



July 29, 2005

## **CANFOR CORPORATION ANNOUNCES SECOND QUARTER EARNINGS**

Vancouver, B.C. – Canfor Corporation (TSX: CFP) today reported net income of \$25.3 million for the second quarter, or \$0.18 per share on a diluted basis. This compares to net income of \$65.6 million, or \$0.46 per share in the first quarter and net income of \$142.1 million, or \$1.00 per share in the second quarter of 2004.

Income for the quarter includes an unrealized loss on translation of US dollar debt of \$14.1 million, a loss on disposal of discontinued operations of \$4.0 million and restructuring costs of \$2.5 million (all after tax), which in total reduced reported net income by \$0.14 per share.

The current quarter's results were impacted by weaker prices for all of our products. Lumber prices declined by 8% from the first quarter, OSB by 16%, plywood by 18% and pulp prices were 5% lower. When compared to the same quarter in 2004, lumber prices averaged 16% lower, OSB 29%, plywood 39% and pulp 6%.

Compared to the previous quarter, lumber shipments increased by 16%, OSB shipments increased by 14% and pulp shipments increased by 12%. These improvements are a result of increased demand during the active building season and efficiencies in supply through improved rail car availability and the scheduling of marine transportation of product to the company's major US customers

As part of the company's strategic realignment of its assets, Canfor completed the sale of three of its higher cost lumber operations and a subsidiary involved in the development and marketing of forest management information systems. As well, Canfor announced the planned construction of its International Distribution Centre in Richmond, BC, dedicated to servicing the Japanese and other developing Asia Pacific markets.

Activity on major capital projects is progressing as planned, with the completion of the Prince George Co-Generation facility, and successful completion and start-up of the capacity upgrades at the OSB mill in Fort Nelson. Both the Plateau mill re-build and the OSB joint venture project are progressing on time and on budget, with start-up of the OSB plant scheduled for September and Plateau scheduled for January 2006.

"Ample product supply during the quarter has led to price weakness in many of our market areas. Efforts on our strategies in market development and production efficiencies are showing positive results. Progress on disposal of non-core operations and an improved balance sheet is positioning Canfor to withstand market uncertainties and to take advantage of growth opportunities as they arise," said Jim Shepherd, President and Chief Executive Officer.

### **Conference Call**

A conference call to discuss the second quarter financial and operating results will be held Friday, July 29, 2005 at 12:00 pm Pacific (3:00 pm Eastern). To participate in the call, please dial 604-639-5227 (Vancouver) or 1-800-387-6216 (Toll-Free North America). The call will be recorded for web casting purposes and will be available at [www.canfor.com](http://www.canfor.com) by the end of the day (PST) on Friday, July 29.

Canfor Corporation is a leading Canadian integrated forest products company based in Vancouver, British Columbia. The Company is the largest producer of softwood lumber and one of the largest producers of northern softwood kraft pulp in Canada. Canfor also produces kraft paper, plywood, remanufactured lumber products, oriented strand board (OSB), hardboard paneling and a range of specialized wood products, including baled fibre and fibre mat at 30 facilities located in British Columbia, Alberta, Quebec and Washington State.

**Forward Looking Statements**

This news release contains statements that are forward-looking in nature. Some of these forward-looking statements can be identified by the use of terminology such as “estimates”, “plans”, “expects”, “anticipates”, “approximately” and “projections”. The accuracy of such statements is subject to a number of risks, uncertainties and assumptions that may cause actual results to differ materially from those expressed or implied.

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**Canfor Corporation**  
**Second Quarter 2005 – Report to Shareholders**

**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 2005 relative to the previous quarter and the last published annual results as at December 31, 2004 and relative to the comparative quarter in 2004. 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, 2004.*

*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 an important indicator for identifying trends in the performance of each operating segment and of the Company's ability to generate funds to meet its debt repayment and capital expenditure requirements. EBITDA is not a generally accepted earnings measure and should not be considered as an alternative to net income or cash flows as determined in accordance with Canadian 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 29, 2005.*

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

**SUMMARIZED RESULTS <sup>1, 2</sup>**

(millions of dollars, except for per share amounts)	Q2 2005	Q1 2005	YTD 2005	Q2 2004	YTD 2004
Sales	\$ 1,067.4	\$ 965.9	\$ 2,033.3	\$ 1,180.6	\$ 1,825.7
Countervailing & anti-dumping duties expensed	\$ 67.5	\$ 58.9	\$ 126.4	\$ 95.8	\$ 131.1
EBITDA	\$ 105.0	\$ 137.2	\$ 242.2	\$ 247.8	\$ 338.6
Operating income	\$ 67.1	\$ 95.6	\$ 162.7	\$ 211.3	\$ 273.4
Foreign exchange loss on long-term debt	\$ (11.7)	\$ (3.6)	\$ (15.3)	\$ (21.9)	\$ (27.9)
Net income from continuing operations, after tax	\$ 28.9	\$ 62.7	\$ 91.6	\$ 133.1	\$ 163.3
Net income (loss) from discontinued operations	\$ (3.6)	\$ 2.9	\$ (0.7)	\$ 9.0	\$ 9.2
Net income	\$ 25.3	\$ 65.6	\$ 90.9	\$ 142.1	\$ 172.5
Per share (diluted)					
Net income from continuing operations	\$ 0.20	\$ 0.44	\$ 0.64	\$ 0.94	\$ 1.40
Net income	\$ 0.18	\$ 0.46	\$ 0.63	\$ 1.00	\$ 1.48
Average Canadian/US exchange rate <sup>3</sup>	\$ 0.804	\$ 0.815	\$ 0.809	\$ 0.736	\$ 0.747

Operating results in the second quarter were impacted by a decrease in product prices. Market prices for all of the major product lines were lower than in the previous quarter. The benchmark 2x4 lumber price decreased by 8%, OSB by 16%, plywood by 18%, and pulp prices decreased by 5%. The decline compared to the second quarter of

<sup>1</sup> Prior year comparative figures quoted in this report reflect the results of the former Slocan operations since April 1, 2004.

<sup>2</sup> Prior period figures have been restated throughout this report to reflect the discontinued operations treatment of the Fort St James, Slocan and Valemount operations, as discussed later in this report.

<sup>3</sup> Source – Bank of Canada (average noon rate for the period)

2004 was even more significant, with lumber decreasing by 16%, OSB by 29%, plywood by 39% and pulp by 6%. The impact of the lower US dollar denominated prices on the operating results was compounded by the strengthening of the Canadian dollar, which averaged 9% stronger in the current quarter than in the second quarter of 2004. Increases in lumber, OSB and pulp shipment volumes over the previous quarter did not offset the full negative impact of lower prices and exchange.

The results in the current quarter were also reduced by \$2.5 million of restructuring and mill closure costs, a \$4.0 million loss on the sale of discontinued operations and a \$14.1 foreign exchange loss on the translation of long-term debt (all figures are after tax).

In comparison, the first quarter results included a \$3.6 million after-tax exchange loss on the translation of long-term debt and a \$5.2 million after-tax favourable adjustment to the prior period's duty expense. The second quarter 2004 results included \$18.5 million of restructuring and mill closure costs, \$5.8 million of special incentive payments and a \$21.9 million exchange loss on the translation of long-term debt (all after tax).

## OPERATING RESULTS BY BUSINESS SEGMENT

### Lumber<sup>4</sup>

(millions of dollars unless otherwise noted)	Q2 2005	Q1 2005	YTD 2005	Q2 2004	YTD 2004
Sales	\$ 704.9	\$ 641.2	\$ 1,346.1	\$ 723.6	\$ 1,101.1
EBITDA	\$ 87.5	\$ 101.3	\$ 188.8	\$ 158.4	\$ 224.7
EBITDA margin	12%	16%	14%	22%	20%
Operating income	\$ 67.4	\$ 76.0	\$ 143.4	\$ 139.8	\$ 191.4
Average 2"x4" #2 & Better lumber price – US \$ <sup>5</sup>	\$ 365	\$ 398	\$ 379	\$ 437	\$ 401
Average price in Cdn \$	\$ 454	\$ 488	\$ 468	\$ 594	\$ 537
Production – lumber (MMfbm)	1,179.1	1,153.5	2,332.6	1,136.2	1,857.5
Shipments – Canfor-produced lumber (MMfbm)	1,253.8	1,088.2	2,342.0	1,190.3	1,851.4
Shipments – wholesale lumber (MMfbm)	102.0	76.6	178.6	87.2	148.7

Lumber shipments increased by 16% over the first quarter and were 6% higher than the second quarter of 2004. However, operating income decreased by \$8.6 million over the previous quarter and by \$72.4 million over the same quarter in 2004, mainly as a result of lower prices. The average 2x4 lumber price, expressed in Canadian dollars, declined by 7% over the first quarter and was 24% lower than in the second quarter in 2004.

