2011 MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the year ended December 31, 2011 relative to the year ended December 31, 2010, and the financial position of the Company at December 31, 2011. It should be read in conjunction with Canfor's Annual Information Form and its audited consolidated financial statements and accompanying notes for the years ended December 31, 2011 and 2010. The financial information contained in this MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which as of January 1, 2011 is the required reporting framework for Canadian publicly accountable enterprises.

Throughout this discussion, reference is made to EBITDA (calculated as operating income before amortization) which Canfor considers to be an important indicator for measuring trends in the performance of each of its operating segments and the Company's ability to generate funds to meet its debt repayment and capital expenditure requirements. Reference is also made to Adjusted Shareholder Net Income (Loss) (calculated as Shareholder Net Income (Loss) less specific items affecting comparability with prior periods – for the full calculation, see reconciliation included in the section "Overview of Consolidated Results – 2011 Compared to 2010") and Adjusted Shareholder Net Income (Loss) per Share (calculated as Adjusted Shareholder Net Income (Loss) divided by the weighted average number of shares outstanding in the period). EBITDA, Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share are not generally accepted earnings measures and should not be considered as an alternative to net income or cash flows as determined in accordance with IFRS. As there is no standardized method of calculating these measures, Canfor's EBITDA, Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of EBITDA and Adjusted Shareholder Net Income (Loss) to net income (loss) reported in accordance with IFRS are included in this MD&A.

Factors that could impact future operations are also discussed. These factors may be influenced by known and unknown risks and uncertainties that could cause the actual results to be materially different from those stated in this discussion. Factors that could have a material impact on any future oriented statements made herein include, but are not limited to: general economic, market and business conditions; product selling prices; raw material and operating costs; currency exchange rates; interest rates; changes in law and public policy; the outcome of labour and trade disputes; and opportunities available to or pursued by Canfor.

2010 prior period comparative financial information throughout this report has been restated, and is shown in accordance with IFRS. All financial references are in millions of Canadian dollars unless otherwise noted. The information in this report is as at February 8, 2012.

<u>Forward Looking Statements</u>

Certain statements in this MD&A constitute "forward-looking statements" which involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from any future results, performance or achievements expressed or implied by such statements. Words such as "expects", "anticipates", "projects", "intends", "plans", "will", "believes", "seeks", "estimates", "should", "may", "could", and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are based on management's current expectations and beliefs and actual events or results may differ materially. There are many factors that could cause such actual events or results expressed or implied by such forward-looking statements to differ materially from any future results expressed or implied by such statements. Forward-looking statements are based on current expectations and the Company assumes no obligation to update such information to reflect later events or developments, except as required by law.

COMPANY OVERVIEW

Canfor is a leading Canadian integrated forest products company based in Vancouver, British Columbia ("BC"), involved primarily in the lumber business, with production facilities in BC, Alberta, Quebec and the United States. Canfor also has a 50.2% interest in the pulp and paper business of Canfor Pulp Limited Partnership ("Canfor Pulp"), a 50% interest in the oriented strand board ("OSB") business of Peace Valley OSB and owns a bleached chemi-thermo mechanical pulp ("BCTMP") mill ("Taylor pulp mill"), all located in BC.

Canfor employs approximately 3,410 people in its wholly owned subsidiaries and 1,320 in jointly owned operations for a total of 4,730 employees.

Lumber

Canfor's lumber operations have a current annual production capacity of approximately 4.8 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 significant proportion of Canfor's lumber production is comprised of specialty products that command premium prices, including Square Edge lumber for the North American market, J-grade lumber for the Japanese market, and machine stress rated ("MSR") lumber used in engineered applications such as roof trusses and floor joists.

Canfor's lumber operations also include a lumber remanufacturing facility, a finger-joint plant, two lumber treating plants, a whole-log chipping plant and a trucking division. The lumber business segment also includes a 60% interest in Houston Pellet Limited Partnership, which has an annual capacity of approximately 220,000 tonnes of wood pellets.

Canfor holds approximately 10 million cubic metres of annual harvesting rights for its solid wood operations under various forest tenures located in the interior region of BC and northern Alberta, and harvests logs from those tenures to supply its interior lumber operations. Any shortfalls in mill requirements are made up with wood purchased from those areas. Operations in Quebec and North and South Carolina mostly purchase logs.

Canfor markets lumber products throughout North America and overseas, through its sales offices in Vancouver, Canada, Myrtle Beach, U.S., Tokyo, Japan and Shanghai, China. In addition to its own production, Canfor also markets lumber produced externally to complement its product line. While a significant proportion of Canfor's product is sold to markets in the United States, the proportion of shipments to offshore markets, particularly China, has risen significantly in recent years. The Company ships substantially all lumber destined for North America by truck and rail, while the vast majority of product sold offshore is transported by container ship.

Pulp and Paper

Canfor's Pulp and Paper segment is comprised of the Canfor Pulp and Taylor pulp mill operations, all of which are located in BC. Canfor Pulp produces northern bleached softwood kraft ("NBSK") pulp and specialty paper. NBSK pulp is primarily a bleached product, although unbleached and semi-bleached grades are also produced at the Prince George Pulp and Paper mill.

The Canfor Pulp mills have the capacity to produce over one million tonnes of pulp annually. Over 200,000 tonnes of BCTMP per year can be produced at the Taylor pulp mill. Canfor Pulp's paper machine, located at the Prince George Pulp and Paper mill, has an annual production capacity, at optimum product mix levels, of 140,000 tonnes of kraft paper.

Canfor supplies Canfor Pulp with residual wood chips and hog fuel (principally bark) produced at certain of its specified sawmills in the Prince George region. Prices paid by Canfor Pulp for residual wood chips are based on a pricing formula to reflect market prices and conditions, with hog fuel purchased by Canfor Pulp at market prices. Canfor Pulp also has fibre supply agreements with third parties to supplement its supply of wood chips and hog fuel.

All pulp produced by Canfor Pulp and the Taylor pulp mill is sold by Canfor Pulp's sales offices in Vancouver, Canada, Brussels, Belgium, and Tokyo, Japan, to customers, primarily in North America, Europe and Asia. The significant majority of product sold to North America is shipped by rail, while product sold overseas is transported by container or breakbulk vessels.

Other Operations

The Company's only currently operating panels facility is the Peace Valley OSB plant in Fort St. John, BC, which is jointly owned with Louisiana-Pacific Canada Ltd. The Peace Valley OSB mill has an annual capacity of approximately 820 million square feet (3/8" basis). OSB production 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. Canfor also owns an OSB plant ("PolarBoard"), which is currently indefinitely idled, and a plywood plant ("Tackama") which was closed in December 2011.

Business Strategy

Canfor's general business strategy is to be a lumber industry leader with top-quartile financial performance, accomplished through:

- Achieving and maintaining a low cost structure,
- Optimizing the extraction of high-margin products and value from its available fibre sources,
- Expanding geographical markets, increasing market share of value-added products and building strong long-term partnerships with valued customers,
- Positioning the Company as a leading supplier of green, environmentally friendly building products,
- Attaining world class supply chain performance,
- Maintaining a strong financial position,
- Fully engaging employees and utilizing their experience and expertise to maximize performance, and
- Capitalizing on attractive growth opportunities.

Canfor is focused on being the preferred supplier of lumber to the building industry around the world, with a particular focus on North America and Asia. The Company is committed to being a major supplier to the retail segment of lumber consumption and expanding its presence in key offshore markets, including China and Japan. This objective includes making higher value structural lumber and specialized products to cater to specific customer requirements.

Canfor Pulp, which on a day-to-day basis operates under a separate Board of Directors and senior management structure, has the following business strategies:

- Preserving its low-cost operating position,
- Maintaining the premium quality of its products, and
- Opportunistically acquiring high quality assets.

OVERVIEW OF 2011

On balance, 2011 was yet another tough year for lumber markets, as the struggles of the U.S. economy and the challenged housing sector continued to weigh heavily on North American lumber markets. Not unlike the previous year, this was tempered by the continued strong growth of shipments of Western SPF (Spruce/Pine/Fir) products to Asia, particularly China. Overall, the North American benchmark Western SPF 2x4 price was little changed from the previous year; however lumber operating results declined, mostly as a result of weaker pricing for other grades and dimensions, a stronger Canadian dollar and upward log cost pressures in the year.

The Company continued to position itself for the anticipated improvement in lumber markets in the coming years, with targeted capital spending at many of its key operations designed to drive down operating costs, significantly reduce the Company's reliance on fossil fuels and increase product values. These included capital upgrades at the Company's Vavenby mill in advance of its reopening in September 2011 after being idled for more than two years. Results to date from these capital initiatives have been encouraging. Another positive development was the Company's agreement in November 2011 to acquire sawmill and timber license assets in south-east BC from Tembec Industries Ltd. This acquisition is very well aligned with the Company's fibre, operating and marketing strategies and is scheduled to close late in the first quarter of 2012.

Late in the year, the Company announced the closures of its Rustad sawmill and Tackama plywood mill, in early 2012. The continued challenging market conditions and investment required to make these operations competitive, as well as the availability of a secure long-term fibre supply, were significant factors behind these difficult decisions.

Operating results for the pulp and paper segment declined from the previous year, as the stronger Canadian dollar, higher unit manufacturing costs and lower shipment volumes more than offset higher average US dollar prices. The increased unit costs and lower shipments were largely attributable to a major recovery boiler upgrade at Canfor Pulp's Northwood pulp mill which was completed in the fourth quarter of 2011, a project that was mostly funded under the Canadian Federal Government's Green Transformation Program.

The Company continued with its strong focus on cash management in 2011, paying close attention to efficient working capital management and delivering on its capital investment, both in terms of being on-time and on-budget and achieving targeted savings. The Company remains in a sound financial position, ending 2011 with cash of approximately $29 million, available operating lines of credit of $415 million and a net debt to total capitalization of 13.4%.

A review of the more significant developments in 2011 follows.

Markets and Pricing

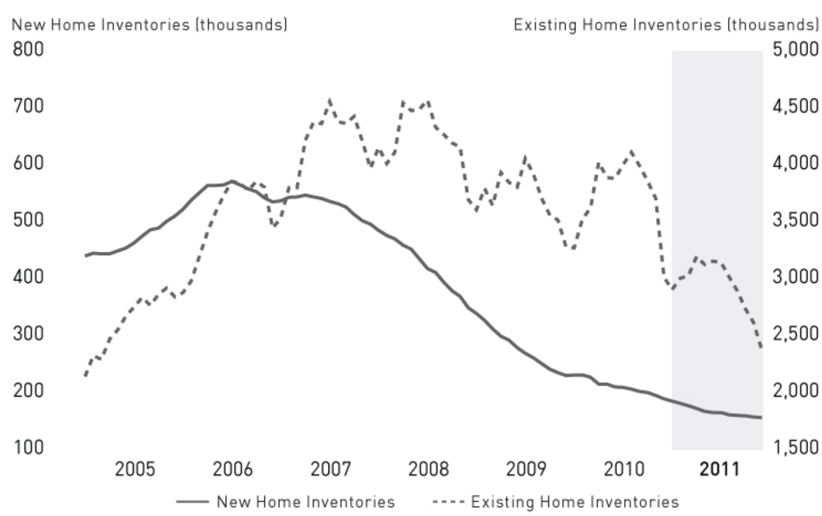
(i) Solid Wood - North American housing sectors and prices flat; Asian lumber demand continues to grow

Lumber demand in North America remained at depressed levels through 2011, showing few signs of any imminent sustained recovery. However, demand from Asia remained strong, despite some softening of demand from China late in the year. Benchmark lumber prices for SPF products saw little change from the previous year, while average prices for Southern Yellow Pine ("SYP") products saw moderate declines.

The U.S. economy continued to struggle in 2011, against a backdrop of continued high foreclosure levels and high unemployment rates, as well as low consumer confidence. Sales of new and existing homes stabilised somewhat in 2011, after seeing big declines in 2010, albeit with volumes remaining at historically-low levels. Levels of existing home inventories reduced significantly in the second half of the year (as highlighted in Chart 1), though it is expected that significant levels of shadow home inventories (homes in default of their mortgages but not currently actively for sale in the market) exist and will have to be worked through before any sustainable housing recovery takes place.

Chart 1

NEW AND EXISTING HOME INVENTORIES IN U.S.

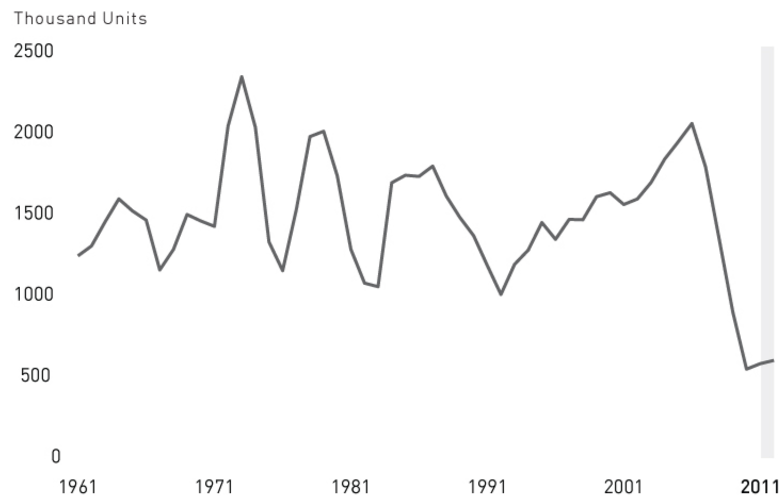


Source: National Association of Home Builders.

Total U.S. housing starts edged up modestly in 2011, with 607,000 starts[1] in the year compared to 587,000 in 2010. Despite the positive trend, housing starts remain approximately 40% below troughs in previous downturns over the last 60 years (Chart 2). In addition, starts for single family units, which use a higher proportion of lumber, actually decreased by 9% in 2011 to 429,000 units, a new record-low. This reduction in single family starts was more than offset by increased starts for multifamily units, which were up more than 50% to 178,000 units, the latter reflecting both greater home affordability and more rental units. Residential remodeling spending saw little change from the previous year.

Chart 2

U.S. HOUSING STARTS



Source: U.S. Bureau of the Census

The Canadian housing market had a slow start to the year reflecting a seasonal slowdown and concern over housing affordability in some regions. However, the sector picked up in the second half of 2011 with seasonally adjusted housing starts reaching their highest level for three years, before falling off slightly as the year came to a close (Chart 3). For the year as a whole, housing starts were at 193,000 units[2], up slightly from 2010.

Chart 3

CANADIAN HOUSING STARTS

Source: Canada Mortgage and Housing Corporation

[1] Source: U.S. Bureau of the Census

[2] Canada Mortgage and Housing Corporation ("CMHC")

While lumber demand in North America remained mostly flat through the year, further positive signs were evident from Asian markets. Lumber shipments to China saw strong growth from the previous year, and shipments to other offshore markets remained solid.

The strong growth of demand from China can be attributed to several factors including:

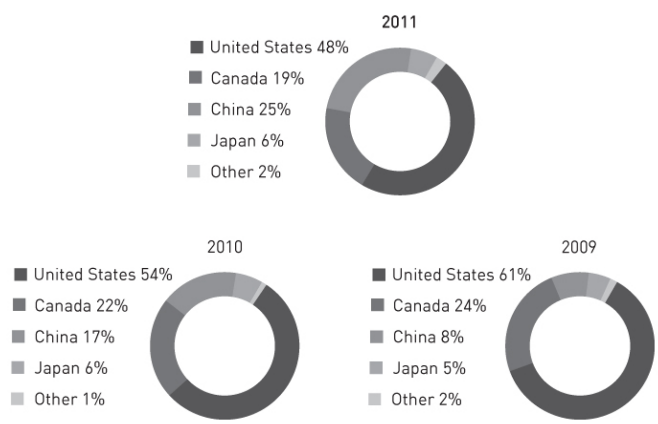
- The continued rapid growth of the Chinese economy and expanding need for urban housing;
- China's increased use of Western Canadian SPF lumber due to economic, environmental and supply concerns related to timber sourced from Russia (traditionally a major supplier to China); and
- Increased acceptance of SPF products, in part reflecting the successful efforts by the BC provincial government and forestry industry leaders, in which Canfor played a prominent role, to promote wood-frame construction and BC lumber products.

Demand for SPF products from China softened somewhat towards the end of the year as orders slowed in advance of the Lunar New Year early in 2012, and construction activity eased as the Chinese government sought to control overall economic growth. While the Company's shipments to China held up despite these factors, prices for low grade lumber, which represents a significant portion of Chinese demand, fell off in the fourth quarter.

The shift in the Company's geographical sales mix is highlighted in Chart 4, which shows the reduced reliance on the U.S. market as a result of the growth of Asian markets over the last three years.

