



**Canfor Corporation**

**Annual Information Form**

**Information in this Annual Information Form  
is as of February 19, 2009 unless otherwise indicated.**

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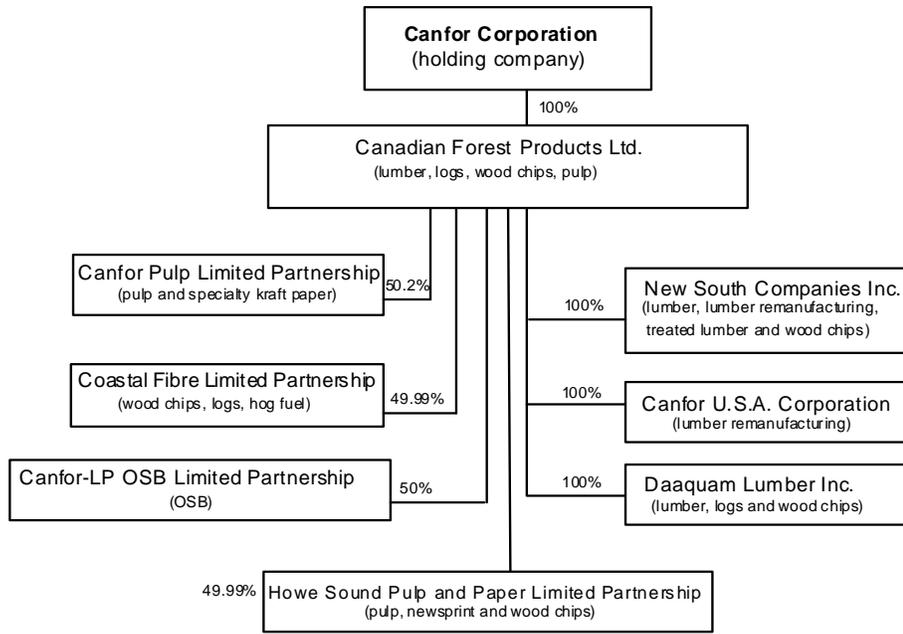
## INCORPORATION

The Company was incorporated on May 17, 1966, under the British Columbia *Company Act* as part of a reorganization of predecessors of the Canfor group of companies, the first of which commenced operations in 1938. The Company is now governed by the British Columbia *Business Corporations Act*, which replaced the *Company Act* in March 2004. In July 1983, Canfor became a public company and the Common Shares of the Company are listed and traded on the Toronto Stock Exchange (“TSX”).

The registered and head office of the Company is located at 100-1700 West 75<sup>th</sup> Avenue, Vancouver, British Columbia. In this Annual Information Form, Canfor Corporation is referred to as the “Company” and, unless otherwise indicated by the context, “Canfor” refers to the Company, its subsidiaries and its interests in the limited partnerships as described under “Corporate Structure” below.

## CORPORATE STRUCTURE

The following chart shows, as at December 31, 2008, the Company's material subsidiaries and its direct or indirect interest in Canfor Pulp Limited Partnership (“Canfor Pulp LP”), Coastal Fibre Limited Partnership (“Coastal Fibre LP”), Howe Sound Pulp and Paper Limited Partnership (“HSLP”) and Canfor – LP OSB Limited Partnership (“Peace Valley OSB”), their primary products or activities and the percentage of voting securities or ownership held. All of the companies listed below were incorporated or amalgamated under the laws of British Columbia and are now governed by the British Columbia *Business Corporations Act*, except Canfor U.S.A. Corporation, which is constituted under the Washington *Business Corporation Act*, Daaquam Lumber Inc. (“Daaquam”), which is constituted under the laws of Québec and New South Companies Inc. (“New South”), which is constituted under the laws of the State of South Carolina. HSLP, Coastal Fibre LP and Peace Valley OSB are partnerships constituted under the *Partnership Act* of British Columbia. Canfor Pulp LP is a partnership constituted under the laws of Manitoba.



On November 30, 2007, Canfor completed the acquisition of the assets of Chesterfield Lumber Company, Inc., in Darlington, South Carolina (“Darlington mill”), through its wholly owned subsidiary, New South, at a cost of US\$18.8 million, including transaction costs. The sawmill has an annual capacity of approximately 79 million board feet of Southern Yellow Pine (“SYP”) lumber.

Canfor completed the spinout of its northern bleached softwood kraft pulp and paper business to Canfor Pulp LP in 2006. Canfor holds 50.2% of the voting securities of Canfor Pulp Holding Inc., general partner and the holder of a 0.001% general partner interest in Canfor Pulp LP.

In partnership with Louisiana-Pacific Canada Ltd., Canfor holds a 49.99% interest in Peace Valley OSB, which owns and operates an oriented strand board (“OSB”) plant in Fort St. John, British Columbia, which commenced operations in late 2005.

The Company, through a wholly owned holding company, holds a one-third interest in each of Lakeland Mills Ltd. (“Lakeland”) and Winton Global Lumber Ltd. (“Winton Global”). Lakeland and Winton Global operate sawmills in the Prince George region of British Columbia and sell their wood chips to Canfor Pulp LP’s Prince George pulp and paper operations.

Canfor's 49.99% interest in HSLP was originally held through its interest in Howe Sound Pulp and Paper Limited (“HSPP”) and was written off in 1998 after management of the Company determined that Canfor would not recover its investment in HSPP. Canfor also owns a 49.99% interest in HSPP General Partner Ltd., general partner and the holder of a 0.02% interest in HSLP (see “Howe Sound Pulp and Paper Limited Partnership”).

## **BUSINESS OF CANFOR**

Canfor is a Canadian integrated forest products company based in Vancouver, British Columbia, involved primarily in the lumber and panels business, with production facilities in British Columbia, Alberta, Québec and the United States. Canfor also has a 50.2% interest in the pulp and paper business owned by Canfor Pulp LP, a 49.99% interest in the panels business of Peace Valley OSB, a 49.99% interest in the pulp and newsprint business of HSLP and owns the Taylor pulp mill. The capacity and production figures set out in this Annual Information Form are presented as at December 31, 2008.

As at December 31, 2008, Canfor employed approximately 4,154 persons in its wholly owned subsidiaries and 1,878 in jointly owned operations for a total of 6,032 employees. For a detailed breakdown of employees and related collective agreements, refer to segmented information below.

Softwood lumber production facilities are located in British Columbia, Alberta, Québec and the United States with annual production capacity at December 31, 2008 of approximately 4.9 billion board feet of lumber, 270 million square feet of plywood (3/8 inch basis) and one billion square feet of OSB (3/8 inch basis), including the Company’s 50% share of Peace Valley OSB. Canfor’s products also include remanufactured and finger-jointed lumber, treated lumber, wood chips, wood pellets and logs.

Canfor also holds a 50.2% interest in the pulp and paper business of Canfor Pulp LP with annual production capacity at December 31, 2008 of over one million tonnes of kraft pulp and 140,000 tonnes of kraft paper and a 49.99% interest in the pulp and newsprint business of HSLP with annual production capacity at December 31, 2008 of 400,000 tonnes of kraft pulp and 230,000 tonnes of newsprint.

Canfor also holds approximately 11.3 million cubic metres of annual harvesting rights under its forest tenures.

Canfor's products are exported primarily to the United States, Europe and Asia. Canfor maintains wood products sales offices in Vancouver, Canada, Tokyo, Japan and Shanghai, China, and pulp sales offices in Vancouver, Canada, Brussels, Belgium, and Tokyo, Japan, and is represented by sales representatives serving various other markets around the world.

### **General Development**

One of Canfor’s primary objectives is to be the preferred supplier of wood products to the building industry around the world. Canfor is focused on increasing its building products business in global markets, and on making higher value structural lumber and specialized products for specific customer needs.

Canfor's overall business strategy is to be an industry leader in profit performance, which will be accomplished through:

- Achieving and maintaining a low cost structure in all business segments.
- Maximizing high-margin products and obtaining maximum value from fibre.
- Supply chain excellence.
- Targeting customers to grow through long-term partnerships.
- Conservative financial management.
- Its experienced employees, and
- Taking advantage of growth opportunities.

During the past three financial years, Canfor has invested \$222.9 million in corporate acquisitions and strategic alliances and \$277.9 million in capital expenditures. In addition, Canfor has added new products and rationalized some of its operations.

The most significant events for Canfor over the past three fiscal years have been the following:

- As a result of continued weak demand and pricing for softwood lumber, OSB and plywood, the Company reduced its production volume significantly in 2008. The downtime took the form of indefinite idling for several operations in the interior of British Columbia, and shortened work weeks and/or reduced shifts at its other operations in British Columbia, Alberta, Québec, North Carolina and South Carolina. A summary of the lumber and panel operations indefinitely idled in 2008 includes:
  - The indefinite closure of Chetwynd sawmill, which took effect in the first quarter of 2008, and reduced Canfor's annual production of spruce, pine, fir ("SPF") lumber by approximately 219 million board feet.
  - The indefinite closure of the Mackenzie sawmill, which took effect in the second quarter and reduced Canfor's annual production of SPF lumber by approximately 305 million board feet.
  - The indefinite closure of the Polarboard OSB mill, which took effect in the second quarter and reduced Canfor's annual panel production by approximately 640 million square feet (3/8" basis).
  - And the indefinite closure of the Tackama plywood mill in the fourth quarter of 2008, reducing the Company's annual panel production by an estimated 270 million square feet (3/8" basis).
- In 2007, Canfor announced the permanent closure of one of the Mackenzie sawmill's two production facilities and the permanent closure of its Panel and Fibre mill operation in New Westminster effective January 8, 2008.
- As a result of a very challenging operating and financial market climate, the Company recorded asset impairment charges totalling \$169.6 million in 2008 (2007 - \$268.0 million). The charges comprised the following:

- In 2008, Canfor recorded charges of \$89.4 million related to the solid wood business, principally on the Company's panel assets highlighted above (2007 - \$231.4 million). Following indefinite closures of all or part of certain sawmills as described above, and ongoing losses and impending closures at certain OSB and plywood mills, assets were written down to fair values where it was determined that the book values of operations were not recoverable from expected future cash flows. Impairments were calculated based on the present values of estimated future cash flows from operations, adjusted for required capital expenditures.
- \$70.0 million (2007 - \$14.0 million) related to the Company's investments in HSLP. The Company's investments include a 49.99% interest in Coastal Fibre LP, an entity that supplies fibre and related services to HSLP. The impairment reflected the continuing deterioration of British Columbia coastal pulp, paper and fibre market conditions.
- \$10.2 million (2007 - \$16.2 million) related to the Company's investment in non-bank asset-backed commercial paper ("ABCP") of four different Canadian trusts with total original principal amount of US\$81.2 million (CDN\$99.4 million at December 31, 2008).

The impairment in 2008 was based on the estimated fair value of the ABCP assets at year end, and took into account information available to Canfor related to its specific holdings of ABCP, and assumed a high likelihood of success restructuring which was completed on January 21, 2009.

- In May 2008, a fire at Canfor's North Central Plywood ("NCP") facility in the British Columbia Interior destroyed the mill. The mill was insured for equivalent replacement value. At the end of 2008, the Company had not reached a final settlement with its insurer and accordingly, estimated the insurance property damage amount receivable using preliminary engineering estimates and other information available. Based on estimated insurance proceeds, net of an aggregate policy deductible of \$2.4 million, and costs related to the fire, the Company recorded a pre-tax gain of \$57.9 million in 2008. The estimates are subject to adjustments in future periods. The Company received cash advances of \$30.0 million from its insurer by the end of 2008. The insurance property damage receivable was estimated on the basis that the insurance proceeds would be applied towards capital improvements at Canfor's other operations.
- On February 13, 2009, Canfor completed the sale of a property located at New Westminster, British Columbia, for gross proceeds of \$47.5 million. The property was the site of Canfor's former Panel and Fibre operation, which was permanently closed at the beginning of 2008. The transaction will result in a pre-tax gain of approximately \$44 million.
- In the first quarter of 2008, a fire destroyed the chip screening and in-feed system at the Canfor Pulp LP Prince George Pulp and Paper mill. A gain of \$8.2 million was recorded in relation to this based on estimated insurance proceeds and costs related to the fire. Construction of the replacement system was substantially completed in the fourth quarter of 2008.
- On October 12, 2006, the Softwood Lumber Agreement ("SLA") was implemented by the governments of Canada and the United States. With this settlement of the softwood

lumber dispute, which began in May 2002, the U.S. Department of Commerce revoked all existing antidumping (ADD) and countervailing (CVD) duty orders on softwood lumber shipped to the U.S. from Canada. As a result, Canfor recorded a net duty refund of \$717.7 million and \$97.7 million of associated interest in income in 2006. Under the SLA, the Canadian federal government is collecting an export tax on lumber shipped from Canfor's Alberta and British Columbia facilities at a variable rate based on composite lumber prices. For a detailed discussion of the SLA, see the Company's "2007 Management's Discussion and Analysis", in particular the "Lumber" sections thereof, which are incorporated by reference herein.