Other factors affecting the comparability of the second quarter with the same period last year include duty rates and restructuring accruals. In the current quarter, countervailing and anti-dumping duties were expensed at the cash deposit rates of 16.37% and 1.83%, compared to 18.79% and 5%, respectively, in the same quarter in 2004. One-time charges of \$11.2 million related to incentive awards, restructuring and mill closure costs were expensed in the second quarter of 2004, compared to \$1.4 million of restructuring and mill closure costs in the current quarter.

### Operations

Lumber operations performed well in the current period, with key performance indicators improving significantly over the first quarter. Better weather and a strong focus on continuous improvement contributed to the performance. Safety performance measurements improved by 22% over the same period last year. Production records were established at many of the mills during the second quarter and, as a group, production increased by 3% over the first

<sup>4</sup> Excludes discontinued operations

<sup>5</sup> Per thousand board feet (Source – Random Lengths Publications, Inc.)

quarter. Lumber recovery continues to be a focus for the group and improved by 1.5% during the second quarter. Cash conversion costs continue to trend down and improved by 3.5% over the first quarter. Log costs were marginally higher than the first quarter, with further increases expected in the third and fourth quarters as a result of stumpage rate increases.

Finished lumber inventories decreased by 13% in the period, as transportation performance improved significantly over the first quarter. Improved sawmill production resulted in increased unfinished lumber inventory during the quarter. Corrective action, including additional planer shifts combined with selected sawmill curtailments, is being taken in the third quarter to reduce rough inventories to target levels.

Log inventories decreased by 56% over the first quarter as a result of the normal seasonal decline. The Prince George truckers' strike has been resolved, reducing the potential for log delivery problems for the remainder of the year.

The capital plan implementation is proceeding, and is expected to continue to deliver the desired improved results going forward. In conjunction with the capital plan, the continuous improvement initiatives around quality control and optimization continue to deliver positive results. The \$104 million capital project at the Plateau division is progressing on time and on budget, with scheduled completion in January 2006.

During the second quarter, the group completed the sale of its Fort St James, Valemount and Slocan sawmills. The Hines Creek sawmill will be permanently closed during the third quarter.

On July 12<sup>th</sup>, Canfor announced its plans to open a new distribution centre by the end of the year, dedicated to servicing the Japanese and other Asia Pacific markets. Canfor's International Distribution Centre will be the Lower Mainland's largest covered lumber re-load facility, with the capacity to accommodate 20 million board feet of lumber.

*Markets and Outlook – see below, following Panels section*

## Panels

(millions of dollars unless otherwise noted)	<b>Q2 2005</b>	Q1 2005	<b>YTD 2005</b>	Q2 2004	YTD 2004
Sales	\$ 89.8	\$ 94.4	\$ 184.2	\$ 136.2	\$ 168.2
EBITDA	\$ 11.8	\$ 20.6	\$ 32.4	\$ 62.2	\$ 68.4
EBITDA margin	13%	22%	18%	46%	41%
Operating income	\$ 9.0	\$ 17.8	\$ 26.8	\$ 59.5	\$ 65.2
Average plywood price in Cdn \$ <sup>6</sup>	\$ 361	\$ 439	\$ 400	\$ 592	\$ 560
Average OSB price in US \$ <sup>7</sup>	\$ 305	\$ 364	\$ 334	\$ 431	\$ 433
Average OSB price in Cdn \$	\$ 379	\$ 447	\$ 413	\$ 586	\$ 579
Production – plywood (MMsf 3/8")	110.9	108.3	219.2	109.1	153.1
Production – OSB (MMsf 3/8")	114.9	120.6	235.5	125.8	125.8
Shipments – plywood (MMsf 3/8")	107.1	106.0	213.1	106.1	151.5
Shipments – OSB (MMsf 3/8")	117.1	102.5	219.6	132.6	132.6

Operating income of \$9.0 million in the quarter was \$8.8 million lower than in the previous quarter and \$50.5 million lower than in the same period last year, primarily as a result of the decline in market prices. Both plywood and OSB

<sup>6</sup> Per Msf 3/8" basis, delivered to Toronto (Source – C.C. Crowe Publications, Inc.)

<sup>7</sup> Per Msf 7/16" North Central (Source – Random Lengths Publications, Inc.)

shipment volumes increased over the previous quarter. OSB shipments were 12% lower than in the second quarter of 2004, which was a time of exceptionally strong demand and pricing.

#### *Operations*

North Central Plywood had excellent performance in the quarter, increasing productivity by 8% over the previous quarter and establishing new daily production records. A software upgrade on the scanner was completed in the quarter and early results indicate that this will have a very positive impact on plywood recovery. Except for some mechanical issues, Tackama also performed well in the quarter. Combined cash conversion costs for plywood are above target levels, but are trending downwards, decreasing by 5% over the previous quarter. The mills are focusing on producing more higher-return and valued-added panels, which will have a positive impact on margins in the future.

The PolarBoard mill had some downtime in the period in order to install new capital upgrades. Since starting up, the mill has set several daily production records and continues to work through the anticipated six-month startup curve. Log recovery has improved by nearly 5% as a result of process improvements associated with the new equipment. Manufacturing costs increased by nearly 9% in the quarter, mainly because of the lower production and cost increases for resins and wax. Resin is a direct input in the OSB manufacturing process and is produced from crude oil, which has experienced significant price increases.

#### *Markets – Lumber and Panels*

During the second quarter of 2005, demand for both lumber and panels remained strong as US housing starts averaged near record highs of 2.01 million units on a seasonally adjusted basis. US housing starts averaged 5% above the same period last year. However, with ample lumber availability throughout the supply chain, Western SPF 2”X4” #2 & Better prices decreased by 8% from the previous quarter, or 16% lower than the same period in 2004, to an average of US \$365 per thousand board feet.

Exports to all major offshore markets improved over the previous quarter. Total offshore shipments increased by 18% from the first quarter of 2005, with much of the gains coming from emerging markets such as China and Korea. The Japanese market had the largest volume increase, and was 14% higher than the previous quarter. The continued strength in Japanese 2x4 housing starts in 2005 has facilitated this growth in demand.

Similar to the lumber market, excess panel supply in North America has resulted in downward pressure on panel prices. The average Canadian softwood plywood price was Cdn \$361 per Msf 3/8”, delivered to Toronto, which is a 39% decrease from the second quarter of 2004. The average oriented strand board price of US\$305 per Msf 7/16” North Central was 29% lower than the same period last year.

#### *Outlook – Lumber and Panel Markets*

Low mortgage rates and positive economic factors will continue to support overall strong demand for both lumber and panels. Lumber and panel prices are expected to improve in the third quarter of 2005 as supply is reduced in some regions because of summer maintenance shutdowns and other production curtailments. Demand is expected to weaken somewhat in the fourth quarter because of the typical seasonal decline in construction activity and further interest rate increases.

## Pulp and Paper

(millions of dollars unless otherwise noted)	<b>Q2 2005</b>	Q1 2005	<b>YTD 2005</b>	Q2 2004	YTD 2004
Sales	<b>\$ 244.2</b>	\$ 223.9	<b>\$ 468.1</b>	\$ 275.6	\$ 494.0
EBITDA	<b>\$ 8.3</b>	\$ 21.3	<b>\$ 29.6</b>	\$ 47.0	\$ 70.3
EBITDA margin	<b>3%</b>	10%	<b>6%</b>	17%	14%
Operating income (loss)	<b>\$ (2.5)</b>	\$ 10.0	<b>\$ 7.5</b>	\$ 36.4	\$ 48.9
Average pulp price – US \$ <sup>8</sup>	<b>\$ 613</b>	\$ 642	<b>\$ 628</b>	\$ 650	\$ 620
Average price in Cdn \$	<b>\$ 763</b>	\$ 788	<b>\$ 776</b>	\$ 884	\$ 830
Production – pulp (000 mt)	<b>286.0</b>	299.6	<b>585.6</b>	297.5	546.5
Production – paper (000 mt)	<b>30.8</b>	33.4	<b>64.2</b>	33.5	67.5
Shipments – Canfor-produced pulp (000 mt)	<b>299.0</b>	268.1	<b>567.1</b>	284.5	526.2
<i>Marketed on behalf of HSLP (000 mt)</i>	<b>102.5</b>	82.1	<b>184.6</b>	89.9	163.5
Shipments – paper (000 mt)	<b>33.0</b>	32.5	<b>65.5</b>	39.4	74.7

Operating income declined by \$12.5 million over the previous quarter, and was \$38.9 million lower than in the same quarter of 2004, primarily as a result of the decline in prices in the current period. Shipment volumes increased in the quarter due to an improvement in railcar service, reducing excess inventory from the first quarter.