Chart 4

CANFOR'S LUMBER SALES VOLUMES BY MARKET



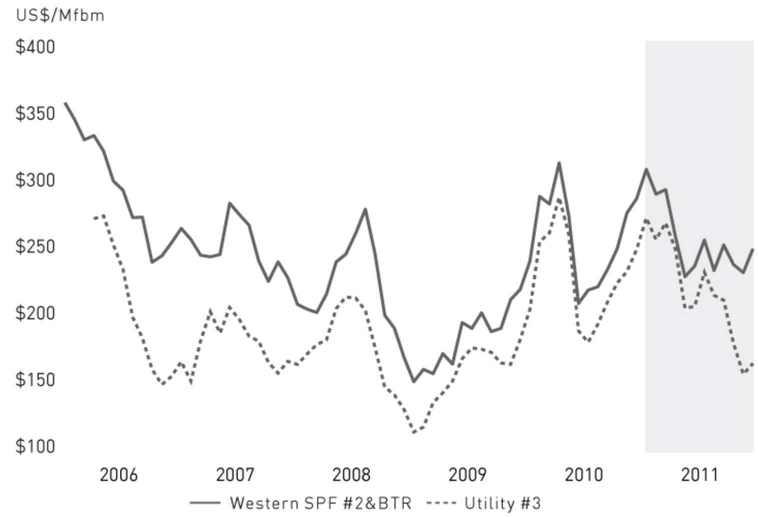
The benchmark Western SPF 2x4 #2 & Better grade ("#2&Btr") price started the year at over US$300 per thousand board feet ("Mfbm")[3], but dropped off sharply before stabilizing at closer to US$250 per Mfbm. The average benchmark price for the 2011 year was substantially unchanged from 2010 at US$255 per Mfbm. However, prices for other dimensions and grades were mixed. For lower grade lumber in particular, prices started the year strong but dropped off towards the end of the year, averaging approximately 5% lower than the levels seen in 2010 overall, partly due to increased demand for #2&Btr product from China.

Traditionally China has consumed low grade lumber products (#3 and Economy grades) for concrete forming, scaffolding and remanufacturing. This strong appetite for low grade lumber favourably impacted prices for these grades of product in North America in 2010 and the first half of 2011, narrowing the traditional price spreads between #2&Btr and #3. During 2011, the volume of #2&Btr grade shipped to China continued to increase reflecting both an increasing use of lumber for construction purposes and the low spreads between #2&Btr and #3 lumber, which make the higher grade lumber more attractive. This trend to higher-value product, coupled with slower construction activity later in the year, saw spreads between #2&Btr and #3 products widen again towards the end of 2011, as shown in Chart 5.

[3] Random Lengths Publications, Inc.

Chart 5

WESTERN SPF 2X4 #2&BTR AND UTILITY #3 LUMBER PRICE COMPARISON



Source: Random Lengths Publications Inc.

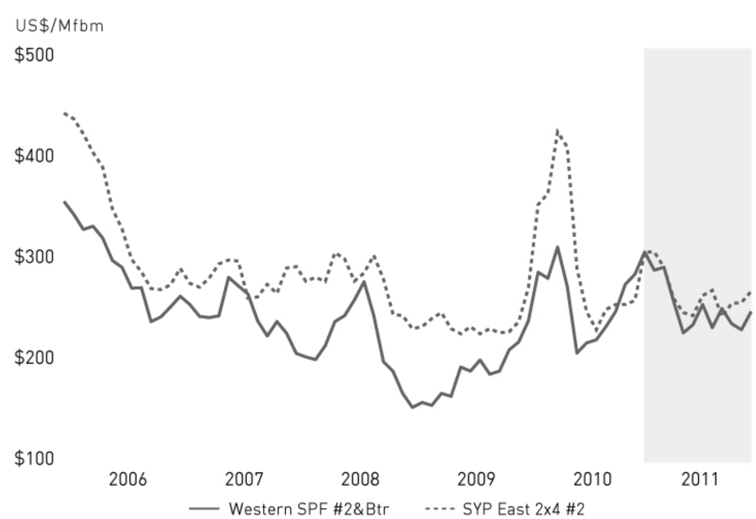
The Canadian dollar strengthened against the US dollar in 2011, trading above par up until late in the third quarter when it dropped back down in response to concerns in global financial markets. On average the Canadian dollar was at $1.011[4], 4 cents, or 4%, higher than in 2010, which negatively impacted sales realizations for all Canadian-produced products.

The benchmark 2x4 #2 price for SYP lumber in 2011 was down 11% compared to 2010 at US$268 per Mfbm. SYP prices broadly tracked Western SPF prices in the year, falling from highs of over US$300 per Mfbm at the start of the year before stabilizing in late spring (Chart 6). This was in contrast to 2010, when SYP prices saw sharp rises in the first half of the year, fuelled in part by weather-related log supply constraints, before declining in the second half of the year. Wider dimensions of SYP products saw larger price declines, in particular 2x12 product where the Random Lengths price was down 24%, and average prices for most wider dimensions traded at discounts to 2x4 #2 lumber.

Higher freight costs had a negative impact in 2011 compared to 2010, reflecting increased fuel charges in the year, as well as higher rates for shipping by truck and rail.

Chart 6

U.S. WESTERN SPF 2X4 #2&BTR AND SYP EAST #2 LUMBER PRICE COMPARISON



Source: Random Lengths Publications Inc.

[4] Bank of Canada

Markets for OSB remained depressed through 2011, with demand reflecting the continued housing downturn in the U.S. Prices for OSB products averaged US$186 per thousand square feet ("Msf")[5] for the 2011 year, down US$35 per Msf, or 16%, from the prior year. (Prices in 2010 benefited from a supply-driven price rally in the early part of that year, during which prices peaked at US$395 per Msf in mid-May. Thereafter, a steep decline in buying saw prices drop off sharply and they have generally remained below US$200 per Msf since then.)

(ii) Pulp - Strong demand / tight inventories support high prices; markets soften towards end of year

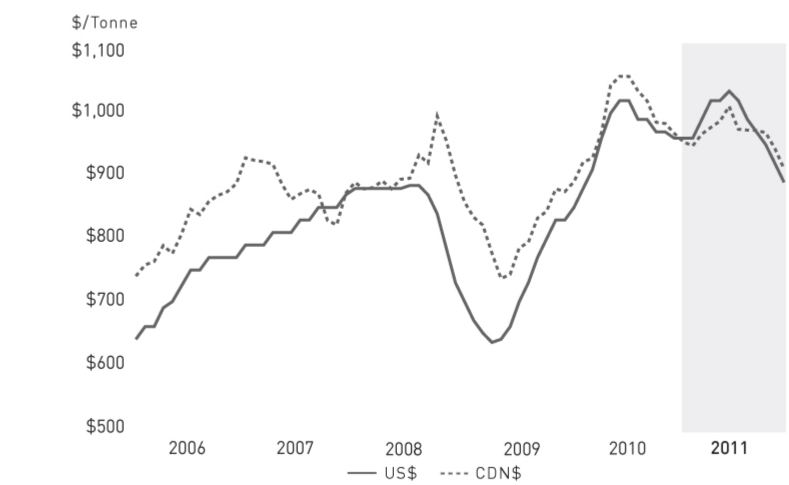
2011 was another strong year for pulp markets, with inventories held by producers and customers at low levels coming into the year. Similar to the previous year, NBSK pulp market prices in 2011 saw successive price increases through the first half of the year, reaching a new record level in June of 2011. Increasing inventory levels and softening demand subsequently led to prices falling through the second half of the year.

The benchmark North American list price for NBSK pulp averaged US$977 per tonne[6] for 2011, up US$17, or 2%, from the prior year. Similar price increases were seen for prices to Europe and China. BCTMP prices, however, averaged slightly lower in 2011 than in 2010. Similar to solid wood products, Canadian dollar sales realizations were negatively impacted by the stronger Canadian dollar in 2011 versus 2010, and pulp realizations were also negatively impacted by deeper discounts from list prices in 2011 versus 2010.

The following charts show the NBSK price movements in 2011 (Chart 7) and the global pulp inventory levels (Chart 8), with prices falling as inventories rise into the second half of the year.

Chart 7

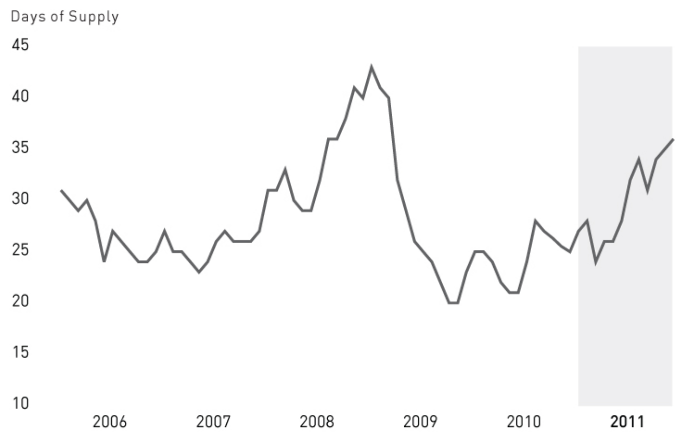
NBSK PULP LIST PRICE DELIVERED TO U.S. - IN US AND CANADIAN DOLLARS



Source: Rescource Information Systems Inc.
Note: Canadian price is calculated at the US price multiplied by the average monthly exchange rates per the Bank of Canada.

[5] Oriented Strand Board, North Central price, 7/16" (Source – Random Lengths Publications, Inc.)
[6] Resource Information Systems, Inc.

Chart 8
WORLD SOFTWOOD PULP INVENTORIES



Source: Pulp and Paper Products Council

Solid Wood Operations

(i) Company achieves "organic" and external growth; Strategic capital spending in 2011 delivering targeted benefits

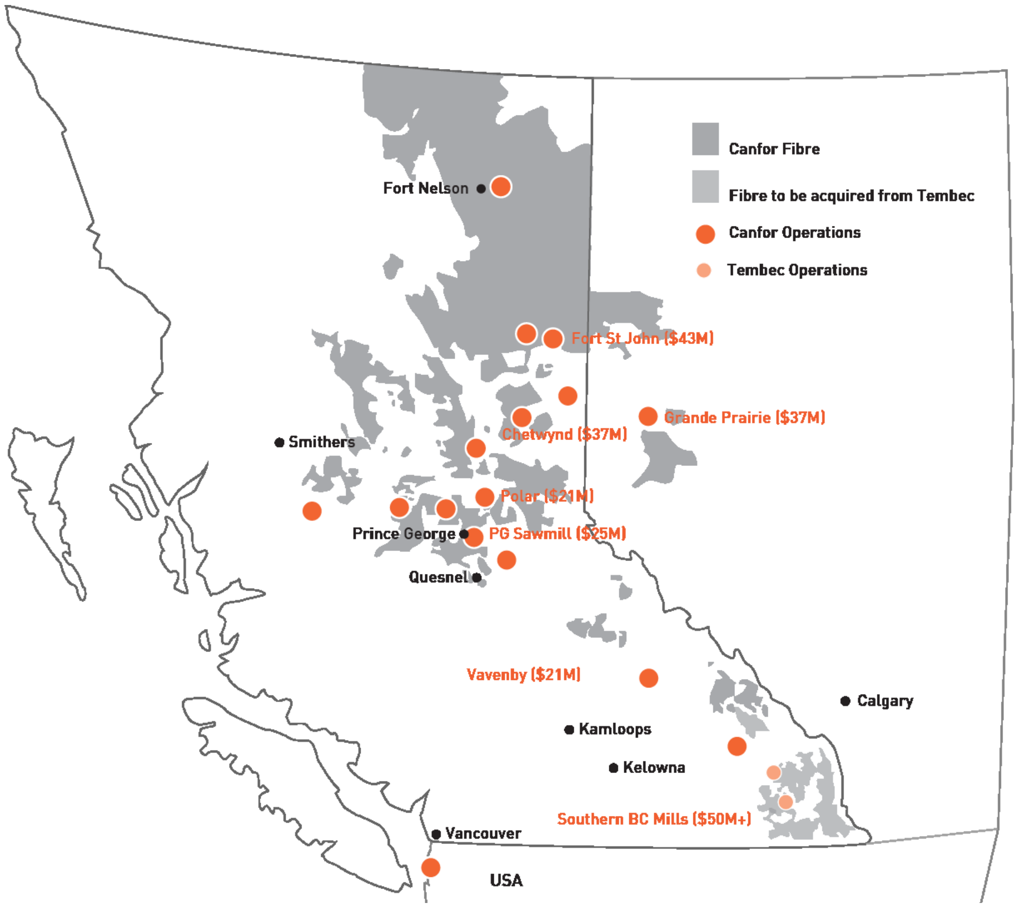
The Company continues to have confidence in the longer-term prospects of the lumber industry and is investing in various strategic programs to position itself as a top-quartile performer ahead of the lumber market recovery. The Company is currently engaged in a three year, $300 million capital expenditure program at its sawmills designed to ensure top tier competitiveness of these operations. Targeted capital investments have been made at many of the Company's strategic operations to improve the Company's productivity and cost position, and improve the quality and value of the Company's products. The Company has significantly reduced its consumption of natural gas and is now energy self-sufficient at almost all of its operations. At the end of 2011, the Company had completed approximately two thirds of its $300 million capital expenditure program.

2011 also saw the restart of another previously idled sawmill operation. The Company's Vavenby sawmill, which had been idle since mid-2009, was upgraded during 2011 and recommenced operations on one shift in September 2011 before moving to two shifts soon after year-end. This restart followed successful restarts in 2009 and 2010 of the Company's upgraded Mackenzie and Chetwynd sawmills; both these mills operated on two shifts through 2011 and delivered significant increases in operational performance as the year progressed.

Capital spending in the lumber segment for 2011 was $155 million and included a major sawmill and planer rebuild at Vavenby ahead of the mill's restart, a major planer rebuild at the Polar sawmill, energy systems at Plateau and Chetwynd and the purchase of an energy co-generation plant at Grande Prairie. The Company also completed various other planer upgrades during the year, and added kiln drying capacity at selected operations. These projects were in addition to a major sawmill and planer rebuild at the Company's Fort St. John sawmill, an upgrade to its Chetwynd sawmill and a new energy system at its Prince George sawmill, all of which were completed in early 2011.

In addition to its strategic capital initiative, the Company in November 2011 signed an agreement to acquire Tembec Industries Ltd.'s southern BC Interior wood products assets (the "Tembec acquisition"), for a purchase price including normal working capital of $60 million. The purchase will include Tembec's Elko and Canal Flats sawmills, approximately 1.1 million cubic metres of combined Crown, private land and contract allowable cut, and a long-term agreement to provide residual fibre supply for Tembec's Skookumchuck pulp mill. The acquisition is currently scheduled to close at the end of the first quarter of 2012, subject to customary closing conditions, including regulatory approval.

The Company's strategic capital investments are designed to capitalize on its strong fibre position in many regions of the BC Interior. In addition, the Tembec acquisition reinforces the Company's strong fibre position, providing access to significant volumes of green fibre. The Company plans to invest in excess of $50 million to upgrade BC Southern Interior mill facilities. The following chart shows the location of the Company's timber licenses in BC and the locations of the sawmills with significant recent and future planned capital upgrades:



(ii) Continued focus on strong operational performance

In order to achieve top-quartile financial performance, and maximize profitability, the Company continues to focus on the key areas of maximizing product quality and value, tightly controlling unit manufacturing costs and maximizing residual fibre revenues.

a. Product quality / value

Product quality and value are key parts of the Company's focus going forward, with a view to ensuring that valued customers are provided with high quality products. Numerous initiatives have been undertaken to ensure continuous improvements in this area, including capital projects, such as the planer upgrades, which are resulting in a higher proportion of higher-value lumber products, and transitioning to harvesting greener fibre for use in the BC Interior sawmills.

The Company also has in place, or takes part in, various initiatives designed to promote the benefits of the use of lumber products by developers and end users. This includes initiatives to promote the environmental qualities of the use of lumber, and also industry wide programs, such as the Blue Ribbon Commission for Softwood Lumber Check-Off program in the U.S., to promote wood as a building product.

b. Unit manufacturing costs

The Company continues to remain focused on ensuring a strong operational performance at all of its operations, with continuous improvement initiatives in place, complementing and maximizing the benefits from capital upgrades. Further improvements were seen in unit conversion costs in 2011 compared to the prior year, and the Company is currently on track to meet its target of top quartile performance by early 2013. The positive impact of capital upgrades on the Company's cost structure, in the form of productivity gains, lower energy costs and improved log-to-lumber recoveries, were significant factors in the cost improvement in 2011.

This improved operational performance went some way to mitigate the impacts of numerous pressures on log costs in 2011. Severe wet weather conditions in the summer of 2011 resulted in increased hauling and road maintenance costs, while tight trucker availability in parts of the BC Interior later in the year put upward pressure on hauling rates. On top of these factors the Company also had to contend with higher diesel prices and longer hauling distances. Despite these challenges, indirect (or fixed) costs were kept in check and the Company was able to maintain adequate log supply at its operations and ensure minimal disruption to sawmill operations.

c. Residual fibre revenue

Residual fibre revenue for the Company relates principally to the sale of sawmill residual chips to be used in the manufacture of pulp products. Prices for sawmill residual chips are typically based on a pricing formula with a number of inputs, including current market prices for pulp products. Increased sawmill residual chip revenues in 2011 for the most part reflected higher operating rates, while prices were in line with the prior year.

Other residual fibre products also hold value, and the Company continued to focus on extracting maximum value from these sources in 2011, increasing its revenue stream from sawdust and shavings. In addition, the Company now has modern energy systems at the significant majority of its sawmills that make use of other residual fibre products, such as bark hog, which have resulted in significantly reduced energy costs and dependence on fossil fuels. In 2011, the Company also purchased the Grande Prairie energy centre, a biomass energy generation facility, which provides "green" electricity to the Company's Grande Prairie sawmill and external customers.

(iii) Softwood Lumber Agreement

Under the Softwood Lumber Agreement ("SLA") implemented by the federal governments of Canada and the U.S. in 2006, Canadian softwood lumber exporters pay an export tax on lumber shipped to the U.S. when the price of lumber is at or below US$355 per Mfbm, as determined by the Random Lengths Framing Lumber Composite Price. When the price is at or below US$355 per Mfbm, the export tax rate ranges between 5% and 15%. In January 2012, the governments of Canada and the U.S. exercised an option to extend the SLA from its original expiry date in 2013 to October 2015.