- In July 2006, Canfor completed a spinout of its Northern Bleached Softwood Kraft ("NBSK") pulp and paper business, including its Northwood pulp mill, Intercontinental pulp mill and Prince George pulp and paper mill, together with associated management and employees, to Canfor Pulp LP, in exchange for a \$125 million promissory note (the "Note"), 14.254 million Class A Limited Partnership Units and 57.016 million Class B Exchangeable Limited Partnership Units of Canfor Pulp LP (see "Pulp and Paper").
- In March 2006, Canfor transferred its Englewood Operations on Northern Vancouver Island, including TFL 37 and certain timber licenses, to a new fibre partnership, Coastal Fibre LP, jointly and equally owned by the Company (through Canadian Forest Products Ltd.) with Oji Paper Canada Ltd. ("Oji Canada"). In return for the transfer, Canfor received a partnership interest in the limited partnership with an agreed value of \$45 million and Oji Canada contributed an equivalent amount of cash. Assets comprising the Englewood Operations and \$35 million cash were then transferred by Coastal Fibre LP to Western Forest Products Inc. ("WFP") in return for, among other things, a long term fibre supply agreement with WFP pursuant to which WFP supplies fibre for sale by Coastal Fibre LP to HSLP. See "Howe Sound Pulp and Paper Limited Partnership".
- In March 2006, Canfor acquired New South, which operated three sawmills, one remanufacturing facility and two lumber treating facilities located in North and South Carolina at a cost of US\$181.6 million, net of assumed debt and including transaction costs. A fourth mill, Darlington was acquired in the fourth quarter of 2007, at a cost of US \$18.8 million including transaction costs (see Corporate Structure). The annual production capacity of New South's four facilities at December 31, 2008 is 552 million board feet of lumber, primarily SYP.
- Canfor, in a joint venture with Pinnacle Pellet Inc. of Quesnel, British Columbia and the Moricetown First Nations Band, commenced operation of Houston Pellet Inc. in late 2006, a wood pellet manufacturing facility adjacent to its Houston sawmill with an annual production capacity of 150,000 oven-dried tonnes of wood pellets. This facility converts all of the Houston sawmill's sawdust and shavings into wood pellets for the U.S. and Japanese pellet markets.

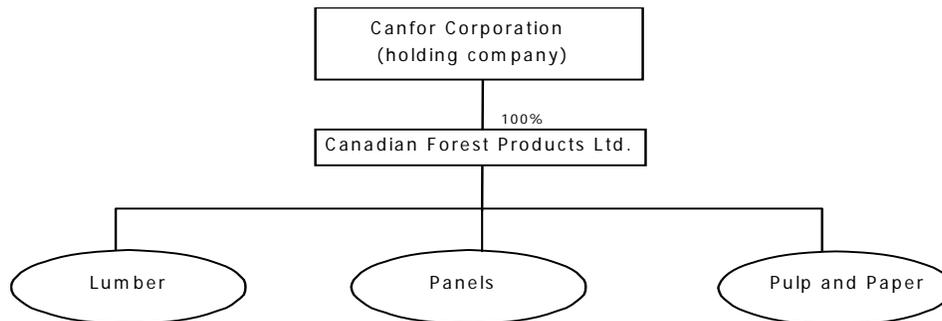
## **Trends, Events, Risks and Uncertainties**

For additional information regarding changes to Canfor's business expected in 2009 and known trends, commitments, events or uncertainties, see Canfor's "2008 Management's Discussion and Analysis", in particular, the " Outlook" and "Risks and Uncertainties" sections thereof, which are incorporated by reference herein.

## **Business Segments**

Canfor's business is reported in three segments: "Lumber", "Panels" and "Pulp and Paper". The Lumber segment includes Canfor's sawmilling and remanufacturing operations; the Panels segment includes Canfor's OSB, and plywood operations; and the Pulp and Paper segment includes the kraft pulp and kraft paper business of Canfor Pulp LP, in which Canfor has a 50.2% interest, and 100% of the Taylor Pulp mill, which was excluded from the Canfor Pulp LP spin-out transaction.

The following chart and notes outline Canfor's business segments and their respective principal operations at December 31, 2008, and the production facility closures announced by the Company in 2007 and in early 2008, indefinite and permanent. Unless otherwise indicated in the diagram below, Canfor has a 100% interest in the operations referred to in each segment. The Pulp and Paper segment does not include HSLP.



- 13 sawmills in British Columbia, one in Alberta and one in Québec, with annual production capacity of 4.3 billion board feet. In 2007, Canfor permanently closed one of the Mackenzie sawmill's two production facilities and in 2008 Canfor idled the Chetwynd mill and the remaining Mackenzie sawmill production facilities indefinitely, effective the first and second quarters of 2008, respectively.
- Four sawmills located in North and South Carolina with annual production capacity of 552 million board feet, for a combined Company estimated capacity of 4.9 billion board feet.
- Other operations include two finger-jointing facilities in British Columbia and in North Carolina, two lumber remanufacturing facilities located in British Columbia and Washington State, two lumber treating plants located in North Carolina and South Carolina and a whole-log chipping plant located in British Columbia.
- Woodlands operations with an allowable annual cut of 11.3 million m<sup>3</sup> (10.3 million m<sup>3</sup> in British Columbia).
- 60% interest in Houston Pellet Inc. in Houston, BC.
- Lumber marketing.
- One plywood mill (Tackama) with annual production capacity of 270 million square feet (3/8" basis), which was idled indefinitely, effective the fourth quarter of 2008.
- An OSB mill (PolarBoard) with annual production capacity of 640 million square feet (3/8" basis), which was idled indefinitely, effective the second quarter of June 2008.
- The NCP plywood facility was destroyed by fire in May 2008.
- Panel and Fibre operation permanently closed effective January 8, 2008.
- 50% interest in Peace Valley OSB LP mill with annual production capacity of 820 million square feet (3/8" basis) of OSB.
- Plywood and OSB marketing.
- 50.2% interest in three pulp mills with annual production capacity of over one million tonnes of kraft pulp, 140,000 tonnes of kraft paper and pulp and paper marketing.
- Taylor BCTMP pulp mill (100% interest) with annual production capacity of 213,000 tonnes.

The following table sets forth, by business segment, Canfor's sales revenues from all production in 2008 (including 100% of the revenues of the pulp and paper business now owned by Canfor Pulp LP and 50% of the revenues of the panels business of Peace Valley OSB):

	<u>Year ended December 31</u>	
	<u>2008</u>	<u>2007<sup>(1)</sup></u>
	(Millions of dollars)	
Lumber.....	\$1,490.5	\$1,942.7
Panels.....	170.3	297.7
Pulp and Paper .....	<u>950.8</u>	<u>1,035.2</u>
Total sales .....	<u>\$2,611.6</u>	<u>\$3,275.6</u>

Notes: (1) Includes the results of the Darlington mill from November 30, 2007.

The following table indicates the percentage composition of Canfor's consolidated sales revenues by market for the last two financial years (including 100% of the revenues of the pulp and paper business now owned by Canfor Pulp LP and 50% of the revenues of the panels business of Peace Valley OSB):

	<u>Year ended December 31</u>	
	<u>2008</u>	<u>2007<sup>(1)</sup></u>
Canada.....	19%	19%
United States .....	53%	57%
Europe .....	7%	6%
Far East and other.....	<u>21%</u>	<u>18%</u>
Total .....	<u>100%</u>	<u>100%</u>

Notes: (1) Includes the results of Darlington mill from November 30, 2007.

## **WOOD SUPPLY**

### **Timber Resources**

Canfor harvests timber under forest tenures held by it in British Columbia, northern Alberta and southern Québec, and has a total allowable annual cut ("AAC") of approximately 11.3 million cubic metres. The forest tenures consist of both area-based and volume-based replaceable tenures and volume-based non-replaceable tenures. Canfor's Canadian wood fibre requirements are also met by open market purchases and exchanges on either a spot or contract basis. The wood fibre requirements of New South in the U.S. are met through long term and open market purchases from private timberland owners in North and South Carolina and other regions.

The following table sets forth Canfor's timber resources as at December 31, 2008:

	<b>Productive Area (Hectares)</b>	<b>Allowable Annual Cut (Cubic metres)</b>
<b>British Columbia</b>		
Tenures having regulated sustained yields <sup>(1)</sup>		
Area-based — Tree Farm Licenses <sup>(2)</sup> .....	899,860	1,212,582
Volume-based — Forest Licenses (replaceable) .....	N/A	7,360,140
— Forest Licenses (non-replaceable) <sup>(3)</sup> .....	N/A	571,666
— Pulpwood Agreements (non-replaceable)	N/A	1,110,000
<b>Alberta</b>		
Tenures having regulated sustained yields		
Forest Management Agreement .....	331,187	640,000
Timber Quotas .....	N/A	230,081
<b>Québec</b>		
Tenures having regulated sustained yields		
Forest Management Agreement .....	N/A	190,000
Timber Supply and Forest Management Agreement .....	<u>N/A</u>	<u>30,640</u>
<b>Total</b> .....	<u>1,231,047</u>	<u>11,345,109</u>

Notes:

- (1) For an explanation of “regulated sustained yields”, see the section entitled “Forest Management” below.
- (2) Comprised of TFL 18 (Clearwater), TFL 30 (Sinclair), and TFL 48 (Chetwynd).
- (3) Includes 250,000 cubic meters held jointly with the West Moberly First Nation.

Note: N/A denotes Not Applicable.

Canfor obtains additional wood fibre through contractual rights to purchase logs by way of business relationships with First Nations and other licensees.

The Province of British Columbia owns approximately 95% of all timberlands in the province. Pursuant to the provisions of the *Forest Act* (British Columbia) (“Forest Act”), the Minister of Forests (the “Minister”) is empowered to grant various forms of tenure and to regulate forestry operations.

A Tree Farm License (“TFL”) requires a licensee to undertake to manage an area of Crown forestland, often in combination with other forestland held by the licensee, to yield an annual cut on a regulated sustained yield basis. TFL's are granted for a 25-year term and, subject to satisfactory levels of performance, will be replaced every five to ten years with a new TFL having a 25-year term. Canfor's currently held TFL's have all been replaced for a 25-year term: TFL 48 (Chetwynd) in 1998 and TFL 30 (Sinclair) and TFL 18 (Clearwater) in 2001. TFL 48 is at its maximum timeline for extension and will require the Government of British Columbia to provide a renewal term.

A Forest License is a volume-based tenure, which authorizes a right to harvest a specified volume of timber each year within a particular timber supply area (“TSA”) and generally provides for 15-year terms. These licenses may be replaced every five to ten years for further 15-year terms, subject to satisfactory levels of performance. Canfor holds 11 replaceable Forest Licenses, under which it is continuing to harvest (in addition to two such licenses which have no remaining AAC as the result of reductions described below), all of which were replaced between 1998 and 2003. To date, the Government of British Columbia has offered, and Canfor has accepted, the replacement of all 11 Forest Licenses. Canfor holds five non-replaceable Forest Licenses, one expiring in each of 2010, 2013 and 2014 and two expiring in 2011. Canfor also holds two non-replaceable Forest Licenses under joint venture agreements with West Moberly First Nations, which expire in 2023.