### Operations

Pulp production volume was lower than in the first quarter and the same quarter last year, mainly due to the Northwood mill taking their 18-month maintenance shutdown in the period. The shutdown lasted 14.5 days, during which time additional work was performed to upgrade the recovery boilers. Subsequent to the shutdown, the mill set a daily production record of 1,707 tonnes, exceeding the previous record of 1,678 tonnes set in 2003.

Conversion costs were 2% higher than in the previous quarter, mainly due to the reduced production volumes and an 8% increase in fibre costs.

The Prince George Co-generation facility was completed in the quarter and is now generating over 880 megawatt hours of electricity per day, which is 92% of the current target. The final target, after the second precipitator is installed in February 2006, will be 1,232 megawatt hours per day.

On June 7<sup>th</sup>, Canfor announced the formation of Premium 1 Papers, a jointly-owned sales and marketing partnership with Tolko Marketing and Sales Ltd. This announcement has been well received by Canfor's customers, many of which are shared with Tolko. This arrangement, effective August 1<sup>st</sup>, is expected to improve sales and marketing activities, and should facilitate more efficient mill operations. In the current quarter, Canfor accrued \$0.6 million of severance and other restructuring costs associated with the integration of its pre-existing paper marketing business into Premium 1 Papers.

### Markets

Worldwide shipments of chemical market pulp were weak during the early part of the second quarter, but rebounded somewhat in June. The shipments to capacity ratio started the quarter at only 90%, but rose in June, registering at 94%. The shipping rate for northern bleached softwood kraft market pulp, Canfor's key grade, matched the overall global rate of 94%. This compares to a shipping rate of 93% for the same month in 2004. On a year-to-date basis, the overall shipping rate was 92% for all grades, with northern bleached softwood kraft market pulp slightly better at

<sup>8</sup> Per tonne, delivered to Northern Europe

94%. Shipments into North America increased by 13% for the year-to-date, which has largely allowed producers to overcome weakened demand into Europe (down by 5% for the year to date) and China (down by 3%). A large portion of the increased shipments into North America can be attributed to the reclassification to “market” of some pulp shipments, due to ownership changes of pulp mills. There has been substantial inventory destocking by pulp consumers in both the European and Chinese markets thus far in 2005.

In the second quarter, market pulp demand was hampered by flat demand for printing and writing papers, which is a major end-use segment. For the year to date period through May, printing and writing paper demand fell by 0.2% compared to the same period last year. The printing and writing papers markets were impacted on the supply side when the entire pulp and paper industry in Finland was shut down for seven weeks due to stalled labour negotiations.

The market pulp industry began the second quarter with 34 days of inventory on hand, and through June had recorded a one-day decline in inventories, to 33 days of supply. This small decrease in inventories was a result of increased shipments to North America and China in June.

#### *Outlook*

Notwithstanding the improvement in inventory levels, the pulp market is considered modestly oversupplied today. This oversupply intensified price competition, with prices declining in Northwestern Europe from the US \$630 per metric tonne level in April, to US \$600 per metric tonne in June. Prices are expected to weaken further during the summer, with some recovery anticipated in the latter part of the year.

### **Coastal Operations**

(millions of dollars unless otherwise noted)	<b>Q2 2005</b>	Q1 2005	<b>YTD 2005</b>	Q2 2004	YTD 2004
Sales	\$ 28.5	\$ 6.4	\$ 34.9	\$ 45.2	\$ 62.4
EBITDA	\$ 3.5	\$ (0.3)	\$ 3.2	\$ 6.9	\$ 8.6
EBITDA margin	12%	(5%)	9%	15%	14%
Operating income (loss)	\$ 1.1	\$ (1.3)	\$ (0.2)	\$ 4.6	\$ 5.2
Production – 000 m <sup>3</sup>	451.3	113.8	565.1	447.3	677.5
Shipments – 000 m <sup>3</sup>	330.3	91.9	422.2	481.3	669.0

The Coastal Operations segment reported operating income of \$1.1 million in the quarter, after a \$1.1 million charge for severance costs. Logging operations had been curtailed for most of the first quarter, as the normal seasonal shutdown was extended because of poor market conditions. Good productivity in the second quarter, along with an April 1<sup>st</sup> stumpage rate decrease, contributed to a 26% decrease in production costs compared to the previous quarter. Sales were steady near the beginning of the quarter but demand, particularly for lower grade logs, slowed in June. Logging operations will be curtailed in July and August in response to weak market conditions to allow inventories to be reduced to target levels.

### **Non-Segmented Items**

(millions of dollars)	<b>Q2 2005</b>	Q1 2005	<b>YTD 2005</b>	Q2 2004	YTD 2004
Corporate costs	\$ (7.9)	\$ (6.9)	\$ (14.8)	\$ (29.0)	\$ (37.3)
Equity income of affiliated companies	\$ 2.4	\$ 1.6	\$ 4.0	\$ 3.5	\$ 4.1
Net interest expense	\$ (11.1)	\$ (11.8)	\$ (22.9)	\$ (18.0)	\$ (32.8)
Foreign exchange loss on long-term debt	\$ (11.7)	\$ (3.6)	\$ (15.3)	\$ (21.9)	\$ (27.9)
Other income (expense)	\$ (0.2)	\$ (0.2)	\$ (0.4)	\$ 0.4	\$ 0.7

Corporate costs were \$1.0 million higher than the previous quarter and \$21.1 million lower than in the second quarter of 2004. The second quarter 2004 expense included \$21.5 million of one-time charges primarily related to restructuring and merging the two head offices after the acquisition of Slocan.

Equity income for the quarter was \$0.8 million higher than in the previous quarter and \$1.1 million lower than in the second quarter of 2004. Canfor's equity investees were affected by similar transportation constraints in the first quarter and declining market prices in the second quarter, as was Canfor's lumber segment.

Net interest expense was \$0.7 million lower than in the previous quarter and \$6.9 million lower than in the same quarter of 2004. Interest income earned on temporary investments increased by \$0.2 million over the previous quarter and by \$1.7 million over the same quarter in 2004. Interest on long-term debt was \$0.5 million lower than in the previous quarter and \$5.2 million lower than in the second quarter of 2004. Interest on long-term debt was significantly lower than in the same period last year as a result of long-term debt reductions, the stronger Canadian dollar and, in accordance with Canadian accounting requirements, the restatement of the second quarter 2004 expense to include \$2.4 million of interest on the convertible debentures (see "Changes in Accounting Policies", below).

### Discontinued Operations

During the quarter, Canfor completed the sale of its Fort St James, Slocan and Valemount sawmills in British Columbia for total cash proceeds of \$59.0 million. A net after-tax loss of \$4.0 million was recorded on the dispositions in the current quarter, and was largely offset by the year-to-date income from these operations up to the disposal dates.

The sale of the Fort St James mill and associated harvesting rights was directed by the federal Commissioner of Competition as a condition to Canfor's acquisition of Slocan Forest Products Ltd. on April 1, 2004. The decision to sell the Slocan and Valemount sawmills was made as part of a process to focus the company's manufacturing assets around certain product lines and fibre baskets. Canfor has retained the right to any refund of countervailing and anti-dumping duties paid prior to the dispositions.

Lumber shipments from discontinued operations before the closing dates totaled 29.7 million board feet<sup>9</sup> in the current quarter (2004 – 109.2 million board feet) and 120.5 million board feet for the year to date (2004 – 174.0 million board feet).

### SUMMARY OF FINANCIAL POSITION

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

(millions of dollars)	<b>Q2 2005</b>	Q1 2005	<b>YTD 2005</b>	Q2 2004	YTD 2004
Ratio of current assets to current liabilities <sup>10</sup>			<b>2.7:1</b>		2.4:1
Ratio of net debt to common shareholders' equity <sup>11</sup>			<b>14:86</b>		33:67
Increase (decrease) in net short-term cash <sup>10</sup>	<b>\$ 98.9</b>	\$ (145.3)	<b>\$ (46.4)</b>	\$ 260.1	\$ 319.9
– comprised of cash flow from (used in):					
Operating activities	<b>\$ 129.8</b>	\$ (24.3)	<b>\$ 105.5</b>	\$ 298.5	\$ 296.8
Financing activities	<b>\$ (14.3)</b>	\$ 1.9	<b>\$ (12.4)</b>	\$ 18.4	\$ 90.2
Investing activities	<b>\$ (18.8)</b>	\$ (119.3)	<b>\$ (138.1)</b>	\$ (67.0)	\$ (81.4)
Discontinued operations	<b>\$ 2.2</b>	\$ (3.6)	<b>\$ (1.4)</b>	\$ 10.2	\$ 14.3

<sup>9</sup> These volumes are excluded from the shipment volumes quoted elsewhere in this report.

