2014

Canfor Corporation

quarter two

interim report

for the three months ended june 30, 2014

CANFOR

To Our Shareholders

Canfor Corporation ("CFP") reported net income attributable to shareholders ("shareholder net income") of $54.3 million, or $0.39 per share, for the second quarter of 2014, compared to $45.5 million, or $0.33 per share, for the first quarter of 2014 and $110.3 million, or $0.77 per share, for the second quarter of 2013. For the six months ended June 30, 2014, the Company's shareholder net income was $99.8 million, or $0.72 per share, compared to shareholder net income of $172.2 million, or $1.21 per share, reported for the first half of 2013.

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

(millions of Canadian dollars, except per share amounts)	Q2 2014	Q1 2014	YTD 2014	Q2 2013	YTD 2013
Sales	**$ 907.3**	$ 741.9	**$ 1,649.2**	$ 843.2	$ 1,629.5
Operating income	**$ 97.3**	$ 84.4	**$ 181.7**	$ 128.2	$ 228.2
Net income attributable to equity shareholders of the Company	**$ 54.3**	$ 45.5	**$ 99.8**	$ 110.3	$ 172.2
Net income per share attributable to equity shareholders of the Company, basic and diluted	**$ 0.39**	$ 0.33	**$ 0.72**	$ 0.77	$ 1.21
Adjusted shareholder net income	**$ 56.7**	$ 46.4	**$ 103.1**	$ 87.7	$ 158.0
Adjusted shareholder net income per share, basic and diluted	**$ 0.41**	$ 0.34	**$ 0.74**	$ 0.61	$ 1.11

After adjusting for items affecting comparability with the prior periods, the Company's adjusted shareholder net income for the second quarter of 2014 was $56.7 million, or $0.41 per share, compared to an adjusted shareholder net income of $46.4 million, or $0.34 per share, for the first quarter of 2014. Canfor's adjusted shareholder net income for the second quarter of 2013 was $87.7 million, or $0.61 per share.

The Company reported operating income of $97.3 million for the second quarter of 2014, compared to operating income of $84.4 million for the first quarter of 2014. The positive variance largely reflected improved shipments across all segments in the current quarter resulting from improved railcar availability and resolution of the truckers' strike at the Vancouver port in the first quarter of 2014, mitigated somewhat by lower sales realizations in both the lumber and pulp and paper segments and maintenance outages at the Company's pulp and paper facilities.

Reflecting the overhang of lumber inventories in British Columbia resulting from the transportation challenges experienced in the previous quarter, Western Spruce/Pine/Fir ("SPF") lumber prices saw a gradual decline through most of the second quarter of 2014. Towards the end of quarter, however, prices picked up in response to improved demand and as inventories reached more balanced levels. The U.S. housing market continued its recovery, albeit at a slower pace than anticipated as home construction activities continued to be hampered by a shortage of building lots and skilled construction workers across the country, as well as tight credit availability. U.S. housing starts averaged 980,000 units SAAR (seasonally adjusted annual rate), up 6% from the previous quarter. In Canada, lumber consumption was higher than the previous quarter, with Canadian housing starts up 11% from the first quarter of 2014, to 196,000 units SAAR. Offshore demand was steady, with higher shipments reflecting the improved transportation performance.

The Company's lumber sales realizations decreased moderately compared to the previous quarter, as a 9% decline in the average North American Western SPF 2x4 #2&Btr price (down US$32 per Mfbm to US$335 per Mfbm) was mitigated by less pronounced decreases on most wider dimension products as well as improved pricing on several other grades and more stable offshore prices. The latter largely reflected the nature of offshore pricing, much of which is negotiated monthly or quarterly in advance. Current quarter sales realizations also reflected the favourable impact of a higher percentage of prime products, in part reflecting the closure of the Company's Quesnel Sawmill in the first quarter of 2014, and the unfavourable impact of a 1% stronger Canadian dollar compared to the US dollar. Overall sales realizations for Southern Yellow Pine ("SYP") products were up modestly compared to the previous quarter; while the benchmark SYP 2x4 #2 price was relatively unchanged, moderate increases were seen for several wider dimension products, which more than offset a decline in the 2x6 #2 price.

Lumber shipments, at over 1.2 billion board feet, were up 33% from the previous quarter, reflecting the aforementioned improved railcar availability and increased offshore shipments. Lumber production, at just under 1.1 billion board feet, was down 2% from the first quarter of 2014, largely as a result of the closure of the Company's Quesnel Sawmill and the sale of the Company's Daaquam Sawmill in the previous quarter. Excluding the impact of the Quesnel and Daaquam Sawmills, the Company's lumber production was up 6% from the previous quarter, principally due to improved productivity following completion of several major capital projects as well as improved weather. Production in the current quarter was impacted by capital related downtime and continued ramp-ups at several sawmills following major capital upgrades in previous quarters. Lumber unit manufacturing costs were down slightly from the previous quarter, driven in part by the continued productivity improvements as well as other seasonal factors. Log costs remained relatively stable, mainly due to seasonally lower logging activity in the current quarter, ahead of an anticipated increase in log costs in the third quarter of 2014.

Global softwood pulp markets were steady through the second quarter of 2014. Softwood pulp demand was solid across all regions and global softwood pulp producer inventory levels tightened through the quarter, decreasing 3 days from the end of March 2014 to 25 days' supply in June 2014, partly reflecting supply constraints due to seasonal maintenance downtime. The North American NBSK pulp list price was stable over the quarter averaging US$1,030 per tonne, up US$13 per tonne, or 1%, compared to the first quarter of 2014. Discount levels were consistent with the previous quarter. The NBSK pulp list price to Europe also remained largely unchanged, averaging US$925 per tonne, up US$5 per tonne from the previous quarter, while the average NBSK pulp list price to China was down US$27 per tonne, or 4%, to US$730 per tonne. Despite the average NBSK pulp prices to North America and Europe increasing slightly compared to the previous quarter, the combination of the weaker prices to China, the 1% stronger Canadian dollar and a higher proportion of shipments to lower-margin markets, including Asia (mostly tied to constraints in the previous quarter due to the Vancouver Port truckers' strike), resulted in a small decrease in pulp unit sales realizations.

Pulp shipments were up 23% from the previous quarter, largely attributable to improved transportation performance following the challenges experienced in the prior quarter. Pulp production levels were down 7% from the previous quarter principally related to the maintenance outages at the Intercontinental and Prince George Pulp Mills, which reduced market pulp production by 18,000 tonnes. Pulp unit manufacturing costs were up moderately compared to the previous quarter, mostly due to the aforementioned maintenance outages and increased fibre costs, partially offset by seasonally lower energy costs. The higher unit fibre costs reflected higher delivered sawmill residual and whole log chip costs and seasonal factors.

Looking ahead, North American lumber consumption is forecast to improve with steady demand in the residential construction market and continued strength from the repair and remodeling sector. The build of lumber inventories from the shortage of railcars in the first quarter of 2014 is projected to be cleared before the end of the third quarter. Offshore shipments are forecast to remain stable reflecting steady demand from China and other emerging markets, while shipments to Japan are projected to ease and prices soften from lower lumber demand. NBSK pulp markets are steady heading into the seasonally slower third quarter of 2014. A risk of pulp price weakness remains for the second half of 2014 due in part to reduced global consumption during the historically slower summer months and new hardwood pulp capacity projected to flow into markets.

Michael J. Korenberg
Chairman

Don B. Kayne
President and Chief Executive Officer

Canfor Corporation
Second Quarter 2014
Management's Discussion and Analysis

This interim Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the quarter ended June 30, 2014 relative to the quarters ended March 31, 2014 and June 30, 2013, and the financial position of the Company at June 30, 2014. It should be read in conjunction with Canfor's unaudited interim consolidated financial statements and accompanying notes for the quarters ended June 30, 2014 and 2013, as well as the 2013 annual MD&A and the 2013 audited consolidated financial statements and notes thereto, which are included in Canfor's Annual Report for the year ended December 31, 2013 (available at www.canfor.com). The financial information in this interim MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which is the required reporting framework for Canadian publicly accountable enterprises.

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

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

All financial references are in millions of Canadian dollars unless otherwise noted. The information in this report is as at July 24, 2014.

