



FOR IMMEDIATE RELEASE

## CANFOR REPORTS RESULTS FOR THIRD QUARTER OF 2012

October 23, 2012 - Vancouver, B.C. - Canfor Corporation (TSX: CFP) today reported net income attributable to shareholders ("shareholder net income") of \$22.2 million, or \$0.16 per share, for the third quarter of 2012, compared to \$4.5 million, or \$0.03 per share, for the second quarter of 2012 and a shareholder net loss of \$21.6 million, or \$0.15 per share, for the third quarter of 2011. For the nine months ended September 30, 2012, the shareholder net income was \$10.5 million, or \$0.08 per share, compared to net loss of \$12.5 million, or \$0.09 per share, for the comparable period of 2011.

The shareholder net income for the third quarter of 2012 included various items affecting comparability with prior periods, which had an overall impact of \$6.9 million, or \$0.05 per share. After adjusting for such items, the Company's adjusted shareholder net income for the third quarter of 2012 was \$15.3 million, or \$0.11 per share, up \$4.2 million, or \$0.03 per share, from an adjusted shareholder net income of \$11.1 million, or \$0.08 per share, for the second quarter of 2012. Adjusted shareholder net loss for the third quarter of 2011 was \$1.8 million, or \$0.01 per share.

The Company reported operating income of \$22.3 million for the third quarter of 2012, down \$3.7 million from \$26.0 million for the second quarter. The negative variance primarily reflected a significant weakening of Northern Bleached Softwood Kraft ("NBSK") pulp markets and one-time restructuring costs which were largely offset by improved results in the lumber and panels segments, where solid demand supported higher sales realizations.

The following table summarizes selected financial information for the Company for the comparative periods:

	Q3	Q2	YTD	Q3	YTD
(millions of dollars, except for per share amounts)	2012	2012	2012	2011	2011
Sales	\$ 683.8	\$ 700.9	\$ 1,992.3	\$ 602.1	\$ 1,845.2
Operating income	\$ 22.3	\$ 26.0	\$ 26.8	\$ 15.4	\$ 75.1
Net income (loss) attributable to equity shareholders of Company	\$ 22.2	\$ 4.5	\$ 10.5	\$ (21.6)	\$ (12.5)
Net income (loss) per share attributable to equity shareholders of Company, basic and diluted	\$ 0.16	\$ 0.03	\$ 0.08	\$ (0.15)	\$ (0.09)
Adjusted shareholder net income (loss)	\$ 15.3	\$ 11.1	\$ 4.1	\$ (1.8)	\$ 0.8
Adjusted shareholder net income (loss) per share	\$ 0.11	\$ 0.08	\$ 0.04	\$ (0.01)	\$ 0.01

Lumber markets improved moderately in the third quarter of 2012, reflecting further stabilization of underlying demand in both North American and offshore markets. U.S. housing activity continued the upward trend seen in the prior quarter, with housing starts for the quarter averaging 786,000 units SAAR (seasonally adjusted annual rate), up 7% from the previous quarter. Canadian housing starts were down 3% from the previous quarter, to 223,000 units SAAR, and up 8% from the third quarter of 2011 when starts were 206,000 units SAAR. Market conditions in China continued to reflect solid demand. Demand in Japan also remained solid through the quarter. Global softwood pulp markets weakened through the summer months, with price erosion occurring for most of the quarter.

The average North American benchmark Western Spruce/Pine/Fir ("SPF") 2x4 #2&Btr price rose 2% to US\$300 per Mfbm, with slightly higher increases seen for most wider SPF products. The export tax on Canadian shipments to the US averaged 8% in the third quarter of 2012, down from a 13% average in the previous quarter. Southern Yellow Pine ("SYP") prices saw similar increases to SPF in 2x4 benchmark pricing but prices for wider products were down over the quarter. For NBSK pulp US dollar sales realizations fell with the average North America list price down US\$47 to US\$853 per tonne, as challenging markets resulted in downward pressure on prices. Canadian dollar sales realizations across all solid wood and pulp products were negatively impacted by an average 1.5% strengthening of the Canadian dollar.

Lumber production and shipments were down 2% from the previous quarter, principally reflecting less operating time as a result of annual maintenance shuts at the Company's southern pine operations and the observance of one additional statutory day in the third quarter. Lumber unit manufacturing costs were up slightly from the previous

quarter, with the positive impact of higher productivity offset by higher unit log costs resulting from market-related stumpage increases and wet weather conditions in the US South, the latter tightening log supply for part of the quarter. Pulp manufacturing costs were up slightly from the previous quarter due to one-time costs of \$3.2 million associated with new five year collective labour agreements, partially offset by the impact of higher production volumes.

Pulp shipment and production levels for the third quarter reflected a scheduled capital and maintenance outage at Canfor Pulp's Prince George Pulp Mill in the quarter, partly offset by higher production at the Northwood Pulp Mill following the unscheduled recovery boiler-related outage from late May to early July. Both mills experienced slower than anticipated ramp ups in the period following the scheduled and unscheduled outages. Inventories subsequently returned to more normal levels by the end of the quarter.

The Company ended the quarter with cheques issued in excess of cash on hand of \$7.1 million and operating loans of \$17.0 million, with a total of \$354.3 million still available under its operating lines.

Commenting on the third quarter performance, Canfor's President and CEO, Don Kayne, said, "The improvement in lumber sales realizations reflected a steady increase in construction activity in North America and continued solid offshore demand for Western SPF lumber products." Kayne added that the Company has now fully integrated its recently acquired operations in the south-east Kootenay region. "The start-up of our upgraded Radium mill early in the fourth quarter of 2012 will further boost our capacity to provide high quality products to our valued customers," said Kayne. Regarding the pulp and paper segment's third quarter results, Kayne said, "It was a tough quarter as our pulp business faced challenges presented by weaker markets and the Canfor Pulp facilities came out of an extended period of major maintenance and capital upgrades. The focus now is on getting these recently upgraded pulp mills achieving targeted operating rates."

Looking forward, U.S. lumber consumption is projected to slow in the fourth quarter of 2012 with traditionally lower seasonal homebuilding activity. The Canadian housing market is forecast to follow a similar trend, with demand projected to level off towards the end of the year. U.S. home inventories are projected to remain relatively low aided by low mortgage rates and gradual appreciation in home prices. Shipments to the U.S. are projected to taper off as export taxes increase from 5% in October to 10% in November, but offshore lumber shipments to China, Japan and Korea are anticipated to offset any slowdown in North American shipments. In the pulp segment, Canfor Pulp has announced an increase in the NBSK pulp list price of US\$20 per tonne in all regions in October.

#### **Additional Information and Conference Call**

A conference call to discuss the third quarter's financial and operating results will be held on Wednesday, October 24, 2012 at 8:00 AM Pacific time. To participate in the call, please dial 416-340-2216 or Toll-Free 866-226-1792. For instant replay access until November 7, 2012, please dial 800-408-3053 and enter participant pass code 5498580#. The conference call will be webcast live and will be available at [www.canfor.com](http://www.canfor.com). This news release, the attached financial statements and a presentation used during the conference call can be accessed via the Company's website at <http://www.canfor.com/investor-relations/webcasts>.

#### **Forward Looking Statements**

Certain statements in this press release 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.

*Canfor is a leading integrated forest products company based in Vancouver, British Columbia (BC) with interests in BC, Alberta, Quebec, Washington state, and North and South Carolina. The Company produces primarily softwood lumber and also produces oriented strand board (OSB), remanufactured lumber products, specialized wood products and bleached chemi-thermo mechanical pulp (BCTMP). Canfor also owns a 50.2% interest in Canfor Pulp Products Inc., which is one of the largest producers of northern softwood kraft pulp in Canada and a leading producer of high performance kraft paper. Canfor shares are traded on the Toronto Stock Exchange under the symbol CFP.*

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**Canfor Corporation**  
**Third Quarter 2012**  
**Management's Discussion and Analysis**

*This interim Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the quarter ended September 30, 2012 relative to the quarters ended June 30, 2012 and September 30, 2011, and the financial position of the Company at September 30, 2012. It should be read in conjunction with Canfor's unaudited interim consolidated financial statements and accompanying notes for the quarters ended September 30, 2012 and 2011, as well as the 2011 annual MD&A and the 2011 audited consolidated financial statements and notes thereto, which are included in Canfor's Annual Report for the year ended December 31, 2011 (available at [www.canfor.com](http://www.canfor.com)). The financial information in this interim MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which is the required reporting framework for Canadian publicly accountable enterprises.*

*Throughout this discussion, reference is made to Operating Income before Amortization which Canfor considers to be a relevant 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 "Analysis of Specific Material Items Affecting Comparability of Shareholder Net Income (Loss)") and Adjusted Shareholder Net Income (Loss) per Share (calculated as Adjusted Shareholder Net Income (Loss) divided by the weighted average number of shares outstanding during the period). Operating Income before Amortization and 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 Operating Income before Amortization, 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 Operating Income before Amortization to operating income (loss) 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 both 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.*

*All financial references are in millions of Canadian dollars unless otherwise noted. The information in this report is as at October 23, 2012.*

**Forward Looking Statements**

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### THIRD QUARTER 2012 OVERVIEW

#### Selected Financial Information and Statistics<sup>1</sup>

(millions of dollars, except for per share amounts)	Q3 2012	Q2 2012	YTD 2012	Q3 2011	YTD 2011
Operating income (loss) by segment:					
Lumber	\$ 34.9	\$ 18.9	\$ 33.7	\$ (11.9)	\$ (25.7)
Pulp and Paper	\$ (7.2)	\$ 11.7	\$ 15.8	\$ 38.0	\$ 134.7
Unallocated and Other	\$ (5.4)	\$ (4.6)	\$ (22.7)	\$ (10.7)	\$ (33.9)
<b>Total operating income (loss)</b>	<b>\$ 22.3</b>	<b>\$ 26.0</b>	<b>\$ 26.8</b>	<b>\$ 15.4</b>	<b>\$ 75.1</b>
Add: Amortization	\$ 45.7	\$ 46.0	\$ 136.8	\$ 39.9	\$ 121.7
<b>Total operating income before amortization</b>	<b>\$ 68.0</b>	<b>\$ 72.0</b>	<b>\$ 163.6</b>	<b>\$ 55.3</b>	<b>\$ 196.8</b>
Add (deduct):					
Working capital movements	\$ (14.0)	\$ 68.4	\$ (24.8)	\$ 19.2	\$ (36.0)
Salary pension plan contributions	\$ (9.0)	\$ (9.0)	\$ (27.0)	\$ (9.6)	\$ (29.2)
Other operating cash flows, net <sup>2</sup>	\$ (11.1)	\$ (12.3)	\$ (14.0)	\$ (4.0)	\$ (6.9)
<b>Cash from operating activities</b>	<b>\$ 33.9</b>	<b>\$ 119.1</b>	<b>\$ 97.8</b>	<b>\$ 60.9</b>	<b>\$ 124.7</b>
Add (deduct):					
Finance expenses paid	\$ (1.4)	\$ (7.4)	\$ (11.9)	\$ (3.1)	\$ (12.7)
Distributions paid to non-controlling interests	\$ (3.0)	\$ (8.2)	\$ (15.5)	\$ (15.7)	\$ (79.6)
Capital additions, net <sup>3</sup>	\$ (44.1)	\$ (44.0)	\$ (198.7)	\$ (60.2)	\$ (133.5)
Proceeds from sale of asset-backed commercial paper ("ABCP")	\$ -	\$ 12.9	\$ 12.9	\$ -	\$ 29.8
Drawdown (repayment) of long-term debt	\$ -	\$ -	\$ 50.1	\$ -	\$ (81.9)
Other, net	\$ 1.5	\$ 1.9	\$ 12.3	\$ (10.6)	\$ (5.8)
<b>Change in cash / operating loans</b>	<b>\$ (13.1)</b>	<b>\$ 74.3</b>	<b>\$ (53.0)</b>	<b>\$ (28.7)</b>	<b>\$ (159.0)</b>
ROIC – Consolidated <sup>4</sup>	1.6%	1.3%	1.5%	0.1%	0.7%
<b>Average exchange rate (US\$ per C\$1.00)<sup>5</sup></b>	<b>\$ 1.005</b>	<b>\$ 0.990</b>	<b>\$ 0.998</b>	<b>\$ 1.020</b>	<b>\$ 1.023</b>

