Slocan's OSB and plywood operations, which generated operating income of $50.5 million in the quarter.

Both plywood operations ran well in the period, with production 2.5% ahead of the previous quarter. Conversion costs at the Tackama Plywood operation were on target, but fibre costs increased slightly because of species mix. Modifications to existing equipment have helped to reduce manning costs. Conversion costs at North Central Plywood averaged 2% lower than in the previous quarter and average log costs were slightly lower.

The PolarBoard OSB operation had a strong quarter and achieved target daily production levels. A third disk flaker is currently being installed and is expected to be in operation in late July. This will result in increased production of OSB by approximately 7%.

Markets:
Panel markets, driven by the same strong demand and transportation challenges as the lumber market, were very strong in the second quarter. The average Canadian Softwood Plywood (CSP) price per Msf 3/8", delivered to Toronto, was 64% higher in the second quarter than in the same period last year.

Oriented Strand Board (OSB) prices set a new all-time high of US $520 per Msf 7/16" North Central in late April, when strong demand outstripped supply. Prices averaged US $437 in the quarter, or 98% higher than in the second quarter of 2003.

[2] Per Msf 3/8" basis (Source - C.C. Crowe Publications, Inc.)

[3] Per Msf 7/16" North Central (Source - Random Lengths publication)

Market conditions for both plywood and OSB weakened towards the end of the quarter, with plywood prices dropping by 4% and OSB prices by 33%. Some improvement in OSB prices was experienced in late June following announcements of extended maintenance shutdowns by other producers.

Pulp and Paper

(millions of dollars unless otherwise noted)		**2nd Quarter 2004**		1st Quarter 2004		**6 months ended June 30, 2004**		2nd Quarter 2003		6 months ended June 30, 2003
Gross sales	**$**	**275.6**	$	218.4	**$**	**494.0**	$	195.6	$	424.0
EBITDA	**$**	**47.0**	$	23.3	**$**	**70.3**	$	7.3	$	26.8
EBITDA margin		**17%**		11%		**14%**		4%		6%
Operating income (loss)	**$**	**36.4**	$	12.5	**$**	**48.9**	$	(3.4)	$	4.6
Average pulp price delivered to Northern Europe - US$ per tonne *(source: Pulp & Paper Week)*	**$**	**652**	$	590	**$**	**621**	$	553	$	517
Average price in Cdn $	**$**	**886**	$	778	**$**	**831**	$	773	$	752

Operating income increased by $23.9 million over the previous quarter and was $39.8 million higher than the same quarter in 2003. Higher prices for pulp and the inclusion of the legacy Slocan Taylor pulp mill's results were the main factors in the improved results.

Pulp productivity was good in the quarter, and was slightly higher overall than in the first quarter, despite the annual maintenance shutdown at the Intercontinental Mill, lightning strikes and a 2 day interruption to the Northwood mill's operations from the Health Employees' Union's picket. Lightning strikes in early June interrupted operations at all of the Prince George mills, but especially at Northwood, where 3,200 tonnes of production was lost and a generator was destroyed, leading to increased hydro costs for a three-week period. The Taylor mill ran very well in the quarter, achieving monthly and quarterly production records.

The kraft paper operation ran at slightly lower rates than in the first quarter and had a negative overall contribution to earnings as market prices for unbleached kraft paper were not adequate to cover incremental costs of production. Several initiatives are currently underway to address this situation.

Markets:

During the second quarter, demand for market pulp continued to be strong. Led by broad-based economic growth in North America and Asia, paper markets have rebounded as a result of strong consumer spending and an increase in advertising spending.

Demand for printing and writing (P&W) papers in North America has increased by 3% this year, which has been led by a surge in lightweight coated paper demand, a large end-user segment of Canfor's pulp. Papermakers have been quite successful in implementing paper price increases in this robust demand environment. Western European markets have also experienced healthy demand growth of 5.2% in the P&W segment this year. The coated woodfree and uncoated mechanical sectors have enjoyed the largest percentage growth in that region, but paper producers are struggling to raise prices due to paper overcapacity in key grades. Asian paper markets have been busy, led by continued strong economic growth through much of the region. Papermakers in Asia have raised prices considerably in some grades this year, but are now having their margins squeezed by the increased costs of energy, woodpulp and transportation.

The strong paper markets have led to an increase in world pulp shipments of 7% as of May. While producer stocks are higher than at the same time last year, it appears that pulp consumers are holding low-to-average stocks of wood pulp. These factors tipped the supply and demand balance in favour of pulp producers early in the year, which resulted in the northwestern European price rising from US $620 per air dry metric tonne at the end of the first quarter to US $670 at the end of June.

Outlook:

Entering into the third quarter of 2004, there has been a decline in demand from Asia, particularly China, where buyers are testing the market. However, it is anticipated that a resurgence in demand will occur later in the third quarter, which, in combination with steady shipments into North America and Europe, should allow for more pricing gains in the latter part of the year.