Forward Looking Statements

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

SECOND QUARTER 2014 OVERVIEW

Selected Financial Information and Statistics

(millions of Canadian dollars, except per share amounts)	Q2 2014	Q1 2014	YTD 2014	Q2 2013	YTD 2013
Operating income (loss) by segment:					
Lumber	**$ 74.1**	$ 56.4	**$ 130.5**	$ 115.5	$ 203.9
Pulp and Paper	**$ 30.9**	$ 36.5	**$ 67.4**	$ 18.6	$ 37.5
Unallocated and Other	**$ (7.7)**	$ (8.5)	**$ (16.2)**	$ (5.9)	$ (13.2)
Total operating income	**$ 97.3**	$ 84.4	**$ 181.7**	$ 128.2	$ 228.2
Add: Amortization	**$ 44.0**	$ 44.5	**$ 88.5**	$ 49.6	$ 96.5
Total operating income before amortization	**$ 141.3**	$ 128.9	**$ 270.2**	$ 177.8	$ 324.7
Add (deduct):					
Working capital movements	**$ 92.8**	$ (177.8)	**$ (85.0)**	$ 96.9	$ 2.4
Defined benefit pension plan contributions	**$ (5.9)**	$ (13.5)	**$ (19.4)**	$ (12.6)	$ (26.1)
Other operating cash flows, net[1]	**$ (21.9)**	$ 12.3	**$ (9.6)**	$ (1.9)	$ 15.2
Cash from (used in) operating activities	**$ 206.3**	$ (50.1)	**$ 156.2**	$ 260.2	$ 316.2
Add (deduct):					
Finance expenses paid	**$ (2.6)**	$ (2.8)	**$ (5.4)**	$ (7.5)	$ (10.0)
Share purchases	**$ (105.7)**	$ (2.0)	**$ (107.7)**	$ -	$ -
Distributions paid to non-controlling interests	**$ (2.9)**	$ (2.1)	**$ (5.0)**	$ (2.1)	$ (4.5)
Capital additions, net	**$ (63.0)**	$ (53.1)	**$ (116.1)**	$ (48.8)	$ (95.2)
Proceeds from the sale of Daaquam Sawmill	**$ 22.9**	$ -	**$ 22.9**	$ -	$ -
Loan repayment from Scotch & Gulf Lumber, LLC	**$ 2.1**	$ 2.6	**$ 4.7**	$ -	$ -
Drawdown (repayment) of long-term debt	**$ -**	$ -	**$ -**	$ (73.2)	$ (73.2)
Proceeds from sale of Canfor-LP OSB	**$ -**	$ -	**$ -**	$ 76.6	$ 76.6
Other, net	**$ 1.7**	$ (0.9)	**$ 0.8**	$ 0.3	$ 5.9
Change in cash / operating loans	**$ 58.8**	$ (108.4)	**$ (49.6)**	$ 205.5	$ 215.8
ROIC – Consolidated period-to-date[2]	**3.7%**	3.5%	**7.2%**	8.8%	13.6%
Average exchange rate (US$ per C$1.00)[3]	**$ 0.917**	$ 0.906	**$ 0.912**	$ 0.977	$ 0.984

[1] Further information on operating cash flows can be found in the Company's unaudited interim consolidated financial statements.
[2] Consolidated Return on Invested Capital ("ROIC") is equal to operating income/loss, plus realized gains/losses on derivatives, equity income/loss from joint venture and other income/expense, all net of minority interest, divided by the average invested capital during the period. Invested capital is equal to capital assets, plus long-term investments and net non-cash working capital, all excluding minority interest components.
[3] Source – Bank of Canada (average noon rate for the period).

Analysis of Specific Material Items Affecting Comparability of Shareholder Net Income

After-tax impact, net of non-controlling interests (millions of Canadian dollars, except per share amounts)	Q2 2014	Q1 2014	YTD 2014	Q2 2013	YTD 2013
Shareholder net income, as reported	**$ 54.3**	$ 45.5	**$ 99.8**	$ 110.3	$ 172.2
(Gain) loss on derivative financial instruments	**$ (2.1)**	$ 2.1	**$ -**	$ 1.0	$ (1.2)
Mark-to-market adjustment to Canfor-LP OSB sale contingent consideration[4]	**$ 4.5**	$ 0.4	**$ 4.9**	$ -	$ -
Gain on completion of sale of Canfor-LP OSB (including contingent consideration)[4]	**$ -**	$ -	**$ -**	$ (33.4)	$ (33.4)
Gain on sale of Daaquam Sawmill	**$ -**	$ (1.6)	**$ (1.6)**	$ -	$ -
Foreign exchange loss on long-term debt	**$ -**	$ -	**$ -**	$ 1.8	$ 4.1
Canfor's 50% interest in Canfor-LP OSB's income, net of tax[4]	**$ -**	$ -	**$ -**	$ 3.8	$ 12.1
Change in substantively enacted tax rate	**$ -**	$ -	**$ -**	$ 4.2	$ 4.2
Net impact of above items	**$ 2.4**	$ 0.9	**$ 3.3**	$ (22.6)	$ (14.2)
Adjusted shareholder net income	**$ 56.7**	$ 46.4	**$ 103.1**	$ 87.7	$ 158.0
Shareholder net income per share (EPS), as reported	**$ 0.39**	$ 0.33	**$ 0.72**	$ 0.77	$ 1.21
Net impact of above items per share[5]	**$ 0.02**	$ 0.01	**$ 0.02**	$ (0.16)	$ (0.10)
Adjusted shareholder net income per share[5]	**$ 0.41**	$ 0.34	**$ 0.74**	$ 0.61	$ 1.11

[4] The Company completed the sale of its 50% share of the Canfor-LP OSB Limited Partnership ("Canfor-LP OSB") in the second quarter of 2013 and recorded a gain of $33.4 million (after tax). As part of the sale, Canfor may receive additional annual consideration over a 3 year period, starting June 1, 2013, based on Peace Valley OSB's annual adjusted earnings before interest, tax, depreciation and amortization. An asset was recorded based on the fair value of this additional consideration and will be adjusted to current estimated fair value each reporting period. Based on the estimated fair value at June 30, 2014, a loss of $4.5 million (after tax) was recorded in the second quarter of 2014.

[5] The year-to-date net impact of the adjusting items per share and adjusted shareholder net income per share does not equal the sum of the quarterly per share amounts due to rounding and the weighted average common shares outstanding during the applicable period.

The Company reported operating income of $97.3 million for the second quarter of 2014, compared to operating income of $84.4 million for the first quarter of 2014. The positive variance largely reflected improved shipments across all segments in the current quarter resulting from improved railcar availability and resolution of the truckers' strike at the Vancouver port in the first quarter of 2014, mitigated somewhat by lower sales realizations in both the lumber and pulp and paper segments and maintenance outages at the Company's pulp and paper facilities.

Reflecting the overhang of lumber inventories in British Columbia resulting from the transportation challenges experienced in the previous quarter, Western Spruce/Pine/Fir ("SPF") lumber prices saw a gradual decline through most of the second quarter of 2014. Towards the end of quarter, however, prices picked up in response to improved demand and as inventories reached more balanced levels. The U.S. housing market continued its recovery, albeit at a slower pace than anticipated as home construction activities continued to be hampered by a shortage of building lots and skilled construction workers across the country, as well as tight credit availability. U.S. housing starts averaged 980,000 units SAAR (seasonally adjusted annual rate), up 6% from the previous quarter. In Canada, lumber consumption was higher than the previous quarter, with Canadian housing starts up 11% from the first quarter of 2014, to 196,000 units SAAR. Offshore demand was steady, with higher shipments reflecting the improved transportation performance.

The Company's lumber sales realizations decreased moderately compared to the previous quarter, as a 9% decline in the average North American Western SPF 2x4 #2&Btr price (down US$32 per Mfbm to US$335 per Mfbm) was mitigated by less pronounced decreases on most wider dimension products as well as improved pricing on several other grades and more stable offshore prices. The latter largely reflected the nature of offshore pricing, much of which is negotiated monthly or quarterly in advance. Current quarter sales realizations also reflected the favourable impact of a higher percentage of prime products, in part reflecting the closure of the Company's Quesnel Sawmill in the first quarter of 2014, and the unfavourable impact of a 1% stronger Canadian dollar compared to the US dollar. Overall sales realizations for Southern Yellow Pine ("SYP") products were up modestly compared to the previous quarter; while the benchmark SYP 2x4 #2 price was relatively unchanged, moderate increases were seen for several wider dimension products, which more than offset a decline in the 2x6 #2 price.

Lumber shipments, at over 1.2 billion board feet, were up 33% from the previous quarter, reflecting the aforementioned improved railcar availability and increased offshore shipments. Lumber production, at just under 1.1 billion board feet, was down 2% from the first quarter of 2014, largely as a result of the closure of the Company's Quesnel Sawmill and the sale of the Company's Daaquam Sawmill in the previous quarter. Excluding the impact of the Quesnel and Daaquam Sawmills, the Company's lumber production was up 6% from the previous quarter, principally due to improved productivity following completion of several major capital projects as well as improved weather. Production in the current quarter was impacted by capital related downtime and continued ramp-ups at several sawmills following major capital upgrades in previous quarters. Lumber unit manufacturing costs were down slightly from the previous quarter, driven in part by the continued productivity improvements as well as other seasonal factors. Log costs remained relatively stable, mainly due to seasonally lower logging activity in the current quarter, ahead of an anticipated increase in log costs in the third quarter of 2014.

Global softwood pulp markets were steady through the second quarter of 2014. Softwood pulp demand was solid across all regions and global softwood pulp producer inventory levels tightened through the quarter, decreasing 3 days from the end of March 2014 to 25 days' supply in June 2014, partly reflecting supply constraints due to seasonal maintenance downtime. The North American NBSK pulp list price was stable over the quarter averaging US$1,030 per tonne, up US$13 per tonne, or 1%, compared to the first quarter of 2014. Discount levels were consistent with the previous quarter. The NBSK pulp list price to Europe also remained largely unchanged, averaging US$925 per tonne, up US$5 per tonne from the previous quarter, while the average NBSK pulp list price to China was down US$27 per tonne, or 4%, to US$730 per tonne. Despite the average NBSK pulp prices to North America and Europe increasing slightly compared to the previous quarter, the combination of the weaker prices to China, the 1% stronger Canadian dollar and a higher proportion of shipments to lower-margin markets, including Asia (mostly tied to constraints in the previous quarter due to the Vancouver Port truckers' strike), resulted in a small decrease in pulp unit sales realizations.

