DELIVERING ON OUR WORD. CANFOR CORPORATION ANNUAL REPORT 2003

>> In all industries, ours included, it's easy to 'talk the talk.' To talk about lowering costs. To talk about improving margins. To talk about delivering value. To talk about being responsible. It's another thing to deliver.

Canfor prides itself on being an organization that 'walks the walk.' And this year is testament to that. Over the years we've shared with you our strategies, goals, and ambitions. This year, we'd like to share with you our achievements.

Corporate Profile

Canfor Corporation is a leading Canadian integrated forest products company based in Vancouver, British Columbia. The company employs approximately 6,656 people – 5,525 directly and 1,131 through affiliated companies.

Canfor has extensive woodlands operations and manufacturing facilities in BC, Alberta and Quebec, and a lumber remanufacturing plant in Washington State. The company is a major producer and supplier of lumber, bleached kraft pulp, specialty kraft paper and plywood. It also produces semi-bleached and unbleached kraft pulp, bleached and unbleached kraft paper, remanufactured lumber products, hardboard paneling and a range of specialized wood products, including baled fibre and fibremat. Howe Sound Pulp and Paper Limited Partnership, owned equally by Canfor and Oji Paper Co., Ltd., produces bleached kraft pulp and newsprint.

Canfor's products are sold in global markets. The company has marketing offices in Canada, Europe, and Japan.

The common shares of Canfor Corporation are listed on the TSX under the symbol 'CFP'. The operating company is Canadian Forest Products Ltd. from which the name Canfor is derived.

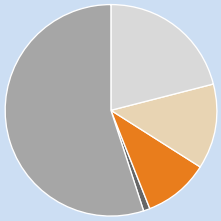
Canfor Business Units

	PRODUCTS
WOOD PRODUCTS	>> Softwood Lumber and Plywood >> Hardboard Products >> Refined Fibre >> Fibremat

PULP AND PAPER	>> Premium Pulp >> Specialty Kraft Paper >> Specialty Pulp

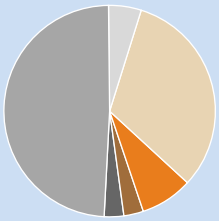
COASTAL OPERATIONS	>> Premium hemlock, cypress, Douglas Fir, and cedar logs

Net sales by market



- 55% US
- 21% Canada
- 13% Far East
- 10% Europe
- 1% other

Net sales mix by product line



- 49% Lumber-Canfor produced
- 5% Lumber-Other producers
- 32% Pulp and Kraft Paper
- 8% Log Sales
- 3% Plywood
- 3% Miscellaneous

PRIMARY MARKETS	2003 HIGHLIGHTS
>> House construction and home repairs and renovations >> Wall panels for home construction and renovations >> Erosion control >> Car components (door panels, dashboards)	>> Implemented third shifts at two sawmills, with another completed for the start of 2004 >> Completed major capital upgrades at Fort St John, Prince George and Houston sawmills >> Acquired a sawmill and timber harvesting operation in Quebec, increasing lumber capacity
>> Raw material for paper manufacturing (printing, fine, and tissue papers) >> High performance packaging papers and specialty papers >> Erosion control >> Raw material for paper manufacturing (base and electrical application papers)	>> $15 per tonne reduction in conversion costs >> Record annual production and quality levels at Northwood and Intercontinental >> Designed and received approval for the PG Pulp Green Power Generation Project, jointly funded with BC Hydro
>> Coastal pulp mills and sawmills	>> Reduced production costs by 11% (excluding stumpage) or 3% overall >> Maintained excellent enviromental record

		2003	2002 [2]
Sales and income (millions of dollars)	Net sales	**$ 2,095.5**	$ 2,112.3
	Operating income (loss)	**(2.8)**	40.0
	Net income from continuing operations	**85.8**	1.9
	Net income	**153.3**	11.5
Cash flow (millions of dollars)	Cash flow from operations	**$ (1.3)**	$ 124.2
Per common share (dollars)	Net income (loss) from continuing operations - diluted	**$ 0.92**	$ (0.05)
	Net income – diluted	**1.65**	0.07
	Dividends	**0.13**	0.26
	Book Value	**11.71**	10.27
	Share price		
	High	**11.68**	11.63
	Low	**7.60**	6.95
	Close - December 31	**11.27**	8.85
	Common shares outstanding – December 31	**81,267,281**	81,156,010
Financial position (millions of dollars)	Working capital	**$ 254.2**	$ 277.0
	Total assets	**2,439.4**	2,328.0
	Long-term liabilities	**566.6**	727.3
	Common shareholders' equity	**1,089.0**	953.9
	Total capitalization	**1,925.0**	1,931.4
Additional information [1]	Return on capital employed	**10.3%**	2.7%
	Return on common shareholders' equity	**15.0%**	1.2%
	Ratio of current assets to current liabilities	**1.5:1**	1.7:1
	Ratio of net debt to common shareholders' equity	**35:65**	41:59
	EBITDA (millions of dollars)	**$ 107.0**	$ 150.4
	EBITDA margin	**5.1%**	7.1%
	Capital expenditures (millions of dollars)	**$ 123.5**	$ 67.4

(1) See Definitions of Selected Financial Terms on page 54
(2) Certain figures have been reclassified to conform with the current year's presentation

Dear fellow shareholders,

Canfor stands today at another watershed in its transformation to one of the leading forest products companies in North America. While we are not the largest, nor do we have a supertanker market capitalization, we do have the premier spruce/pine/fir lumber franchise in the world. And, our pulp and specialty paper business occupies a secure and profitable niche focusing on high quality reinforcement pulp from some of the best fibre available. With the recent acquisition of Slocan Forest Products, Canfor becomes a truly focused, powerful presence in the forest products business.

Where we are today reflects the strategic plan our Board of Directors put in place six years ago. At that time we committed to growing our core wood products business from 1.5 billion board feet to 5 billion board feet of annual lumber capacity. Today we are at 5.2 billion board feet. We also targeted to expand our premium reinforcement pulp business, which we have grown from 450 thousand tonnes per year to over 1 million tonnes while, at the same time, taking advantage of Canfor's superior pulp quality to pursue high margin specialty products such as high performance kraft paper.

David L. Emerson
President and Chief Executive Officer

Through both the Northwood acquisition in 1999, and the current Slocan acquisition, we have succeeded in adding a third major business line in the form of a panels segment that includes significant capacity of OSB, plywood and pressed hardboard panels. Here again, we have stayed close to our basic strengths while improving both profitability and financial stability.

Growth by itself doesn't create true value. It's what you do with your expanded asset base that creates value. Our strategy over the past few years has been to make quantum reductions in Canfor's cost base, continue to focus on quality, improve profit margins and build product franchises that incorporate branding, eco-certification of forest practices and logistically efficient supply chains anchored to key customers. Our central theme has been to create value throughout a tightly integrated supply chain.

Thanks to the tireless efforts of our people we can report that our costs have come down dramatically, our forests are now over 90 percent eco-certified under either the CSA or SFI standards, our quality and service standards are second to none and our customers want us to continue growing with them.

Peter J.G.Bentley
Chairman

>> The progress that has been made in the past six years has been in large part due to the leadership of David Emerson. The Board appreciated the strategic vision and management focus he brought to the Company. We thank him for the contribution he has made and we wish him well in his future endeavours.

Peter J.G. Bentley

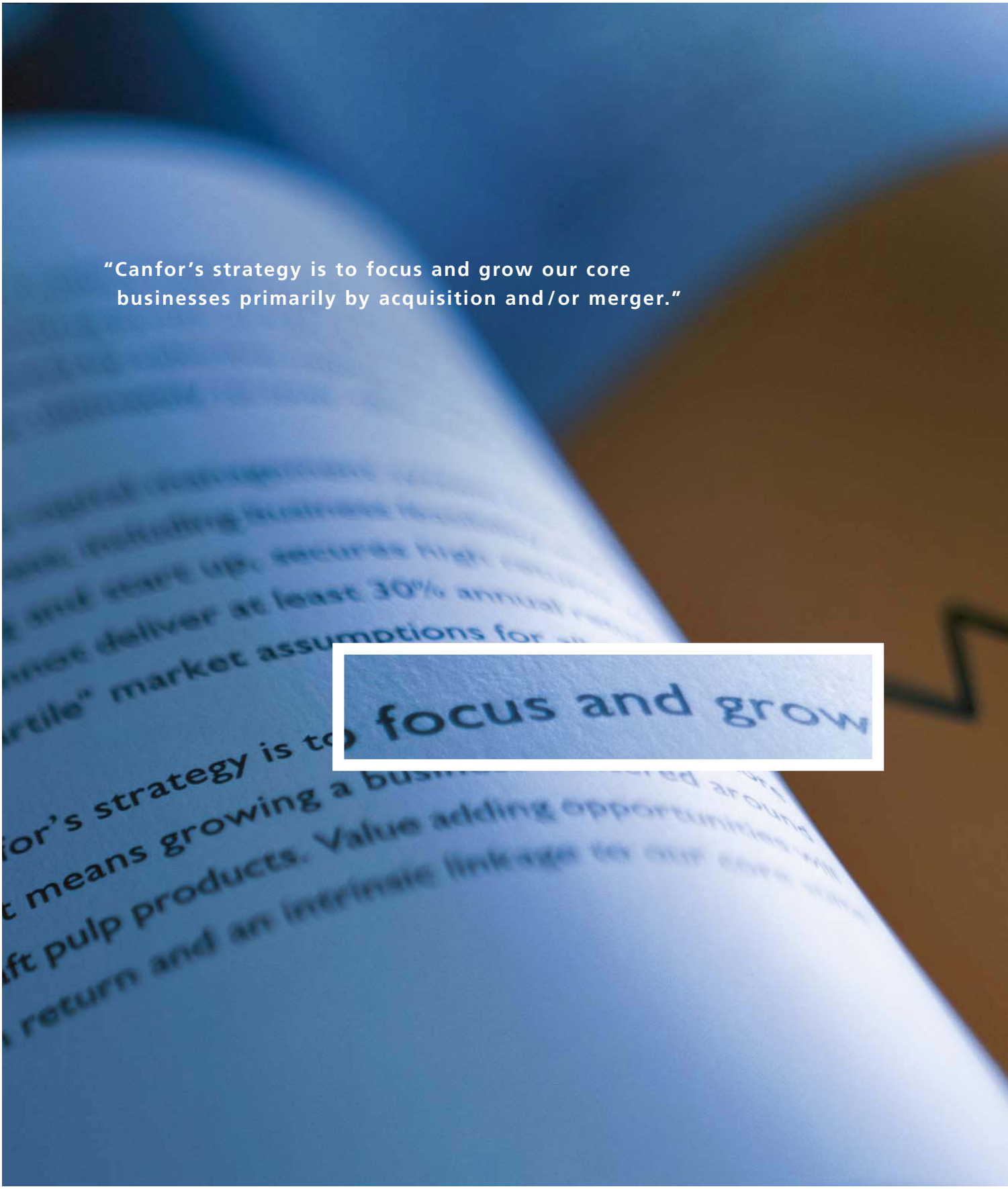
Today we are far more than a commodity producer. We are an international supply chain manager and the value of our business is far more than the sum of the parts. Our market and competitive position is stronger than ever, and we are finally seeing a value creation payoff for many years of patience and hard work.

Workplace safety has been a core value at Canfor for many, many years. While our safety performance continues to improve, we still see too many accidents. Your Board of Directors and management are constantly striving for higher standards of safety performance. This mission will not change.

We thank the dedicated, energetic people of Canfor and we thank our Board for wise counsel and support. We hope you, the shareholder, have found Canfor ownership to be rewarding and we thank you for putting your trust in us.

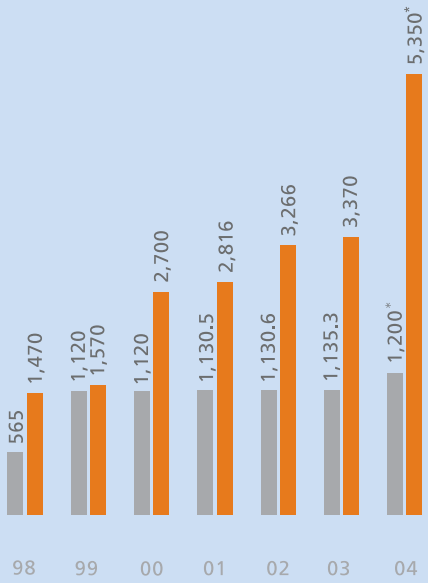
Peter J.G. Bentley
Chairman

David L. Emerson
President and Chief Executive Officer



1998 Annual Report: Perceptions, Views, Ideas (pg.2)

Lumber and Pulp Capacity



Pulp Capacity ('000 tonnes)

Lumber Capacity (Mmfbm)

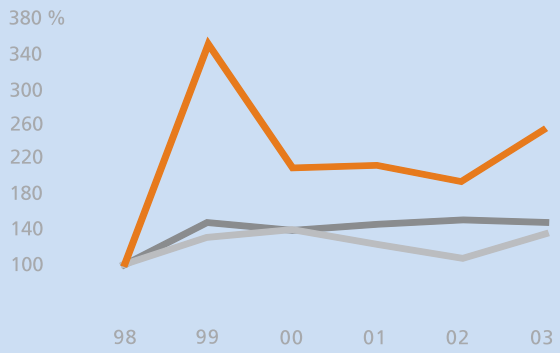
*Capacity upon completion of Slocan acquisition

Capital investments, best practices, and strategic acquisition have significantly increased Canfor's pulp and lumber capacities.

"...the Board and management of Canfor defined, approved and set in motion a five-year strategy to grow the company and generate superior returns to shareholders."

2000 Annual Report: A Year of Growth Like No Other (pg.2)

Cumulative Total Return

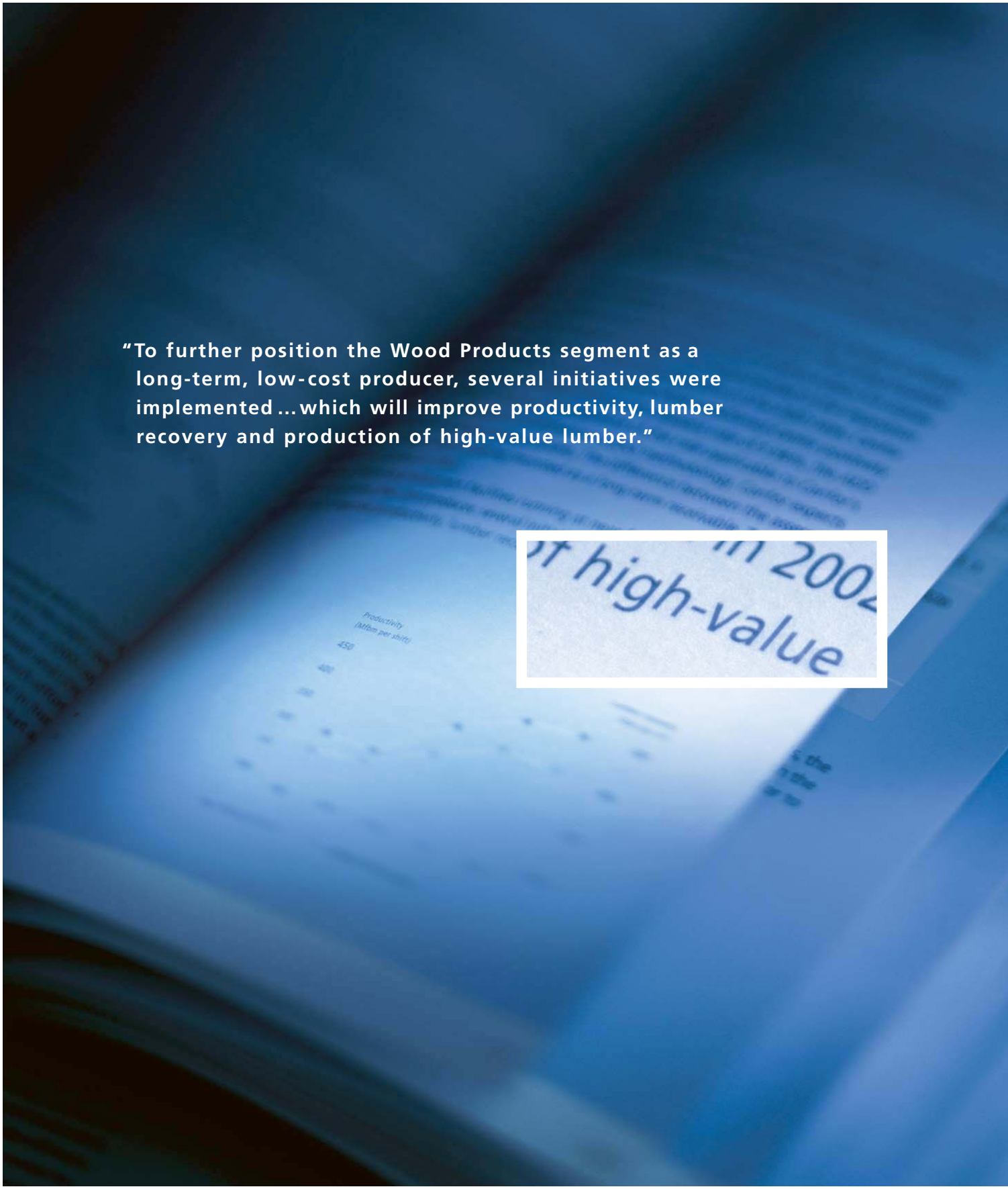


Canfor Common Shares

TSX Paper & Forest Index

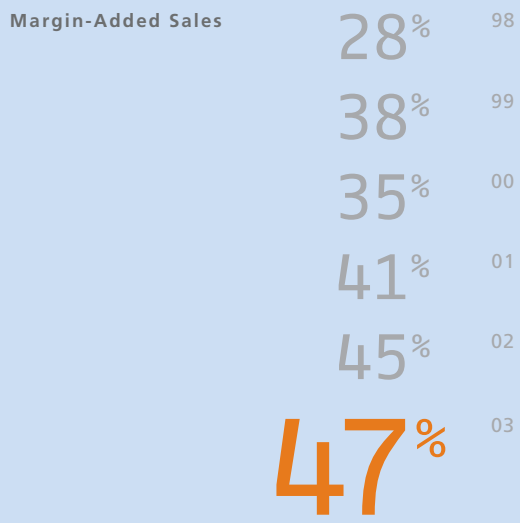
S&P/TSX Composite Index

In addition to outperforming the S&P/TSX Composite and the TSX Paper & Forest Index, the book value of Canfor shares has increased 60% from 1998 to 2003.



"To further position the Wood Products segment as a long-term, low-cost producer, several initiatives were implemented ... which will improve productivity, lumber recovery and production of high-value lumber."

2002 Annual Report: Now (pg.31)

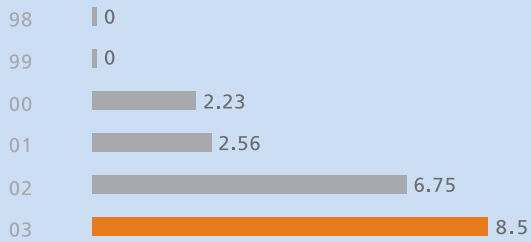


Key capital projects and the implementation of Canfor's Square-Edge program have helped Canfor grow its margin-added sales dramatically.

Margin-Added Sales Growth 2003

1999 Annual Report: Where Forestry is Going (pg.4)

Harvest Volume
(millions of m^3)

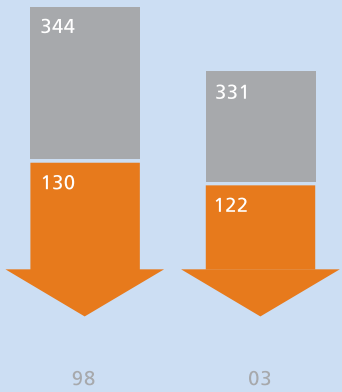


91% of Canfor's total harvest volume is now certified to Sustainable Forest Management Standards.

"Canfor's strategy remains to focus on the controllable areas of the business - production and distribution of quality products, costs, higher margin product expansion, productivity, and fibre utilization."

2001 Annual Report: Realize (pg.32)

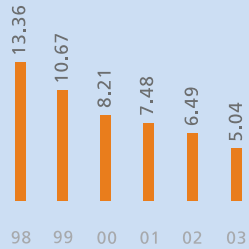
Pulp and Lumber Conversion Costs

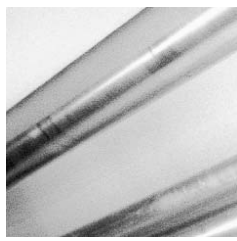


Pulp Conversion Cost ($/tonne)

Lumber Conversion Cost ($/Mfbm)

Canfor has been able to steadily decrease conversion costs despite punishing lumber duties, market downtime, and an appreciating Canadian dollar.





Medical Incident Rate
(incidents per 200,000 man hours)

Company - wide, Canfor’s MIR has continually declined over the last 5 years.

1998 - 2003 : “Safety Comes First At Canfor”

Employee Report

"Safety Comes First At Canfor" is the guiding philosophy for occupational health and safety for the company. Employees and management take this responsibility seriously and moved to strengthen its guiding principles through the codification of Canfor's Occupational Health and Safety policy last year. Again, audits for the President's Safety Award took place over the course of the winter to ascertain how each operation measured up to the company's stringent guidelines. Each President's Safety Committee concluded its respective tours of Canfor's operating divisions in November and the winners for 2003 were Rustad sawmill in the over 400,000 hours per year category and the Fort St. John sawmill in the under 400,000 hours category. The winner of the Interior Woodlands "Health & Safety Award" is Peace Woodlands.

Also in November, Canfor held its annual Health & Safety Conference in Prince George. All of Canfor's operating divisions were once again represented, with an equal mix of hourly and salaried delegates. Once again, this year's attendees thought the conference was worthwhile and a valuable forum to discuss industry health and safety issues.

How the company measures up against its industry peers is always a source of pride for Canfor. Based on the BC Forest Industry Advisory Service (FIAS), Canfor's Interior sawmills ranked 2nd out of eight in the Interior Lumber Sector in both Lost Time Frequency and Medical Incidence Rates.

The Englewood Logging Operation ranked 2nd out of four in the Coast Forest Sector in terms of Lost Time frequency and 3rd in Medical Incidence.

Within its comparative group of five companies in the Panels/Plywood sector, Canfor ranked 4th in terms of Lost Time frequency and 2nd in Medical Incidence Rate (MIR). Through several ongoing management initatives there was a marked decrease in incidents in the second half of the year.

Among BC's 11 primary pulp mills Canfor's three pulp and paper operations ranked as follows: PG Pulp 2nd, Intercon 4th and Northwood 5th in lost time frequency, and Intercon 1st, Northwood 2nd and PG Pulp 4th in medical incidence.

Community Report

Community Investment At Canfor, we have a long tradition of investing in the communities that we call "home" by supporting initiatives and organizations that enhance the regions where our employees live and work. In 2003, Canfor provided support to nearly 300 charitable organizations and initiatives in our operating areas. Sponsorship decisions are made locally, by employees who live and work in the community, and Canfor funds charitable organizations in the following areas based on what our employees told us were priorities to them:

>> Youth & Education >> Amateur Sports >> Health & Wellness
>> Community Enhancement >> Forestry & Environment

Scholarships & Bursaries As part of our ongoing commitment to education, Canfor offers numerous scholarships and bursaries to make learning more accessible for students in our operating regions. This includes awards with University of Northern British Columbia, College of New Caledonia, Northern Lights College, Grande Prairie Regional College, University of British Columbia, Simon Fraser University, BCIT, and Vancouver Community College. To assist graduating high school students in continuing their education, Canfor offers 27 awards at secondary schools in our operating regions in BC and Alberta.

Tour Program Canfor's Tour Program continues to be one of the most popular places in BC to experience and learn about the forest industry. In the summer of 2003, over 1200 people toured one of our Prince George pulpmills, Rustad sawmill or the JD Little Forest Centre. We also offered all-day Sustainable Forest Management tours which took people out into the field to learn about forestry first-hand.

Communicating To Communities Keeping our communities informed and giving people an opportunity to ask questions is essential at Canfor. At our semi-annual community visits, senior management speak with community stakeholders about current corporate initiatives and the state of the company and industry, as well as get feedback and answer questions from the community.

Environment Report

Today, Canfor can proudly declare that 8.5 million cubic metres, or 91% of its total annual harvest is certified to sustainable forest management standards.

Air Quality

Canfor signed a 15-year agreement with BC Hydro to upgrade its Prince George Pulp and Paper mill to displace all of its purchased electricity at that facility and its Intercontinental Pulp mill. BC Hydro will contribute $49 million to Canfor's $81 million project to install a 48-megawatt turbo generator project at the mill site. The project will allow Canfor to be self-sufficient in electricity generation at its Prince George Pulp and Paper and Intercontinental Pulp mills. In addition to lowering Canfor's production costs, the project provides significant environmental benefits to the area. The upgrade will significantly lower Canfor's emissions in the Prince George air shed and allow the company to decommission one Tier I beehive burner at its Bear Lake sawmill, one beehive burner at its Isle Pierre sawmill and possibly a third beehive burner once the generator is running at full capacity.

Coast Forest Conservation Initiative

Canfor has been a member of the Coast Forest Conservation Initiative (CFCI) since it began in 1999. CFCI is a collaboration of five British Columbia-based forest companies dedicated to the sustainable development and conservation of coastal forests. CFCI members have been in dialogue with environmental groups ForestEthics, Greenpeace, Rainforest Action Network and the Sierra Club of BC in a forum known as the Joint Solutions Project (JSP).

The CFCI and its environmental group collaborators in the JSP generated a workable package of solutions regarding conservation and forest management which served as the basis of consensus recommendations reached by the Central Coast Land and Resource Management Plan (CCLRMP) planning table in December 2003. The recommendations have been forwarded to the provincial government which will work with First Nations in the region to finalize the land use plan by mid-2004.

Certification

Living up to the commitment to its customers to pursue credible certification of its forestlands, Canfor announced the conclusion of registration audits for its Houston Operations in the Morice Timber Supply Area (TSA) and for the Fort St. John TSA Pilot Project, both in the northern interior of British Columbia. The audits were conducted by KPMG Performance Registrar Inc. and resulted in both operations being recommended for certification to the Canadian Standard Association's (CSA) Sustainable Forest Management (SFM) standard CAN/CSA-Z809-02. As a result of these certifications, Canfor can proudly declare that 91% of its harvest volume is certified to a SFM standard under either the CSA or Sustainable Forestry Initiative® (SFISM) programs.

Forestry Report

Compliance with Regulations

During 2003, a total of 46 non-compliance incidents occurred on company tenures, 52 percent fewer than in 2002, and 56 percent fewer than in 2001. In all cases, Canfor promptly took necessary actions to mitigate any environmental consequences and correct conditions that may have led to the incident. Of the 46 incidents, 25 were originally detected and reported by Canfor staff.