In addition, Canfor has five Pulpwood Agreements with the Province of British Columbia, which grant a holder the right to obtain licenses to harvest up to a specified volume of timber within a particular geographic area, subject to certain conditions. Canfor has the right, if necessary and subject to the terms of the Pulpwood agreement, to supply the requirements of Canfor Pulp LP’s three pulp mills at Prince George under Pulpwood Agreement No. 1, which expires in 2018, Pulpwood Agreement No. 3, which expires in 2020, and Pulpwood Agreement No. 7, which expires in 2022. None of these Pulpwood Agreements are replaceable under the *Forest Act* and Canfor has not needed to access timber under these or their predecessor agreements since 1976. Canfor also has the right under Pulpwood Agreement No. 12 to 500,000 cubic metres of deciduous timber per year in the Fort St. John TSA in connection with the Taylor Pulp Mill and the Peace Valley OSB mill in Fort St. John, and under Pulpwood Agreement No.14 up to 610,000 cubic metres of deciduous timber per year in the Fort Nelson TSA in connection with the Company’s PolarBoard OSB mill in Fort Nelson.

For each Forest License and TFL, an AAC is determined. The actual cut in any one year may vary from year to year provided that the actual cut over a five-year period does not exceed 110% of the aggregate AAC for that period. As required by the *Forest Act*, the provincial Chief Forester determines the AAC for each TFL and the total AAC in each TSA (which affects the AAC of Forest Licenses in that TSA) in the Province. The Chief Forester is required to repeat such determination every five years, but has the option of postponing a redetermination for a period of up to ten years after the last determination if he concludes that the AAC will not change significantly from the previous determination. The AAC reflects harvesting practices in the previous five years, timber conditions, regional and local economic and social interests and environmental considerations for these licenses and areas.

In northern Alberta, Canfor has a Forest Management Agreement (“FMA”) #9900037 under which it undertakes to manage a designated area of Crown forestland. This FMA was renewed in 1999 for a 20-year period. In June 2003, the Government of Alberta approved the Detailed Forest Management Plan for the FMA and determined the coniferous AAC for the term of the FMA (1999-2019) to be 630,400 cubic metres.

The Province of Alberta also grants Timber Quotas having terms of 20 years and containing provisions for renewal. These quotas are intended to provide a continuous supply of timber in perpetuity. As a result of the amalgamation of forest management units by the Province of Alberta during 2004, Canfor now has two Timber Quotas, which expire in 2021 and 2024 respectively.

Canfor's regulated sustained yield tenures in Alberta specify an AAC and an aggregate allowable cut over a five-year period. The actual cut during each five-year period must be at least 60% of the aggregate specified for that period for the tenure to remain in good standing. Canfor would be subject to

significant levies if its production were to exceed 110% of the aggregate allowable cut for that period.

In the Province of Québec, the Minister of Natural Resources and Wildlife has a number of tools for allocating timber harvesting rights and associated forest resource management responsibility. They include Timber Supply and Forest Management Agreements (“TSFMA”) and Forest Management Agreements (“FMA”). Both require the agreement holder to fulfill management obligations similar to those in British Columbia with regard to planning, monitoring and reporting activities. A TSFMA is a volume-based agreement that authorizes an owner of a wood processing mill to harvest an annual amount of volume from a specified timber supply area. A license holder is evaluated based on the collective forest management and environmental performance of all operators within the timber supply area and on the effective utilization of the allocated volume by the individual mill owner. An FMA is a volume-based agreement by which a single licensee is responsible for the management of a forest reserve where no TSFMA or Forest Management Contracts have been granted.

Canfor acquired Daaquam and Produits Forestiers Anticosti Inc., two lumber and timber harvesting companies based in Québec in May 2003. Anticosti has woodlands and harvesting operations on Anticosti Island located in the Gulf of St. Lawrence and holds an FMA with an AAC of 190,000 cubic metres. The timber is sold on a market price basis with Daaquam having first right of refusal on 40,000 cubic metres. Daaquam maintains a TSFMA near Saint Just-de-Bretenières with an annual harvest allocation of 30,640 cubic metres. The Company secures an additional volume of wood for its Québec operations through procurement contracts with suppliers in Ontario, Québec and the U.S.

Canfor is in substantial compliance with the harvesting terms of all of its tenure agreements in British Columbia, Alberta and Québec.

### **Mountain Pine Beetle**

The infestation of the Mountain Pine Beetle (*Dendroctonus ponderosae*) has reached critical levels in many timber supply areas throughout the interior of British Columbia and in some of Canfor’s operating areas. The impact of this outbreak is expected to affect the long-term timber supply in the interior of British Columbia. Given the nature and extent of the infestation, its long term operational and financial impact on Canfor is not quantifiable at this time, but could be significant. For additional information regarding the beetle infestation and its impact on Canfor and its operations, see the Company’s “2008 Management’s Discussion and Analysis”, in particular, the “Risks and Uncertainties – Mountain Pine Beetle” section thereof, which is incorporated by reference herein.

### **Aboriginal Issues**

The issues relating to Aboriginal rights and title and consultation continue to be heard, developed and resolved by Canadian courts at all levels. Canfor continues to cooperate, communicate and exchange information and views with Aboriginal groups in order to foster good relationships and minimize risks to its tenures, operations and operational plans, and will continue to participate with the Province in its consultations with Aboriginal groups. Due to their complexity, it is not expected that the issues regarding Aboriginal rights and title or consultation will be resolved in the short term and their impact, if any, on the timber supply from Crown lands and Canfor’s tenures and operations is unknown at this time. For additional information regarding the Aboriginal issues and their impact on Canfor and its operations, see the Company’s “2008 Management’s Discussion and Analysis”, in particular, the “Aboriginal Issues” section thereof, which is incorporated by reference herein.

## Forest Management

Canfor is responsible for all aspects of forest management on the lands within its TFL's in British Columbia. In Alberta, Canfor is responsible for all aspects of forest management on the lands covered by its FMA's except forest fire protection, which is a responsibility of the Province of Alberta. In Québec, Canfor is responsible for all aspects of forest management on lands specified within its FMA and TSFMA. The lands held under TFL's, FMA's, TSFMA's, Forest Licenses and Timber Quotas are managed on a “sustained yield” basis, whereby the volume of timber harvested is regulated according to the productive capacity of the land and the inventory of mature timber available for harvest. In British Columbia, Alberta and Québec, Canfor is responsible for reforestation of areas logged on all of its sustained yield tenures. The overall management of forestlands held under Forest Licenses and Timber Quotas is the responsibility of the respective Forest Services of British Columbia and Alberta.

The British Columbia government introduced the Market Pricing System (“MPS”) for the pricing of timber harvested in the British Columbia Interior on July 1, 2006. This replaced the long standing target rate driven Comparative Value Pricing (“CVP”) system, which had been in place since October 1, 1987 for timber harvested in the interior of the province. In contrast to the CVP system, MPS uses auction-based prices to derive stumpage rates for license holders in the British Columbia Interior.

Canfor carries out its forest management responsibilities through a full compliment of registered professional foresters, technologists and biologists, as well as additional professional staff on part-time and contract basis. This forestry staff is engaged in supervising all aspects of forest development including planning, road development, harvesting methods and forest protection, and in research and development programs to increase the yield of its forestlands and improve the quality of its timber resources. Canfor currently operates, directly or under contract, seed orchards for the genetic improvement of forest seed at Sechelt and Vernon, British Columbia, and at Grande Prairie, Alberta. As part of the 2006 sale of the Englewood Operations, Canfor has sold certain quantities of seed stock from the Sechelt orchard to WFP and has agreed to maintain that orchard for a minimum of three years.

Customers of forest products companies increasingly require assurances that products purchased are derived from well-managed forests. Canfor has responded by implementing a comprehensive third-party sustainable forest management (“SFM”) certification strategy to verify the quality of its forest management practices.

Canfor retains an International Organization for Standardization 14001 (“ISO”) certification of its environmental management system for its forest operations, first obtained in 1999 and re-certified as required for subsequent three-year terms. In addition, Canfor retains certification under the Canadian Standards Association (“CSA”) standard for sustainable forest management (CAN/CSA Z809) for its FMA area at Grande Prairie, Alberta, for its TFL's at Chetwynd, Prince George and Vavenby, British Columbia, for its Forest Licenses at Fort St John, Houston, Prince George, Fort Nelson, Vanderhoof, Vavenby, Quesnel, Radium and Mackenzie, British Columbia and for its Pulpwood Agreements at Fort St John and Fort Nelson, British Columbia. At present, 96% of Canfor's AAC is certified to the ISO 14001 standards. Canfor received its continued registration under the CSAZ809 standard and ISO 14001 corporately in December of 2008.

Canfor has seen an increased interest from customers worldwide in understanding the origin of the products they purchase. Canfor continues to make significant progress in implementing a certified Program for Endorsement of Forest Certification (“PEFC”), Chain of Custody system to provide this information. PEFC is a global, independent non-government organization for the assessment and mutual recognition of forest certification schemes.

“Chain of custody” is the process of tracking forest products from their place of origin (forest)

through all stages of transfer and production to the final consumer as an end product. The PEFC Chain of Custody system Canfor has put in place is able to track all of the Company's wood raw material and its certification status both from the company's own managed forest tenures and as well as those from outside suppliers. It also provides an assurance that any uncertified portion is from legal and non-controversial sources.

Canfor received a new Chain of Custody Certificate (PEFC-certified) based on third quarter 2008 audits by the accounting firm KPMG LLP. This new certificate, revised December 1, 2008, covers the production of residual chips and whole log chips to the point of sale and the production of lumber and plywood to the point of sale from the following facilities: Chetwynd sawmill, Clearlake sawmill, Fort St. John sawmill, Grande Prairie sawmill, Houston sawmill, North Central Plywood, Polar sawmill, Prince George chip plant, Prince George sawmill, Tackama Plywood mill, Plateau sawmill, Isle Pierre sawmill, Quesnel sawmill, Vavenby sawmill and Radium sawmill.

### **Wood Fibre Supply**

The wood fibre supply for Canfor's lumber, panels and Taylor pulp mill operations is obtained from logging of Canfor's forest tenures and purchasing logs and chips and waste materials from the manufacture of wood products. Logs are purchased from other tenure holders and from farmers, Aboriginal groups and other private landholders. Chips and waste materials are purchased from sawmillers and other wood products producers. Often, Canfor trades logs with these sawmillers and other wood products producers, receiving chips and waste materials in exchange.

As part of the sale of the Englewood Operations, Coastal Fibre LP entered into a long-term fibre supply agreement with Western Forest Products Inc. ("WFP"), which is used to supply wood fibre for HSLP's operations. See "Howe Sound Pulp and Paper Limited Partnership". As part of the spinout of its pulp and paper business, Canfor entered into residual wood chip and hog fuel agreements with Canfor Pulp LP (see "Pulp and Paper").