Pulp shipments were up 23% from the previous quarter, largely attributable to improved transportation performance following the challenges experienced in the prior quarter. Pulp production levels were down 7% from the previous quarter principally related to the maintenance outages at the Intercontinental and Prince George Pulp Mills, which reduced market pulp production by 18,000 tonnes. Pulp unit manufacturing costs were up moderately compared to the previous quarter, mostly due to the aforementioned maintenance outages and increased fibre costs, partially offset by seasonally lower energy costs. The higher unit fibre costs reflected higher delivered sawmill residual and whole log chip costs and seasonal factors.

Compared to the second quarter of 2013, operating income was down $30.9 million, reflecting a $41.4 million decrease in the lumber segment partly offset by a $12.3 million improvement in the pulp and paper segment. Both segments benefitted from gains in unit sales realizations, in part reflecting a 6% weaker Canadian dollar compared to the US dollar, with the pulp and paper segment seeing both solid increases in sales realizations and higher shipments compared to the second quarter of 2013. These gains were offset in part by higher unit manufacturing costs mostly as a result of market-driven increases to fibre and log costs, particularly for the lumber segment, coupled with the unfavourable unit impact of lower production levels in both segments.

OPERATING RESULTS BY BUSINESS SEGMENT

Lumber

Selected Financial Information and Statistics – Lumber

(millions of Canadian dollars unless otherwise noted)	Q2 2014	Q1 2014	YTD 2014	Q2 2013	YTD 2013
Sales	**$ 614.5**	$ 495.7	**$ 1,110.2**	$ 586.8	$ 1,129.1
Operating income before amortization	**$ 102.2**	$ 84.3	**$ 186.5**	$ 145.4	$ 261.1
Operating income	**$ 74.1**	$ 56.4	**$ 130.5**	$ 115.5	$ 203.9
Average SPF 2x4 #2&Btr lumber price in US$[6]	**$ 335**	$ 367	**$ 351**	$ 335	$ 363
Average SPF price in Cdn$	**$ 365**	$ 405	**$ 385**	$ 343	$ 369
Average SYP 2x4 #2 lumber price in US$[7]	**$ 405**	$ 403	**$ 404**	$ 392	$ 422
Average SYP price in Cdn$	**$ 442**	$ 445	**$ 443**	$ 401	$ 429
U.S. housing starts (thousand units SAAR)[8]	**980**	925	**953**	865	906
Production – SPF lumber (MMfbm)[9]	**935.0**	980.8	**1,915.8**	1,078.9	2,105.5
Production – SYP lumber (MMfbm)[9]	**153.6**	135.4	**289.0**	131.9	263.0
Shipments – SPF lumber (MMfbm)[10]	**1,062.6**	779.4	**1,842.0**	1,075.5	2,038.8
Shipments – SYP lumber (MMfbm)[10]	**168.4**	143.2	**311.6**	141.7	264.1
Shipments – wholesale lumber (MMfbm)	**5.4**	4.8	**10.2**	6.8	13.9

[6] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.).
[7] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.).
[8] Source – U.S. Census Bureau, seasonally adjusted annual rate ("SAAR").
[9] Excluding production of trim blocks.
[10] Canfor-produced lumber, including lumber purchased for remanufacture and excluding trim blocks.

Overview

Operating income for the lumber segment was $74.1 million for the second quarter of 2014, an increase of $17.7 million compared to operating income of $56.4 million in the previous quarter, and down $41.4 million from operating income of $115.5 million reported for the second quarter of 2013.

The improved earnings compared to the previous quarter were mostly attributable to a 33% increase in shipments principally due to the aforementioned improvement in transportation performance following the challenges experienced in the first quarter of 2014. These higher shipments were offset in part by a moderate decrease in unit sales realizations resulting from a modest reduction in prices and a 1% stronger Canadian dollar compared to the US dollar. Overall unit manufacturing costs were down slightly compared to the first quarter of 2014, stemming principally from improved productivity.

The decrease in lumber segment earnings compared to the second quarter of 2013, for the most part reflected higher unit manufacturing costs, offset somewhat by modest improvements in unit sales realizations and a 6% weaker Canadian dollar compared to the US dollar. The increased unit manufacturing costs reflected higher log costs, driven by market-related stumpage increases and to a lesser extent, higher hauling and logging costs, coupled with increased unit conversion costs, reflecting more capital related downtime and ramp-ups and elevated dust management efforts in the current period.

Shipments and production in the current period were also impacted by the closure of the Company's Quesnel Sawmill and sale of the Company's Daaquam Sawmill late in the first quarter of 2014, which reduced total production levels compared to both comparable periods.

Markets

During the second quarter of 2014, Western SPF lumber prices declined gradually through most of the quarter as the market was impacted by the buildup of lumber supply in British Columbia resulting from the transportation challenges experienced in the first quarter of 2014. Western SPF lumber prices picked up towards the end of the quarter reflecting an increase in demand and more balanced inventory levels. The U.S. housing market recovery continued, albeit at a slower pace than anticipated as home construction activities continued to be hampered by a shortage of building lots and skilled construction workers across the country, as well as tighter credit availability. U.S. housing starts averaged 980,000 units[11] SAAR, up 6% from the first quarter of 2014 and 13% higher than the same period in 2013. Single-family starts, which consume a larger proportion of lumber, increased modestly by 3% compared to the first quarter of 2014 to 619,000 units[11] SAAR. Demand in the repair and remodeling sector also picked up as better weather in the second quarter led to increased home improvement projects in North America.

In Canada, housing starts averaged 196,000 units[12] SAAR for the quarter, up 20,000 units, or 11%, compared to the first quarter of 2014 and up 4% compared to the same period in 2013.

Canfor's offshore lumber shipments were higher compared to the previous quarter, reflecting improved railcar availability and resolution of the truckers' strike, both of which unfavourably impacted shipments in the previous quarter. China and Japan bound shipments returned to more normal levels in the second quarter.

Sales

Sales for the lumber segment for the second quarter of 2014 were $614.5 million, compared to $495.7 million in the previous quarter and $586.8 million in the second quarter of 2013. Higher shipments in the current period more than offset moderate decreases in sales realizations compared to the previous quarter. Total shipments in the second quarter of 2014, at over 1.2 billion board feet, were up 33% from the previous quarter and broadly in line with the same period in 2013, primarily reflecting the aforementioned improved railcar availability and increased offshore shipments, offset slightly by the impact of reduced production compared to both prior periods. Current quarter sales also reflected seasonally lower log sales volumes compared to the previous quarter.

Sales realizations decreased moderately compared to the previous quarter. The benchmark North American Random Lengths Western SPF 2x4 #2&Btr price saw a 9% decline quarter-over-quarter, down US$32 per Mfbm to US$335 per Mfbm, but this impact on North American sales realizations was mitigated by less pronounced decreases on most wider dimension products as well as improved pricing on several other grades, such as machine stress rated ("MSR") grades, and more stable offshore prices. Current quarter sales realizations also included the favourable impact of a higher percentage of prime products, in part reflecting the closure of the Company's Quesnel Sawmill in the first quarter of 2014. Offshore sales realizations remained broadly in line with the previous quarter, due in part to the nature of pricing, much of which is negotiated monthly or quarterly in advance. Current quarter sales realizations were also unfavourably impacted by a 1% stronger Canadian dollar (for the Company's Canadian operations). Overall sales realizations for SYP products were up modestly compared to the previous quarter, with the benchmark SYP 2x4 #2 price relatively unchanged, up US$2 per Mfbm from the previous quarter, and more marked increases in certain wider dimension products, which more than offset a decline in the 2x6 #2 price.

Compared to the second quarter of 2013, sales realizations showed a modest improvement. Despite an unchanged benchmark North American Random Lengths Western SPF 2x4 #2&Btr price, sales realizations were boosted by a 6 cent, or 6%, weaker Canadian dollar and, to a lesser extent, a more favourable product mix. Gains on North American sales realizations were partly offset by a moderate decrease in quarter-over-quarter offshore sales realizations reflecting a more pronounced impact from the advance nature of pricing seen in the second quarter of 2013. Overall sales realizations for SYP products saw modest declines compared to the same quarter in the previous year, as a small improvement in pricing was offset by a lower-value grade mix.

Total residual fibre revenue was down compared to the first quarter of 2014, as lower shipments, partly reflecting the absence of Daaquam and Quesnel sawmill volumes, offset market-driven increases in sawmill residual chip prices and other seasonal factors. Compared to the second quarter of 2013, total residual fibre revenue was up slightly, with lower shipments of sawmill residual chips offset by higher sawmill residual chip prices.

[11] U.S. Census Bureau
[12] CMHC – Canada Mortgage and Housing Corporation

Operations

Lumber production, at just under 1.1 billion board feet, was down 2% from the previous quarter, largely as a result of the closure of the Company's Quesnel Sawmill and sale of the Company's Daaquam Sawmill in the previous quarter. Excluding the impact of the Quesnel and Daaquam Sawmills in the previous quarter, the Company's production was up 6% from the first quarter of 2014, principally due to improved productivity following completion of several major capital projects as well as improved weather compared to the previous quarter. Capital related downtime and ramp-ups impacted both the current quarter and the first quarter of 2014 as well as continued ramp-ups at several sawmills following major capital upgrades in the previous quarters.