<sup>1</sup> Certain prior period amounts have been restated due to a change in accounting policy for treatment of net interest expense for defined benefit post-retirement plans. Further details can be found in the "Changes in Accounting Policy" section later in this document.

<sup>2</sup> Further information on operating cash flows can be found in the Company's unaudited interim consolidated financial statements.

<sup>3</sup> Additions to property, plant and equipment include the acquisition of assets from Tembec Industries Ltd. ("Tembec") in the first quarter of 2012, and are shown net of amount received under Government funding initiatives in the pulp and paper segment.

<sup>4</sup> Consolidated Return on Invested Capital ("ROIC") is equal to operating income/loss, plus realized gains/losses on derivatives and other income/expense, all net of minority interest, divided by the average invested capital during the year. Invested capital is equal to capital assets, plus long-term investments and net non-cash working capital, all excluding minority interest components.

<sup>5</sup> Source – Bank of Canada (average noon rate for the period).

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

(millions of dollars, except for per share amounts)	Q3 2012	Q2 2012	YTD 2012	Q3 2011	YTD 2011
After-tax impact, net of non-controlling interests					
<b>Shareholder Net Income (Loss)</b>	<b>\$ 22.2</b>	<b>\$ 4.5</b>	<b>\$ 10.5</b>	<b>\$ (21.6)</b>	<b>\$ (12.5)</b>
Foreign exchange (gain) loss on long-term debt and investments, net	\$ (4.0)	\$ 2.4	\$ (4.3)	\$ 11.0	\$ 6.5
(Gain) loss on derivative financial instruments	\$ (4.4)	\$ 4.2	\$ (5.3)	\$ 7.0	\$ 3.4
Restructuring charges for management changes	\$ 1.5	\$ -	\$ 1.5	\$ -	\$ 2.6
Increase in fair value of ABCP	\$ -	\$ -	\$ (1.1)	\$ 1.8	\$ 0.8
Costs related to Tembec acquisition	\$ -	\$ -	\$ 2.8	\$ -	\$ -
Net impact of above items	\$ (6.9)	\$ 6.6	\$ (6.4)	\$ 19.8	\$ 13.3
<b>Adjusted Shareholder Net Income (Loss)</b>	<b>\$ 15.3</b>	<b>\$ 11.1</b>	<b>\$ 4.1</b>	<b>\$ (1.8)</b>	<b>\$ 0.8</b>
<b>Shareholder Net Income (Loss) per share (EPS), as reported</b>	<b>\$ 0.16</b>	<b>\$ 0.03</b>	<b>\$ 0.08</b>	<b>\$ (0.15)</b>	<b>\$ (0.09)</b>
Net impact of above items per share	\$ (0.05)	\$ 0.05	\$ (0.04)	\$ 0.14	\$ 0.10
<b>Adjusted Shareholder Net Income (Loss) per share</b>	<b>\$ 0.11</b>	<b>\$ 0.08</b>	<b>\$ 0.04</b>	<b>\$ (0.01)</b>	<b>\$ 0.01</b>

The Company reported operating income of \$22.3 million for the third quarter of 2012, down \$3.7 million from \$26.0 million for the second quarter. The negative variance primarily reflected a significant weakening of NBSK pulp markets and restructuring costs which were largely offset by improved results in the lumber and panels segments, where solid demand supported higher sales realizations.

Lumber markets improved moderately in the third quarter of 2012, reflecting further stabilization of underlying demand in both North American and offshore markets. U.S. housing activity continued the upward trend seen in the prior quarter, with housing starts for the quarter averaging 786,000 units SAAR (seasonally adjusted annual rate), up 7% from the previous quarter. Canadian housing starts were down 3% from the previous quarter, to 223,000 units SAAR, and up 8% from the third quarter of 2011 when starts were 206,000 units SAAR. Market conditions in China continued to reflect solid demand. Demand in Japan also remained solid through the quarter. Global softwood pulp markets weakened through the summer months, with price erosion occurring for most of the quarter.

The average North American benchmark Western Spruce/Pine/Fir ("SPF") 2x4 #2&Btr price rose 2% to US\$300 per Mfbm, with slightly higher increases seen for most wider SPF products. The export tax on Canadian shipments to the US averaged 8% in the third quarter of 2012, down from a 13% average in the previous quarter. Southern Yellow Pine ("SYP") prices saw similar increases to SPF in 2x4 benchmark pricing but prices for wider products were down over the quarter. For NBSK pulp US dollar sales realizations fell with the average North America list price down US\$47 to US\$853 per tonne, as challenging markets resulted in downward pressure on prices. Canadian dollar sales realizations across all solid wood and pulp products were negatively impacted by an average 1.5% strengthening of the Canadian dollar.

Lumber production and shipments were down 2% from the previous quarter, principally reflecting less operating time as a result of annual maintenance shuts at the Company's southern pine operations and the observance of one additional statutory day in the third quarter. Lumber unit manufacturing costs were up slightly from the previous quarter, with the positive impact of higher productivity offset by higher unit log costs resulting from market-related stumpage increases and wet weather conditions in the US South, the latter tightening log supply for part of the quarter. Pulp manufacturing costs were up slightly from the previous quarter due to one-time costs of \$3.2 million associated with new five year collective labour agreements, partially offset by the impact of higher production volumes.

Pulp shipment and production levels for the third quarter reflected a scheduled capital and maintenance outage at Canfor Pulp's Prince George Pulp Mill in the quarter, partly offset by higher production at the Northwood Pulp Mill following the unscheduled recovery boiler-related outage from late May to early July. Both mills experienced slower than anticipated ramp ups in the period following the scheduled and unscheduled outages. Inventories subsequently returned to more normal levels by the end of the quarter.

Compared to the third quarter of 2011, operating income was up \$6.9 million, with a decrease of \$45.2 million in the pulp and paper segment, primarily driven by significantly lower prices for NBSK pulp products and the impact of the increased unit manufacturing costs, offset by an increase of \$46.8 million in the lumber segment and \$7.0 million in the Company's panel operations, reflecting the improved lumber and panels markets.

## OPERATING RESULTS BY BUSINESS SEGMENT

### Lumber

#### Selected Financial Information and Statistics – Lumber

(millions of dollars unless otherwise noted)	Q3 2012	Q2 2012	YTD 2012	Q3 2011	YTD 2011
Sales	\$ 454.7	\$ 443.5	\$ 1,241.9	\$ 331.4	\$ 991.2
Operating income (loss) before amortization	\$ 60.4	\$ 45.4	\$ 108.9	\$ 9.5	\$ 36.7
Operating income (loss)	\$ 34.9	\$ 18.9	\$ 33.7	\$ (11.9)	\$ (25.7)
Negative (positive) impact of inventory valuation adjustments <sup>6</sup>	\$ -	\$ (2.9)	\$ (13.1)	\$ 1.5	\$ 2.7
Costs related to Tembec acquisition	\$ -	\$ -	\$ 2.5	\$ -	\$ -
Operating income (loss) excluding impact of inventory valuation adjustments and unusual items	\$ 34.9	\$ 16.0	\$ 23.1	\$ (10.4)	\$ (23.0)
Average SPF 2x4 #2&Btr lumber price in US\$ <sup>7</sup>	\$ 300	\$ 295	\$ 287	\$ 246	\$ 261
Average SPF price in Cdn\$	\$ 299	\$ 298	\$ 288	\$ 241	\$ 255
Average SYP 2x4 #2 lumber price in US\$ <sup>8</sup>	\$ 322	\$ 325	\$ 315	\$ 259	\$ 270
Average SYP price in Cdn\$	\$ 320	\$ 328	\$ 316	\$ 254	\$ 264
U.S. housing starts (thousand units SAAR) <sup>9</sup>	786	736	745	615	590
Production – SPF lumber (MMfbm)	973.9	994.4	2,872.0	813.6	2,373.5
Production – SYP lumber (MMfbm)	118.6	124.4	357.3	117.3	324.9
Shipments – SPF lumber (MMfbm) <sup>10</sup>	996.8	1,010.5	2,859.6	812.0	2,348.9
Shipments – SYP lumber (MMfbm) <sup>10</sup>	127.9	132.8	378.3	122.7	337.2
Shipments – wholesale lumber (MMfbm)	7.9	14.3	46.7	34.2	113.1

<sup>6</sup> 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, if any, required at each period end.

<sup>7</sup> Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)

<sup>8</sup> Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)

<sup>9</sup> Source – U.S. Census Bureau, seasonally adjusted annual rate (“SAAR”)

<sup>10</sup> Canfor-produced lumber, including lumber purchased for remanufacture.

#### Overview

Operating income for the lumber segment was \$34.9 million for the third quarter of 2012, an increase of \$16.0 million compared to the operating income of \$18.9 million in the immediately preceding quarter, and a \$46.8 million improvement from the operating loss reported for the third quarter of 2011.

The stronger results compared to the second quarter of 2012 for the most part reflected improved sales realizations, with higher prices received for most products in both North American and offshore markets. Overall operational productivity improved moderately over the previous quarter partially offsetting market-related stumpage cost increases.

The improvement in operating income compared to the third quarter of 2011 reflected improved market prices and realizations, increased lumber shipments as a result of both productivity improvement and the integration of the two south-east Kootenay region operations acquired at the end of the first quarter of 2012, and reduced unit manufacturing costs. Offsetting some of these gains was an increase in log costs, again largely attributable to market-related stumpage increases. Sawmill residual chip prices were well down compared to the same quarter of 2011, consistent with the decline in NBSK pulp sales realizations over the period.