During 2011 the export tax rate was at 15% for the whole year, resulting in export tax payments of approximately $40 million by the Company during the year.

On January 18, 2011, the U.S. triggered the arbitration provision of the SLA by delivering a Request for Arbitration. The U.S. claims that the province of British Columbia has not properly applied the timber pricing system grandparented in the SLA. The U.S. also claims that subsequent to 2006, BC made additional changes to the timber pricing system which had the effect of reducing timber prices. The claim focuses on substantial increases in Grade 4 (non sawlog or low grade) volumes commencing in 2007. It is alleged that timber was scaled and graded as Grade 4 that did not meet the criteria for that grade, and was accordingly priced too low.

As the arbitration is a state-to-state international dispute under the SLA, Canada is preparing a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. A hearing before the arbitration panel is currently expected before the end of the first quarter of 2012. Further details can be found in the 'Risks and Uncertainties' section late in this document.

(iv) Impacts of Mountain Pine Beetle ("MPB") remain significant; efforts to mitigate continue

The Company continued to process a large volume of dry MPB killed logs in 2011, and to minimize the impact on its operations through further application of new technology and best practices. The Company plans to continue salvaging dead fibre before the end of its commercial shelf life, which can vary between 3 and 15 years depending on soil moisture levels.

Once the salvage of dead pine is complete, it is anticipated that the current elevated Annual Allowable Cut ("AAC") levels in certain BC Interior regions where the MPB presence is high will be adjusted downward. In some areas, this adjustment will be significant to reflect lower mature inventory levels of surviving pine, offset in part by higher inventories of unaffected non-pine species such as spruce, balsam fir and Douglas-fir stands, where strict harvesting limits are currently in force. In 2010, the Chief Forester for the Province of BC commenced AAC reviews for six timber supply areas ("TSAs"), with Canfor having operations in five of these. In January 2011, the Chief Forester released his determinations for the Prince George and Quesnel TSAs which resulted in AAC reductions of 16% and 24%, respectively, for these areas, with most of the reductions coming from the temporary MPB uplift in AAC. These AAC reductions did not have an impact on the Company's licenses. In addition, the Chief Forester for the Province of BC reduced the AAC in the Lakes TSA by approximately 38%, which also had no impact on Canfor. The Company does not expect that determinations for the remaining TSAs will significantly impact the AAC at its other operations in the near term, however it is anticipated that future determinations in the longer term will impact the Company's licenses, although it is currently unclear as to how much this might be.

On July 1, 2010, the Ministry of Forests and Range implemented changes to the BC Interior market pricing system for timber. These changes dealt with issues raised by the MPB epidemic and included: the introduction of stand-as-a-whole pricing with cruise-based billing for MPB damaged timber; and, from a stumpage distribution perspective, the transition over two years to a system more sensitive to market forces. For stands with 35% or more MPB damaged timber, a single stumpage rate is established with billing based on a cruise measurement (estimate) rather than scaling. For these stands, determination of log grades is no longer necessary. An impact of these changes is to increase the overall market sensitivity of BC Interior timber pricing and to improve the utilization of low value material. These changes are consistent with the 2006 Softwood Lumber Agreement.

(v) Closed and indefinitely idled operations

Reflecting the continued difficult market conditions for solid wood products, the expectation of a slow recovery in U.S. housing markets, and current and projected future fibre supply challenges relating to the MPB impact, the Company in 2011 closed, or announced as closing, three of its operations. In January 2011 the Clear Lake lumber operation was closed due to weak prices for stud lumber and a lack of economical long-term fibre available to that mill. In December 2011 the closures of the Rustad sawmill and Tackama plywood plant were announced, effective January 20, 2012 due to a combination of the difficult market conditions and the level of capital investment required to make both operations economically viable.

The Radium sawmill and the PolarBoard OSB plant in Fort Nelson remained idled through 2011. The Radium sawmill was idled in mid-2009 and has a production capacity of 185 million board feet ("MMfbm"), while the PolarBoard plant was idled in mid-2008 and has a capacity of 640 million square feet ("MMsf") (3/8" basis).

Pulp and Paper Operations

The Canfor Pulp operations are top quartile mills, and strong operational performance for these continues to be a key focus. Solid results were seen in terms of production performance in 2011. Unit pulp manufacturing costs in 2011 were up slightly from 2010, mostly reflecting the impact of downtime at Canfor Pulp's Northwood pulp mill which outweighed productivity gains.

In October 2009, the Canadian federal government announced the introduction of a Pulp and Paper Green Transformation Program (the "Program") designed to reimburse funds spent by Canadian kraft pulp producers on qualifying energy and environmental capital projects. Canfor Pulp was allocated $122.2 million from this Program, most of which related to the installation of a recovery boiler and precipitator upgrade at the Northwood pulp mill. As of December 31, 2011 Canfor Pulp has spent its full allocation under the Program. During 2011, Canfor Pulp received reimbursements totaling $75.6 million and $19.7 million was receivable at year end. These projects are expected to provide economic and environmental benefits to Canfor Pulp's operations.

In addition to capital expenditures funded under the Program, Canfor Pulp also spent a further $68.5 million on capital projects in 2011, mostly relating to maintenance of business.

OVERVIEW OF CONSOLIDATED RESULTS – 2011 COMPARED TO 2010

Selected Financial Information and Statistics:

(millions of dollars, except for per share amounts)		2011		2010
Sales	**$**	**2,421.4**	$	2,430.4
EBITDA	**$**	**177.7**	$	354.4
Operating income	**$**	**8.4**	$	186.7
Foreign exchange gain (loss) on long-term debt and investments, net	**$**	**(5.0)**	$	14.7
Gain on derivative financial instruments[7]	**$**	**3.5**	$	0.1
Net income	**$**	**10.8**	$	173.3
Net income (loss) attributable to equity shareholders of Company	**$**	**(56.6)**	$	81.4
Net income (loss) per share attributable to equity shareholders of Company, basic and diluted	**$**	**(0.40)**	$	0.57
Average exchange rate (US$/CDN$)[8]	**$**	**1.011**	$	0.971

[7] Includes gains (losses) from natural gas, diesel, foreign exchange and lumber price derivatives (see "Unallocated and Other Items" section for more details).
[8] Source – Bank of Canada (average noon rate for the period)

Effective January 1, 2011, Canfor is required to prepare financial statements in accordance with International Financial Reporting Standards ("IFRS"). The Company's 2011 annual financial statements are the first to be prepared in accordance with IFRS, and a number of additional disclosures have been included in those financial statements to explain the changes. 2010 comparative information has been restated to be shown under IFRS.

More information on this can be found in the "International Financial Reporting Standards" section later in this document.

Analysis of Specific Items Affecting Comparability of Shareholder Net Income (Loss)

After-tax impact, net of non-controlling interests

(millions of dollars, except for per share amounts)		2011		2010
Shareholder Net Income (Loss)	**$**	**(56.6)**	$	81.4
Foreign exchange (gain) loss on long-term debt and investments, net	**$**	**3.3**	$	(10.4)
(Gain) loss on derivative financial instruments	**$**	**(3.3)**	$	0.5
Increase in fair value of asset-backed commercial paper	**$**	**(0.2)**	$	(5.5)
Mill closure provisions	**$**	**17.0**	$	13.0
Asset impairment charges	**$**	**5.5**	$	-
Restructuring costs related to changes in management group	**$**	**2.6**	$	-
Gain on sale of operating assets of Howe Sound Pulp and Paper Limited Partnership	**$**	**-**	$	(4.9)
Net impact of above items	**$**	**24.9**	$	(7.3)
Adjusted shareholder net income (loss)	**$**	**(31.7)**	$	74.1
Shareholder net income (loss) per share, as reported	**$**	**(0.40)**	$	0.57
Net impact of above items per share	**$**	**0.18**	$	(0.05)
Adjusted shareholder net income (loss) per share	**$**	**(0.22)**	$	0.52

The Company recorded a net loss attributable to equity shareholders ("shareholder net loss") of $56.6 million, or $0.40 per share, for the year ended December 31, 2011, an adverse variance of $138.0 million, or $0.97 per share, from shareholder net income of $81.4 million, or $0.57 per share, reported for the year ended December 31, 2010.

After taking account of specific items affecting comparability with prior periods, the Company's 2011 adjusted shareholder net loss was $31.7 million, or $0.22 per share, an adverse variance of $105.8 million, or $0.74 per share, compared to similarly adjusted shareholder net income of $74.1 million, or $0.52 per share, for 2010.

EBITDA

The following table reconciles the Company's net income (loss), as reported in accordance with IFRS, to EBITDA:

(millions of dollars)	2011	2010
Net income, as reported	**$ 10.8**	$ 173.3
Add (subtract):		
Amortization	**$ 169.3**	$ 167.7
Finance expense, net	**$ 22.5**	$ 26.8
Foreign exchange (gain) loss on long-term debt and investments, net	**$ 5.0**	$ (14.7)
Gain on derivative financial instruments	**$ (3.5)**	$ (0.1)
Other income, net	**$ (5.9)**	$ (8.1)
Income tax (recovery) expense	**$ (20.5)**	$ 9.5
EBITDA, as reported	**$ 177.7**	$ 354.4
Negative (positive) impact of inventory valuation adjustments[9]	**$ 12.3**	$ (20.2)
Mill closure provisions	**$ 22.5**	$ 17.3
Asset impairment charges	**$ 9.2**	$ -
EBITDA excluding impact of inventory valuation adjustments, closure provisions and impairment charges	**$ 221.7**	$ 351.5

[9] In accordance with IFRS, Canfor records its log and finished product inventories at the lower of cost and net realizable value ("NRV"). Changes in inventory volumes, market prices, foreign exchange rates and costs over the respective reporting periods can all affect inventory write-downs required at each year end.

Reported EBITDA for 2011 was $177.7 million, down $176.7 million from EBITDA of $354.4 million for 2010. Included in EBITDA for the current year are restructuring costs of $22.5 million, related to the announced closures of the Rustad sawmill and Tackama Plywood plant, asset impairment charges of $9.2 million on certain lumber and panel assets and negative inventory valuation adjustments of $12.3 million. EBITDA in 2010 included positive inventory valuation adjustments of $20.2 million and a restructuring provision of $17.3 million related to the permanent closure of the Clear Lake sawmill. Excluding these items, EBITDA for 2011 was $221.7 million, down $129.8 million from similarly adjusted EBITDA of $351.5 million in 2010.

Operating results in all segments were adversely impacted by lower average sales realizations, reflecting the 4% stronger Canadian dollar, and, in the case of the lumber segment, price declines across many products. In addition, results in the lumber segment were adversely impacted by an increase in unit log costs compared to the prior year, reflecting the aforementioned cost pressures, though these were partially offset by operational cost improvements in the current year.

A more detailed review of the Company's operational performance and results is provided in "Operating Results by Business Segment – 2011 compared to 2010", which follows this overview of consolidated results.

OPERATING RESULTS BY BUSINESS SEGMENT – 2011 COMPARED TO 2010

The following discussion of Canfor's operating results relates to the operating segments and the non-segmented items as per the Segmented Information note in the Company's consolidated financial statements.

Canfor's operations include the Lumber and Pulp and Paper segments. The results of the panels business are included in the Unallocated & Other segment.

Lumber

Selected Financial Information and Statistics - Lumber

Summarized results for the Lumber segment for 2011 and 2010 are as follows:

(millions of dollars, unless otherwise noted)		2011		2010
Sales	**$**	**1,317.1**	$	1,255.2
Operating income (loss)	**$**	**(80.7)**	$	23.9
EBITDA, as reported	**$**	**3.2**	$	106.7
Negative (positive) impact of inventory valuation adjustments	**$**	**12.4**	$	(21.4)
Mill closure provisions	**$**	**11.9**	$	17.3
Asset impairment charges	**$**	**7.2**	$	-
EBITDA excluding impact of inventory valuation adjustments, closure provisions and impairment charges	**$**	**34.7**	$	102.6
Capital expenditures	**$**	**155.3**	$	88.1
Average SPF 2x4 #2&Btr lumber price in US$[10]	**$**	**255**	$	256
Average SPF price in Cdn$	**$**	**252**	$	264
Average SYP 2x4 #2 lumber price in US$[11]	**$**	**268**	$	301
Average SYP price in Cdn$	**$**	**265**	$	310
U.S. housing starts (thousand units) [12]		**607**		587
Production – SPF lumber (MMfbm)		**3,134.3**		2,886.7
Production – SYP lumber (MMfbm)		**431.3**		355.0
Shipments – Canfor-produced SPF lumber (MMfbm)[13]		**3,182.8**		2,906.0
Shipments – Canfor-produced SYP lumber (MMfbm)[13]		**449.9**		378.9
Shipments – wholesale lumber (MMfbm)		**140.5**		115.2

[10] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)
[11] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)
[12] Source – U.S. Census Bureau
[13] Includes shipments of lumber purchased for remanufacture.

Overview

The Lumber segment reported EBITDA of $3.2 million for 2011, down $103.5 million from EBITDA of $106.7 million in 2010. Results in the lumber segment for 2011 were adversely impacted by an expense of $11.9 million relating to the announced closure of manufacturing operations at the Rustad sawmill and asset impairments of $7.2 million. In addition, inventory valuation adjustments in 2011 had a negative impact of $12.4 million, compared to a positive impact of $21.4 million in 2010.

Excluding the above noted items, as well as a $17.3 million restructuring expense recorded in 2010 relating to the closure of the Clear Lake sawmill, EBITDA was $34.7 million, down $67.9 million from the prior year. For the most part, the decrease was attributable to lower sales realizations, reflecting lower market prices and the impact of the stronger Canadian dollar, and higher delivered log costs, partially mitigated by lower unit conversion costs and improved log-to-lumber recoveries.

Markets

Canfor's total lumber sales volume for 2011 was almost 3.8 billion board feet, compared to 3.4 billion for 2010, with SPF and SYP making up 88% and 12% of total sales, respectively. As highlighted earlier, in part (i) of the Overview of 2011, U.S demand saw little change in 2011 versus 2010, but demand from Asia continued to show solid growth. Shipments to the U.S. represented 48% of total lumber sales volumes in 2011, down 6% from the prior year, while offshore shipments, particularly to China, moved up 9%.

Total U.S. housing starts of 607,000 units represented a small improvement from the previous year. Single family starts, however, fell to 429,000 units, the lowest on record, as excess home inventory, including the overhang of foreclosed properties, continued to hamper recovery in the housing market. Multifamily starts, which consume a smaller proportion of lumber, continued the upward trend seen since 2009, gaining more than 50% over 2010, which reflected both greater home affordability and more rental units.

Total Canadian housing starts were 193,000 units in 2011, an increase of 2% from 2010. Housing activity had a slow start before reaching levels in the second half of 2011 not seen since 2008.

The U.S. repair and remodeling sector showed little change compared to 2010, remaining at historically low levels.

Canfor's offshore lumber shipments reached another new record-high level in 2011. Total shipments to offshore markets accounted for 33% of Canfor total lumber sales during the year, up from 28% in 2010. In China, lumber consumption is transitioning to include greater volumes of #2&Btr grade, as well as low grade. Steady lumber demand was also evident in Japan and Korea, contributing to the overall growth in shipments to Asia.

Sales

Lumber segment revenues of $1,317 million for 2011 were up $62 million, or 5%, compared to 2010, reflecting increased sales volumes, offset in part by lower unit sales realizations. Total shipments were just under 3.8 billion board feet for the year, up from 3.4 billion board feet in the previous year. The Western SPF lumber 2x4 #2&Btr Random Lengths price averaged US$255 per Mfbm, substantially unchanged from the previous year; however decreases were seen for certain wider dimensions and lower grades as can be seen from the following table which shows benchmark Random Lengths prices for selected key grades and widths of Western SPF lumber:

(Average Western SPF US$ price, per thousand board feet)	**2011**	2010
2x4 #2&Btr	**$ 255**	$ 256
2x4 #3	**$ 217**	$ 227
2x10	**$ 286**	$ 319

The 4% increase in the average value of the Canadian dollar versus the US dollar for 2011 compared to 2010 also contributed to lower overall Canadian dollar sales realizations. Freight costs were up compared to the prior year, due to higher fuel surcharges and higher truck and rail rates.

Prices for SYP products were well down in the year, with the benchmark 2x4 #2 price down US$33, or 11%, from 2010 to US$268 per Mfbm. Wider dimensions of SYP product also saw steeper decreases, as evidenced by a 24% fall in the 2x12 price, for which the average price in 2011 was less than that of the 2x4 price.

Total residual fibre revenue for 2011 was up from the prior year, mostly reflecting increased sales volumes of sawmill residual chips, resulting from the higher operating rates in the year. Revenues for other by-products saw moderate increases compared to the prior year.

Export Tax

Under the Softwood Lumber Agreement ("SLA") implemented by the federal governments of Canada and the U.S. in 2006, Canadian softwood lumber exporters pay an export tax on lumber shipped to the U.S. when the price of lumber is at or below US$355 per Mfbm, as determined by the Random Lengths Framing Lumber Composite Price[15] ("RLCP"). The export tax rate is determined monthly, with the rate being based on the following trigger prices:

Trigger RLCP Price	Tax Rate
Over US$355	0 %
US$336-$355	5 %
US$316-$335	10 %
US$315 and under	15 %

The SLA also includes a "Surge Mechanism", which increases the export tax rate for the month by 50% when the monthly volume of exports from a region exceeds a "Trigger Volume" as defined in the SLA.