British Columbia government agencies assessed 3 administrative penalties to Canfor during 2003, totaling $15,100. The 3 incidents occurred prior to 2003. The company also received one violation ticket under the British Columbia Forest Practices Code Act. The incident was related to administrative procedures and did not result in any environmental consequences.

No administrative penalties were assessed to Canfor by Alberta government agencies in 2003.

Canfor forestry operations had 6 reportable spills in 2003, 50% fewer than in 2002. All were contained, cleaned up and preventive actions taken.

Certification

Canfor continues to be a leader in third-party sustainable forest management certification of its forestry operations.

Canfor completed certification of its Houston Operations in the Morice Timber Supply Area (TSA) and its Fort St. John Operations in the Fort St John TSA, both in the northern interior of British Columbia, to the Canadian Standard Association's (CSA) Sustainable Forest Management (SFM) standard CAN/CSA-Z809-02. Canfor also re-certified the Prince George area Tree Farm Licence 30 to the CSA SFM standard. All audits were conducted by KPMG Performance Registrar Inc.

Also during 2003 Canfor maintained the existing certification of its Nimpkish and Chetwynd Tree Farm Licences and Grande Prairie Forest Management Agreement to the CSA standard, and all operations in the Prince George and Quesnel TSAs to the Sustainable Forestry Initiative® (SFISM). As a result, in addition to all of its tenures certified to the International Organization for Standardization (ISO) 14001 standard, Canfor now has 91% of its annual harvest volume in BC and Alberta certified to a sustainable forest management standard under either the CSA or SFISM programs.

Performance Versus Targets in 2003

Canfor established five corporate wide environmental targets for forestry operations in 2003. Targets were specific and measurable and each was aimed at achieving continuous improvement in our forestry operations.

Indicator 1: Number of determinations related to trespass or damage to the environment measured over a 3 year period. The 2003 target was no increase in the three year rolling average. The 2004 target is a 10% decrease in the three year rolling average of significant non-compliance determinations.

Company-wide Target 1: ***No Increase in Trespass or Damage to the Environment Determinations***

Average Number of Determinations Per Year

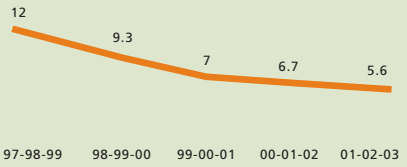


Figure 1 – Figure 1 indicates the trend in trespass or environmental damage determinations for the period 1997 to 2003. These incidents are usually caused by a failure to follow project plans. There were two determinations in this category in 2003. Both incidents occurred prior to 2003, and each involved minor trespasses that occurred during timber harvesting operations.

Indicator 2:

Number of non-compliance incidents during the calendar year per 100,000 m^3 of harvest. The 2003 target was no increase in non-compliance incidents compared to 2002 results. The 2004 target is no increase in non-compliance incidents compared to 2003 results.

Company-wide Target 2: *10% Decrease in the Three Year Rolling Average of Significant Non-compliance Determinations*

Incidents Per 100,000 m^3 Harvested (Canfor-wide)

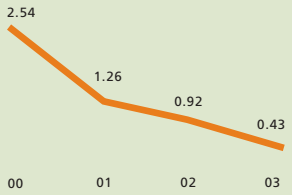


Figure 2 – Non-compliance incidents by volume of timber harvested

Indicator 3:

Number of legally reportable spills. The 2003 target was a 10% decrease in reportable spills compared to 2002.

Company-wide Target 3: *10% Fewer Reportable Spills*

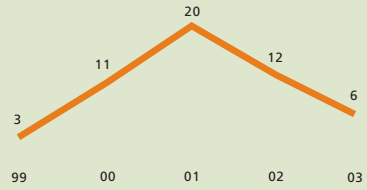


Figure 3 – Total number of reportable spills

Indicator 4:

Number of non-compliance incidents related to riparian resources during the calendar year per 100,00m^3 of harvest. The 2003 target was 5% fewer incidents than in 2002.

Company-wide Target 4: *5% Fewer Non-compliance Incidents Related to Riparian Resources*

Incidents Per 100,000 m^3 Harvested (Canfor-wide)

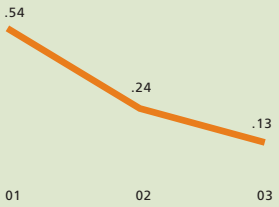


Figure 4 – Non-compliance incidents related to riparian resources

Indicator 5: Number of non-compliance incidents related to road maintenance and construction during the calendar year. The 2003 target was 5% fewer than 2002.

Company-wide Target 5: ***5% Fewer Non-compliance Incidents Related to Road Maintenance or Construction***

Incidents Per 100,000 m^3 Harvested (Canfor-wide)

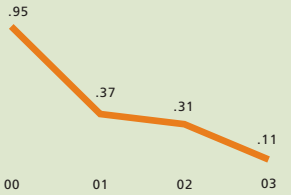


Figure 5 – Non-compliance incidents related to road maintenance and construction.

Manufacturing

Compliance Report

Canfor is committed to transparency in our environmental reporting and includes compliance reporting as part of this process. The following is an inventory of non-compliance for Canfor's manufacturing operations.

Administrative

An administrative penalty of $1,500 was assessed against a sawmill for the late filing of their 2002 annual environment report.

Air

One sawmill beehive burner operated below approval temperature limits for the first 8 months of 2003 and was shut down at the end of August when value-added options were secured for the wood residue. Two burners operated out of compliance for a combined total of 7 days in 2003. At pulpmill operations, particulate limits were not met on one occasion (and one retest) for combined power boiler emissions and on two occasions for smelt dissolving tank vent emissions. At a chemical plant, chlorine discharge levels exceeded Permit limits on 5 occasions and there were 9 brief releases of unscrubbed cell gas.

Effluent

At pulpmills, BOD limits were exceeded 2 times. On two occasions at a chemical plant, cooling water discharge temperature exceeded Permit limit. The phenol limit was exceeded one time at a panel board plant.

Landfill

3 sawmill operations were found to be out of compliance with Permit or Approval requirements. Action has been taken to address these issues.

Spills

Canfor manufacturing operations had 9 reportable spills in 2003, down from 17 reported in 2002. All were contained, cleaned up and preventive actions have been taken. Spills included: 2 spills of hydraulic oil to ground from mobile equipment; 4 spills of black liquor to ground; one spill of mixed oil and condensate to ground; one spill of weak caustic solution to air and ground; 1 small spill (1 L) of wax emulsion to the Fraser River.

Performance Versus Objectives in 2003

Wood Residue Utilization

Objective: We will continue to actively pursue opportunities to substantially increase utilization of our sawmill wood residues such as electricity cogeneration at our pulp mills and sawmills and wood residue fueled energy systems at our sawmills.

Performance: The Canadian Hydro (CG&E) 25 MW cogeneration project under construction adjacent to Canfor's Grande Prairie Sawmill, scheduled for start-up in Q4 2004, and the Prince George Pulp and Paper mill 48 MW cogeneration project, scheduled for start-up in Q1 2005, will utilize a total of 365,000 tonnes (bone dry) of wood residue. Both will generate steam and electricity from sawmill residue currently being incinerated with no energy recovery. These two projects will increase Canfor's overall sawmill wood residue utilization to 65% from current levels of 40%, reduce Canfor's electricity purchases by 25% and reduce our annual natural gas purchases by one million gigajoules.

Greenhouse Gases

Objective: Through projects that increase utilization of our sawmill wood residues and offset electricity and natural gas purchases, we will continue to reduce our greenhouse gas emission profile.

Performance: The Grande Prairie and Prince George Pulp and Paper Mill cogeneration projects will reduce Canfor's direct GHG emissions by 48,000 tonnes of carbon dioxide equivalents (CO2e) and indirect GHG emissions (due to displacement of purchased electricity) by another 47,000 tonnes CO2e.

Audits

Objective: We will carry out corporate environmental audits of three pulp mills, four sawmill operations, one panel board plant, and a wood treating plant.

Performance: Corporate audits of two sawmill operations were conducted in 2003. Two sawmill audits were deferred until 2004 because of significant capital projects at the mills, the panel board plant audit was also deferred and the wood treating plant was sold in 2003. As a result of ISO 14001 registration and the annual mill internal EMS audits and annual registrar surveillance audits, the pulp mills were put on a three year frequency for corporate environmental audits. As a result, no pulp mills were audited under the corporate program in 2003.

Wood Products Environmental Management System (EMS) Enhancement

Objective: We will enhance Wood Products EMS including training needs assessments relative to significant aspects, emergency/spill response training and EMS documentation.

Performance: All Canfor wood products operations completed enhancements of their EMS's in 2003.

Thermal Oil Systems

Objective: We will complete and implement a Canfor Engineering Standard for Thermal Oil Systems that ensures environmental aspects relating to these systems are considered and managed.

Performance: A task force of employees from operations, supported by system suppliers and regulatory sources, worked together to produce the Canfor Standards & Guidelines for Design, Operation & Maintenance of Heat Transfer Fluid Systems. This document, endorsed by Canfor Senior Management, sets out minimum standards for new systems and a guideline for the upgrade of existing systems in line with their priority aspects. Minimum standards and recommended options are designed to minimize the risk of spills to the environment.

Objectives and Targets for 2004

The following are corporate level objectives and targets for 2004.

Air Quality

The combined effect of air emissions from Canfor activities and operations on local airsheds and on regional and global environments is a high priority aspect managed at the Corporate level within Canfor. We will continue to actively participate on local airshed management committees and support local monitoring and research initiatives.

Wood Residue Utilization

We will continue to actively pursue economically viable opportunities to increase utilization of our sawmill wood residues that will enable shutdown of our remaining Tier 1 beehive burners.

Wood Products EMS

We will make further improvements to the Wood Products EMS including updating environmental aspects and EMS training for individuals with key environmental responsibilities.

Pulpmill EMS

We will reassess the significance of all remaining environmental aspects at the three pulpmills in Prince George. In order to ensure environmental resources are most appropriately allocated, the mill aspect registries will be consolidated. Action plans will be developed for the most significant risks identified across the tri-mill complex.

Audits

We will carry out refresher environmental audit training for internal auditors and conduct corporate environmental audits of one pulp mill, four sawmill operations, one panel board plant, and one plywood plant.

Financial Report

The Management's Discussion and Analysis (MD&A) provides a review of the significant developments that have impacted Canfor's performance during 2003 relative to 2002. Factors that could impact future operations are also discussed. These factors may be influenced by known and unknown risks and uncertainties that could cause the actual results to be materially different from those stated in this discussion. In addition to the risks and uncertainties discussed at the end of this MD&A, factors that could have a material impact on any future oriented statements made herein include, but are not limited to: general economic, market and business conditions; product selling prices; raw material and operating costs; foreign exchange rates; changes in law and public policy; and opportunities available to or pursued by Canfor.

The financial data contained within this report has been prepared in accordance with Canadian generally accepted accounting principals. Throughout this discussion, reference is also made to EBITDA (calculated as operating income before amortization), which Canfor considers to be a key indicator for identifying trends in the performance of each operating segment and of the Company's ability to generate funds to meet its debt repayment and capital expenditure requirements. EBITDA is not a generally accepted earnings measure and should not be considered as an alternative to net income or cash flows as determined in accordance with Canadian generally accepted accounting principles. As there is no standardized method of calculating EBITDA, the Company's use of the term may not be directly comparable with similarly titled measures used by other companies.

The information in this report is as at February 5, 2004.

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

2003 Highlights

- >> Completed major upgrades at Houston, Fort St John and Prince George sawmills; Houston mill now has largest annual lumber capacity in the world
- >> Reached 91% certification of Company's harvest volume to a Sustainable Forest Management standard under either the Canadian Standards Association (CSA) or Sustainable Forest Initiative (SFI) programs
- >> Divested of non-core assets totaling nearly $150 million
- >> Entered into an agreement with BC Hydro to build a major electrical cogeneration facility at the Prince George Pulp and Paper Mill
- >> Improved paper production by 19% and quality reached a new level in the second half of 2003, with prime production increasing by 29,000 tonnes from the level achieved in 2002
- >> Announced acquisition of Slocan Forest Products Ltd., which, when completed, will increase annual lumber capacity to 5.2 billion board feet

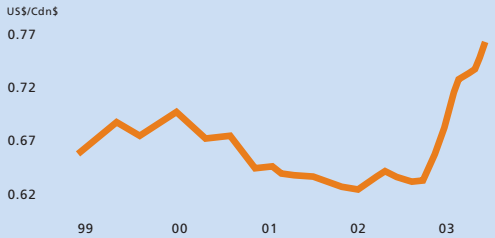
Overview of 2003

While difficult conditions persisted in 2003, from the ongoing trade dispute to the strengthening Canadian dollar, Management remained focused on the controllable areas of the business, driving down costs and increasing margins. The Cost Reduction/ Margin Improvement (CRMI) Program included nearly 500 separate initiatives, with over 100 capital expenditure projects completed during the year. The CRMI program provided some financial benefits in 2003, however, with ramp up time for capital and operational adjustments occurring throughout the year, full benefits will not be realized until 2004.

In 2003, the effect of the stronger Canadian dollar on the Company's revenues and operating results has been significant. The 21% increase in the value of the Canadian dollar since the end of 2002 reduced net sales by over $250 million (before tax). This was partially offset by unrealized exchange gains on long-term debt ($112 million before tax, $96 million after tax) and gains on US dollar forward contracts of $32 million before tax ($24 million after tax).

Finally, during 2003, Canfor continued to implement its core business growth strategy, establishing a foothold in eastern North America and announcing the proposed acquisition of 100% of the shares of Slocan Forest Products Ltd. The transaction is expected to be completed early in 2004.

US/Cdn$ average quarterly exchange rates



Source: Bank of Canada

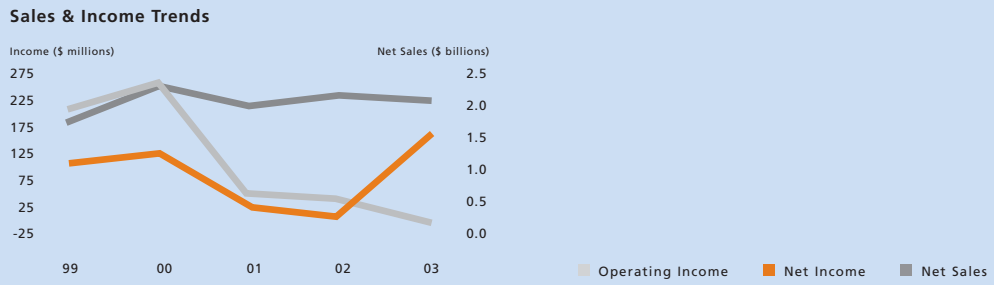
Selected Annual Information [1] [2]

(millions of Canadian dollars)	2003	2002	2001
Sales volume - major products [3]			
Lumber – millions of board feet (MMfbm)	**2,942.0**	2,817.3	2,265.9
Plywood – millions of square feet, 3/8" basis (000 Msf 3/8")	**172.3**	162.0	161.6
Pulp – thousands of metric tonnes (000 mt)	**999.2**	993.5	940.1
Specialty Kraft Paper – thousands of metric tonnes (000 mt)	**121.4**	108.9	106.7
Coastal Logs – thousands of cubic metres (000 m^3)	**1,237.0**	1,228.9	1,240.8
Net sales			
Wood Products	**$ 1,313.5**	$ 1,348.1	$ 1,192.1
Pulp and Paper	**664.9**	641.6	676.7
Coastal Operations	**117.1**	122.6	116.9
Total net sales	**$ 2,095.5**	$ 2,112.3	$ 1,985.7
Operating income (loss)			
Wood Products	**$ (4.7)**	$ 70.8	$ 74.9
Pulp and Paper	**25.7**	(2.4)	12.3
Coastal Operations	**1.4**	5.7	(6.8)
Corporate and Other	**(25.2)**	(34.1)	(29.7)
Total operating income (loss)	**(2.8)**	40.0	50.7
Non-operating income (expense)			
Equity income (loss) of affiliated companies	**(0.4)**	5.0	1.1
Net interest expense	**(50.5)**	(59.2)	(64.2)
Foreign exchange gain on long-term debt [4]	**110.9**	-	-
Other income and unusual items	**24.9**	9.0	8.2
Total non-operating income (expense)	**84.9**	(45.2)	(54.9)
Income (loss) from continuing operations before income taxes	**82.1**	(5.2)	(4.2)
Income tax recovery	**3.7**	7.1	23.5
Income from continuing operations	**85.8**	1.9	19.3
Income from discontinued operations, net of taxes [5]	**67.5**	9.6	7.1
Net income	**$ 153.3**	$ 11.5	$ 26.4
Total assets	**$ 2,439.4**	$ 2,328.0	$ 2,378.8
Total long-term financial liabilities	**$ 478.0**	$ 643.4	$ 714.7

(dollars per common share)			
Per common share			
Income (loss) from continuing operations			
Basic	**$ 0.98**	$ (0.05)	$ 0.19
Diluted	**$ 0.92**	$ (0.05)	$ 0.19
Net income			
Basic	**$ 1.81**	$ 0.07	$ 0.27
Diluted	**$ 1.65**	$ 0.07	$ 0.27
Cash dividends declared	**$ 0.13**	$ 0.26	$ 0.26

(1) The financial information presented in this Management's Discussion and Analysis has been prepared in accordance with Canadian generally accepted accounting principles, with the exception of references to EBITDA, as discussed in the introductory paragraph.
(2) 2003 figures reflect the operating results of Daaquam Lumber Inc. and Produits Forestiers Anticosti Inc., which were acquired by Canfor on May 27, 2003.
(3) Sales volumes of Canfor-produced product only.
(4) Effective January 1, 2003, Canfor terminated the designated hedging relationship between its US dollar denominated long-term debt and its US dollar revenue streams. Unrealized exchange gains or losses on debt after January 1, 2003 are recognized in income each period.
(5) Reflects the operating results of Canfor's BC Chemicals division until August 29, 2003, which was previously included in the Pulp and Paper segment. The division was sold in 2003, and a gain on disposal of $60.2 million after tax was realized. All comparative figures in this report have been reclassified.

2003 vs. 2002



The major factor impacting operating earnings in 2003 was the rapid and dramatic rise of the Canadian dollar against the US dollar. Although prices for lumber and pulp increased over 2002 levels, by 3% and 14% respectively, the favourable impact was eliminated by the effect of the stronger dollar. Demand for Canfor's products was relatively strong in 2003, and shipments increased over 2002 levels. Excellent progress was made in productivity and cost reduction, as discussed below under each of Canfor's operating segments.

Other significant factors affecting the comparability of 2003 and 2002 are noted below:

(millions of Canadian dollars, after tax)	2003	2002
Operating Income		
Accrual for termination benefits and mill closure costs	$ -	$ (26.2)
Gains from US dollar forward contract hedging program	**24.6**	-
CVD/ADD adjustments		
Reversal of preliminary duties accrued prior to May 22, 2002	-	36.2
Adjustment to ADD expensed in 2002	**7.3**	0.9
Adjustment to ADD expensed in 2003	**13.1**	-
	45.0	10.9
Non-Operating / Discontinued Operation		
Unrealized foreign exchange gain on US dollar long-term debt	**96.0**	-
Loss on repayment of US dollar long-term debt	**(1.2)**	(5.6)
Gain on sale of property	**19.5**	10.0
Gain on sale of discontinued operation	**60.2**	-
Total favourable impact on net income	**$ 219.5**	$ 15.3
Exchange Rate and Price Factors:		
Average value of the Canadian dollar against the US dollar	**$ 0.7138**	$ 0.6368
Year-end closing value of the Canadian dollar against the US dollar	**$ 0.7738**	$ 0.6376
Average lumber price in US$ (2"x4" Random Lengths #2 & Better)	**$ 277**	$ 270
Average lumber price expressed in Canadian dollars	**$ 387**	$ 424
Average pulp price to northern Europe, in US$	**$ 527**	$ 462
Average pulp price expressed in Canadian dollars	**$ 738**	$ 725

Quarterly Financial Information

	2003				2002			
	1st	2nd	3rd	4th	1st	2nd	3rd	4th
Sales and income (millions of dollars)								
Net sales	**$ 527.4**	**$ 483.3**	**$ 555.1**	**$ 529.7**	$ 505.9	$ 577.0	$ 548.9	$ 480.5
Operating income (loss)	**3.1**	**(47.5)**	**41.9**	**(0.3)**	25.1	82.6	(2.2)	(65.5)
Income (loss) from continuing operations, after income taxes	**37.1**	**(3.7)**	**17.8**	**34.6**	8.7	67.9	(14.6)	(60.1)
Net income (loss)	**40.2**	**(1.1)**	**80.1**	**34.1**	11.1	70.2	(11.8)	(58.0)
Per common share (dollars)								
Income (loss) from continuing operations								
Basic	**$ 0.44**	**$ (0.06)**	**$ 0.20**	**$ 0.41**	$ 0.09	$ 0.82	$ (0.20)	$ (0.76)
Diluted	**0.40**	**(0.06)**	**0.19**	**0.37**	0.09	0.73	(0.20)	(0.76)
Net Income (loss)								
Basic	**0.48**	**(0.03)**	**0.97**	**0.40**	0.12	0.85	(0.16)	(0.73)
Diluted	**0.43**	**(0.03)**	**0.86**	**0.37**	0.12	0.75	(0.16)	(0.73)

The following factors affected the comparability of the quarterly results in 2003:

- The average value of the Canadian dollar strengthened each quarter, with the largest quarterly increases occurring in the second (8%) and fourth (5%) quarters.
- Lumber prices were relatively stable in the first two quarters, increased by 28% from the second to the third quarter, and then declined by 6% in the fourth quarter. Seasonal demand is generally highest in the second and third quarters.
- Lumber production costs in the second half of the year were approximately 15% higher than in the first half, mainly as a result of shutdowns for major capital installations, which temporarily reduced productivity.
- Pulp prices rose by 15% from the first to the second quarter, fell by 6% in the third quarter and then rose by 7% in the fourth quarter. Pulp shipment volumes dropped by 20% from the first to the second quarter due to soft demand late in the period. Prices and shipment volumes were strong in the fourth quarter, as the market for softwood pulp began to tighten.
- Coastal logging operations were curtailed from July to mid September because of poor market conditions. This resulted in a significant drop in log sales in the third quarter, which continued into the beginning of the fourth quarter.
- Non-operating items affecting the comparability of the periods include: unrealized foreign exchange gains on US dollar long-term debt, coinciding with the strengthening of the Canadian dollar; a $60.2 million after-tax gain on the disposition of BC Chemicals in the third quarter; and a $19.5 million after-tax gain on the sale of Coastal property in the fourth quarter.

Fourth Quarter Results (2003 vs. 2002)

An operating loss of $0.3 million and net income of $34.1 million were recorded in the fourth quarter of 2003, compared with an operating loss of $65.5 million and a net loss of $58.0 million in 2002.

When comparing the operating losses in these two quarters, the main factors affecting the results include:

- The Canadian dollar average value increased by 19% in the fourth quarter of 2003, compared to the same period in 2002, which had a negative impact on fourth quarter 2003 net sales of approximately $100 million. This was only partially offset by gains on US dollar forward contracts exercised in the fourth quarter of 2003, which amounted to $11.6 million ($9.2 million after tax).
- A $33.1 million accrual (or $26.2 million after tax) for termination benefits and mill closure costs was included in the fourth quarter of 2002, as part of the CRMI program initiated in that period, of which $22.5 million was included in the Wood Products segment, $6.9 million in Pulp and Paper, $2.7 million in Coastal Operations and $1.0 million in Corporate.
- The Wood Products segment earned operating income of $2.4 million in the fourth quarter of 2003, compared to a loss of $43.3 million in 2002. Average lumber prices for 2"x4" "#2 and Better" random lengths increased by 29% over the same period in 2002, although when factoring in the impact of exchange rates, the increase was reduced to 8%. Lumber shipments were 3% higher compared to 2002. CVD and ADD duties of $33.3 million were expensed in the fourth quarter of 2003, compared to $40.9 million in 2002. The decrease was due to a $9.7 million adjustment to the estimated ADD rate, as discussed further in the Wood Products section. Fourth quarter 2003 productivity and costs were impacted by the downtime taken to complete major capital installations.

>> The Pulp and Paper segment earned operating income of $9.2 million in the fourth quarter of 2003, compared to a loss of $10.2 million in 2002. Strong demand and tight supply of softwood pulp increased the average price delivered to northern Europe by 23% compared to the same period in 2002, or 3% when factoring in the impact of exchange rates. Pulp shipments were 7% higher than in 2002. Cost reductions resulting from CRMI initiatives also had a favourable impact on the quarter's results compared to the prior year.

>> The Coastal Operations segment incurred an operating loss of $3.3 million in the fourth quarter of 2003, compared to a loss of $2.6 million in 2002. Weak market conditions and a Coastal workers' strike in the fourth quarter of 2003 resulted in lower shipment and production volumes.

Other factors to consider when comparing the net income in the fourth quarter of 2003 with the net loss in 2002, include a $20.7 million after-tax unrealized exchange gain on the translation of US dollar long-term debt, which partially offset the impact of the stronger Canadian dollar on operating income, and a $19.5 million after-tax gain on the sale of property located on the Coast of BC.

Cost Reduction/Margin Improvement (CRMI) Program

In October 2002, Canfor announced a company-wide Cost Reduction/Margin Improvement (CRMI) Program to achieve $150 million in net structural improvements on an annualized basis by the fourth quarter of 2003. With the dramatic and unprecedented upward swing in the Canadian dollar, the gross target has been substantially increased in order to compensate for this and other negative cost pressures. The current goal is to achieve $230 million in gross annualized cost reductions and margin improvements. Work is also underway to identify further CRMI initiatives for implementation commencing in 2004.

On an annualized basis, structural savings achieved at the end of 2003 from Interior Fibre (included in the Wood Products reporting segment), Pulp and Paper, Coastal Operations, Centralized Services and Corporate totaled $131 million. Management estimates that Wood Products has completed initiatives by the end of the year which will generate annual savings of $100 million in 2004. Manufacturing-related savings in Wood Products are more difficult to confirm because a number of the major projects were not completed until the fourth quarter. However, all projects had started up before the end of the year and are on track with Management's plans and objectives. With the completion of the annual maintenance shutdown at the Northwood Pulp Mill during the fourth quarter, the Pulp and Paper group estimates they have a further $14 million of savings that will be achieved in 2004.