## Markets

During the third quarter of 2012, improved U.S. demand and low home inventories continued to support a gradual housing recovery and improved lumber prices. Total U.S. housing starts averaged 786,000 units<sup>11</sup> SAAR, an increase of 7% from the previous quarter and up 28% from the third quarter of 2011. Single-family starts, which consume a larger proportion of lumber, have steadily improved to 551,000 SAAR, the highest level since late 2008. The repair and remodeling activity was steady and trended higher than a year ago.

In Canada, lumber consumption was firm reflecting steady housing demand across the country. Canadian housing starts were 223,000 units<sup>12</sup> SAAR for the quarter, down 6,000 units, or 3%, compared to the second quarter of 2012, but were up 8% from the comparable quarter in 2011 when starts were at 206,000 units SAAR.

Canfor's offshore lumber shipments decreased by 7% compared to the previous quarter, but remained at historically high levels and were 6% higher than the third quarter of 2011. The lower offshore shipments in part reflected some shift in volume to the U.S. related to the reduced export tax.

## Sales

Lumber sales revenue for the third quarter of 2012 was \$454.7 million, compared to \$443.5 million in the previous quarter and \$331.4 million in the third quarter of 2011. Increases from both comparative periods reflected the impact of improved pricing, with the change from the third quarter of 2011 to the third quarter of 2012 also reflecting increased shipments. Total shipments in the third quarter of 2012 were just over 1.1 billion board feet, down 2% from the previous quarter, and up 17% from the third quarter of 2011 reflecting higher production from various capital upgrades and other efficiency improvements, as well as from the mill operations acquired at the end of the first quarter of 2012.

Overall sales realizations saw positive gains in the quarter, with North American sales realizations benefiting from the continued upward trend in pricing coupled with lower export taxes. For sales to North America, the Random Lengths Western SPF 2x4 #2&Btr price was up 2% to US\$300 per Mfbm, with slightly higher increases seen in most other widths and dimensions during the quarter. Sales realizations for SYP products dropped slightly, with the benchmark SYP 2x4 #2 price at US\$322 per Mfbm, down 1% from the previous quarter, and wider dimensions seeing larger reductions. Sales realizations for offshore products experienced strong gains in the current quarter, particularly in China where market inventories returned to more normal levels following the inventory build earlier in the year and contributed to solid increases relative to North America in the third quarter.

Compared to the third quarter of 2011, the benchmark North American Random Lengths Western SPF 2x4 #2&Btr price was up US\$54 per Mfbm, or 22%, with increases seen in all widths and dimensions. SYP products followed a similar trend, with the benchmark SYP 2x4 #2 price up 24%. Increases were seen for offshore sales realizations for similar products.

The average value of the Canadian dollar compared to the US dollar in the third quarter was up 1.5% from the previous quarter, partially offsetting the contribution of improved pricing to increased sales realizations. Compared to the third quarter of 2011, realizations benefited from a 1.5 cent, or 1.5%, weaker Canadian dollar.

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 ("RLCP"). The export tax rate is calculated monthly based on an average of preceding pricing periods, with the rate being based on the following trigger prices:

<u>Trigger RLCP</u>	<u>Tax Rate</u>
Over US\$355	0 %
US\$336-\$355	5 %
US\$316-\$335	10 %
US\$315 and under	15 %

<sup>11</sup> U.S. Census Bureau

<sup>12</sup> CMHC – Canada Mortgage and Housing Corporation

Total residual fibre revenue was down from the second quarter of 2012, reflecting market-driven pulp price reductions which reduced chip prices. Compared to the third quarter of 2011, net residual fibre realizations were down 14%, again reflecting significant reductions in the pulp market drivers.

#### Operations

Lumber production, at just under 1.1 billion board feet, was down 2% from the previous quarter, reflecting annual maintenance shuts at the Company's southern pine operations and an additional day of statutory downtime in comparison to the second quarter of 2012. Compared to the third quarter of 2011 production was up 17%, again largely reflecting the recent Kootenay mills acquisition, coupled with increased productivity following various capital improvement projects in 2011 and early 2012.

Overall lumber unit manufacturing costs were up compared to the previous quarter, largely the result of market-driven log cost factors and adverse weather conditions in the US South that constricted log supply. Total unit cash conversion costs were up slightly, proportionate to the dip in production in the quarter resulting from less operating hours.

Compared to the third quarter of 2011, unit manufacturing costs showed a slight increase, again reflecting higher unit log costs partially offset by improved conversion costs. The increase in unit log costs resulted largely from increased hauling costs stemming from tight trucker availability and higher diesel costs, as well as higher market stumpage.

### **Pulp and Paper**

#### **Selected Financial Information and Statistics – Pulp and Paper**<sup>13</sup>

(millions of dollars unless otherwise noted)	Q3 2012	Q2 2012	YTD 2012	Q3 2011	YTD 2011
Sales	\$ 206.3	\$ 239.4	\$ 695.1	\$ 260.5	\$ 820.5
Operating income (loss) before amortization	\$ 8.5	\$ 26.8	\$ 64.3	\$ 52.2	\$ 181.0
Operating income (loss)	\$ (7.2)	\$ 11.7	\$ 15.8	\$ 38.0	\$ 134.7
Average pulp price delivered to U.S. – US\$ <sup>14</sup>	\$ 853	\$ 900	\$ 874	\$ 993	\$ 996
Average price in Cdn\$	\$ 849	\$ 909	\$ 876	\$ 974	\$ 974
Production – pulp (000 mt)	276.8	263.1	855.8	273.9	905.5
Production – paper (000 mt)	31.9	30.0	94.8	36.7	103.0
Shipments –pulp (000 mt)	268.9	282.1	878.8	291.2	913.3
Shipments – paper (000 mt)	30.6	36.8	97.0	32.1	97.4

<sup>13</sup> Includes the Taylor pulp mill and 100% of Canfor Pulp Products Inc., which is consolidated in Canfor's results. Pulp production and shipment volumes presented are for both northern bleached softwood kraft ("NBSK") and bleached chemi-thermo mechanical pulp ("BCTMP").

<sup>14</sup> Per tonne, NBSK pulp list price delivered to U.S. (Resource Information Systems, Inc.).

#### Overview

The operating loss for the pulp and paper segment was \$7.2 million for the third quarter of 2012, down \$18.9 million from operating income of \$11.7 million for the previous quarter and down \$45.2 million from the third quarter of 2011. Results in the current quarter were impacted by lower market pulp prices and to a certain extent lower shipment volumes. Unit manufacturing costs were up slightly, primarily due to one-time costs of \$3.2 million associated with new five year collective labour agreements, partially offset by the impact of higher production volumes.

NBSK pulp list prices decreased in all regions, with prices to North America down US\$47 to US\$853 per tonne. Sales realizations were also negatively impacted by the 1.5% stronger Canadian dollar compared to the previous quarter.

Lower operating earnings compared to the third quarter of 2011 reflected a significant reduction in NBSK pulp prices, with North America prices down US\$140 per tonne, coupled with Europe and China both down US\$200 per tonne. Unit manufacturing costs were 3% higher, with the one-time costs associated with new five year collective labour agreements and higher chemical costs, partially offset by lower fibre costs. Lower quarter-over-quarter shipments for the most part reflected the scheduled Prince George Pulp Mill outage in the current period and a return to normal inventory levels.



## Markets

Global softwood pulp markets weakened through the summer months, with price erosion occurring for most of the quarter. While softwood pulp inventories remained relatively stable, global hardwood pulp producer inventories increased throughout the quarter. After a weak start to the quarter, global softwood pulp demand showed signs of picking up in August, as evidenced by an 8.5% increase in shipments of bleached softwood sulphate pulp compared to the prior year<sup>15</sup>. The increase in softwood shipments was primarily due to increased purchasing from China, partially offset by reductions in shipments to North America and Europe. Global demand for printing and writing papers decreased 1.8% for the first eight months of 2012 as compared to 2011<sup>15</sup>.

At the end of August 2012, World 20<sup>16</sup> producers of bleached softwood pulp inventories were at 30 days of supply. By comparison, June 2012 inventories were at 29 days of supply.

## Sales

Pulp shipments in the third quarter of 2012 were 269,000 tonnes, down over 13,000 tonnes, from the previous quarter. For the most part, this reflected the impact of the extended capital and maintenance outage at the Prince George Pulp Mill in the first part of the quarter. Inventories also returned to more normal levels after the unscheduled outage at the Northwood Pulp Mill at the end of the previous quarter. Compared to the third quarter of 2011, shipments were down 22,000 tonnes, or 8%, principally related to the impacts of the extended Prince George shut as well as the impact from the earlier unscheduled Northwood shutdown.

Increasing global hardwood pulp producer inventories combined with the seasonal slowdown through the summer months, resulted in further downward pressure on global softwood prices. North America NBSK pulp list prices averaged US\$853 per tonne for the quarter, down US\$47 from the previous quarter. Canfor Pulp's average list prices to China and Europe also decreased through the quarter with China pricing down US\$57 to US\$650 per tonne, and Europe also down US\$57 to US\$780 per tonnes. Sales realizations were also negatively impacted by the 1.5% stronger average Canadian dollar compared to the prior quarter. The BCTMP market remained relatively stable through the third quarter of 2012; BCTMP sales realizations were down 3% from the prior quarter but a 5% improvement in production contributed to a corresponding improvement in unit manufacturing costs.

Compared to the third quarter of 2011, pulp sales realizations were well down as NBSK pulp list prices to all markets decreased. The average NBSK list price for North America decreased US\$140 per tonne, while prices to Europe and China decreased US\$200 per tonne. The price reductions were offset in part by a 1.5% weaker Canadian dollar.

## Operations

Pulp production in the third quarter of 2012 was 277,000 tonnes, up 14,000 tonnes, or 5%, from the previous quarter and in line with the third quarter of 2011. The increase in production compared to the second quarter of 2012 reflected a reduction in outages in the current quarter.

Pulp unit manufacturing costs increased slightly from the previous quarter, principally reflecting the costs associated with the new five year collective labour agreements, partially offset by the impact of higher production volumes and a reduction in maintenance spending.

Compared to the third quarter of 2011, unit manufacturing costs were 3% higher, with costs associated with the new five year collective labour agreements and higher chemical costs, more than offsetting lower fibre costs. Lower fibre costs primarily resulted from lower-cost sawmill residual chips, where prices are linked to NBSK pulp sales realizations.

<sup>15</sup> As reported by Pulp and Paper Products Council ("PPPC") statistics.

<sup>16</sup> 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 PPPC.