The following table sets forth the volume of wood fibre produced and purchased, the volume of wood fibre consumed in Canfor's operations and the volume of wood fibre sold to other wood fibre consumers for the last two financial years:

	<u>Year ended</u>	
	<u>December 31</u>	
	<u>2008</u>	<u>2007<sup>(1)</sup></u>
	('000 cubic metres)	
Production from Canfor's timber tenures		
Central / Northern Interior of British Columbia .....	8,916	9,260
Northern Alberta.....	802	656
Eastern Region (Québec).....	240	175
United States.....	<u>219</u>	<u>271</u>
Total production .....	<u>10,177</u>	<u>10,362</u>
Purchases		
Logs .....	6,960	7,928
Chips <sup>(2)</sup> .....	<u>4,397</u>	<u>4,670</u>
Total purchases.....	<u>11,357</u>	<u>12,598</u>
Total production and purchases.....	<u>21,534</u>	<u>22,960</u>
Less trades and sales		
Logs .....	1,174	743
Chips <sup>(3)</sup> .....	<u>2,077</u>	<u>2,568</u>
Total traded and sales .....	<u>3,251</u>	<u>3,311</u>
Total available for conversion into finished goods .....	<u>18,283</u>	<u>19,649</u>
Total converted by Canfor, Canfor Pulp LP, Peace Valley OSB and HSLP into finished goods .....	<u>18,325</u>	<u>20,996</u>

- (1) Includes the results of New South's Darlington mill from November 30, 2007.
- (2) Included in 2007 chip purchases are 398,591 cubic metres purchased from Lakeland and Winton Global, in which Canfor owns a one-third interest.
- (3) Included in chip sales are 294,018 cubic metres (2007 - 257,905 cubic metres) of chips sold by the Alberta operations, 156,312 cubic metres (2007 - 170,383 cubic metres) of chips sold by the Québec operations and 1,126,916 cubic metres (2007 - 1,259,371 cubic metres) of chips sold by the United States operations where Canfor does not have pulp mills.
- (4) During 2008, Canfor Pulp LP purchased 3,746,984 cubic metres (2007 - 3,984,494 cubic metres) of chips from Canfor pursuant to the fibre supply agreements between the two companies, which purchases are not included in the above table. See "Pulp and Paper".

Canfor has one whole-log chipping facility with available capacity of 362,000 oven-dried tonnes of chips annually, to supplement its supply of sawmill residual chips.

Historically, Canfor has competed successfully for the chips required that cannot be supplied by its own sawmills and timber tenures and does not expect that this situation will change in 2009.

## LUMBER

### Lumber Production Facilities

As at December 31, 2008, Canfor owned 13 sawmills in the central and northern interior of British Columbia, one in Alberta, one in Québec, three in South Carolina and one in North Carolina. The Company reduced its solid wood production levels during 2008 to reflect the significantly lower levels of demand, indefinitely idling its Chetwynd and Mackenzie sawmills in the interior of British Columbia, and reducing shifts and operating shortened work weeks at certain of its other operations. At December 31, 2008 Canfor's owned sawmills had annual production capacity of approximately 4.9 billion board feet of lumber. The majority of lumber produced by Canfor from its facilities is construction and specialty grade dimension lumber that ranges in size from one by three inches to two by twelve inches and in lengths from six to twenty-four feet. A growing portion of Canfor's lumber production is comprised of specialty products that command premium prices and include machine stress rated ("MSR") lumber that is used in engineering applications such as roof trusses and floor joists. Other specialty products include Square Edge lumber for the North American market and J-grade lumber for the Japanese market.

As a by-product of Canfor's lumber production facilities, wood chips are produced from the portion of each log not converted into lumber, and these wood chips are sold to pulp mills for use as their raw material, including to the Taylor pulp mill and to Canfor Pulp LP pursuant to fibre supply agreements entered into between Canfor and Canfor Pulp LP in connection with Canfor's spinout of its pulp and paper business on July 1, 2006 (see "Pulp and Paper"). In addition, Canfor extracts pulpwood from its northern forestry operations and converts this wood to chips for Canfor Pulp LP's pulp and paper operations and its Taylor pulp mill. Canfor also owns and operates one whole-log chipping facility capable of producing 362,000 oven-dried tonnes of wood chips annually.

Canfor's other operations include two lumber remanufacturing facilities, one in British Columbia and one in Washington State, a whole-log chipping plant and a finger-joint mill in British Columbia, and in the Carolinas the operations include two lumber treating plants, a finger joint plant, and a trucking division. This segment also includes Canfor's wood products marketing division, located in Vancouver. Also included is Canfor's 60% interest in Houston Pellet Inc., which has an annual capacity of 150,000 tonnes of wood pellets.

The following table sets forth Canfor's lumber production and sales for the last two financial years:

	<u>Year ended December 31</u>	
	<u>2008</u>	<u>2007<sup>(1)</sup></u>
	(MMfbm) <sup>(2)</sup>	
British Columbia.....	2,978.3	3,792.5
Alberta.....	216.2	203.5
Québec .....	119.0	129.1
United States .....	<u>374.5</u>	<u>375.7</u>
	<u>3,688.0</u>	<u>4,500.8</u>
Sales.....	<u>3,820.9</u>	<u>4,682.2</u>

#### Notes:

- (1) Includes the results of New South's Darlington mill from November 30, 2007.
- (2) MMfbm denotes million foot board measure.

Canfor harvests logs from tenures located in the northern interior region of British Columbia and northern Alberta to supply its interior lumber operations with any shortfall in mill requirements being made up with wood purchased from these areas (see “Wood Supply Timber Resources” above). Operations in Québec and North and South Carolina rely mainly on purchased logs. The following table sets forth the log production, log purchases and wood chip production for the last two financial years:

	<u>Year ended December 31</u>	
	<u>2008</u>	<u>2007</u>
Log Production (cubic metres) <sup>(1)</sup> .....	9,718,381	9,915,898
Log Purchases (cubic metres) .....	6,133,000	7,235,013
Wood Chip Production (oven-dried tonnes) .....	2,492,079	2,676,660
Wood Pellet Production (tonnes) .....	137,481	110,554

(1) Log production in 2007 and 2008 was negatively impacted due to market related production curtailment. Production represents volume from the Company’s tenures located in the northern interior region of British Columbia and Alberta.

### **Lumber Markets and Distribution**

Canfor markets lumber products throughout North America and overseas. In addition to its own production, Canfor also markets lumber produced from independent mills and offshore countries to complement its product line.

In 2008, approximately 72% of Canfor's lumber sales were to United States markets (75% - 2007) and 16% to Canadian markets (15% - 2007). The remaining 12% (10% - 2007) was sold to offshore markets, predominantly to Japan and China. Other offshore markets consisted of Taiwan, Korea, Europe, and the Middle East. 2008 sales of SYP were down 4% and SPF down 25%, from the previous year. Virtually all lumber destined for North America was shipped by truck and rail. For product transported offshore, 94% was sent by container ship and 6% by breakbulk vessel.

For detailed discussion of the markets for Canfor’s lumber products see the Company’s “2008 Management’s Discussion and Analysis”.

### **Human Resources**

As at December 31, 2008, Canfor employed approximately 2,769 persons in its lumber operations in British Columbia, 176 persons in Alberta, 176 persons in Québec and 727 persons in the United States. Of these, approximately 57% are covered by collective agreements with the United Steel Workers (“USW”), the Pulp, Paper and Woodworkers of Canada (“PPWC”) and the Communications, Energy and Paperworkers Union (“CEP”).

The collective agreements with the USW, the CEP (which represent the majority of the workers in the British Columbia operations) and the PPWC expire in June 2009; the contract with the CEP, which represents workers at Canfor's Grande Prairie operation in Alberta, expires in February 2010; with both providing for wage increases totaling 11% over a six-year term. The contract with the USW, representing workers at Canfor’s Uneeda operations in Chilliwack, British Columbia was renewed February 2006. This agreement provides for wage increases averaging 6% over a four-year term that expires in January 2010.

In 2008 the Company indefinitely closed the Chetwynd sawmill and Mackenzie sawmill, both unionized operations represented by the USW and PPWC, respectively.

## PANELS

The Panels segment includes the Tackama plywood plant, with an annual production capacity of 270 million square feet (3/8" basis), and the PolarBoard OSB facility, with an annual production capacity of 640 million square feet (3/8" basis), both of which are currently indefinitely closed. Also included in this segment is Canfor's 50% share of the Peace Valley OSB mill in Fort St. John, British Columbia, which is jointly owned with Louisiana-Pacific Canada Ltd. The Peace Valley OSB mill has an annual capacity of 820 million square feet (3/8" basis). OSB production from all facilities (including Peace Valley OSB) is primarily Performance Rated Sheathing and flooring, which is used in wall, roof and flooring construction of new homes and in repair and remodeling projects.

A fire destroyed the NCP plywood facility in May, 2008 permanently reducing Canfor's plywood capacity by 170 million square feet (3/8" basis).

The following table sets forth Canfor's OSB and plywood production and sales (including 50% of Peace Valley OSB's production and sales) for the last two financial years:

	<b>Year ended December 31</b>	
	<b>2008</b>	<b>2007</b>
	(MMsf 3/8") <sup>(1)</sup>	
<b>Production</b>		
OSB .....	434.8	673.2
Plywood.....	233.4	385.0
	<b>668.2</b>	<b>1,058.2</b>
<b>Sales</b>		
OSB .....	462.9	669.9
Plywood.....	264.1	385.4
	<b>727.0</b>	<b>1,055.3</b>

Notes:

(1) MMsf denotes million square feet, 3/8" basis.

### **Panel and Fibre operation**

In January of 2008 Canfor permanently closed its Panel and Fibre operation in New Westminister, British Columbia.

### **Panels Markets and Distribution**

The North American structural panel market in 2008 was affected by the same factors as the lumber market, with a substantial reduction in U.S. housing starts placing significant downward pressure on panel prices throughout the year. In 2008, approximately 73% of Canfor's OSB sales (excluding Peace Valley OSB's sales, which are handled by Louisiana-Pacific Canada Ltd. and Louisiana-Pacific Corporation) were made to United States markets (72% - 2007), 24% to Canadian markets (26% - 2007), and 3% to Korea (2% - 2007). For plywood, approximately 92% of Canfor's 2008 sales were made to Canadian markets (88% - 2007) and 8% to U.S. markets (10% - 2007), and 0% offshore (2% - 2007). Substantially all panel products destined for North America were shipped by truck and rail.

## **Human Resources**

As at December 31, 2008, Canfor employed approximately 196 (867 - 2007) persons in its Panels operations in British Columbia, with approximately 20% covered by collective agreements with the USWA and the PPWC, which both expire in June of 2009.

## **PULP AND PAPER**

On July 1, 2006, Canfor completed the separation of its pulp and paper business from its wood products business by transferring to Canfor Pulp LP its northern softwood kraft pulp and paper business, including its Northwood pulp mill, Intercontinental pulp mill and Prince George pulp and paper mill, together with associated management and employees. At that time, Canfor distributed a 20% indirect interest in Canfor Pulp LP to Canfor's shareholders and retained an 80% interest. On November 30, 2006, Canfor distributed a further 29.8% indirect interest in Canfor Pulp LP to its shareholders, retaining a 50.2% interest. Canfor Pulp LP now operates as a separate business from Canfor, with separate management, and in which all of the financing arranged by Canfor Pulp LP is without recourse to the Company. See "Business of Canfor – General Development".

In connection with the spinout, Canfor entered into a number of significant agreements with Canfor Pulp LP relating to the transfer of the pulp and paper business assets to Canfor Pulp LP, including: an Acquisition Agreement providing for the transfer of assets to, and the assumption of liabilities by, Canfor Pulp LP; an Exchange Agreement providing Canfor the right to exchange its Class B Exchangeable Limited Partnership Units in Canfor Pulp LP for Fund Units; and a Shareholders Agreement relating to, among other things, the appointment of directors and management of Canfor Pulp Holding Inc., the general partner of Canfor Pulp LP, the transfer of shares of the general partner and approval thresholds for certain corporate matters. For a detailed description of these agreements and certain other agreements relating to the spinout, see the section entitled "The Spinout - Transfer of the Pulp Business and Related Agreements" of the Company's Information Circular dated April 28, 2006, which is incorporated by reference herein.

Canfor's Taylor pulp mill was not included in the spinout of the NBSK pulp and paper business and remains 100% owned by the Company. See "Taylor Pulp Mill" below.

### **Canfor Pulp LP Production Facilities**

Canfor Pulp LP is a leading global supplier of pulp and paper products with operations based in the central interior of British Columbia. Canfor Pulp LP's strategy is to maximize cash flows and enhance the value of its assets by preserving its low cost operating position, maintaining the premium quality of its products.