Compared to the second quarter of 2013, lumber production was down 10%, and excluding the production from the Quesnel and Daaquam Sawmills, production was down 2% principally reflecting the impact of capital related downtime and ramp-ups in the current quarter as well as less operating hours in the current period mainly due to the timing of the Easter holiday, offset in part by additional shifts at the Company's southern pine operations.

Unit manufacturing costs showed a small improvement from the previous quarter, with a modest decrease in unit cash conversion costs and relatively unchanged unit log costs. The improvement in unit cash conversion costs was largely due to higher productivity. Current quarter unit manufacturing costs continued to reflect ongoing dust control efforts. Log costs for most operations remained stable, reflecting seasonally lower logging activity and improved recovery due in part to recent capital improvements and seasonality. Log costs are anticipated to increase in the third quarter of 2014.

Compared to the second quarter of 2013, unit manufacturing costs were up as a result of increases to both unit log costs and unit cash conversion costs. The increase in unit log costs was primarily the result of market-driven increases in stumpage and to a lesser extent, higher hauling and logging costs, due in part to increased contractor rates and higher diesel costs. Higher unit cash conversion costs principally reflected the lower production levels in the current quarter as well as market-related increases in energy costs, further dust management efforts and higher labour costs.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[13]

(millions of Canadian dollars unless otherwise noted)	**Q2 2014**	Q1 2014	**YTD 2014**	Q2 2013	YTD 2013
Sales	**$ 292.8**	$ 246.2	**$ 539.0**	$ 255.5	$ 499.0
Operating income before amortization	**$ 46.6**	$ 53.0	**$ 99.6**	$ 38.0	$ 76.3
Operating income	**$ 30.9**	$ 36.5	**$ 67.4**	$ 18.6	$ 37.5
Average pulp price delivered to U.S. – US$[14]	**$ 1,030**	$ 1,017	**$ 1,023**	$ 937	$ 917
Average price in Cdn$	**$ 1,123**	$ 1,122	**$ 1,122**	$ 959	$ 932
Production – pulp (000 mt)	**288.7**	310.4	**599.1**	301.6	618.6
Production – paper (000 mt)	**35.4**	36.7	**72.1**	35.3	70.1
Shipments –pulp (000 mt)	**314.4**	255.9	**570.3**	307.8	616.0
Shipments – paper (000 mt)	**39.7**	31.3	**71.0**	37.2	72.2

[13] Includes the Taylor Pulp Mill and 100% of Canfor Pulp Products Inc., which is consolidated in Canfor's results. Pulp production and shipment volumes presented are for both NBSK and bleached chemi-thermo mechanical pulp ("BCTMP").
[14] Per tonne, NBSK pulp list price delivered to U.S. (Resource Information Systems, Inc.).

Overview

Operating income for the pulp and paper segment was $30.9 million for the second quarter of 2014, down $5.6 million from the previous quarter, and up $12.3 million from the second quarter of 2013.

Increased shipments in the current quarter reflected the release of inventories built in the first quarter of 2014 as a result of the transportation related challenges. While prices to North America and Europe held up well during the period, a combination of lower prices to China, a slightly stronger Canadian dollar compared to the US dollar, and a higher proportion of shipments to Asia resulted in a small decrease in the average unit sales realizations. Results in the current quarter were also impacted by maintenance outages at the Intercontinental and Prince George Pulp Mills and, to a lesser extent, operational challenges encountered following the outages, both of which contributed to lower production levels in the current quarter. Increased unit manufacturing costs in the current quarter were largely attributable to higher delivered fibre costs, which reflected market and seasonal factors, as well as increased freight costs, coupled with higher costs primarily driven by the maintenance outages and the lower production levels.

Compared to the second quarter of 2013, results reflected improved unit sales realizations, reflecting strong gains in NBSK pulp prices across all regions coupled with the benefit of a 6% weaker Canadian dollar, as well as the impact of slightly higher shipments. Unit manufacturing costs were up compared to the same period in 2013, principally as the result of higher fibre (linked to NBSK pulp sales realizations) and energy costs and the unfavourable impact to unit costs of the reduced production levels in the current quarter, reflecting operational challenges encountered following the maintenance outages in the current quarter. Increased energy revenue resulting from the recent turbine generator upgrades also contributed to the higher quarter-over-quarter earnings.

Markets

Global softwood pulp markets were steady through the second quarter of 2014. Softwood pulp demand was solid across all regions and global softwood pulp producer inventory levels tightened through the quarter, decreasing 3 days from the end of March 2014 to 25 days' supply in June 2014[15], partly reflecting supply constraints due to seasonal maintenance downtime. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

Global shipments of bleached softwood kraft pulp improved modestly in the second quarter in part reflecting efforts to clear the inventory backlog created by transportation challenges experienced in the first quarter of 2014. However, global shipments of bleached softwood kraft pulp were relatively unchanged for the first half of 2014 compared to the same period in 2013[16], due in part to the transportation challenges experienced in North America in the first quarter of 2014.

Sales

The Company's pulp shipments in the second quarter of 2014 were 314,400 tonnes, an increase of 58,500 tonnes, or 23%, from the previous quarter, and up 6,600 tonnes, or 2%, from the same period in 2013. Increased shipments compared to the both comparative quarters largely reflected the aforementioned improved transportation performance. Shipments to Asia were up relative to both comparable periods, with the increase relative to the immediately preceding quarter reflecting both the truckers' strike at the Vancouver Port as well as the traditional Chinese Lunar New Year Holiday in the previous quarter. Total shipments compared to the same period in 2013 included the impact of the maintenance outages in the current quarter, while the second quarter of 2013 also included a drawdown in inventory levels.

Global softwood pulp markets were steady through the current quarter, with the average North American NBSK pulp list price holding for the quarter at an almost three-year high of US$1,030 per tonne, up US$13 per tonne, or 1%, compared to the first quarter of 2014, in part reflecting the spring maintenance period offset slightly by the release of inventories built due to the transportation challenges experienced in the previous quarter. Discount levels were consistent with the previous quarter. The NBSK pulp list price to Europe also remained largely unchanged, averaging US$925 per tonne, up US$5 per tonne from the previous quarter, while the average NBSK pulp list price to China saw a modest decline, down US$27 per tonne, or 4%, to US$730 per tonne. Current quarter sales realizations were down slightly compared to the previous quarter, mainly reflecting the lower pulp prices to China, the 1% stronger Canadian dollar and increased shipments to lower-margin markets, particularly Asia. Current quarter sales included a modest increase in energy output resulting from the recently commissioned turbine upgrades at the Northwood Pulp Mill. Bleached chemi-thermo mechanical pulp ("BCTMP") average sales realizations were broadly in line with the previous quarter.

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

Compared to the second quarter of 2013, pulp sales realizations continued to see strong gains as a result of increases in average pulp list prices in all regions and the 6% weaker Canadian dollar. The North American NBSK pulp list price increased US$93 per tonne, or 10%. NBSK pulp list prices to China and Europe also experienced gains, up 4% and 8%, respectively, from the same period in 2013. These gains were partly offset by increased discounts in North American markets through the second half of 2013 and increased volumes to lower-margin regions, principally Asia. Energy revenue also saw solid gains compared to the second quarter of 2013, principally due to the aforementioned upgrades to the Northwood Pulp Mill turbines completed earlier in 2014. BCTMP sales realizations were well up compared to the second quarter of 2013, also reflecting higher market pricing and the weaker Canadian dollar.

Operations

Pulp production in the current quarter was 288,700 tonnes, down 21,700 tonnes, or 7%, from the previous quarter, and down 12,900 tonnes, or 4%, from the second quarter of 2013. Production in the current quarter reflected maintenance outages at the Intercontinental and Prince George Pulp Mills, which reduced market pulp production by 18,000 tonnes. The Company's BCTMP Taylor Pulp Mill also took a five day maintenance shutdown in the current quarter. In the comparative second quarter of 2013, production levels included maintenance outages at the Northwood and Intercontinental Pulp Mills, which reduced market pulp production by a similar level and a maintenance shutdown at the Company's BCTMP Taylor Pulp Mill. Operating rates at the Company's NBSK Pulp Mills in the current quarter were lower than both comparable periods as a result of several operational challenges encountered following the maintenance outages.

Pulp unit manufacturing costs were up moderately compared to the previous quarter, reflecting higher fibre costs and the maintenance outages in the quarter. The increased fibre costs compared to the first quarter of 2014 reflected higher prices for sawmill residual and whole log chips, seasonal pricing adjustments and higher freight costs, all of which were partially offset by a lower proportion of the higher-cost whole log chips. Somewhat mitigating these factors were seasonally lower energy costs and usage in the current quarter.

Compared to the second quarter of 2013, unit manufacturing costs were higher primarily driven by increased fibre costs, largely attributable to market-driven increases to sawmill residual chip and whole log chip prices and higher freight costs, offset slightly by a lower proportion of the higher-cost whole log chips. Also contributing to higher unit manufacturing costs compared to the same period in 2013 were lower production levels as well as higher natural gas prices and usage, with the higher usage related to maintenance work performed in the current quarter.