## Unallocated and Other Items

(millions of dollars)	Q3 2012	Q2 2012	YTD 2012	Q3 2011	YTD 2011
Operating income (loss) of Panels operations <sup>17</sup>	\$ 2.1	\$ 2.0	\$ (0.7)	\$ (4.9)	\$ (14.8)
Corporate costs	\$ (7.5)	\$ (6.6)	\$ (22.0)	\$ (5.8)	\$ (19.1)
Finance expense, net	\$ (5.8)	\$ (6.2)	\$ (18.2)	\$ (7.9)	\$ (20.9)
Foreign exchange gain (loss) on long-term debt and investments, net	\$ 6.5	\$ (3.8)	\$ 6.7	\$ (16.6)	\$ (9.9)
Gain (loss) on derivative financial instruments	\$ 6.8	\$ (6.3)	\$ 7.9	\$ (12.1)	\$ (6.1)
Other income (expense), net	\$ (2.6)	\$ 2.6	\$ (0.2)	\$ 5.2	\$ 4.6

<sup>17</sup> 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.

The panels operations reported operating income of \$2.1 million for the third quarter of 2012, compared to \$2.0 million for the previous quarter. Excluding the impact of inventory valuation adjustments, the operating income of panels operations increased \$3.6 million, with the improvement in operating income in the current period principally reflecting continued improvement in OSB markets, driven primarily by increased housing activity, as evidenced by a US\$77 per thousand square feet ("msf") increase in the benchmark OSB price to US\$312 per msf<sup>18</sup>. Compared to the third quarter of 2011, excluding inventory valuation adjustments, results for the panel operations improved by \$7.5 million, largely reflecting considerably stronger market prices, with the benchmark OSB price up by US\$128 per msf, or 70% partially offset by a 5% increase in costs driven largely by log cost increases.

Corporate costs were \$7.5 million for the third quarter of 2012, up \$0.9 million from the previous quarter, largely reflecting restructuring costs associated with the integration of Canfor Pulp. Corporate costs were higher by \$1.7 million compared to the third quarter of 2011, in part reflecting the integration related costs coupled with higher share-based compensation expense.

Net finance expense for the third quarter of 2012 was \$5.8 million, down \$0.4 million from the previous quarter, reflecting a lower draw on the Company's operating lines during the current quarter. Compared to the third quarter of 2011, finance expense was down \$2.1 million, primarily due to costs recorded in the third quarter of 2011 in connection with an extension of the Company's main operating line of credit.

The Company recorded a foreign exchange translation gain on its US dollar denominated debt of \$6.5 million for the third quarter of 2012, as a result of the strengthening of the Canadian dollar against the US dollar, which rose over 3% between the respective quarter ends. The \$3.8 million loss in the second quarter of 2012 and \$16.6 million loss in the third quarter of 2011, resulted from a weakening of the Canadian dollar in the previous periods.

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs, lumber prices and interest rates. For the third quarter of 2012, the Company recorded a net gain of \$6.8 million related to its derivative financial instruments, largely reflecting realized and unrealized gains on the US dollar forward contracts and collars, related to the strengthening of the Canadian dollar, and gains on energy hedges and lumber futures.

The following table summarizes the gains (losses) on derivative financial instruments for the comparable periods:

(millions of dollars)	Q3 2012	Q2 2012	YTD 2012	Q3 2011	YTD 2011
Foreign exchange collars and forward contracts	\$ 3.8	\$ (2.5)	\$ 4.2	\$ (14.9)	\$ (12.0)
Energy derivatives	\$ 1.5	\$ (1.8)	\$ 0.9	\$ (0.9)	\$ (0.3)
Lumber futures	\$ 1.3	\$ (0.4)	\$ 3.9	\$ 3.7	\$ 6.2
Interest rate swaps	\$ 0.2	\$ (1.6)	\$ (1.1)	\$ -	\$ -
	\$ 6.8	\$ (6.3)	\$ 7.9	\$ (12.1)	\$ (6.1)

<sup>18</sup> Oriented Strand Board, North Central price, 7/16" (Source – Random Lengths Publications, Inc.)

Other expense, net of \$2.6 million reflected unfavourable exchange movements on US dollar denominated cash, receivables and payables of Canadian operations of the same amount, compared to a gain in the previous quarter of \$1.7 million and a gain of \$7.2 million in the third quarter of 2011 resulting from the effect of the weakening of the Canadian dollar during those periods. Other income in the second quarter of 2012 also included a \$0.9 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 in late 2010, while other income in the third quarter of 2011 included a loss of \$2.0 million related to a decrease in fair value of the Company's investment in asset-backed commercial paper.

### Other Comprehensive Income (Loss)

The following table summarizes Canfor's Other Comprehensive Income (Loss) for the comparable periods:

(millions of dollars)	Q3 2012	Q2 2012	YTD 2012	Q3 2011	YTD 2011
Foreign exchange translation differences for foreign operations	\$ (7.0)	\$ 4.1	\$ (6.5)	\$ 14.6	\$ 8.7
Defined benefit actuarial loss, net of tax	\$ (16.7)	\$ (22.7)	\$ (44.7)	\$ (56.6)	\$ (61.0)
Other comprehensive income (loss), net of tax	\$ (23.7)	\$ (18.6)	\$ (51.2)	\$ (42.0)	\$ (52.3)

In the third quarter of 2012, the Company recorded an after-tax charge to the statements of other comprehensive income (loss) of \$16.7 million in relation to changes in the valuation of its defined benefit post-employment compensation plans. The charge reflects a reduction in the discount rate used to value the plans offset slightly by a higher than expected rate of return for the period. In the previous quarter, a charge of \$22.7 million was recorded, reflecting a reduction in discount rates and a lower than expected rate of return for the period. An after-tax loss of \$56.6 million was recorded in the third quarter of 2011.

In addition, the Company recorded \$7.0 million of other comprehensive loss in the quarter for foreign exchange differences for foreign operations, reflecting the strengthening of the Canadian dollar by over 3% over the quarter. This compared to other comprehensive income of \$4.1 million in the previous quarter and \$14.6 million in the third quarter of 2011, when the Canadian dollar weakened over both comparative periods.

### SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's cash flow and selected ratios for and as at the end of the following periods:

(millions of dollars)	Q3 2012	Q2 2012	YTD 2012	Q3 2011	YTD 2011
Increase (decrease) in cash and cash equivalents	\$ (13.1)	\$ (2.7)	\$ (36.0)	\$ (28.7)	\$ (159.0)
Operating activities	\$ 33.9	\$ 119.1	\$ 97.8	\$ 60.9	\$ 124.7
Financing activities	\$ (4.4)	\$ (92.6)	\$ 40.0	\$ (18.7)	\$ (173.8)
Investing activities	\$ (42.6)	\$ (29.2)	\$ (173.8)	\$ (70.9)	\$ (109.9)
Ratio of current assets to current liabilities			1.4 : 1		1.7 : 1
Net debt to capitalization			19.2%		9.2%
ROIC – Consolidated	1.6%	1.3%	1.5%	0.1%	0.7%
ROCE - Canfor solid wood business <sup>19</sup>	2.5%	0.2%	1.1%	(3.0)%	(4.6)%

<sup>19</sup> Return on Capital Employed ("ROCE") for the Canfor solid wood business represents consolidated ROCE adjusted to remove the Company's interest in the Peace Valley OSB Joint Venture and pulp and paper operations, including Canfor Pulp and the Taylor pulp mill. Consolidated ROCE is equal to shareholder net income for the period plus finance expense, after tax, divided by the average capital employed during the period (which consists of current and long-term debt and operating loans, and shareholders' equity, less cash and temporary investments).

## **Changes in Financial Position**

Cash generated from operating activities was \$33.9 million in the third quarter of 2012, compared to \$119.1 million in the previous quarter. The decrease in cash generated from operating activities principally reflected a seasonal increase in inventory, in contrast to a significant drawdown in the second quarter of 2012 (reflecting spring break up). Partially offsetting these decreases in cash flow were decreased accounts receivable balances, in part reflecting lower sales volumes in the pulp segment, along with the effect of property tax payments made at the end of the second quarter. The second quarter of 2012 also included seasonally higher reforestation-related payments. Compared to the third quarter of 2011, cash generated from operating activities was down \$27.0 million reflecting higher non-cash working capital balances required to support the growth in shipments, offset in part by slightly higher cash earnings in the current quarter.

Financing activities used cash of \$4.4 million in the current quarter, compared to \$92.6 million in the previous quarter and \$18.7 million in the third quarter of 2011. The current quarter's cash flows included cash distributions to non-controlling interests of \$3.0 million (Q2 2012: \$8.2 million; Q3 2011: \$15.7 million). Finance expenses paid in the current quarter were \$1.4 million, down \$6.0 million from the previous quarter, principally reflecting timing of scheduled payments, and down \$1.7 million from the third quarter of 2011 which included fees paid in connection to the extension of the Company's main operating line of credit. The immediately preceding quarter's cash flows included a \$77.0 million repayment on the Company's outstanding operating lines of credit.

Investing activities used cash of \$42.6 million in the third quarter of 2012, compared to \$29.2 million in the second quarter of 2012 and \$70.9 million in the third quarter of 2011. Cash used for capital additions was \$54.1 million, up \$9.7 million from the second quarter of 2012, and down \$25.3 million from the third quarter of 2011. Capital additions for lumber operations in the current quarter included work carried out at the Company's Radium sawmill in preparation for its restart in the fourth quarter. In the pulp segment, current quarter capital expenditures were \$30.0 million, principally related to capital and major maintenance expenditure at the Company's Prince George Pulp Mill. CPPI received cash of \$10.0 million in the current quarter as reimbursement for capital additions under the Green Transformation Program. Investing cash flows in the previous quarter included \$12.9 million in net proceeds realized on the sale of the Company's ABCP in early April, while the third quarter of 2011 included \$12.2 million paid into escrow in connection with the purchase of a biomass energy facility in Grande Prairie.

## **Liquidity and Financial Requirements**

At September 30, 2012, the Company on a consolidated basis had cheques issued in excess of cash on hand of \$7.1 million, \$17.0 million drawn on its operating lines of credit, and an additional \$29.1 million reserved for several standby letters of credit. Total remaining available operating lines of credit were \$354.3 million. The Company and Canfor Pulp remained in compliance with the covenants relating to their operating lines of credit and long-term debt during the quarter, and expect to remain so for the foreseeable future.

During the first quarter of 2012, the Company issued new term debt of \$100.0 million to fund a US\$50.0 million term debt repayment on February 1, 2012 and the acquisition of assets from Tembec. The new debt is in the form of an unsecured non-revolving term loan, with a maturity date of February 13, 2017. Interest rates are floating based on the lenders' Canadian prime rate or bankers acceptances. During the first half of 2012, the Company put in place \$100.0 million of floating to fixed interest rate swaps.

Canfor has US\$75.0 million of term debt that is scheduled for repayment on April 1, 2013, and Canfor Pulp has US\$110.0 million of term debt that is scheduled for repayment on November 30, 2013.

The Company's consolidated net debt to total capitalization at the end of the third quarter of 2012 was 19.2%. For Canfor, excluding Canfor Pulp, net debt to capitalization at the end of the third quarter was 14.5%.