Coastal Operations

(millions of dollars unless otherwise noted)		2nd Quarter 2004		1st Quarter 2004		6 months ended June 30, 2004		2nd Quarter 2003		6 months ended June 30, 2003
Gross sales	$	**45.2**	$	17.2	$	**62.4**	$	38.9	$	77.0
EBITDA	$	**6.9**	$	1.7	$	**8.6**	$	1.6	$	11.8
EBITDA margin		**15%**		10%		**14%**		4%		15%
Operating income (loss)	$	**4.6**	$	0.6	$	**5.2**	$	(0.4)	$	7.8

Operating income increased significantly from the previous quarter and compared to the same quarter in 2003, mainly because of higher sales volumes. Logging operations were shutdown for most of the first quarter, which reduced the amount of inventory available for sale in that period. With the exception of the last two weeks of June, production was at full capacity in the second quarter, which allowed for higher sales volumes. Conditions on the Coast have been extremely dry, which contributed to a 6-hectare fire at the Englewood operations in mid-June. Quick and aggressive action prevented the fire from spreading further and there was minimal damage to felled and standing timber. Logging operations may be shut down in the July and August time period because of the fire hazard.

Non-Segmented Items

(millions of dollars)		2nd Quarter 2004		1st Quarter 2004		6 months ended June 30, 2004		2nd Quarter 2003		6 months ended June 30, 2003
Corporate costs	$	**(29.0)**	$	(8.3)	$	**(37.3)**	$	(5.5)	$	(10.6)
Equity income (loss) of affiliated companies	$	**3.5**	$	0.6	$	**4.1**	$	(0.8)	$	(0.6)
Net interest expense	$	**(15.6)**	$	(12.4)	$	**(28.0)**	$	(13.1)	$	(25.8)
Foreign exchange gain (loss) on long-term debt	$	**(21.9)**	$	(6.0)	$	**(27.9)**	$	43.6	$	87.9
Other income (expense)	$	**0.4**	$	0.3	$	**0.7**	$	(0.5)	$	1.4

The significant increase in corporate costs in the quarter is attributable to the following: $14.8 million of restructuring costs, as discussed above; $3.7 million of corporate administration costs resulting from the merging of the two organizations; $2.3 million of special incentive awards; and a $0.7 million write-off of abandoned project costs.

SUMMARY OF FINANCIAL POSITION

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

(millions of dollars)		2nd Quarter 2004		1st Quarter 2004		6 months ended June 30, 2004		2nd Quarter 2003		6 months ended June 30, 2003
Ratio of current assets to current liabilities						**2.3: 1**				1.4:1
Ratio of net debt to common shareholders' equity						**26:74**				42:58
Increase (decrease) in net cash position	$	**264.5**	$	51.8	$	**316.3**	$	(52.8)	$	(163.3)
- comprised of cash flow from (used in):										
Operating activities	$	**316.7**	$	(6.4)	$	**310.3**	$	58.4	$	(35.0)
Financing activities	$	**15.3**	$	71.8	$	**87.1**	$	(57.1)	$	(62.5)
Investing activities	$	**(67.5)**	$	(13.6)	$	**(81.1)**	$	(55.6)	$	(70.9)
Discontinued operations	$	**-**	$	-	$	**-**	$	1.5	$	5.1

Cash flow from operating activities increased significantly in the quarter, to $316.7 million, which was a $323.1 million improvement over the previous quarter and $258.3 million over the same quarter in 2003. The improvement is mainly as a result of the following:

- the inclusion of the legacy Slocan results in the quarter;
- significantly higher product prices, as discussed in the segmented results above;
- a $128.5 million decline in inventories in the quarter, mainly as a result of reducing log inventories by $173.6 million (which had been built up, as usual, during the winter months), offset by a $34.8 million increase in lumber inventories due to the railcar shortages;
- lower interest payments. Total interest paid in the quarter amounted to $8.2 million, which was $2.3 million lower than the same period last year, primarily from the effect of the stronger Canadian dollar on US dollar interest payments.

Cash flow from financing activities was $15.3 million in the quarter and $87.1 million for the year to date. The main financing activities in the quarter were as follows:

- legacy Slocan's long-term debt of US $160 million was repaid on April 1st;
- new private placement financing of US $185 million was received on April 1st, with a weighted average interest rate of 5.7% and a weighted average life of 7.2 years;
- a long-term debt payment of US $12.5 million was made in June;
- $2.3 million of proceeds were received from the exercise of stock options in the quarter ($8.1 million for the year to date);
- a $3.1 million interest payment was made on the convertible debentures.

In the first quarter, proceeds of US $50 million from new private placement financing were received in February. These funds were utilized for general corporate purposes and capital expenditures. In comparison, during the second quarter of 2003, US $32.5 million of debt repayments were made, $5.3 million of dividends were paid ($10.6 million in the year to date) and no stock options were exercised.

Cash used in investing activities was $67.5 million in the quarter and $81.1 million in the year to date. The main investing activities in the quarter included:

- a net cash outflow in the combination with Slocan of $37.9 million, which is comprised of a $28.6 million make-whole penalty on Slocan's debt and transaction costs of $29.8 million, partially offset by Slocan's cash balance of $20.5 million;
- capital expenditures totalling $18.7 million ($34.1 million in the year to date), as discussed further below;
- an $8.5 million investment in the new OSB joint venture project in Fort St John.

Liquidity and Financial Requirements

At the end of the quarter, Canfor had net cash of $258.9 million and $270.3 million of unused operating bank lines available. This compares to the March 31, 2004 net short-term indebtedness position of $5.6 million, and $225.2 million of unused operating lines of credit and the December 31, 2003 net short-term indebtedness position of $57.4 million and $96.1 million of unused operating lines of credit. The significant increase in cash in the current quarter is due to the recent improvements in operating cash flow and the reduction in inventories, as discussed above.