Unallocated and Other Items

Selected Financial Information

(millions of Canadian dollars)	Q2 2014	Q1 2014	YTD 2014	Q2 2013	YTD 2013
Operating loss of Panels operations[17]	**$ (1.1)**	$ (1.3)	**$ (2.4)**	$ (0.6)	$ (1.3)
Corporate costs	**$ (6.6)**	$ (7.2)	**$ (13.8)**	$ (5.3)	$ (11.9)
Finance expense, net	**$ (4.4)**	$ (4.4)	**$ (8.8)**	$ (6.3)	$ (15.1)
Foreign exchange loss on long-term debt	**$ -**	$ -	**$ -**	$ (4.0)	$ (7.8)
Gain (loss) on derivative financial instruments	**$ 3.1**	$ (3.5)	**$ (0.4)**	$ (2.7)	$ 0.6
Gain on sale of Canfor–LP OSB joint venture	**$ -**	$ -	**$ -**	$ 38.3	$ 38.3
Other income (expense), net	**$ (10.8)**	$ 3.3	**$ (7.5)**	$ 6.8	$ 8.5

[17] The Panels operations include the Company's PolarBoard oriented strand board ("OSB") plant, which is currently indefinitely idled and its Tackama plywood plant, which was closed in January 2012.

Corporate costs were $6.6 million for the second quarter of 2014, down $0.6 million from the previous quarter and up $1.3 million from second quarter of 2013.

Net finance expense for the first quarter of 2014 was $4.4 million, in line with the first quarter of 2014 and down $1.9 million from the second quarter of 2013. The decrease compared to the second quarter of 2013 reflected lower debt levels and lower employee future benefit net interest costs, due in part to the improved financial position of most of the Company's defined benefit plans.

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs, lumber prices, pulp prices and interest rates. In the second quarter of 2014, the Company recorded a net gain of $3.1 million related to its derivative instruments, principally reflecting unrealized gains on US dollar foreign exchange collars as a result of the strengthening of the Canadian dollar through the quarter, as well as realized gains on the settlement of lumber futures.

Other expense, net of $10.8 million in the second quarter of 2014 included a $6.1 million negative fair value adjustment to the Canfor-LP OSB contingent consideration asset, reflecting weaker forecast OSB prices over the contingent consideration period. The first year of the three year contingent consideration earn-out period ended on May 31, 2014 and no amounts were paid to Canfor under the contingent consideration arrangement as minimum earnings thresholds were not met. Also included in other expense, net in the current quarter were foreign exchange losses on US dollar denominated working capital of $4.7 million resulting from the strengthening of the Canadian dollar relative to the US dollar over the course of the quarter.

Other Comprehensive Income (Loss)

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

(millions of Canadian dollars)	Q2 2014	Q1 2014	YTD 2014	Q2 2013	YTD 2013
Foreign exchange translation differences for foreign operations	**$ (10.0)**	$ 10.6	**$ 0.6**	$ 9.1	$ 12.6
Defined benefit actuarial gains (losses), net of tax	**$ (26.2)**	$ (24.3)	**$ (50.5)**	$ 28.4	$ 34.2
Other comprehensive income (loss), net of tax	**$ (36.2)**	$ (13.7)	**$ (49.9)**	$ 37.5	$ 46.8

In the second quarter of 2014, the Company recorded an after-tax loss to the Statements of Other Comprehensive Income (Loss) of $26.2 million in relation to changes in the valuation of the Company's employee future benefit plans. During the second quarter of 2014, actuarial funding valuations were completed for a number of the Company's employee future benefit plans resulting in revisions to actuarial assumptions as well as adjustments for plan member experience. Based on completion of the actuarial funding valuations, Canfor's overall funded position on a solvency basis has improved and future pension funding requirements will decrease. The Company's largest pension plan is now 100% funded on a solvency basis. On an accounting basis, as at June 30, 2014, the Company's largest pension plan was in a slight net liability position while certain of the Company's other employee future benefit plans were in net asset positions.

The defined benefit actuarial loss recorded in the second quarter of 2014 reflects a lower discount rate used to value the net retirement benefit obligations, as well as the actuarial assumption and experience adjustments, offset in part by a modest return on plan assets. In the previous quarter, a loss of $24.3 million (after-tax) was recorded, while an after-tax gain of $28.4 million was recorded in the second quarter of 2013.

In addition, the Company recorded $10.0 million of other comprehensive loss in the quarter for foreign exchange differences for foreign operations, reflecting unfavourable foreign exchange movements during the quarter. This compared to a foreign exchange gain of $10.6 million in the previous quarter and $9.1 million in the second quarter of 2013.

SUMMARY OF FINANCIAL POSITION

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

(millions of Canadian dollars, except for ratios)	Q2 2014	Q1 2014	YTD 2014	Q2 2013	YTD 2013
Increase (decrease) in cash and cash equivalents	**$ 19.8**	$ (1.6)	**$ 18.2**	$ 165.5	$ 188.8
Operating activities	**$ 206.3**	$ (50.1)	**$ 156.2**	$ 260.2	$ 316.2
Financing activities	**$ (150.2)**	$ 99.9	**$ (50.3)**	$ (134.1)	$ (126.0)
Investing activities	**$ (36.3)**	$ (51.4)	**$ (87.7)**	$ 39.4	$ (1.4)
Ratio of current assets to current liabilities			**1.7:1**		1.8:1
Net debt to capitalization			**10.8%**		3.0%
ROIC - Consolidated period-to-date	**3.7%**	3.5%	**7.2%**	8.8%	13.6%
ROCE - Canfor solid wood business[18] period-to-date	**4.1%**	2.7%	**6.8%**	7.0%	12.6%

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

Changes in Financial Position

Cash generated from operating activities was $206.3 million in the second quarter of 2014, compared to cash used of $50.1 million in the previous quarter and cash generated of $260.2 million in the same quarter of 2013. The increase in operating cash flows from the previous quarter principally reflected higher cash earnings and a decrease in non-cash working capital in the current quarter. The most significant driver of the decrease in non-cash working capital was a drawdown of log inventories during the Canadian spring break-up period as well as reductions in finished inventories as transportation constraints from the first quarter of 2014 eased somewhat in some regions. Partially offsetting these reductions in working capital was an increase in prepaid assets in part due to seasonally higher reforestation-related payments, an increase in trade accounts receivable due to transportation-related lower shipments at the end of the first quarter and a decrease in stumpage payable stemming from seasonally lower logging activity in the second quarter of 2014. Compared to the second quarter of 2013, the decrease in cash generated from operating activities was mostly attributable to lower cash earnings.

Cash used in financing activities was $150.2 million in the current quarter, compared to cash generated of $99.9 million in the previous quarter and cash used of $134.1 million in the same quarter of 2013. In the current quarter, Canfor purchased 4,331,200 common shares under its Normal Course Issuer Bid for $103.9 million, of which $102.7 million was paid in cash in the period, with the balance paid in early July. Cash paid for share purchases in the second quarter also included $3.0 million related to shares purchased at the end of the first quarter. This compares to cash paid for Normal Course Issuer Bid share purchases of $2.0 million in previous quarter and $10.3 million in the same quarter of 2013. During the current quarter, the Company paid $2.6 million in finance expenses which is broadly in line with the previous quarter and down $4.9 million from same quarter in 2013 reflecting less interest in the current period. During the current quarter, Canfor repaid $39.0 million against its operating loan facility and had $143.0 million outstanding at the end of the quarter, while the investing cash flow in the first quarter of 2014 included a $106.8 million drawn on the operating loan facility. In the second quarter of 2013, Canfor repaid its US$75 million 5.42% term debt and $40.0 million of its operating loan facility.

Cash used for investing activities was $36.3 million in the second quarter of 2014, compared to $51.4 million in the previous quarter and cash generated of $39.4 million in the same quarter of 2013. Cash used for capital additions was $63.0 million, up $9.9 million from the previous quarter and up $14.2 million from the second quarter of 2013. Cash paid for capital in the current quarter included capital expenditures for the Company's Grande Prairie Sawmill upgrade and payments for various other upgrades in the lumber segment. In the pulp and paper segment, capital expenditures primarily related to Canfor Pulp's Intercontinental Pulp Mill's turbine upgrade and maintenance capital related to the maintenance outages during the quarter. Investing activities in the current quarter also included $22.9 million cash received from the sale of the Daaquam operation which occurred at the end of the first quarter of 2014. In the second quarter of 2013, Canfor received $76.6 million in proceeds from the sale of the Company's 50% share in the Canfor-LP OSB joint venture.

Liquidity and Financial Requirements

At June 30, 2014, the Company on a consolidated basis had cash of $107.7 million, $143.0 million drawn on its operating loans, and an additional $25.8 million reserved for several standby letters of credit. Total available undrawn operating loans were $311.2 million.

Canfor has $100.0 million of floating interest rate term debt, repayable in February 2017 and CPPI has $50.0 million of floating interest rate term debt, repayable in November 2018.

The Company and CPPI remained in compliance with the covenants relating to their operating loans and long-term debt during the quarter, and expect to remain so for the foreseeable future.

The Company's consolidated net debt to total capitalization at the end of the second quarter of 2014 was 10.8%. For Canfor, excluding CPPI, net debt to capitalization at the end of the second quarter of 2014 was 11.8%.

On March 5, 2014, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 6,995,228 common shares or approximately 5% of its issued and outstanding common shares as of February 28, 2014. The renewed normal course issuer bid is set to expire on March 4, 2015. During the second quarter of 2014, Canfor purchased 4,331,200 common shares for $103.9 million (an average of $23.99 per common share), of which $102.7 million was paid in cash in the period, with the balance paid in early July. Cash paid for share purchases in the second quarter of 2014 of $105.7 million also included payment of $3.0 million for purchases that occurred in the first quarter of 2014.