## **Softwood Lumber Agreement (“SLA”) Update**

On January 18, 2011, the U.S. triggered the arbitration provision of the 2006 Softwood Lumber Agreement (“SLA”) by delivering a Request for Arbitration. The U.S. claimed that the province of British Columbia (“BC”) had not properly applied the timber pricing system grandfathered in the SLA. The U.S. also claimed that subsequent to 2006, BC made additional changes to the timber pricing system which had the effect of reducing timber prices. The claim focused on substantial increases in Grade 4 (non sawlog or low grade) volumes commencing in 2007. It was 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 prepared a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. After numerous representations from both sides, a hearing was held before the arbitration panel in the first quarter of 2012.

On July 18, 2012 the arbitration panel ruled in favour of Canada and dismissed the claims of the U.S. in their entirety.

## **Canfor Pulp Collective Agreements with Labour Unions**

The Company ratified new five year collective agreements with the CEP (Communications, Energy and Paperworkers Union) and PPWC (Pulp, Paper and Woodworkers of Canada) during the third quarter of 2012. Both agreements expire on April 30, 2017.

## **CPPI Share Exchange**

On March 2, 2012, Canadian Forest Products Ltd. (“CFP”), a wholly owned subsidiary of Canfor, acquired 35,776,483 common shares of Canfor Pulp Products, Inc. (“CPPI”) in exchange for its 35,776,483 Class B Exchangeable LP Units of Canfor Pulp Limited Partnership (“CPLP”) and 35,776,483 common shares of Canfor Pulp Holding Inc. (“Canfor Holding”), pursuant to the terms of an Exchange Agreement made as of January 1, 2011 among CFP, CPPI, Canfor Holding and CPLP.

Prior to the share exchange, CFP and CPPI entered into a one-time dividend waiver agreement, waiving CFP’s right to the first \$7.8 million of future dividends declared by CPPI. The full \$7.8 million dividend was paid by CPPI during the second quarter of 2012.

## **OUTLOOK**

### **Lumber**

For the fourth quarter of 2012, a seasonal slowdown in the North American lumber market is projected reflecting traditionally slower homebuilding activity. U.S. home inventories are anticipated to remain relatively low aided by low mortgage rates and a forecast slow but gradual appreciation in home prices. Shipments to the U.S. are forecast to taper off as export taxes increase from 5% in October to 10% in November. The repair and remodeling sector is projected to decrease slightly through the balance of the year, reflecting normal seasonal slowdown. Offshore lumber shipments are anticipated to remain robust to ensure products arrive prior to the Chinese New Year.

### **Pulp and Paper**

For the month of October, Canfor Pulp has announced an increase in the NBSK pulp list price of US\$20 per tonne in all regions. A scheduled maintenance outage is planned in the fourth quarter at the Northwood Pulp Mill which is projected to result in a reduction in market pulp production of approximately 6,000 tonnes.

## **OUTSTANDING SHARES**

At October 23, 2012, there were 142,752,431 common shares outstanding.

## **CRITICAL ACCOUNTING ESTIMATES**

The preparation of financial statements in conformity with International Financial Reporting Standards requires management to make estimates and assumptions that affect the amounts recorded in the financial statements. On an ongoing basis, management reviews its estimates, including those related to useful lives for amortization, impairment of long-lived assets, certain accounts receivable, pension and other employee future benefit plans and asset retirement and deferred reforestation obligations based upon 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 the Company's financial condition.

## **CHANGES IN ACCOUNTING POLICY**

Effective January 1, 2012, the Company retroactively changed its accounting policy for the presentation of interest expense and expected rate of return on assets of defined benefit post-retirement plans. The net expense has been reclassified from operating income, included in manufacturing and product costs and in selling and administration costs, to net finance expense. Management considers the classification of net pension interest expense as a finance expense more accurately reflects the nature of this cost. The effect on the three months ended September 30, 2011 and nine months ended September 30, 2011 is an increase in operating income and an increase in net finance expense of \$0.9 million and \$2.7 million, respectively. There is no impact on amounts recorded in the consolidated balance sheet or opening equity as at January 1, 2012.

## **NEW ACCOUNTING PRONOUNCEMENTS**

In the first half of 2011, the International Accounting Standards Board ("IASB") issued a number of new and revised accounting standards which are effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. These new and revised accounting standards have not yet been adopted by Canfor and the Company does not plan to early adopt any of the standards.

The following new or revised standards are not expected to have a material impact on the amounts recorded in the financial statements of Canfor:

- IFRS 10, *Consolidated Financial Statements*;
- IFRS 12, *Disclosure of Interests in Other Entities*;
- IAS 27, *Separate Financial Statements*; and
- IFRS 13, *Fair Value Measurement*.

The Company is still in the process of assessing the full impact, if any, of the following new or revised standards:

- IFRS 11, *Joint Arrangements*;
- Amended IAS 19, *Employee Benefits*; and
- Amended IAS 28, *Investments in Associates and Joint Ventures*.

In the first half of 2011, the IASB also issued amended IAS 1, *Presentation of Financial Statements*, which is effective for annual periods beginning on or after July 1, 2012 and IFRS 9, *Financial Instruments*, which is effective for annual periods beginning on or after January 1, 2015, with early adoption permitted. IAS 1 and IFRS 9 are not expected to have a material impact on amounts recorded in the financial statements of Canfor.

Further details of the new or revised accounting standards and potential impact on Canfor can be found in Canfor's Annual Report for the year ended December 31, 2011.

## **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

During the quarter ended September 30, 2012, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

## **RISKS AND UNCERTAINTIES**

A comprehensive discussion of risks and uncertainties is included in the Company's 2011 annual statutory reports which are available on [www.canfor.com](http://www.canfor.com) or [www.sedar.com](http://www.sedar.com).

## SELECTED QUARTERLY FINANCIAL INFORMATION<sup>20</sup>

	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010
<b>Sales and income</b> (millions of dollars)								
Sales	\$ 683.8	\$ 700.9	\$ 607.6	\$ 576.2	\$ 602.1	\$ 619.1	\$ 624.0	\$ 629.1
Operating income (loss)	\$ 22.3	\$ 26.0	\$ (21.5)	\$ (63.1)	\$ 15.4	\$ 27.4	\$ 32.3	\$ 43.9
Net income (loss)	\$ 20.7	\$ 7.0	\$ (10.9)	\$ (38.1)	\$ (9.6)	\$ 26.2	\$ 32.3	\$ 55.4
Shareholder net income (loss)	\$ 22.2	\$ 4.5	\$ (16.2)	\$ (44.1)	\$ (21.6)	\$ 2.1	\$ 7.0	\$ 31.4
<b>Per common share</b> (dollars)								
Shareholder net income (loss) – basic and diluted	\$ 0.16	\$ 0.03	\$ (0.11)	\$ (0.31)	\$ (0.15)	\$ 0.01	\$ 0.05	\$ 0.22
<b>Statistics</b>								
Lumber shipments (MMfbm)	1,133	1,158	994	974	969	973	857	885
OSB shipments (MMsf 3/8")	75	72	65	75	62	69	63	57
Pulp shipments (000 mt)	269	282	328	275	291	303	318	331
Average exchange rate – US\$/Cdn\$	\$ 1.005	\$ 0.990	\$ 0.999	\$ 0.977	\$ 1.020	\$ 1.033	\$ 1.014	\$ 0.987
Average Western SPF 2x4 #2&Btr lumber price (US\$)	\$ 300	\$ 295	\$ 266	\$ 238	\$ 246	\$ 240	\$ 296	\$ 269
Average SYP (East) 2x4 #2 lumber price (US\$)	\$ 322	\$ 325	\$ 298	\$ 260	\$ 259	\$ 251	\$ 302	\$ 256
Average OSB price – North Central (US\$)	\$ 312	\$ 235	\$ 202	\$ 190	\$ 184	\$ 172	\$ 199	\$ 191
Average NBSK pulp list price delivered to U.S. (US\$)	\$ 853	\$ 900	\$ 870	\$ 920	\$ 993	\$ 1,025	\$ 970	\$ 967

<sup>20</sup> Certain prior period amounts have been restated due to a change in accounting policy for treatment of net interest expense for defined benefit post-retirement plans. Further details can be found in the "Changes in Accounting Policy" section earlier in this document.

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.

Other material factors that impact the comparability of the quarters are noted below:

After-tax impact, net of non-controlling interests <sup>21</sup>								
(millions of dollars, except for per share amounts)								
	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010
<b>Shareholder net income (loss), as reported</b>	\$ 22.2	\$ 4.5	\$ (16.2)	\$ (44.1)	\$ (21.6)	\$ 2.1	\$ 7.0	\$ 32.9
Foreign exchange (gain) loss on long-term debt and investments, net	\$ (4.0)	\$ 2.4	\$ (2.7)	\$ (3.3)	\$ 11.0	\$ (1.4)	\$ (3.0)	\$ (6.9)
(Gain) loss on derivative financial instruments	\$ (4.4)	\$ 4.2	\$ (5.1)	\$ (6.7)	\$ 7.0	\$ (0.7)	\$ (2.9)	\$ (0.5)
Restructuring costs related to changes in management group	\$ 1.5	\$ -	\$ -	\$ -	\$ -	\$ 2.6	\$ -	\$ -
Decrease (increase) in fair value of asset-backed commercial paper	\$ -	\$ -	\$ (1.1)	\$ (0.5)	\$ 1.8	\$ (0.5)	\$ (1.0)	\$ (5.5)
Costs recorded in relation to Tembec acquisition	\$ -	\$ -	\$ 2.8	\$ -	\$ -	\$ -	\$ -	\$ -
Mill closure provisions	\$ -	\$ -	\$ -	\$ 17.0	\$ -	\$ -	\$ -	\$ -
Asset impairment charges	\$ -	\$ -	\$ -	\$ 5.5	\$ -	\$ -	\$ -	\$ -
Gain on sale of operating assets of Howe Sound Pulp and Paper Limited Partnership	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (4.9)
Net impact of above items	\$ (6.9)	\$ 6.6	\$ (6.1)	\$ 12.0	\$ 19.8	\$ -	\$ (6.9)	\$ (17.8)
<b>Adjusted shareholder net income (loss)</b>	\$ 15.3	\$ 11.1	\$ (22.3)	\$ (32.1)	\$ (1.8)	\$ 2.1	\$ 0.1	\$ 15.1
<b>Shareholder net income (loss) per share (EPS), as reported</b>	\$ 0.16	\$ 0.03	\$ (0.11)	\$ (0.31)	\$ (0.15)	\$ 0.01	\$ 0.05	\$ 0.23
Net impact of above items per share	\$ (0.05)	\$ 0.05	\$ (0.05)	\$ 0.09	\$ 0.14	\$ 0.00	\$ (0.05)	\$ (0.12)
<b>Adjusted net income (loss) per share</b>	\$ 0.11	\$ 0.08	\$ (0.16)	\$ (0.22)	\$ (0.01)	\$ 0.01	\$ 0.00	\$ 0.11

<sup>21</sup> Certain prior period amounts have been restated due to a change in accounting policy for treatment of net interest expense for defined benefit post-retirement plans. Further details can be found in the "Changes in Accounting Policy" section earlier in this document.