Capital spending for the first six months of 2004 amounted to $34.1 million, $18.7 million of which was in the second quarter. Approximately 70% of the expenditures have been strategic in nature, to increase shareholder value by improving the Company's cost position, productivity and production capacity. 30% of capital spending has been to maintain the existing productive capacity of the operations or to ensure proficient safety and environmental performance.

Capital spending and new project approvals slowed down during the first half of the year, due in large part to the Company's focus on the business combination with Slocan. However, that pace will be accelerated over the last six months of the year. Planned expenditures in the last six months of 2004 include $23 million on the Co-Generation Project at the Prince George pulp mill, $12 million on Company-wide road projects and $4.4 million to purchase a log barge in the Mackenzie region. In addition, Canfor has contributed $8.5 million in the current quarter to the new 50%-owned OSB plant currently under construction in Fort St John, BC. Further contributions of $23.5 million will be made in 2004 and $75 million in 2005.

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 $284.0 million or $2.16 per share. The Company can incur an additional $855.0 million of long-term debt under these borrowing arrangements.

Howe Sound Pulp and Paper Limited Partnership

Although Canfor no longer consolidates Howe Sound Pulp and Paper Limited Partnership (HSLP) into its financial results, the operation reported a net loss of $3.3 million for the quarter, compared to a net loss of $9.9 million in the same period last year. The increase in pulp prices was the main factor in the improved results, with EBITDA increasing by $15.0 million in the quarter, to $16.3 million ($17.6 million for the year to date). 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 $48.5 million to HSLP in advance of the due date of receivables for pulp marketed and collected on their behalf ($44.5 million had been prepaid at the end of the previous quarter and $33.5 million had been prepaid at December 31, 2003). The prepayment is covered by the assignment of current and future accounts receivable.

Outstanding Shares

At July 22, 2004, there were 131,513,777 common shares outstanding.

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.

Update on the Canada/US softwood lumber dispute

Countervailing duties (CVD)

As discussed in the first quarter 2004 MD&A, Canfor was granted a company-specific expedited review of its CVD rate. This review was completed in March 2004 and, as a result, Canfor's CVD cash deposit rate was reduced from 18.79% to 12.24% for shipments to the US after March 9, 2004. This deposit rate is expected to remain in effect until December 2004. The US has indicated that it will not conduct company-specific administrative reviews, even for companies such as Canfor that have been granted expedited reviews. Consequently, even though Canfor is paying deposits at the expedited review rate the actual assessments will be based on a country-wide rate. On April 14, 2004 the Government of Canada commenced an appeal via the World Trade Organization (WTO) against the US decision not to conduct company-specific administrative reviews for expedited review companies such as Canfor, and not to complete expedited reviews on a timely basis for companies such as Slocan. This appeal will likely take at least a year to complete.

On June 3, 2004 the US Department of Commerce (DOC) released their preliminary results of a countrywide CVD administrative review for the period May 22, 2002 to March 31, 2003 (POR1). This rate was calculated to be 9.24% and is applicable for all non-zero rate producers including those, like Canfor, that had been granted company-specific cash deposit rates. This preliminary rate is expected to be finalized in December 2004 and will be used to determine the actual duties due for entries made during POR1, and sets the new deposit rate for the company going forward.

As a result of the uncertainty as to whether Canfor will be granted a company-specific administrative review and because all the results are subject to further review and appeal, Canfor has continued to expense the CVD at the original rate of 18.79%. Also, no adjustment is being made to reflect the lower preliminary rate of 9.24% calculated in the country-wide administrative review for POR1 by the DOC because of the anticipated challenges and appeals.

Threat of injury determination

The NAFTA Panel ruling on the US International Trade Commission (ITC)'s remand decision regarding threat of injury to the US softwood industry was released on April 29, 2004. The Panel again found that the US threat of injury claim "was not supported by substantial evidence on the record" and ordered the ITC to issue a revised determination. On June 10, 2004 the ITC resubmitted its findings of threat of injury. NAFTA has up to 90 days to rule on the remand, at which time it could remand the case a third time, reject the ITC determination, or accept it. If the end result of the NAFTA appeal is a negative threat of injury determination, the order allowing collection of duties should be rescinded. In that situation there is a potential dispute concerning the refund of deposits already collected. It is expected that the US would appeal a negative threat of injury finding to a NAFTA Extraordinary Challenge Committee, which would extend proceedings for a further period of time.

Anti-dumping duty (ADD) rate determination

On June 1, 2004 the DOC issued its preliminary ADD results for the first administrative review for the period May 22, 2002 to April 30, 2003 (POR1). The preliminary rates for Canfor and Slocan were 2.06% and 1.64% respectively. The deposit rates currently in effect will not change until the final results of this review are determined, which is expected to be in December 2004. The final results will determine the actual ADD due for the entries made during POR1, and will set a new ADD deposit rate for the Company going forward.

As at June 30, 2004, Canfor (including legacy Slocan) had paid combined duty deposits of US $409 million since inception of CVD and ADD in May 2002.

Labour Agreements

During the second quarter, contract negotiations with the Industrial, Wood and Allied Workers Union (IWA) were successfully concluded at all remaining BC Interior operations including Tackama, Plateau and Houston. Negotiations with the Pulp, Paper and Woodworkers of Canada (PPWC) at North Central Plywood and Mackenzie were also successfully concluded during the period. The terms of the Interior agreements include wage increases totaling 11% over a six-year term ending June 30, 2009. Most of the agreements also contain a provision for a bonus plan based on a "return on capital employed" formula. There were very few benefit plan improvements included in the agreements and most contain benefit plan changes that will either control or minimize some of the future employer-paid benefit plan premium cost increases. There are also provisions for increased employee (ongoing) and employer (2 years) pension plan contributions as well as increased employee and employer long-term disability premium contributions.