<sup>10</sup> 2004 comparative figures have been restated to present cash net of unrepresented cheques.

<sup>11</sup> 2004 comparative figures have been restated to present the convertible subordinated debentures as liabilities.

### **Changes in Financial Position**

Cash flow generated by operating activities was \$129.8 million in the second quarter, compared to \$298.5 million generated in the same quarter in 2004 and \$22.7 million used in the first quarter. The main reason for the increase over the previous quarter was a \$146.9 million decrease in inventories, which had risen by \$169.2 million in the first quarter, primarily due to the seasonal build-up of log inventories. Lumber and pulp inventories also increased in the first quarter as a result of railcar shortages in the period. When comparing cash generated from operating activities in the second quarter to the same quarter in 2004, the decrease is mainly attributable to lower operating earnings in the current period, due to lower product prices and a less favourable exchange rate, as discussed earlier in this report.

Cash used in financing activities of \$14.3 million in the current quarter was comprised of scheduled long-term debt repayments. Cash generated by financing activities of \$1.9 million in the previous quarter was mainly comprised of proceeds from the exercise of stock options. In the second quarter of 2004, financing activities generated \$18.4 million, which included proceeds from new financing (net US \$25.0 million, after repaying Slocan's long-term debt of US \$160 million), and proceeds of \$2.3 million from stock options exercised, partially offset by a scheduled long-term debt repayment.

Investing activities used up \$18.8 million of cash in the current quarter. Proceeds of \$59.0 million were received on the dispositions of the Fort St James, Slocan and Valemout operations and \$5.6 million of dividends and other distributions were received from affiliated companies. Capital expenditures of \$81.0 million in the quarter included \$27.5 million contributed to the construction of the OSB joint venture project in Fort St John, \$19.6 million for the Prince George Pulp and Paper Co-generation Project and \$15.7 million for the Plateau mill modernization project. The \$119.3 million used in investing activities in the first quarter was mainly comprised of capital expenditures of \$68.1 million, including \$28.8 million for the OSB mill, \$17.3 million for the co-generation project and \$2.1 million for the Plateau project, and a \$50 million payment to Howe Sound Limited Partnership for income tax losses, as discussed further below. The majority of the \$67.0 million of cash used in investing activities in the second quarter in 2004 was for capital expenditures and Slocan acquisition costs, net of cash acquired.

### **Liquidity and Financial Requirements**

At the end of the current period, Canfor was in a net cash position of \$387.6 million and had \$278.8 million of unused operating bank lines of credit available, as compared to the December 31, 2004 net cash position of \$434.0 million and \$280.4 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 approximately \$522 million or \$3.64 per share. The Company can incur approximately \$1,290 million in additional long-term debt under these borrowing arrangements.

### **HOWE SOUND PULP AND PAPER LIMITED PARTNERSHIP (HSLP)**

Canfor wrote off its investment in HSLP in 1998, and therefore no longer consolidates HSLP into its financial results. The HSLP operation reported a net loss of \$16.0 million in the quarter and \$31.1 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 second quarter Canfor had prepaid \$49.9 million to HSLP in advance of the due date of receivables and pulp inventory for pulp marketed, or to be marketed, and collected on behalf of HSLP. This agreement provides for the partners to prepay up to a maximum amount of \$50 million each, which is used as short-term operating funds by HSLP. Canfor charges HSLP a market rate of interest for the period of prepayment and the prepayment is covered by the assignment of current and future accounts receivable.

Canfor acquired \$643 million of tax losses from HSLP in 2001, which gave rise to a deferred credit of \$104.0 million.

On January 2, 2005, Canfor made a final contribution of \$50 million to HSLP with respect to these losses. As at June 30, 2005 Canfor had \$6.4 million of deferred tax credits remaining available to reduce income tax expense in future periods.

## **OUTSTANDING SHARES**

At July 29, 2005, there were 143,508,397 common shares outstanding.

## **CHANGES IN ACCOUNTING POLICIES**

*Convertible Debentures* – Effective January 1, 2005, Canfor retroactively adopted new recommendations of the Canadian Institute of Chartered Accountants (CICA) concerning the balance sheet presentation of financial instruments as liabilities or equity. Canfor had previously accounted for its convertible subordinated debentures as equity, including the related interest charges, in accordance with EIC-71 *Financial Instruments That May Be Settled at the Issuer's Option in Cash or its Own Equity Instruments*. The prior year's figures have been restated to reflect the debentures as liabilities and the related interest as an expense on the income statement. There was no impact on previously reported earnings per share. The debentures had a maturity date of November 23, 2006 but were converted in November 2004 with the issuance of 11,742,424 Common Shares.

*Variable Interest Entities* – Effective January 1, 2005, Canfor adopted the CICA's new accounting guideline for the consolidation of variable interest entities. The primary objective of the guideline is to identify and report on entities over which control is achieved through means other than voting rights. The adoption of this guideline did not have a material impact on Canfor's financial position or results of operations.

*Cash and Temporary Investments* – Effective January 1, 2005, Canfor retroactively amended its presentation of cash and temporary investments to include unrepresented cheques, which were previously included in accounts payable and disclosed in the notes to the consolidated financial statements.

## **RISKS AND UNCERTAINTIES**

A comprehensive discussion of Risks and Uncertainties was included in the 2004 Annual Report. An update of that discussion is included below.

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

On December 14, 2004, after completing its administrative review for the period from May 2002 to April 2003 (POR1), the US Department of Commerce (DOC) determined the countervailing duty (CVD) assessment rate of 17.18% applicable to all Canadian companies for POR1. At that time, Canfor recorded a favourable adjustment to reduce its POR1 expense to 17.18%. In February 2005, the DOC announced a further reduction to the rate, to 16.37%, applicable to POR1 and to future cash deposits. As a result, in the first quarter, Canfor reduced its CVD accrual by \$6.5 million, to record CVD expense at 16.37% for POR1. Canfor is currently paying deposits at 16.37% for CVD and 1.83% for antidumping duties (ADD) and is expensing the duties at the same rates.

On June 2, 2005 the DOC released the preliminary results of their second countrywide CVD administrative review for the period from May 1, 2003 to April 30, 2004 (POR2). The CVD rate was calculated to be 8.18% and was applicable for all non-zero rate producers. At the same time, the DOC announced the preliminary results of their second ADD administrative review for POR2, which indicated a rate for Canfor of 1.42%. These assessment rates, as amended when the final determination rates are published later in 2005, would be applied to the entries for POR2. Canfor has made no adjustment to reflect these lower preliminary rates because of uncertainty surrounding the outcome of anticipated challenges and appeals, and the rates will not be final until they are confirmed, with the DOC Final

Determination expected in the fourth quarter of 2005. The cash deposit rate for shipments made subsequent to the Final Determination date will be set at the new rates.

As at June 30, 2005, Canfor (including Slocan before April 1, 2004) had paid combined duty deposits of US \$652.0 million (CVD of \$487.2 million and ADD of \$164.8 million) since inception of CVD and ADD in May 2002.

The current dispute between Canada and the US over alleged subsidies provided through provincial forest policies has continued since April 2001. Currently, there are multiple legal cases underway regarding CVD relative to subsidy levels, injury to the US industry and anti-dumping accusations. Cases are being heard by WTO and NAFTA panels and in the US Court of International Trade.

A NAFTA Panel decision in August 2004 determined that no injury or threat of injury to the US industry had been established for the period of investigation, and, accordingly, the NAFTA Panel ruled that the DOC should revoke CVD and ADD orders. However, the US government has appealed this NAFTA Injury Panel decision to an Extraordinary Challenge Committee (ECC). Hearings took place in June 2005, and a decision is pending. Notwithstanding the ECC's decision, further actions and appeals could delay any return of duty deposits. The length of such delay cannot be determined at this time.

#### **NAFTA Lawsuit**

In July 2002, Canfor filed a Notice of Arbitration and Statement of Claim against the Government of the United States for damages of not less than US \$250 million under Chapter 11 of the North American Free Trade Agreement (NAFTA) as a result of the DOC's actions in issuing the preliminary and final determinations in the countervailing and anti-dumping proceedings. Canfor has asserted that the actions of the US Government have amounted to breaches of certain provisions of NAFTA, including the failure to provide Canfor with fair and equitable treatment in accordance with international law. Canfor and the US Government selected a three-member panel to hear the dispute and a hearing on jurisdiction occurred in November 2004. However, a decision from the panel on jurisdiction has been stayed pending the US Government's request to consolidate Canfor's action with other lumber companies that have sought Chapter 11 proceedings. The consolidation application of the US Government was heard by a separate three-member panel in June 2005 and a decision is expected in the third quarter.