The following table summarizes the status of the CRMI program by business segment:

	Gross CRMI Improvements	
(millions of dollars)	Target	Achieved
Annualized benefits		
Interior Fibre	$ 40	$ 48
Pulp and Paper	63	51
Coastal Operations	6	9
Centralized Services [6]	11	13
Corporate	10	10
	$ 130	$ 131
	Target	Estimated
Estimated benefits to be achieved in 2004		
Wood Products	$ 100	$ 100
Pulp and Paper	$ -	$ 14

(6) Consists of Technology and Research groups, Sourcing and Centralized Accounting Services. For reporting purposes these savings are separated out and allocated back to the business segments.

Wood Products

At the end of the fourth quarter, Management estimates that Wood Products has completed initiatives representing $100 million of savings, which are expected to be achieved in 2004. The majority of the estimated savings is based on full production from the Houston, Fort St John and Prince George sawmill projects and various other high-return cost saving capital projects.

The Interior Fibre group achieved $48 million of annualized savings. These initiatives include improved log quality management, operating area changes, managing hauling practices and reduced overhead spending.

Pulp and Paper
By the end of the year, the Pulp and Paper group had achieved annualized savings of $51 million. The savings reported by the segment include energy reduction capital projects, personnel reductions, improved machine reliability and enhanced paper machine performance. At the end of the year, Management believes the group has further initiatives in place that will generate additional annual savings of $14 million.

Coastal Operations
The annualized savings from Coastal Operations total $9 million. The savings arise from personnel reductions, improved business practices and a general spending reduction.

Corporate and Centralized Services
Corporate office initiatives have delivered annualized savings of $10 million from personnel reductions and general spending decreases in all areas. Initiatives within Centralized Services (Technology, Research, Sourcing and Centralized Accounting Services) have delivered $13 million of annualized savings.

2003 Operating Results

The following discussion of Canfor's operating results relates to the operating segments and the non-segmented items as per the Statement of Segmented Information in the Financial Statements. Canfor's operations include the following three operating segments: Wood Products, Pulp and Paper and Coastal Operations.

WOOD PRODUCTS

GOALS

- >> Achieve top quartile performance compared to North American producers
- >> Optimize value from sawmill assets and fibre resources
- >> Meet customer needs for high-quality, eco-certified, branded products

MAJOR ACHIEVEMENTS IN 2003

- >> Implemented third shifts at two additional sawmills, with another completed for the start of 2004
- >> Completed major capital installations at Fort St John, Prince George and Houston sawmills — the Houston sawmill is now the largest in the world with annual capacity of approximately 600 million board feet
- >> Acquired additional lumber capacity of 150 million board feet through the acquisition of a sawmill and timber harvesting operation in Quebec

The segment consists of logging and forestry operations, which harvested from over eight million cubic metres of allowable annual cut in northern British Columbia and northern Alberta in 2003.

In 2003, the group reduced the number of sawmills in the northern interior of British Columbia from eleven to nine, while converting two additional sawmills to third shifts. The segment also operates two sawmills in northern Alberta. In May 2003, Canfor acquired a sawmill and timber harvesting operation located in Quebec which harvests over 200,000 cubic metres of allowable annual cut. Other operations include a plywood manufacturing facility, three re-manufacturing operations, two whole-log chipping plants and two finger-joint mills. The segment's wood treatment plant was sold during the year.

The operations have an annual capacity of over 3.2 billion board feet of lumber, 179 million square feet of plywood (3/8" basis) and over 1.7 million oven-dried tonnes of wood chips. The segment employs approximately 4,100 people, located within the Prince George and Peace regions of British Columbia, and in northern Alberta, Quebec and Washington State. The segment also includes Canfor's wood products marketing division, located in Vancouver, and the Panel and Fibre operation, located in New Westminster, British Columbia.

Included in the Wood Products segment is the Interior Fibre Management group, which was established to coordinate the raw material fibre supply for all manufacturing facilities. This group oversees the woodlands operations of northern British Columbia and northern Alberta, with the goal of reducing costs and maximizing the value from the fibre resource.

Summarized results for the Wood Products segment for 2003 and 2002 are as follows:

(millions of dollars)	2003	2002
Net sales*	**$ 1,313.5**	$ 1,348.1
**after countervailing and anti-dumping duties*	*$ 146.6*	*$ 107.6*
Operating income (loss)	**$ (4.7)**	$ 70.8
EBITDA	**$ 49.2**	$ 120.7
EBITDA margin	**4%**	9%
Capital expenditures	**$ 94.9**	$ 35.4
Lumber shipments (millions of board feet)		
Canfor produced	**2,942**	2,817
Other producers	**296**	278
Lumber production (millions of board feet)	**2,893**	2,960
Plywood shipments (millions of square feet – 3/8" basis)	**172**	162
Chip shipments (thousands of oven-dried tonnes)	**1,484**	1,666
Hardboard shipments (millions of square feet – 3/8" basis)	**38**	37
Refined fibre and fibremat shipments (thousands of oven-dried metric tonnes)	**38**	39
Average random length 2"x4" SPF lumber price (US$ per thousand board feet) (7)	**$ 277**	$ 270
Average lumber price expressed in Canadian dollars	**$ 387**	$ 424

(7) Average Western SPF 2" x 4" #2 and Better Random Length price (F.O.B. Mill) *Source - Random Lengths publication*

The segment's operating income and EBITDA for 2003 were significantly below the 2002 results, mainly because of the appreciation of the Canadian dollar, which had an adverse impact of approximately $132 million. Countervailing and anti-dumping duties, which were applicable for the full year, compared with seven months in 2002, also continued to have a major impact on operating income and cash flow from operations. However, shipment volumes of Canfor-produced lumber were over 4% higher than the prior year, which, in combination with higher average lumber prices, helped to partially offset the full impact of exchange rate fluctuations and duties. Production was just 2% lower than the prior year, despite the permanent shutdown of two sawmills and production curtailments related to major capital installations.

In 2003, the segment took significant structural steps to position itself as a top quartile performer. Two of the highest cost mills (Upper Fraser and Taylor) were closed and capital expenditures of $74 million were made to modernize and upgrade the Fort St John, Prince George and Houston sawmills. Houston is now the largest sawmill in the world, with annual capacity of approximately 600 million board feet. In conjunction with the major strategic capital projects, an additional $27 million was spent on numerous initiatives to reduce costs and enhance value. Some examples include a staff reduction of 290 employees and an increase in margin-added products, such as machine stress rated (MSR) lumber.

As part of their continuous improvement program and in an effort to reduce costs and improve inventory turnover, the group completed a thorough review of its supply chain management. Projects implemented during the year included improved forecasting through information technology innovation and optimized logistic routes, along with consolidation of reload centers. Through these projects, dressed lumber inventories decreased by over 55 million board feet from 2002 to 2003.

In summary, significant progress towards achieving top quartile performance for the group was made in 2003.

Countervailing (CVD) and Anti-dumping (ADD) Duties

During the fourth quarter, Canfor's legal counsel in Washington recalculated the ADD margin at 2.51% for the first period of review (May 22, 2002 to April 30, 2003), down from the 5.6% estimated at the end of 2002. This revised estimate is based on the final database submission to the US Department of Commerce (DOC) during their review process. The projected rate for the second period of review has been estimated at 3.21%, based on sales and cost data from May to November 2003. The total adjustment recorded to the duty expense in 2003 was $25.8 million (before tax), of which $9.2 million relates to duties expensed in 2002. The preliminary results of the DOC's anti-dumping review should be known sometime between February and June 2004, after which Canfor will have the opportunity to comment on the calculations. Final results of the review may not be known until as late as December 2004. The cumulative difference between the assessed (cash payment)

rate and the expensed rate is $26.9 million at December 31, 2003, and is shown in the "long-term investments and other" line on the balance sheet.

Canfor has paid, and expensed, CVD at the prescribed rate of 18.79% throughout the year. Towards the end of 2003, there were a number of announcements concerning both Canfor's specific CVD rate and the countrywide rate. A comprehensive discussion of the history and current status of the duties is included in the Risks and Uncertainties section of this document.

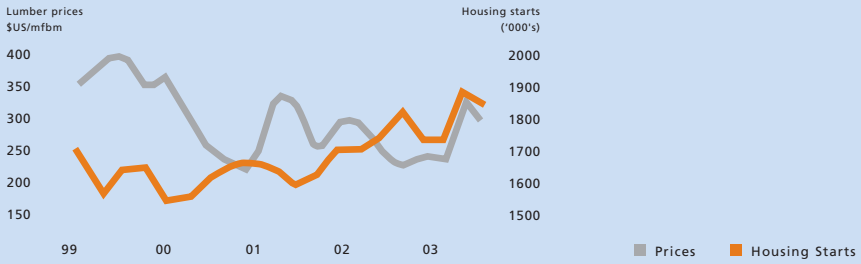
Markets

Lumber Demand for lumber products was exceptionally strong in 2003, fueled by very low interest rates and record levels of new home construction, repair and remodeling activity. Total US lumber consumption increased to a new record of 58.3 billion board feet[8] during the year. Total US housing starts reached 1.8 million units[9], 7% higher than 2002. Single-family housing starts were at an all-time high of 1.5 million units, a 10% increase from one year ago. Canadian housing starts, at 218,000 units[10], were the highest in 15 years.

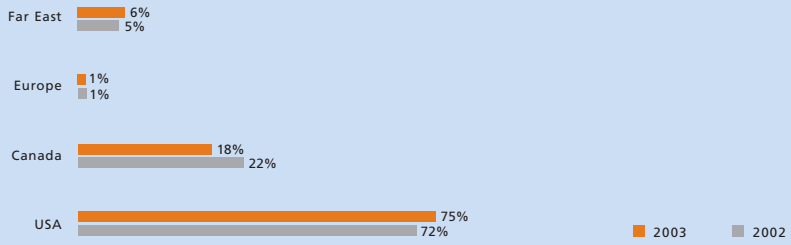
Despite strong demand, North American lumber markets were oversupplied for the first half of the year. To offset the effect of a strengthening Canadian dollar and CVD/ADD, Canadian lumber producers increased production in order to reduce unit costs. As a result of the oversupply conditions, Western SPF 2"x4" Random Length "#2 & Better" prices averaged US $245 per thousand board feet in the first half of the year, or 18% below the same period in 2002. However, by the third quarter, Canadian sawmill curtailments and log shortages resulting from forest fires in British Columbia quickly reduced supply at a time when demand for lumber was reaching a seasonal peak. Western SPF 2"x4" "#2 & Better" prices averaged US $307 during the second half of the year, an increase of 26% from the same period in 2002. For 2003, the average SPF 2"x4" "#2 & Better" lumber price was US $277, or almost 3% higher than the 2002 average price of US $270.

(8) RISI (Resource Information Systems, Inc.) estimation of lumber consumption – *Lumber Commentary,* December 2003
(9) US Census Bureau
(10) Canadian Mortgage and Housing Corporation

Lumber Prices vs US Housing Starts



Lumber Sales by Market



The weakening US dollar affected the competitiveness of both Canadian and European producers exporting into the United States. The Canadian dollar strengthened by 21% against the US dollar during the year. While Canadian producers strived to lower costs by increasing production during the first half of the year, several mills curtailed production once the Canadian dollar reached 75¢. The stronger Euro also resulted in the first decline in European lumber imports into the US in over a decade.

Canfor's total sales volume for 2003 was 3.2 billion board feet, almost 5% higher than 2002. Sales to the home centres reached 24% of Canfor's total sales volume, as these large retailers continued to experience strong growth. Sales to the Pro Dealer segment were 37% and continue to be Canfor's largest market segment. Shipments to the industrial and component segment have grown each year and, in 2003, were 10% of total sales. Offshore shipment volumes were the highest in seven years, at 7% of the total volume shipped.

Japan's economy started to show signs of recovery in 2003, with increased consumer spending and capital investment. Although total housing starts increased by only 1,000 units, to 1.152 million units[11], during 2003, wooden housing, which constitutes approximately 45% of total housing, increased by 20,000 units during 2003. 2"x4" housing starts totaled 81,000 units, 3% higher than in 2002. Sales to other key Asian markets, including Korea, China and Taiwan, increased by 36% in 2003, primarily because of higher sales of Western style 2"x4" homes in those countries.

(11) Japan Ministry of Land, Infrastructure and Transportation

Plywood Plywood from Canfor's North Central Plywood mill is used in home construction and in specialty applications. Approximately 73% of Canfor's 2003 plywood sales were in Canada, 21% went to the US and 6% to Japan. Very strong housing construction in North America created shortages of panel products during the second half of 2003. This resulted in Canadian spruce plywood prices increasing from an average of Cdn $359[12] per thousand square feet (3/8" basis) in the first half of 2003 to an average of Cdn $480 in the second half of 2003. For the full year, plywood prices rose by 10% from 2002 to Cdn $421 per thousand square feet.

(12) Crow's Publications, Inc.

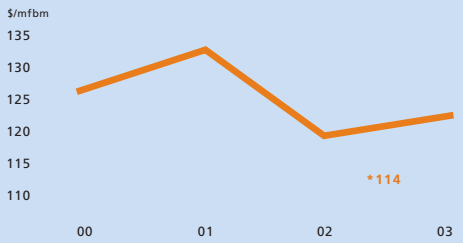
Operating Performance

The Wood Products segment continued to run close to full capacity in 2003, with the exception of some downtime for capital installations, annual maintenance at sawmills running third shifts, and market downtime imposed on the chip plants by the pulp mills. As part of the CRMI program, the segment implemented third shifts at two more sawmills during the year, with another starting up early in 2004. A total of six sawmills are now running on three shifts. Start-up targets on the capital installations are being exceeded, with full benefits expected to be achieved in 2004.

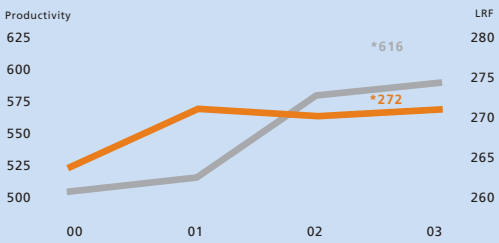
Sawmills that did not take downtime for capital installations continued to improve their performance over 2002, with several mills achieving exceptional results in the fourth quarter. However, because of the disruptions caused by the major capital installation shutdowns at the Fort St John, Houston and Prince George sawmills, overall conversion costs were 2% higher than in 2002. On the positive side, despite the downtime, sales volumes were maintained and inventories were reduced by 55 million board feet as compared with the same period last year.

Other CRMI initiatives continued to drive down costs and improve sales margins. A clear focus on customers and product mix allowed the segment to further increase its market share with key customers. For example, by increasing J-Grade production in the fourth quarter, the group took advantage of the strong Japanese demand and corresponding price increases.

Operating Improvements



Cash conversion costs per Mfbm



Productivity (Mfbm per man hour)
Lumber Recovery (fbm per m³)

*comparative statistics for 1st half of 2003, prior to the permanent mill closures and commencement of the major capital installations

Log costs decreased by 12% from 2002 to 2003, mainly as a result of CRMI-related structural changes, including improvements in log quality management and hauling practices and reduced overhead spending.

The segment's results include the Panel and Fibre operation, which produces high quality, value-added panel products, baled fibre, hydroseed and woodmat from recycled urban wood waste. After the completion of a press expansion early in the year, which increased production by 25%, Panel and Fibre performed well in 2003. However, operating income declined by 39% from 2002, primarily as a result of the appreciation of the Canadian dollar.

Risks and Uncertainties

Forest Policy Developments Discussed under "Risks and Uncertainties – Provincial Forest Policy Reform" later in this document.

Mountain Pine Beetle The mountain pine beetle continues to pose a significant and increasing threat to the lodgepole pine forests in the west-central interior region of British Columbia, which are within Canfor's operating area. Lodgepole pine accounts for 25% of the total timber volume harvested in British Columbia and 50% of the total timber volume harvested by Canfor in that region. The present outbreak covers over ten million hectares of land or 11% of the province's land base. The volume of dead timber within this area is estimated to be 173.5 million cubic metres, which is a 60% increase over the previous year. The hot, dry summer of 2003 provided ideal conditions for the beetle infestation to spread, and, with the current state of the infestation, it would likely take temperatures of –40°C or more, for several days, to stop the spread. This has not occurred, to date, in the winter of 2003/2004.

Canfor is working with the Ministry of Forests and other operators in the area to implement an aggressive program to mitigate the spread of infestation by redirecting planned timber development to infected regions over the next five years. As a result, approximately 85% of Canfor's planned log consumption in the Prince George region in 2004 will be from beetle-infested stands.

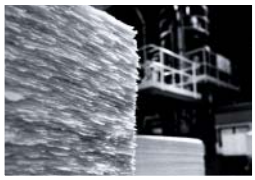
The average diameter of affected lodgepole pine logs tends to be smaller than traditional harvests and does not match well with existing sawmill equipment in the Prince George region. This issue is being addressed through realignment of manufacturing facilities to fit with future fibre supply. In the short-term, Canfor has undertaken major capital expenditures to realign its Prince George region manufacturing capabilities to accommodate the increase in fibre from beetle-infested logs. However, if the outbreak continues to spread, the potential implications to Canfor include a change in lumber product mix, increased costs and a potential decrease in the quality of lumber and chips produced.

Softwood Lumber Agreement In December 2003 an agreement in principle was reached between the Canadian and US governments on a proposal to end litigation and payment of duties. The proposal called for Canadian lumber to supply 31.5% of the US market, free of duty or penalty, but with a penalty of US $200 per thousand board feet for volume in excess of the 31.5%. The agreement also provided for a review in three years, by province, enabling a possible elimination of quota restrictions should the forest policy reforms be acceptable to the US government. 52% of the duties paid to December 6, 2003 were to have been refunded by the US, with the other 48% going to the US industry groups. This proposal was met with mixed reviews and was ultimately rejected by the provinces.

Outlook

Although economists are predicting that both the Canadian and US economies will improve in 2004, interest rates are expected to increase during the second half of the year as inflation starts to pick up. Higher interest rates will likely cause some reduction in new home construction and repair and renovation projects. Nevertheless, housing starts in both countries are predicted to be only slightly lower than the levels reached in 2003. During 2004, lumber prices may be affected by Canadian sawmill curtailments, which are possible if the Canadian dollar continues to strengthen and if a softwood lumber trade settlement involving quotas is reached between the US and Canada.

PULP AND PAPER



GOALS

- >> To be a low cost producer of superior strength reinforcing pulp
- >> To be a world-class manufacturer of high-value, high performance papers and optimize profit through growth in niche markets

MAJOR ACHIEVEMENTS IN 2003

- >> $15 per tonne reduction in conversion costs
- >> Record annual production and quality levels at both the Northwood and Intercontinental mills
- >> Designed and received approval for the PG Pulp Green Power Generation Project, jointly funded with BC Hydro

In 2003, the former Pulp Products and Pulp and Specialty Kraft Paper segments were combined to form one business unit. This business unit is managed to maximize overall earnings potential.

Canfor's pulp, which is produced from long northern British Columbia wood fibres, offers the strength sought by paper makers world wide. This segment consists of the Prince George, Intercontinental and Northwood pulp mills and the Specialty Paper Machine, all located within five kilometres of each other in Prince George, British Columbia. The pulp mills have the annual capacity to produce over one million tonnes of premium pulp and the paper machine has the capacity, at optimum product mix levels, to produce 142 thousand tonnes of kraft paper. The segment directly employs approximately 1,240 people. Also included in the Pulp Products segment is Canfor's pulp and paper marketing division, located in Vancouver. The BC Chemicals operation was sold in August 2003.

Summarized results of the Pulp and Paper segment for 2003 and 2002 are as follows:

(millions of dollars)	2003	2002 [13]
Net sales	**$ 664.9**	$ 641.6
Operating income (loss)	**$ 25.7**	$ (2.4)
EBITDA	**$ 69.8**	$ 43.2
EBITDA margin	**10%**	7%
Capital expenditures	**$ 23.3**	$ 21.7
Average pulp price – delivered to northern Europe (US$ per tonne)	**$ 527**	$ 462
Average pulp price expressed in Canadian dollars	**$ 738**	$ 725
Average Canfor paper selling price (gross, Cdn$ per tonne)	**$ 1,014**	$ 999
Pulp shipments (thousands of tonnes)	**999**	994
Pulp production (thousands of tonnes)	**992**	1,002
Specialty kraft paper shipments (thousands of tonnes)	**121**	109
Specialty kraft paper production (thousands of tonnes)	**129**	108

(13) Prior period figures have been restated to include the former Pulp Products and Pulp and Specialty Kraft Paper segments and to exclude the discontinued operations of the BC Chemicals division.

The segment's results for the year improved significantly over the previous year, mainly as a result of the higher pulp prices and lower conversion costs. However, these factors were partially offset by the strengthening of the Canadian dollar and higher costs for fibre (which are contractually tied to overall pulp prices) and energy. Although average energy prices increased, overall usage was reduced as a result of cost reduction initiatives.

In October 2003, Canfor announced that it had entered into an agreement to build a major electrical cogeneration facility at the Prince George Pulp and Paper Mill. The $81 million project is a joint undertaking with BC Hydro, who is contributing $49 million under their "Power Smart" program. Under the 15-year agreement, Canfor will install a 48-megawatt turbo-generator and a wood residue handling and conditioning system. Modifications will be made to the pulp mill boilers and processes to optimize steam production for the generation of electricity. An upgrade of the mill's electrical system will also be completed. At December 31, 2003, Canfor had capitalized $4.9 million of initial project costs.

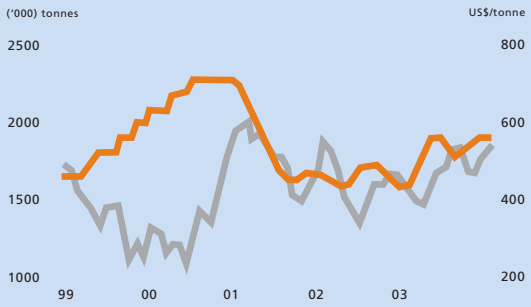
The plant, which is scheduled for completion by February 2005, will enable Canfor's Prince George Pulp and Paper and Intercontinental Pulp mills to be 100% self-sufficient in electricity generation. In addition to lowering the segment's production costs, this project will provide environmental benefits to the area by significantly lowering emissions in the Prince George air shed and allowing for the decommissioning of beehive burners at sawmills in Bear Lake and Isle Pierre. The project is subject to final documentation and customary closing conditions.

Markets

Pulp Pulp markets were impacted by several external factors in the first half of 2003, including the invasion of Iraq and the outbreak of SARS, which caused paper demand to remain stagnant in the early months of the year, particularly in the US and Europe. However, the supply side of the market experienced dramatic change because of unforeseen constraints. Unusually wet weather in the southern US during the winter of 2002/2003 prevented harvesting of logs, and supply was further constrained in eastern Canada as sawmills curtailed production in reaction to softwood lumber duties on shipments to the US. The resulting shortage of woodchips caused several pulp mills to curtail production for one to two weeks.

At the beginning of 2003, pricing in northern Europe was at US $440 per tonne. This was a cyclical low, caused by destocking in Asia during the latter part of the third quarter of 2002 and continuing into the fourth quarter of 2002. However, Asian buyers had begun restocking depleted inventories before the end of 2002. This demand pressure, combined with the supply side constraints in North America, quickly tipped the supply and demand balance in favour of pulp producers. Driven on by a rapidly weakening US dollar, market pulp sellers were able to increase prices to US $560 per tonne in northern Europe by May 2003.

Prices vs Inventories



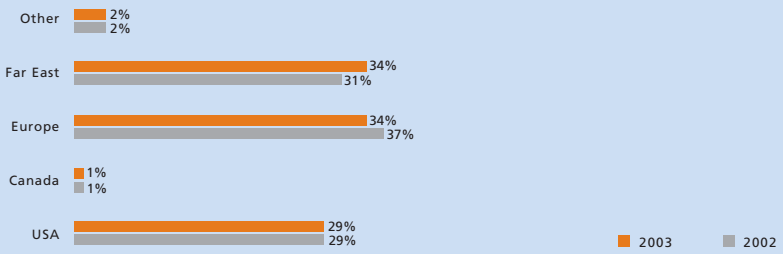
Average NBSK price paid by contract buyers, delivered to Northern Europe - *Source: Pulp and Paper Week*

NORSCAN NA/Nordic Chemical Paper Grade Market Pulp Producer Inventories - *Source: Pulp and Paper Products Council*

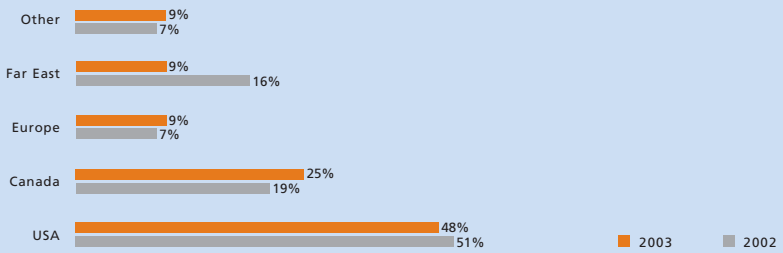
Norscan Inventories NBSK price

The upward pricing momentum was abruptly halted when Asian markets tested the pricing level again by working off inventories during the second quarter of the year. This fall off in demand caused downward pricing pressure in Asia to spread to other markets, forcing prices in Europe down to US $510 per tonne in August. In the third quarter China entered the market again with strong purchases to restock depleted inventories. This demand boost allowed producers to raise prices again in steps, finishing the year at US $560 per tonne in northern Europe.

Pulp Sales by Market



Paper Sales by Market



Paper The overall strategy of Specialty Paper is to focus on the sale of bleached and high performance papers in the North American market. Bleached paper has higher returns than unbleached paper and North American returns are generally higher than in the export market. In 2003, the segment increased its sales of prime papers into North America by 33%. North American sales are targeted at 75-80% of total paper sales. Growth of bleached sales, particularly Polar™ sales, have been slow but steady. The target is to accelerate the growth rate to match sales with the increased productivity of the paper machine.

The kraft high-performance paper industry is characterized by relatively few competitors. Although the commodity kraft paper industry in developed markets is stable, there is a conversion beginning in North America from commodity to high-strength specialty kraft papers. Canfor is well positioned to capitalize on this change. The marketing strategy has emphasized working with independent converters and flexible packaging end-users to create customer demand for new high-performance products. Price levels in the kraft paper market have tended to be fairly stable, with niche market producers enjoying generally good operating rates.

An agency agreement was established in 2003 to outsource all export paper sales outside of North America to one agent. This will allow the segment to continue to downsize and reduce internal costs, while allowing the internal sales team to focus on the North American market.

Operating Performance

Pulp The pulp mills ran steadily during 2003, with no downtime other than for maintenance shutdowns and a few disruptions caused by mechanical failures, lightning strikes and start up difficulties following annual maintenance shutdowns. Despite these problems, the Northwood and Intercontinental mills achieved record annual production in 2003. Conversion costs averaged 4% lower than the prior year, mainly as a result of improved productivity and the successful implementation of CRMI initiatives, including reduced hourly overtime expenditures, staff reductions and reduced energy usage. Going forward, the time between maintenance shutdowns will be extended to 18 months from 12 months, which will reduce costs and improve productivity by increasing the number of operating days per year.