On the Coast, the government-appointed arbitrator handed down his binding contract settlement covering the Forest Industrial Relations (FIR) member companies and the IWA. The settlement, which affects the Englewood Logging operation as an FIR member operation and the Panel and Fibre operation (through a previous 'me-too' agreement with the IWA), includes wage increases totaling 6% over a four-year term expiring June 15, 2007. The settlement gives employers the ability to unilaterally implement alternate shift schedules, without overtime or premium penalties, within a flexible 40 hour work week averaging period. There are also employer cost reduction provisions involving travel time payments (logging) and vacation scheduling requirements. The bonus plan, benefit plan and pension plan provisions mirror those of the Interior agreements.

Mountain Pine Beetle

The mountain pine beetle infestation has been worse than previously expected. The latest research suggests that up to 80% of the lodgepole pine in BC's Interior could be affected by 2013. The government of BC has committed over $100 million to control the spread of the infestation and has increased the allowable annual cut in the hardest hit areas. The focus was originally on trying to halt the outbreak through harvesting but has recently shifted more to salvage mode. In the short term Canfor will meet its fibre needs, especially given that the government is considering a further increase in allowable cut of approximately 5.5 million cubic metres for five years in the Prince George, Lakes and Quesnel Timber Supply Areas. Quality will not be a problem for the next few years, but over time there will be a degradation of the quality of the timber. Eventually there will be a reduction in allowable cut, possibly ranging from 10 to 50% in some forest districts.

BC Forest Fires

Fire is a significant concern for the summer of 2004, with weather forecasts suggesting one of the driest years on record. There have already been a number of fires in Canfor's general operating areas, the most significant one being the Kenney Dam fire, which blackened about 10,000 hectares. The fire was contained but the area will require salvage efforts in the winter by some licensees. All of Canfor's divisions are fire ready, in terms of both manpower and equipment.

Consolidated Statements of Income and Retained Earnings

(unaudited) (millions of dollars)	3 months ended June 30, 2004	3 months ended June 30, 2003	6 months ended June 30, 2004	6 months ended June 30, 2003
Gross sales	**$ 1,277.5**	$ 639.4	**$ 1,963.1**	$ 1,321.2
Costs and expenses				
Manufacturing and product costs	**706.8**	492.0	**1,138.6**	972.6
Freight and other distribution costs	**161.0**	109.3	**269.7**	229.8
Countervailing and anti-dumping duties (Note 6)	**100.2**	46.8	**137.6**	80.7
Amortization	**38.9**	25.4	**68.9**	55.8
Selling and administration costs	**22.3**	13.4	**37.6**	26.7
	1,029.2	686.9	**1,652.4**	1,365.6
Restructuring costs (Note 7)	**23.1**	-	**23.1**	-
Operating income (loss) from continuing operations	**225.2**	(47.5)	**287.6**	(44.4)
Equity income (loss) of affiliated companies	**3.5**	(0.8)	**4.1**	(0.6)
Interest expense	**(15.6)**	(13.1)	**(28.0)**	(25.8)
Foreign exchange gain (loss) on long-term debt	**(21.9)**	43.6	**(27.9)**	87.9
Other income (expenses)	**0.4**	(0.5)	**0.7**	1.4
Net income (loss) from continuing operations before income taxes	**191.6**	(18.3)	**236.5**	18.5
Income tax recovery (expense) (Note 9)	**(48.0)**	14.6	**(60.9)**	14.9
Net income (loss) from continuing operations	**143.6**	(3.7)	**175.6**	33.4
Net income from discontinued operation	**-**	2.6	**-**	5.7
Net income (loss)	**$ 143.6**	$ (1.1)	**$ 175.6**	$ 39.1
Per common share (in dollars) (Note 10)				
Net income (loss) from continuing operations				
Basic	**$ 1.08**	$ (0.06)	**$ 1.62**	$ 0.37
Diluted	**$ 1.00**	$ (0.06)	**$ 1.48**	$ 0.36
Net income (loss)				
Basic	**$ 1.08**	$ (0.03)	**$ 1.62**	$ 0.44
Diluted	**$ 1.00**	$ (0.03)	**$ 1.48**	$ 0.42
Retained earnings, beginning of year – as reported			**$ 273.4**	$ 136.7
Cumulative effect of change in accounting policy (Note 2)			**3.6**	3.6
Retained earnings, beginning of year – as restated			**$ 277.0**	$ 140.3
Net income for the year-to-date			**175.6**	39.1
Common share dividends			**-**	(10.6)
Interest on equity component of convertible subordinated debentures, net of taxes			**(3.1)**	(3.0)
Retained earnings, end of current period			**$ 449.5**	$ 165.8