## Canfor Corporation

### Condensed Consolidated Balance Sheets

(millions of Canadian dollars, unaudited)	As at September 30, 2012	As at December 31, 2011
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ -	\$ 28.9
Accounts receivable - Trade	116.8	105.1
- Other	57.5	65.7
Inventories (Note 2)	394.0	348.3
Prepaid expenses	33.2	20.4
<b>Total current assets</b>	<b>601.5</b>	<b>568.4</b>
<b>Property, plant and equipment</b>	<b>1,163.8</b>	<b>1,139.2</b>
<b>Timber licenses</b>	<b>559.0</b>	<b>530.1</b>
<b>Goodwill and other intangible assets</b>	<b>78.0</b>	<b>83.0</b>
<b>Long-term investments and other</b> (Note 3)	<b>46.2</b>	<b>62.8</b>
<b>Deferred income taxes, net</b>	<b>44.6</b>	<b>18.1</b>
<b>Total assets</b>	<b>\$ 2,493.1</b>	<b>\$ 2,401.6</b>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Cheques issued in excess of cash on hand	\$ 7.1	\$ -
Operating loans (Note 4(a))	17.0	-
Accounts payable and accrued liabilities	293.2	290.5
Current portion of long-term debt (Note 4(b))	73.8	50.9
Current portion of deferred reforestation obligations	37.8	31.6
<b>Total current liabilities</b>	<b>428.9</b>	<b>373.0</b>
<b>Long-term debt</b> (Note 4(b))	<b>208.2</b>	<b>188.1</b>
<b>Retirement benefit obligations</b>	<b>329.9</b>	<b>298.3</b>
<b>Deferred reforestation obligations</b>	<b>69.3</b>	<b>65.0</b>
<b>Other long-term liabilities</b>	<b>15.6</b>	<b>13.8</b>
<b>Deferred income taxes, net</b>	<b>151.8</b>	<b>103.3</b>
<b>Total liabilities</b>	<b>\$ 1,203.7</b>	<b>\$ 1,041.5</b>
<b>EQUITY</b>		
Share capital	\$ 1,126.2	\$ 1,125.9
Contributed surplus	31.9	31.9
Retained earnings	(53.5)	(24.6)
Accumulated foreign exchange translation differences	(12.4)	(5.9)
<b>Total equity attributable to equity holders of the Company</b>	<b>1,092.2</b>	<b>1,127.3</b>
<b>Non-controlling interests</b>	<b>197.2</b>	<b>232.8</b>
<b>Total equity</b>	<b>\$ 1,289.4</b>	<b>\$ 1,360.1</b>
<b>Total liabilities and equity</b>	<b>\$ 2,493.1</b>	<b>\$ 2,401.6</b>

The accompanying notes are an integral part of these condensed consolidated financial statements.

APPROVED BY THE BOARD

*"R.S. Smith"*

Director, R.S. Smith

*"R.L. Cliff"*

Director, R.L. Cliff

**Canfor Corporation**  
**Condensed Consolidated Statements of Income (Loss)**

(millions of Canadian dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2012	2011	2012	2011
<b>Sales</b>	<b>\$ 683.8</b>	\$ 602.1	<b>\$ 1,992.3</b>	\$ 1,845.2
<b>Costs and expenses</b>				
Manufacturing and product costs	459.7	399.6	1,354.5	1,206.5
Freight and other distribution costs	123.3	117.9	378.7	354.3
Export taxes	10.6	10.1	35.7	30.3
Amortization	45.7	39.9	136.8	121.7
Selling and administration costs	15.2	13.4	46.1	41.8
Restructuring, mill closure and severance costs	7.0	5.8	13.7	15.5
	<b>661.5</b>	586.7	<b>1,965.5</b>	1,770.1
<b>Operating income</b>	<b>22.3</b>	15.4	<b>26.8</b>	75.1
Finance expense, net	(5.8)	(7.9)	(18.2)	(20.9)
Foreign exchange gain (loss) on long-term debt and investments, net	6.5	(16.6)	6.7	(9.9)
Gain (loss) on derivative financial instruments (Note 6)	6.8	(12.1)	7.9	(6.1)
Other income (expense), net	(2.6)	5.2	(0.2)	4.6
Net income (loss) before income taxes	27.2	(16.0)	23.0	42.8
Income tax recovery (expense) (Note 7)	(6.5)	6.4	(6.2)	6.1
<b>Net income (loss)</b>	<b>\$ 20.7</b>	\$ (9.6)	<b>\$ 16.8</b>	\$ 48.9
<b>Net income (loss) attributable to:</b>				
Equity shareholders of the Company	\$ 22.2	\$ (21.6)	\$ 10.5	\$ (12.5)
Non-controlling interests	(1.5)	12.0	6.3	61.4
<b>Net income (loss)</b>	<b>\$ 20.7</b>	\$ (9.6)	<b>\$ 16.8</b>	\$ 48.9
<b>Net income (loss) per common share:</b> (in dollars)				
Attributable to equity shareholders of the Company				
- Basic and diluted (Note 8)	\$ 0.16	\$ (0.15)	\$ 0.08	\$ (0.09)

The accompanying notes are an integral part of these condensed consolidated financial statements.

## Canfor Corporation

### Condensed Consolidated Statements of Other Comprehensive Income (Loss)

(millions of Canadian dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2012	2011	2012	2011
<b>Net income (loss)</b>	\$ 20.7	\$ (9.6)	\$ 16.8	\$ 48.9
<b>Other comprehensive income (loss)</b>				
Foreign exchange translation differences for foreign operations	(7.0)	14.6	(6.5)	8.7
Defined benefit plan actuarial losses (Note 5)	(22.3)	(73.6)	(59.8)	(79.4)
Income tax recovery on defined benefit plan actuarial losses (Note 7)	5.6	17.0	15.1	18.4
Other comprehensive income (loss), net of tax	(23.7)	(42.0)	(51.2)	(52.3)
<b>Total comprehensive income (loss)</b>	\$ (3.0)	\$ (51.6)	\$ (34.4)	\$ (3.4)
<b>Total comprehensive income (loss) attributable to:</b>				
Equity shareholders of the Company	\$ 0.8	\$ (57.9)	\$ (35.4)	\$ (58.5)
Non-controlling interests	(3.8)	6.3	1.0	55.1
<b>Total comprehensive income (loss)</b>	\$ (3.0)	\$ (51.6)	\$ (34.4)	\$ (3.4)

### Condensed Consolidated Statements of Changes in Equity

(millions of Canadian dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2012	2011	2012	2011
<b>Share capital</b>				
Balance at beginning of period	\$ 1,126.2	\$ 1,125.7	\$ 1,125.9	\$ 1,125.4
Common shares issued on exercise of stock options	-	-	0.3	0.3
Balance at end of period	\$ 1,126.2	\$ 1,125.7	\$ 1,126.2	\$ 1,125.7
<b>Contributed surplus</b>				
Balance at beginning and end of period	\$ 31.9	\$ 31.9	\$ 31.9	\$ 31.9
<b>Retained earnings</b>				
Balance at beginning of period	\$ (61.3)	\$ 78.8	\$ (24.6)	\$ 73.5
Net income (loss) attributable to equity shareholders of the Company	22.2	(21.6)	10.5	(12.5)
Defined benefit plan actuarial losses, net of tax	(14.4)	(50.9)	(39.4)	(54.7)
Balance at end of period	\$ (53.5)	\$ 6.3	\$ (53.5)	\$ 6.3
<b>Accumulated foreign exchange translation differences</b>				
Balance at beginning of period	\$ (5.4)	\$ (16.2)	\$ (5.9)	\$ (10.3)
Foreign exchange translation differences for foreign operations	(7.0)	14.6	(6.5)	8.7
Balance at end of period	\$ (12.4)	\$ (1.6)	\$ (12.4)	\$ (1.6)
<b>Total equity attributable to equity holders of the Company</b>	\$ 1,092.2	\$ 1,162.3	\$ 1,092.2	\$ 1,162.3
<b>Non-controlling interests</b>				
Balance at beginning of period	\$ 204.0	\$ 245.7	\$ 232.8	\$ 249.5
Net income (loss) attributable to non-controlling interests	(1.5)	12.0	6.3	61.4
Defined benefit plan actuarial losses attributable to non-controlling interests	(2.3)	(5.7)	(5.3)	(6.3)
Distributions to non-controlling interests	(3.0)	(11.0)	(11.6)	(63.6)
Share exchange (Note 13)	-	-	(25.0)	-
Balance at end of period	\$ 197.2	\$ 241.0	\$ 197.2	\$ 241.0
<b>Total equity</b>	\$ 1,289.4	\$ 1,403.3	\$ 1,289.4	\$ 1,403.3

The accompanying notes are an integral part of these condensed consolidated financial statements.

## Canfor Corporation

### Condensed Consolidated Statements of Cash Flows

(millions of Canadian dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2012	2011	2012	2011
<b>Cash generated from (used in):</b>				
<b>Operating activities</b>				
Net income (loss)	\$ 20.7	\$ (9.6)	\$ 16.8	\$ 48.9
Items not affecting cash:				
Amortization	45.7	39.9	136.8	121.7
Income tax (recovery) expense	6.5	(6.4)	6.2	(6.1)
Long-term portion of deferred reforestation obligations	(8.5)	(9.3)	(6.4)	(3.2)
Change in fair value of long-term investment	-	2.0	(1.3)	0.2
Foreign exchange (gain) loss on long-term debt and investments, net	(6.5)	16.6	(6.7)	9.9
Changes in mark-to-market value of derivative financial instruments	(3.6)	11.8	(1.9)	7.2
Employee future benefits	(2.6)	0.3	(4.9)	(0.7)
Net finance expense	5.8	7.9	18.2	20.9
Other, net	0.2	(1.6)	(1.8)	(8.6)
Salary pension plan contributions	(9.0)	(9.6)	(27.0)	(29.2)
Income taxes recovered (paid), net	(0.8)	(0.3)	(5.4)	(0.3)
Net change in non-cash working capital (Note 9)	(14.0)	19.2	(24.8)	(36.0)
	<b>33.9</b>	<b>60.9</b>	<b>97.8</b>	<b>124.7</b>
<b>Financing activities</b>				
Change in operating bank loans (Note 4(a))	-	-	17.0	-
Proceeds from long-term debt (Note 4(b))	-	-	100.0	-
Repayment of long-term debt (Note 4(b))	-	-	(49.9)	(81.9)
Finance expenses paid	(1.4)	(3.1)	(11.9)	(12.7)
Cash distributions paid to non-controlling interests	(3.0)	(15.7)	(15.5)	(79.6)
Other, net	-	0.1	0.3	0.4
	<b>(4.4)</b>	<b>(18.7)</b>	<b>40.0</b>	<b>(173.8)</b>
<b>Investing activities</b>				
Additions to property, plant and equipment	(54.1)	(79.4)	(152.1)	(183.9)
Reimbursements from Government under Green Transformation Program	10.0	19.2	19.0	50.4
Acquisition of Tembec assets (Note 12)	-	-	(65.6)	-
Share exchange (Note 13)	-	-	6.8	-
Proceeds from redemption of asset-backed commercial paper (Note 3)	-	-	12.9	29.8
Amounts paid to escrow	-	(12.2)	-	(12.2)
Other, net	1.5	1.5	5.2	6.0
	<b>(42.6)</b>	<b>(70.9)</b>	<b>(173.8)</b>	<b>(109.9)</b>
<b>Increase (decrease) in cash and cash equivalents*</b>	<b>(13.1)</b>	<b>(28.7)</b>	<b>(36.0)</b>	<b>(159.0)</b>
Cash and cash equivalents at beginning of period*	6.0	130.0	28.9	260.3
<b>Cash and cash equivalents at end of period*</b>	<b>\$ (7.1)</b>	<b>\$ 101.3</b>	<b>\$ (7.1)</b>	<b>\$ 101.3</b>

\*Cash and cash equivalents include cash on hand less unrepresented cheques.