Paper In the years following the installation of new equipment and the move to higher value products, the paper machine has struggled with numerous, often technically difficult issues that have significantly affected productivity, quality and, consequently, profitability. During 2003, the group built on improvements achieved in the latter half of 2002. Production and quality reached a new level in the second half of 2003, with prime production (a key performance indicator measured by "customer tonnes per day") increasing by 29,000 tonnes from the level achieved in 2002. Other improvements in 2003 include a significant decrease in the frequency and duration of breaks, an overall improvement in machine reliability and a significant improvement in basis weight and moisture control.

In addition to the previously trademarked product brands, Polar™ and Kodiak™, during 2003 Specialty Paper was successful in developing a new bleached, high-performance, high-porous paper, PolAir P™, and an unbleached, high-performance, high-porous paper, KodAir P™, which now compete with European products. It is expected that the new PolAir P™ product will be a major contributor to increasing our bleached sales. Other new products that have good profit potential, such as our Polar Pulp Wrap™, are being introduced into the marketplace.

Discontinued Operation

On August 29, 2003, Canfor completed the sale of its BC Chemicals division, formerly included in the Pulp and Paper segment, to a limited partnership owned by Chemtrade Logistics Income Fund for proceeds of $117.3 million. A gain of $79.6 million ($60.2 million after tax) was realized for accounting purposes. The gain on sale and operating results prior to the sale ($11.4 million for the eight months in 2003 and $15.1 million in 2002) are included in the "Discontinued Operation" line on the income statement.

The BC Chemicals plant is located adjacent to Canfor's Prince George/Intercontinental Pulp mills and Specialty Paper Mill, with a major portion of its production of sodium chlorate and crude tall oil being used by Canfor's mills, and the remainder being allocated between merchant sales and trades. Sodium chlorate is used in the bleaching phase of the kraft pulping process and crude tall oil, produced from soap skimmings recovered from pulp mills, is used by Canfor's pulp mills as a substitute for natural gas. Canfor has entered into several long-term agreements with Chemtrade Logistics, at market prices, to ensure a supply of chlorate and also the processing of soap skimmings into crude tall oil.

Risks and Uncertainties

The main business risks for the pulp segment center around pulp pricing, exchange rates and energy prices.

The strengthening Canadian dollar had a significant impact on profitability in 2003. Although pulp prices will likely reach a new higher equilibrium price, kraft paper is more likely to take longer to adjust to currency changes. To counter this risk, Canfor will continue to strive for a low-cost position on the global cost curve for both pulp and paper. Projects, such as the Prince George power plant and bleaching changes, will help bring the Prince George mill's conversion costs down to the level of Canfor's other mills. Canfor has signed an agreement with Shell Global Solutions to implement an asset management process that will help reduce maintenance costs and increase reliability of production. In addition, the period of time in between maintenance shutdowns will be lengthened, which will increase productivity and further reduce overall maintenance shutdown spending.

For paper, the focus will also be on increasing sales of higher-value products and phasing out less profitable grades, customers and geographic regions.

Outlook

To date in 2004, demand from Asia has remained strong and pulp price increases were realized on sales into China, in particular, in January. Steady to strong order patterns are also being experienced in the North American and European markets early in the year. As the year progresses, supply is expected to become constrained as producers take maintenance downtime, while demand should grow with the recovering economies. This will lead to a tightening of the supply and demand balance and allow for price improvements in our major markets. Reasonably strong economic growth is forecasted to increase paper demand in 2004. The demand growth, combined with a weakening US dollar, will provide further impetus to force prices higher. While the summer months are expected to be seasonally slow, there appears to be little softwood pulp capacity growth in 2004. The solid demand fundamentals and restrained capacity growth should allow for a positive pricing environment throughout the year.

Softwood pulp supply remains tight. In January, Canfor announced February 1st pulp price increases of US $30 in Europe (to US $590 per tonne) and US $20 in the United States (to US $600 per tonne).

COASTAL OPERATIONS

GOAL

>> Maintain a profitable, market-sensitive, cost-competitive logging and fibre management operation

MAJOR ACHIEVEMENTS IN 2003

>> Reduced production costs by 11% (excluding stumpage) or 3% overall

>> Maintained excellent environmental record

Canfor's Coastal Operations segment is comprised of the Coastal Logging operations, which includes the Englewood logging operation, located on northern Vancouver Island and the Mainland logging operation, located in the Fraser Valley, Sunshine Coast and in the lower Lillooet River areas of British Columbia. These operations logged on tenures having an allowable annual cut of 1.5 million cubic metres in 2003, of which 1.4 million was harvested in the year. The segment directly employs approximately 430 people.

Summarized results of the Coastal Operations segment for 2003 and 2002 are as follows:

(millions of dollars)	2003	2002
Net sales	**$ 117.1**	$ 122.6
Operating income	**$ 1.4**	$ 5.7
EBITDA	**$ 7.2**	$ 13.6
EBITDA margin	**6%**	11%
Capital expenditures	**$ 5.0**	$ 6.4
Log shipments (thousands of cubic metres)	**1,237**	1,229
Log production (thousands of cubic metres)	**1,258**	1,336

Despite weak market conditions for coastal logs, the segment was able to remain profitable in 2003 due in large part to its CRMI program.

At the end of 2003, the segment successfully concluded the sale of property on the Coast of British Columbia, comprising private timberlands and a gravel pit, for proceeds of $25.5 million. An accounting gain of $23.8 million (before tax) was recognized on the sale, and is included in non-operating income in the financial statements.

Markets

The Coastal market was relatively strong at the beginning of 2003, mainly as a result of low inventory levels caused by reduced logging activity by other producers in the region. Canfor took advantage of the increased demand and higher prices by continuing to run at full capacity, except when prevented from doing so by weather conditions. However, by the end of the second quarter, uncertainties in the Japanese market, the continuing softwood lumber dispute and the strengthening Canadian dollar caused the market to erode. Demand and prices remained weak for the remainder of the year.

Operating Performance

Production costs, excluding stumpage, were down by 11% from 2002 levels, mainly due to productivity improvements which reduced camp and contractor costs. Other cost reductions were achieved through reduced helicopter logging, lower repair and maintenance costs and employee reductions. However, the benefits from these cost reductions were significantly reduced by weaker prices in the second half of the year, which caused the average log selling price in 2003 to be approximately 8% lower than in 2002. A 20% increase in stumpage rates also partially offset the cost reductions. However, this increase would have been even higher had it not been for the segment's improved stumpage management practices.

Risks and Uncertainties

The reduction in the number of manufacturing mills on the Coast, together with uncertainties in the Japanese market, will have a major impact on log markets for the Coast. Going forward, Canfor will continue to monitor its competitors' operating levels and adjust its strategy accordingly. In addition to pricing and market demand, the critical factor that will impact profitability going forward is Canfor's ability to continue to drive down costs.

The disposition of the private timberlands in 2003, as discussed above, may increase stumpage in the future, as the harvest volume will be shifted to other licences. The 20% tenure take-back, discussed under "Risks and Uncertainties — Provincial Forest Policy Reform" later in this document, also creates uncertainties for Canfor and all other major companies operating in the BC forest industry.

Outlook

Coastal logging operations continued their seasonal shutdown into the beginning of 2004 due to winter weather conditions. With the announcement, in mid-January, of the launch of the new market-based timber pricing system for the Coastal forest sector, effective February 29, logging operations will be delayed until at least the middle of February in order to take advantage of the reduced stumpage rates that are expected to result from the new pricing system.

First quarter prices are expected to improve slightly, mainly as a result of the sale of winter second growth and some higher-grade old growth logs, although inventories will begin the year at a low point due to the strike by Coastal unionized workers during 2003 and weather-related shutdowns. Pulp log prices are expected to remain steady in the first quarter due to soft demand and reduced logging levels by other operators on the Coast of British Columbia.

NON-SEGMENTED ITEMS

Corporate and Other

Corporate costs, information technology costs and research and development costs decreased by $8.9 million, or 26%, from 2002 to 2003, mainly as a result of staff reductions and significant spending reductions in all areas arising from the CRMI program.

Affiliated Companies

Canfor's affiliated companies, which are accounted for on an equity basis, consist of Lakeland Mills Ltd., The Pas Lumber Company Ltd., Vernon Seed Orchard Co. and Kyahwood Forest Products. Lakeland and The Pas operate sawmills in the Prince George region and supply wood chips to Canfor's pulp mills. Kyahwood, which is owned 49% by Canfor, is a value-added lumber facility in Moricetown, British Columbia. The combined income of these affiliates decreased by $5.4 million from 2002 to 2003, mainly as a result of the difficulties suffered by Lakeland and The Pas in the lumber markets in 2003, similar to those discussed in the Wood Products segment.

Interest Expense

Interest expense, net of interest income of $1.8 million, decreased by $8.7 million in 2003 from 2002, mainly due to the effect of the stronger Canadian dollar on US denominated interest payments and reduced long-term debt as a result of scheduled repayments of US $32.5 million during the year. The favourable impact of exchange was partially offset by a $2.7 million increase in short-term borrowing costs over 2002 as a result of Canfor's higher usage of its operating lines of credit during the year.

Other Income

Other income of $24.9 million is mainly comprised of a $23.8 million gain from the sale of a gravel pit and timberland property located on the coast of British Columbia. In 2002, other income of $9.0 million mainly consisted of an $11.4 million gain on the sale of the former Eburne Sawmill site, partly offset by losses from a subsidiary in a non-core line of business.

Income Taxes

The income tax recovery of $3.7 million recorded in 2003 includes future income tax savings of $8.1 million (2002 – $8.0 million) arising from Canfor's share of Howe Sound Pulp and Paper Limited Partnership's current operating losses. The history behind these losses is as follows.

On March 10, 2001, Canfor and Oji Paper Co., Ltd. (Oji Paper) of Japan, its 50% co-venturer in the Howe Sound Pulp and Paper Limited (Howe Sound) joint venture, transferred the business of Howe Sound into a limited partnership, Howe Sound Pulp and Paper Limited Partnership (HSLP). HSLP continues to be jointly owned by Canfor and Oji Paper and continues to carry on the existing operations of Howe Sound. As a result of the reorganization, Howe Sound was amalgamated with Canadian Forest Products Ltd. (CFP), Canfor's principal operating subsidiary, and approximately $643 million of tax losses of Howe Sound became available to reduce the future taxable income of CFP. CFP has seven years in which to utilize these losses. The ability to use these losses is contingent upon HSLP's continuing operations, which may require continued funding by the owners. Also, as part of the reorganization, CFP made a payment of $60.2 million to HSLP in 2001, which was applied to reduce its long-term debt. During 2002, CFP made additional payments, totaling $5.0 million, to HSLP and has agreed to make further payments, up to a maximum of $57.1 million, as it utilizes the tax losses of Howe Sound. No payments were made to HSLP in 2003. Canfor wrote off its interest in the joint venture in 1998 and no longer reflects its share of Howe Sound's results. Canfor's method of accounting for its interest in HSLP has not changed as a result of the reorganization.

The other significant factor affecting the 2003 tax figure when compared to the 2002 figure is the impact of capital gains. Included in the 2003 taxable income figure are $134.7 million (2002 – nil) of capital gains resulting from property dispositions and the translation of US dollar denominated debt.

In 2002, Canfor received a Notice of Assessment from the Income Taxation Branch of the British Columbia Ministry of Provincial Revenue with respect to property transfer taxes associated with the amalgamation of Howe Sound and CFP described above. The notice denied CFP's claim for an exemption from property transfer tax resulting from the amalgamation. The potential liability arising from this assessment, including accrued interest to December 31, 2003, is $11.1 million. In the opinion of Management and counsel, the amalgamation qualifies for exemption from property transfer taxes and, therefore, CFP is vigorously contesting the assessment. A Notice of Objection was filed but was declined by the Minister. Canfor has appealed the Minister's decision to the BC Supreme Court and no provision has been made for the amount in the accounts. As required by the Ministry, CFP has posted a Letter of Credit for the assessed amount plus accrued interest.

Transactions with Related Parties

Howe Sound Pulp and Paper Limited Partnership (HSLP) Canfor's Coast Fibre Supply group, included in the Coastal Operations segment, sells and trades the log production of the Coastal logging operations to acquire the logs and chips required for HSLP's pulp and newsprint mills. Logs that can be chipped by HSLP's Westcoast Cellufibre operation are sold to that operation at market value. Logs that cannot be used by Westcoast Cellufibre are sold to or traded with other coastal operators, with the primary objective of obtaining the pulp logs and chips required by HSLP. In 2003, HSLP purchased logs valued at $9.1 million from Coast Fibre Supply (2002 – $8.9 million). In addition, the Coast Fibre Supply operation sources logs and chips for HSLP from areas such as southern Alaska, northern Washington and the interior of British Columbia. Coast Fibre Supply provides these management, fibre supply and other services to HSLP at cost, for which it charged $1.8 million in fees for 2003 (2002 – $2.2 million).

Canfor's BC Chemicals division sold sodium chlorate, at market value, to HSLP, until that operation was sold in August 2003. Sodium chlorate sales to HSLP amounted to $4.2 million for the eight months in 2003 (2002 – $6.4 million for the year).

Canfor's Pulp and Paper marketing division markets the pulp production of HSLP, for which it received commissions totaling $2.8 million, on sales volume of 361,700 tonnes, in 2003 (2002 – $2.7 million, on volume of 343,500 tonnes). Based on a separate prepayment agreement between Canfor and Oji, the partners of HSLP, at December 31, 2003, Canfor had prepaid $33.5 million to HSLP in advance of the due date of receivables for pulp marketed and collected on their behalf. This agreement provides for the partners to prepay up to a maximum amount of $50 million each, which is used as short-term operating funds by HSLP. Canfor charges HSLP a market rate of interest for the period paid in advance.

Lakeland and The Pas Canfor purchases pulp chips and lumber, at market value, from Lakeland Mills Ltd. and The Pas Lumber Company Ltd., in which it holds a one-third equity interest, through its subsidiary 317231 British Columbia Ltd. In 2003, Canfor purchased $10.7 million in pulp chips and $10.8 million in lumber from these mills (2002 – $11.5 million and $8.8 million, respectively).

Kyahwood Forest Products Canfor has a joint venture, Kyahwood Forest Products, with the Moricetown Indian Band. The investment is being accounted for on the equity basis due to its relative size in relation to Canfor's other investments and to the fact that the joint venture is managed by the Band. During 2003, Kyahwood Forest Products provided remanufacturing services, at market value, to Canfor in the amount of $5.1 million (2002 – $6.3 million).

Summary of Financial Position

The following table summarizes Canfor's financial position as at the end of the years 2003 and 2002 and the cash flow related to the changes in financial position for those years.

(millions of dollars, except for ratios)	2003	2002
Net cash (short-term indebtedness)	**$ (57.4)**	$ 22.9
Operating working capital	**407.0**	350.1
Current portion of long-term debt	**(57.2)**	(51.4)
Current portion of deferred reforestation	**(39.6)**	(38.8)
Income taxes recoverable (payable)	**1.4**	(5.8)
Working capital of discontinued operation	**-**	(3.8)
Net working capital	**254.2**	273.2
Long-term investments	**100.5**	90.3
Property, plant, equipment and timber	**1,443.5**	1,394.7
Deferred charges	**126.8**	139.3
Non-current assets of discontinued operation	**-**	33.9
Net assets	**$ 1,925.0**	$ 1,931.4
Long-term debt	**$ 478.0**	$ 643.4
Deferred reforestation provision	**39.6**	42.3
Other long-term provisions and accruals	**49.0**	41.6
Future income taxes – net	**173.7**	154.5
Deferred credit	**95.7**	95.7
Common shareholders' equity	**1,089.0**	953.9
Total capitalization	**$ 1,925.0**	$ 1,931.4
Ratio of current assets to current liabilities	**1.5:1**	1.7:1
Ratio of net debt to common shareholders' equity	**35:65**	41:59
Cash generated from (used in)		
Operating activities	**$ (1.3)**	$ 124.2
Dividends	**(10.6)**	(21.1)
Financing activities	**(58.4)**	(55.2)
Investing activities	**(131.2)**	(70.0)
Discontinued operation	**121.2**	14.8
Increase in short-term indebtedness / decrease in net cash	**$ (80.3)**	$ (7.3)

Changes in Financial Position

Canfor's ratio of current assets to current liabilities decreased to 1.5:1 at the end of 2003 from 1.7:1 at the end of 2002, mainly as a result of an increase in operating bank loans and accounts payable. This increase in loans and payables is partly due to an acceleration of logging activity in the fourth quarter of 2003 in order to mitigate a January 1, 2004 stumpage rate increase. Although this strategy has caused an additional $37 million in cash to be tied up in inventories, it will result in a stumpage savings of over $3 million in 2004.

Canfor's ratio of net debt to equity (defined as the ratio of total debt, net of cash and temporary investments, to shareholders' equity) improved to a ratio of 35:65 from 41:59 in 2002. The improvement mainly resulted from the impact of the stronger Canadian dollar on US dollar denominated long-term debt at the end of the year, which has reduced the Canadian equivalent of Canfor's long-term debt by Cdn $112.5 million. Long-term debt was also reduced as a result of US $32.5 million of scheduled repayments being made during the year.

The changes in the components of these ratios during 2003 are detailed in the Consolidated Cash Flow Statement of the Financial Statements. The more significant changes are discussed below.

Operating Activities Cash generated from operating activities during 2003 was $125.5 million lower than the amount generated in 2002. Excluding the unrealized foreign exchange gain on long-term debt, net income from continuing operations was $28.5 million lower than in 2002, mainly due to the impact of the stronger Canadian dollar on EBITDA. In 2002, changes in non-cash working capital contributed $67.2 million to cash, whereas in 2003, changes in these balances used up $30.0 million in cash.

In 2003, the major changes in non-cash working capital were an increase in accounts payable and accrued liabilities of $37.4 million, an increase in accounts receivable of $52.3 million and an increase in inventories of $8.9 million. The increase in payables and inventories is mainly due to the acceleration of logging in the fourth quarter, as discussed above. The increased receivables balance includes $16.5 million from the sale of property at the end of 2003, the movement from long-term to short-term of a $16 million mortgage receivable balance from 2002, and a $19 million increase in sales in the last two months of the year compared to the same period in 2002.

Financing Activities In 2003, Canfor used $69.0 million for financing activities, compared to $76.3 million in 2002. The decrease is mainly attributable to reduced dividend payments, which were temporarily suspended in the second quarter of 2003 in order to preserve cash for strategic capital investments and for ongoing duty payments. Long-term debt repayments of US $32.5 million were made in the year. In addition, a subsidiary made long-term debt repayments of $11.2 million and received new proceeds from long-term debt of $4.8 million in the year.

Investing Activities Canfor invested $123.5 million in capital assets in 2003, a $56.1 million increase over the previous year. In 2002, Canfor's capital program had been primarily focused on maintaining operations, while conserving cash. However, in response to the cost pressures imposed by the countervailing and anti-dumping duties and the lowest prices in a decade for lumber and pulp, Canfor introduced a program of high-return capital projects beginning in 2003 under the CRMI program. The largest projects completed in the year were in the Wood Products segment, totaling approximately $74 million. These projects included the modernization of the Fort St John and Prince George sawmills, which are now able to run three shifts, a major expansion and modernization of the Houston mill, which is now the largest sawmill in the world and the installation of linear wane optimizers at several mills. Of the $123.5 million invested in capital expenditures in 2003, approximately $22 million, or 20% of amortization, was spent on maintenance of business projects.

The majority of the proceeds from the sale of property, plant and equipment in 2003 arose from the sale of property located on the Coast of British Columbia, which included a gravel pit that was previously leased to an unrelated party and private timberlands used in the Coastal Operations segment. Total proceeds were $25.5 million, of which $3.2 million was received in 2003, $16.6 million is due early in 2004 and the remainder is secured by two five-year mortgages. The proceeds from the sale of property, plant and equipment in 2002 mainly arose from the sale of the former Eburne Sawmill property, a portion of which was secured by a mortgage, which is due for repayment on or before May 2004.

Financial Requirements and Liquidity

At the end of 2003, Canfor was in a short-term indebtedness position of $57.4 million, net of $24.7 million in cash and had $96.1 million of unused bank operating lines of credit. The amount of credit available under these lines was $200 million, of which $55.0 million in bankers' acceptances and $27.1 million of prime rate based borrowings were issued and $21.8 million was utilized for several standby letters of credit that were outstanding at December 31, 2003.

Provisions contained in Canfor's long-term borrowing agreements limit the amount of indebtedness that the Company can incur and the amount of dividends it may pay on its Common Shares. The amount of dividends the Company is permitted to pay under its long-term borrowing agreements is determined by reference to consolidated net earnings less certain restricted payments. As at December 31, 2003, the Company was permitted under these agreements to incur $573.9 million of additional long-term debt (2002 – $216.0 million) and pay up to $164.3 million, or $2.02 per share, in dividends on its Common Shares (2002 – $68.7 million, or $0.85 per share). The agreements do not restrict payment of dividends on preferred shares or dividends paid in Common Shares of the Company.

For 2004, Canfor plans to invest approximately $79 million in capital projects, which includes $38 million on normal maintenance of business capital and $41 million on strategic capital. Strategic capital is targeted to either reduce costs or increase the value of the products that Canfor manufactures. The planned strategic capital spending in 2004 includes approximately $25 million related to the Prince George Pulp Green Power Generation Project, as discussed in the Pulp and Paper segment.

In 2004, $56.6 million is required for scheduled long-term debt repayments.

Canfor intends to finance its planned capital expenditures and scheduled debt repayments from cash generated from its operations.

In December 2003, Canfor negotiated a US $160 million private placement debt with one of its long-time lenders. The unsecured senior notes were structured to allow Canfor to draw down US $50 million in February 2004 and the remaining balance of US $110 million to be drawn down conditional on the closing of the Slocan acquisition (discussed below). Should the Slocan acquisition not close, the US $50 million to be drawn in February 2004 will be used for general corporate purposes to finance capital expenditures and scheduled debt repayments. The financing, with three separate tranches, has a weighted average coupon rate of 6.03% and an average life of 6.6 years, with final maturity on August 15, 2011.

The following table summarizes Canfor's financial contractual obligations at December 31, 2003 and for each of the next five years and thereafter:

(Cdn $ millions)	Total	2004	2005	2006	2007	2008	Thereafter
Long-term debt and capital lease obligations	$ 535.2	$ 57.2	$ 69.3	$ 107.0	$ 97.8	$ 20.5	$ 183.4
Convertible debentures	155.0	-	-	155.0	-	-	-
Operating leases	66.4	24.1	14.6	8.0	4.8	3.2	11.7
Other contractual obligations	10.0	5.0	5.0	-	-	-	-
	$ 766.6	$ 86.3	$ 88.9	$ 270.0	$ 102.6	$ 23.7	$ 195.1

Other contractual obligations not included above are:

>> Purchase obligations in the normal course of business, which have not been included above due to the impracticality of compiling the information, and the individual immateriality of the amounts involved. Purchase obligations of a more substantial dollar amount generally relate to the pulp business and are subject to "force majeure" clauses. In these instances, actual volumes purchased may vary significantly from contracted amounts depending on Canfor's requirements in any given year. As discussed in the Pulp and Paper segment, Canfor has entered into several long-term agreements with the purchaser of BC Chemicals to ensure a continued supply of chlorate and processing of the pulp mills' soap skimmings. The minimum commitment under these agreements is for ten years, at $29 million per year for chlorate and $4.5 million for soap skimming.

>> Deferred reforestation, for which a liability of $79.2 million has been recorded at December 31, 2003 (2002 – $81.1 million). The reforestation liability is a moving obligation, based on the volume of timber harvested. The future cash outflows are a function of the actual costs of harvesting at the time and are based on, among other things, the location of the harvesting.

Agreement to Acquire Shares of Slocan Forest Products Ltd. (Slocan)

On November 25, 2003, Canfor announced that it had signed an agreement to acquire all of the issued and outstanding shares of Slocan in a share exchange transaction in which Slocan shareholders will receive 1.3147 Canfor shares for each Slocan share. The Board of Directors of Canfor and Slocan have unanimously approved the combination. The Board of Directors of Slocan is recommending that the Slocan shareholders approve the transaction at a shareholder meeting expected to be held by the end of the first quarter of 2004. The agreement provides for the payment of a $9 million break fee to Canfor in the event that, among other things, Slocan's Board of Directors changes its recommendation in favour of a competing bid under certain circumstances. The agreement is also subject to the approval of the British Columbia Supreme Court, approval under the *Competition Act (Canada)*, other regulatory approvals, compliance with the *British Columbia Forest Act*, and satisfaction of other conditions.

The combined company will have approximately 5.2 billion board feet of lumber capacity, 1.2 million tonnes of pulp capacity, 950 million square feet of plywood and oriented strand board (OSB) capacity and 142,000 tonnes of kraft paper capacity. Upon completion, the combined company will be the largest spruce/pine/fir manufacturer in the world, with the second largest lumber capacity in North America. Canfor believes the combination will create a business with both the production capability and product diversification necessary to succeed and grow in the highly competitive global forest products marketplace. Canfor expects to capture annual synergies of approximately $60 million through marketing programs and operational efficiencies. The transaction is expected to be accretive to earnings in the first 12 months following closing.

The combined company will have market capitalization in excess of $1.6 billion based on Canfor's share price at February 5, 2004, annual sales of approximately $3 billion and assets greater than $3 billion. The aggregate value of the transaction, including assumed net debt, is approximately $620 million. Slocan's debt was US $160 million at December 31, 2003.

Canfor has arranged a US $160 million private placement debt to finance any of Slocan's debt that may become due as a result of this transaction. The private placement financing is comprised of unsecured senior notes, with an average life of 6.6 years and a weighted average coupon rate fixed at 6.03%. US $50 million will be drawn down in February 2004, and a further US $110 million is to be drawn down at the closing of the acquisition. In the event that the transaction does not proceed, a cancellation fee is payable on the US $110 million. Canfor has covered the exposure of this cancellation fee by purchasing an interest rate call option to expire on March 31, 2004. The fair value of the option is $1.2 million at December 31, 2003.

Critical Accounting Estimates

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

Employee Future Benefits

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

Canfor uses an independent actuarial firm to perform actuarial valuations of the fair value of pension and other retirement benefit plan obligations. The application of these recommendations requires judgments regarding certain assumptions that affect the accrued benefit provisions and related expenses, including the discount rate used to calculate the present value of the obligation, the expected rate of return on plan assets and the rate of compensation increase. Management evaluates these assumptions annually based on its own experience and the recommendations of its actuarial firm. Changes in these assumptions result in actuarial gains or losses, which are amortized over the average remaining service period of the active employee group covered by the plans, only to the extent that the unrecognized net actuarial gains and losses are in excess of 10% of the greater of the accrued benefit obligation and the market-related value of plan assets.