For 2011 and most of 2010, the export tax rate on lumber shipments from BC to the U.S. was 15%, while Alberta's shipments attracted a surge rate of 22.5% for most of that period. A short-lived price rally in North American lumber markets in early 2010 resulted in the export tax rate falling from 15% to 10% on BC shipments for May and July of that year (15% for Alberta) and 0% for June. The average RLCP for 2011 was US$272 per Mfbm, down US$12 from US$284 per Mfbm in 2010.

Total export tax paid by the Company in 2011 was $39.9 million, substantially the same as in 2010.

Operations

Total lumber production for 2011 was almost 3.6 billion board feet, up 320 million board feet, or 10% from 2010. A significant part of the increase relates to a full year of operations in 2011 for the Company's Chetwynd and Quesnel sawmills. The Chetwynd operation was restarted on a single shift in May 2010 after being closed for two years, and moved to a two shift configuration in October 2010, while the Quesnel sawmill was curtailed for five months in the first half of 2010. In addition, the current year includes production at the Vavenby sawmill, which was restarted in September 2011, and the positive impact of increased productivity, related to both capital upgrades and continuous improvement initiatives. Partially offsetting these factors was the reduced production due to the closure of the Clear Lake sawmill early in 2011.

Total lumber unit manufacturing costs were up slightly from the previous year, with lower unit conversion costs being more than offset by the impact of higher unit log costs at Western SPF operations. The improved unit conversion costs largely reflected the improved productivity levels in the current year and the increasingly positive impact on the Company's cost structure of capital upgrades in the last two years. Unit log costs in 2011 saw moderate increases, with adverse weather conditions, including an unusually wet summer, having a detrimental impact especially on logging and road maintenance costs. In addition, higher diesel prices, tight trucker availability in parts of the BC Interior leading to higher hauling rates, and increased competition for purchased wood led to increased unit log costs. Improved lumber recoveries, relating in part to recently-completed capital upgrades and other initiatives, mitigated the increases seen in delivered log costs.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[14]

(millions of dollars, unless otherwise noted)	**2011**	2010
Sales	**$ 1,057.5**	$ 1,119.6
Operating income	**$ 150.1**	$ 192.7
EBITDA	**$ 218.1**	$ 260.0
Capital expenditures	**$ 156.2**	$ 53.9
Average pulp price delivered to U.S. - in US$[15]	**$ 977**	$ 960
Average pulp price in Cdn$	**$ 966**	$ 989
Production – pulp (000 mt)	**1,200.0**	1,229.0
Production – paper (000 mt)	**136.5**	136.7
Shipments – Canfor-produced pulp (000 mt)	**1,188.7**	1,225.0
Pulp marketed on behalf of HSLP (000 mt)[16]	**-**	271.9
Shipments – paper (000 mt)	**127.6**	144.7

[14] Includes Taylor pulp mill and 100% of Canfor Pulp, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.
[15] Per tonne, NBSK pulp list price delivered to U.S. (Resource Information Systems, Inc, - "RISI")
[16] Howe Sound Pulp and Paper Limited Partnership pulp mill

Overview

Operating income for the pulp and paper segment for 2011 was $150.1 million, down $42.6 million from $192.7 million in 2010. EBITDA for the pulp and paper segment was $218.1 million, down $41.9 million from the previous year. The decline in operating results was attributable to higher unit manufacturing costs, lower shipment volumes and lower Canadian dollar sales realizations, partially offset by higher energy sales. The higher unit manufacturing costs and lower shipment volumes both reflected downtime at Canfor Pulp's Northwood pulp mill in 2011 to complete the installation of a recovery boiler and precipitator upgrade (the "Northwood upgrade").

Markets

The 2011 year began with pulp inventories held by producers and customers at low levels, allowing successive price increases through the first half of the year. The second half of the year was characterized by increasing inventory levels and softening demand resulting in downward pressure on prices.

Pulp and Paper Products Council ("PPPC") statistics reported decreased global demand for printing and writing papers of 2% while tissue demand is projected to have increased 3% for 2011 as compared to 2010. PPPC also reported an increase in shipments of bleached softwood sulphate pulp of 3% in 2011 with increased shipments to Asia offset by reductions in Europe and North America.

At the end of December 2011, World 20[17] producers of bleached softwood pulp inventories were at 36 days of supply. By comparison, December 2010 inventories were at 25 days of supply. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

Sales

Shipments of Canfor-produced pulp for 2011 were down 36,000 tonnes, or 3%, from the prior year at just under 1.2 million tonnes, with the reduction reflecting the impact of the Northwood upgrade on volumes available for sale.

Producers successfully implemented price increases through the first half of 2011 and North American U.S. list prices peaked at US$1,040 per tonne in June 2011, up from US$960 per tonne in January 2011. Downward pressure was exerted on pricing in the second half of 2011 with softening demand and increasing producer inventories, and North American U.S. list prices ended the year at US$890 per tonne. For the year as a whole, the average North American NBSK pulp list price was US$977 per tonne for the year, up slightly from 2010. NBSK pulp prices to Europe were also up slightly, averaging US$956 per tonne for 2011 (2010: US$938 per tonne) and Canfor Pulp's average list price to China saw an increase of US$21 to US$845 per tonne. Sales realizations for NBSK pulp products were also positively impacted by a shift in volumes to higher-margin geographic regions and customers.

BCTMP prices, however, saw modest decreases from the prior year. Realized pulp prices in Canadian dollar terms were negatively impacted by the 4% strengthening of the Canadian dollar compared to the prior year.

Results for paper operations were improved from the prior year, reflecting a 9% increase in realized prices in Canadian dollar terms, offset in part by lower shipment volumes.

Operations

Pulp production volume was 1.2 million tonnes for 2011, down 29,000 tonnes or 2% compared to the prior year, as lower NBSK production volumes due to the Northwood upgrade were partially offset by an increase in BCTMP production.

Unit manufacturing costs saw a small increase compared to the prior year, due primarily to the impact of the Northwood upgrade downtime and related maintenance costs, as well as higher chemical and energy costs, which more than offset improved productivity at certain operations. Unit fibre costs were in line with those seen in 2010.

[17] World 20 data is based on twenty producing countries representing 80% of world chemical market pulp capacity and is based on information compiled and prepared by the Pulp and Paper Products Council ("PPPC").

Unallocated and Other Items

(millions of dollars)	2011	2010
Operating loss of Panels operations[18]	**$ (33.8)**	$ (7.9)
Corporate costs	**$ (27.2)**	$ (22.0)
Finance expense, net	**$ (22.5)**	$ (26.8)
Foreign exchange gain (loss) on long-term debt and investments, net	**$ (5.0)**	$ 14.7
Gain on derivative financial instruments	**$ 3.5**	$ 0.1
Other income, net	**$ 5.9**	$ 8.1

[18] The Panels operations include the Peace Valley OSB (Oriented Strand Board) joint venture, the only facility currently operating, and the Company's Tackama plywood plant, which was closed in January 2012, and its PolarBoard OSB plant, which is currently indefinitely idled.

Operating Loss of Panels Operations

The panels operations reported an operating loss of $33.8 million for 2011, compared to a loss of $7.9 million for the previous year. Results for 2011 include an expense of $10.6 million relating to the announced closure of the Tackama plywood plant, as well as an asset impairment charge of $2.0 million relating to other idled panels assets. Excluding the impact of these items, the operating loss of panels operations was $21.2 million for 2011, an adverse variance of $13.3 million from 2010.

The decline in operating results from 2010 reflects a decline in OSB markets, as evidenced by a US$35 per thousand square foot ("msf"), or 16%, decrease in the average benchmark OSB North Central 7/16" price to US$186 per msf. Prices in 2011 generally remained in the range of US$170 to US$200 per msf in contrast to prices in 2010, which peaked at US$395 per Msf in mid-May following a supply-driven price rally in the early part of that year, before dropping off sharply to end the year at US$195 per msf. The stronger average Canadian dollar in 2011 also contributed to lower sales realizations in the current year. Unit manufacturing costs saw a small increase from the prior year as lower unit conversion costs were more than offset by increases to unit log and wax and resin costs.

Corporate Costs

Corporate costs, which comprise corporate, head office and certain information technology costs, were $27.2 million in 2011, up $5.2 million from 2010. The increase primarily reflected severance and restructuring costs in 2011 following changes in the management group in the second quarter, and to a lesser extent increased consulting costs reflecting various initiatives undertaken in 2011, and a positive one-time pension adjustment recorded in 2010. These factors were partially offset by more favourable movements in share-based compensation expense in 2011 compared to 2010.

Interest Income and Expense

Net finance expense for 2011 was $22.5 million, down $4.3 million from 2010. The decrease was mostly a result of lower long-term debt levels following repayments made in 2010 and 2011.

Foreign Exchange Gain (Loss) on Translation of Long-Term Debt and Investments

The Canadian dollar ended 2011 slightly below par compared to the US dollar, and down more than 2 cents, or 2%, from a year earlier. As a result, the Company recorded a foreign exchange translation loss on its US dollar denominated debt less investments of $5.0 million in 2011 (2010 – gain of $14.7 million).

Gain (Loss) on Derivative Financial Instruments

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs and lumber prices. During the third and fourth quarters of 2011, the Company entered into various additional financial instrument contracts, including significant new foreign exchange collars. The contracts cover a period from January to December, 2012. As at December 31, 2011, these collars had a total notional amount of $257 million and weighted average protection and topside rates of $0.97 and $1.08 per US dollar, respectively.

For 2011, the Company recorded a net gain of $3.5 million related to its derivative financial instruments, principally reflecting gains on lumber futures in the period, partially offset by modest losses on foreign exchange forward contracts and collars.

The following table summarizes the amounts of the various components for the comparable periods. Additional information on the derivative financial instruments in place at year end can be found in the "Financial Requirements and Liquidity" section, later in this document.

Gain (Loss) on Derivative Financial Instruments:

(millions of dollars)		2011		2010
Foreign exchange collars and forward contracts	**$**	**(2.7)**	$	4.0
Natural gas swaps	**$**	**(0.2)**	$	(5.2)
Diesel options and swaps	**$**	**0.8**	$	0.8
Lumber futures	**$**	**5.6**	$	0.5
	$	**3.5**	$	0.1

Other Income, net

Other income in 2011 included a gain of $2.0 million relating to foreign exchange movements on US dollar denominated cash, receivables and payables of Canadian operations, compared to a loss on foreign exchange in the prior year of $4.9 million.

Also included in other income in 2011 was a $2.2 million positive fair value adjustment related to a royalty agreement associated with the sale of the operating assets of Howe Sound Pulp and Paper Limited Partnership ("HSPP"), which occurred in late 2010. Other income in 2010 included a gain of $5.5 million relating to the HSPP asset sale.

Other income in 2011 also reflected a $0.2 million gain relating to the change in fair value of the Company's investment in asset-backed commercial paper ("ABCP"), compared to a gain of $6.3 million in 2010.

Income Tax Recovery

The Company recorded an income tax recovery of $20.5 million in 2011, compared to an expense of $9.5 million in 2010, with an overall effective tax rate of 211% (2010 – 5%). The most significant factor accounting for the 2011 tax rate differing from the Canadian statutory tax rate of 26.5% is the non-taxable income attributable to non-controlling interests of Canfor Pulp and Houston Pellet Limited Partnership.

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

(millions of dollars)		2011		2010
Net income (loss) before income taxes	**$**	**(9.7)**	$	182.8
Income tax recovery (expense) at statutory rate 2011 – 26.5% (2010 – 28.5%)	**$**	**2.6**	$	(52.1)
Add (deduct):				
Non-taxable income related to non-controlling interests in limited partnerships		**17.9**		26.1
Entities with different income tax rates and other tax adjustments		**1.0**		1.4
Tax recovery (expense) at rates other than statutory rate		**(0.9)**		3.4
Permanent difference from capital gains and losses and other non-deductible items		**(0.1)**		11.7
Income tax recovery (expense)	**$**	**20.5**	$	(9.5)

Other Comprehensive Income (Loss)

(millions of dollars)	2011	2010
Foreign exchange translation differences for foreign operations	**$ 4.4**	$ (10.3)
Defined benefit actuarial losses, net of tax	**(50.3)**	(48.0)
Other comprehensive income (loss), net of tax	**$ (45.9)**	$ (58.3)

Canfor measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. Any actuarial gains or losses which arise are recognized immediately by means of a credit or charge through other comprehensive income. For 2011, an after-tax amount of $50.3 million was charged to other comprehensive income, principally reflecting a decrease in the discount rate over the year, falling 0.50% for defined benefit pension plans and 0.45% for other post-retirement benefit plans. In 2010, the after-tax charge was $48.0 million, also reflecting a lower discount rate over the year, offset in part by gains on plan assets. For more information, see the 'Employee Future Benefits' part of the 'Critical Accounting Estimates' section later in this report.

In addition, the Company recorded a credit of $4.4 million to other comprehensive income in 2011 for foreign exchange differences for foreign operations, reflecting the 2% weakening of the Canadian dollar over the year. This compared to a $10.3 million charge in 2010 due to a 5% strengthening of the Canadian dollar over that year.

SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's financial position as at the end of the years 2011 and 2010:

(millions of dollars, except for ratios)	2011	2010
Cash and cash equivalents	**$ 28.9**	$ 260.3
Operating working capital	**249.0**	262.1
Current portion of long-term debt	**(50.9)**	(82.5)
Current portion of deferred reforestation	**(31.6)**	(31.6)
Net working capital	**195.4**	408.3
Property, plant and equipment	**1,139.2**	1,049.1
Timber licenses	**530.1**	546.7
Goodwill and other intangible assets	**83.0**	84.5
Long-term investments and other	**62.8**	89.1
Net assets	**$ 2,010.5**	$ 2,177.7
Long-term debt	**$ 188.1**	$ 235.6
Retirement benefit obligations	**298.3**	272.2
Deferred reforestation obligations	**65.0**	60.6
Other long-term liabilities	**13.8**	17.5
Future income taxes, net	**85.2**	121.8
Non-controlling interests	**232.8**	249.5
Equity attributable to shareholders of Company	**1,127.3**	1,220.5
	$ 2,010.5	$ 2,177.7
Ratio of current assets to current liabilities	**1.5 : 1**	2.0 : 1
Net debt to total capitalization	**13.4%**	3.8%

The ratio of current assets to current liabilities at the end of 2011 was 1.5:1, compared to 2.0:1 at the end of 2010. The reduction reflects a decrease in current assets at the end of 2011, especially with respect to cash at year end. The lower cash reflected in part the capital spending during 2011. See the following section ("Changes in financial position") for more details.

The Company's net debt to capitalization was 13.4% at December 31, 2011 (December 31, 2010: 3.8%). The increase is explained principally by higher net debt balances at year end mostly resulting from the aforementioned lower cash balances, offset in part by lower long-term debt balances and lower total equity, the latter including overall comprehensive losses relating to pension plans and distributions to non-controlling interests of Canfor Pulp.

CHANGES IN FINANCIAL POSITION

At the end of 2011, Canfor had $28.9 million of cash and cash equivalents.

(millions of dollars, except for ratios)	2011	2010
Cash generated from (used in)		
Operating activities	**$ 163.0**	$ 381.6
Financing activities	**(191.4)**	(139.3)
Investing activities	**(202.7)**	(114.3)
Foreign exchange gain (loss) on cash and cash equivalents of self-sustaining foreign operations	**(0.3)**	(1.1)
Increase (decrease) in cash and cash equivalents	**$ (231.4)**	$ 126.9

The changes in the components of these cash flows during 2011 are discussed in the following sections:

Operating Activities

During 2011, Canfor generated cash from operations of $163.0 million, down $218.6 million from cash generated of $381.6 million in the previous year. The significant decrease in 2011 relates substantially to a decline in cash earnings in both the lumber and pulp and paper business segments, as well as a $45.9 million cash refund of taxes in the prior year. A reduction in accounts receivable balances was more than offset by an increase in inventories and a reduction in payables.

Financing Activities

Financing activities in 2011 used net cash of $191.4 million, $52.1 million more than the $139.3 million used in 2010. The increase reflected an $81.9 million repayment of long-term debt in 2011 compared to $35.1 million of long-term debt repaid in the prior year. In addition, cash distributions of $91.0 million were paid in 2011, up $12.0 million from the prior year. Partly offsetting these factors was a reduction in finance expenses paid, down $6.2 million to $18.9 million, principally due to the lower debt levels in the current year.

Investing Activities

Net cash used for investing activities in 2011 amounted to $202.7 million, compared to $114.3 million used in 2010. Property, plant and equipment additions for 2011 totaled $236.7 million, net of proceeds from the federal government's green transformation program of $75.6 million, of which approximately $130 million was spent to improve the Company's cost position, production and capacity. The balance was to maintain the existing productive capacity of the operations or to ensure Canfor's safety and environmental performance.

Capital spending in the current year included amounts spent as part of the Company's $300 million, three-year strategic capital investment program at its lumber operations. Capital spending in the lumber segment for 2011 was $155.3 million reflecting costs incurred on the previously highlighted capital projects.

In the pulp and paper segment, capital spending of $156.2 million for 2011 consisted primarily of projects eligible for funding by the Green Transformation Program (the "Program"), as well as essential maintenance of business project. Program funding received in 2011 was $75.6 million.

Cash of $29.8 million was received from the partial redemption of ABCP in early 2011, compared to $4.6 million received in 2010.