#### **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 results in a reduction of approximately 2.4 million cubic metres to Canfor's existing allowable annual cut on its replaceable tenures. While the legislation taking back the 20% was passed in March 2003, the government has not yet reduced the allowable harvest levels. Canfor has worked with the government to identify those licenses and operating areas that are to be returned to the Crown and this allocation was determined in December 2004. The second phase of the take-back is a negotiation with the government concerning the "on-the-ground" sites or operating areas to be taken back. The site selection process is complete for Canfor on the coast and in the northeastern portion of the province but continues in the central interior. The third phase is associated with compensation, concerning which Canfor is engaged in discussions with the Minister. The completion of negotiations with respect to site selection and compensation cannot be determined at this time.

As the amount of compensation to be made to Canfor for the take-back has not yet been determined 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.

**Port of Vancouver Container Truckers' Work Stoppage**

The container truck drivers that serve the Port of Vancouver began strike action on June 27<sup>th</sup>. The provincial and federal governments have appointed a facilitator to resolve the dispute, but to date there has been little progress toward reaching a solution.

To mitigate the impact of the strike on shipment volumes to offshore customers, Canfor has converted several of its lumber and pulp orders in July and August to break-bulk shipping, a less preferred method in which product is loaded directly onto ships without the protection of containers. Container pulp shipments out of Seattle have also been secured for orders where containers must be used.

## SELECTED QUARTERLY FINANCIAL INFORMATION <sup>12</sup>

	Q2 2005	Q1 2005	Q4 2004	Q3 2004	Q2 2004	Q1 2004	Q4 2003	Q3 2003
<b>Sales and Income</b> (millions of dollars)								
Sales	\$1,067.4	\$ 965.9	\$1,072.7	\$1,130.7	\$1,180.7	\$ 645.1	\$ 616.2	\$ 641.5
Operating income	\$ 67.1	\$ 95.6	\$ 15.7	\$ 203.2	\$ 211.3	\$ 62.1	\$ 0.8	\$ 47.1
Net income from continuing operations	\$ 28.9	\$ 62.7	\$ 42.0	\$ 191.3	\$ 133.1	\$ 30.2	\$ 33.8	\$ 19.7
Net income	\$ 25.3	\$ 65.6	\$ 43.0	\$ 200.0	\$ 142.0	\$ 30.4	\$ 32.6	\$ 78.6
<b>Per common share</b> (dollars)								
<b>Net income from continuing operations</b>								
Basic	\$ 0.20	\$ 0.44	\$ 0.31	\$ 1.45	\$ 1.01	\$ 0.37	\$ 0.42	\$ 0.24
Diluted	\$ 0.20	\$ 0.44	\$ 0.30	\$ 1.34	\$ 0.94	\$ 0.34	\$ 0.38	\$ 0.23
<b>Net income</b>								
Basic	\$ 0.18	\$ 0.46	\$ 0.31	\$ 1.52	\$ 1.08	\$ 0.37	\$ 0.40	\$ 0.97
Diluted	\$ 0.18	\$ 0.46	\$ 0.30	\$ 1.40	\$ 1.00	\$ 0.34	\$ 0.37	\$ 0.86
<b>Statistics</b>								
Lumber shipments (MMfbm)	1,356	1,165	1,344	1,181	1,298	724	711	754
Pulp shipments (000 mt)	299	268	313	275	285	242	261	244
Plywood shipments (MMsf 3/8")	107	106	96	93	109	45	36	48
OSB shipments (MMsf 3/8")	117	103	127	121	133	-	-	-
Average exchange rate (Cdn\$/US\$)	\$ 0.804	\$ 0.815	\$ 0.819	\$ 0.765	\$ 0.736	\$ 0.759	\$ 0.760	\$ 0.725
Average 2x4 #2&Btr lumber price (US\$)	\$ 365	\$ 398	\$ 338	\$ 440	\$ 437	\$ 370	\$ 298	\$ 316
Average NBSK final pulp price delivered to Northern Europe (US\$)	\$ 613	\$ 642	\$ 609	\$ 637	\$ 650	\$ 590	\$ 555	\$ 520
Average plywood price-Toronto (Cdn\$)	\$ 361	\$ 439	\$ 444	\$ 548	\$ 592	\$ 528	\$ 542	\$ 475
Average OSB price-North Central (US\$)	\$ 305	\$ 364	\$ 260	\$ 353	\$ 437	n/a	n/a	n/a

The main factors affecting the comparability of the results over the last eight quarters are the integration of the former Slocan operations as of April 1, 2004, changes in the value of the Canadian dollar against the US dollar and changes in lumber, pulp, plywood and OSB prices, as highlighted in the table above.

One-time items that had a significant impact on quarterly results include a \$62.3 million gain on the sale of the BC Chemicals operation in the third quarter of 2003, a \$19.5 million gain from the sale of property in the fourth quarter of 2003, and restructuring and mill closure provisions of \$18.3 million, \$0.3 million and \$10.2 million in the second, third and fourth quarters of 2004 respectively and \$2.5 million in the second quarter of 2005 (all after tax). The second quarter 2005 results were also reduced by a \$4.0 million after-tax loss on the sale of the Fort St James, Slocan and Valemount sawmills.

The quarterly results are impacted by seasonal factors such as weather and building activity. Adverse weather conditions can cause logging curtailments, which can affect the supply of raw materials to sawmills, plywood and OSB plants, and pulp mills. Market demand also varies seasonally to some degree. For example, building activity and repair and renovation work, which affects demand for lumber and panel products, is generally stronger in the spring and summer months. Shipment volumes are affected by these factors as well as by global supply and demand conditions. Shortages in railcar supply had an adverse impact on shipment volumes in the first quarter of 2005 and also in the first three quarters of 2004.

<sup>12</sup> Certain prior period figures have been restated for comparability.

## Consolidated Statements of Income and Retained Earnings

(millions of dollars, unaudited)	3 months ended June 30,		6 months ended June 30,	
	2005	2004	2005	2004
<b>Sales</b>	<b>\$ 1,067.4</b>	<b>\$ 1,180.6</b>	<b>\$ 2,033.3</b>	<b>\$ 1,825.7</b>
<b>Costs and expenses</b>				
Manufacturing and product costs	686.6	637.4	1,284.8	1,036.5
Freight and other distribution costs	187.4	154.2	342.3	258.9
Countervailing and anti-dumping duties (Note 7)	67.5	95.8	126.4	131.1
Amortization	37.9	36.5	79.5	65.2
Selling and administration costs	17.8	22.3	34.3	37.5
	<b>997.2</b>	<b>946.2</b>	<b>1,867.3</b>	<b>1,529.2</b>
Restructuring, mill closure and other severance costs (Note 8)	3.1	23.1	3.3	23.1
<b>Operating income from continuing operations</b>	<b>67.1</b>	<b>211.3</b>	<b>162.7</b>	<b>273.4</b>
Equity income of affiliated companies	2.4	3.5	4.0	4.1
Interest expense (Note 2)	(11.1)	(18.0)	(22.9)	(32.8)
Foreign exchange loss on long-term debt	(11.7)	(21.9)	(15.3)	(27.9)
Other income (expense)	(0.2)	0.4	(0.4)	0.7
Net income from continuing operations before income taxes	46.5	175.3	128.1	217.5
Income tax expense (Note 10)	(17.6)	(42.2)	(36.5)	(54.2)
<b>Net income from continuing operations</b>	<b>28.9</b>	<b>133.1</b>	<b>91.6</b>	<b>163.3</b>
<b>Net income (loss) from discontinued operations (Note 3)</b>	<b>(3.6)</b>	<b>9.0</b>	<b>(0.7)</b>	<b>9.2</b>
<b>Net income</b>	<b>\$ 25.3</b>	<b>\$ 142.1</b>	<b>\$ 90.9</b>	<b>\$ 172.5</b>
<b>Per common share (in dollars) (Note 11)</b>				
Net income from continuing operations				
Basic	\$ 0.20	\$ 1.01	\$ 0.64	\$ 1.53
Diluted	\$ 0.20	\$ 0.94	\$ 0.64	\$ 1.40
Net income				
Basic	\$ 0.18	\$ 1.08	\$ 0.63	\$ 1.62
Diluted	\$ 0.18	\$ 1.00	\$ 0.63	\$ 1.48
<b>Retained earnings, beginning of year</b>			<b>\$ 691.9</b>	<b>\$ 277.0</b>
Net income for the year to date			<b>90.9</b>	<b>172.5</b>
<b>Retained earnings, end of current period</b>			<b>\$ 782.8</b>	<b>\$ 449.5</b>