OUTLOOK

Lumber

For the third quarter of 2014, North American lumber consumption is forecast to improve with steady demand in the residential construction market and continued strength from the repair and remodeling sector. The build of lumber inventories from the shortage of railcars in the first quarter of 2014 is projected to be cleared before the end of the third quarter. Offshore shipments are forecast to remain stable reflecting steady demand from China and other emerging markets, while shipments to Japan are projected to ease and prices soften from lower lumber demand.

Pulp and Paper

NBSK pulp markets are steady heading into the seasonally slower third quarter of 2014. For the month of July 2014, Canfor Pulp announced NBSK pulp list prices of US$1,030 per tonne in North America and US$730 per tonne in China, both unchanged from June 2014. A risk of pulp price weakness remains for the second half of 2014 due in part to reduced global consumption during the historically slower summer months and new hardwood pulp capacity projected to flow into markets.

OUTSTANDING SHARES

At July 24, 2014, there were 135,376,993 common shares outstanding.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with International Financial Reporting Standards requires management to make estimates and assumptions that affect the amounts recorded in the financial statements. On an ongoing basis, management reviews its estimates, including those related to useful lives for amortization, impairment of long-lived assets, certain accounts receivable, pension and other employee future benefit plans and asset retirement and deferred reforestation obligations based upon currently available information. While it is reasonably possible that circumstances may arise which cause actual results to differ from these estimates, management does not believe it is likely that any such differences will materially affect the Company's financial condition.

ACCOUNTING STANDARDS ISSUED AND NOT APPLIED

In May 2011, the International Accounting Standards Board ("IASB") issued IFRS 9, *Financial Instruments*. The required adoption date for IFRS 9 has been deferred from the original date of January 1, 2015 and is currently under review by the IASB.

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*, which will supersede IAS 18, *Revenue*, IAS 11, *Construction Contracts* and related interpretations. The new standard is effective for annual periods beginning on or after January 1, 2017. The Company is still in the process of assessing the impact, if any, on the financial statements of this new standard.

Further details of the new accounting Standards and the potential impact on Canfor can be found in the Company's Annual Report for the year ended December 31, 2013.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ended June 30, 2014, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

RISKS AND UNCERTAINTIES

A comprehensive discussion of risks and uncertainties is included in the Company's 2013 annual statutory reports which are available on www.canfor.com or www.sedar.com.

On June 26, 2014 the Supreme Court of Canada ("SCC") handed down its decision regarding *Tsilhqot'in v. British Columbia* ("the William case"). The SCC has recognized that Aboriginal title to land exists and the decision also provides guidance on the extensive evidence Aboriginal groups must provide to establish title, including sufficiency, continuity and exclusivity of use. The decision has implications for the treaty negotiation process and it is unclear how government will respond.

Canfor does not have any forest tenures in the area involved in the William case and although Aboriginal groups have asserted title over substantial portions of BC, Aboriginal title has not been established in areas overlapping with Canfor's forest tenures. The process of establishing title can be lengthy and complex and in the meantime, Canfor's operations can continue under the existing requirements for Aboriginal consultation and accommodation. As such, risks and uncertainties remain consistent with those discussed in the above-referenced risks and uncertainties section of the 2013 annual statutory report, specifically titled "Aboriginal Issues".

Canfor builds mutually beneficial and lasting relationships with local First Nations whose traditional territories overlap Canfor's areas of operations. The Company communicates frequently with Aboriginal groups in the areas that Canfor operates in and, where appropriate, develops business relationships and evolves strategy, especially in the areas of timber harvesting and silviculture.

SELECTED QUARTERLY FINANCIAL INFORMATION

	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013	Q4 2012	Q3 2012
Sales and income (millions of Canadian dollars)								
Sales	**$ 907.3**	$ 741.9	$ 809.5	$ 755.9	$ 843.2	$ 786.3	$ 700.3	$ 663.7
Operating income	**$ 97.3**	$ 84.4	$ 53.8	$ 49.3	$ 128.2	$ 100.0	$ 49.0	$ 18.1
Net income	**$ 64.5**	$ 58.6	$ 35.1	$ 33.6	$ 114.3	$ 67.5	$ 24.7	$ 18.8
Shareholder net income	**$ 54.3**	$ 45.5	$ 28.0	$ 28.4	$ 110.3	$ 61.9	$ 21.3	$ 20.5
Per common share (Canadian dollars)								
Shareholder net income – basic and diluted	**$ 0.39**	$ 0.33	$ 0.20	$ 0.20	$ 0.77	$ 0.43	$ 0.15	$ 0.14
Book value[19]	**$ 9.75**	$ 10.05	$ 9.82	$ 9.47	$ 9.25	$ 8.29	$ 7.79	$ 7.65
Statistics								
Lumber shipments (MMfbm)	**1,236**	927	1,109	1,172	1,224	1,093	1,110	1,093
Pulp shipments (000 mt)	**314**	256	330	268	308	308	298	269
Average exchange rate – US$/Cdn$	**$ 0.917**	$ 0.906	$ 0.953	$ 0.963	$ 0.977	$ 0.991	$ 1.009	$ 1.005
Average Western SPF 2x4 #2&Btr lumber price (US$)	**$ 335**	$ 367	$ 370	$ 328	$ 335	$ 391	$ 335	$ 300
Average SYP (East) 2x4 #2 lumber price (US$)	**$ 405**	$ 403	$ 415	$ 393	$ 392	$ 452	$ 386	$ 322
Average NBSK pulp list price delivered to U.S. (US$)	**$ 1,030**	$ 1,017	$ 983	$ 947	$ 937	$ 897	$ 863	$ 853

[19] Book value per common share is equal to shareholders' equity at the end of the period, divided by the number of common shares outstanding at the end of the period.

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

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

After-tax impact, net of non-controlling interests (millions of Canadian dollars, except for per share amounts)	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013	Q4 2012	Q3 2012
Shareholder net income, as reported	**$ 54.3**	$ 45.5	$ 28.0	$ 28.4	$ 110.3	$ 61.9	$ 21.3	$ 20.5
(Gain) loss on derivative financial instruments	**$ (2.1)**	$ 2.1	$ 0.1	$ (2.2)	$ 1.0	$ (2.2)	$ 6.5	$ (4.4)
Mark-to-market adjustment to Canfor-LP OSB sale contingent consideration	**$ 4.5**	$ 0.4	$ 3.6	$ 1.0	$ -	$ -	$ -	$ -
Gain on sale of Canfor-LP OSB (including contingent consideration)	**$ -**	$ -	$ -	$ -	$ (33.4)	$ -	$ -	$ -
Gain on sale of Daaquam Sawmill	**$ -**	$ (1.6)	$ -	$ -	$ -	$ -	$ -	$ -
Foreign exchange (gain) loss on long-term debt and investments, net	**$ -**	$ -	$ 1.5	$ (1.0)	$ 1.8	$ 2.3	$ 1.2	$ (4.0)
Mill closure provisions	**$ -**	$ -	$ 14.8	$ -	$ -	$ -	$ -	$ -
One-time costs associated with collective agreements for the lumber business	**$ -**	$ -	$ 0.8	$ -	$ -	$ -	$ -	$ -
Canfor's 50% interest in Canfor-LP OSB's income, net of tax	**$ -**	$ -	$ -	$ -	$ 3.8	$ 8.3	$ -	$ -
Change in substantively enacted tax rate	**$ -**	$ -	$ -	$ -	$ 4.2	$ -	$ -	$ -
Net gain on post retirement and pension plan amendments	**$ -**	$ -	$ -	$ -	$ -	$ -	$ (8.7)	$ -
Restructuring charges for management changes	**$ -**	$ -	$ -	$ -	$ -	$ -	$ -	$ 1.5
Net impact of above items	**$ 2.4**	$ 0.9	$ 20.8	$ (2.2)	$ (22.6)	$ 8.4	$ (1.0)	$ (6.9)
Adjusted shareholder net income	**$ 56.7**	$ 46.4	$ 48.8	$ 26.2	$ 87.7	$ 70.3	$ 20.3	$ 13.6
Shareholder net income per share (EPS), as reported	**$ 0.39**	$ 0.33	$ 0.20	$ 0.20	$ 0.77	$ 0.43	$ 0.15	$ 0.14
Net impact of above items per share	**$ 0.02**	$ 0.01	$ 0.15	$ (0.02)	$ (0.16)	$ 0.06	$ (0.01)	$ (0.05)
Adjusted net income per share	**$ 0.41**	$ 0.34	$ 0.35	$ 0.18	$ 0.61	$ 0.49	$ 0.14	$ 0.09