FINANCIAL REQUIREMENTS AND LIQUIDITY

Operating Loans

On a consolidated basis, at December 31, 2011, the Company had $443.3 million of unsecured operating loan facilities, which were undrawn, with $28.1 million reserved for several standby letters of credit.

Excluding Canfor Pulp, the Company's bank operating lines at December 31, 2011 totalled $362.9 million, which were undrawn, with $17.2 million reserved for several standby letters of credit, the majority of which related to unregistered pension plans. On August 22, 2011 the Company amended its main $350 million bank credit facility, extending the maturity of the facility to October 31, 2015 from October 31, 2013. The general terms and conditions of the new facility are similar to the previous facility. The Company's also had an operating loan facility in the amount of US$12.7 million at December 31, 2011, which expired in January 2012.

At December 31, 2011, Canfor Pulp had a $40.0 million bank loan facility with a maturity date of November 30, 2013, of which $0.5 million was utilized for a standby letter of credit issued for general business purposes. In addition, Canfor Pulp had a $30.0 million bridge loan credit facility with a maturity date of December 31, 2012 to fund timing differences between expenditures and reimbursements for projects funded under the Green Transformation Program, as well as a separate facility with a maturity date of November 30, 2013 to cover a $10.4 million standby letter of credit issued to BC Hydro.

Debt Covenants

Canfor has certain financial covenants on its debt obligations that stipulate maximum net debt to total capitalization ratios and minimum net worth amounts based on total shareholders' equity. The net debt to total capitalization is calculated by dividing total debt, less cash and cash equivalents, by shareholders' equity plus total debt less cash and cash equivalents. Debt obligations are held by various entities within the Canfor group and the individual debt agreements specify the entities within the group that are to be included in the covenant calculations.

In circumstances when net debt to total capitalization exceeds a threshold, Canfor (excluding Canfor Pulp) is subject to an interest coverage ratio that requires a minimum amount of EBITDA relative to net interest expense. Canfor is not currently subject to this test.

In addition, Canfor Pulp has leverage and interest coverage ratios calculated by reference to earnings before interest, taxes, depreciation and amortization and other non-cash items.

Provisions contained in Canfor's long-term borrowing agreements also limit the amount of indebtedness that the Company may incur and the amount of dividends it may pay on its common shares. The amount of dividends the Company is permitted to pay under its long-term borrowing agreements is determined by reference to consolidated net earnings less certain restricted payments.

Management reviews results and forecasts to monitor the Company's compliance with these covenant requirements. Canfor was in compliance with all its debt covenants for the year ended December 31, 2011.

All borrowings of Canfor Pulp (operating loans and long-term debt) are non-recourse to other entities within the Company.

2012 Projected Capital Spending and Debt Repayments

Based on its current outlook for 2012, assuming no deterioration in market conditions during the year, the Company anticipates that it may invest approximately $140 million in capital projects, which will consist primarily of various improvement projects as well as maintenance of business expenditures. Scheduled long-term debt repayments in 2012 consist of a US$50.0 million payment, which was paid on February 2, 2012. Canfor has sufficient liquidity in its cash reserves and operating lines of credit to finance its planned capital expenditures and scheduled debt repayments as required during 2012.

Derivative Financial Instruments

As at December 31, 2011, the Company had the following derivatives:

a. Foreign exchange collars of $256.8 million and forward contracts of US$70.9 million. There were unrealized losses of $0.4 million on the foreign exchange derivatives at the end of the year. The contracts in place at the end of 2011 were as follows:

	2011	
	Notional Amount	**Exchange Rates**
US dollar collars	(millions of US dollars)	(protection/topside, per dollar)
0-12 months	**$ 256.8**	**$ 0.9500 - $ 1.1461**
US dollar forward contracts	(millions of US dollars)	(range of rates, per dollar)
0-12 months	**$ 70.9**	**$ 0.9984 - $ 1.0470**

b. Canfor partly uses heating oil and Brent crude oil contracts as proxy to hedge its diesel purchases. At 2011 year end collars for 5.3 million gallons of heating oil and 65.2 thousand barrels of Brent oil were in place. There were unrealized losses of $0.2 million on these collars at the end of the year.

	2011	
	Notional Amount	**Average Rate**
Diesel	(millions of gallons)	(dollars per gallon)
Heating Oil Collars		
0 – 12 months	**5.0**	**$2.55 - $2.95**
13 – 36 months	**0.3**	**$2.55 - $2.95**
	(thousands of barrels)	(dollars per barrel)
Brent Collars		
0 – 12 months	**59.2**	**$84.17-$108.47**
13 – 24 months	**6.0**	**$93.90-$110.00**

c. Futures contracts for the sale of lumber with a total notional amount of 59.7 MMfbm. There were unrealized gains of $0.4 million at year end on these contracts.

	2011	
	Notional Amount	**Average Rate**
Lumber	(MMfbm)	(US dollars per Mfbm)
Futures contracts		
0 – 12 months	**59.7**	**$ 286.10**

Commitments

The following table summarizes Canfor's financial contractual obligations at December 31, 2011 for each of the next five years and thereafter:

(millions of dollars)	**2012**	**2013**	**2014**	**2015**	**2016**	**Thereafter**	**Total**
Long-term debt obligations	$ 50.9	$ 188.1	$ -	$ -	$ -	$ -	$ 239.0
Interest payments on long-term debt	$ 11.6	$ 7.6	$ -	$ -	$ -	$ -	$ 19.2
Operating leases	$ 9.4	$ 6.6	$ 3.6	$ 1.5	$ 0.8	$ 0.2	$ 22.1
	$ 71.9	$ 202.3	$ 3.6	$ 1.5	$ 0.8	$ 0.2	$ 280.3

Other contractual obligations not included in the table above are:

- In November, 2011, the Company announced that it has signed an agreement to acquire Tembec Industries Ltd.'s southern BC Interior wood products assets, for a purchase price including normal working capital of $60 million. The purchase will include Tembec's Elko and Canal Flats sawmills, approximately 1.1 million cubic metres of combined Crown, private land and contract allowable cut, and a long-term agreement to provide residual fibre supply for Tembec's Skookumchuck pulp mill. The acquisition is currently scheduled to close towards the end of the first quarter of 2012, subject to customary closing conditions including regulatory approval.
- Contractual commitments totaling $21.7 million, principally related to the construction of capital assets. This relates mostly to a planer rebuild project at the Company's Grande Prairie sawmill and work on the recovery boiler and feedwater treatment system at Canfor Pulp's Prince George Pulp and Paper mill.
- Purchase obligations and contractual obligations in the normal course of business. For example, purchase obligations of a more substantial dollar amount generally relate to the pulp business and are subject to "force majeure" clauses. In these instances, actual volumes purchased may vary significantly from contracted amounts depending on Canfor's requirements in any given year.
- Deferred reforestation, for which a liability of $96.6 million has been recorded at December 31, 2011 (2010 – $92.2 million). The reforestation liability is a fluctuating obligation, based on the area harvested. The future cash outflows are a function of the actual costs of silviculture programs and of harvesting and are based on, among other things, the location of the harvesting and the activities necessary to adequately stock harvested areas and achieve a "free-to-grow" state.
- Obligations to pay pension and other post-employment benefits, for which the liability for accounting purposes at December 31, 2011 was $298.3 million (2010 - $272.2 million). As at December 31, 2011, Canfor estimated that it would make contribution payments of $52.6 million to its defined benefit plans in 2012.
- Canfor Pulp has an energy agreement with BC Hydro which provides for the sale of electrical power production that exceeds an amended commitment of the cogeneration project at the Prince George Pulp and Paper Mill. Under the agreement, Canfor Pulp is required to post a standby letter of credit as security in annually decreasing amounts as the minimum required amount of electricity is generated. At December 31, 2011, Canfor Pulp had no repayment obligation under the terms of the agreement and a standby letter of credit in the amount of $10.4 million had been issued to BC Hydro as security for future power generation commitments.

TRANSACTIONS WITH RELATED PARTIES

The Company undertakes transactions with various related entities. These transactions are in the normal course of business and are generally on the same terms as those accorded to unrelated third parties, except where noted otherwise. Related party transactions include the purchase of pulp chips and lumber, at market value, from Lakeland Mills Ltd., in which Canfor holds a one-third equity interest.

As at December 31, 2011, the Company had entered into an agreement with Jim Pattison Lease to provide lease management services in 2012. Jim Pattison Lease is a related party to the Company. There were no material transactions with the party during the year and no material amounts were outstanding at December 31, 2011.

Additional details on related party transactions are contained in note 24 to Canfor's 2011 consolidated financial statements.

SELECTED QUARTERLY FINANCIAL INFORMATION

	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010	Q1 2010
Sales and income (millions of dollars)								
Sales	**$ 576.2**	$ 602.1	$ 619.1	$ 624.0	$ 629.1	$ 588.7	$ 634.7	$ 577.9
Operating income (loss)	**$ (64.0)**	$ 14.5	$ 26.5	$ 31.4	$ 41.7	$ 32.0	$ 69.1	$ 43.9
Net income (loss)	**$ (38.1)**	$ (9.6)	$ 26.2	$ 32.3	$ 56.9	$ 37.2	$ 43.7	$ 35.5
Shareholder net income (loss)	**$ (44.1)**	$ (21.6)	$ 2.1	$ 7.0	$ 32.9	$ 9.1	$ 21.1	$ 18.3
Per common share (dollars)								
Shareholder net income (loss) – basic and diluted	**$ (0.31)**	$ (0.15)	$ 0.01	$ 0.05	$ 0.23	$ 0.06	$ 0.15	$ 0.13
Statistics								
Lumber shipments (MMfbm)	**974**	969	973	857	885	865	865	785
OSB shipments (MMsf 3/8”)	**75**	62	69	63	57	58	72	73
Pulp shipments (000 mt)	**275**	291	303	318	331	277	301	316
Average exchange rate – US$/Cdn$	**$ 0.977**	$ 1.020	$ 1.033	$ 1.014	$ 0.987	$ 0.962	$ 0.973	$ 0.961
Average Western SPF 2x4 #2&Btr lumber price (US$)	**$ 238**	$ 246	$ 240	$ 296	$ 269	$ 223	$ 266	$ 268
Average SYP (East) 2x4 #2 lumber price (US$)	**$ 260**	$ 259	$ 251	$ 302	$ 256	$ 243	$ 379	$ 329
Average OSB price – North Central (US$)	**$ 190**	$ 184	$ 172	$ 199	$ 191	$ 178	$ 295	$ 214
Average NBSK pulp list price delivered to U.S. (US$)	**$ 920**	$ 993	$ 1,025	$ 970	$ 967	$ 1,000	$ 993	$ 880

In addition to exposure to changes in product prices and foreign exchange, the Company’s financial results are impacted by seasonal factors such as weather and building activity. Adverse weather conditions can cause logging curtailments, which can affect the supply of raw materials to manufacturing facilities. Market demand also varies seasonally to some degree. For example, building activity and repair and renovation work, which affects demand for lumber products, is generally stronger in the spring and summer months. These factors, along with global supply and demand conditions, affect the Company’s shipment volumes.

THREE-YEAR COMPARATIVE REVIEW

(millions of dollars, except per share amounts)	2011	2010	2009[19]
Sales	**$ 2,421.4**	$ 2,430.4	$ 2,075.8
Net income (loss)	**$ 10.8**	$ 173.3	$ (62.8)
Shareholder net income (loss)	**$ (56.6)**	$ 81.4	$ (70.5)
Total assets	**$ 2,401.6**	$ 2,594.1	$ 2,677.8
Total long-term financial liabilities	**$ 188.1**	$ 235.6	$ 333.3
Shareholder net income (loss) per share, basic and diluted	**$ (0.40)**	$ 0.57	$ (0.50)

[19]Amounts shown for 2009 are presented in accordance with previous Canadian GAAP. Amounts shown for 2010 and 2011 are presented in accordance with IFRS.

QUARTER ENDED DECEMBER 31, 2011 VS. QUARTER ENDED DECEMBER 31, 2010

Overview of Operating Results

The Company recorded EBITDA of negative $16.4 million and a shareholder net loss of $44.1 million for the fourth quarter of 2011, compared to positive EBITDA of $83.5 million and shareholder net income of $32.9 million in the fourth quarter of 2010. The shareholder net loss per share (basic and diluted) was $0.31 for the fourth quarter of 2011, compared to shareholder income per share of $0.23 in the fourth quarter of 2010.

An overview of the results by business segment for the fourth quarter of 2011 compared to the last quarter of 2010 follows.

Lumber

Selected Financial Information and Statistics - Lumber

Summarized results for the Lumber segment for the fourth quarter of 2011 and 2010 were as follows:

(millions of dollars, unless otherwise noted)		Q4 2011		Q4 2010
Sales	**$**	**325.9**	$	318.0
Operating income (loss)	**$**	**(55.6)**	$	0.7
EBITDA, as reported	**$**	**(34.1)**	$	21.7
Negative (positive) impact of inventory write-downs	**$**	**9.7**	$	(0.7)
Mill closure provisions	**$**	**11.9**	$	-
Asset impairment charges	**$**	**7.2**	$	-
EBITDA excluding impact of inventory valuation adjustments, closure provisions and impairment charges	**$**	**(5.3)**	$	21.0
Average SPF 2x4 #2 & Btr lumber price in US$[20]	**$**	**238**	$	269
Average SPF price in Cdn$	**$**	**244**	$	273
Average SYP 2x4 #2 lumber price in US$[21]	**$**	**260**	$	256
Average SYP price in Cdn$	**$**	**266**	$	259
U.S. housing starts (thousand units SAAR)[22]		**657**		539
Production – SPF lumber (MMfbm)		**760.8**		725.1
Production – SYP lumber (MMfbm)		**106.4**		82.9
Shipments – Canfor-produced SPF lumber (MMfbm)[23]		**833.9**		760.1
Shipments – Canfor-produced SYP lumber (MMfbm)[23]		**112.7**		93.4
Shipments – wholesale lumber (MMfbm)		**27.4**		31.4

[20] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)
[21] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)
[22] Source – U.S. Census Bureau
[23] Includes shipments of lumber purchased for remanufacture.

Overview

The operating loss for the lumber segment was $55.6 million for the fourth quarter of 2011, an adverse variance of $56.3 million compared to the fourth quarter of 2010. Reported EBITDA for the lumber segment was negative $34.1 million, compared to positive EBITDA of $21.7 million for the fourth quarter of 2010. Results in the lumber segment for the fourth quarter of 2011 were impacted by various unusual items including an inventory devaluation expense of $9.7 million reflecting lower average market prices and higher unit log costs, an expense of $11.9 million relating to the announced closure of manufacturing operations at the Rustad sawmill and asset impairments of $7.2 million.

Excluding the impact of these unusual items, EBITDA for the fourth quarter of 2011 was negative $5.3 million, an adverse variance of $26.3 million from the fourth quarter of 2010. A significant part of the decrease related to lower market prices, as evidenced by a US$31 per Mfbm fall in the benchmark Western SPF price and weaker low grade prices. In addition, unit manufacturing costs were up compared to the fourth quarter of 2010, with higher log costs more than offsetting a reduction in unit conversion costs resulting from improved operational performance. A current quarter deferred reforestation obligation fair value charge also contributed to the variance.

Markets

During the fourth quarter of 2011, unseasonably mild weather and a slight improvement in the U.S. economy held housing activity steady into the end of the year. Total U.S. housing starts averaged 657,000 units SAAR for the quarter, up 22% from the same quarter in 2010. Multifamily starts continued to gain momentum, and were double the level seen in the comparative quarter, reflecting the better homeownership affordability of this residential structure. Starts for single family units, which consume a larger proportion of lumber were 4% higher than the fourth quarter of 2010.

In Canada, lumber consumption decreased moderately reflecting lower seasonal housing activity. Housing starts averaged 200,000 units SAAR for the quarter, up 20,000 units from the comparable quarter in 2010.

Canfor's offshore lumber shipments were 15% higher than the same quarter in 2010, reflecting the continued growth of shipments to China. Sales volumes to Japan and Korea also saw moderate increases over the comparative quarter.

Sales

Sales for the lumber segment for the fourth quarter of 2011 were $325.9 million, up slightly from the fourth quarter of 2010, while total shipments were 974 million board feet, up 10%.

Compared to the fourth quarter of 2010, the benchmark Random Lengths Western SPF 2x4 #2&Btr price was down US$31, or 12%, at US$238 per Mfbm. Certain other SPF products saw steeper price decreases, with 2x10 product down 19% and 2x4 #3 down 29%, though declines were more modest for studs and MSR (machine stress rated) products. SYP price movements were less pronounced, with the benchmark 2x4 price up US$4 per Mfbm compared to the fourth quarter of 2010, while certain wider dimensions saw modest decreases.

The average value of the Canadian dollar compared to the US dollar in the fourth quarter was down 1 cent, or 1%, compared to the fourth quarter of 2010, partly offsetting the effects of weaker US dollar prices.

The Random Lengths Framing Lumber Composite price averaged US$261 per Mfbm for the fourth quarter of 2011, well below the trigger price of US$315 that is required to reduce the export tax rate on all U.S. bound shipments below the current rate of 15%.

Total residual fibre revenue was up compared to the fourth quarter of 2010, with higher shipments of sawmill residual chips offsetting lower prices resulting from weaker NBSK market pulp prices.

Operations

Lumber production was up 7% compared to the fourth quarter of 2010, at 867 million board feet, for the most part resulting from solid productivity improvements and the Vavenby restart, offset in part by the closure of the Clear Lake sawmill in early 2011.