(unaudited) (millions of dollars)	3 months ended June 30, 2004	3 months ended June 30, 2003	6 months ended June 30, 2004	6 months ended June 30, 2003
Cash generated from (used in)				
Operating activities				
Net income (loss) from continuing operations	**$ 143.6**	$ (3.7)	**$ 175.6**	$ 33.4
Items not affecting cash:				
Amortization	**38.9**	25.4	**68.9**	55.8
Long-term portion of deferred reforestation	**(3.0)**	(11.3)	**17.2**	3.6
Income taxes	**15.5**	0.3	**24.4**	-
Unrealized foreign exchange loss (gain) on long-term debt	**22.1**	(45.1)	**28.1**	(89.4)
Adjustment to accrued duties (Note 6)	**25.2**	3.3	**19.9**	(4.1)
Loss (gain) on disposal of assets	**2.7**	(0.5)	**2.2**	(1.1)
Other	**(2.3)**	6.5	**2.6**	6.3
Changes in non-cash working capital	**74.0**	83.5	**(28.6)**	(39.5)
	316.7	58.4	**310.3**	(35.0)
Financing activities				
Proceeds from long-term debt (Note 4)	**246.2**	-	**313.1**	-
Repayment of long-term debt (Note 4)	**(229.8)**	(48.7)	**(230.6)**	(48.7)
Net proceeds on issuance of common shares (Note 11)	**2.3**	-	**8.1**	-
Dividends paid to common shareholders	**-**	(5.3)	**-**	(10.6)
Interest on convertible debentures, net of taxes	**(3.1)**	(3.0)	**(3.1)**	(3.0)
Other	**(0.3)**	(0.1)	**(0.4)**	(0.2)
	15.3	(57.1)	**87.1**	(62.5)
Investing activities				
Business acquisition costs, net of cash acquired (Note 3)	**(37.9)**	(30.6)	**(37.9)**	(30.6)
Property, plant, equipment and timber	**(18.7)**	(25.9)	**(34.1)**	(39.2)
Proceeds on disposal of property, plant and equipment	**0.9**	1.4	**1.5**	2.2
Other	**(11.8)**	(0.5)	**(10.6)**	(3.3)
	(67.5)	(55.6)	**(81.1)**	(70.9)
Decrease (increase) in net short-term indebtedness / (decrease in net cash) from continuing operations	**264.5**	(54.3)	**316.3**	(168.4)
Cash generated by discontinued operation	**-**	1.5	**-**	5.1
Decrease (increase) in net short-term indebtedness / (decrease in net cash)	**264.5**	(52.8)	**316.3**	(163.3)
Net cash (short-term indebtedness) at beginning of period	**(5.6)**	(87.6)	**(57.4)**	22.9
Net cash (short-term indebtedness) at end of period	**$ 258.9**	$ (140.4)	**$ 258.9**	$ (140.4)
Net cash (short-term indebtedness) is comprised of:				
Cash and temporary investments	**$ 261.7**	$ 11.2	**$ 261.7**	$ 11.2
Operating bank loans	**(2.8)**	(151.6)	**(2.8)**	(151.6)
	$ 258.9	$ (140.4)	**$ 258.9**	$ (140.4)
Changes in non-cash working capital				
Accounts receivable	**$ 6.3**	$ 60.3	**$ (1.8)**	$ (12.6)
Inventories	**128.5**	134.2	**(10.4)**	(34.1)
Prepaid expenses	**(13.9)**	(4.3)	**(7.2)**	7.1
Accounts payable, accrued liabilities and current portion of deferred reforestation	**(26.5)**	(91.2)	**8.9**	14.2
Income taxes	**(20.4)**	(15.5)	**(18.1)**	(14.1)
	$ 74.0	$ 83.5	**$ (28.6)**	$ (39.5)

Interest paid for the six months ended June 30, 2004 was $26.8 million (2003 - $31.4 million) and income taxes paid were $28.3 million (2003 - $0.8 million).

Consolidated Balance Sheets

(millions of dollars)	as at June 30, 2004	as at December 31, 2003
	(unaudited)	(audited)
ASSETS		
Current assets		
Cash	**$ 1.6**	$ 24.7
Temporary investments	**260.1**	-
Accounts receivable		
Trade	**315.6**	173.2
Other	**38.8**	78.3
Income taxes recoverable	**-**	1.4
Future income taxes	**37.0**	21.9
Inventories	**697.3**	445.0
Prepaid expenses	**40.9**	24.1
Total current assets	**1,391.3**	768.6
Long-term investments and other	**153.3**	100.5
Property, plant, equipment and timber	**2,159.1**	1,443.5
Deferred charges	**125.4**	126.8
	$ 3,829.1	$ 2,439.4
LIABILITIES		
Current liabilities		
Operating bank loans (Note 4)	**$ 2.8**	$ 82.1
Accounts payable and accrued liabilities	**503.1**	335.5
Current portion of long-term debt	**56.0**	57.2
Current portion of deferred reforestation	**46.2**	39.6
Income taxes payable	**2.0**	-
Total current liabilities	**610.1**	514.4
Long-term debt (Note 4)	**796.4**	478.0
Other accruals and provisions (Note 5)	**199.3**	83.0
Future income taxes, net	**438.1**	175.7
Deferred credit	**58.8**	95.7
SHAREHOLDERS' EQUITY		
Share capital - 131,513,777 shares outstanding (Note 11)	**1,120.1**	659.2
Convertible subordinated debentures	**155.0**	155.0
Retained earnings	**449.5**	277.0
Foreign exchange translation adjustment	**1.8**	1.4
Total shareholders' equity	**1,726.4**	1,092.6
	$ 3,829.1	$ 2,439.4

Contingencies (Note 13)