The accompanying notes are an integral part of these condensed consolidated financial statements.

# Canfor Corporation

## Notes to the Condensed Consolidated Financial Statements

(unaudited, millions of Canadian dollars unless otherwise noted)

### 1. Basis of Preparation

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting*, and include the accounts of Canfor Corporation and its subsidiary entities, hereinafter referred to as "Canfor" or "the Company".

These interim financial statements do not include all of the disclosures required by International Financial Reporting Standards ("IFRS") for annual financial statements. Additional disclosures relevant to the understanding of these interim financial statements, including the accounting policies applied, can be found in Canfor's Annual Report for the year ended December 31, 2011, available at [www.canfor.com](http://www.canfor.com) or [www.sedar.com](http://www.sedar.com).

Canfor'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 sawmills and pulp mills. Market demand also varies seasonally to some degree. For example, building activity and repair and renovation work, which affects demand for solid wood products, are generally stronger in the spring and summer months. Shipment volumes are affected by these factors as well as by global supply and demand conditions.

The currency of presentation for these financial statements is the Canadian dollar.

#### ***Change in accounting policy***

Effective January 1, 2012, the Company retroactively changed its accounting policy for the presentation of interest expense and expected rate of return on assets of defined benefit post-retirement plans. The net expense has been reclassified from operating income, included in manufacturing and product costs and in selling and administration costs, to net finance expense. Management considers the classification of net pension interest expense as a finance expense more accurately reflects the nature of this cost. The effect on the three months ended September 30, 2011 and nine months ended September 30, 2011 is an increase in operating income and net finance expense of \$0.9 million and \$2.7 million, respectively. There is no impact on amounts recorded in the consolidated balance sheet or opening equity as at January 1, 2012.

#### ***Accounting standards issued and not applied***

In the first half of 2011, the International Accounting Standards Board ("IASB") issued a number of new and revised accounting standards which are effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. These new and revised accounting standards have not yet been adopted by Canfor and the Company does not plan to early adopt any of the standards.

The following new or revised standards are not expected to have a material impact on the amounts recorded in the financial statements of Canfor:

- IFRS 10, *Consolidated Financial Statements*;
- IFRS 12, *Disclosure of Interests in Other Entities*;
- IAS 27, *Separate Financial Statements*; and
- IFRS 13, *Fair Value Measurement*.

The Company is still in the process of assessing the full impact, if any, of the following new or revised standards:

- IFRS 11, *Joint Arrangements*;
- Amended IAS 19, *Employee Benefits*; and
- Amended IAS 28, *Investments in Associates and Joint Ventures*.

In the first half of 2011, the IASB also issued amended IAS 1, *Presentation of Financial Statements*, which is effective for annual periods beginning on or after July 1, 2012 and IFRS 9, *Financial Instruments*, which is effective for annual periods beginning on or after January 1, 2015, with early adoption permitted. IAS 1 and IFRS 9 are not expected to have a material impact on amounts recorded in the financial statements of Canfor.

Further details of the new or revised accounting standards and potential impact on Canfor can be found in Canfor's Annual Report for the year ended December 31, 2011.

## 2. Inventories

(millions of Canadian dollars)	As at September 30, 2012	As at December 31, 2011
Logs	\$ 83.0	\$ 55.9
Finished products	196.9	186.3
Residual fibre	19.5	17.3
Processing materials and supplies	94.6	88.8
	<b>\$ 394.0</b>	<b>\$ 348.3</b>

The above inventory balances are stated after inventory write-downs from cost to net realizable value. Write-downs at September 30, 2012 totaled \$0.4 million (December 31, 2011 - \$15.5 million).

## 3. Long-term Investments and Other

(millions of Canadian dollars)	As at September 30, 2012	As at December 31, 2011
Asset-backed commercial paper ("ABCP")	\$ -	\$ 11.8
Other investments	23.5	24.3
Investment tax credits	8.6	8.6
Defined benefit plan assets	3.2	3.0
Other deposits, loans and advances	10.9	15.1
	<b>\$ 46.2</b>	<b>\$ 62.8</b>

During the second quarter of 2012, the Company sold the ABCP assets for net proceeds of \$12.9 million.

## 4. Operating Lines and Long-Term Debt

### (a) Available Operating Lines

(millions of Canadian dollars)	As at September 30, 2012	As at December 31, 2011
<b>Canfor (excluding CPLP)</b>		
Principal operating lines	\$ 350.0	\$ 350.0
Facility A	-	12.9
Total operating lines - Canfor (excluding CPLP)	350.0	362.9
Drawn	(10.0)	-
Letters of credit (principally unregistered pension plans)	(17.9)	(17.2)
Total available operating lines - Canfor (excluding CPLP)	<b>\$ 322.1</b>	<b>\$ 345.7</b>
<b>CPLP</b>		
Main bank loan facility	\$ 40.0	\$ 40.0
Bridge loan credit facility (maximum \$30.0 million)	-	19.7
Facility for BC Hydro letter of credit	10.4	10.4
Total operating lines - CPLP	50.4	70.1
Drawn	(7.0)	-
Letters of credit (for general business purposes)	(0.8)	(0.5)
BC Hydro letter of credit	(10.4)	(10.4)
Total available operating lines - CPLP	<b>\$ 32.2</b>	<b>\$ 59.2</b>
<b>Consolidated:</b>		
<b>Total operating lines</b>	<b>\$ 400.4</b>	<b>\$ 433.0</b>
<b>Total available operating lines</b>	<b>\$ 354.3</b>	<b>\$ 404.9</b>

For Canfor, excluding CPLP, the principal operating lines mature on October 31, 2015. Interest is payable at floating rates based on lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin that varies with the Company's net debt to total capitalization ratio. Facility A, which was for US\$12.7 million at December 31, 2011, expired in January 2012.

The terms of CPLP's principal bank loan facility include interest payable at floating rates that vary depending on the ratio of net debt to operating earnings before interest, taxes, depreciation, amortization and certain other non-cash items, and is based on lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin. The maturity date of this facility is November 30, 2013.

During the third quarter of 2012, CPLP terminated its \$30.0 million bridge loan credit facility in conjunction with the completion of the Canadian Federal Government Green Transformation Program ("Program"). The facility was used to fund timing differences between expenditures and reimbursements for projects funded by the Program. The Company has 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.

As at September 30, 2012, the Company and CPLP were in compliance with all covenants relating to their operating lines of credit.

Substantially all borrowings of CPLP (operating lines and long-term debt) are non-recourse to other entities within the Company.

#### ***(b) Long-Term Debt***

During the first quarter of 2012, the Company repaid \$49.9 million (US\$50.0 million) of 6.33% interest rate privately placed senior notes.

During the first quarter of 2012, the Company also issued new term debt totaling \$100.0 million which was used to fund the above debt repayment and the acquisition of assets from Tembec (Note 12). The new debt is in the form of an unsecured non-revolving term loan, with a maturity date of February 13, 2017. Interest rates are floating based on the lenders' Canadian prime rate or bankers acceptances. In addition, during the first half of 2012 the Company put in place \$100.0 million of floating to fixed interest rate swaps.

At September 30, 2012, the fair value of the long-term debt, measured at its amortized cost of \$282.0 million, was \$286.4 million. The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

### **5. Employee Future Benefits**

Canfor measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. At the end of each interim reporting period, the Company estimates movements in its accrued benefit liabilities based upon movements in discount rates and the rates of return on plan assets, as well as any significant changes to the plans. Adjustments are also made for payments made and current service and interest costs.

For the nine months ended September 30, 2012, \$59.8 million (before tax) was charged to other comprehensive income. The charge reflects a reduction in the discount rate used to value the plans offset slightly by a higher than expected rate of return for the period. For the three months ended September 30, 2012, the charge was \$22.3 million (before tax). For the nine months ended September 30, 2011, a pre-tax amount of \$79.4 million was charged to other comprehensive income relating to a lower than expected rate of return on plan assets, partially offset by a reduction in discount rates. For the three months ended September 30, 2011 the pre-tax charge was \$73.6 million.

For the Company's pension and other retirement benefit obligations, a one percentage point increase (decrease) in the discount rate would reduce (increase) the estimated retirement benefit obligations by approximately \$90.0 million before tax.

The assumptions used to estimate the changes in net accrued benefit liabilities were as follows:

<b>Pension Benefit Plans</b>	
Discount rate	
September 30, 2012	<b>4.30%</b>
June 30, 2012	4.65%
December 31, 2011	5.00%
September 30, 2011	5.00%
June 30, 2011	5.50%
December 31, 2010	5.50%
Rate of return on plan assets	
9 months ended September 30, 2012	<b>6.60%</b>
6 months ended June 30, 2012	2.60%
9 months ended September 30, 2011	(2.50)%
6 months ended June 30, 2011	1.80%
<b>Other Benefit Plans</b>	
Discount rate	
September 30, 2012	<b>4.50%</b>
June 30, 2012	4.90%
December 31, 2011	5.30%
September 30, 2011	5.40%
June 30, 2011	5.75%
December 31, 2010	5.75%

## 6. Derivative Financial Instruments

The Company uses a variety of derivative financial instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, lumber prices, energy costs, electricity sales and floating interest rates on certain long-term debt. At September 30, 2012, the fair value of derivative financial instruments was a net asset of \$1.7 million (December 31, 2011 – net liability of \$0.2 million). The fair value of these financial instruments was determined based on prevailing market rates for instruments with similar characteristics.