Compared to the fourth quarter of 2010, unit manufacturing costs showed a small increase, with lower unit conversion costs being more than offset by increases in unit log costs at Western SPF operations. The lower unit conversion costs reflected the impact of productivity improvements in the current quarter as well as the closure of the higher cost Clear Lake sawmill operation. The higher unit log costs were principally due to higher diesel and hauling costs and the challenges presented by unseasonably milder weather in the current period.

Total restructuring, mill closure and severance costs for the lumber segment were $10.9 million in the current quarter, largely due to an $11.9 million provision for the announced closure of manufacturing operations at the Rustad sawmill. Restructuring costs were $1.9 million in the fourth quarter of 2010, reflecting ongoing costs for mills idled at that time.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[24]

Summarized results for the Pulp and Paper segment for the fourth quarter of 2011 and 2010 were as follows:

(millions of dollars, unless otherwise noted)		Q4 2011		Q4 2010
Sales	**$**	**237.0**	$	300.8
Operating income	**$**	**17.5**	$	50.0
EBITDA	**$**	**39.2**	$	66.4
Average pulp price delivered to U.S. – US$[25]	**$**	**920**	$	967
Average price in Cdn$	**$**	**942**	$	980
Production – pulp (000 mt)		**294.5**		320.6
Production – paper (000 mt)		**33.5**		34.7
Shipments – Canfor-produced pulp (000 mt)		**275.4**		331.1
Shipments – paper (000 mt)		**30.2**		39.0

[24] Includes the Taylor pulp mill and 100% of Canfor Pulp, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.
[25] Per tonne, NBSK pulp price delivered to U.S. (RISI)

Overview

Operating income for the pulp and paper segment was $17.5 million for the fourth quarter of 2011, down $32.5 million from the fourth quarter of 2010. EBITDA for the pulp and paper segment for the fourth quarter of 2011 was $39.2 million, down $27.2 million from the fourth quarter of 2010.

The lower earnings compared to the fourth quarter of 2010 were primarily attributable to lower market NBSK pulp prices, as well as lower shipment levels. Unit manufacturing costs were flat compared to the fourth quarter of 2010, as a small increase in unit conversion costs relating to lower production volumes, mostly reflecting downtime related to the Northwood upgrade, was offset by lower fibre costs, reflecting lower sawmill residual chip costs (linked to the NBSK market pulp price). In addition, results were negatively impacted in the current quarter by accelerated amortization related to assets replaced during the Northwood upgrade.

Markets

Global softwood pulp markets remained weak during the fourth quarter of 2011. Producer inventory levels increased through the period resulting in successive price decreases. According to the latest published World 20 report, global bleached softwood shipments were unchanged compared to the same period in 2010.

PPPC statistics reported increased global demand for printing and writing papers and tissue of 1% for 2011 as compared to 2010. PPPC also reported an increase in shipments of bleached softwood sulphate pulp of 3% for 2011 as compared to 2010, with increased shipments to Asia offset by reductions in Europe and North America.

At the end of December 2011, World 20 producers of bleached softwood pulp inventories were at 36 days of supply. By comparison, December 2010 inventories were at 25 days of supply. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

Sales

Shipments of Canfor-produced pulp in the fourth quarter of 2011 were 275,000 tonnes, down 56,000 tonnes, or 17%, from the fourth quarter of 2010, reflecting softening global demand.

NBSK pulp list prices in the fourth quarter of 2011 were well down from the fourth quarter of 2010, with prices to the U.S. falling US$47, to US$920 per tonne, and prices to Europe down almost US$90, to US$868 per tonne. CPLP's China list price was also down significantly, dropping just over US$100 per tonne from the comparative period. The slightly weaker Canadian dollar went a small way to offsetting some of these pricing losses. BCTMP sales realizations showed a modest improvement, reflecting higher market prices for this product, as well as the weaker Canadian dollar.

Operations

Pulp production in the fourth quarter of 2011 was 295,000 tonnes, down 26,000 tonnes from the fourth quarter of 2010, mostly reflecting downtime for the Northwood upgrade completed in October 2011.

Compared to the fourth quarter of 2010, unit cash manufacturing costs were substantially unchanged, with an increase in conversion costs reflecting lower production levels offset by lower unit fibre costs. The decrease in fibre costs in part reflected lower prices for sawmill residual chips. Higher overall costs in the current quarter also reflected the increased amortization, while the comparative quarter of 2010 included higher short-term incentive compensation costs and expenses relating to the conversion of Canfor Pulp Income Fund to a public corporation (Canfor Pulp Products Inc.) on January 1, 2011.

Unallocated and Other Items

(millions of dollars)		Q4 2011		Q4 2010
Operating loss of Panels operations[26]	**$**	**(19.0)**	$	(2.8)
Corporate costs	**$**	**(6.9)**	$	(6.2)
Finance expense, net	**$**	**(4.3)**	$	(4.6)
Foreign exchange gain on long-term debt and investments, net	**$**	**4.9**	$	9.8
Gain on derivative financial instruments	**$**	**9.6**	$	1.8
Other income, net	**$**	**1.3**	$	11.0

[26] The Panels operations include the Peace Valley OSB joint venture, the only facility currently operating, and the Company's Tackama plywood and PolarBoard OSB plants, both of which are currently indefinitely idled.

The panels operations reported an operating loss of $19.0 million for the fourth quarter of 2011, compared to a loss of $2.8 million for the fourth quarter of 2010. Results for the fourth quarter of 2011 include an expense of $10.6 million relating to the announced closure of the Tackama plywood plant, as well as an asset impairment charge of $2.0 million relating to other idled panels assets. Excluding the impact of these items, and inventory valuation adjustments in the respective periods, the operating loss of panels operations was $5.2 million in the fourth quarter of 2011. In the fourth quarter of 2010, the panels operating loss included a gain on sale of non-core assets and other positive one-time adjustments. Excluding these items, and inventory valuation adjustments, the operating loss was $4.7 million. Compared to the fourth quarter of 2010, the decline in results reflects weaker market conditions and pricing for OSB products.

Corporate costs were $6.9 million for the fourth quarter of 2011, up $0.7 million from the fourth quarter of 2010. The current quarter expense reflected further restructuring costs and costs relating to the pending acquisition of two sawmills and timber tenure from Tembec which was announced in the quarter.

Net finance expense for the fourth quarter of 2011 was $4.3 million, down $0.3 million from the fourth quarter of 2010, with lower interest costs on long term debt being partially offset by a positive accretion expense adjustment related to the Company's reforestation obligation in the comparative quarter.

The Company recorded a foreign exchange translation gain on its US dollar denominated debt, net of investments, of $4.9 million for the fourth quarter of 2011, as a result of the strengthening of the Canadian dollar against the US dollar, which rose 2% between the respective quarter ends. The fourth quarter of 2010 showed a $9.8 million gain, due to the Canadian dollar rising 4%.

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs and lumber prices. For the fourth quarter of 2011, the Company recorded a net gain of $9.6 million related to its derivative financial instruments, principally reflecting unrealized gains attributable to the stronger Canadian dollar during the quarter, and gains relating to diesel derivatives.

Other income, net of $1.3 million for the fourth quarter of 2011 includes a $2.2 million positive fair value adjustment on a receivable related to the sale of assets in a prior period. This gain was mostly offset by unfavourable foreign exchange movements on US dollar denominated cash, receivables and payables of Canadian operations of $2.1 million, compared to a loss of $3.7 million in the fourth quarter of 2010.

In addition, in the fourth quarter of 2011, there was also a $0.5 million gain relating to the change in fair value of the Company's investment in ABCP. This compares to an ABCP-related gain of $6.3 million in the fourth quarter of 2010. In addition, a gain of $5.5 million was recorded in the fourth quarter of 2010 relating to the sale of the operating assets of Howe Sound Pulp and Paper Limited Partnership.

EBITDA RECONCILIATION AND SPECIFIC ITEMS AFFECTING COMPARABILITY

EBITDA Reconciliation

The following table reconciles the Company's net income (loss) from continuing operations, as reported in accordance with IFRS, to EBITDA:

(millions of dollars)	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010	Q1 2010
Net income (loss), as reported	**$ (38.1)**	**$ (9.6)**	**$ 26.2**	**$ 32.3**	$ 56.9	$ 37.2	$ 43.7	$ 35.5
Add (subtract):								
Amortization	**$ 47.6**	**$ 39.9**	**$ 40.3**	**$ 41.5**	$ 41.8	$ 42.2	$ 41.9	$ 41.8
Finance expense, net	**$ 4.3**	**$ 7.0**	**$ 4.9**	**$ 6.3**	$ 4.6	$ 6.9	$ 7.6	$ 7.7
Foreign exchange (gain) loss on long-term debt and temporary investments, net	**$ (4.9)**	**$ 16.6**	**$ (2.0)**	**$ (4.7)**	$ (9.8)	$ (8.9)	$ 12.8	$ (8.8)
(Gain)loss on derivative financial instruments	**$ (9.6)**	**$ 12.1**	**$ (1.3)**	**$ (4.7)**	$ (1.8)	$ (2.8)	$ 3.3	$ 1.2
Other (income) expense	**$ (1.3)**	**$ (5.2)**	**$ (1.1)**	**$ 1.7**	$ (11.0)	$ 3.3	$ (3.3)	$ 2.9
Income tax (recovery) expense	**$ (14.4)**	**$ (6.4)**	**$ (0.2)**	**$ 0.5**	$ 2.8	$ (3.7)	$ 5.0	$ 5.4
EBITDA, as reported	**$ (16.4)**	**$ 54.4**	**$ 66.8**	**$ 72.9**	$ 83.5	$ 74.2	$ 111.0	$ 85.7
Negative (positive) impact of inventory write-downs[27]	**$ 10.9**	**$ 0.1**	**$ (1.6)**	**$ 2.9**	$ (0.1)	$ (2.6)	$ 5.5	$ (23.0)
Mill closure provisions	**$ 22.5**	**$ -**	**$ -**	**$ -**	$ -	$ 17.3	$ -	$ -
Asset impairment charges	**$ 9.2**	**$ -**	**$ -**	**$ -**	$ -	$ -	$ -	$ -
EBITDA excluding impact of inventory write-downs and closure & idling provisions	**$ 26.2**	**$ 54.5**	**$ 65.2**	**$ 75.8**	$ 83.4	$ 88.9	$ 116.5	$ 62.7

[27] In accordance with IFRS, Canfor records its log and finished product inventories at the lower of cost and net realizable value ("NRV"). Significant movements in inventory volumes occur due to the seasonal build and drawdown of logs in the first and second quarters each year, respectively. In periods where market prices are depressed and NRVs are below cost, this movement in log inventory volumes can result in large swings in inventory write-down amounts recorded in those periods. In addition, changes in market prices, foreign exchange rates, and costs over the respective reporting periods affect inventory write-downs.

Specific Items Affecting Comparability of Shareholder Net Income (Loss)

Factors that impact the comparability of the quarters are noted below:

After-tax impact, net of non-controlling interests (millions of dollars, except per share amounts)	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010	Q1 2010
Shareholder net income (loss), as reported	**$ (44.1)**	$ (21.6)	$ 2.1	$ 7.0	$ 32.9	$ 9.1	$ 21.1	$ 18.3
Foreign exchange (gain) loss on long-term debt and investments, net	**$ (3.3)**	$ 11.0	$ (1.4)	$ (3.0)	$ (6.9)	$ (6.3)	$ 9.0	$ (6.2)
(Gain) loss on derivative financial instruments	**$ (6.7)**	$ 7.0	$ (0.7)	$ (2.9)	$ (0.5)	$ (1.1)	$ 1.1	$ 1.0
Decrease (increase) in fair value of asset-backed commercial paper	**$ (0.5)**	$ 1.8	$ (0.5)	$ (1.0)	$ (5.5)	$ -	$ -	$ -
Mill closure provisions	**$ 17.0**	$ -	$ -	$ -	$ -	$ 13.0	$ -	$ -
Asset impairment charges	**$ 5.5**	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Restructuring costs related to changes in management group	**$ -**	$ -	$ 2.6	$ -	$ -	$ -	$ -	$ -
Gain on sale of operating assets of Howe Sound Pulp and Paper Limited Partnership	**$ -**	$ -	$ -	$ -	$ (4.9)	$ -	$ -	$ -
Net impact of above items	**$ 12.0**	$ 19.8	$ -	$ (6.9)	$ (17.8)	$ 5.6	$ 10.1	$ (5.2)
Adjusted net income (loss)	**$ (32.1)**	$ (1.8)	$ 2.1	$ 0.1	$ 15.1	$ 14.7	$ 31.2	$ 13.1
Shareholder net income (loss) per share (EPS), as reported	**$ (0.31)**	$ (0.15)	$ 0.01	$ 0.05	$ 0.23	$ 0.06	$ 0.15	$ 0.13
Net impact of above items per share	**$ 0.09**	$ 0.14	$ 0.00	$ (0.05)	$ (0.12)	$ 0.04	$ 0.07	$ (0.04)
Adjusted net income (loss) per share	**$ (0.22)**	$ (0.01)	$ 0.01	$ 0.00	$ 0.11	$ 0.10	$ 0.22	$ 0.09

OUTLOOK

Lumber Markets

The North American lumber market is forecast to improve modestly as the U.S. economy continues on its slow road to recovery. The residential construction market is projected to trend higher with historically low mortgage rates and improved job markets contributing to record levels of housing affordability and attracting potential homebuyers into the market. The repair and remodeling segment is also projected to show a modest pick up following the recent improvement in housing activity. The Canadian housing market is projected to remain steady.

Strong offshore demand is anticipated to continue into 2012. Shipments to China have rebounded in early 2012 after slowing in advance of the Lunar New Year, although prices for lower grade lumber are forecast to remain at low levels through the first quarter. Demand from Japan is forecast to remain stable through early 2012.

Pulp and Paper Markets

The global softwood pulp market is forecast to remain soft through the first quarter of 2012. There is ample supply as historically there is minimal scheduled maintenance downtime at pulp mills during the winter months. However, current pricing at or below cash costs for some NBSK producers may reduce the risk of further price erosion. Global softwood pulp demand is projected to remain flat in 2012 on slowed growth from China and declining production of graphic papers in mature markets. European demand may be somewhat influenced by the ability of Europe to manage through the current debt crisis in certain countries.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with International Financial Reporting Standards ("IFRS") requires management to make estimates and assumptions that affect the amounts recorded in the financial statements. Management regularly reviews these estimates and assumptions based on currently available information. While it is reasonably possible that circumstances may arise which cause actual results to differ from these estimates, management does not believe it is likely that any such differences will materially affect Canfor's financial position.

Employee Future Benefits

Canfor has various defined benefit and defined contribution plans providing both pension and other retirement benefits to most of its salaried employees and certain hourly employees not covered by forest industry union plans. Canfor also provides certain health care benefits and pension bridging benefits to eligible retired employees. The costs and related obligations of the pension and other retirement benefit plans are accrued in accordance with the requirements of IFRS.

Canfor uses independent actuarial firms to perform actuarial valuations of the fair value of pension and other retirement benefit plan obligations. The application of IFRS requires judgments regarding certain assumptions that affect the accrued benefit provisions and related expenses, including the discount rate used to calculate the present value of the obligations, the expected rate of return on plan assets, the rate of compensation increase and the assumed health care cost trend rates. Management and the Board of Directors' Pension Committee evaluate these assumptions annually based on experience and the recommendations of its actuarial firms. Changes in these assumptions result in actuarial gains or losses, which are recognized in full in each period with an adjustment through Other Comprehensive Income.

The actuarial assumptions used in measuring Canfor's defined benefit plan are as follows:

	2011		2010	
(weighted average assumptions)	**Pension Benefit Plans**	**Other Benefit Plans**	**Pension Benefit Plans**	**Other Benefit Plans**
Accrued benefit obligation as of December 31:				
Discount rate	**5.00%**	**5.30%**	5.50%	5.75%
Rate of compensation increase	**3.00%**	**n/a**	3.00%	n/a
Benefit costs for year ended December 31:				
Discount rate	**5.50%**	**5.75%**	6.25%	6.75%
Expected long-term rate of return on plan assets	**7.00%**	**n/a**	7.50%	n/a
Rate of compensation increase	**3.00%**	**n/a**	3.00%	n/a

Assumed health care cost trend rates used in the accrued benefit obligation were as follows:

(weighted average assumptions)	2011	2010
Initial health care cost trend rate	**6.33%**	6.95%
Ultimate health care trend rate	**4.50%**	4.20%
Year ultimate rate reached	**2029**	2029

Assumed health care cost trend rates have a significant effect on the amounts reported for the other post-retirement benefit plans. A one percentage point change in assumed health care cost trend rates in each year would have had the following impact on the amounts recorded in 2011:

	1% Increase	1% Decrease
Accrued benefit obligation	$ 30.0	$ 24.1
Total service and interest cost	$ 1.9	$ 1.5

See "Financial Requirements and Liquidity – Pension Obligations" section for further discussion regarding the funding position of Canfor's pension plans.

Deferred Reforestation

Canfor accrues an estimate of its future liability to perform forestry activities, defined to mean those silviculture treatments or activities that are carried out to ensure the establishment of a free-growing stand of young trees, including logging road rehabilitation on its forestry tenures in BC, Alberta and Quebec. An estimate is recorded in the financial statements based on the number of hectares of timber harvested in the period and the estimated costs of fulfilling Canfor's obligation. Payments in relation to reforestation are expected to occur over periods of up to 15 years (the significant majority occurring in the first seven years) and have been discounted accordingly at risk-free rates ranging from 1.0% to 2.3%. The actual costs that will be incurred in the future may vary based on, among other things, the actual costs at the time of silviculture activities.