## Consolidated Cash Flow Statements

(millions of dollars, unaudited)	3 months ended June 30,		6 months ended June 30,	
	2005	2004	2005	2004
<b>Cash generated from (used in)</b>				
<b>Operating activities</b>				
Net income from continuing operations	\$ 28.9	\$ 133.1	\$ 91.6	\$ 163.3
Items not affecting cash:				
Amortization	37.9	36.5	79.5	65.2
Income taxes	15.6	32.9	32.1	42.6
Long-term portion of deferred reforestation	(9.8)	(2.8)	8.0	16.0
Employee future benefits	2.3	5.1	8.1	10.3
Unrealized foreign exchange loss on long-term debt	13.0	22.1	16.6	28.1
Adjustment to accrued duties (Note 7)	(0.5)	25.2	(7.5)	19.9
Other	(6.5)	(4.6)	(7.5)	(5.2)
Changes in non-cash working capital	48.9	51.0	(115.4)	(43.4)
	<b>129.8</b>	<b>298.5</b>	<b>105.5</b>	<b>296.8</b>
<b>Financing activities</b>				
Proceeds from long-term debt	-	242.4	0.6	309.3
Repayment of long-term debt	(14.3)	(226.0)	(14.6)	(226.8)
Net proceeds on issuance of common shares	0.1	2.3	1.9	8.1
Other	(0.1)	(0.3)	(0.3)	(0.4)
	<b>(14.3)</b>	<b>18.4</b>	<b>(12.4)</b>	<b>90.2</b>
<b>Investing activities</b>				
Proceeds from sale of discontinued operations (Note 3)	59.0	-	59.0	-
Property, plant, equipment and timber	(81.0)	(26.8)	(149.1)	(42.1)
Howe Sound Pulp and Paper Limited Partnership (Note 13)	-	-	(50.0)	-
Business acquisition costs, net of cash acquired	-	(37.9)	-	(37.9)
Distributions from affiliated companies	5.6	-	5.6	-
Proceeds on disposal of property, plant and equipment	0.4	0.9	1.1	1.5
Other	(2.8)	(3.2)	(4.7)	(2.9)
	<b>(18.8)</b>	<b>(67.0)</b>	<b>(138.1)</b>	<b>(81.4)</b>
Increase (decrease) in net cash from continuing operations	96.7	249.9	(45.0)	305.6
Increase (decrease) in net cash from discontinued operations (Note 3)	2.2	10.2	(1.4)	14.3
<b>Increase (decrease) in net cash</b>	<b>98.9</b>	<b>260.1</b>	<b>(46.4)</b>	<b>319.9</b>
<b>Net cash (short-term indebtedness) at beginning of period</b>	<b>288.7</b>	<b>(37.8)</b>	<b>434.0</b>	<b>(97.6)</b>
<b>Net cash at end of period</b>	<b>\$ 387.6</b>	<b>\$ 222.3</b>	<b>\$ 387.6</b>	<b>\$ 222.3</b>
<b>Net cash is comprised of:</b>				
Cash and temporary investments (Note 2)	\$ 393.1	\$ 225.1	\$ 393.1	\$ 225.1
Operating bank loans	(5.5)	(2.8)	(5.5)	(2.8)
	<b>\$ 387.6</b>	<b>\$ 222.3</b>	<b>\$ 387.6</b>	<b>\$ 222.3</b>
<b>Changes in non-cash working capital</b>				
Accounts receivable	\$ (2.8)	\$ 11.8	\$ (22.5)	\$ (3.7)
Income taxes	(2.3)	(19.5)	(0.8)	(18.1)
Inventories	146.9	118.0	(22.3)	(14.7)
Prepaid expenses	(25.9)	(13.6)	(16.2)	(7.6)
Accounts payable, accrued liabilities and current portion of deferred reforestation	(67.0)	(45.7)	(53.6)	0.7
	<b>\$ 48.9</b>	<b>\$ 51.0</b>	<b>\$ (115.4)</b>	<b>\$ (43.4)</b>
<b>Cash payments (recoveries) in the period</b>				
Interest, net	\$ (1.7)	\$ 7.6	\$ 22.1	\$ 26.2
Income taxes	\$ 4.2	\$ 1.3	\$ 2.2	\$ 1.8

## Consolidated Balance Sheets

(millions of dollars)	As at June 30, 2005 (unaudited)	As at December 31, 2004 (audited)
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and temporary investments (Note 2)	\$ 393.1	\$ 438.5
Accounts receivable		
Trade	268.5	239.4
Other	56.0	62.2
Income taxes recoverable	15.7	14.7
Future income taxes	27.2	32.5
Inventories	631.5	609.2
Prepaid expenses	56.1	40.0
Current assets of discontinued operations (Note 3)	-	31.6
<b>Total current assets</b>	<b>1,448.1</b>	<b>1,468.1</b>
<b>Long-term investments and other</b>	<b>200.4</b>	<b>197.4</b>
<b>Property, plant, equipment and timber</b>	<b>2,229.3</b>	<b>2,185.4</b>
<b>Deferred charges</b>	<b>92.7</b>	<b>94.9</b>
<b>Non-current assets of discontinued operations (Note 3)</b>	<b>-</b>	<b>33.8</b>
	<b>\$ 3,970.5</b>	<b>\$ 3,979.6</b>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Operating bank loans (Note 5)	\$ 5.5	\$ 4.5
Accounts payable and accrued liabilities	368.6	463.5
Current portion of long-term debt	104.4	68.1
Current portion of deferred reforestation	51.6	46.6
Current liabilities of discontinued operations (Note 3)	-	19.5
<b>Total current liabilities</b>	<b>530.1</b>	<b>602.2</b>
<b>Long-term debt (Note 5)</b>	<b>623.1</b>	<b>660.5</b>
<b>Other accruals and provisions (Note 6)</b>	<b>226.0</b>	<b>218.7</b>
<b>Long-term liabilities of discontinued operations (Note 3)</b>	<b>-</b>	<b>5.0</b>
<b>Future income taxes, net</b>	<b>525.0</b>	<b>499.2</b>
<b>Deferred credit</b>	<b>6.4</b>	<b>27.2</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital - 143,508,397 shares outstanding	1,277.6	1,275.7
Retained earnings	782.8	691.9
Foreign exchange translation adjustment	(0.5)	(0.8)
<b>Total shareholders' equity</b>	<b>2,059.9</b>	<b>1,966.8</b>
	<b>\$ 3,970.5</b>	<b>\$ 3,979.6</b>

**Contingencies (Note 15)**

APPROVED BY THE BOARD

Director, R.L. Cliff

Director, J. A. Shepherd

## 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, 2004. These interim financial statements follow the same accounting policies and methods of computation as used in the 2004 consolidated financial statements, except as described in Note 2.

### 2. Changes in Accounting Policies and Presentation

#### *Convertible Debentures*

Effective January 1, 2005, Canfor retroactively adopted the new recommendations of the Canadian Institute of Chartered Accountants (CICA) concerning the balance sheet presentation of financial instruments as liabilities or equity. Canfor had previously accounted for its convertible subordinated debentures as equity, including the related interest charges, in accordance with EIC-71 *Financial Instruments That May Be Settled at the Issuer's Option in Cash or its Own Equity Instruments*. Prior year figures have been restated to reflect the debentures as liabilities and the related interest as an expense on the income statement. This had no impact on previously reported earnings per share or retained earnings. The debentures had a maturity date of November 23, 2006 but were converted in November 2004 with the issuance of 11,742,424 Common Shares.

#### *Variable Interest Entities*

Effective January 1, 2005, Canfor adopted the CICA's new accounting guideline for the consolidation of variable interest entities. The primary objective of the guideline is to identify and report on entities over which control is achieved through means other than voting rights. The adoption of this guideline did not have a material impact on Canfor's financial position or results of operations.

#### *Cash and Temporary Investments*

Effective January 1, 2005, Canfor retroactively amended its presentation of cash and temporary investments to include unrepresented cheques, which were previously included in accounts payable.

### 3. Discontinued Operations

During the quarter, Canfor completed the sale of its Fort St James, Slocan and Valemout sawmills in British Columbia for total cash proceeds of \$59.0 million. A net after-tax loss of \$4.0 million was recorded on the dispositions in the current quarter.

The sale of the Fort St James mill and associated harvesting rights was directed by the federal Commissioner of Competition as a condition to Canfor's acquisition of Slocan Forest Products Ltd. on April 1, 2004. The decision to sell the Slocan and Valemout sawmills was made as part of a process to focus the company's manufacturing assets around certain product lines and fibre baskets. Canfor retained the right to any refund of countervailing and anti-dumping duty (note 7) paid prior to the dispositions.