Deferred Reforestation

Canfor accrues an estimate, in current dollars, of its future liability to perform forestry activities, defined to mean those silviculture treatments or activities that are carried out to ensure the establishment of a free-growing stand of young trees, including logging road rehabilitation. An estimate is recorded based on the number of hectares of timber harvested in the period. The actual costs that will be incurred in the future may vary, based on, among other things, the actual costs at the time. As discussed below, the CICA has introduced new recommendations relating to Asset Retirement Obligations, which will result in a change in the way Canfor accounts for its deferred reforestation liability.

Future Income Taxes

In according with CICA recommendations, Canfor recognizes future income tax assets when it is more likely than not that the future income tax assets will be realized. This assumption is based on Management's best estimate of future circumstances and events. If these estimates and assumptions are changed in the future, the value of the future income tax assets could be reduced or increased, resulting in an income tax expense or recovery. Canfor reevaluates its future income tax assets on a regular basis.

Anti-dumping Duty Expense

As discussed in the Wood Products segment, Canfor expenses anti-dumping duties at an estimated rate, while cash payments are made at the assessed rate of 5.96%. The actual rate applicable to Canfor's product shipment profile will be reassessed by the US Department of Commerce (DOC) during their administrative review process. Canfor regularly reviews its estimate of the effective rate by applying the DOC's calculation methodology to updated sales and cost data. The difference between the estimated rate and the assessed rate is recorded as an offset to the anti-dumping duty expensed at the assessed rate and a long-term receivable on the balance sheet. A comprehensive discussion of the softwood lumber duty situation follows in the Risks and Uncertainties section.

Changes in Accounting Policies

Foreign Currency Translation and Accounting Guideline for Hedging Relationships

Effective January 1, 2002, the CICA amended its recommendations related to foreign currency translation to eliminate the deferral and amortization method of accounting for unrealized translation gains and losses on long-term monetary assets and liabilities. As permitted by the revised policy, Canfor continued to hedge its US dollar long-term debt with its US dollar revenue streams, and, therefore, no change in accounting for the unrealized translation loss on long-term debt was required. In accordance with the hedging recommendations, Canfor officially designates, documents and tests the effectiveness of its hedging relationships for the purpose of applying hedge accounting. While not a "change in accounting policy", on January 1, 2003, Canfor terminated the designation of the hedging relationship between its long-term debt and revenue streams. As a result, exchange gains and losses on long-term debt after January 1, 2003 have been recognized in income in the current year.

Exchange losses deferred prior to Canfor's termination of this hedging relationship will be recognized into income in the same periods as the corresponding debt repayments, in accordance with the CICA's recommendations.

Disposal of Long-lived Assets and Discontinued Operations
In December 2002, the CICA issued new guidance related to the disposal of long-lived assets and presentation of discontinued operations. The recommendations were applicable to disposal activities initiated on or after May 1, 2003. Canfor has applied these recommendations in the current year to the disposition of its BC Chemicals division.

Stock-Based Compensation
In October 2003, the CICA amended its recommendations relating to stock-based compensation, which will require that, effective in 2004, all stock-based compensation be expensed when granted, using a fair value based method of accounting. Canfor has elected to adopt the new recommendations on a prospective basis, effective January 1, 2003, for all stock-based compensation granted after January 1, 2003. As no stock options were granted in 2003, there was no financial statement impact in the current year. As required by the standard, Canfor has continued to provide disclosure of the pro forma income and earnings impact of stock options granted between January 1, 2002, the date of initial adoption of the standard, and December 31, 2002.

New Accounting Policies Affecting Future Periods

Asset Retirement Obligations
The CICA has issued new recommendations, effective January 1, 2004, to require that asset retirement obligations be measured initially at fair value, with subsequent changes in fair value recognized in income. This revised policy will impact Canfor's deferred reforestation liability (discussed above), which is not presently measured at fair value. Upon initial application of the recommendations, Canfor anticipates recording a credit to opening retained earnings. However, the impact on subsequent periods is not expected to be materially different from the present method of accounting.

Impairment of Long-lived Assets
The CICA has issued new recommendations, effective January 1, 2004, related to the recognition, measurement and disclosure of impairment of long-lived assets. An asset is tested for recoverability whenever events or changes in circumstances indicate that its carrying value may not be recoverable. An impairment loss is recognized when the carrying value is not recoverable and exceeds its fair value. Canfor regularly reviews its long-lived assets for impairment and does not anticipate a material impact upon initial adoption of these recommendations.

Liabilities and Equity
The CICA has issued amendments to the existing Financial Instruments standard that will require obligations that can be settled, at the issuer's option, with a variable number of the issuer's own equity instruments, to be presented as liabilities. Canfor's convertible subordinated debentures are currently being presented as equity in accordance with existing CICA recommendations. As required by the revised standard, the convertible debentures will be reclassified as liabilities effective January 1, 2005. This change will reduce the amount of indebtedness that Canfor can incur under its long-term borrowing agreements by $310 million.

Risks and Uncertainties

Most companies in the forest industry in North America, including Canfor, face similar business risks and uncertainties. In addition to the specific issues discussed above under each reporting segment, risks and uncertainties fall into the general business areas of markets, international commodity prices, currency exchange rates, environmental issues, forest land base, government regulations and policy reform and, for Canadian companies, trade barriers and Aboriginal land claims.

In order to address these risks and effectively manage them, Canfor's senior management has developed a vision for risk management and its interrelationship with Canfor's strategic plan. The Director, Risk Management, who reports to the Chief Financial Officer, and gives regular updates to the Audit Committee, works with corporate and operational management to identify, measure and prioritize the critical risks facing the Company, and to manage these risks by ensuring that they are adequately addressed through control and mitigating procedures and other management actions. The objectives of the risk management function include developing a common framework for understanding what constitute principal business risks, ensuring that risk management activities are aligned with business strategies and planning activities, and providing effective governance in the area of risk management policies and programs. Additionally, Canfor's internal audit function contributes to this governance process by monitoring risk exposure, reviewing the risk management process, validating controls and other mitigating procedures, and giving assurance to senior management and the Audit Committee on Management's assertions of residual risk exposure.

The future impact of the various uncertainties and potential risks described in the following paragraphs cannot be quantified or predicted. However, Canfor does not foresee unmanageable adverse effects on its business operations from, and believes that it is well positioned to deal with, such matters as may arise.

Aboriginal Issues

In 1997, the Supreme Court of Canada, in the Delgamuukw decision, confirmed the continued existence of Aboriginal title and rights in areas of British Columbia which are not covered by treaties. Accordingly, Aboriginal groups have claimed Aboriginal title and rights over substantial portions of British Columbia, including areas where Canfor's forest tenures are situated, creating uncertainty as to the status of competing property rights. The Federal and Provincial governments have been seeking to negotiate settlements with Aboriginal groups throughout British Columbia in order to resolve these land claims.

In August 2002, the British Columbia Court of Appeal extended to a publicly traded forest company the Crown's duty to consult with an Aboriginal group in the context of a renewal of a tree farm licence. In a subsequent case, the British Columbia Supreme Court found that the Crown must also consult Aboriginal groups prior to approving a change in the control of a company which holds a forest licence. The duty to consult is triggered when the Crown is preparing to make a decision that may infringe Aboriginal and treaty rights. At this time, the existence and extent of any legal obligation of tenure holders to separately consult with, and make reasonable efforts to accommodate, Aboriginal groups remains unclear. However, Canfor will continue to consult with Aboriginal groups and address legitimate concerns to foster good relationships and minimize risks to its tenures and operational plans and will continue to participate with the Province in its consultations with Aboriginal groups.

The issues surrounding Aboriginal title and rights are not likely to be resolved in the near future. However, in 2003, the Government of British Columbia made fundamental changes to its regulation of the forest industry. One of the basic elements of the Government of British Columbia's changes included the reallocation of approximately 20% of available cut from replaceable long-term tenures, 8% of which will be awarded to Aboriginal groups. In total, Canfor will lose approximately 1.5 million cubic metres of available cut. As a result of these reallocations, a number of Aboriginal groups have entered into Accommodation Agreements with the Government of British Columbia pertaining to forestry development and many have expressed a desire to enter into these types of agreements. The purpose of these agreements is to provide a period of stability for forest resource development on Crown lands, while the longer-term interests of Aboriginal groups are addressed through other negotiations and processes. Over the next 12 months, we expect more of these agreements to be concluded. At this time it is too early to predict whether these agreements will provide the desired period of stability in the forest sector on Crown lands.

Canada/US Softwood Lumber Dispute

The Canada/US Softwood Lumber Agreement expired on March 31, 2001 without being renewed or replaced. On April 2, 2001, countervailing duty (CVD) and anti-dumping (ADD) petitions covering certain softwood lumber products from Canada were filed with the US Department of Commerce (DOC) and the US International Trade Commission (ITC) by certain US industry and trade groups.

On August 9, 2001, the DOC announced their belief that imports of softwood lumber from Canada are subsidized and imposed a preliminary CVD rate of 19.31% on sales from August 17, 2001 to December 15, 2001. At December 31, 2001, Canfor had accrued CVD of $40.9 million.

On October 31, 2001, the DOC announced their belief that Canfor had been dumping product into the US marketplace, which has caused injury or a threat of injury to the US industry. The company-specific ADD preliminary rate assigned to Canfor was 12.98% for products sold into the US market commencing November 6, 2001. At December 31, 2001, Canfor had accrued ADD of $6.5 million.

On May 16, 2002, the ITC published its final written determination on injury and stated that Canadian softwood lumber threatens material injury to the US industry. CVD at 18.79% was applied to all producers and ADD at 5.96% was applied specifically to Canfor. Cash deposits were required for shipments into the US, effective from the Final Order date of May 22, 2002. As a result of the ITC's ruling that Canadian lumber shipments only posed a threat of injury, in the second quarter of 2002 Canfor reversed all preliminary CVD and ADD duties accrued prior to May 22, 2002.

From May 22, 2002 to the end of 2003 Canfor has paid and expensed CVD at the assessed rate of 18.79%. In the case of the ADD, payments have been made at the assessed rate of 5.96% but, as discussed in the Wood Products segment, a lesser rate has been expensed based on Canfor's estimate of the rate that will be confirmed when an official administrative review is complete for the respective periods.

Canfor filed for an expedited review of its CVD rate on March 31, 2003 to obtain a company-specific rate rather than be assessed under the national rate of 18.79%. On November 17, 2003, the DOC issued Canfor with a preliminary specific CVD rate of 12.24% following the expedited review process. This deposit rate takes effect soon after the DOC issues its final results, which is expected to be on February 12, 2004. Canfor decided not to recognize the retroactive impact of the lower rate in 2003 results because of uncertainties as to whether the DOC would actually permit the use of company-specific rates for the administrative review process, which ultimately determines what rate is paid.

On August 13, 2003 a NAFTA panel ruled that the stumpage fee system conferred a financial benefit to Canadian

companies but also ruled that the US did not use an appropriate benchmark to determine the benefit to these companies. The panel ordered the DOC to issue a new determination by January 12, 2004. On September 5, 2003, a third NAFTA panel ruled that the ITC did not have sufficient evidence to support a finding of threat of injury to the US softwood lumber industry and returned the case to the ITC to reevaluate the evidence and issue a new determination by December 6, 2003. The ITC responded in December essentially reaffirming their previous position without adding any significant new analysis. If the NAFTA panel does not agree with the determination that there is a threat of injury, then the issue could be returned to the ITC for additional review. Ultimately, if the ITC cannot convince the NAFTA panel, then it will have no choice but to revoke the CVD and ADD orders. The NAFTA panel's decision on this is expected on March 15, 2004.

On January 13, 2004, as a result of the NAFTA panel ruling in September 2003 rejecting cross-border price comparisons, the DOC announced that the national CVD rate would be reduced from 18.79% to 13.23%. The new rate is now based on a benchmark that uses Canadian log prices. This preliminary rate is subject to approval by the NAFTA panel, which has 90 days to consider the change and could accept it or send it back to the DOC to address specific concerns. The coalition may also appeal to NAFTA for modifications. In the meantime, the Canadian industry will continue to pay cash deposits at the 18.79% rate until the DOC declares that the revised rate is final. Once the rate is declared final, Canfor would make the accounting entry to recognize the full retroactive adjustment and reverse previously expensed duties of $49 million for the period from May 2002 to December 2003. Actual cash refunds of the difference, with interest, will be received following the completion of an administrative review and a final rate determination.

Canfor continues to seek an administrative review to establish a company-specific CVD rate. Currently, the DOC has not committed to this legal requirement, preferring to maintain a national aggregate rate. The new benchmarks used by the DOC in arriving at the 13.23% countrywide CVD rate would also be used to derive Canfor's specific rate. Once the impact of Canfor's species and provincial mix is factored into the calculation, Canfor estimates that its specific rate will be lower than the countrywide average. As mentioned above, for company-specific rate changes, the deposit rate takes effect as soon as approved. However, for the amounts already paid there is no immediate retroactive refund until the administrative reviews have been performed to determine the actual applicable rate.

On January 19, 2004 the World Trade Organization (WTO) issued a ruling stating that the use of cross-border pricing was permissible as the benchmark for comparison with Canadian log prices, apparently contradicting the September NAFTA ruling. However, the WTO report says the use of cross-border prices is limited to certain situations, provided adjustments are made to reflect Canadian market conditions. Ultimately the NAFTA ruling takes precedence over the WTO ruling and the DOC has already changed its benchmarks and issued the preliminary result, but this is another ruling that serves to cloud an issue that is becoming increasingly complex.

The final amount and effective date of CVD and ADD that may be assessed on Canadian softwood lumber exports to the US cannot be determined at this time and will depend on appeals of the final determinations to any reviewing courts, NAFTA or WTO panels.

The Company and other Canadian forest product companies, the Federal Government and Canadian provincial governments (Canadian Interests) categorically deny the US allegations and strongly disagree with the final countervailing and dumping determinations made by the ITC and DOC. Canadian Interests continue to aggressively defend the Canadian industry in this US trade dispute. Canadian Interests may appeal the decision of these administrative agencies to the appropriate courts, NAFTA panels and the WTO. Notwithstanding the final rates established in the investigations, the final liability for the assessment of CVD and ADD will not be determined until each annual administrative review process is complete, or another settlement of the dispute is achieved.

Environmental Certification

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

Canfor retains an International Organization for Standardization (ISO) 14001 certification of its environmental management system for all forest operations, first obtained in 1999 and re-certified in 2002 for another 3-year term. In addition, Canfor retains certification under the Canadian Standards Association (CSA) standard for sustainable forest management (Sustainable Forest Management System Standard CAN/CSA Z809-96) for its Forest Management Agreement (FMA) area at Grande Prairie, Alberta and for its Tree Farm Licences (TFL) at its Chetwynd, Englewood, and Prince George, British Columbia operations. Canfor re-certified the Grande Prairie FMA and the Chetwynd and Englewood TFLs to the CSA standard in 2002 and re-certified the Prince George TFL in 2003, each for another 3-year term. Canfor also maintains certification of its forest operations in the Prince George and Quesnel timber supply areas to the Sustainable Forestry Initiative® (SFI) standard. The SFI program was created by the American Forest & Paper Association.

In 2003, Canfor received certification of its Fort St John and Houston forest operations to the CSA Sustainable Forest Management Standard CAN/CSA Z809-02. With the addition of these latest certifications, Canfor now has 91% of its annual harvest volume certified to sustainable forest management standards and is committed to having SFM certification in place for all of its tenures.

Environmental Issues

The Species at Risk Act (SARA) was proclaimed by the Government of Canada in June 2003. The purpose of SARA is to prevent wildlife species present in Canada for at least 50 years from becoming extirpated or becoming extinct, to provide for the recovery of wildlife species that are extirpated, endangered or threatened as a result of human activity, and encourage the management of other species to prevent them from becoming at risk. SARA is coming into force in phases. Two thirds of SARA came into force in June 2003 and the remaining sections are expected to come into force June 1, 2004. These remaining sections pertain to the protection of critical habitat, and compliance and enforcement of SARA. The economic implications of SARA are potential reductions in timber harvests and increases in harvesting costs, none of which can be predicted at this time.

In December 2002 the Government of Canada ratified the Kyoto Agreement. The Climate Change Plan for Canada, which sets out Canada's Kyoto implementation strategy, indicates that federal and provincial energy and environment ministers have endorsed the principle that companies that take early action should not be disadvantaged by an output based emissions regime. Canfor was an early signatory to the Voluntary Climate Registry, a federal program introduced in 1994 to encourage companies to inventory and track their greenhouse gas emissions (GHGs) and take actions to stabilize and reduce those emissions. As of 2002, Canfor has reduced GHGs by 8% from 1990 levels, compared with the Canada Kyoto reduction commitment of 6%. In November 2003, the Forest Products Association of Canada (FPAC), on behalf of Canfor and other forest product companies, signed a "Memorandum of Understanding Respecting Action on Climate Change" (MOU) with the Federal Government. The MOU establishes a framework for upcoming negotiations of a Pulp and Paper Sector covenant with the Federal Government. The MOU specifies that, "the Government of Canada will work with FPAC Parties and other industries to design a system that will not disadvantage those firms that have taken early action to reduce greenhouse gas emissions." The outcome of the covenant negotiations will determine what further GHG reductions may be required.

Canada-wide standards have been established by the Government of Canada for respirable particulate (PM 2.5) and ozone levels in the ambient air. The standard will be effective in 2010 following additional technical, scientific and economic analysis required to be completed by the end of 2005. The PM 2.5 standard could require future source reductions of particulate emissions from Canfor's pulp, paper and sawmill facilities, the cost of which cannot yet be determined.

Canfor has three remaining Tier 1 burners in British Columbia, which are regulated by the Ministry of Water, Land and Air Protection for phase out in mid-2005. One of the three burners, along with up to two other non Tier 1 Canfor burners, will be shut down in the first quarter of 2005 with planned completion of the Prince George Pulp Green Power Generation Project, as discussed in the Pulp and Paper segment. Canfor is diligently seeking economically viable solutions for the two remaining Tier 1 burners including a wood residue-fueled cogeneration facility for one, and off-site transport to third parties for utilization for the other.

Financial Market Risk

Demand for forest products, both pulp and paper and wood products, is closely related to global business conditions and tends to be cyclical in nature. Product prices can be subject to volatile change. Canfor, like the majority of the Canadian forest products industry, competes in a global market and the majority of its products are sold in US dollars. Consequently, foreign currency relationships pose a significant uncertainty. Shifts in these relationships can have a major impact, positive or negative, on profits from operations. The strengthening of the Canadian dollar relative to the US dollar in the last year has had a major negative impact on sales and profits from operations. However, by maintaining a substantial proportion of its debt in US dollars, Canfor has partially mitigated the impact of currency fluctuations.

Financial Instruments

Canfor, from time to time, uses derivative markets to hedge future movements of exchange rates or commodity prices. During 2003, forward contracts totaling US $160 million were exercised and an after-tax gain of $24.6 million was realized (nil in 2002). At the end of 2003, Canfor had forward contracts totaling US $26 million outstanding, at an average rate of 1.4342, which will be exercised at various dates through to October 2004. These contracts have been designated as a hedge against future US dollar revenues, and, therefore, the gain realized when the contracts are exercised will be recognized into income when the related hedged revenue is recorded. There was an unrealized gain of $3.6 million on these contracts at December 31, 2003.

Canfor also uses financial instruments to reduce its exposure to price risk associated with energy costs. Commodity swaps hedging future natural gas purchases of 1.8 million Gigajoules, at an average price of $6.29 per Gigajoule, were outstanding at December 31, 2003. There was an unrealized loss of $0.7 million on these swaps at December 31, 2003, but given the volatility of energy prices, the unrealized loss had reversed by the first week of January 2004. Any gains or losses on natural gas swaps are recognized as an adjustment to manufacturing costs when the contracts are settled.

Since Canfor's long-term debt is primarily fixed in rate, there is no significant impact to net income when interest rates change.

Sensitivities The sensitivity of Canfor's results to currency swings and prices for its principal products, when operating at full capacity, is estimated to be approximately as follows:

(millions of dollars)	Impact on after-tax earnings
Lumber - US $10 change per Mfbm	$ 24.3
Pulp - US $10 change per tonne	9.6
Specialty Kraft Paper - US $10 change per tonne	1.5
Canadian dollar - US $0.01 change per Canadian dollar	13.5

Labour Agreements

In December 2002, Canfor negotiated an early renewal of the labour agreement with the PPWC (Pulp, Paper and Woodworkers of Canada) Local 9, covering all hourly workers, except for the paper machine crew, at the Prince George Pulp and Paper Mill. The renewed contract provides for wage increases totaling 11% over a five-year term, expiring April 30, 2008.

Several labour agreements expired in 2003. Labour agreements with the CEP (Communications, Energy and Paperworkers Union) for the Northwood Pulp Mill and the paper machine crew at the Prince George Pulp and Paper Mill expired in April 2003. Negotiations were concluded and the agreement was ratified with the CEP. The new contract provides for wage increases totaling 11% over a five-year term, expiring April 30, 2008. The labour agreement with the IWA (Industrial, Wood and Allied Workers of Canada) covering all of their BC certified solid wood operations expired in June 2003. Negotiations were successfully concluded in October with the IWA for the agreement covering most of the BC Interior solid wood operations, and the Union is currently conducting ratification votes at each operation. The agreement provides for wage increases totaling 11% over a six-year term, expiring June 30, 2009.

Negotiations between Forest Industrial Relations (FIR), which represents most Coastal forest industry employers, including Canfor's Englewood Logging division, and the IWA broke down in November, resulting in a strike in the Coastal sector beginning November 21, 2003. On December 14, the Government of British Columbia introduced back-to-work legislation under the terms of the collective agreement that expired in June 2003. The IWA and FIR have agreed to the appointment of a mediation-arbitration commissioner who will finalize a new agreement by May 31, 2004.

Other collective agreements expiring in 2003 were the CEP agreement covering the Taylor operation (which is scheduled to permanently close in the second quarter of 2004) and the PPWC agreement representing the plywood production and maintenance employees at Canfor's plywood operation. Negotiations for a plant closure agreement have been successfully concluded with the CEP for the Taylor operation. Negotiations for the renewal of the PPWC agreement are currently underway.

The IWA contract with the Hines Creek operation and the CEP contract with the Grande Prairie operation (both in Alberta) expire at the end February 2004.

NAFTA Lawsuit

On July 11, 2002, Canfor filed a Notice of Arbitration and Statement of Claim against the Government of the United States for damages under the North American Free Trade Agreement (NAFTA) as a result of the US Department of Commerce's (DOC) preliminary and final determinations in the countervailing and anti-dumping proceedings. Canfor has asserted that the actions of the US Government have amounted to breaches of certain provisions of NAFTA, including the failure to provide Canfor with fair and equitable treatment in accordance with international law.

The Statement of Claim seeks damages for not less than US $250 million resulting from the actions of the US Government in issuing the preliminary and final countervailing duty (CVD) and anti-dumping duty (ADD) against Canfor. Canfor believes that the DOC has been arbitrary, discriminatory and capricious in making the preliminary and final CVD and ADD determinations.

Canfor and the US Government have selected a three-member panel, which will hear the dispute. A procedural hearing was held on October 28, 2003, in which several technical aspects of the proceeding were discussed. Written submissions on a number of the matters raised have been made by Canfor and the United States. In January 2004, the Panel ruled on a number of preliminary matters, including setting Washington DC as the legal jurisdiction of the hearing, requiring the US to file a Statement of Defence, and requiring a jurisdictional hearing be held. It is expected that the hearing will commence in the fall of 2004.

Provincial Forest Policy Reform

On March 26, 2003, the Government of British Columbia (the Crown) announced the implementation of its long-awaited forest policy reforms. The Forestry Revitalization Plan (the Plan) provides for significant changes to Crown forest policy and to the existing allocation of Crown timber tenures to licensees. The main components of the Plan are: a 20% take-back of forest tenures from the major forest licensees, which will eventually make up to 45% of the province's total harvest available through the open market; the establishment of a new timber pricing system; and the elimination of constraints such as minimum cut controls, penalties for mill closures, consent requirements for tenure transfers or changes of control, limitations

on consolidation and subdivision of forest tenures and appurtenancy (which require that timber cut from specific forest licences be processed in specific mills).

In principle, Canfor believes these changes will create a more market-based approach to regulation. Management believes that the introduction of a market-based pricing system will end the current stumpage distortions and put Canfor on a more equal footing with other lumber companies operating in the Interior of British Columbia. The new policies may also help strengthen the province's position in future negotiations on the Canada/US softwood lumber dispute.

On January 16, 2004 the Government of British Columbia announced the launch of market-based timber pricing for the Coastal forest sector, effective February 29, 2004. The identification of land parcels for auction is expected to be completed in the summer. The implementation schedule for market-based timber pricing in the Interior is still uncertain and it may be several more months before it has been put in place.

The Plan provides that each tenure holder subjected to allowable annual cut (AAC) reductions is entitled to compensation. The basis for determining the value of the AAC reductions is to be established by regulation. The total amount to be paid in compensation to long-term tenure holders is unclear. An amount of $200 million was set aside in the 2002-2003 Government of British Columbia fiscal year for such compensation. The Plan contemplates a timeframe of up to three years to implement the AAC reductions, creating the possibility of further compensation in years to come. The Plan prevents court challenges to awards of compensation arising from reductions in AAC, but does allow access to arbitration. Over the longer-term, the AAC reduction and subsequent reallocation to Aboriginal groups may help to reduce the tensions around Aboriginal rights and title that exist today.

Given that numerous aspects of the application of the Government of British Columbia's changes to the management of the forest industry in British Columbia have yet to be finalized, including compensation for the take-back, the application of AAC reductions to particular tenures and the details of the new timber pricing system, the overall effect of these changes on Canfor's operations cannot be determined at this time. Canfor believes that any reductions in AAC can be made up through market purchases and that production capacity will not be impacted.

Outstanding Share Data

At February 5, 2004, there were 81,318,366 common shares issued and outstanding.

Additional information about the Company, including its 2003 Annual Information Form, is available at www.sedar.com or at www.canfor.com.

Definitions of Selected Financial Terms

Book Value per Share is the shareholders' equity, including the equity component of the convertible subordinated debentures, at the end of the year, divided by the number of common shares outstanding at the end of the year plus the number of common shares exchangeable for the convertible subordinated debentures.

Capital Employed consists of the funds invested or retained in Canfor in the form of shares or liabilities. It is composed of unpresented cheques, current bank loans (net of cash and temporary investments), current portion of long-term debt, long-term debt, future income taxes arising from timing differences and shareholders' equity. Long-term liabilities and other accruals such as deferred reforestation costs, unfunded pension and post employment benefits, countervailing and anti-dumping duty provisions and unrealized foreign exchange losses on long-term debt are specifically excluded because they do not represent borrowed funds or funds invested by shareholders.