The following table summarizes the gain (loss) on derivative financial instruments for the three and nine month periods ended September 30, 2012 and 2011:

(millions of Canadian dollars)	3 months ended September 30,		9 months ended September 30,	
	2012	2011	2012	2011
Foreign exchange collars and forward contracts	\$ 3.8	\$ (14.9)	\$ 4.2	\$ (12.0)
Energy derivatives	1.5	(0.9)	0.9	(0.3)
Lumber futures	1.3	3.7	3.9	6.2
Interest rate swaps	0.2	-	(1.1)	-
	<b>\$ 6.8</b>	<b>\$ (12.1)</b>	<b>\$ 7.9</b>	<b>\$ (6.1)</b>

The following table summarizes the fair value of the derivative financial instruments included in the balance sheet at September 30, 2012 and December 31, 2011:

(millions of Canadian dollars)	As at	As at
	September 30, 2012	December 31, 2011
Foreign exchange collars and forward contracts	\$ 1.6	\$ (0.4)
Energy derivatives	0.5	(0.2)
Lumber futures	0.5	0.4
Interest rate swaps	(0.9)	-
Total asset (liability), net	1.7	(0.2)
Less: current portion asset (liability), net	2.7	0.2
Long-term portion asset (liability)	<b>\$ (1.0)</b>	<b>\$ -</b>



## 7. Income Taxes

(millions of Canadian dollars)	3 months ended September 30,		9 months ended September 30,	
	2012	2011	2012	2011
Current	\$ 1.5	\$ -	\$ (0.7)	\$ (0.3)
Deferred	(8.0)	6.4	(5.5)	6.4
Income tax recovery (expense)	\$ (6.5)	\$ 6.4	\$ (6.2)	\$ 6.1

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

(millions of Canadian dollars)	3 months ended September 30,		9 months ended September 30,	
	2012	2011	2012	2011
Income tax recovery (expense) at statutory rate				
2012 – 25.0% (2011 – 26.5%)	\$ (6.8)	\$ 4.3	\$ (5.7)	\$ (11.3)
Add (deduct):				
Non-taxable income related to non-controlling interests in limited partnerships	0.2	3.2	1.5	16.3
Entities with different income tax rates and other tax adjustments	(0.5)	0.5	(2.7)	1.1
Tax recovery at rates other than statutory rate	(0.1)	(0.3)	0.1	(0.1)
Permanent difference from capital gains and losses and other non-deductible items	0.7	(1.3)	0.6	0.1
Income tax recovery (expense)	\$ (6.5)	\$ 6.4	\$ (6.2)	\$ 6.1

In addition to the amounts recorded to net income, a tax recovery of \$5.6 million was recorded to other comprehensive income for the three month period ended September 30, 2012 (three months ended September 30, 2011 – \$17.0 million) in relation to the actuarial losses on defined benefit employee compensation plans. For the nine months ended September 30, 2012, the tax recovery was \$15.1 million (nine months ended September 30, 2011 - \$18.4 million).

## 8. Earnings Per Share

Basic net income (loss) per share is calculated by dividing the net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is calculated by dividing the net income (loss) available to common shareholders by the weighted average number of common shares during the period using the treasury stock method. Under this method, proceeds from the potential exercise of stock options are assumed to be used to purchase the Company's common shares. When there is a net loss, the exercise of stock options would result in a calculated diluted net loss per share that is anti-dilutive. As at September 30, 2012, there were no outstanding stock options.

	3 months ended September 30,		9 months ended September 30,	
	2012	2011	2012	2011
Weighted average number of common shares	142,752,431	142,705,764	142,747,976	142,696,217
Incremental shares from potential exercise of options	-	1,760	-	7,181
Diluted number of common shares	142,752,431	142,707,524	142,747,976	142,703,398

## 9. Net Change in Non-Cash Working Capital

(millions of Canadian dollars)	3 months ended September 30,		9 months ended September 30,	
	2012	2011	2012	2011
Accounts receivable	\$ 20.5	\$ (3.3)	\$ (11.8)	\$ (34.5)
Inventories	(35.5)	(7.0)	(19.5)	(0.8)
Prepaid expenses	2.5	(1.1)	(11.3)	(12.3)
Accounts payable, accrued liabilities and current portion of deferred reforestation obligations	(1.5)	30.6	17.8	11.6
Net increase (decrease) in non-cash working capital	\$ (14.0)	\$ 19.2	\$ (24.8)	\$ (36.0)

## 10. Segment Information

Canfor has two reportable segments which offer different products and are managed separately because they require different production processes and marketing strategies.

Sales between segments are accounted for at prices that approximate fair value. These include sales of residual fibre from the lumber segment to the pulp and paper segment for use in the pulp production process.

The Company's panels business does not meet the criteria to be reported fully as a separate segment and is included in Unallocated & Other below. Sales for panels operations for the three months ended September 30, 2012 were \$22.8 million (three months ended September 30, 2011 - \$10.2 million) and \$55.3 million for the nine months ended September 30, 2012 (nine months ended September 30, 2011 - \$33.5 million).

(millions of Canadian dollars)	Lumber	Pulp & Paper	Unallocated & Other	Elimination Adjustment	Consolidated
<b>3 months ended September 30, 2012</b>					
Sales to external customers	\$ 454.7	206.3	22.8	-	\$ 683.8
Sales to other segments	\$ 27.4	-	-	(27.4)	\$ -
Operating income (loss)	\$ 34.9	(7.2)	(5.4)	-	\$ 22.3
Amortization	\$ 25.5	15.7	4.5	-	\$ 45.7
Capital expenditures <sup>1</sup>	\$ 24.1	30.0	-	-	\$ 54.1
3 months ended September 30, 2011					
Sales to external customers	\$ 331.4	260.5	10.2	-	\$ 602.1
Sales to other segments	\$ 34.4	-	-	(34.4)	\$ -
Operating income (loss)	\$ (11.9)	38.0	(10.7)	-	\$ 15.4
Amortization	\$ 21.4	14.2	4.3	-	\$ 39.9
Capital expenditures <sup>1</sup>	\$ 43.8	35.2	0.4	-	\$ 79.4
<b>9 months ended September 30, 2012</b>					
Sales to external customers	\$ 1,241.9	695.1	55.3	-	\$ 1,992.3
Sales to other segments	\$ 85.8	-	-	(85.8)	\$ -
Operating income (loss)	\$ 33.7	15.8	(22.7)	-	\$ 26.8
Amortization	\$ 75.2	48.5	13.1	-	\$ 136.8
Capital expenditures <sup>1</sup>	\$ 76.1	76.0	-	-	\$ 152.1
Identifiable assets	\$ 1,527.3	795.0	170.8	-	\$ 2,493.1
9 months ended September 30, 2011					
Sales to external customers	\$ 991.2	820.5	33.5	-	\$ 1,845.2
Sales to other segments	\$ 96.3	-	-	(96.3)	\$ -
Operating income (loss)	\$ (25.7)	134.7	(33.9)	-	\$ 75.1
Amortization	\$ 62.4	46.3	13.0	-	\$ 121.7
Capital expenditures <sup>1</sup>	\$ 93.8	89.3	0.8	-	\$ 183.9
Identifiable assets	\$ 1,390.9	903.5	222.3	-	\$ 2,516.7

<sup>1</sup> Capital expenditures represent cash paid for capital assets, excluding acquisition of Tembec assets, during the period. Pulp & Paper includes capital expenditures by CPLP that are financed by the government-funded Green Transformation Program.

## **11. Softwood Lumber Agreement (“SLA”)**

On January 18, 2011, the U.S. triggered the arbitration provision of the 2006 Softwood Lumber Agreement (“SLA”) by delivering a Request for Arbitration. The U.S. claimed that the province of British Columbia (“BC”) had not properly applied the timber pricing system grandfathered in the SLA. The U.S. also claimed that subsequent to 2006, BC made additional changes to the timber pricing system which had the effect of reducing timber prices. The claim focused on substantial increases in Grade 4 (non sawlog or low grade) volumes commencing in 2007. It was 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 was a state-to-state international dispute under the SLA, Canada prepared a defense to the claim with the assistance of the BC provincial government and the BC lumber industry. After numerous representations from both sides, a hearing was held before the arbitration panel in the first quarter of 2012.

On July 18, 2012 the arbitration panel ruled in favour of Canada and dismissed the claims of the U.S. in their entirety.

## **12. Acquisition of Tembec Assets**

On March 23, 2012, the Company completed the acquisition of Tembec Industries Ltd.’s (“Tembec”) southern British Columbia Interior wood products assets for cash consideration of approximately \$65 million, including a payment relating to net working capital, which excluded certain liabilities retained by Tembec. The acquisition has been accounted for in accordance with IFRS 3 *Business Combinations*.

The acquisition included Tembec’s Elko and Canal Flats sawmills and approximately 1.1 million cubic metres of combined Crown, private land and contract annual allowable cut. The transaction also included a long-term agreement to provide residual fibre supply for Tembec’s Skookumchuck pulp mill. The assets acquired increase the Company’s fibre availability and production capacity.

Of the consideration paid, approximately \$44 million represented the preliminary fair value of the timber licenses acquired, with the balance split between the fair value of the property, plant and equipment and net non-cash working capital balances.

If the acquisition had occurred on January 1, 2012, consolidated sales would have increased by approximately \$37.0 million, with no material change to consolidated net loss. In determining these amounts, the fair value adjustments that arose on the acquisition date have been assumed to be the same as if the acquisition had occurred on January 1, 2012.

The Company incurred acquisition-related costs of \$1.3 million, principally relating to external legal fees and due diligence costs, which have been included in selling and administration costs, and severance costs of \$2.5 million related to restructuring of the acquired assets. These amounts are recorded in the Company’s consolidated statement of income (loss) for the nine months ended September 30, 2012.

## **13. Share Exchange**

On March 2, 2012, Canadian Forest Products Ltd. (“CFP”), a wholly owned subsidiary of Canfor, acquired 35,776,483 common shares of Canfor Pulp Products, Inc. (“CPPI”) in exchange for its 35,776,483 Class B Exchangeable LP Units of Canfor Pulp Limited Partnership (“CPLP”) and 35,776,483 common shares of Canfor Pulp Holding Inc. (“Canfor Holding”), pursuant to the terms of an Exchange Agreement made as of January 1, 2011 among CFP, CPPI, Canfor Holding and CPLP.

As of the date of exchange, the Company consolidated the balances of CPPI and Canfor Holding, including an additional deferred income tax liability of \$31.4 million and cash of \$6.8 million. The non-controlling interest in consolidated equity increased by \$25.0 million on the date of exchange, representing the additional non-controlling interest balances in CPPI and Canfor Holding.

Prior to the share exchange, CFP and CPPI entered into a one-time dividend waiver agreement, waiving CFP’s right to the first \$7.8 million of future dividends declared by CPPI. As such, \$7.8 million was included in non-controlling interests to account for future distributions which the Company had waived its entitlement to. The full \$7.8 million dividend was paid by CPPI during the second quarter of 2012.