APPROVED BY THE BOARD

R. Lloyd Cliff

Director, R.L. Cliff

J. Shepherd

Director, J.A. Shepherd

(unaudited) (millions of dollars)		Lumber (Notes a, d)	Panels (Note a)	Pulp and Paper	Coastal Operations	Corporate and Other		Consolidated
3 months ended June 30, 2004								
Gross sales to external customers	**$**	**819.9**	**136.8**	**275.6**	**45.2**	**-**	**$**	**1,277.5**
Gross sales to other segments (Note c)	**$**	**29.9**	**1.0**	**-**	**3.2**	**-**	**$**	**34.1**
Operating income (loss)	**$**	**153.7**	**59.5**	**36.4**	**4.6**	**(29.0)**	**$**	**225.2**
Amortization	**$**	**21.0**	**2.7**	**10.6**	**2.3**	**2.3**	**$**	**38.9**
Capital expenditures	**$**	**9.4**	**5.7**	**2.0**	**1.6**	**-**	**$**	**18.7**
3 months ended June 30, 2003								
Gross sales to external customers	$	375.2	29.7	195.6	38.9	-	$	639.4
Gross sales to other segments (Note c)	$	31.0	0.9	-	2.6	-	$	34.5
Operating income (loss)	$	(39.7)	1.5	(3.4)	(0.4)	(5.5)	$	(47.5)
Amortization	$	10.5	0.7	10.7	2.0	1.5	$	25.4
Capital expenditures	$	18.4	0.2	5.7	1.4	0.2	$	25.9

Summary of Consolidated Production and Shipments

	Production		Shipments	
3 months ended June 30, (unaudited)	**2004**	2003	**2004**	2003
Lumber - MMfbm				
Canfor produced	**1,280.7**	821.5	**1,320.4**	766.3
Purchased from other wholesale producers			**87.2**	79.0
Total Lumber			**1,407.6**	845.3
Plywood - 000 Msf 3/8"	**109.1**	46.9	**108.9**	47.7
Oriented Strand Board - 000 Msf 3/8"	**125.8**	-	**132.6**	-
Pulp - 000 mt				
Canfor produced	**297.5**	236.0	**284.5**	220.2
Marketed on behalf of HSLP (Note e)			**89.9**	84.6
Total Pulp			**374.4**	304.8
Kraft paper - 000 mt	**33.5**	27.9	**39.4**	27.4
Coastal Logs - 000 m^3	**447.3**	441.4	**481.3**	406.9

a. In the second quarter of 2004, subsequent to the business combination discussed in Note 3 of the Consolidated Financial Statements, Canfor divided its former Wood Products segment into its two major product categories. The Lumber segment includes all logging and forestry operations formerly included in Wood Products and the sawmill and remanufacturing operations. The Panels segment includes the plywood, OSB and panel and fibre operations.

b. 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.

c. Sales to other segments are accounted for at prices which approximate market value.

d. Gross sales for the quarter include sales of Canfor produced lumber of $721.1 million (2003 - $331.7 million) and $1,087.9 million for the year-to-date (2003 - $669.3 million).

e. Canfor is responsible for marketing, on a commission basis, the pulp production of Howe Sound Pulp and Paper Limited Partnership (HSLP).

f. Certain prior year figures have been reclassified to conform to the current year's presentation.

Statements of Segmented Information

(unaudited) (millions of dollars)	Lumber (Notes a, d)	Panels (Note a)	Pulp and Paper	Coastal Operations	Corporate and Other	Consolidated
6 months ended June 30, 2004						
Gross sales to external customers	**$ 1,237.9**	**168.8**	**494.0**	**62.4**	**-**	**$ 1,963.1**
Gross sales to other segments (Note c)	**$ 54.4**	**1.8**	**-**	**4.1**	**-**	**$ 60.3**
Operating income (loss)	**$ 205.6**	**65.2**	**48.9**	**5.2**	**(37.3)**	**$ 287.6**
Amortization	**$ 37.0**	**3.2**	**21.4**	**3.4**	**3.9**	**$ 68.9**
Capital expenditures	**$ 16.8**	**5.7**	**9.0**	**2.6**	**-**	**$ 34.1**
Identifiable assets	**$ 1,841.9**	**213.4**	**880.5**	**76.5**	**816.8**	**$ 3,829.1**
6 months ended June 30, 2003						
Gross sales to external customers	$ 763.2	57.0	424.0	77.0	-	$ 1,321.2
Gross sales to other segments (Note c)	$ 50.4	1.7	-	5.0	-	$ 57.1
Operating income (loss)	$ (47.3)	1.1	4.6	7.8	(10.6)	$ (44.4)
Amortization	$ 25.4	1.4	22.2	4.0	2.8	$ 55.8
Capital expenditures	$ 26.3	1.3	8.4	2.8	0.4	$ 39.2
Identifiable assets	$ 1,007.4	44.8	824.4	86.3	441.8	$ 2,404.7

Summary of Consolidated Production and Shipments

	Production		Shipments	
6 months ended June 30, (unaudited)	**2004**	2003	**2004**	2003
Lumber - MMfbm				
Canfor produced	**2,107.7**	1,573.4	**2,047.6**	1,485.9
Purchased from other wholesale producers			**148.7**	149.4
Total Lumber			**2,196.3**	1,635.3
Plywood - 000 Msf 3/8"	**153.1**	92.2	**154.3**	87.7
Oriented Strand Board - 000 Msf 3/8"	**125.8**	-	**132.6**	-
Pulp - 000 mt				
Canfor produced	**546.5**	498.6	**526.2**	494.1
Marketed on behalf of HSLP (Note e)			**163.5**	176.9
Total Pulp			**689.7**	671.0
Kraft paper - 000 mt	**67.5**	59.0	**74.7**	60.6
Coastal Logs - 000 m^3	**677.5**	868.6	**669.0**	746.8

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.