The following table presents selected financial information for Fort St James, Slocan and Valemout up to the dates of disposition:

(millions of dollars)	3 months ended June 30,		6 months ended June 30,	
	2005	2004	2005	2004
Sales to external customers	\$ 13.8	\$ 63.4	\$ 61.7	\$ 90.8
Operating income before income taxes	0.6	13.8	5.1	14.2
Loss on disposal before income taxes	(6.2)	-	(6.2)	-
Income tax recovery (expense)	2.0	(4.8)	0.4	(5.0)
Net income (loss)	\$ (3.6)	\$ 9.0	\$ (0.7)	\$ 9.2
Net income (loss) per share - diluted	\$ (0.02)	\$ 0.06	\$ (0.01)	\$ 0.08
Cash flows from discontinued operations				
Cash generated from (used in) operating activities	\$ 1.8	\$ 10.5	\$ (2.1)	\$ 13.8
Cash generated from (used in) investing activities	0.4	(0.3)	0.7	0.5
	\$ 2.2	\$ 10.2	\$ (1.4)	\$ 14.3

#### 4. Canfor-LP OSB Limited Partnership

Canfor has entered into a limited partnership agreement with Louisiana-Pacific Canada Ltd. to jointly undertake construction and operation of an oriented strand board mill with rated annual capacity of 820 million square feet (3/8" basis) in Fort St. John, British Columbia. Canfor has agreed to supply 330,000 cubic metres of timber annually to the joint venture out of its existing timber tenure in the area. The joint venture is in the pre-operating construction phase.

During the second quarter of 2005, Canfor made capital contributions of \$27.5 million to the venture (year to date – \$56.3 million). In order to retain its 50% interest, Canfor has agreed to contribute 50% of the capital to fund the project, which is estimated to have a total cost of \$233.8 million.

These consolidated financial statements include the following amounts, which represent Canfor's 50% ownership interest in the partnership:

(millions of dollars)	June 30, 2005	December 31, 2004
Balance Sheet		
Cash	\$ 4.7	\$ 1.2
Other current assets	2.2	1.3
Construction in progress	91.9	41.8
Deferred start-up costs	5.1	3.0
Accounts payable and accrued liabilities	(7.3)	(7.0)
	\$ 96.6	\$ 40.3
Cash flow		
Cash used in operating activities - working capital	\$ (4.1)	\$ 5.7
Cash used in investing activities	(52.2)	(44.8)
	\$ (56.3)	\$ (39.1)

## 5. Bank Indebtedness and Long-Term Debt

At June 30, 2005, Canfor had \$332.0 million of bank operating lines of credit available, of which \$5.5 million was drawn down and an additional \$47.7 million was utilized for several standby letters of credit.

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 approximately \$1,290 million in additional long-term debt and pay up to \$522 million, or approximately \$3.64 per share, in dividends to its common shareholders.

At June 30, 2005, the fair value of Canfor's long-term debt was \$770.1 million.

## 6. Other Accruals and Provisions

(millions of dollars)	June 30, 2005	December 31, 2004
Deferred reforestation	\$ 75.5	\$ 67.4
Countervailing duty provision (Note 7)	70.8	76.7
Accrued pension obligations	19.1	17.7
Post employment benefits	59.0	54.7
Other liabilities	1.6	2.2
Total other accruals and provisions	\$ 226.0	\$ 218.7

## 7. Countervailing and Anti-dumping Duties

The US Department of Commerce (DOC) imposed an 18.79% countervailing duty (CVD) on Canadian lumber shipments to the US effective May 16, 2002. Canfor's company-specific cash deposit rate was subsequently reduced to 12.24%, effective prospectively from March 10, 2004. Canfor continued to expense CVD at the 18.79% rate after this date, because of the uncertainty about whether a company-specific administrative review would be granted. On December 14, 2004, after completing its administrative review for the period from May 2002 to April 2003 (POR1), the DOC determined the CVD assessment rate of 17.18% applicable to all Canadian companies for POR1. At that time, Canfor recorded a favourable adjustment to reduce its POR1 expense to 17.18%. In February 2005, the DOC announced a further reduction to the rate, to 16.37%, applicable to POR1 and to future cash deposits, due to a calculation error on their part. As a result, in the first quarter, Canfor reduced its CVD accrual by \$6.5 million, to record CVD expense at 16.37% for POR1. The combined additional CVD accrued in excess of the cash deposits made at June 30, 2005 is \$70.8 million and is included in "other accruals and provisions" (Note 6).

The DOC also imposed anti-dumping duties (ADD) on Canadian lumber shipments to the US effective May 16, 2002. Canfor's company-specific rate was determined at 5.96% and Slocan's company-specific rate was determined at 7.71%. While the cash payments up to December 20, 2004 were made at the required deposit rates, Canfor regularly reviews its estimate of the ADD expense rate by applying the DOC's methodology to updated sales and cost data as it becomes available. On December 14, 2004, the DOC determined the ADD assessment rate for Canfor at 2.06% and for Slocan at 1.37% for POR1 and the cash deposit rate was reduced to 1.83% for US lumber shipments after December 20, 2004. The cumulative ADD cash deposits in excess of the calculated expense accrued at June 30, 2005 is \$119.3 million and is being carried as a receivable under "long-term investments and other".

The DOC officially announced in the Federal Register that it would be assessing duties in accordance with the rates that it determined in the reviews, which legal counsel advise would result in the excess ADD deposits being recoverable. 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 and all subsequent challenges or appeals are finalized.

As at June 30, 2005, Canfor (including Slocan before April 1, 2004) had paid combined duty deposits of US \$652.0 million (CVD of \$487.2 million and ADD of \$164.8 million) since inception of CVD and ADD in May 2002.

On August 31, 2004, a NAFTA Panel ruled, for the third time, that the US International Trade Commission (ITC) had failed to prove that Canadian lumber imports posed a threat of material injury to the US industry. The Panel gave the ITC ten days to comply with its ruling, which would effectively end the case and result in the return of all duties collected to date. On September 10, 2004, the ITC released a decision indicating that the Canadian lumber industry did not threaten the US industry with material injury during the period of investigation. On October 13, 2004, NAFTA formally issued its affirmation of the ITC's negative injury ruling. The United States has filed a request for an Extraordinary Challenge and a decision from the Extraordinary Challenge Committee is pending. If not reversed by the Extraordinary Challenge Committee, the ITC's negative threat determination will become final, requiring revocation of the anti-dumping and countervailing duty orders on softwood lumber from Canada.

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.

## 8. Restructuring, Mill Closure and Other Severance Costs

Restructuring costs of \$0.6 million were recorded in the quarter in connection with the formation of a jointly owned paper sales and marketing partnership with an external party. Mill closure costs of \$0.3 million were also recorded in the quarter. This amount includes \$0.7 million of site restoration costs associated with the closure of the Hines Creek sawmill, partially offset by a \$0.4 million favourable adjustment to costs previously accrued for the closure of the Taylor sawmill in 2004. In addition, severance costs of \$2.2 million were recorded in the quarter.

The second quarter 2004 expense was comprised of \$17.2 million of severance and other costs associated with the integration of Canfor and Slocan operations and \$5.9 million of closure costs for the Taylor sawmill.

The following provides a reconciliation of the restructuring, mill closure and other severance provision for the current period:

(millions of dollars)	3 months ended June 30, 2005			6 months ended June 30, 2005		
	Integration Costs	Mill Closure & Other Restructuring Costs	Total	Integration Costs	Mill Closure & Other Restructuring Costs	Total
Balance of liability at beginning of period	\$ 7.7	\$ 7.1	\$ 14.8	\$ 10.8	\$ 13.5	\$ 24.3
Accrued in the period *	-	3.1	3.1	-	3.3	3.3
Less: non-cash items	-	(1.0)	(1.0)	-	(1.0)	(1.0)
Payments in the period	(1.2)	(0.2)	(1.4)	(4.3)	(6.8)	(11.1)
Balance of liability at end of period	\$ 6.5	\$ 9.0	\$ 15.5	\$ 6.5	\$ 9.0	\$ 15.5

\* reported in the following segments:

Lumber	\$ 1.4	\$ 1.6
Pulp and Paper	\$ 0.6	\$ 0.6
Coastal Operations	\$ 1.1	\$ 1.1

## 9. Employee Future Benefits

Canfor's total benefit costs were as follows:

(millions of dollars)	3 months ended June 30,		6 months ended June 30,	
	2005	2004	2005	2004
Defined benefit pension plans	\$ 4.1	\$ 3.5	\$ 8.3	\$ 6.0
Other employee future benefit plans	2.1	3.8	4.2	7.3
Defined contribution pension plans	0.3	0.4	0.8	0.4
	<b>\$ 6.5</b>	<b>\$ 7.7</b>	<b>\$ 13.3</b>	<b>\$ 13.7</b>