Canfor Pulp LP owns and operates three mills with annual capacity to produce over one million tonnes of northern softwood market kraft pulp, 90% of which is bleached to become northern bleached softwood kraft ("NBSK") pulp for sale to the market, and approximately 140,000 tonnes of kraft paper.

In connection with the spinout of the pulp and paper business to Canfor Pulp LP, Canfor entered into fibre supply agreements under which Canfor has agreed to supply Canfor Pulp LP with annual quantities of residual wood chips and hog fuel produced at certain of its specified sawmills in the Prince George region. Prices paid by Canfor Pulp LP for residual wood chips are based on a pricing formula that currently results in Canfor Pulp LP paying market prices for wood chips, subject to adjustment to the formula to reflect market conditions. Prices paid for hog fuel are based on market prices. Canfor Pulp LP

is also entitled, upon giving three months notice to Canfor, to request Canfor to supply it with pulplugs or other pulpwood harvested from its woodlands operations, at market prices. These fibre supply agreements, together with supplemental agreements by Canfor Pulp LP with third parties for the supply of wood chips and hog fuel, are expected to satisfy all of the anticipated fibre requirements to operate Canfor Pulp LP's mills at their current capacity levels of operation.

Under arrangements entered into with the Company in connection with the spinout, Canfor Pulp LP also purchases, at cost, a number of administrative, accounting, legal and management services from Canfor under a partnership services agreement, which can be terminated, in whole or in part on twelve months notice by either party.

The following table sets forth pulp production and sales volumes for Canfor Pulp LP pulp mills for the last two financial years:

	<u>Year ended December 31</u>	
	<u>2008</u>	<u>2007</u>
	(000 mt)	
Pulp production .....	932.8	1,044.3
Pulp sales .....	905.4	1,023.6

The following table sets forth the kraft paper production and sales volumes for Canfor Pulp LP's kraft paper production for the last two financial years:

	<u>Year ended December 31</u>	
	<u>2008</u>	<u>2007</u>
	(000 mt)	
Kraft paper production .....	132.6	131.6
Kraft paper sales .....	124.8	129.5

### **Canfor Pulp LP Markets and Distribution**

Canfor Pulp LP has a sales and marketing department staffed by full time marketing professionals who are responsible for global sales of all of the NBSK pulp produced by the mills through three regional offices. Canfor Pulp LP also sells the pulp produced by HSLP and the Taylor pulp mill. Customers in the Americas are serviced through a Vancouver office while European customers are serviced through a Brussels office. Asian customers (excluding Japanese customers) are generally serviced through long-term sales agents who have been granted exclusive territories. These sales agents generally realize a commission of between one and two percent of the net selling price of the NBSK pulp, with the fee varying depending on the selling price, services provided and the tonnage sold.

A joint venture marketing company, Canfor April Corporation, owned equally by Canfor Pulp LP and Asia Pacific Resources International Holdings Ltd. ("April"), is responsible for selling in Japan the market pulp produced by the mills and by April's Riaupulp mill in Indonesia.

In 2008, the approximate geographic distribution of Canfor Pulp LP's mills' kraft pulp sales was 15% to the European market, 45% to Asia, 39% to the Americas and 1% to other markets (14%, 43%, 41% and 2%, respectively in 2007).

Premium 1 Papers, a sales and marketing partnership, owned equally by Canfor Pulp LP and Tolko Marketing and Sales Ltd. ("Tolko") is responsible for marketing all bleached and unbleached kraft

paper products produced by Prince George Pulp and Paper operation in Prince George, British Columbia and Tolko's unbleached kraft paper mill in The Pas, Manitoba. Premium 1 Papers has approximately 15 full time marketing professionals.

The approximate geographic distribution of kraft paper sales in 2008 was 62% in North America, 7% to Asia, 18% to Europe and 13% to other markets (56%, 7%, 21%, and 16% respectively, in 2007).

Canfor Pulp LP uses various modes of surface transportation to distribute its pulp and kraft paper products. In the case of pulp, nearly all is shipped from the mills by rail and each of the mills is serviced by at least one dedicated rail spur. In the case of kraft paper, due to the smaller average order size, a much higher percentage is shipped by truck, with the balance being shipped by rail. Products destined for overseas customers are loaded at one of three terminals in Vancouver, and are then transported by breakbulk cargo vessel for European customers, and either breakbulk or container cargo vessels for Asian customers, depending on which mode is most cost effective.

The cost of transportation over the past three years has risen due to increasing fuel costs. Canfor Pulp LP is working to minimize the effect of these cost increases by optimizing their geographic pulp distribution.

For a detailed discussion of the markets for Canfor Pulp LP's pulp and paper products, see the Company's "2008 Management Discussion and Analysis", in particular, the "Pulp and Paper – Markets" and "2009 Outlook – Pulp and Paper Markets" sections thereof, which are incorporated by reference herein.

### **Canfor Pulp LP Human Resources**

As at December 31, 2008, Canfor Pulp LP employed approximately 1,190 people in its operations and approximately 75% of these employees are hourly employees covered by collective agreements with the CEP and the PPWC. Negotiations with the CEP and PPWC for the renewal of the collective agreements were successfully concluded and ratified in 2008 for the term of four years expiring on April 30, 2012.

### **Taylor Pulp Mill**

The Taylor pulp mill produces both hardwood and softwood bleached chemi-thermal mechanical pulp ("BCTMP") using wood chips from northern white spruce softwood and aspen hardwood species. The mill is located near Taylor, British Columbia. The Taylor pulp mill was not included in the Canfor Pulp LP transaction.

## Taylor Production and Sales

The Taylor pulp mill has an annual production capacity of 213,000 tonnes. The following table sets forth the pulp production and sales volumes for the Taylor pulp mill for the last two financial years:

	<u>Year ended December 31</u>	
	<u>2008</u>	<u>2007</u>
	(000 mt)	
BCTMP pulp production .....	191.8	200.2
BCTMP pulp sales .....	182.6	205.3

## Taylor Pulp Markets and Distribution

BCTMP pulp is marketed to customers globally through Canfor Pulp LP's sales force. Similar to kraft pulp, the BCTMP market is global. However, Asia, not Europe is the largest consumer of BCTMP and also the fastest growing and is Taylor pulp mill's largest market, accounting for nearly 97% of all sales made in 2008 (91% in 2007). China, India, Korea and Indonesia represent the top four markets.

The production of the Taylor pulp mill is loaded in rail cars for transport direct to the customer (in North America) or to terminals in Vancouver and Squamish, British Columbia, where the products are transferred to vessels to be sent overseas.

## Taylor Pulp Human Resources

As at December 31, 2008, Canfor employed approximately 104 persons in the Taylor pulp mill operation, none of whom are part of any collective agreement.

## HOWE SOUND PULP AND PAPER LIMITED PARTNERSHIP

HSLP is 49.99% owned by each of Canfor and Oji Paper Co., Ltd. ("Oji Paper"), a leading Japanese producer and marketer of paper, including newsprint. Canfor does not reflect its share of HSLP's results in its financial statements, as its investment has been written off.

HSLP operates a kraft pulp mill and newsprint mill at Port Mellon, British Columbia with an annual production capacity of 400,000 tonnes of kraft pulp and 230,000 tonnes of newsprint. HSLP has its own management and operates as a separate business in which all of the financing arranged by HSLP is without recourse to either Canfor or Oji Paper.

As a consequence of a debt restructuring agreement among HSLP, Canfor, Oji and a consortium of Japanese banks (the "Banks") in February 2008, Canfor contributed additional funds to HSLP of \$18.8 million, which were still outstanding at year end. The assets of HSLP, subject to other security granted to the Banks and Oji, secure these funds. The repayment of these funds has priority over all other repayments, except a minimum bank debt repayment, from the annual free cash flow of HSLP.

Coastal Fibre LP, jointly owned by Canfor and Oji, purchases chips for resale to HSLP under a long-term fibre agreement with WFP, for which CFLP charges HSLP a commission. The related transactions and balances outstanding are proportionately consolidated in Canfor's financial statements. At year end, Canfor's share of the outstanding balance owing by HSLP was \$9.5 million. In January of 2009, WFP defaulted on its three year rolling average minimum chip volume supply obligation, and subsequently entered into negotiations with CFLP to resolve this matter.

HSLP manages its own fibre acquisitions but has Canfor Pulp LP market its kraft pulp on a commission basis and has Canfor provide certain management services for a fee related to cost. Oji Paper provides HSLP with limited administrative services, also for a fee related to cost. HSLP markets its own newsprint primarily in North America, with some product going to South East Asia.

The following table sets forth HSLP's pulp and newsprint production and sales for the last two fiscal years:

	<u>Year ended December 31</u>	
	<u>2008</u>	<u>2007</u>
	(000 mt)	
Pulp production.....	325.5	364.6
Pulp sales .....	313.2	366.6
Newsprint production.....	211.4	188.6
Newsprint sales .....	208.3	185.2

## **HSLP Human Resources**

As at December 31, 2008, HSLP employed approximately 562 persons in the pulp and newsprint mill operation. Approximately 81% are hourly employees covered by collective agreements with the CEP and United Steelworkers (“USW”), with contracts expiring April 30, 2012 and March 31, 2010, respectively.

## **ENVIRONMENT**

Canfor is committed to the responsible stewardship of the environment throughout its operations. Canfor meets this commitment by: practicing forest management that recognizes ecological processes and diversity and supports integrated use of the forest; designing and operating its facilities to comply with or surpass legal requirements; setting environmental objectives and targets to reduce the risk of pollution and continue to achieve improvements in environmental performance; and promoting environmental awareness throughout Canfor's operations.

Canfor has implemented a program of regular audits of its Environmental Management System (“EMS”) and compliance with government regulations and industry practices at all operations. Canfor's management believes it has sound environmental management programs established in all operations. These programs are continually being improved to help ensure that Canfor is exercising due diligence and is fulfilling its environmental commitments and responsibilities.

At present, 96% of Canfor’s AAC is certified to the Canadian Standards Association sustainable forest management standard and the ISO 14001 standard.

Canfor Pulp LP’s Prince George Pulp and Paper and Intercontinental Pulp mills and the HSLP mill were among the first mills in North America to achieve ISO 14001 registrations in early 1998. The Northwood Pulp mill achieved ISO 14001 registration in June 2001. These mills were all successful in

retaining registration following audits by the registrar for these standards in 2003 and 2006. Canfor's wood products operations have been implementing an ISO 14001-based EMS, but are not seeking ISO 14001 registration at this time.

The British Columbia Ministry of Environment currently has no regulated phase out date for beehive and unmodified silo wood residue burners located in remote rural locations ("Tier 2"). As at the end of 2008, Canfor has one Tier 2 wood residue burner at a sawmill in British Columbia. Four Tier 2 burners were shut down in the year, two as a result of indefinite plant closures and two through third party agreements utilizing the wood residue.

During 2008, Canfor's operations were in substantial compliance with environmental requirements, except for incidents, which have not had, nor are they expected to have, a material effect on Canfor or its operations.

## **COMPETITIVE POSITION**

Each of the markets in which Canfor sells lumber, panels, pulp, paper and newsprint products is highly competitive with many major firms in each market. Canfor's competitive position is influenced by the availability, quality and cost of its raw materials, energy and labour, and its plant efficiencies and productivity in relation to its competitors. Like the rest of the Canadian forest products industry, Canfor (including Canfor Pulp LP, Peace Valley OSB and HSLP) competes in an international market and is therefore subject to the impact of currency fluctuations and global business conditions. Many of Canfor's lumber and panel products also compete with substitutes for wooden building materials of various kinds.

## **RESEARCH AND DEVELOPMENT**

Canfor conducts and is committed to research and development in the areas of fibre analysis, manufacturing processes, quality control and product development. Canfor is an active member and participant in key industry research and development organizations and currently contracts out its research and development services. Canfor maintains its connection to developments in industry research and technical information through its relationships with various associations, universities, research institutes, suppliers and customers.