These interim 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 accounting standard which 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. Business Combination

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. A total of 49,333,571 Canfor shares were issued and were valued at $9.18 per share, which was the average market price of the shares shortly before and after the date that the terms of the combination were agreed to and announced.

Slocan was amalgamated with Canadian Forest Products Ltd., Canfor's principal operating subsidiary, on April 1, 2004. The acquisition has been accounted for using the purchase method, in which the purchase consideration was allocated to the estimated fair values of the assets and liabilities assumed as of April 1, 2004. The following fair value allocation is based on Management's best estimates and information known at the time of preparing these consolidated financial statements, but may change upon the completion of an independent valuation of certain assets and the identification of additional integration costs related to Slocan's operations.

(millions of dollars)		
Net assets acquired		
Cash	$	20.5
Non-cash working capital		160.1
Property, plant, equipment and timber		756.6
Other assets		23.8
Long-term debt		(209.7)
Long-term liabilities		(58.8)
Future income tax liabilities		(181.2)
Fair value of net assets acquired	$	511.3
Consideration paid		
Common shares issued to Slocan shareholders	$	452.9
Make-whole penalty on Slocan's long-term debt		28.6
Transaction costs		29.8
	$	511.3

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 sawmill located at Fort St James, British Columbia and certain associated harvesting rights. The sales process is currently underway, with the expectation that the full book value of the assets will be recovered. Due to the size of the Fort St James operation in relation to the entire lumber segment, it has not been accounted for as a discontinued operation.

4. Bank Indebtedness and Long-Term Debt

At June 30, 2004 Canfor had $307.0 million of bank operating lines of credit available, of which $2.8 million was drawn down and an additional $33.9 million was utilized for several standby letters of credit.

New private placement financing of US $50 million was drawn down on February 2, 2004 and was utilized for general operating purposes and capital expenditures. On April 1, 2004, the US $160 million of long-term debt acquired in the acquisition of Slocan (Note 3) was refinanced with new private placement debt of US $185 million. The balance was used to pay a make-whole penalty on Slocan's debt and for general corporate purposes. The new debt is in the form of unsecured senior notes, which have the following interest rates and maturities: US $60 million at 5.66% (2009), US $50 million at 6.18% (2011), US $50 million at 6.33% (2012), 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 paid to its common shareholders. Under these agreements, Canfor and its designated subsidiaries can presently incur $855.0 million in additional long-term debt and pay up to $284.0 million, or $2.16 per share, in dividends to its common shareholders.

At June 30, 2004, the fair value of Canfor's long-term debt was $918.3 million and the fair value of the convertible subordinated debentures was $180.0 million.

5. Other Accruals and Provisions

(millions of dollars)	June 30, 2004	December 31, 2003
Deferred reforestation	**$ 86.7**	$ 34.0
Countervailing duty provision (Note 6)	**38.1**	-
Accrued pension obligations	**23.5**	6.3
Post employment benefits	**46.9**	33.3
Other liabilities	**4.1**	9.4
Total other accruals and provisions	**$ 199.3**	$ 83.0

6. 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 deposit 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 cumulative difference between the expensed amount and the cash paid is $38.1 million ($32.3 million in the second quarter) and is included in "other accruals and provisions" (Note 5).

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 2.51% for the first period of review (May 2002 to April 2003) and at 3.13% for the second period of review (May 2003 to April 2004). In May and June, ADD has been expensed at the cash deposit rate because it is too early in the period of review to be able to determine what rate will be applicable for the entire period. Canfor reassesses its estimate of the ADD rate on a regular basis, by applying the US Department of Commerce's (DOC) methodology to updated sales and cost data as it becomes available. The cumulative difference between the assessed rate and the effective rate at June 30, 2004 is $63.1 million, and is being carried as a receivable under "long-term investments and other". This balance includes Slocan's $17.5 million receivable at the combination date (Note 3).

On June 3, 2004, the DOC announced the results of its preliminary administrative reviews of the CVD and ADD cash deposit rates, based on lumber shipments from Canada to the US during the first period of review. The national CVD rate was reduced to 9.24%. Canfor's specific ADD rate was reduced to 2.06% and Slocan's was reduced to 1.64%. A final determination on these rates is expected in December, at which time the new rates will become effective. No adjustment has been recorded in the current period because of uncertainty over the timing of any refunds to be received.

As at June 30, 2004, Canfor (including legacy Slocan) had paid combined duty deposits of US $409 million since inception of CVD and ADD in May 2002.

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.

7. Restructuring Costs

In the second quarter, Canfor accrued $17.2 million of severance and other costs associated with the integration of Canfor and Slocan's operations.

The closure of the Taylor sawmill, announced as part of the Company's Cost Reduction/Margin Improvement program in the fourth quarter of 2002 was completed in the current quarter and resulted in the recognition of further severance, pension and other costs of $5.9 million.

8. Employee Future Benefits

The total benefit cost of Canfor's pension plans was $3.5 million in the second quarter of 2004 and $6.0 million for the year to date. The total benefit cost of Canfor's other future benefit plans was $3.8 million in the second quarter and $7.3 million for the year to date.