## 10. Income Tax Expense

(millions of dollars)	3 months ended June 30,		6 months ended June 30,	
	2005	2004	2005	2004
Current	\$ (2.2)	\$ (3.0)	\$ (5.1)	\$ (5.3)
Future	(22.8)	(67.7)	(50.7)	(85.2)
Tax benefit of current Howe Sound Pulp and Paper Limited Partnership losses	-	(0.5)	-	0.6
Tax on equity earnings	(0.9)	(1.1)	(1.5)	(1.2)
	(25.9)	(72.3)	(57.3)	(91.1)
Amortization of deferred credit on utilization of acquired tax losses	8.3	30.1	20.8	36.9
	<b>\$ (17.6)</b>	<b>\$ (42.2)</b>	<b>\$ (36.5)</b>	<b>\$ (54.2)</b>

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,		6 months ended June 30,	
	2005	2004	2005	2004
Income tax expense at statutory tax rate	\$ (16.5)	\$ (62.2)	\$ (45.5)	\$ (77.3)
Large corporation tax	(1.2)	(1.8)	(2.5)	(3.1)
Tax benefit of current Howe Sound Pulp and Paper Limited Partnership losses	-	(0.5)	-	0.6
Amortization of deferred credit on utilization of acquired tax losses	8.3	30.1	20.8	36.9
Permanent difference from capital gains and losses	(3.6)	(7.8)	(4.9)	(9.9)
Change in estimate of available capital losses	(3.9)	-	(3.9)	-
Other permanent differences and adjustments	(0.7)	-	(0.5)	(1.4)
Tax expense	<b>\$ (17.6)</b>	<b>\$ (42.2)</b>	<b>\$ (36.5)</b>	<b>\$ (54.2)</b>

## 11. Earnings Per Share

(millions of dollars, except for number of shares and per share amounts)	3 months ended June 30,		6 months ended June 30,	
	<b>2005</b>	2004	<b>2005</b>	2004
<b>Earnings per share from continuing operations</b>				
Net income from continuing operations	\$ 28.9	\$ 133.1	\$ 91.6	\$ 163.3
Basic earnings per share from continuing operations	\$ 0.20	\$ 1.01	\$ 0.64	\$ 1.53
Net income from continuing operations – diluted earnings per share <sup>(a)</sup>	\$ 28.9	\$ 134.6	\$ 91.6	\$ 166.4
Diluted earnings per share from continuing operations	\$ 0.20	\$ 0.94	\$ 0.64	\$ 1.40
<b>Earnings per share</b>				
Net income	\$ 25.3	\$ 142.1	\$ 90.9	\$ 172.5
Basic earnings per share	\$ 0.18	\$ 1.08	\$ 0.63	\$ 1.62
Net income – diluted earnings per share <sup>(a)</sup>	\$ 25.3	\$ 143.6	\$ 90.9	\$ 175.6
Diluted earnings per share	\$ 0.18	\$ 1.00	\$ 0.63	\$ 1.48
Weighted average number of common shares	<b>143,502,439</b>	131,412,059	<b>143,451,818</b>	106,505,171
Incremental shares from stock options	<b>174,554</b>	249,688	<b>211,222</b>	246,936
Shares issuable upon conversion of convertible debentures	-	11,742,424	-	11,742,424
Diluted number of common shares	<b>143,676,993</b>	143,404,171	<b>143,663,040</b>	118,494,531

(a) 2004 – after adding back interest on liability component of convertible debentures

## 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, 2005, Canfor had US \$39.9 million of forward contracts outstanding (2004 – US \$3 million). These contracts were fixed at an average rate of 1.2454 and have option periods extending through to April 2006. There was an unrecognized gain of \$0.6 million on these contracts at June 30, 2005. Contracts totaling \$38.3 million were exercised in the current quarter and a loss of \$0.4 million was realized (2004 – contracts totaling US \$5.0 million were exercised and a gain of \$0.3 million was realized).

Canfor also uses a variety of financial instruments to reduce its exposure to risks associated with lumber and pulp prices and energy costs. At the end of the current quarter, there were 114 lumber futures contracts outstanding, which had an unrealized gain of \$0.4 million. At June 30, 2005, Canfor had entered into swaps to hedge 10,500 tonnes of pulp at an average price of US \$664 per tonne. There was an unrealized gain of \$0.7 million on these contracts at June 30, 2005. Commodity swaps hedging future natural gas purchases of 6.0 million Gigajoules were outstanding (2004 – 2.5 million Gigajoules). There was an unrealized gain of \$8.8 million on these swaps at June 30, 2005.

## 13. Howe Sound Pulp & Paper Limited Partnership (HSLP)

Canfor acquired \$643 million of tax losses from HSLP in 2001, which gave rise to a deferred credit of \$104.0 million. On January 2, 2005, Canfor made a final contribution of \$50 million to HSLP with respect to these losses. As at June 30, 2005, Canfor had \$6.4 million of deferred credits remaining available to reduce income tax expense in future periods.

## 14. Segmented Information <sup>(a)</sup>

(millions of dollars)	Lumber <sup>(b)</sup>	Panels	Pulp & Paper	Coastal Operations	Corporate & Other	Consolidated
<b>3 months ended June 30, 2005</b>						
Sales to external customers	\$ 704.9	89.8	244.2	28.5	-	\$ 1,067.4
Sales to other segments <sup>(c)</sup>	\$ 40.2	-	-	2.8	-	\$ 43.0
Operating income (loss)	\$ 67.4	9.0	(2.5)	1.1	(7.9)	\$ 67.1
Amortization	\$ 20.1	2.8	10.8	2.4	1.8	\$ 37.9
Capital expenditures	\$ 25.8	28.6	23.5	1.2	1.9	\$ 81.0
<b>3 months ended June 30, 2004 <sup>(d)</sup></b>						
Sales to external customers	\$ 723.6	136.2	275.6	45.2	-	\$ 1,180.6
Sales to other segments <sup>(c)</sup>	\$ 27.6	1.0	-	3.2	-	\$ 31.8
Operating income (loss)	\$ 139.8	59.5	36.4	4.6	(29.0)	\$ 211.3
Amortization	\$ 18.6	2.7	10.6	2.3	2.3	\$ 36.5
Capital expenditures	\$ 11.8	11.4	2.0	1.6	-	\$ 26.8
<b>6 months ended June 30, 2005</b>						
Sales to external customers	\$ 1,346.1	184.2	468.1	34.9	-	\$ 2,033.3
Sales to other segments <sup>(c)</sup>	\$ 74.8	-	-	3.1	-	\$ 77.9
Operating income (loss)	\$ 143.4	26.8	7.5	(0.2)	(14.8)	\$ 162.7
Amortization	\$ 45.4	5.6	22.1	3.4	3.0	\$ 79.5
Capital expenditures	\$ 34.7	64.3	44.2	2.5	3.4	\$ 149.1
Identifiable assets	\$ 1,715.5	311.2	946.8	89.1	907.9	\$ 3,970.5
<b>6 months ended June 30, 2004 <sup>(d)</sup></b>						
Sales to external customers	\$ 1,101.1	168.2	494.0	62.4	-	\$ 1,825.7
Sales to other segments <sup>(c)</sup>	\$ 50.3	1.8	-	4.1	-	\$ 56.2
Operating income (loss)	\$ 191.4	65.2	48.9	5.2	(37.3)	\$ 273.4
Amortization	\$ 33.3	3.2	21.4	3.4	3.9	\$ 65.2
Capital expenditures	\$ 19.1	11.4	9.0	2.6	-	\$ 42.1
Identifiable assets	\$ 1,779.5	213.4	880.5	76.5	842.9	\$ 3,792.8

(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 for the quarter include sales of Canfor produced lumber of \$639.5 million (2004 – \$662.4 million) and \$1,231.3 million for the year to date (2004 – \$1,003.0 million). Excludes discontinued operations (Note 3).

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

(d) These figures include the results of the former Slocan operations since April 1, 2004.

## **15. 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 results in a reduction of approximately 2.4 million cubic metres to Canfor's existing allowable annual cut on its replaceable tenures. While the legislation taking back the 20% was passed in March 2003, the government has not yet reduced the allowable harvest levels. Canfor has worked with the government to identify those licenses and operating areas that are to be returned to the Crown and this allocation was determined in December 2004. The second phase of the take-back is a negotiation with the government concerning the "on-the-ground" sites or operating areas to be taken back. The site selection process is complete for Canfor on the coast and in the northeastern portion of the province but continues in the central interior. The third phase is associated with compensation, concerning which Canfor is engaged in discussions with the Minister. The completion of negotiations with respect to site selection and compensation cannot be determined at this time.

As the amount of compensation to be made to Canfor for the take-back has not yet been determined 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.

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