Earnings Before Interest, Taxes and Amortization (EBITDA) represents operating income plus amortization.

Net Debt is total debt less cash and temporary investments.

Net Income per Common Share is calculated as described in Note 19 to the Consolidated Financial Statements.

Return on Assets is equal to net income plus interest, after tax, divided by the average of the total assets at the beginning and end of the year.

Return on Capital Employed is equal to net income plus interest, after tax, divided by the average of the capital employed during of the year.

Return on Common Shareholders' Equity is equal to net income for the year, divided by the average of total shareholders' equity at the beginning and end of the year.

Management's Responsibility

The information and representations in this Annual Report are the responsibility of Management and have been approved by the Board of Directors. The consolidated financial statements were prepared by Management in accordance with accounting principles generally accepted in Canada and, where necessary, reflect Management's best estimates and judgments at this time. It is reasonably possible that circumstances may arise which cause actual results to differ. Management does not believe it is likely that any differences will be material. The financial information presented throughout this report is consistent with that contained in the consolidated financial statements.

Canfor maintains systems of internal accounting controls, policies and procedures to provide reasonable assurances as to the reliability of the financial records and the safeguarding of its assets. The Internal Audit Department performs independent reviews of the accounting records and related procedures. The Internal Audit Department reports its findings and recommendations both to Management and the Audit Committee.

The Board of Directors is responsible for ensuring that Management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements and Management's Discussion and Analysis. The Board carries out these activities primarily through its Audit Committee.

The Audit Committee is comprised of 4 Directors who are not employees of the company. The Committee meets periodically throughout the year with Management, external auditors and internal auditors to review their respective responsibilities, results of the reviews of internal accounting controls, policies and procedures and financial reporting matters. The external and internal auditors meet separately with the Audit Committee.

The consolidated financial statements and Management's Discussion and Analysis have been reviewed by the Audit Committee, which recommended their approval by the Board of Directors. The consolidated financial statements have been audited by PricewaterhouseCoopers LLP, the external auditors, whose report follows.

February 5, 2004

David L. Emerson
President and
Chief Executive Officer

Charles W. Reid
Group Vice-President,
Finance and Chief Financial Officer

Auditors' Report

To the Shareholders of Canfor Corporation

We have audited the consolidated balance sheets of Canfor Corporation as at December 31, 2003 and December 31, 2002, and the consolidated statements of income and retained earnings and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and December 31, 2002, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles. As required by the British Columbia Company Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

PricewaterhouseCoopers LLP

February 5, 2004
Chartered Accountants
Vancouver, B.C.

Consolidated Statements of Income and Retained Earnings

Year ended December 31 (millions of dollars)	2003	2002
Gross sales	**$ 2,662.6**	$ 2,652.8
Freight and other distribution costs	**420.5**	432.9
Countervailing and anti-dumping duties (Note 15)	**146.6**	107.6
Net sales	**2,095.5**	2,112.3
Costs and expenses		
Manufacturing and product costs	**1,932.7**	1,909.6
Amortization	**109.8**	110.4
Selling and administration	**55.8**	65.0
	2,098.3	2,085.0
Reversal of preliminary duties accrued in prior year (Note 15)	**-**	45.8
Termination benefits and mill closure costs (Note 16)	**-**	(33.1)
Operating income (loss) from continuing operations	**(2.8)**	40.0
Equity income (loss) of affiliated companies (Note 5)	**(0.4)**	5.0
Interest expense (Note 17)	**(50.5)**	(59.2)
Foreign exchange gain on long-term debt	**110.9**	-
Other income	**24.9**	9.0
Income (loss) from continuing operations before income taxes	**82.1**	(5.2)
Income tax recovery (Note 18)	**3.7**	7.1
Income from continuing operations	**85.8**	1.9
Income from discontinued operation net of income taxes (Note 3)	**67.5**	9.6
Net income	**$ 153.3**	$ 11.5
Per common share (in dollars) (Note 19)		
Income (loss) from continuing operations		
Basic	**$ 0.98**	$ (0.05)
Diluted	**$ 0.92**	$ (0.05)
Net income		
Basic	**$ 1.81**	$ 0.07
Diluted	**$ 1.65**	$ 0.07
Retained earnings, beginning of year	**$ 136.7**	$ 151.9
Net income for the year	**153.3**	11.5
Common share dividends	**(10.6)**	(21.1)
Interest on equity component of convertible subordinated debentures, net of income taxes (Note 10)	**(6.0)**	(5.6)
Retained earnings, end of year	**$ 273.4**	$ 136.7

Year ended December 31 (millions of dollars)	2003	2002
Cash generated from (used in)		
Operating activities		
Income from continuing operations	$ 85.8	$ 1.9
Items not affecting cash:		
Amortization	109.8	110.4
Reversal of accrued duties (Note 15)	(25.8)	(46.9)
Long-term portion of deferred reforestation	(2.7)	-
Unrealized foreign exchange gain on long-term debt	(112.4)	-
Gain on disposal of assets	(23.8)	(11.7)
Income taxes	(8.3)	(13.0)
Other	6.1	16.3
	28.7	57.0
Changes in non-cash working capital (Note 20)	(30.0)	67.2
	(1.3)	124.2
Financing activities		
Proceeds from long-term debt	4.8	-
Repayment of long-term debt	(57.7)	(49.9)
Dividends paid to common shareholders	(10.6)	(21.1)
Interest on convertible subordinated debentures, net of income taxes	(6.0)	(5.5)
Other	0.5	0.2
	(69.0)	(76.3)
Investing activities		
Business acquisition (Note 3)	(30.6)	-
Purchase of property, plant, equipment and timber	(123.5)	(67.4)
Proceeds from sale of property, plant and equipment	28.3	21.7
Mortgage receivable on sale of property (Note 5)	(5.8)	(15.7)
Howe Sound Pulp and Paper Limited Partnership (Note 23)	-	(5.0)
Other	0.4	(3.6)
	(131.2)	(70.0)
Decrease in net cash from continuing operations	(201.5)	(22.1)
Cash generated from discontinued operation (Note 3)	121.2	14.8
Decrease in net cash	(80.3)	(7.3)
Net cash at beginning of year	22.9	30.2
Net cash (short-term indebtedness) at end of year	$ (57.4)	$ 22.9
Net cash (short-term indebtedness) comprises		
Cash	$ 24.7	$ 18.4
Temporary investments	-	4.5
Operating bank loans	(82.1)	-
	$ (57.4)	$ 22.9

Interest paid in 2003 was $59.2 million (2002 – $63.5 million) and income taxes paid were $5.6 million (2002 – $2.1 million).

Consolidated Balance Sheets

As at December 31 (millions of dollars)	2003	2002
Assets		
Current assets		
Cash	$ 24.7	$ 18.4
Temporary investments	-	4.5
Accounts receivable		
Trade	173.2	147.1
Other	78.3	29.3
Income taxes recoverable	1.4	-
Future income taxes (Note 18)	21.9	25.4
Inventories (Note 4)	445.0	421.2
Prepaid expenses	24.1	20.6
Current assets of discontinued operation (Note 3)	-	3.3
Total current assets	768.6	669.8
Long-term investments and other (Note 5)	100.5	90.3
Property, plant, equipment and timber (Note 6)	1,443.5	1,394.7
Deferred charges (Note 7)	126.8	139.3
Non-current assets of discontinued operation (Note 3)	-	33.9
	$ 2,439.4	$ 2,328.0
Liabilities		
Current liabilities		
Operating bank loans (Note 8)	$ 82.1	$ -
Accounts payable and accrued liabilities	335.5	293.5
Current portion of long-term debt (Note 9)	57.2	51.4
Current portion of deferred reforestation	39.6	38.8
Income taxes payable	-	5.8
Current liabilities of discontinued operation (Note 3)	-	7.1
Total current liabilities	514.4	396.6
Long-term debt (Note 9)	478.0	643.4
Other accruals and provisions (Note 11)	88.6	83.9
Future income taxes, net (Note 18)	173.7	154.5
Deferred credit (Note 23)	95.7	95.7
Shareholders' Equity		
Share capital (Note 12)	659.2	658.3
Convertible subordinated debentures (Note 10)	155.0	155.0
Retained earnings	273.4	136.7
Foreign exchange translation adjustment	1.4	3.9
Total shareholders' equity	1,089.0	953.9
	$ 2,439.4	$ 2,328.0

Commitments and contingencies (Note 24)

APPROVED BY THE BOARD

Director, R.L. Cliff

Director, D.L. Emerson

(millions of dollars)	Wood Products	Pulp and Paper (note d)	Coastal Operations	Corporate and Other	Consolidated
Year ended December 31, 2003					
Gross sales to external customers (Note a)	**$ 1,689.7**	**853.4**	**119.5**	**-**	**$ 2,662.6**
Net sales to external customers	**$ 1,313.5**	**664.9**	**117.1**	**-**	**$ 2,095.5**
Net sales to other segments (Note b)	**$ 89.1**	**-**	**8.1**	**-**	**$ 97.2**
Operating income (loss)	**$ (4.7)**	**25.7**	**1.4**	**(25.2)**	**$ (2.8)**
Amortization	**$ 53.9**	**44.1**	**5.8**	**6.0**	**$ 109.8**
Capital expenditures	**$ 94.9**	**23.3**	**5.0**	**0.3**	**$ 123.5**
Identifiable assets (Note c)	**$ 1,119.8**	**828.7**	**65.5**	**425.4**	**$ 2,439.4**
Year ended December 31, 2002					
Gross sales to external customers (Note a)	$ 1,702.1	825.6	125.1	-	$ 2,652.8
Net sales to external customers	$ 1,348.1	641.6	122.6	-	$ 2,112.3
Net sales to other segments (Note b)	$ 88.0	-	16.9	-	$ 104.9
Operating income (loss)	$ 70.8	(2.4)	5.7	(34.1)	$ 40.0
Amortization	$ 49.9	45.6	7.9	7.0	$ 110.4
Capital expenditures	$ 35.4	21.7	6.4	3.9	$ 67.4
Identifiable assets (Note c)	$ 975.7	839.2	69.6	443.5	$ 2,328.0

Year ended December 31 (millions of dollars)	**2003**	2002
Net sales by location of customer		
Canada	**$ 431.2**	$ 421.0
United States	**1,143.2**	1,204.0
Europe	**215.3**	207.7
Far East and Other	**305.8**	279.6
	$ 2,095.5	$ 2,112.3

(a) No single customer accounted for 10% or more of the Company's total sales.
(b) Sales to other segments are accounted for at prices which approximate market value.
(c) Substantially all of the Company's property, plant, equipment and timber are located in Canada.
(d) Includes the former Pulp Products and Pulp and Specialty Kraft Paper segments, which have been realigned to form one decision-making unit. Excludes discontinued operation of BC Chemicals.

1. Significant Accounting Policies

Basis of Presentation of Financial Statements

These financial statements include the accounts of Canfor Corporation (the Company) and its subsidiary companies, hereinafter referred to as "Canfor". Equity investments are accounted for by recording the original investment at cost and subsequently adjusting for the Company's share of post acquisition earnings.

Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires Management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. It is reasonably possible that circumstances may arise which cause actual results to differ from Management estimates, however, Management does not believe it is likely that such differences will materially affect Canfor's financial position.

Significant areas requiring the use of Management estimates are deferred reforestation costs, inventory valuations, amortization rates, accrued anti-dumping duties and pension and other benefit plan assumptions.

Temporary Investments

Temporary investments are comprised of bankers acceptances, commercial paper and other short-term instruments and are valued at cost, which approximates fair value.

Valuation of Inventories

Inventories of wood products, pulp and kraft paper are valued at the lower of average cost and net realizable value. Logs and chips are valued at average cost or the greater of net realizable value and replacement cost if lower than average cost. Processing materials and supplies are valued at the lower of average cost and replacement cost.

Property, Plant, Equipment and Timber

Canfor capitalizes the costs of major replacements, extensions and improvements to plant and equipment, together with related interest incurred during the construction period on major projects.

Assets are amortized over the following estimated productive lives:

Buildings	10 to 50 years
Mobile equipment	3 to 20 years
Pulp and kraft paper machinery and equipment	20 years
Sawmill machinery and equipment	5 to 12 years
Logging machinery and equipment	4 to 20 years
Logging roads and bridges	5 to 20 years
Other machinery and equipment	3 to 20 years

Amortization of logging and manufacturing assets is calculated on a unit of production basis.

Amortization of plant and equipment not employed in logging and manufacturing is calculated on a straight-line basis.

Amortization of logging roads and timber is calculated on a basis related to the volume of timber harvested.

Deferred Charges

Software development costs relating to major systems are deferred and amortized over periods not longer than ten years.

Deferred Reforestation

Canfor accrues the undiscounted cost of the reforestation required under its timber harvest agreements at the time that the timber is harvested.

Employee Benefit Plans

Canfor has various defined benefit plans providing both pension and other retirement benefits to most of its salaried employees and certain hourly employees not covered by forest industry union plans. Canfor also provides certain health care benefits and pension bridging benefits to eligible retired employees.

Canfor accrues the costs and related obligations of the pension and other retirement benefit plans using the projected benefit actuarial method prorated on service and Management's best estimates of expected plan investment performance, salary escalation, and other relevant factors. The difference between costs of employee benefits charged against earnings and Canfor's contributions to the plans, which are made in accordance with actuarial recommendations and pension commission regulations, is included in prepaid pension benefits or post employment benefits on the balance sheet.

For hourly employees covered by forest industry union defined benefit pension plans, earnings are charged with Canfor's contributions required under the collective agreements.

Revenue Recognition

Canfor's revenues are derived from four major product lines: softwood lumber, pulp, kraft paper and raw logs. Revenue is also derived from other products, including chips, plywood, panels, refined fibre and fibremat, and from commissions on pulp, logs and chips. Revenue is recognized when the significant risks and rewards of ownership are transferred, which is generally at the time of shipment.

Foreign Currency Translation

Effective January 1, 2002, the Canadian Institute of Chartered Accountants amended its policy for foreign currency translation to eliminate the deferral and amortization method of accounting for unrealized translation gains and losses on long-term monetary assets and liabilities. As permitted by the revised policy, Canfor continued to hedge its US dollar long-term debt with its US dollar revenue streams, and, therefore, no change in accounting for the unrealized translation loss on long-term debt was required. However, on January 1, 2003, Canfor made the decision to terminate this hedging relationship, and, as a result, exchange gains and losses on long-term debt after January 1, 2003 have been recognized in income in the current year. Exchange losses deferred prior to Canfor's termination of this hedging relationship will be recognized into income in the same periods as the corresponding debt repayments (Note 7).

The majority of Canfor's sales and long-term debt are denominated in foreign currencies. Foreign currencies are translated into Canadian dollars using the temporal method as follows: monetary assets and liabilities at year-end exchange rates; non-monetary assets and liabilities at historical rates; and revenues and expenses at exchange rates prevailing at the time the transaction occurs. Exchange gains and losses are reflected in income immediately.

Canfor's foreign operations are considered to be self-sustaining and the assets and liabilities are translated using the current rate method. The translation gain or loss is included as a component of shareholders' equity.

Income Taxes

Canfor accounts for income taxes using the liability method. Under this method, future income tax assets and liabilities are determined based on the temporary differences between the accounting basis and the tax basis of assets and liabilities. These temporary differences are measured using the current tax rates and laws expected to apply when these differences reverse. Future tax benefits, such as capital loss carry-forwards, are recognized to the extent that realization of such benefits is considered more likely than not. The effect on future tax assets and liabilities of a change in income tax rates is recognized in earnings in the period that the substantive enactment date of the change occurs.

Derivative Financial Instruments

Canfor utilizes derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange and commodity price risk. For example, Canfor purchases foreign exchange forward contracts to hedge anticipated sales to customers in the United States and the related accounts receivable and also enters into swap transactions to reduce its exposure to fluctuating natural gas prices. Canfor's policy is not to utilize derivative financial instruments for trading or speculative purposes.

Canfor formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities or to specific firm commitments or forecasted transactions. Canfor also formally assesses, both at the inception of the hedge and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items.

Gains and losses on forward foreign exchange contracts used to hedge US dollar denominated sales are recognized as an adjustment to revenue at the time that the contracts are exercised. Gains and losses on natural gas swaps are recognized as an adjustment to manufacturing costs when the contracts are settled.

Stock-based Compensation Plans

Canfor has three stock-based compensation plans, as described in Note 13.

When stock options are granted to employees under the Stock Option Performance Plan, compensation expense is recorded based on a fair value method of accounting (Note 2). The fair value of the options is determined using an option pricing model that takes into account, as of the grant date, the exercise price, the expected life of the option, the current price of the underlying stock and its expected volatility, expected dividends on the stock, and the risk-free interest rate over the expected life of the option. The resulting fair value of the options is amortized over their vesting periods. Cash consideration received from employees when they exercise the options is credited to share capital.

Compensation expense is recognized for Canfor's contributions to the Employee Share Purchase Plan when they are made.

Compensation expense is recognized for Canfor's Deferred Share Unit Plan when the deferred share units are granted, and changes in market value of the underlying shares are reflected in earnings at the end of each period.

2. Change in Accounting Policy

Prior to January 1, 2003, as permitted by Canadian generally accepted accounting principles, Canfor had elected not to use the fair value based method of accounting for stock options because of its limited use of stock-based compensation. Pro forma net income and earnings per share disclosure was provided for stock options granted after January 1, 2002, the date of initial adoption of Section 3870 *Stock-based Compensation and Other Stock-based Payments.*

In October 2003, the Canadian Institute of Chartered Accountants amended its recommendations relating to Section 3870 to require that all stock-based compensation be expensed when granted, using a fair value based method of accounting. Canfor has elected to adopt the new recommendations on a prospective basis, effective January 1, 2003, for all stock-based compensation granted after January 1, 2003. No new stock options were granted in 2003.

3. Acquisitions and Divestitures

Acquisition of Daaquam Lumber Inc. and Produits Forestiers Anticosti Inc.

On May 27, 2003, Canfor acquired 100% of the shares of Daaquam Lumber Inc. and Produits Forestiers Anticosti Inc., two privately owned lumber manufacturing and timber harvesting companies based in Quebec. A cash payment of $30.6 million was paid on closing and another $10.0 million is payable in two installments, on the first and second anniversaries of the closing date. An additional payment may be made to the vendors if a specified earnings target is achieved in the three-year period following the closing date.

The allocation of the purchase price was based on the estimated fair values of the assets and liabilities acquired, as follows:

(millions of dollars)	
Non-cash working capital	**$ 22.0**
Property, plant and equipment	**40.6**
Net debt	**(14.3)**
Other long-term liabilities	**(0.2)**
Future income taxes	**(7.5)**
	$ 40.6

Sale of BC Chemicals

On August 29, 2003, Canfor completed the sale of its BC Chemicals division to a limited partnership owned by Chemtrade Logistics Income Fund for $117.3 million. Cash proceeds of $114.2 million were received, net of transaction costs. The results of BC Chemicals were formerly included in the Pulp and Paper segment and have now been classified as a discontinued operation.

The following table presents selected financial information for BC Chemicals up to the date of disposal:

(millions of dollars)	2003	2002
Net sales to external customers	**$ 9.2**	$ 16.7
Operating income before income taxes	**11.4**	15.1
Income tax expense	**(4.1)**	(5.5)
	7.3	9.6
Gain on disposal before income taxes	**79.6**	-
Income tax expense	**(19.4)**	-
	60.2	-
Net income	**$ 67.5**	$ 9.6
Net income per share (diluted)	**$ 0.73**	$ 0.12
Condensed cash flows:		
Cash flow from operating activities	**$ 7.0**	$ 20.2
Cash flow from investing activities	**114.2**	(5.4)
Cash generated by discontinued operation	**$ 121.2**	$ 14.8

Canfor has entered into long-term agreements with the purchaser to ensure a continued supply of chlorate to the pulp operations (minimum of $29 million per year for ten years) and for processing of the pulp mills' soap skimmings ($4.5 million per year). A ten-year agreement has also been signed to provide the purchaser with effluent treatment, steam and water supply.

4. Inventories

(millions of dollars)	2003	2002
Wood products, pulp and kraft paper	$ 239.0	$ 253.5
Logs and chips	138.0	101.3
Processing materials and supplies	68.0	66.4
	$ 445.0	$ 421.2

5. Long-term Investments and Other

(millions of dollars)	2003	2002
Investment in 317231 British Columbia Ltd. (1)		
Cost of common shares	$ 45.1	$ 45.1
Accumulated equity income	2.2	3.3
Other investments	13.8	15.2
Mortgage receivable from sale of property (2)	5.8	16.6
Anti-dumping duties receivable (Note 15)	26.9	1.1
Other deposits and loans	6.7	9.0
	$ 100.5	$ 90.3

(1) Through its investment in 317231 British Columbia Ltd., Canfor owns a one-third interest in Lakeland Mills Ltd. and The Pas Lumber Company Ltd., which own sawmills in the Prince George, British Columbia region (Note 24). The combined assets and liabilities of the two mills are $143.4 million (2002 – $138.3 million) and $84.3 million (2002 – $75.4 million), respectively.

(2) Proceeds from property sold in 2003 were partially secured with two vendor take-back second mortgages. The mortgages have 5-year terms, with monthly interest payments. The mortgage balance in 2002, also from the sale of property, is due on or before May 15, 2004 and is now included in Other Accounts Receivable.

6. Property, Plant, Equipment and Timber

	2003			2002		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Land	$ 16.8	$ -	$ 16.8	$ 12.7	$ -	$ 12.7
Pulp and kraft paper mills	1,157.0	545.6	611.4	1,134.6	500.9	633.7
Wood products mills	610.1	331.9	278.2	520.0	319.2	200.8
Logging building and equipment	58.2	45.7	12.5	65.4	54.0	11.4
Logging roads and bridges	256.6	187.6	69.0	245.7	174.5	71.2
Other equipment and facilities	54.4	28.6	25.8	57.1	27.9	29.2
Timber	481.4	51.6	429.8	481.7	46.0	435.7
	$ 2,634.5	$ 1,191.0	$ 1,443.5	$ 2,517.2	$ 1,122.5	$ 1,394.7

Included in the above are assets under construction in the amount of $20.5 million (2002 – $18.3 million), which are not being amortized.

7. Deferred Charges

(millions of dollars)	2003	2002
Prepaid pension benefits (Note 14)	$ 69.6	$ 70.6
Unrealized foreign exchange loss on long-term debt	44.6	52.9
Software development costs	11.6	14.3
Debt issue and other expenses	1.0	1.5
	$ 126.8	$ 139.3

Deferred charges expensed during the year amounted to $19.3 million (2002 – $16.6 million), including a foreign exchange loss of $8.3 million realized on the repayment of US dollar long-term debt (2002 – $6.9 million).

8. Bank Loans

Canfor had $96.1 million of unused bank operating lines of credit as of December 31, 2003 (2002 – $164.2 million). The amount of credit available under these lines of credit was $200.0 million, of which $55.0 million in bankers' acceptances and $27.1 million of prime rate based borrowings were issued and $21.8 million was utilized for several standby letters of credit that were outstanding at December 31, 2003.

9. Long-term Debt

Summary of Long-term Debt

(millions of dollars)	2003	2002
Privately placed senior notes		
Nil (2002 – US $20 million), interest at 7.75%, repayable in 5 equal annual instalments commencing June 1, 1999	**$ -**	$ 31.4
US $12.5 million (2002 – US $25 million), interest at 7.73%, repayable in 4 equal annual instalments commencing June 28, 2001	**16.2**	39.2
US $125 million, interest at 8.24%, repayable in 4 equal annual instalments commencing September 1, 2004	**161.5**	196.1
US $50 million, interest at 6.82%, repayable in 5 equal semi-annual instalments commencing April 1, 2005	**64.6**	78.4
US $30 million, interest at 7.64%, repayable March 14, 2006	**38.8**	47.1
US $33 million, interest at 7.74%, repayable March 1, 2007	**42.6**	51.8
US $15 million, interest at 7.88%, repayable March 1, 2008	**19.4**	23.5
US $45 million, interest at 7.98%, repayable March 1, 2009	**58.2**	70.6
US $97 million, interest at 8.03%, repayable in 3 equal annual instalments commencing March 1, 2009	**125.4**	152.1
Canadian dollar revolving facilities, bearing interest at various fixed and floating rates with various maturity dates	**7.0**	-
Other long-term obligations	**1.5**	4.6
	535.2	694.8
Less current portion	**57.2**	51.4
	$ 478.0	$ 643.4

The agreements relative to the privately placed senior notes contain provisions limiting the amount of indebtedness that the Company and its designated subsidiaries can incur and the amount of dividends payable on its common shares. Under these agreements, the Company and its designated subsidiaries can presently incur $573.9 million in additional long-term debt (at December 31, 2002 – $216.0 million additional long-term debt could be incurred) and pay up to $164.3 million or $2.02 per share in dividends on its Common Shares (2002 – dividends up to $68.7 million or $0.85 per share could be paid).

Fair Value of Total Long-term Debt

The fair value of total long-term debt at December 31, 2003 was $579.0 million (2002 – $748.3 million).

Scheduled Long-term Debt Repayments

Long-term debt repayments for the next five years are as follows:

(millions of dollars)	
2004	$ 57.2
2005	69.3
2006	107.0
2007	97.6
2008	20.5

10. Convertible Subordinated Debentures

On November 23, 1999, the Company issued $155.0 million of unsecured convertible subordinated debentures as part of the purchase price payable by the Company for all the outstanding shares of Northwood Inc. The debentures bear interest at 6.25% per annum, payable semi-annually, and mature on November 23, 2006. The debentures are convertible, at the holder's option, into common shares of the Company at a conversion price of $13.20 per share. Upon a change of control of the Company, each holder may require the Company to purchase the holder's debentures at 100% of principal plus accrued and unpaid interest. The debentures are redeemable after November 23, 2002, at the option of the Company, at 100% of principal plus accrued and unpaid interest, provided that from the third year to the fifth year the debentures may only be redeemed if the weighted average closing price of the Company's common shares for the 20 consecutive trading days ending five days prior to the date on which notice of redemption is given exceeds 120% of the conversion price. The Company has the option to satisfy its obligation to pay any portion of the applicable principal and interest, or redemption or purchase price, by delivery of shares to the trustee and subsequent sale of such shares and delivery to the holders of cash equal to the principal and interest, or redemption or purchase price, of the debentures.