## DIRECTORS AND OFFICERS

### Directors

The name and municipality, province and country of residence of the Directors of the Company, their principal occupations and the periods during which they have been Directors of the Company are as follows:

<u>Name and Municipality, Province and Country of Residence</u>	<u>Principal Occupation and Background</u>	<u>Director Since</u>
P. J. G. Bentley, O.C., LL.D. <sup>(2), (3), (4), (6)</sup> Vancouver, British Columbia Canada	Chairman of the Board of Directors of the Company Background: Peter J. G. Bentley is Chairman of the Board of the Company and of the Company's principal subsidiary, Canadian Forest Products Ltd., and Co-chairman and a director of HSPG General Partner Ltd. Mr. Bentley is a director of Canfor Pulp Holding Inc., the general partner of Canfor Pulp LP. After working in several positions throughout Canfor, Mr. Bentley became Executive Vice-President in 1970, President in 1975, and Chairman and Chief Executive Officer in 1985, a position he held until April 24, 1995. Mr. Bentley was reappointed to the position of President and Chief Executive Officer of the Company on July 25, 1997, but relinquished the position of President and Chief Executive Officer of the Company on January 1, 1998. Mr. Bentley is President and a director of Sierra Mountain Minerals Inc., a member of the Board of the Canadian Institute for Advanced Research, a member of the Advisory Board of BuildDirect.com, and a Trustee and Chair Emeritus of the VGH and UBC Hospital Foundation. He also served for many years as a director of Bank of Montreal and Shell Canada Ltd. Mr. Bentley served as Chancellor of the University of Northern British Columbia from 2004 to 2007. Mr. Bentley holds Honorary Doctorate of Laws degrees from the University of British Columbia and University of Northern British Columbia.	1966
R. L. Cliff, C.M., F.C.A. <sup>(1), (2)</sup> West Vancouver, British Columbia Canada	Chairman of the Board, Heathcliff Properties Ltd. Background: Mr. Cliff is Chairman of Heathcliff Properties Ltd. He is also President of the Heathcliff Foundation. Mr. Cliff was Chairman and a director of BC Gas Inc. (now Terasen Inc.) from 1972 to 2002. He also served as a director of the Royal Bank of Canada and was a director and Chairman of Southam Inc. Mr. Cliff is a Trustee of the Vancouver Police Foundation; a Trustee and Treasurer of VGH & UBC Hospital	1983

Foundation and the Chairman of the Vancouver Symphony Foundation. Mr. Cliff received his Commerce Degree from the University of British Columbia and qualified as a Chartered Accountant in 1954.

<p>M. J. Korenberg<sup>(1),(3),(6)</sup> West Vancouver, British Columbia Canada</p>	<p>Managing Director, Vice-Chairman of The Jim Pattison Group Background: Mr. Korenberg is a director of Jim Pattison Group Inc. (and its affiliates), a director of Sun-Rype Products Ltd., a trustee of Westshore Terminals Income Fund, and an adjunct professor, Faculty of Law, University of British Columbia.</p>	<p>2003</p>
<p>J. A. Pattison, O.C., O.B.C.<sup>(2), (4)</sup> West Vancouver, British Columbia Canada</p>	<p>President, Managing Director, Chief Executive Officer and Chairman, The Jim Pattison Group Background: Mr. Pattison is a director of Jim Pattison Group Inc. (and its affiliates), BCE Inc., Brookfield Asset Management Inc., Bell Canada Enterprises Inc., Telesat Canada and a Trustee of the Board of the Ronald Reagan Presidential Foundation.</p>	<p>2003</p>
<p>C. A. Pinette<sup>(4)(6)</sup> Vancouver, British Columbia Canada</p>	<p>Former owner and President, Pinette &amp; Terrien Mills Ltd. Background: Through his ownership and position as president of Pinette &amp; Terrien Mills Ltd, Mr. Pinette has over 40 years experience in the Canadian forest industry. Mr. Pinette is a director of TimberWest Forest Corp, Northgate Minerals Corporation, A&amp;W Revenue Royalties Income Fund and Finning International Inc. from 2000 to 2007 and a director of the British Columbia Business Council from 2003 to 2005.</p>	<p>2008</p>
<p>D. C. Selman, F.C.A.<sup>(1), (3), (5), (6)</sup> Richmond, British Columbia Canada</p>	<p>Senior Consultant, Wolrige Mahon Background: Mr. Selman is a senior consultant with Wolrige Mahon, a firm of chartered accountants and is a chartered business valuator, a director of Rainmaker Entertainment Inc and Sun-Rype Products Ltd. He obtained his C.A. designation in 1958 and a Law Degree from the University of British Columbia in 1960.</p>	<p>2004</p>

J. F. Shepard, P. Eng. <sup>(4), (6)</sup>  
Vancouver, British Columbia  
Canada

President and Chief Executive Officer of the  
Company

2007

Background: Mr. Shepard was appointed as a Director and as interim President and Chief Executive Officer on May 4, 2007 and as President and Chief Executive Officer on July 27, 2007. Mr. Shepard retired from Finning International Inc. in April 2000 after a 32 year career, including nine years as Chief Executive Officer (1991 to 2000). Mr. Shepard also served as Chairman of the Board of Finning International Inc., Chairman of the Board of MacDonald Dettwiler and Associates, Vice-Chairman of the Conference Board of Canada, Vice-Chairman of the Business Council on National Issues, Honorary Chairman of Leadership Vancouver and is the past Chairman of the Executive Committee for the Business Council of British Columbia. He was founding Co-Chairman of the Business Summit of British Columbia and is a member of The Conference Board, Inc. New York. Mr. Shepard was a Director of Imperial Oil Limited and initial Chairman of the Cabinet of the Business Laureates of the British Columbia Hall of Fame. Mr. Shepard received a B.Sc. Degree in Civil Engineering from the University of British Columbia and is a member of the Association of Professional Engineers of British Columbia.

J.M. Singleton, BA <sup>(4), (6)</sup>  
Myrtle Beach, South Carolina, USA

Chief Executive Officer of New South Companies,  
Inc., headquartered in Myrtle Beach, South Carolina,  
a wholly owned subsidiary of the Company

2007

Background: Mr. Singleton was appointed as a Director on October 31, 2007. Mr. Singleton has 35 years of experience in the wood products industry, all with New South or its predecessor companies and has been Chief Executive Officer since 1985. Mr. Singleton has served on numerous industry associations and committees and is past chairman of the US Coalition for Fair Lumber Imports and Southern Forest Products Association. He is involved with many civic organizations including serving on the Board of Visitors of Coastal Carolina University's Wall School of Business and is Past President and Chairman of the United Way of Horry County. Mr. Singleton received a BA degree from Presbyterian College, a J.D. degree from the University of South Carolina School of Law, and completed the PMD Program at Harvard Business School.

T. Tutsch. . (2), (3), (5)  
Toronto, Ontario  
Canada

2007

Former Deputy Chairman of BMO Nesbitt Burns and  
Chief Executive Officer of BMO Nesbitt Burns  
Equity Partners

Background: Mr. Tutsch was appointed as a Director  
on May 24, 2007. Mr. Tutsch served as Interim Vice  
President, Private Markets of the Canada Pension  
Plan Investment Board (2004 to 2005). During the  
past 10 years, Mr. Tutsch also served on several  
corporate and not-for-profit boards.

- (1) Member of the Audit Committee.
- (2) Member of the Management Resources and Compensation Committee.
- (3) Member of the Corporate Governance Committee.
- (4) Member of the Environmental, Health and Safety Committee.
- (5) Member of the Pension Committee.
- (6) Member of the Capital Expenditure Committee.

Mr. J.D. Lapey, who became a Director in 2007, resigned as a Director of the Company effective May 2, 2008. Mr. C.A. Pinette became a Director of the Company effective May 2, 2008.

The term of office of each Director expires on the date of the next Annual General Meeting of the Company to be held on April 30, 2009.

## Officers

The names and municipality, province and country of residence of the executive officers of the Company and the offices held by them are as follows:

<u>Name</u>	<u>Municipality of Residence</u>	<u>Office and Principal Occupation</u>
P. J. G. Bentley.....	Vancouver, British Columbia, Canada	Chairman
J. F. Shepard .....	Vancouver, British Columbia, Canada	President and Chief Executive Officer
D.M Calabrigo .....	Surrey, British Columbia, Canada	Vice-President Corporate Development, General Counsel and Corporate Secretary
A. Cook .....	Surrey, British Columbia, Canada	Vice-President, Capital Projects
M. Feldinger .....	Prince George, British Columbia, Canada	Vice-President, Manufacturing
K. O. Higginbotham .....	Surrey, British Columbia, Canada	Vice-President, Forestry and Environment

D. B. Kayne .....	Tsawwassen, British Columbia, Canada	Vice-President, Wood Products Marketing and Sales
T. Sitar .....	Vancouver, British Columbia, Canada	Vice-President, Finance and Chief Financial Officer
R. W. Stewart .....	Delta, British Columbia, Canada	Vice-President, Human Resources

All of the above directors and officers have had the same or similar principal occupations with the organizations indicated for the last five years except that: prior to July 2007, Mr. Shepard was retired from a 30 year career with Finning International Inc., including nine years as Chief Executive Officer (1991 – 2000); prior to August 2007, Mr. Feldinger held senior management roles in Canfor including Regional Manager, Prince George; Mr. Calabrigo was Vice-President, Human Resources, General Counsel and Corporate Secretary of the Company and prior to July 2003, was General Counsel and Corporate Secretary; prior to August 2007, Mr. Cook held senior management roles in Canfor including General Manager, Value Optimization; Mr. Stewart has 30 years with Canfor including his most recent senior management role as General Manager of Learning and Organizational Development; Mr. Sitar was Chief Financial Officer and Secretary of Canfor Pulp LP (2006 – 2007) and Chief Financial Officer of Gryphon Gold Corporation (2004 – 2006), and had 23 years with Weldwood of Canada Limited including Vice-President Finance (1998 – 2003).

#### **INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS**

To the knowledge of Canfor, no director or executive officer of the Company, or any of their associates, has or had any material interest, directly or indirectly, in any transaction of the Company within the three most recently completed financial years of the Company that has materially affected or will materially affect the Company.

#### **CONFLICTS OF INTEREST**

To the knowledge of the Company, no director or executive officer of the Company has an existing or potential conflict of interest with Canfor.

#### **DESCRIPTION OF CAPITAL STRUCTURE**

The authorized share capital of the Company consists of 1,010,000,000 shares divided into 1,000,000,000 Common Shares without par value and 10,000,000 Preferred shares with a par value of \$25 each. At January 1, 2008 there were 142,589,297 Common Shares issued and outstanding and no Preferred shares issued and outstanding.

Holders of the Common Shares are entitled to vote at all meetings of shareholders of the Company, except meetings at which only the holders of Preferred shares would be entitled to vote. The Common Shareholders are entitled to receive dividends, as and when declared on the Common Shares.

Holders of Preferred shares are not generally entitled as such to receive notice of, or to attend or vote at, general meetings of shareholders of the Company. Preferred shareholders are entitled to preference over the Common Shares with respect to the payment of dividends and upon any distribution of assets in the event of liquidation, dissolution and winding-up of the Company.

Under the plan of arrangement in connection with the spinout of Canfor’s pulp and paper business to Canfor Pulp LP, the previously existing “Common Shares” of the Company were redesignated as “Class A Common Shares”, the authorized capital of the Company was increased to authorize the issuance of up to 1,000,000,000 new Common Shares and special rights and restrictions were added to the redesignated Class A Common Shares. As part of the arrangement, each Canfor shareholder received one Common Share and 0.1 Fund Units in exchange for each Class A Common Share held by them and all of the outstanding Class A Common Shares were then cancelled by the Company. Upon completion of the spinout, Canfor shareholders owned all of the issued and outstanding Common Shares and all of the issued and outstanding Fund Units and the authorized capital of the Company were subsequently reduced to delete the 1,000,000,000 Class A Common Shares, none of which were then issued and outstanding. See “Business of Canfor – General Development”.