Deferred Taxes

In accordance with IFRS, Canfor recognizes deferred income tax assets when it is probable that the deferred income tax assets will be realized. This assumption is based on management's best estimate of future circumstances and events. If these estimates and assumptions are changed in the future, the value of the deferred income tax assets could be reduced or increased, resulting in an income tax expense or recovery. Canfor reevaluates its deferred income tax assets on a regular basis.

Asset Retirement Obligations

Canfor records the estimated fair value of a liability for asset retirement obligations, such as landfill closures, in the period when it is incurred. For Canfor Pulp's landfill closure costs, the fair value is determined using estimated closure costs discounted over the estimated useful life. Payments relating to landfill closure costs are expected to occur at periods ranging from 7 to 40 years and have been discounted at risk-free rates ranging from 1.5% to 2.5%. The actual closure costs and periods of payment may differ from the estimates used in determining the year end liability. On initial recognition, the fair value of the liability is added to the carrying amount of the associated asset and amortized over its useful life. The liability is accreted over time through charges to earnings and reduced by actual costs of settlement.

Environmental Remediation Costs

Costs associated with environmental remediation obligations are accrued and expensed when there exists a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Such accruals are adjusted as further information develops or circumstances change. Costs of future expenditures for environmental remediation obligations are discounted to their present value when the amount and timing of expected cash payments are reliably determinable.

Impairment of Goodwill

Goodwill, which is the excess of the cost of an acquisition over the fair value of the net identifiable assets acquired, is not amortized but is assessed annually for impairment or more frequently if events or circumstances indicate that it may be impaired.

An impairment loss is recognized in net income at the amount that the carrying value, including goodwill, of the relevant operating division exceeds its recoverable amount. The recoverable amount is the higher of the unit's fair value less costs to sell and value in use. For Canfor's goodwill, the fair value of the relevant assets is determined by estimating the future expected discounted cash flows of the unit as a whole on an annual basis, and more often if required. As part of this process, assumptions are made in relation to forecast product prices and exchange rates. Price forecasts are determined with reference to Resource Information Systems, Inc. ("RISI") and Forest Economic Advisors ("FEA") publications and management estimates. Other significant assumptions include the discount rate and foreign exchange rate used. The net present value of the future expected cash flows, which approximates fair value, is compared to the carrying value of the Company's investment in these assets, including goodwill, at year end.

Based upon the analysis performed in 2011 the net present value of the estimated future discounted cash flows exceeded the value of the investment, and therefore no impairments to goodwill were required. However, if the U.S. and global economic downturn were to be longer or more severe than anticipated in the forecast assumptions, there is a possibility that an impairment of goodwill may be required in future periods.

Asset Impairments

Canfor reviews the carrying values of its long-lived assets, including property, plant and equipment and timber licenses, on a regular basis as events or changes in circumstances may warrant. An impairment loss is recognized in net income at the amount that the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. A review of the carrying values of Canfor's sawmill and panel operations and various other assets was undertaken in 2010 and 2011 as a result of the ongoing difficult market conditions and global economic uncertainty.

Discounted future cash flow models were used to estimate the fair value of the majority of Canfor's long-lived assets. Key assumptions used related to forecast product prices and exchange rates, which were determined in a similar manner to tests for impairment of goodwill, as above. Other significant assumptions are the estimated useful life of the long-lived assets, the discount rate used and the impact of the Mountain Pine Beetle epidemic.

As a result of its review, impairment charges totaling $9.2 million were recorded in 2011 relating to certain of the Company's sawmill and panel assets. No impairments were recorded in 2010, however impairments totaling $56.0 million were recorded in the Company's opening IFRS balance sheet as at January 1, 2010. These impairments related to certain of the Company's timber license and property, plant and equipment assets.

Valuation of Log and Finished Product Inventories

Log and finished product inventories are recorded at the lower of cost and net realizable value. For inventories of solid wood products, where valuation adjustments were recorded in 2011, the net realizable value is determined by taking into account forecast prices and exchange rates for the period over which the inventories are expected to be sold. Forecast prices are determined using RISI forecasts and management's estimates as at the year end, and may differ from the actual prices at which the inventories are sold. At the end of December 2011, the inventory balances included total write-downs of $15.5 million.

Allowance for Doubtful Accounts

An allowance for doubtful accounts of $2.8 million has been recorded at December 31, 2011 which reflects management's assessment of risks attached to the collection of receivable balances. While significant bad debts have not been experienced in prior years, the provision is considered appropriate due to the ongoing U.S. housing downturn which may affect the ability of certain customers to pay amounts owed to the Company.

INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

Canfor's transition date to IFRS was January 1, 2010 and the Company's financial statements for the year ended December 31, 2011 are the first annual financial statements prepared in accordance with IFRS. Comparative information for the 2010 year has been restated and various reconciliations between the amounts reported under previous Canadian generally accepted accounting principles ("previous GAAP") and IFRS are set out in note 31 to the financial statements, together with explanatory notes and details of transition exemptions available that were applied. The principal impacts on equity of the transition to IFRS at the date of transition are as follows:

- There are differences in the methodology used to determine if an asset should be impaired under IFRS compared to that under previous GAAP. The previous GAAP rules provided for a two-step test, with no impairment being required if the undiscounted future expected cash flows relating to an asset exceeded the carrying value of that asset. Under IFRS, the undiscounted cash flows are not considered and an impairment is recorded where the recoverable amount (defined as the higher of 'value in use' and 'fair value less costs to sell') is below the asset's carrying value. As a result, impairments were required at January 1, 2010 for certain assets under IFRS that were not recorded under previous GAAP. The effect at the date of transition was to decrease the book value of certain sawmill assets included within property, plant and equipment by $9.4 million and timber licenses by $46.6 million. An impairment of $0.8 million was also recorded against capital spares inventory.

- Under IFRS, the Company's accounting policy is to recognize all actuarial gains and losses, arising on its defined benefit pension and other non-pension post retirement plans, immediately in other comprehensive income. Under previous GAAP, actuarial gains and losses were deferred and taken through the income statement over a number of years. At the date of transition, all previously unrecognized cumulative actuarial gains and losses were recognized in retained earnings.

  This resulted in pension assets recorded under previous GAAP of $110.6 million being removed from the Company's balance sheet, and liabilities of $101.3 million being recorded to reflect the actual funding position of the defined benefit pension plans. Going forward, Canfor has elected to recognize these actuarial gains and losses immediately through other comprehensive income under IFRS.

- Under previous GAAP, long-term provisions were discounted at the credit-adjusted risk-free rate in effect at the date the liability was recorded, whereas under IFRS these are discounted at the risk-free rate in effect at the balance sheet date. This resulted in a lower discount rate being used to value the Company's deferred reforestation and asset retirement obligations, with increases of $7.1 million and $1.1 million, respectively, to these provisions at January 1, 2010.

- In accordance with IFRS 1, the Company has elected to deem all foreign currency translation differences that arose prior to the date of transition in respect of entities with functional currencies other than the Canadian dollar to be nil at the date of transition. This resulted in a credit of $16.0 million to accumulated foreign translation differences and a charge of the same amount to retained earnings.

Reporting in accordance with IFRS is now fully engrained into Canfor's reporting systems and processes.

FUTURE CHANGES IN ACCOUNTING POLICIES

A number of new or revised accounting standards have recently been issued by the International Accounting Standards Board ("IASB"). These are mostly effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. Canfor has completed an initial review of the potential impact of these new standards on the Company, and is currently considering whether or not to adopt any of these in advance of the mandatory date.

Consolidation and interests in other entities

In May 2011, as part of its consolidation project, the IASB issued the following new suite of consolidation and related standards. The suite is intended to cover all aspects of interests in other entities from determination of how to account for interests in other entities to required disclosure of the interest in those entities. Early adoption is permitted provided that the entire suite of consolidation standards is adopted at the same time.

- IFRS 10, *Consolidated Financial Statements,* introduces a new single control model and single consolidation model built on a revised definition of control and criteria for assessment of consolidation. The new Standard requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvements with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12, *Consolidation – Special Purpose Entities* and parts of IAS 27, *Consolidated and Separate Financial Statements.* IFRS 10 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.
- IFRS 11, *Joint Arrangements,* redefines joint operations and joint ventures with a focus on the rights and obligations of an arrangement, rather than its legal form. The new Standard requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interest in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures,* and SIC-13, *Jointly Controlled Entities – Non-monetary Contributions by Venturers.* Canfor is in the process of assessing the full impact of IFRS 11 on amounts recorded in the financial statements.
- IFRS 12, *Disclosures of Interests in Other Entities,* establishes disclosure requirements for interest in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The Standard carries forward existing disclosures and also introduces significant additional disclosures that address the nature of, and risks associated with, an entity's interests in other entities. IFRS 12 is not expected to have a material impact on amounts recorded in the financial statements of Canfor; the principal impact will be in the form of additional disclosures.
- There have been amendments to existing standards, including IAS 27 (2011), *Separate Financial Statements,* and IAS 28 (2011), *Investments in Associates and Joint Ventures.* IAS 27 (2011) addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 (2011) sets out the equity accounting for joint ventures, as well as associates, once the assessment of the arrangement has been made under IFRS 11. The amendments to IAS 27 are not expected to have a material impact on amounts recorded in the financial statements of the Company. Canfor is in the process of assessing the full impact of the amendments to IAS 28 which is dependent upon the assessment of the Company's joint arrangements under IFRS 11.

Employee benefits

- IAS 19, *Employee Benefits,* has been amended to make changes to the recognition and measurement of defined benefit pension expense and termination benefits and to enhance the disclosure of all employee benefits. Pension benefit cost will be split between (i) the cost of benefits accrued in the current period (service cost) and benefit changes (past-service costs (including plan amendments, settlements and curtailments)); and (ii) finance expense or income. Interest cost and expected return on plan assets, which currently reflect different rates, will be replaced with a net interest amount that is calculated by applying one discount rate to the net defined benefit liability (asset). The principal impact on the Company of this portion of the amended standard is expected to be an increase in net finance cost as the Company's return on plan assets will effectively be estimated at a lower rate.

  The amended standard also requires immediate recognition of actuarial gains and losses in other comprehensive income as they arise, without subsequent recycling to net income. This is consistent with the Company's current accounting policy.

  In addition, under the amended standard, the impact of plan amendments related to past service will no longer be recognized over a vesting period but instead will be recognized immediately in the period of a plan amendment. A number of other amendments have been made to recognition, measurement and classification including redefining short-term and other long-term benefits, guidance on the treatment of taxes related to benefit plans, guidance on risk/cost sharing features, and expanded disclosures. Canfor is in the process of assessing the full impact of IAS 19 on amounts recorded in the financial statements and related disclosures.

Other standards and amendments

- IFRS 9, *Financial Instruments,* addresses classification and measurement of financial assets, financial liabilities and equity instruments, and is effective January 1, 2015, with earlier adoption permitted. The Standard replaces the multiple category and measurement models in IAS 39, *Financial Instruments – Recognition and Measurement*. The new Standard limits the number of categories for classification of financial assets to two: amortized cost and fair value through profit or loss. Equity instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. The ability to recognize unquoted equity instruments at cost under IAS 39 is eliminated. The requirements for financial liabilities are largely in line with IAS 39. IFRS 9 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.

- IFRS 13, *Fair Value Measurement,* is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received on sale of an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures. IFRS 13 is not expected to have material impact on amounts recorded in the financial statements of Canfor.

- IAS 1, *Presentation of Financial Statements,* has been amended to require entities to separate items presented in OCI into two groups, based on whether or not items may be recycled in the future. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately. The amendment is effective for annual periods beginning on or after July 1, 2012 with earlier application permitted. IAS 1 is not expected to have a material impact on amounts recorded in the financial statements of Canfor.

RISKS AND UNCERTAINTIES

Risks and uncertainties fall into the general business areas of markets, international commodity prices, competition, currency exchange rates, environmental issues, forest land base, government regulations, public policy and labour disputes, and, for Canadian companies, a history of trade disputes and issues and Aboriginal land claims. The future impact of the various uncertainties and potential risks described in the following paragraphs (together with the risks and uncertainties identified under each of the Company's business segments) cannot be quantified or predicted with certainty. However, Canfor does not foresee unmanageable adverse effects on its business operations from, and believes that it is well positioned to deal with, such matters as may arise. The risks and uncertainties are set out in alphabetical order.

Aboriginal Issues

Canadian judicial decisions have recognized the continued existence in the country of Aboriginal rights, including title, to lands continuously used or occupied by Aboriginal groups. Although Aboriginal groups have claimed Aboriginal rights over substantial portions of BC no Aboriginal right or title has yet been determined in areas overlapping with Canfor's forest tenures and other operations that aren't currently subject to treaties. While uncertainty regarding property rights in Canada (including forest tenure and other resource rights) continues to exist, particularly in those areas where treaties have not been concluded with Aboriginal groups, the Government of BC has provided greater certainty for the forest industry by reaching agreements on forest resources with many bands. As a means of protecting treaty and aboriginal rights, as well as undetermined Aboriginal rights, Canadian courts continue to confirm a duty to consult with Aboriginal groups when the Crown has knowledge of existing rights or the potential existence of an Aboriginal right, such as title, and contemplates conduct that might adversely impact them. The courts have not extended this duty to third parties, such as forest companies.

As issues relating to Aboriginal and treaty rights and consultation continue to be heard, developed and resolved in Canadian courts, Canfor will continue to cooperate, communicate and exchange information and views with Aboriginal groups and government, and participate with the Crown in its consultation processes with Aboriginal groups in order to foster good relationships and minimize risks to its tenures and operational plans. Due to their complexity, it is not expected that the issues regarding Aboriginal and treaty rights or consultation will be finally resolved in the short term and, accordingly, the impact of these issues on the timber supply from Crown lands and Canfor's tenures and on Canfor's operations is unknown at this time.

Canfor believes in building mutually beneficial and lasting relationships with local First Nations whose treaty rights or potential Aboriginal rights overlap with Canfor's areas of operations. The Company continues to communicate frequently with Aboriginal groups in the areas that Canfor operates in and, where appropriate, to develop business relationships, especially in the areas of timber harvesting and silviculture.

Employee Future Benefits

Canfor has several defined benefit plans, which provide pension and other post-retirement benefits to certain salaried and hourly employees. Pension plan benefits are based on years of service and final average salary (for salaried employees), and flat rate benefit and years of service (for hourly employees). Canfor's other post-retirement benefit plans are non-contributory and include a range of health care and other benefits. Canfor also provides pension bridge benefits to certain eligible former employees.

Cash payments required to fund the pension plan are determined by actuarial valuation completed at least once every three years, with the most recent actuarial valuation for the largest plan completed as of December 31, 2010. Other post-retirement benefit plans are unfunded, and the Company makes payments as required to cover liabilities as they arise.

The funded surplus (deficit) of each defined benefit plan is calculated as the difference between the value of any plan assets and an actuarial estimate of future liabilities. Any deficit in the registered pension plans determined following an actuarial valuation must be funded in accordance with regulatory requirements, normally over 5 or 15 years. Some of the unregistered plans are also partially funded.

Through its pension funding requirements, Canfor is exposed to the risk of fluctuating market values for the securities making up the plan assets, and to changes in prevailing interest rates which determine the discount rate used in calculating the estimated future liabilities. The funding requirements may also change to the extent that other assumptions used are revised, such as inflation rates or mortality assumptions.

For Canfor's main Salaried Pension Plan, a one percentage point increase in the rate of return on plan assets over one year would reduce the funded deficit by an estimated $4.0 million. A one percent increase in the discount rate used in calculating the actuarial estimate of future liabilities would reduce the funded deficit by an estimated $50.0 million. These changes would only impact the Company's funding requirements in years where a new actuarial funding valuation was performed and regulator approval for a change in funding contributions was obtained.

Environmental Issues

Canfor's operations are subject to environmental regulation by federal, provincial, state and local authorities, including specific environmental regulations relating to air emissions and pollutants, wastewater (effluent) discharges, solid waste, landfill operations, forestry practices, site remediation and the protection of endangered species and critical habitat. Canfor has incurred, and will continue to incur, capital expenditures and operating costs to comply with environmental laws and regulations. No assurance can be given that changes in these laws and regulations or their application will not have a material adverse effect on Canfor's business, operations, financial condition and operational results. Similarly, no assurance can be given that capital expenditures necessary for future compliance with existing and new environmental laws and regulations could be financed from Canfor's available cash flow. In addition, Canfor may discover currently unknown environmental issues, contamination, or conditions relating to its past or present operations. This may require site or other remediation costs to maintain compliance or correct violations or result in governmental or private claims for damage to person, property or the environment, which could have a material adverse effect on Canfor's business, financial condition and operational results.

Canfor has systems in place to identify, account for and appropriately address potential environmental liabilities. The Company also has governance in place including an Environmental, Health and Safety Committee of the Board, a Corporate Environmental Management Committee including Officers of the Company, and environmental professionals on staff to manage potential risks, issues and liabilities.