9. Income Tax Recovery (Expense)

(millions of dollars)	3 months ended June 30, 2004	3 months ended June 30, 2003	6 months ended June 30, 2004	6 months ended June 30, 2003
Current	**$ (87.5)**	$ 25.0	**$ (114.1)**	$ 15.2
Future	**11.0**	(12.3)	**16.9**	(2.8)
Tax benefit of current Howe Sound Pulp and Paper Limited Partnership losses	**(0.5)**	1.6	**0.6**	2.2
Affiliates	**(1.1)**	0.3	**(1.2)**	0.3
	(78.1)	14.6	**(97.8)**	14.9
Amortization of deferred credit on utilization of acquired tax losses	**30.1**	-	**36.9**	-
	$ (48.0)	$ 14.6	**$ (60.9)**	$ 14.9

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 June 30, 2004	3 months ended June 30, 2003	6 months ended June 30, 2004	6 months ended June 30, 2003
Income tax expense at statutory tax rate	**$ (68.0)**	$ 6.6	**$ (84.0)**	$ (6.8)
Large corporation tax	**(1.8)**	(1.3)	**(3.1)**	(2.6)
Tax benefit of current Howe Sound Pulp and Paper Limited Partnership losses	**(0.5)**	1.6	**0.6**	2.2
Deferred income tax credit amortized	**30.1**	-	**36.9**	-
Permanent difference from foreign exchange gains and losses on long-term debt	**(7.8)**	8.0	**(9.9)**	21.4
Other permanent differences and tax adjustments	**-**	(0.3)	**(1.4)**	0.7
	$ (48.0)	$ 14.6	**$ (60.9)**	$ 14.9

10. Earnings Per Share

(millions of dollars, except for number of shares and per share amounts)	3 months ended June 30, **2004**	2003	6 months ended June 30, **2004**	2003
Basic Earnings				
Net income (loss) from continuing operations	**$ 143.6**	$ (3.7)	**$ 175.6**	$ 33.4
Less interest on equity component of convertible debentures, net of taxes	**(1.5)**	(1.5)	**(3.1)**	(3.0)
Net income (loss) from continuing operations available to common shareholders	**142.1**	(5.2)	**172.5**	30.4
Net income from discontinued operations	**-**	2.6	**-**	5.7
Net income (loss) available to common shareholders	**142.1**	(2.6)	**172.5**	36.1
Diluted Earnings				
Add back interest on equity component of convertible debentures	**1.5**	- (a)	**3.1**	3.0
Net income (loss) from continuing operations available to common shareholders	**143.6**	(5.2)	**175.6**	33.4
Net income available to common shareholders	**$ 143.6**	$ (2.6)	**$ 175.6**	$ 39.1
Weighted average number of common shares	**131,412,059**	81,156,010	**106,505,171**	81,156,010
Incremental shares from stock options	**249,688**	- (b)	**246,936**	60,401
Shares issuable upon conversion of convertible debentures	**11,742,424**	- (a)	**11,742,424**	11,742,424
Diluted number of common shares	**143,404,171**	81,156,010	**118,494,531**	92,958,835
Per common share				
Net income (loss) from continuing operations				
Basic	**$ 1.08**	$ (0.06)	**$ 1.62**	$ 0.37
Diluted	**$ 1.00**	$ (0.06)	**$ 1.48**	$ 0.36
Net income (loss)				
Basic	**$ 1.08**	$ (0.03)	**$ 1.62**	$ 0.44
Diluted	**$ 1.00**	$ (0.03)	**$ 1.48**	$ 0.42

(a) Anti-dilutive - $1.5 million interest and 11,742,424 shares issuable

(b) Anti-dilutive - 33,920 incremental shares

11. Stock-Based Compensation

During the quarter, proceeds of $2.3 million were received from the exercise of 252,415 stock options at a weighted-average exercise price of $9.13. For the year to date, proceeds of $8.1 million were received from the exercise of 918,928 options at an average of $8.76 per share.

No new stock options were granted in the current quarter or in 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.

	3 months ended June 30,		6 months ended June 30,	
(millions of dollars, except for per share amounts)	**2004**	2003	**2004**	2003
Net income				
As reported	**$ 143.6**	$ (1.1)	**$ 175.6**	$ 39.1
Pro forma	**$ 143.5**	$ (1.3)	**$ 175.5**	$ 38.8
Net income per common share				
As reported - basic	**$ 1.08**	$ (0.03)	**$ 1.62**	$ 0.44
As reported - diluted	**$ 1.00**	$ (0.03)	**$ 1.48**	$ 0.42
Pro forma - basic	**$ 1.08**	$ (0.03)	**$ 1.62**	$ 0.44
Pro forma - diluted	**$ 1.00**	$ (0.03)	**$ 1.48**	$ 0.42

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.

12. 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 June 30, 2004, Canfor had US $3 million of forward exchange contracts outstanding (2003 - US $95 million). These contracts were fixed at an average rate of 1.4505 and have option periods that are spread through to the end of the year. At June 30, 2004, there was an unrealized gain of $0.3 million on these contracts. During the quarter, one US $5 million contract was exercised and the realized gain of $0.3 million is reflected in sales (year-to-date: $1.8 million gain on total contracts of US $20 million).

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 2.5 million Gigajoules were outstanding at the end of the current quarter. There was an unrealized gain of $1.5 million on these swaps at June 30, 2004.

13. 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 2.2 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.

14. Certain comparative figures have been reclassified to conform to the presentation in the current period.

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