Canfor Corporation
Condensed Consolidated Balance Sheets

(millions of Canadian dollars, unaudited)	**As at June 30, 2014**	As at December 31, 2013
ASSETS		
Current assets		
Cash and cash equivalents	**$ 107.7**	$ 89.5
Accounts receivable - Trade	**146.7**	112.6
- Other	**35.6**	39.3
Inventories (Note 2)	**481.8**	471.9
Prepaid expenses and other assets	**47.7**	39.1
Total current assets	**819.5**	752.4
Property, plant and equipment	**1,175.2**	1,151.9
Timber licenses	**527.0**	534.6
Goodwill and other intangible assets	**98.9**	93.5
Retirement benefit surplus (Note 5)	**4.6**	42.2
Long-term investments and other (Note 3)	**101.9**	112.5
Deferred income taxes, net	**5.8**	6.2
Total assets	**$ 2,732.9**	$ 2,693.3
LIABILITIES		
Current liabilities		
Operating loans (Note 4)	**$ 143.0**	$ 74.6
Accounts payable and accrued liabilities	**307.9**	321.8
Current portion of deferred reforestation obligations	**43.9**	44.1
Total current liabilities	**494.8**	440.5
Long-term debt	**153.2**	153.1
Retirement benefit obligations (Note 5)	**221.0**	200.5
Deferred reforestation obligations	**74.6**	69.8
Other long-term liabilities	**15.3**	14.9
Deferred income taxes, net	**217.3**	217.1
Total liabilities	**$ 1,176.2**	$ 1,095.9
EQUITY		
Share capital	**$ 1,068.0**	$ 1,103.7
Contributed surplus	**31.9**	31.9
Retained earnings	**214.6**	234.2
Accumulated foreign exchange translation differences	**5.1**	4.5
Total equity attributable to equity holders of the Company	**1,319.6**	1,374.3
Non-controlling interests	**237.1**	223.1
Total equity	**$ 1,556.7**	$ 1,597.4
Total liabilities and equity	**$ 2,732.9**	$ 2,693.3

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

APPROVED BY THE BOARD

Director, R.S. Smith

Director, M.J. Korenberg

Canfor Corporation
Condensed Consolidated Statements of Income

(millions of Canadian dollars, except per share data, unaudited)	3 months ended June 30, **2014**	3 months ended June 30, 2013	6 months ended June 30, **2014**	6 months ended June 30, 2013
Sales	**$ 907.3**	$ 843.2	**$ 1,649.2**	$ 1,629.5
Costs and expenses				
Manufacturing and product costs	**587.2**	508.2	**1,065.9**	1,000.4
Freight and other distribution costs	**156.4**	141.5	**270.2**	270.9
Amortization	**44.0**	49.6	**88.5**	96.5
Selling and administration costs	**20.7**	14.8	**39.0**	31.1
Restructuring, mill closure and severance costs	**1.7**	0.9	**3.9**	2.4
	810.0	715.0	**1,467.5**	1,401.3
Operating income	**97.3**	128.2	**181.7**	228.2
Finance expense, net	**(4.4)**	(6.3)	**(8.8)**	(15.1)
Foreign exchange loss on long-term debt	**-**	(4.0)	**-**	(7.8)
Gain (loss) on derivative financial instruments (Note 6)	**3.1**	(2.7)	**(0.4)**	0.6
Gain on sale of Canfor-LP OSB joint venture (Note 12)	**-**	38.3	**-**	38.3
Other income (expense), net	**(10.8)**	6.8	**(7.5)**	8.5
Net income before income taxes	**85.2**	160.3	**165.0**	252.7
Income tax expense (Note 7)	**(20.7)**	(46.0)	**(41.9)**	(70.9)
Net income	**$ 64.5**	$ 114.3	**$ 123.1**	$ 181.8
Net income attributable to:				
Equity shareholders of the Company	**$ 54.3**	$ 110.3	**$ 99.8**	$ 172.2
Non-controlling interests	**10.2**	4.0	**23.3**	9.6
Net income	**$ 64.5**	$ 114.3	**$ 123.1**	$ 181.8
Net income per common share: (in Canadian dollars)				
Attributable to equity shareholders of the Company				
- Basic and diluted (Note 8)	**$ 0.39**	$ 0.77	**$ 0.72**	$ 1.21

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

Canfor Corporation
Condensed Consolidated Statements of Other Comprehensive Income (Loss)

(millions of Canadian dollars, unaudited)	3 months ended June 30, 2014	3 months ended June 30, 2013	6 months ended June 30, 2014	6 months ended June 30, 2013
Net income	**$ 64.5**	$ 114.3	**$ 123.1**	$ 181.8
Other comprehensive income (loss)				
Items that will not be recycled through net income:				
Defined benefit plan actuarial gains (losses) (Note 5)	**(35.5)**	38.5	**(68.3)**	46.2
Income tax recovery (expense) on defined benefit plan actuarial gains (losses) (Note 7)	**9.3**	(10.1)	**17.8**	(12.0)
	(26.2)	28.4	**(50.5)**	34.2
Items that may be recycled through net income:				
Foreign exchange translation differences for foreign operations	**(10.0)**	9.1	**0.6**	12.6
Other comprehensive income (loss), net of tax	**(36.2)**	37.5	**(49.9)**	46.8
Total comprehensive income	**$ 28.3**	$ 151.8	**$ 73.2**	$ 228.6
Total comprehensive income attributable to:				
Equity shareholders of the Company	**$ 19.0**	$ 144.5	**$ 54.2**	$ 215.6
Non-controlling interests	**9.3**	7.3	**19.0**	13.0
Total comprehensive income	**$ 28.3**	$ 151.8	**$ 73.2**	$ 228.6

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

Canfor Corporation
Condensed Consolidated Statements of Changes in Equity

(millions of Canadian dollars, unaudited)	3 months ended June 30, **2014**	3 months ended June 30, 2013	6 months ended June 30, **2014**	6 months ended June 30, 2013
Share capital				
Balance at beginning of period	**$ 1,102.2**	$ 1,126.2	**$ 1,103.7**	$ 1,126.2
Share purchases (Note 8)	**(34.2)**	(6.0)	**(35.7)**	(6.0)
Balance at end of period	**$ 1,068.0**	$ 1,120.2	**$ 1,068.0**	$ 1,120.2
Contributed surplus				
Balance at beginning and end of period	**$ 31.9**	$ 31.9	**$ 31.9**	$ 31.9
Retained earnings				
Balance at beginning of period	**$ 255.3**	$ 32.5	**$ 234.2**	$ (35.1)
Net income attributable to equity shareholders of the Company	**54.3**	110.3	**99.8**	172.2
Defined benefit plan actuarial gains (losses), net of tax	**(25.3)**	25.1	**(46.2)**	30.8
Share purchases (Note 8)	**(69.7)**	(8.4)	**(73.2)**	(8.4)
Balance at end of period	**$ 214.6**	$ 159.5	**$ 214.6**	$ 159.5
Accumulated foreign exchange translation differences				
Balance at beginning of period	**$ 15.1**	$ (7.0)	**$ 4.5**	$ (10.5)
Foreign exchange translation differences for foreign operations	**(10.0)**	9.1	**0.6**	12.6
Balance at end of period	**$ 5.1**	$ 2.1	**$ 5.1**	$ 2.1
Total equity attributable to equity holders of the Company	**$ 1,319.6**	$ 1,313.7	**$ 1,319.6**	$ 1,313.7
Non-controlling interests				
Balance at beginning of period	**$ 230.7**	$ 202.7	**$ 223.1**	$ 199.4
Net income attributable to non-controlling interests	**10.2**	4.0	**23.3**	9.6
Defined benefit plan actuarial gains (losses) attributable to non-controlling interests, net of taxes	**(0.9)**	3.3	**(4.3)**	3.4
Distributions to non-controlling interests	**(2.9)**	(2.1)	**(5.0)**	(4.5)
Acquisition of non-controlling interests	**-**	(1.2)	**-**	(1.2)
Balance at end of period	**$ 237.1**	$ 206.7	**$ 237.1**	$ 206.7
Total equity	**$ 1,556.7**	$ 1,520.4	**$ 1,556.7**	$ 1,520.4

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

Canfor Corporation
Condensed Consolidated Statements of Cash Flows

(millions of Canadian dollars, unaudited)	3 months ended June 30, **2014**	3 months ended June 30, 2013	6 months ended June 30, **2014**	6 months ended June 30, 2013
Cash generated from (used in):				
Operating activities				
Net income	**$ 64.5**	$ 114.3	**$ 123.1**	$ 181.8
Items not affecting cash:				
Amortization	**44.0**	49.6	**88.5**	96.5
Income tax expense	**20.7**	46.0	**41.9**	70.9
Long-term portion of deferred reforestation obligations	**(9.2)**	(12.9)	**4.2**	1.2
Foreign exchange loss on long-term debt	**-**	4.0	**-**	7.8
Changes in mark-to-market value of derivative financial instruments	**(3.0)**	3.9	**0.4**	(1.4)
Employee future benefits	**3.2**	3.2	**6.4**	6.7
Net finance expense	**4.4**	6.3	**8.8**	15.1
Gain on sale of joint venture (Note 12)	**-**	(38.3)	**-**	(38.3)
Other, net	**4.3**	(0.2)	**8.6**	(0.9)
Defined benefit pension plan contributions	**(5.9)**	(12.6)	**(19.4)**	(26.1)
Income taxes recovered (paid), net	**(9.5)**	-	**(21.3)**	0.5
	113.5	163.3	**241.2**	313.8
Net change in non-cash working capital (Note 9)	**92.8**	96.9	**(85.0)**	2.4
	206.3	260.2	**156.2**	316.2
Financing activities				
Change in operating bank loans (Note 4)	**(39.0)**	(40.0)	**67.8**	(27.0)
Proceeds from long-term debt	**-**	3.1	**-**	3.1
Repayment of long-term debt	**-**	(76.3)	**-**	(76.3)
Finance expenses paid	**(2.6)**	(7.5)	**(5.4)**	(10.0)
Share purchases (Note 8)	**(105.7)**	(10.3)	**(107.7)**	(10.3)
Acquisition of non-controlling interests	**-**	(1.0)	**-**	(1.0)
Cash distributions paid to non-controlling interests	**(2.9)**	(2.1)	**(5.0)**	(4.5)
	(150.2)	(134.1)	**(50.3)**	(126.0)
Investing activities				
Additions to property, plant and equipment and intangible assets, net	**(63.0)**	(48.8)	**(116.1)**	(95.2)
Proceeds on sale of Daaquam Sawmill (Note 13)	**22.9**	-	**22.9**	-
Loan repayment from Scotch & Golf Lumber, LLC (Note 11)	**2.1**	-	**4.7**	-
Proceeds on sale of Canfor-LP OSB joint venture (Note 12)	**-**	76.6	**-**	76.6
Other, net	**1.7**	11.6	**0.8**	17.2
	(36.3)	39.4	**(87.7)**	(1.4)
Increase in cash and cash equivalents*	**19.8**	165.5	**18.2**	188.8
Cash and cash equivalents at beginning of period*	**87.9**	6.2	**89.5**	(17.1)
Cash and cash equivalents at end of period*	**$ 107.7**	$ 171.7	**$ 107.7**	$ 171.7

*Cash and cash equivalents include cash on hand less unpresented cheques.