The convertible subordinated debentures are being accounted for in accordance with their substance and were initially presented in the financial statements in their component parts, measured at their respective fair values at the time of issue. By November 23, 2002, the equity component of the debentures had increased to the full face value by charges to retained earnings and a corresponding reduction in interest expense. In 2003, The Canadian Institute of Chartered Accountants amended the existing Financial Instruments accounting standard for obligations that can be settled, at the issuer's option, by a variable number of the issuer's own equity instruments. As a result of this amendment, which is effective for the 2005 fiscal year, Canfor's convertible subordinated debentures will be reclassified as liabilities as of January 1, 2005. This change will reduce the amount of indebtedness that Canfor can incur under its long-term borrowing agreements by $310 million.

In computing basic earnings per share, the charges to retained earnings are deducted from net earnings to arrive at net earnings attributable to common shareholders.

The fair value of the convertible subordinated debentures at December 31, 2003 was equal to carrying value (2002 – $150.5 million).

11. Other Accruals and Provisions

(millions of dollars)	2003	2002
Deferred reforestation	**$ 39.6**	$ 42.3
Post-employment benefits (Note 14)	**33.3**	26.1
Other long-term liabilities	**15.7**	15.5
	$ 88.6	$ 83.9

12. Share Capital

Authorized

10,000,000 preferred shares, with a par value of $25 each

1,000,000,000 common shares without par value

(millions of dollars)	2003	2002
Issued		
81,267,281 common shares (2002 – 81,156,010)	**$ 659.2**	$ 658.3

During 2003, The Company issued 111,271 common shares in connection with its stock option plans, as discussed in Note 13 (2002 – 67,163 common shares were issued).

13. Stock-based Compensation

The Company has three stock-based compensation plans, which are described below.

Stock Option Performance Plan

The Company has a stock option performance plan pursuant to which stock options are granted to selected officers and senior managers. The stock option performance plan provides for the issuance of up to a maximum of 5.8 million common shares at an exercise price equal to the market price of the Company's common shares on the date of grant. However, there are various criteria that limit the amount of options exercisable during each option year within the option period. A summary of the status of the plan as of December 31, 2003 and 2002, and changes during the years ending on those dates is presented below:

	2003		2002	
	Shares	**Weighted Average Exercise Price**	Shares	Weighted Average Exercise Price
Outstanding at the beginning of year	**5,536,187**	**$ 10.80**	4,886,850	$ 10.93
Granted	**-**	**-**	737,500	9.78
Exercised	**(111,271)**	**8.30**	(67,163)	8.58
Cancelled	**(3,757,600)**	**11.70**	(21,000)	12.30
Outstanding at the end of the year	**1,667,316**	**$ 8.94**	5,536,187	$ 10.80

The following table summarizes information about stock options outstanding at December 31, 2003:

	Options outstanding			Options exercisable	
Range of exercise prices	Options Outstanding	Weighted Average Remaining Life (years)	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
$7.30 to $7.57	97,000	0.71	$ 7.32	2,333	$ 7.57
$8.30 to $8.66	842,316	6.60	8.34	548,733	8.37
$9.25 to $11.80	728,000	8.07	9.84	244,834	9.87
	1,667,316		$ 8.94	795,900	$ 8.83

Employee Share Purchase Plan

Canfor has a share purchase plan, which is available to all employees. Purchases of common shares under this plan occur on the open market. Under the plan the employees can purchase up to 10% of their base salary or wage. Canfor matches 30% of the first 5% of the amount contributed by the employee and pays the share purchase plan brokerage fees. In 2003, contributions of $1.3 million were made towards the purchase of the Company's common shares under the terms of the plan (2002 – $1.2 million).

Deferred Share Unit Plan

On January 1, 2002, the Company implemented a Deferred Share Unit Plan for non-employee directors of the Company. A Deferred Share Unit (DSU) is a right granted to a non-employee director to receive one common share of the Company, purchased on the open market, or the cash equivalent, on a deferred payment basis. The maximum number of DSUs outstanding under the plan is 1,000,000, and currently each non-employee director is entitled to 2,500 DSUs per year. The value of the DSUs, when redeemed, is equal to the market value of the shares on the redemption date, including the value of dividends paid on the Company's common shares, if any, as if they had been reinvested in additional DSUs on each payment date. The DSUs may be only redeemed upon a director's retirement from the Company, its subsidiaries or any affiliated entity. The value of the outstanding DSUs at December 31, 2003 was $0.6 million (2002 – $0.2 million).

Pro-forma Disclosure

No new stock options were granted in 2003. During 2002, Canfor granted a total of 737,500 stock options to employees at exercise prices ranging from $7.57 to $10.10, which were the market prices on the dates the options were granted. One third of the options are exercisable after each of the first, second and third years and the options expire in 2012. The following pro forma disclosure presents the effect on net income and earnings per share had the fair value based method been applied on a graded vesting basis to options granted after January 1, 2002:

(millions of dollars, except per share amounts)	2003	2002
Net income		
As reported	**$ 153.3**	$ 11.5
Pro forma	**$ 152.6**	$ 10.2
Net income per common share		
As reported – basic	**$ 1.81**	$ 0.07
As reported – diluted	**$ 1.65**	$ 0.07
Pro forma – basic	**$ 1.81**	$ 0.06
Pro forma – diluted	**$ 1.64**	$ 0.06

The fair value of the stock options granted after January 1, 2002 was estimated on each grant date using a Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield of 2.6%; expected volatility of 44%; risk-free interest rate of 3.75%; and an expected life of 4 years. The weighted average fair value of each option was $3.10.

14. Employee Future Benefits

Information about Canfor's defined benefit plans, in aggregate, is as follows:

	2003		2002	
(millions of dollars)	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Plan assets, at fair market value				
Beginning of year	**$ 341.9**	**$ -**	$ 368.9	$ -
Actual gain/(loss) on plan assets	**31.3**	**-**	(11.0)	-
Canfor contributions	**6.6**	**2.3**	2.3	2.2
Employee contributions	**1.9**	**-**	1.2	-
Benefit payments	**(19.0)**	**(2.3)**	(19.5)	(2.2)
End of year*	**$ 362.7**	**$ -**	$ 341.9	$ -
Pension and other retirement benefit provisions				
Beginning of year	**$ 314.9**	**$ 75.2**	$ 318.1	$ 56.8
Interest cost	**22.5**	**6.3**	22.8	4.1
Current service cost – Canfor	**8.2**	**2.1**	10.2	1.3
Current service cost – employees	**1.9**	**-**	1.2	-
Benefit payments	**(19.0)**	**(2.3)**	(19.5)	(2.2)
Actuarial loss (gain)	**31.1**	**24.2**	(18.2)	15.2
Plan amendments	**-**	**-**	0.3	-
End of year	**$ 359.6**	**$ 105.5**	$ 314.9	$ 75.2
Plan surplus (deficit)	**$ 3.1**	**$ (105.5)**	$ 27.0	$ (75.2)
Surplus (deficit)				
Plan surplus (deficit)	**$ 3.1**	**$ (105.5)**	$ 27.0	$ (75.2)
Employer contributions after measurement date	**7.0**	**-**	5.2	-
Unamortized transitional amount	**(35.3)**	**23.7**	(39.1)	25.7
Unamortized past service costs	**4.6**	**-**	5.0	-
Unamortized net actuarial loss	**90.9**	**47.8**	70.5	25.4
	70.3	**(34.0)**	68.6	(24.1)
Post employment provision recognized in the Consolidated Balance Sheet (Note 11)	**0.7**	**(34.0)**	(2.0)	(24.1)
Prepaid pension benefits (Note 7)	**$ 69.6**	**$ -**	$ 70.6	$ -

*Canfor has adopted a measurement date of September 30th for accounting purposes. At December 31, 2003, the market value of the plan assets had increased by $14.4 million.

Included in the above pension and other retirement benefit provisions and fair value of plan assets at year-end are the following amounts in respect of plans that are not fully funded:

	2003		2002	
(millions of dollars)	**Pension Benefit Plans**	**Other Benefit Plans**	Pension Benefit Plans	Other Benefit Plans
Fair value of plan assets	**$ 77.0**	**$ -**	$ 54.0	$ -
Pension and other retirement benefit provisions	**(103.1)**	**(105.5)**	(76.9)	(75.2)
Plan deficit	**$ (26.1)**	**$ (105.5)**	$ (22.9)	$ (75.2)

Canfor's expense (income) for company-sponsored benefit plans is:

	2003		2002	
(millions of dollars)	**Pension Benefit Plans**	**Other Benefit Plans**	Pension Benefit Plans	Other Benefit Plans
Interest cost	**$ 22.5**	**$ 6.3**	$ 22.8	$ 4.1
Current service cost	**8.2**	**2.1**	10.2	1.3
Expected return on plan assets	**(24.2)**	**-**	(27.7)	-
Amortization of transitional amount	**(3.8)**	**2.0**	(3.7)	2.0
Other	**3.7**	**1.8**	1.6	0.3
Expense recognized in the current year	**$ 6.4**	**$ 12.2**	$ 3.2	$ 7.7

In addition to the above, Canfor's contributions to forest industry-union defined benefit pension plans amounted to $18.6 million in 2003 (2002 – $17.6 million).

Canfor also provides pension bridge benefits to certain eligible former employees. At December 31, 2003, the actuarially determined obligation for these benefits was $10.5 million (2002 – $9.7 million). The accrued benefit liability for these benefits, included in "other long-term liabilities" on the balance sheet at December 31, 2003, was $6.2 million (2002 – $5.5 million) and the related expense recognized in the current year was $1.4 million (2002 – $1.1 million).

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

	2003		2002	
(weighted-average assumption as of December 31)	**Pension Benefit Plans**	**Other Benefit Plans**	Pension Benefit Plans	Other Benefit Plans
Discount rate	**6.50%**	**6.50%**	7.25%	7.25%
Rate of compensation increase	**2% for 5 years 3% thereafter**	**n/a**	2% for 5 years 3% thereafter	n/a
Expected long-term rate of return on plan assets	**7.20%**	**n/a**	7.20%	n/a

For measurement purposes, an annual rate of increase in the per capita cost of covered health care benefits of 5.7% was assumed for 2003. The rate was assumed to decrease annually to 4.2% by 2010 and remain at that level thereafter.

15. Countervailing and Anti-dumping Duties

On April 2, 2001, petitions for the imposition of anti-dumping and countervailing duties on softwood lumber from Canada were filed with the US Department of Commerce (DOC) and the US International Trade Commission (ITC) by certain US industry and trade groups.

On May 16, 2002, the ITC made a final determination that softwood lumber shipments by Canadian producers posed a threat of injury to the US softwood lumber industry. As a result of this determination, countervailing duty at 18.79% (all producers) and anti-dumping duty at 5.96% (specific to Canfor) became applicable prospectively from the date of publishing of the final order. The ITC final order was published on May 22, 2002, with the result that entries into the US after that date required the posting of cash deposits. All preliminary countervailing and anti-dumping duties accrued prior to May 22, 2002 were reversed in the second quarter of 2002.

While the cash payments for the anti-dumping duty are being made at the assessed rate, the expense is being accrued at Canfor's best estimate of the rate applicable to its product shipment profile, as determined by applying the DOC's methodology. Canfor reassesses its estimate of the anti-dumping duty rate on a regular basis, by applying the DOC's methodology to updated sales and cost data as it becomes available. The rate applicable to the first period of review (POR), from May 22, 2002 to April 30, 2003, was adjusted to 2.51% during the fourth quarter, based on the final data submitted to the DOC during their review process. During the fourth quarter, the estimated rate for the second POR was recalculated at 3.21%. The cumulative difference between the assessed rate and the effective rate at December 31, 2003 is $26.9 million (2002 – $1.1 million), and is being carried as a receivable under "long-term investments and other" (Note 5).

In September 2003, a NAFTA Panel rejected the cross-border pricing methodology used by the DOC as the basis for establishing the CVD rate of 18.79%. On January 12, 2004, the DOC submitted its revised methodology to the Panel, using Canadian log prices as the basis for determining a new CVD rate of 13.23%. The NAFTA Panel has 90 days to consider the DOC report, which, if affirmed, will reduce the CVD cash deposit rate from 18.79% to 13.23% prospectively.

Canfor and other Canadian forest product companies, the Federal Government and Canadian provincial governments (Canadian Interests) categorically deny the US allegations and strongly disagree with the countervailing and dumping determinations made by the ITC and DOC. Canadian Interests continue to aggressively defend the Canadian industry in this US trade dispute and are appealing the decision of these administrative agencies to the appropriate courts, NAFTA panels and the WTO. Notwithstanding the rates established in the investigations and the posting of cash deposits, the final liability for the assessment of countervailing and anti-dumping duties will not be determined until the DOC's administrative review process is complete. The first administrative review, covering the period from May 22, 2002 to April 30, 2003, is currently underway. With the finalization of any appeals, completion of the first administrative review could extend beyond 2004.

16. Termination Benefits and Mill Closure Costs

In October 2002, Canfor announced plans to implement a cost reduction and margin improvement program with a target to achieve $150 million in annualized benefits by the end of 2003. The specific details of the plan were approved by Management in December 2002. As part of the program, a reduction to the employee base of approximately 300 people was announced and, consequently, $25.8 million of termination benefits were accrued at December 31, 2002. An additional provision of $7.3 million was accrued at December 31, 2002 for costs associated with the closure of the Upper Fraser Sawmill in the third quarter of 2003. The closure costs included asset write-downs, demolition costs, environmental clean-up costs and other post-closure costs. The actions identified under this initiative were substantially completed as of December 31, 2003.

17. Interest Expense

	2003			2002		
(millions of dollars)	**Long-term**	**Short-term**	**Total**	Long-term	Short-term	Total
Total interest cost	**$ 45.0**	**$ 7.9**	**$ 52.9**	$ 56.3	$ 4.8	$ 61.1
Less: Interest income	**0.6**	**1.2**	**1.8**	0.5	1.4	1.9
Interest capitalized	**-**	**0.6**	**0.6**	-	-	-
	$ 44.4	**$ 6.1**	**$ 50.5**	$ 55.8	$ 3.4	$ 59.2

18. Income Taxes

The tax effects of the significant components of temporary differences that give rise to future income tax assets and liabilities are as follows:

	2003		2002	
(millions of dollars)	Current	Long-term	Current	Long-term
Future income tax assets				
Capital loss carry forward	$ -	$ 2.9	$ -	$ 22.1
Accruals not currently deductible	21.5	16.5	24.9	21.2
Post employment benefits	-	14.0	-	11.6
Loss carry forward arising from restructuring of Howe Sound Pulp and Paper Limited (Note 23)	-	192.2	-	184.8
Other	0.4	4.6	0.5	6.0
	21.9	230.2	25.4	245.7
Future income tax liabilities				
Depreciable capital assets	-	(365.6)	-	(371.9)
Deferred pension costs	-	(24.7)	-	(26.0)
Other	-	(13.6)	-	(2.3)
	-	(403.9)	-	(400.2)
Future income taxes, net	$ 21.9	$ (173.7)	$ 25.4	$ (154.5)

The components of income tax recovery (expense) are as follows:

(millions of dollars)	2003	2002
Current	$ 9.5	$ (3.7)
Future	(5.5)	12.7
Affiliates	(0.3)	(1.9)
	$ 3.7	$ 7.1

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

(millions of dollars)	2003	2002
Net income (loss) before income taxes:	$ 82.1	$ (5.2)
Income tax recovery (expense) at statutory tax rate	$ (29.9)	$ 1.9
Large corporation tax	(4.7)	(5.2)
Permanent difference from capital gains and losses	29.9	-
Howe Sound Pulp and Paper Limited Partnership losses (Note 23)	8.1	8.0
Other permanent differences and tax adjustments	0.3	2.4
Income tax recovery	$ 3.7	$ 7.1

19. Earnings Per Share

Basic earnings per share are based on the weighted average number of common shares outstanding during the period. Diluted earnings per share are based on the weighted average number of common shares, convertible subordinated debentures and stock options outstanding at the beginning of or granted during the period.

(millions of dollars, except for number of shares and per share amounts)	2003	2002
Basic Earnings		
Income from continuing operations	**$ 85.8**	$ 1.9
Less interest on equity component of convertible subordinated debentures, net of income taxes	**(6.0)**	(5.6)
Income (loss) from continuing operations	**79.8**	(3.7)
Income from discontinued operation	**67.5**	9.6
Net income available to common shareholders	**147.3**	5.9
Diluted Earnings		
Add back interest on equity and liability components of convertible subordinated debentures	**6.0**	- (a)
Income (loss) from continuing operations	**85.8**	(3.7)
Income from discontinued operation	**67.5**	9.6
Net income available to common shareholders	**$ 153.3**	$ 5.9
Weighted average number of common shares	**81,179,973**	81,144,842
Incremental shares from stock options	**88,891**	175,265
Shares issuable upon conversion of convertible subordinated debentures	**11,742,424**	- (b)
Diluted number of common shares	**93,011,288**	81,320,107
Per common share		
Income (loss) from continuing operations		
Basic	**$ 0.98**	$ (0.05)
Diluted	**$ 0.92**	$ (0.05)
Net income		
Basic	**$ 1.81**	$ 0.07
Diluted	**$ 1.65**	$ 0.07

(a) Anti-dilutive – $5.9 million
(b) Anti-dilutive – 11,742,424 shares issuable

Options to purchase 818,000 common shares at various prices, from $7.30 to $11.80 per share, were outstanding at the end of 2003 (2002 – 4,002,250) but were not included in the computation of dilutive earnings per share either because the options' exercise prices were greater than the average market price of the common shares or, in the case of performance-based stock options, market value targets had not been met.

20. Changes in Non-Cash Working Capital

(millions of dollars)	2003	2002
Accounts receivable	**$ (52.3)**	$ 22.5
Inventories	**(8.9)**	(11.2)
Prepaid expenses	**(2.3)**	(0.8)
Accounts payable, accrued liabilities and current portion of deferred reforestation	**37.4**	54.0
Income taxes	**(3.9)**	2.7
	$ (30.0)	$ 67.2

21. Financial Instruments

Currency Risk

A significant portion of Canfor's income from operations is generated from sales denominated in US dollars. In order to manage some of the risk associated with fluctuating exchange rates, Canfor enters into forward exchange contracts from time to time. Contracts totaling US $143.5 million were exercised in the current year (2002 – nil) and the realized gain of $32.0 million is reflected in net sales. At December 31, 2003, Canfor had forward exchange contracts outstanding of US $26.0 million in total (2002 - $140.0 million). These contracts were fixed at an average rate of 1.4342 and have option periods that are spread through to October 2004. As at December 31, 2003, there was an unrecognized gain on the contracts in the amount of $3.6 million (2002 – $1.6 million).

Credit Risk

Canfor does not have a significant concentration of credit risk as no one individual customer accounts for 10% or more of total company sales. Canfor reviews the credit history of all new customers before extending credit and also performs regular reviews of the credit performance of existing customers. Canfor may require payment guarantees, such as letters of credit, or obtains credit insurance coverage. The allowance for doubtful accounts as at December 31, 2003 was $0.2 million (2002 - $0.6 million).

Commodity Price Risk

Canfor uses financial instruments to reduce its exposure to price risk associated with energy costs. Commodity swaps hedging future natural gas purchases of 1.8 million Gigajoules were outstanding at the end of the year at an average price of $6.29 per Gigajoule (2002 – nil). There was an unrealized loss of $0.7 million on these swaps at December 31, 2003.

22. Related Party Transactions

Transactions with related parties occur at fair market value, unless otherwise noted below.

Canfor markets the pulp production of Howe Sound Pulp and Paper Limited Partnership (HSLP) (Note 23) for which it received commissions totaling $2.8 million in 2003 (2002 – $2.7 million) under the terms of its agency sales agreement. Based on a separate prepayment agreement between Canfor and Oji, the partners of HSLP, at December 31, 2003, Canfor had prepaid $33.5 million to HSLP in advance of the due date of receivables for pulp marketed and collected on their behalf. Canfor charges a market rate of interest to HSLP for the period paid in advance. The agreement provides for the partners to prepay up to a maximum amount of $50 million each, which is used as short-term operating funds by HSLP. Canfor provides management, fibre supply and other services to HSLP at cost, for which it charged $1.8 million in fees for 2003 (2002 – $2.2 million). Canfor sells logs to HSLP, which amounted to $9.1 million in 2003 (2002 – $8.9 million). Canfor's BC Chemicals operation sold sodium chlorate to HSLP, until that operation was sold in August 2003 (Note 3). Sodium chlorate sales to HSLP amounted to $4.2 million in 2003 (2002 – $6.4 million).

Canfor purchases pulp chips and lumber from Lakeland Mills Ltd. and The Pas Lumber Company Ltd. During 2003, Canfor purchased $10.7 million in pulp chips and $10.8 million in lumber (2002 - $11.5 million and $8.8 million respectively).

During 2003, Kyahwood Forest Products Ltd. provided remanufacturing services to Canfor in the amount of $5.1 million (2002 – $6.3 million).

23. Howe Sound Pulp and Paper Limited Partnership

On March 10, 2001, Canfor and Oji Paper Co., Ltd., its 50% co-venturer in the Howe Sound Pulp and Paper Limited (Howe Sound) joint venture, transferred the business of Howe Sound into a limited partnership, Howe Sound Pulp and Paper Limited Partnership (HSLP). HSLP continues to be jointly owned by Canfor and Oji and continues to carry on the existing operations of Howe Sound.

As part of the reorganization, Howe Sound was amalgamated with Canadian Forest Products Ltd. (CFP), Canfor's principal operating subsidiary, and approximately $643 million of tax losses of Howe Sound are available to reduce the future taxable income of CFP. The ability to use these losses is contingent upon HSLP's continuing operations, which may require continued funding by the owners. In 2001, as part of the reorganization, CFP made a payment of $60.2 million to HSLP, which was applied to reduce the long-term debt of Howe Sound assumed by HSLP. During 2002, additional payments totaling $5.0 million were made to HSLP. CFP has agreed to make further payments to HSLP, up to a maximum of $57.1 million, contingent upon its ability to utilize the tax losses of Howe Sound and payable upon utilization of the losses. These future payments will be recognized as a future income tax asset.

As a result of this reorganization, CFP recorded a future income tax asset and a deferred credit, which were $192.2 million and $95.7 million, respectively, at December 31, 2003 ($184.8 million and $95.7 million at December 31, 2002). The deferred credit will be recognized in income on a systematic basis.

Canfor wrote off its investment in the joint venture in 1998 and no longer reflects its share of Howe Sound's results in its earnings. Canfor's method of accounting for its interest in HSLP did not change as a result of the reorganization.

While Canfor does not reflect HSLP's results in its earnings, it is required to include its share of the limited partner's income or loss, within the limits imposed by the Income Tax Act (Canada), in the calculation of taxable income. This had the effect of increasing Canfor's future income tax recovery in 2003 by $8.1 million (2002 - $8.0 million). Any income tax expense incurred by Canfor will be reimbursed by HSLP.

The following financial information reflects 100% of HSLP's operations for their year ended January 3, 2004 and comparative figures for 2003.

a. Statement of Net Income of Howe Sound Pulp and Paper Limited Partnership

(millions of dollars)	January 3, 2004	January 3, 2003
Net sales	$ 339.5	$ 338.1
Costs and expenses	368.8	377.3
Operating loss	(29.3)	(39.2)
Interest expense and foreign exchange loss	(16.1)	(8.0)
Loss before income taxes	(45.4)	(47.2)
Income tax expense	-	-
Net loss	$ (45.4)	$ (47.2)

b. Statement of Financial Position of Howe Sound Pulp and Paper Limited Partnership

(millions of dollars)	January 3, 2004	January 3, 2003
Assets		
Current assets	$ 77.9	$ 97.8
Fixed assets	834.6	879.5
Other assets	14.7	77.8
	$ 927.2	$ 1,055.1
Liabilities*		
Current liabilities	$ 123.3	$ 109.9
Long-term debt	378.5	495.2
Other liabilities	29.3	4.9
Equity	396.1	445.1
	$ 927.2	$ 1,055.1

* The liabilities of Howe Sound Pulp and Paper Limited Partnership are non-recourse to Canfor.

c. Statement of Changes in Cash Position of Howe Sound Pulp and Paper Limited Partnership

(millions of dollars)	January 3, 2004	January 3, 2003
Operating		
Net loss	$ (45.4)	$ (47.2)
Adjustments for non-cash items:		
Amortization	45.2	45.8
Other operating items	45.3	33.3
	45.1	31.9
Financing		
Repayment of long-term debt	(42.1)	(36.8)
Issue of partnership share	(3.6)	5.1
	(45.7)	(31.7)
Investing	(0.7)	(2.1)
Increase (decrease) in net cash for year	$ (1.3)	$ (1.9)

24. Commitments and Contingencies

Commitments

a. Operating leases – future minimum lease payments

(millions of dollars)	
2004	$ 24.1
2005	14.6
2006	8.0
2007	4.8
2008	3.2
Thereafter	11.7
Total minimum lease payments	$ 66.4

b. Canfor's investment in Lakeland Mills Ltd. and The Pas Lumber Company Ltd. is pledged as security for the bank debt of those mills.

c. Capital expenditures

On October 31, 2003, Canfor announced that it had entered into an agreement with BC Hydro to build a major electrical cogeneration facility at Canfor's Prince George Pulp and Paper Mill. This project will make Canfor's Prince George Pulp and Paper and Intercontinental Pulp mills 100% self-sufficient in electricity generation. BC Hydro will contribute $49 million and Canfor will contribute $32 million to the $81 million project, which is scheduled for completion by February 2005. Canfor has capitalized $4.9 million of initial project costs at December 31, 2003.

d. Agreement to acquire shares of Slocan Forest Products Ltd.

On November 25, 2003, Canfor announced that it had signed an agreement to acquire all of the shares of Slocan Forest Products Ltd. (Slocan) in a share exchange transaction in which Slocan shareholders will receive 1.3147 Canfor shares for each Slocan share. The Boards of Directors of Canfor and Slocan have unanimously approved the combination. The Board of Directors of Slocan is recommending that the Slocan shareholders approve the transaction at a shareholder meeting expected to be held by the end of the first quarter of 2004. The agreement provides for the payment of a $9 million break fee to Canfor in the event that, among other things, Slocan's Board of Directors changes its recommendation in favour of a competing bid under certain circumstances. The agreement is also subject to the approval of the British Columbia Supreme Court, approval under the Competition Act (Canada), regulatory approval, compliance with the British Columbia Forest Act and satisfaction of other conditions.

The aggregate value of the transaction, including assumed net debt, is approximately $620 million. Slocan's debt was US $160 million at December 31, 2003.

In December 2003, Canfor negotiated a US $160 million private placement debt with one of its long-time lenders. The unsecured senior notes were structured to allow Canfor to draw down US $50 million in February 2004 and the remaining balance of US $110 million to be drawn down conditional on the closing of the Slocan acquisition. Should the Slocan acquisition not close, the US $50 million to be drawn in February 2004 will be used for general corporate purposes to finance capital expenditures and scheduled debt repayments. The financing, with three separate tranches, has a weighted average coupon rate of 6.03% and an average life of 6.6 years, with final maturity on August 15, 2011. In the event that the Slocan transaction does not proceed, a cancellation fee is payable on the US $110 million. Canfor has covered the exposure of this cancellation fee by purchasing an interest rate call option to expire on March 31, 2004. The fair value of the option was US $1.2 million as at December 31, 2003.