## **RATINGS**

The credit rating agency listed below has assigned the following rating to the senior notes issued by Canfor under the February Note Agreement and the April Note Agreement (see “Material Contracts”):

DBRS Ltd. (“DBRS”)	BB (high)	(the fifth ranking category out of ten granted by DBRS for long-term debt)
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A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the rating organization. The foregoing DBRS rating was not requested by Canfor and is based, as specified by DBRS in its rating report, on publicly available information about the Company. Canfor did not participate with or provide information to DBRS in connection with this rating. Accordingly, Canfor cannot comment on the accuracy of the rating or of the appropriateness of the factors considered by DBRS in preparing the rating.

The following information about DBRS credit ratings is taken from publicly available information provided by DBRS on its website. DBRS credit ratings are on a long-term debt rating scale that ranges from AAA to D, which represents the range from highest to lowest quality of such securities rated and is meant to give an indication of the risk that a borrower will not fulfill its obligations in a timely manner. Every DBRS rating is based on quantitative and qualitative considerations relevant to the borrower. According to the DBRS rating system, an obligation rated BB is defined to be speculative and non-investment grade, where the degree of protection afforded interest and principal is uncertain, particularly during periods of economic recession. Entities in the BB range typically have limited access to capital markets and additional liquidity support. In many cases, deficiencies in critical mass, diversification, and competitive strength are additional negative considerations.

The ratings from AA to CCC may be modified by the addition of a high or low modifier to show relative standing within the major rating categories. The lack of one of these designations indicates a rating, which is essentially in the “middle” of the category.

## **DIVIDENDS**

The declaration and payment of dividends is at the discretion of the Company's Board of Directors. There were no dividends paid in 2007 and 2008 on common shares. In 2006 there was an eligible taxable dividend in kind of 1.49 fund units of Canfor Pulp Income Fund for every 10 Common Shares of the Company. The total dividend consisted of 21,239,537 fund units, after taking into account the payment of cash for fractional units.

The amount of dividends the Company is permitted to pay under its term loan agreements is determined by reference to consolidated net earnings less certain restricted payments. As at September 30, 2008, the Company would be permitted under these agreements to pay up to \$213 million or \$1.49 per share in dividends on its Common Shares. The agreements do not restrict payment of dividends on Preferred shares or dividends paid in Common Shares of the Company.

### SHAREHOLDINGS OF DIRECTORS AND EXECUTIVE OFFICERS

At February 19, 2009, the Directors and executive officers of the Company, as a group, beneficially owned, directly or indirectly, or exercised control or direction over, 44,424,593 Common Shares representing approximately 31.2% of the outstanding Common Shares.

At February 19, 2009, James A. Pattison beneficially owned 43,772,110 Common Shares, which are held by companies wholly owned by Mr. Pattison, and represent approximately 30.7% of the outstanding Common Shares of the Company. This amount is included in the calculation of the Directors and executive officers holdings above.

### MARKETS FOR SECURITIES

The Common Shares are listed and traded on the TSX under the symbol CFP. The main operating company is Canadian Forest Products Ltd., from which the name Canfor is derived.

### TRADING PRICE AND VOLUME

The following table presents the high and low closing prices for the Company's Common Shares and the average daily trading volume of those shares, on a monthly basis, on the TSX for 2008.

<b>Month of 2008</b>	<b>High</b>	<b>Low</b>	<b>Average Daily Trading Volume</b>
January	10.26	8.50	359,768
February	10.15	7.99	338,774
March	8.55	7.46	472,920
April	9.05	7.62	235,726
May	9.15	7.55	306,613
June	9.05	7.55	253,541
July	8.01	6.76	216,267
August	10.88	7.60	205,464
September	11.10	8.10	414,399
October	8.77	5.59	408,141
November	7.90	6.35	295,973
December	9.00	6.91	276,833

## SECURITY

The Company's operating lines of credit and term indebtedness are unsecured, except for two operating credit loan facilities (Facility A and B totaling US\$60.4 million described under Material Contracts) for which the ABCP assets of the Company have been pledged as security.

## MATERIAL CONTRACTS

Canfor and Canadian Forest Products Ltd. entered into a revolving credit agreement dated for reference June 8, 2006 with Royal Bank of Canada and other institutional lenders to amend and restate its previous credit facilities and to remove Canadian Forest Products Ltd. as a borrower. This credit agreement provides for an unsecured and committed \$325 million revolving credit facility to replace the previous credit facility of the same aggregate amount. This facility is for a term of five years and provides for floating rates of interest. Effective August 1, 2008, the facility was increased to \$355 million with no change in maturity date.

On January 30 2009, Canfor entered into two new operating loan facilities in the amounts of US\$16.7 million ("Facility A") and US\$43.7 million ("Facility B"). Facility A expires in January 2012, with the option of four one-year extensions, and is non-recourse to Canfor, except for US\$6.7 million. Facility B expires in January 2011, with the option of five one-year extensions, and is non-recourse to Canfor under normal circumstances. The ABCP assets of the Company have been pledged as security to support these credit facilities.

Canfor entered into a note purchase agreement dated February 2, 2004 with The Prudential Investment Management, Inc. and other purchasers providing financing of up to US \$160 million (the "February Note Agreement"). Canfor also entered into a note purchase agreement on April 1, 2004 with John Hancock Life Insurance Company, Investors Partner Life Insurance Company, John Hancock Insurance Company of Vermont and The Maritime Life Assurance Company providing financing of up to US \$75 million (the "April Note Agreement").

On February 4, 2004, Canfor issued US\$50 million of senior notes under the February Note Agreement for general operating purposes and capital expenditures. On April 1, 2004, Canfor issued US \$110 million of senior notes under the February Note Agreement and US \$75 million under the April Note Agreement for the repayment of \$160 million of long term debt existing at the time of acquisition of Slocan Forest Products Ltd. ("Slocan"). Certain of the funds under the February Note Agreement and the April Note Agreement were also used to pay a make-whole payment on Slocan's outstanding indebtedness at the time of acquisition and for general corporate purposes.

The senior notes issued under the February Note Agreement and the April Note Agreement have the following interest rates and maturities: US \$60 million at 5.66% (April 1, 2009), US \$50 million at 6.18% (April 1, 2011), US \$50 million at 6.33% (February 2, 2012), and US \$75 million at 5.42% (April 1, 2013).

All of the foregoing note agreements and credit facility are unsecured but require compliance with certain covenants that could in certain circumstances restrict the ability of Canfor or its subsidiaries to incur additional indebtedness, to encumber or dispose of their assets, or to make certain payments or distributions.

Canfor and Canfor Pulp LP each entered into a number of material contracts in connection with the spinout of the NBSK pulp and paper business by Canfor to Canfor Pulp LP on July 1, 2006, including an Acquisition Agreement, an Exchange Agreement and a Shareholders Agreement. For a description of these contracts see “Pulp and Paper” and the section entitled “The Spinout - Transfer of the Pulp Business and Related Agreements” of the Company’s Information Circular dated April 28, 2006, which is incorporated by reference herein and is available on SEDAR at [www.sedar.com](http://www.sedar.com).

### **CEASE TRADE ORDERS, BANKRUPTCIES, PENALTIES, SANCTIONS**

To the knowledge of the Company, no director or executive officer of the Company is at the date hereof or was within the last 10 years of the date of this Annual Information Form, a director, chief executive officer or chief financial officer of a company that, (i) while acting in that capacity, was subject to a cease trade or similar order or an order that denied the Company access to any exemption under securities legislation for a period of 30 consecutive days; (ii) was subject to an event that resulted, after ceasing to act in such capacity, in a cease trade or similar order or an order that denied the Company access to any exemption under securities legislation for a period of 30 consecutive days. To the knowledge of the Company, no director or executive officer of the Company or a shareholder holding a sufficient number of securities of the Company to materially affect the control of the Company is at the date hereof, or has been within the 10 years before the date of this Annual Information Form, a director or executive officer of a company that, while acting in that capacity, or within a year of ceasing to act in such capacity became bankrupt, made a proposal under legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver or trustee appointed to hold its assets, other than i) Mr. James A. Pattison who, from May 1997 to September 1999, was a director of Livent Inc., which in November 1998 filed for protection from creditors under the *Companies’ Creditors Arrangement Act* (Canada) and in September 1999 filed for protection from creditors under Chapter 11 of the *U.S. Bankruptcy Code* in the United States and ii) Messrs. Bentley, Shepard, Sitar and Calabrigo each of whom were directors and officers of HSPP General Partner during the period of January 29 to February 1, 2008 when HSLP completed a restructuring under the *Companies’ Creditors Arrangement Act* (Canada); or has, within the last 10 years of the date of this Annual Information Form, become bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency, or become subject to or instituted any proceedings, arrangement or compromise with creditors, or had a receiver, receiver manager or trustee appointed to hold the assets of the director, officer or shareholder.

### **EXPERTS**

PricewaterhouseCoopers LLP, Chartered Accountants, of Vancouver, British Columbia are the auditors of the Company. PricewaterhouseCoopers LLP, Chartered Accountants, have reported that they are independent of the Company in accordance with the auditor’s rules of professional conduct in British Columbia, Canada.

### **TRANSFER AGENT AND REGISTRAR**

CIBC Mellon Trust Company is the Company’s transfer agent and registrar with registers of transfers in Vancouver and Toronto.

## AUDIT COMMITTEE INFORMATION

*Audit Committee Terms of Reference – See Appendix A*

### *Composition of Audit Committee*

The Audit Committee is composed entirely of independent directors all of whom are financially literate as defined in Multilateral Instrument form 52-110F1. Mr. Cliff, the Chairman of the Committee is a Chartered Accountant and received a commerce degree from the University of British Columbia. Mr. Selman is a Chartered Accountant and a senior consultant with Wolrige Mahon, a national accounting firm, and is a chartered business valuator. Mr. Korenberg is the Vice-Chairman of the Jim Pattison Group and an adjunct professor of the Faculty of Law, University of British Columbia.

The Audit Committee has adopted a policy for the engagement of non-audit services whereby the external auditor of the Company is not entitled to provide any non-audit services to the Company exceeding \$50,000 in value without the Audit Committee Chairman's prior approval and any such services exceeding \$100,000 are to be approved by the Audit Committee. All such engagements are reported to the Audit Committee.

### *External Auditor Service Fees (By Category)*

The aggregate fees billed by PricewaterhouseCoopers LLP, the auditor of the Company for the last two years, was \$2,626,000. This entire amount was for audit, tax and financial services.

<b>External Auditor Service Fees</b>	<b>2008</b>	<b>2007</b>
Audit <sup>(1)</sup>	\$895,000	\$1,005,000
Audit Related Fees <sup>(2)</sup>	125,000	184,000
Tax Fees <sup>(3)</sup>	191,000	214,000
Other Fees <sup>(4)</sup>	N/A	12,000
<b>Total Fees</b>	<b>\$1,211,000</b>	<b>\$1,415,000</b>

- (1) For the audit of the Company's annual financial statements and services normally provided by the principal auditor in connection with the Company's statutory and regulatory filings.
- (2) For assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements and are not reported in (1), including accounting consultations and various agreed upon procedures.
- (3) For tax compliance services.
- (4) For tax and other consulting services other than the fees reported in (1) to (3).

## ADDITIONAL INFORMATION

Additional financial information regarding Canfor is provided in the Company's "2008 Management's Discussion and Analysis" and "Consolidated Financial Statements" for the year ended December 31, 2008, which is incorporated by reference herein. Additional information, including Directors' and Officers' remuneration and indebtedness, principal holders of the Company's securities, options to purchase securities and interests of insiders in material transactions, where applicable, and securities authorized for issuance under equity compensation plans, is contained in the Information Circular for the Annual General and Special Meeting of the Company held on May 4, 2008 and in the Information Circular for the Annual General Meeting of the Company to be held on April 30, 2009.