Canfor has in place internal policies and procedures under which all its forestry and manufacturing operations are regularly audited for compliance with laws and accepted standards and with its management system requirements. Canfor's woodlands operations employ environmental management systems following the ISO 14001 Environmental Management System Standard. Further, approximately 97% of Canfor's forest tenures in Canada are third-party certified to the Canadian Standards Association's ("CSA") sustainable forest management standard. With the pending acquisition of Tembec Industries Inc.'s southern BC forestlands, Canfor will be assuming an operation certified to the Forest Stewardship Council certification program and will need to transfer this certificate or, should transferring prove impracticable, transition the operation to CSA certification. Canfor's operations and its ability to sell its products could be adversely affected if those operations did not, or were perceived by the public as failing to, comply with applicable laws and standards, including responsible environmental and sustainable forestry standards. Additionally, as many of Canfor's environmental management systems are based on third-party standards, any dissolution of these standards organizations could impact Canfor's operations in the short term while transitioning to a new system or standard.

On November 25, 2009, the BC Ministry of Environment released the greenhouse gas ("GHG") reporting regulations under the Greenhouse Gas Reduction Act, requiring any facilities emitting more than 10,000 tonnes of CO2 to report 2010 emissions in 2011. In 2011, two of Canfor's sawmills and all of the pulp mills (including Canfor Pulp's pulp mills) registered and reported GHG emissions under the BC GHG reporting regulation. GHG emission reporting has been required federally and in Alberta for several years with Canfor Pulp's facilities meeting the requirements for federal reporting, though Canfor's wood products facilities have not triggered federal or Alberta reporting thresholds. Canfor's New South facilities located in North and South Carolina are subject to state GHG reporting requirements.

The BC government is in the process of assessing whether or not it will proceed with plans to participate in the Western Climate Initiative regional GHG cap and trade system. Should cap and trade be implemented for BC, the Canfor Pulp mills and Taylor pulp would likely be subject to cap and trade legislation. The economic impact on pulp and paper mills will depend on factors such as cost to purchase carbon credits and allocation allowance, which are currently underterminable.

The Quebec government in December 2011 announced adoption of GHG cap and trade legislation with capping and reduction of emissions starting January 1, 2013. Canfor's Daaquam facility in Quebec falls well under the 25,000 tonnes CO_2e annual emission threshold so is not subject to capping and reduction requirements.

Canfor is a participant in the carbon offset market in Alberta and British Columbia, selling offset credits tied to its recently purchased (October 2011) biomass cogeneration facility in Grande Prairie and from biomass heat energy projects recently completed at several mills in BC. Canfor Pulp is also a participant in the carbon offset market in BC.

Fibre Cost and Availability

The Company's fibre costs are affected by a number of different factors which could have a significant impact on operating results. These include logging and hauling costs, stumpage and road and reforestation costs. Lumber market fluctuations and log market speculative bidding can also have a significant impact on both fibre supply and costs.

In addition, the Company's ability to harvest fibre for use in its operations could be adversely impacted by natural events such as forest fires, severe weather conditions or insect infestations. In the event that sufficient volumes of economically viable fibre cannot be provided to an operation, it may be necessary to close that operation for a period of time, or even permanently. Such closures could result in significant costs to the Company. The Company is not insured for loss of standing timber.

Financial Risk Management and Earnings Sensitivities

Demand for forest products, both wood products and pulp and paper, is closely related to global business conditions and tends to be cyclical in nature. Product prices can be subject to volatile change. Canfor, like the majority of the Canadian forest products industry, competes in a global market and the majority of its products are sold in US dollars. Consequently, changes in foreign currency relative to the Canadian dollar can impact Canfor's revenues and earnings.

Financial Risk Management

Canfor is exposed to a number of risks as a result of holding financial instruments. These risks include credit risk, liquidity risk and market price risk.

Canfor's Risk Management Committee manages risk in accordance with a Board approved Price Risk Management Controls Policy. This policy provides the framework for risk management related to commodity price, foreign exchange, interest rate and counterparty credit risk.

(a) Credit risk:

Credit risk is the risk of financial loss to Canfor if a customer or third party to a derivative instrument fails to meet its contractual obligations.

Financial instruments that are subject to credit risk include cash and cash equivalents, accounts receivable and long-term investments and other. Cash and cash equivalents includes cash held through major Canadian and international financial institutions and temporary investments with an original maturity date of three months or less.

Canfor utilizes a combination of credit insurance, letters of credit and self-insurance to manage the risk associated with trade receivables. Approximately 60% of the outstanding trade receivables are covered by credit insurance. Canfor's trade receivable balance at December 31, 2011 is $105.1 million, net of an allowance for doubtful accounts of $2.8 million. At December 31, 2011, approximately 99% of the trade accounts receivable balance was within Canfor's established credit terms.

(b) Liquidity risk:

Liquidity risk is the risk that Canfor will be unable to meet its financial obligations on a current basis. Canfor manages liquidity risk through regular cash-flow forecasting in conjunction with maintaining in good standing adequate committed operating bank loan facilities.

At December 31, 2011, Canfor has accounts payable and accrued liabilities of $290.5 million and current debt obligations of $50.9 million, all of which fall due for payment within one year of the balance sheet date.

(c) Market risk:

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates, foreign currency or commodity prices.

(i) Interest Rate risk:

Canfor is exposed to interest rate risk through its current financial assets and financial obligations bearing variable interest rates. Canfor's cash and cash equivalents include term deposits with original maturity dates of three months or less.

Changes in the market interest rates do not have a significant impact on Canfor's results of operations due to the short-term nature of the respective financial assets and obligations and because all long-term debt is based on fixed rates of interest.

As noted earlier in this section (under "Employee Future Benefits"), Canfor is also exposed to interest rate risk in relation to the measurement of the Company's pension liabilities.

Canfor currently does not use derivative instruments to reduce its exposure to interest rate risk.

(ii) Currency risk:

Canfor is exposed to foreign exchange risk primarily related to the US dollar, as Canfor's products are sold principally in US dollars and all long-term debt is currently denominated in US dollars. In addition, Canfor holds financial assets and liabilities primarily related to New South Companies Inc. based in South Carolina, in US dollars.

A portion of the currency risk associated with US dollar denominated sales is naturally offset by US dollar denominated expenses and the US dollar denominated debt. Part of the remaining exposure is at times covered by option contracts (foreign exchange collars) that effectively limit the minimum and maximum Canadian dollar recovery related to the sale of those US dollars (See "Derivative Financial Instruments" section later in this document).

(iii) Energy price risk:

Canfor is exposed to energy price risk relating to purchases of natural gas and diesel oil for use in its operations.

The exposure may be hedged up to 100% through the use of floating to fixed swap contracts or option contracts with maturity dates up to a maximum of three years. In the case of diesel oil, Canfor uses heating oil contracts to hedge its exposure (See "Derivative Financial Instruments" section later in this document).

(iv) Commodity price risk:

Canfor is exposed to commodity price risk related to the sale of lumber, pulp, paper, and oriented strand board. From time to time, Canfor enters into futures contracts on the Chicago Mercantile Exchange for lumber and forward contracts direct with customers for pulp. Under the Price Risk Management Controls Policy, up to 15% of lumber sales and 5% of pulp sales may be sold in this way.

Derivative Financial Instruments

Subject to risk management policies approved by its Board of Directors, Canfor, from time to time, uses derivative instruments, such as forward exchange contracts and option contracts to hedge future movements of exchange rates and futures and forward contracts to hedge commodity prices and energy costs. See section "Financial Requirements and Liquidity" for details of Canfor's derivative financial instruments outstanding at year end.

Earnings Sensitivities

Estimates of the sensitivity of Canfor's pre-tax results to currency fluctuations and prices for its principal products, based on 2012 Business Plan forecast production and year end foreign exchange rates, are set out in the following table:

(millions of dollars)	Impact on annual pre-tax earnings
SPF lumber – US$10 change per Mfbm[28, 29]	$ 33
SYP lumber – US$10 change per Mfbm[28, 29]	$ 5
Pulp – US$10 change per tonne [28, 29, 30]	$ 13
Canadian dollar – US$0.01 change per Canadian dollar:	
Operations[30]	$ 13
US dollar denominated debt[30]	$ 2

[28] Based on sales of Canfor-produced product.
[29] Excluding potential change in fibre costs.
[30] Includes 100% of Canfor Pulp.

Government and Other Regulations

Canfor is subject to a wide range of general and industry-specific environmental, health and safety, building standard and other laws and regulations imposed by federal, provincial and local authorities, including those governing the use, storage, handling, generation, treatment, emission, release, discharge and disposal of certain hazardous materials and wastes, the remediation of contaminated soil and ground water, the use and design values of the Company's products and the health and safety of employees. If Canfor is unable to extend or renew a material licence or permit required by such laws, or if there is a delay in renewing any material approval, licence or permit, Canfor's business, financial condition, results of operations and cash flows could be materially adversely affected. Future events such as any changes in these laws and regulations or any change in their interpretation or enforcement, or the discovery of currently unknown conditions, may give rise to additional expenditures or liabilities.

Labour Agreements and Competition for Professional Skilled Labour

Canfor's collective agreement with the USWA (United Steelworkers of America) expires in June 2013 and its collective agreement with the PPWC (Pulp, Paper and Woodworkers of Canada) expires in June 2014. The Company's collective agreement with the CEP (Communications, Energy and Paperworkers Union) for its Grande Prairie lumber operation expires September 30, 2014. Any inability to negotiate acceptable contracts with the unions as they expire could result in a strike or work stoppage by the affected workers and increased operating costs as a result of higher wages or benefits paid to unionized workers.

In addition, Canfor Pulp's collective agreements with the CEP and PPWC have terms expiring on April 30, 2012.

Market conditions may cause shortages of both professional and skilled labour, which could have an adverse impact on the operation and management of Canfor's facilities.

Maintenance Obligations and Facility Disruptions

Canfor's manufacturing processes are vulnerable to operational problems that could impair its ability to manufacture its products. Canfor could experience a breakdown in any of its machines, or other important equipment, and from time to time, planned or unplanned maintenance outages that cannot be performed safely or efficiently during operations must be conducted. Such disruptions could cause a significant loss of production, which could have a material adverse effect on Canfor's business, financial condition and operating results.

Mountain Pine Beetle

As noted earlier in this document (Section (iv) of the Overview of 2011), timber affected by the Mountain Pine Beetle continued to be a focus for Canfor harvesting activities in BC in 2011. The impact of the infestation on Canfor's operations continues to be manageable in the short term and the Company plans to continue harvesting MPB infected fibre. However, given the nature and extent of the infestation, the longer term operational and financial impact on Canfor could be significant.

In the long term, the volume of fibre available to Canfor is impacted by the length of time that the dead pine remains of sufficient quality to produce commercially viable sawlogs. Current indications are that this period can vary from 3 to 15 years, depending on soil moisture levels. One approach taken to increase utilization of MPB infected fibre has been to adjust harvesting processes to allocate more of this timber to pulping operations.

In Alberta, the Mountain Pine Beetle outbreak, which is significantly less wide-spread than in the BC Interior, also continues to impact the quality of fibre but to a lesser degree. Monitoring of MPB populations in 2011 indicated that mortality from winter weather continued to reduce the spread of the beetle in all except the northern portion of Alberta. Licensees continue to focus harvest activities in Alberta on "green" attacked and susceptible timber types. Canfor has received approval of a modest increase in allowable annual cut in order to accelerate the harvest of pine stands that are most susceptible to attack. The Alberta government continues to fund MPB programs, focusing on monitoring, which helps with forest planning, and some single tree removal in isolated areas.

Residual Fibre Revenues

Wood chips are a residual product of Canfor's lumber manufacturing process and are primarily sold to Canfor Pulp. These chips are the principal raw material utilized by Canfor Pulp in its pulp manufacturing operations. Canfor has a Fibre Supply Agreement with Canfor Pulp, which contains a pricing formula that currently results in Canfor Pulp paying Canfor a price for wood chips based on pulp markets and Canfor Pulp's product mix. Canfor currently provides approximately 54% of Canfor Pulp's chip requirements. If market conditions caused Canfor Pulp to cease pulp operations for an extended period of time, Canfor would have a limited market for its chip supply and this could affect its ability to run its sawmills economically. Similarly, if lumber market conditions were such that Canfor is unable to provide the current volume of chips to Canfor Pulp as a result of sawmill closures, whether temporary or permanent, Canfor Pulp's financial results could be materially affected.

Bark hog is a residual product of Canfor's lumber manufacturing process. Bark hog has increasing value to Canfor, for internal use in bark-fueled thermal oil energy systems used to dry lumber, as well as for sales externally or, in the Prince George region, to Canfor Pulp to be used in the generation of steam to manufacture power and heat.

Sales of sawdust and shavings are made primarily to other users and the demand is varied and robust.

Softwood Lumber Agreement

The SLA, in effect from October 2006, provides both Canada and the U.S. with rights to terminate the agreement. In order to terminate under all circumstances except one, the U.S. must provide a six month notice period, and cannot launch a new countervailing duty ("CVD") or anti-dumping duty ("ADD") investigation for 12 months after termination. The exception is that the U.S. may terminate immediately and launch new CVD or ADD cases without the 12 month standstill if Canada is accused of an egregious breach of the SLA. Canada may terminate at any time with six months notice.

Any early termination of the SLA would likely result in the U.S. initiating a new CVD and ADD investigation, potentially leading to duties imposed on the Canadian lumber producers, including the Company.

On January 18, 2011, the U.S. triggered the arbitration provision of the SLA by delivering a Request for Arbitration. The U.S. claims that the province of British Columbia has not properly applied the timber pricing system grandparented in the SLA. The U.S. also claims that subsequent to 2006, BC made additional changes to the timber pricing system which had the effect of reducing timber prices. The claim focuses on substantial increases in Grade 4 (non sawlog or low grade) volumes commencing in 2007. It is alleged that timber was scaled and graded as Grade 4 that did not meet the criteria for that grade, and was accordingly priced too low.

As the arbitration is a state-to-state international dispute under the SLA, Canada is preparing a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. In August 2011, the U.S. filed a detailed statement of claim with the arbitration panel, which Canada responded to in November 2011. The U.S. subsequently filed a reply, to which Canada filed a response in early February 2012. A hearing before the arbitration panel is currently expected before the end of the first quarter of 2012. It is not possible at this time to predict the outcome or the value of any final claim, and accordingly no provision has been recorded by the Company.

In addition to the above, the SLA includes a "Surge Mechanism", which increases the export tax rate for the month by 50% when the monthly volume of exports from a region exceeds a certain "Trigger Volume" as defined in the SLA. In 2011, the Company paid surge tax of $0.3 million on shipments from Alberta. The Company has attempted to minimize the impact of the surge tax by directing shipments from the Company's Alberta operation to domestic or offshore markets where possible.

Stumpage Rates

The BC government introduced a Market Pricing System ("MPS") for the BC Interior on July 1, 2006. On July 1, 2010 the Ministry of Forests and Range (the "Ministry") implemented changes to the interior market pricing system for timber. These changes dealt with issues raised by the MPB epidemic. These changes included the introduction of "stand-as-a-whole" pricing with cruise-based billing for MPB damaged timber and, from a stumpage distribution perspective, transition over two years to a system more sensitive to market forces. For stands with 35% or more MPB damaged timber a single stumpage rate is established with billing based on the cruise rather than scaling. For these stands, determination of log grades is no longer necessary. An impact of these changes is to increase the overall market sensitivity of interior timber pricing and to improve the utilization of low value material. These changes are consistent with the 2006 SLA.

Canfor is actively participating in discussions on MPS with the Ministry, which is scheduled for its sixth annual update on July 1, 2012. Canfor will continue to seek to manage and reduce the stumpage costs for its Interior operations under the stumpage appraisal system. The near-term imperative is to ensure that the stumpage system accurately reflects the market value of timber and is responsive to the deteriorating quality of the beetle-impacted fibre. Further changes to the BC Interior market driven stumpage system and resultant stumpage rates could have a material impact on Canfor's business.

For the Company's operations in North and South Carolina, the Company does not directly own timberlands or have any lease rights to timber. There is therefore a risk that traditional sellers of timber may discontinue selling logs to our mills.

Transportation Services

Canfor relies primarily on third parties for transportation of its products, as well as delivery of raw materials, a significant portion of which are transported by railroad, trucks and ships. If any of Canfor's third party transportation providers were to fail to deliver the raw materials or products or distribute them in a timely manner, Canfor may be unable to sell those products at full value, or at all, or unable to manufacture its products in response to customer demand, which could have a material adverse effect on Canfor's financial condition and operating results. In addition, if any of these third parties were to cease operations, suffer labour-related disruptions, or cease doing business with Canfor, the Company's operations or cost structure may be adversely impacted. The protracted downturn in the U.S. economy is adversely affecting the availability of trucks throughout North America. If market conditions in the trucking industry continue to worsen, competition for trucking assets could affect Canfor's ability to move its logs, lumber and wood chips at market competitive prices.

OUTSTANDING SHARE DATA

At February 8, 2012, there were 142,749,431 common shares issued and outstanding. In addition, at February 8, 2012, there were 3,000 stock options outstanding with an exercise price of $10.10 per share.

DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Board of Directors and the Audit Committee. The Company's chief executive officer ("CEO") and chief financial officer ("CFO") have evaluated the effectiveness of these disclosure controls and procedures for the year ending December 31, 2011, and have concluded that they are effective.

The CEO and CFO acknowledge responsibility for the design of internal controls over financial reporting ("ICFR"), and confirm that there were no changes in these controls that occurred during the year ended December 31, 2011 which materially affected, or are reasonably likely to materially affect, the Company's ICFR. Based upon their evaluation of these controls for the year ended December 31, 2011, the CEO and CFO have concluded that these controls are operating effectively.

Additional information about the Company, including its 2011 Annual Information Form, is available at www.sedar.com or at www.canfor.com.