Contingencies

The Forestry Revitalization Plan

In March 2003, the Government of British Columbia (the Crown) introduced the Forestry Revitalization Plan (the Plan) that provides for significant changes to Crown forest policy and to the existing allocation of Crown timber tenures to licensees. The changes prescribed in the Plan include the elimination of minimum cut control regulations, the elimination of existing timber processing regulations, and the elimination of restrictions limiting the transfer and subdivision of existing licenses. As well, through legislation, licensees, including Canfor, will be required to return 20% of their replaceable tenure to the Crown. The Plan states that approximately half of this volume will be redistributed to open up opportunities for woodlots, community forests and First Nations and the other half will be available for public auction. The Crown has acknowledged that licensees will be fairly compensated for the return of tenure and related infrastructure costs such as roads and bridges.

The effect of the timber take-back is expected to result in a reduction of approximately 1.5 million cubic metres to Canfor's existing allowable annual cut on its replaceable tenures. The effect of the Plan on Canfor's financial position and

results of operations cannot be determined at this time. Canfor will record the effects of the Plan at the time that the amounts to be recorded are estimable.

Property Transfer Tax Assessment

Canfor has received a Notice of Assessment from the Income Taxation Branch of the British Columbia Ministry of Provincial Revenue with respect to property transfer taxes associated with the amalgamation of Canadian Forest Products Ltd. (CFP) and Howe Sound Pulp and Paper Limited (HSPP) in 2001. The notice denied CFP's claim for an exemption from property transfer tax resulting from the amalgamation of CFP and HSPP. The potential liability arising from this assessment, including accrued interest to December 31, 2003, is $11.1 million.

In the opinion of Management and counsel, the amalgamation qualifies for exemption from property transfer taxes and, therefore, CFP will vigorously contest the assessment. A Notice of Objection has been filed, however, it was declined by the Minister. Canfor has appealed the Minister's decision to the BC Supreme Court and no provision has been made for the amount in the accounts. As required by the Ministry, CFP has posted a Letter of Credit for the assessed amount plus accrued interest.

25. Comparative Figures

Certain 2002 figures have been reclassified to conform to the current year's presentation.

Subsidiary Companies

(wholly owned)

Operating Companies

Canadian Forest Products Ltd.

Canfor Europe

Canfor Japan Corporation

Canfor Panel and Fibre Marketing Ltd.

Canfor Pulp and Paper Marketing Ltd.

Canfor U.S.A. Corporation

Canfor Wood Products Marketing Ltd.

Genus Resource Management Technologies Inc.

Howe Sound Transportation Company Limited

Nanika Timber Limited

Bois Daaquam Inc.

Produits Forestiers Anticosti Inc.

Daaquam Maine Inc.

Inactive/Holding Companies

317231 British Columbia Ltd.

615157 B.C. Ltd.

9129-1211 Quebec Inc.

B.C. Chemicals Ltd.

Canfor Hong Kong Corporation

Canfor Limited

Canfor US Holdings Inc.

Eburne Sawmills Limited

Northwood Properties Limited

Willowcale Storage Inc.

Joint Ventures

(proportionately consolidated)

Canfor Georgia-Pacific Japan Corporation (50% interest)

Partnerships/Other

Howe Sound Pulp and Paper Limited Partnership (49.99% interest) (Note 23)

HSPP General Partner Ltd. (50% interest)

Investments

(equity accounted)

Kyahwood Forest Products

Lakeland Mills Ltd.

The Pas Lumber Company Ltd.

Vernon Seed Orchard Co.

Canfor Corporation – 2003 Selected Quarterly Financial Information

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Year
			(unaudited)		(audited)
Sales and income (millions of dollars)					
Net sales	$ 527.4	$ 483.3	$ 555.1	$ 529.7	$ 2,095.5
Manufacturing and product costs	480.6	491.0	473.6	487.5	1,932.7
Amortization	30.4	25.4	26.5	27.5	109.8
Selling and administration	13.3	14.4	13.1	15.0	55.8
Operating income (loss)	3.1	(47.5)	41.9	(0.3)	(2.8)
Equity income (loss) of affiliated companies	0.2	(0.8)	(0.6)	0.8	(0.4)
Interest expense	(12.7)	(13.1)	(13.6)	(11.1)	(50.5)
Foreign exchange gain (loss) on long-term debt	44.3	43.6	(2.4)	25.4	110.9
Other income (expense)	1.9	(0.5)	(0.7)	24.2	24.9
Income (loss) from continuing operations before income taxes	36.8	(18.3)	24.6	39.0	82.1
Income tax recovery (expense)	0.3	14.6	(6.8)	(4.4)	3.7
Income (loss) from continuing operations	37.1	(3.7)	17.8	34.6	85.8
Income (loss) from discontinued operation after income taxes	3.1	2.6	62.3	(0.5)	67.5
Net income (loss)	$ 40.2	$ (1.1)	$ 80.1	$ 34.1	$ 153.3
Per common share (dollars)					
From continuing operations					
Basic	$ 0.44	$ (0.06)	$ 0.20	$ 0.41	$ 0.98
Diluted	$ 0.40	$ (0.06)	$ 0.19	$ 0.37	$ 0.92
Net Income					
Basic	$ 0.48	$ (0.03)	$ 0.97	$ 0.40	$ 1.81
Diluted	$ 0.43	$ (0.03)	$ 0.86	$ 0.37	$ 1.65
Cash generated from (used in) (millions of dollars)					
Operating activities	$ (93.4)	$ 58.4	$ 43.3	$ (9.6)	$ (1.3)
Financing activities					
Long-term debt	-	(48.7)	4.2	(8.4)	(52.9)
Dividends paid	(5.3)	(5.3)	-	-	(10.6)
Other	(0.1)	(3.1)	0.2	(2.5)	(5.5)
	(5.4)	(57.1)	4.4	(10.9)	(69.0)
Investing activities					
Property, plant, equipment and timber	(12.5)	(24.5)	(44.4)	(13.8)	(95.2)
Other	(2.8)	(31.1)	3.1	(5.2)	(36.0)
	(15.3)	(55.6)	(41.3)	(19.0)	(131.2)
Cash generated by discontinued operation	3.6	1.5	116.4	(0.3)	121.2
Increase (decrease) in net cash	$ (110.5)	$ (52.8)	$ 122.8	$ (39.8)	$ (80.3)
Summary of consolidated shipments (unaudited)					
Logs – 000 m^3	339.9	406.9	195.4	294.8	1,237.0
Lumber – MMfbm					
Canfor produced	719.6	766.3	753.7	702.4	2,942.0
Purchased from other wholesale producers	70.4	79.0	69.4	77.3	296.1
Total Lumber	790.0	845.3	823.1	779.7	3,238.1
Plywood – 000 Msf 3/8" basis	40.0	47.7	48.4	36.2	172.3
Pulp – 000 mt					
Canfor produced	273.9	220.2	244.3	260.8	999.2
Marketed on behalf of HSLP*	92.3	84.6	101.8	83.0	361.7
Total Pulp	366.2	304.8	346.1	343.8	1,360.9
Kraft paper – 000 mt	33.2	27.4	30.2	30.6	121.4

Certain previously published figures have been reclassified to conform to the current presentation.
*Howe Sound Pulp and Paper Limited Partnership, herein referred to as HSLP.

Canfor Corporation – 2002 Selected Quarterly Financial Information

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Year
			(unaudited)		(audited)
Sales and income (millions of dollars)					
Net sales	$ 505.9	$ 577.0	$ 548.9	$ 480.5	$ 2,112.3
Manufacturing and product costs	438.5	494.9	508.0	468.2	1,909.6
Amortization	28.5	26.4	27.1	28.4	110.4
Selling and administration	13.8	18.9	16.0	16.3	65.0
Reversal of duties accrued in prior year	-	(45.8)	-	-	(45.8)
Termination benefits and mill closure costs	-	-	-	33.1	33.1
Operating income (loss)	25.1	82.6	(2.2)	(65.5)	40.0
Equity income (loss) of affiliated companies	(0.1)	4.7	-	0.4	5.0
Interest expense	(15.4)	(14.5)	(14.6)	(14.7)	(59.2)
Other income (expense)	(0.8)	10.8	(0.5)	(0.5)	9.0
Income (loss) from continuing operations before income taxes	8.8	83.6	(17.3)	(80.3)	(5.2)
Income tax recovery (expense)	(0.1)	(15.7)	2.7	20.2	7.1
Income (loss) from continuing operations	8.7	67.9	(14.6)	(60.1)	1.9
Income from discontinued operation after income taxes	2.4	2.3	2.8	2.1	9.6
Net income (loss)	$ 11.1	$ 70.2	$ (11.8)	$ (58.0)	$ 11.5
Per common share (dollars)					
From continuing operations					
Basic	$ 0.09	$ 0.82	$ (0.20)	$ (0.76)	$ (0.05)
Diluted	$ 0.09	$ 0.73	$ (0.20)	$ (0.76)	$ (0.05)
Net Income					
Basic	$ 0.12	$ 0.85	$ (0.16)	$ (0.73)	$ 0.07
Diluted	$ 0.12	$ 0.75	$ (0.16)	$ (0.73)	$ 0.07
Cash generated from (used in) (millions of dollars)					
Operating activities	$ (14.4)	$ 83.4	$ 46.4	$ 8.8	$ 124.2
Financing activities					
Long-term debt	-	(49.9)	-	-	(49.9)
Dividends paid	(5.3)	(5.3)	(5.2)	(5.3)	(21.1)
Other	0.5	(2.7)	(0.1)	(3.0)	(5.3)
	(4.8)	(57.9)	(5.3)	(8.3)	(76.3)
Investing activities					
Property, plant, equipment and timber	(8.1)	12.2	(18.2)	(31.6)	(45.7)
Other	(4.2)	(26.2)	1.5	4.6	(24.3)
	(12.3)	(14.0)	(16.7)	(27.0)	(70.0)
Cash generated by discontinued operation	5.1	2.0	2.9	4.8	14.8
Increase (decrease) in net cash	$ (26.4)	$ 13.5	$ 27.3	$ (21.7)	$ (7.3)
Summary of consolidated shipments (unaudited)					
Logs – 000 m^3	184.7	362.1	369.2	312.9	1,228.9
Lumber – MMfbm					
Canfor produced	664.3	744.4	718.1	690.5	2,817.3
Purchased from other wholesale producers	53.6	67.6	89.8	66.8	277.8
Total Lumber	717.9	812.0	807.9	757.3	3,095.1
Plywood – 000 Msf 3/8" basis	41.6	41.3	42.0	37.1	162.0
Pulp – 000 mt					
Canfor produced	236.9	274.4	238.5	243.7	993.5
Marketed on behalf of HSLP*	82.2	99.3	85.8	76.2	343.5
Total Pulp	319.1	373.7	324.3	319.9	1,337.0
Kraft paper – 000 mt	25.8	25.9	28.5	28.7	108.9

Certain previously published figures have been reclassified to conform to the current presentation.
*Howe Sound Pulp and Paper Limited Partnership, herein referred to as HSLP.

Canfor Corporation – Five-Year Comparative Review

	2003	2002	2001	2000	1999
Sales and income (millions of dollars)					
Net sales	**$ 2,095.5**	$ 2,112.3	$ 1,985.7	$ 2,265.9	$ 1,725.2
Manufacturing and product costs	**1,932.7**	1,909.6	1,773.6	1,838.1	1,406.1
Amortization	**109.8**	110.4	101.8	109.1	67.7
Selling and administration	**55.8**	65.0	59.6	67.5	47.4
Reversal of duties accrued in prior year	**-**	(45.8)	-	-	-
Termination benefits and mill closure costs	**-**	33.1	-	-	-
Operating income (loss)	**(2.8)**	40.0	50.7	251.2	204.0
Equity income (loss) of affiliated companies	**(0.4)**	5.0	1.1	1.2	7.8
Interest expense	**(50.5)**	(59.2)	(64.2)	(60.4)	(33.2)
Foreign exchange gain on translation of long-term debt	**110.9**	-	-	-	-
Other income (expense)	**24.9**	9.0	(0.3)	7.5	(0.5)
Unusual items	**-**	-	8.5	(3.0)	-
Income (loss) from continuing operations before income taxes	**82.1**	(5.2)	(4.2)	196.5	178.1
Income tax recovery (expense)	**3.7**	7.1	23.5	(78.7)	(74.1)
Income from continuing operations	**85.8**	1.9	19.3	117.8	104.0
Discontinued operation	**67.5**	9.6	7.1	7.8	(1.4)
Net income	**$ 153.3**	$ 11.5	$ 26.4	$ 125.6	$ 102.6
Per common share (dollars)					
Income (loss) from continuing operations					
Basic	**$ 0.98**	$ (0.05)	$ 0.19	$ 1.41	$ 1.70
Diluted	**$ 0.92**	$ (0.05)	$ 0.19	$ 1.28	$ -
Net income					
Basic	**$ 1.81**	$ 0.07	$ 0.27	$ 1.50	$ 1.68
Diluted	**$ 1.65**	$ 0.07	$ 0.27	$ 1.36	$ 1.66
Dividends paid on common shares	**$ 0.13**	$ 0.26	$ 0.26	$ 0.26	$ -
Book value per share	**$ 11.71**	$ 10.27	$ 10.35	$ 10.24	$ 9.72
Assets and capitalization (millions of dollars)					
Working capital	**$ 254.2**	$ 277.0	$ 342.2	$ 65.6	$ (15.8)
Long-term investments	**100.5**	90.3	71.3	74.0	66.9
Property, plant, equipment and timber	**1,443.5**	1,394.7	1,435.8	1,483.5	1,343.6
Other assets and deferred charges	**126.8**	139.3	159.9	116.8	93.1
Net assets of discontinued operation	**-**	30.1	35.4	40.4	44.7
Net assets	**$ 1,925.0**	$ 1,931.4	$ 2,044.6	$ 1,780.3	$ 1,532.5
Long-term debt	**$ 478.0**	$ 643.4	$ 714.7	$ 400.9	$ 442.1
Other accruals and provisions	**88.6**	83.9	118.4	64.8	50.2
Future income taxes	**173.7**	154.5	147.0	363.9	138.4
Deferred credit	**95.7**	95.7	104.0	-	-
Common shareholders' equity	**1,089.0**	953.9	960.5	950.7	901.8
Total capitalization	**$ 1,925.0**	$ 1,931.4	$ 2,044.6	$ 1,780.3	$ 1,532.5
Additions to property, plant, equipment and timber (millions of dollars)	**$ 123.5**	**$ 67.4**	**$ 52.2**	**$ 121.8**	**$ 120.3**

Certain prior years' figures have been reclassified to conform to the 2003 presentation.

	2003	2002	2001	2000	1999
Cash generated from (used in) (million of dollars)					
Operating activities	**$ (1.3)**	$ 124.2	$ 105.8	$ 93.8	$ 219.4
Financing activities					
Long-term debt	**(52.9)**	(49.9)	66.0	(50.2)	19.5
Common shares	**-**	-	-	0.1	239.5
Dividends paid	**(10.6)**	(21.1)	(21.1)	(21.1)	-
Interest on convertible subordinated debentures, net of income tax	**(6.0)**	(5.5)	(4.3)	(4.7)	-
Other	**0.5**	0.2	8.5	14.1	-
	(69.0)	(76.3)	49.1	(61.8)	259.0
Investing activities					
Property, plant, equipment and timber	**(95.2)**	(45.7)	(48.8)	(110.7)	(119.8)
Howe Sound Pulp and Paper Limited Partnership	**-**	(5.0)	(60.2)	-	-
Investment in subsidiaries and affiliates	**(30.6)**	-	-	-	(433.2)
Mortgage receivable on sale of property	**(5.8)**	(15.7)	-	-	-
Other	**0.4**	(3.6)	(10.3)	(14.2)	21.7
	(131.2)	(70.0)	(119.3)	(124.9)	(531.3)
Increase (decrease) in net cash					
From continuing operations	**(201.5)**	(22.1)	35.6	(92.9)	(52.9)
From discontinued operation	**121.2**	14.8	18.2	(3.3)	11.4
	$ (80.3)	$ (7.3)	$ 53.8	$ (96.2)	$ (41.5)
Financial statistics					
EBITDA	**107.0**	150.4	152.5	360.3	271.7
Return on capital employed	**10.3%**	2.7%	3.5%	9.3%	12.3%
Return on common shareholders' equity	**15.0%**	1.2%	2.8%	13.6%	15.4%
Ratio of current assets to current liabilities	**1.5:1**	1.7:1	2.0:1	1.1:1	1.0:1
Ratio of net debt to shareholders' equity	**35:65**	41:59	43:57	42:58	41:59
Production statistics					
Pulp – 000 mt	**992.1**	1,001.5	900.1	980.1	521.8
Kraft paper – 000 mt	**128.5**	107.6	108.8	109.9	103.7
Lumber – MMfbm	**2,893.3**	2,960.1	2,260.3	2,235.3	1,423.8
Plywood – 000 Msf 3/8" basis	**175.6**	165.4	168.7	158.7	-
Hardboard – 000 Msf 3/8" basis	**28.3**	26.3	24.8	24.1	22.9
Refined fibre – 000 mt	**37.3**	39.5	40.2	38.5	33.9
Sales by product line					
Log sales	**8%**	6%	6%	7%	10%
Pulp and kraft paper	**32**	30	34	39	26
Lumber – Canfor produced	**49**	52	48	41	42
Lumber – Other producers	**5**	6	6	8	17
Plywood	**3**	3	3	2	-
Miscellaneous	**3**	3	3	3	5
	100%	100%	100%	100%	100%
Sales by market					
Canada	**21%**	20%	21%	20%	22%
United States	**55**	57	55	54	56
Europe	**10**	10	11	15	10
Far East	**13**	12	12	10	11
Other	**1**	1	1	1	1
	100%	100%	100%	100%	100%

Certain prior years' figures have been reclassified to conform to the 2003 presentation.

Directors and Officers

Directors

The names, principal occupations, municipalities of residence, and the periods during which they have been Directors of the Company are as below. For more information visit www.canfor.com.

P.J.G. Bentley, O.C., LL.D. (1)(4)(5)
Chairman of the Board,
Canfor Corporation
Vancouver, British Columbia
Director since 1966

R.L. Cliff, C.M., F.C.A. (1)(2)(3)
Chairman of the Board,
Heathcliff Properties Ltd.
West Vancouver, British Columbia
Director since 1983

M.L. Cullen (2)(3)
Corporate Director,
Vancouver, British Columbia
Director since 2000

C.W. Daniel, O.C., LL.D (3)(5)
Corporate Director;
Consultant
Toronto, Ontario
Director since 1985

D.L. Emerson (1)
President and Chief Executive Officer,
Canfor Corporation
Vancouver, British Columbia
Director since 1998

B.R. Hislop (5)
Group Vice-President and Chief
Technology Officer,
Canfor Corporation
Vancouver, British Columbia
Director since 2003

M.E. Hurst (4)(5)
Educational Author
Vancouver, British Columbia
Director since 1987

Michael J. Korenberg (2)(4)
Managing Director, Vice-Chairman,
The Jim Pattison Group (diversified businesses)
Vancouver, British Columbia
Director since 2003

P.A. Lusztig, C.G.A. (2)(4)
Dean Emeritus,
University of British Columbia;
Chair and Trustee,
Health Benefit Trust (B.C.)
Vancouver, British Columbia
Director since 1983

E.P. Newell, O.C., LL.D (3)(4)
Corporate Director
Edmonton, Alberta
Director since 1999

J.A. Pattison, O.C., O.B.C. (1)
President, Managing Director, Chief Executive
Officer and Chairman,
The Jim Pattison Group (diversified businesses)
Vancouver, British Columbia
Director since 2003

M.E.J. Phelps, O.C. (1)(3)(4)
Chairman, Dornoch Capital Inc.
West Vancouver, British Columbia
Director since 1990

R.T. Riley (4)(5)
Vice-President of L.B.G. Capital,
a Division of National Bank Financial
Montreal, Quebec
Director since 1987

C. Taylor, O.C. (5)
Chair of the Canadian
Broadcasting Corporation
Vancouver, British Columbia
Director since 2000

Officers

The names, offices held, and municipalities of residence of the officers of the Company and the offices held by them are as below. For more information visit www.canfor.com.

P.J.G. Bentley, O.C., LL.D.
Chairman
Vancouver, British Columbia

D.L. Emerson
President and Chief Executive Officer
Vancouver, British Columbia

C.W. Reid
Group Vice-President,
Finance and Chief Financial Officer
Surrey, British Columbia

J.B. Engleson
Group Vice-President, Wood Products
Prince George, British Columbia

B.R. Hislop
Group Vice-President and
Chief Technology Officer,
Vancouver, British Columbia

R.A. Luoma
Group Vice-President, Pulp and Paper
Prince George, British Columbia

J.R. Williams
Group Vice-President, Fibre Management
Surrey, British Columbia

R. Belanger
Senior Vice-President, Eastern Operations and
Corporate Development
Lac Beauport, Quebec

D.M. Calabrigo
Vice-President, Human Resources, General
Counsel and Corporate Secretary
Surrey, British Columbia

K.O. Higginbotham
Vice-President, Forestry and Environment
Surrey, British Columbia

D.B. Kayne
Vice-President, Wood Products Marketing
Tsawwassen, British Columbia

J.K. Pau
Vice-President and Treasurer
Vancouver, British Columbia

S. Yurkovich
Vice-President, Corporate Affairs
Vancouver, British Columbia

K.J. Clayton
Corporate Controller
North Vancouver, British Columbia

(1) Member of Capital Projects Committee, which acts generally on behalf of the Board of Directors between meetings.

(2) Member of the Audit Committee, which reviews the Company's financial statements, the scope and results of the external auditor's work, the adequacy of internal accounting and audit programs and compliance with accounting and reporting standards.

(3) Member of the Management Resources and Compensation Committee, which makes recommendations to the Board regarding the Company's pension plans and the remuneration of its Directors and senior officers and ensures management development and succession programs are in place.

(4) Member of the Corporate Governance Committee, which ensures that the Company through its Board of Directors sustains an effective approach to corporate governance.

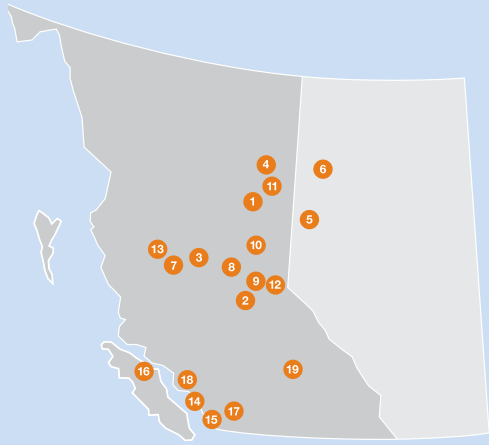
(5) Member of the Environmental, Health and Safety Committee, which develops, reviews and makes recommendations on matters related to the Company's environmental, health and safety policies, and monitors compliance with those policies and with government regulations.

The term of office of each Director expires on the date of the next Annual General Meeting of the Company.

Canfor Operations

	Lumber (Mfbm)	2003 Production	2004 Capacity
	Primary Mills		
1	Chetwynd	219,900	244,700
2	Clear Lake	153,400	153,500
3	Fort St. James	186,400	240,000
4	Fort St. John	242,400	302,400
5	Grande Prairie	205,500	227,200
6	Hines Creek	89,300	93,800
7	Houston	405,000	602,800
8	Isle Pierre	245,800	247,300
9	Prince George	192,300	356,600
10	Polar	253,100	260,000
9	Rustad	304,200	356,300
11	Taylor	43,700	- (5)
12	Upper Fraser	135,400	- (6)
	Daaquam(1)	66,000 (7)	150,000
	Sub-total	**2,742,400**	**3,234,600**
	Remanufacturing		
	Canfor USA(1)	189,000	190,900
2	Clear Lake	33,600	34,000
5	Grande Prairie	9,400	17,000
13	Houston/Kyahwood(3)(4)	29,900	35,000
	Sub-total	261,900	276,900
	Total Lumber	**3,004,300**	**3,511,500**
	Plywood (Msf)		
9	North Central Plywood	**175,600**	**178,800**
	Pulp (mt)		
9	Prince George Pulp	139,500	137,300
9	Intercontinental	308,900	311,000
9	Northwood	543,700	562,900
14	Howe Sound(3)	364,900	364,400
	Total Pulp	**1,357,000**	**1,375,600**
	Paper (mt)		
9	Specialty Paper Mill	**128,500**	**142,200**
	Newsprint (mt)		
14	Howe Sound(3)	**202,600**	**207,500**

(1) not shown on map
(2) jointly owned with Riverside Forest Products, Weldwood of Canada and West Fraser Timber
(3) includes 100% of production
(4) joint venture
(5) sawmill line closed in 3rd Quarter 2003
(6) closed in 3rd Quarter 2003
(7) acquired May 27, 2003
(8) sold August 29, 2003



Other Operations

15 Corporate Office
15 Canfor Wood Products Marketing (Toronto, ON office not shown)
15 Canfor Pulp and Paper Marketing
Canfor Georgia-Pacific Japan Corporation(1)
Canfor Europe(1)
15 Canfor Research and Development Centre
9 BC Chemicals(8)
16 Englewood
9 Executive Office
9 Administration Centre
17 Harrison
15 Panel and Fibre

Nurseries/Seed Orchards

9 J.D. Little Forest Centre
5 Grande Prairie
18 Sunshine Coast
19 Vernon Seed Orchard(2)

Woodlands

Prince George Operations
Fort St. James Operations
Houston Operations
Alberta-Peace Operations
Coastal Operations

Corporate and Shareholder Information

Annual General Meeting
Canfor's Annual General Meeting will be held at the Hyatt Regency Hotel, Plaza Ballroom, 655 Burrard St., Vancouver, B.C., on Friday, April 30, 2004 at 11:30 a.m.

Transfer Agent and Registrar
CIBC Mellon Trust Company
Vancouver, Calgary, Regina, Winnipeg, Toronto, Montreal and Halifax

Stock Listing
Toronto Stock Exchange
Symbol: CFP

Investor Contact
Charles W. Reid
Group Vice-President, Finance and Chief Financial Officer
Telephone: (604) 661-5200
Fax: (604) 661-5429

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Vancouver, B.C.

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Web: www.canfor.com

Canfor also produces an Annual Information Form. To obtain this publication or more information about the company, please contact Canfor Corporation, Corporate Affairs.

Lee Coonfer
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www.canfor.com