The Company will provide upon request to the Secretary of the Company, 100-1700 West 75<sup>th</sup> Avenue, Vancouver, British Columbia V6P 6G2:

- a) at no cost when the securities of the Company are in the course of a distribution under a short form prospectus or a preliminary short form prospectus,
  - (i) one copy of this Annual Information Form, together with one copy of any document, or the pertinent pages of any document, incorporated by reference in this Annual Information Form;
  - (ii) one copy of the comparative financial statements of the Company for its most recently completed financial year together with the accompanying report of the auditor and one copy of any interim financial statements of the Company that have been filed, if any, for every period subsequent to the financial statements for its most recently completed financial year;
  - (iii) one copy of the Information Circular of the Company in respect of its most recent annual meeting of shareholders that involved the election of Directors or one copy of any annual filing prepared in lieu of that Information Circular, as appropriate, and;
  - (iv) one copy of any other documents that are incorporated by reference into the preliminary short form prospectus or the short form prospectus and are not required to be provided under (i) to (iii) above; or
- b) at any other time, one copy of any other documents referred to in (a)(i), (ii) and (iii) above, provided the Company may require the payment of a reasonable charge if the request is made by a person who is not a security holder of the Company.

Additional information about Canfor is available on SEDAR (System for Electronic Document Analysis and Retrieval) at [www.sedar.com](http://www.sedar.com). In addition, all documents identified in this Annual Information Form as being incorporated by reference herein are available on SEDAR at [www.sedar.com](http://www.sedar.com).

## **APPENDIX A – AUDIT COMMITTEE TERMS OF REFERENCE**

### **1. Purpose**

The Audit Committee is appointed by the Board to assist the Board in fulfilling its oversight responsibilities. The Audit Committee will:

- (a) Review the financial reports and other financial information provided by the Company to its shareholders;
- (b) Monitor the integrity of the financial reporting process and the system of internal controls that management and the Board have established;
- (c) Monitor the management of the principal risks that could impact the financial performance of the Company;
- (d) Review and receive the Audit Plan, process, results and performance of the Company's independent external auditors and the Internal Audit department while providing an open avenue of communication between the external auditors, the internal auditors, management and the Board; and
- (e) Monitor the management of risk by the Company generally.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities and it has direct access to the external auditors as well as anyone in the organization. The Audit Committee has the authority to retain, at the Company's expense, special legal, accounting and other consultants or experts it deems necessary in the performance of its duties.

### **2. Audit Committee Composition and Meetings**

All members of the Audit Committee must be Independent Directors.

All Audit Committee members must be financially literate with the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements. At least one Audit Committee member should have accounting or related financial expertise, including:

- An understanding of financial statements and accounting principles used by the Company to prepare its financial statements;
- The ability to assess the general application of such accounting principles in connection with accounting for estimates, accruals and reserves;
- Experience preparing, auditing, analyzing or evaluating financial statements, or experience supervising the preparation, audit, analysis or evaluation of financial statements, that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements;

- An understanding of internal controls and procedures for financial reporting; and
- An understanding of audit committee functions.

On an annual basis the Board shall appoint a Chair from among the members of the Audit Committee.

The Audit Committee shall schedule regular meetings and shall meet at least four times annually, or more frequently as deemed necessary by the Chair. The Chair shall prepare and/or approve an agenda in advance of each meeting. The Audit Committee shall meet privately at least annually with management, the director of the Internal Audit department and the external auditors to discuss any matters that the Audit Committee or each of these groups believe should be discussed.

The Chief Executive Officer, the Chief Financial Officer, the Director, Internal Audit (“the Internal Auditor”) and the external auditors shall be given notice of, and have the right to appear before and to be heard at, every meeting of the Audit Committee, and shall appear before the Audit Committee when requested to do so by the Committee.

### **3. Primary Duties and Responsibilities**

To fulfill its primary duties and responsibilities, the Audit Committee shall adhere to the following terms:

#### **(a) Review and Reporting Procedures**

- (i) The Audit Committee is authorized to review and/or investigate any financial, internal control, or risk management related issue or activity of the Company. The Audit Committee shall report to the Board at its next regular meeting all such action it has taken since the previous report.
- (ii) The Audit Committee is authorized to request the presence, at any meeting, of a representative from the external auditors, senior management, internal audit, legal counsel or anyone else who could contribute to the subject of a meeting.
- (iii) The Audit Committee will review and reassess these Terms of Reference at least annually to determine whether revisions are necessary. The Audit Committee shall periodically self-assess its performance and effectiveness in fulfilling its role.
- (iv) Supporting schedules and information reviewed by the Committee will be available for examination by any director of the Audit Committee upon request to the Secretary of the Audit Committee.

#### **(b) Internal Controls and Risk Management Processes**

- (i) To assure itself that the Company has appropriate controls in place to achieve the following objectives:
  - Effectiveness and efficiency of operations (including safeguarding of assets);
  - Reliability of internal and external reporting;
  - Compliance with applicable laws and regulations and internal policies.

(ii) To ensure the Company has appropriate processes in place to manage the principal risks of its businesses, the Audit Committee shall:

- Consider and review internal processes for managing the principal risks of the Company's businesses, including a review of insurance coverage.
- Obtain assurance from both management and the Internal Auditor regarding the adequacy of risk management processes.
- Review with management, Internal Auditor and the external auditor:
  - The adequacy of the Company's internal controls including computerized information systems, controls and security.
  - Any related significant internal control findings and recommendations of the external auditor and/or Internal Auditor together with management's responses thereto.
  - The Company's compliance or adherence to debt covenants terms or conditions.

(c) **Financial Reporting**

In order to satisfy itself that the Company's annual financial statements are fairly presented in accordance with generally accepted accounting principles ("GAAP") and in a form sufficient for the Audit Committee's recommendation for approval by the Board, and that the financial information contained in the Company's financial statements, Annual Report to Shareholders, Annual Information Form and other financial disclosure documents such as Management's Discussion and Analysis, is complete and accurate in all material respects, the Audit Committee shall:

(i) General

- Review significant accounting and reporting issues, including recent professional and regulatory pronouncements, and understand their impact on the financial statements.

(ii) Interim Financial Statements

- Review the Company's interim financial statements with management prior to their release or distribution. This review will include a detailed reporting of quarterly and year-to-date results, variance against budget and prior year and a discussion with the external auditor. Upon satisfactory completion of the review, the Audit Committee shall recommend to the Board approval of the financial statement release.
- Review any significant proposed changes to the Company's accounting principles or policies, or financial reporting practices.
- Review the financial statement impact of any significant, unusual event or transaction.
- Review news releases containing financial information disclosure and Management's Discussion and Analysis.

(iii) **Annual Financial Statements and Other Financial Information**

- Obtain draft annual financial statements in advance of the Committee meeting and assess, on a preliminary basis, the reasonableness of the financial statements in light of the analyses provided by management.
- Review any material changes in accounting policies, GAAP, or financial reporting requirements that may affect the current year's financial statements.
- Obtain and review summaries of significant or unusual transactions, and other potentially complex matters whose treatment in the annual financial statements merits advance consideration.
- Review a summary provided by the Company's legal counsel of the status of any material pending or threatened litigation, claims and assessments.
- Review and discuss the annual financial statements and the external auditor's report thereon in detail with management and the external auditors.
- Through discussion with management, the Internal Auditor and the external auditors, obtain assurance that the risk of material misstatement of the financial statements is acceptably low.
- Review the financial information included in the Management's Discussion and Analysis, and consider whether the information is adequate and consistent with the Audit Committee members' knowledge of the Company.
- Review the tax status of the Company and understand the status of any related tax reserves, potential reassessments or other matters, which could affect the annual financial statements.
- Review and assess the quality and appropriateness of the Company's accounting and reporting principles and policies.
- Provide to the Board a recommendation as to whether the annual financial statements should be approved.
- Review the news release announcing the annual financial results of the Company.
- Review the annual financial disclosure contained in the Annual Information Form.

(iv) **Prospectus and Information Circular**

- Review the financial information included in any prospectus or information circular prior to their release and, as appropriate, recommend to the Board whether such prospectus or information circular should be approved by the Board.

(d) **External Audit**

The external auditors are accountable to the Audit Committee and the Board as representatives of the shareholders.

In order to assure itself that the external audit function has been effectively carried out and that any matters that the external auditors consider appropriate to bring to the attention of the Board have been addressed, the Audit Committee shall:

- (i) Recommend to the Board the selection (retention or replacement) of the external auditors, considering independence and effectiveness, and approve the fees and other compensation to be paid to the external auditors. On an annual basis, the Audit Committee should review and discuss with the external auditors all significant relationships its accountants have with the Company to confirm their independence. If there is a recommendation to change auditors, review all the issues to change and the steps planned for an orderly transition.
  - (ii) Review the external auditor's Audit Plan and engagement letter with management and the external auditors, including audit scope and approach.
  - (iii) Meet with the external auditor and management in separate private sessions to discuss any matters that the Audit Committee or these groups believe should be discussed privately with the Audit Committee.
  - (iv) Review any non-audit services that have been rendered by the external auditor.
  - (v) Review and assess the performance of the external auditor, including consideration of demonstrated external audit judgment and application and adherence to accounting policy and standards.
  - (vi) Review the external auditor's policy on partner rotation.
- (e) **Internal Audit**

In order to assure itself that the internal audit function has been effectively carried out and that any matter that the Internal Auditor considers appropriate to bring to the attention of the Board has been addressed, the Audit Committee shall:

- (i) Be advised of and concur with the appointment, replacement, reassignment or dismissal of the Internal Auditor and consider resource requirements.
- (ii) Review and approve Internal Audit Terms of Reference, including scope, organization structure and mandate.
- (iii) Confirm and assure the independence of the Internal Auditor.
- (iv) Review jointly with the Internal Auditor and the external auditor the coordination of audit effort to assure completeness of coverage, reduction of redundant efforts, and the effective use of audit resources.
- (v) Review with management and the Internal Auditor the annual Audit Plan and monitor any changes required in the scope of the plan.

- (vi) Meet with the Internal Auditor and management in separate private sessions to discuss any matters that the Audit Committee or these groups believe should be discussed privately with the Audit Committee.
- (vii) Review significant internal audit reports together with management's response and follow-up actions, including any problems or issues encountered in the course of an audit.
- (viii) Review and assess the performance of the Internal Auditor.

(f) **Finance**

The Audit Committee is authorized to review and approve for recommendation to the Board:

- (i) the Company's annual financing plan and any amendments thereto from time to time;
- (ii) any proposed financings;
- (iii) the method by which the Company measures financial results or performance.

**4. Other Duties**

(a) **Legal and Regulatory Compliance**

To provide assurance of Company compliance with all legal and regulatory requirements, the Audit Committee shall:

- (i) In areas in which it has oversight responsibility, monitor the Company's compliance and obtain management's assurance of compliance with applicable laws, regulations and internal policies in all jurisdictions where the Company does business. The Audit Committee will consider the financial statement implications of applicable laws and regulations, including the laws and regulations overseen by other Committees of the Board.
- (ii) Receive and review copies of legal letters provided to the external auditors by in-house and outside counsel regarding claims and possible claims against the Company.
- (iii) Make inquiries of management, the external auditors and Internal Auditor, to ensure that all material legal matters have been brought to the attention of the Audit Committee.
- (iv) On at least an annual basis, review with the Company's counsel any legal matters that could have a significant impact on the organization's financial statements or risk profile, the Company's compliance with applicable laws and regulations, and inquiries received from regulators or governmental agencies.
- (v) Ensure that all annual and interim financial statement filings are personally certified by the Chief Executive Officer and the Chief Financial Officer if and as required by applicable law.

(b) **Officer Expenses**

Review policies and procedures with respect to the Chairman of the Board and President and Chief Executive Officer's expense accounts and perquisites, including the use of corporate assets.

Periodically review major expenses incurred by the office of the Chairman of the Board and President and Chief Executive Officer.

(c) **Other Duties**

The Audit Committee will perform such other functions as assigned by law or regulation or as required by the Board.

The Audit Committee will receive reports from the Canfor Pulp Holding Inc. audit committee at such times that the Chairman considers appropriate, detailing such matters, issues and circumstances of a financial nature that may impact the Company or be of interest to the Audit Committee.