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

Canfor Corporation
Notes to the Condensed Consolidated Financial Statements
(unaudited, millions of Canadian dollars unless otherwise noted)

1. Basis of Preparation

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

These financial statements do not include all of the disclosures required by International Financial Reporting Standards ("IFRS") for annual financial statements. Additional disclosures relevant to the understanding of these financial statements, including the accounting policies applied, can be found in Canfor's Annual Report for the year ended December 31, 2013, available at www.canfor.com or www.sedar.com.

Canfor's financial results are impacted by seasonal factors such as weather and building activity. Adverse weather conditions can cause logging curtailments, which can affect the supply of raw materials to sawmills and pulp mills. Market demand also varies seasonally to some degree. For example, building activity and repair and renovation work, which affects demand for solid wood products, are generally stronger in the spring and summer months. Shipment volumes are affected by these factors as well as by global supply and demand conditions.

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

Accounting Standards Issued and Not Applied

In May 2011, the International Accounting Standards Board ("IASB") issued IFRS 9, *Financial Instruments*. The required adoption date for IFRS 9 has been deferred from the original date of January 1, 2015 and is currently under review by the IASB.

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*, which will supersede IAS 18, *Revenue*, IAS 11, *Construction Contracts* and related interpretations. The new standard is effective for annual periods beginning on or after January 1, 2017. The Company is still in the process of assessing the impact, if any, on the financial statements of this new standard.

Further details of the new accounting Standards and the potential impact on Canfor can be found in the Company's Annual Report for the year ended December 31, 2013.

2. Inventories

(millions of Canadian dollars)		**As at June 30, 2014**		As at December 31, 2013
Logs	**$**	**102.2**	$	134.5
Finished products		**267.5**		222.3
Residual fibre		**11.0**		14.9
Processing materials and supplies		**101.1**		100.2
	$	**481.8**	$	471.9

3. Long-Term Investments and Other

(millions of Canadian dollars)		**As at June 30, 2014**		As at December 31, 2013
Investments	**$**	**53.8**	$	53.8
Term loan to Scotch & Golf Lumber, LLC (Note 11)		**28.5**		33.0
Contingent consideration (Note 12)		**6.1**		11.4
Other deposits, loans and advances		**13.5**		14.3
	$	**101.9**	$	112.5

Included in Long-Term Investments and Other is Canfor's initial 25% interest in Scotch & Gulf Lumber, LLC ("Scotch Gulf") and a term loan receivable from Scotch Gulf (Note 11). Investments also include the Company's 33.3% investment in Lakeland Mills Ltd. and Winton Global Lumber Ltd. The Company does not have significant influence with respect to this investment. During the second quarter of 2014, the Company recorded a negative fair value adjustment of $6.1 million to the contingent consideration asset associated with the Peace Valley OSB sale (Note 12).

4. Operating Loans

Available Operating Loans

(millions of Canadian dollars)		**As at June 30, 2014**		As at December 31, 2013
Canfor (excluding CPPI)				
Available Operating Loans:				
Total operating loans - Canfor (excluding CPPI)	**$**	**350.0**	$	350.0
Drawn		**(143.0)**		(64.0)
Letters of credit (principally unregistered pension plans)		**(13.6)**		(14.8)
Total available operating loans - Canfor (excluding CPPI)	**$**	**193.4**	$	271.2
CPPI				
Available Operating Loans:				
Operating loan facility	**$**	**110.0**	$	110.0
Facility for letters of credit related to energy agreements		**20.0**		20.0
Total operating loans - CPPI		**130.0**		130.0
Drawn		**-**		(10.6)
Energy letters of credit		**(12.2)**		(12.2)
Total available operating loans - CPPI	**$**	**117.8**	$	107.2
Consolidated:				
Total operating loans	**$**	**480.0**	$	480.0
Total available operating loans	**$**	**311.2**	$	378.4

Canfor's principal operating loans, excluding Canfor Pulp Products Inc. ("CPPI"), mature on February 28, 2018. Interest is payable at floating rates based on the lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin that varies with the Company's net debt to total capitalization ratio.

The terms of CPPI's operating loan facility include interest payable at floating rates that vary depending on the ratio of net debt to total capitalization and is based on lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin. The maturity date of this facility is January 31, 2018.

Both Canfor's and CPPI's operating loan facilities have certain financial covenants that stipulate maximum net debt to total capitalization ratios and minimum net worth amounts based on shareholders' equity.

CPPI has a separate facility with a maturity date of June 30, 2015 to cover energy-related letters of credit. At June 30, 2014, $9.4 million of energy-related letters of credit were covered under this facility with the balance of $2.8 million covered under CPPI's general operating loan facility.

As at June 30, 2014, the Company and CPPI were in compliance with all covenants relating to their operating loans. Substantially all borrowings of CPPI (operating loans and long-term debt) are non-recourse to other entities within the Company.

5. Employee Future Benefits

For the three months ended June 30, 2014, a defined benefit actuarial loss of $35.5 million (before-tax) was recognized in other comprehensive income. During the second quarter of 2014, actuarial funding valuations were completed for a number of the Company's employee future benefit plans resulting in revisions to actuarial assumptions and adjustments for plan member experience. The defined benefit actuarial loss recorded in the second quarter of 2014 reflects a lower discount rate used to value the net retirement benefit obligations, as well as the actuarial assumption and experience adjustments, offset by a return on plan assets. For the six months ended

June 30, 2014, a defined benefit actuarial loss of $68.3 million (before-tax) was recognized in other comprehensive income. For the three months ended June 30, 2013, an amount of $38.5 million (before-tax) was credited to other comprehensive income, and for the six months ended June 30, 2013, the gain was $46.2 million (before-tax).

For the Company's employee future benefit plans, a one percentage point increase in the discount rate used in calculating the actuarial estimate of future liabilities would decrease the accrued benefit obligation by an estimated $96.9 million.

The discount rate assumptions used to estimate the changes in net retirement benefit obligations were as follows:

Pension Benefit Plans	
Discount rate	
June 30, 2014	**4.30%**
March 31, 2014	4.40%
December 31, 2013	4.80%
June 30, 2013	4.60%
March 31, 2013	4.10%
December 31, 2012	4.20%
Other Benefit Plans	
Discount rate	
June 30, 2014	**4.40%**
March 31, 2014	4.50%
December 31, 2013	4.90%
June 30, 2013	4.70%
March 31, 2013	4.30%
December 31, 2012	4.40%

6. Financial Instruments

Canfor's cash and cash equivalents, accounts receivable, other deposits, loans and advances, operating loans, accounts payable and accrued liabilities, and long-term debt are measured at amortized cost subsequent to initial measurement. At June 30, 2014, the fair value of the Company's long-term debt approximates its amortized cost of $153.2 million (December 31, 2013 - $153.1 million).

Derivative instruments are measured at fair value. IFRS 13, *Fair Value Measurement,* requires classification of financial instruments within a hierarchy that prioritizes the inputs to fair value measurement.

The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly;

Level 3 – Inputs that are not based on observable market data.

The following table summarizes Canfor's financial instruments measured at fair value at June 30, 2014 and December 31, 2013, and shows the level within the fair value hierarchy in which they have been classified:

(millions of Canadian dollars)	Fair Value Hierarchy Level	**As at June 30, 2014**	As at December 31, 2013
Financial assets			
Derivative financial instruments – held for trading	Level 2	**$ 0.9**	$ 0.6
Royalty receivable – available for sale	Level 3	**4.1**	5.3
Contingent consideration – available for sale (Note 12)	Level 3	**6.1**	12.8
		$ 11.1	$ 18.7
Financial liabilities			
Derivative financial instruments – held for trading	Level 2	**1.0**	0.3
		$ 1.0	$ 0.3

The royalty receivable and contingent consideration are measured at fair value at each reporting period and are presented in Other Accounts Receivable and Long-Term Investments and Other on the consolidated balance sheet, depending on their respective liquidity. The fair value of the royalty receivable is determined by discounting future expected cash flows based on energy price assumptions and future sales volume assumptions until the termination of the royalty agreement in September 2015. The fair value of the contingent consideration is determined by discounting future expected cash flows based on forecast oriented strand board ("OSB") prices, sales volumes, foreign exchange rates and margins for the Peace Valley OSB operation (Note 12).

The Company uses a variety of derivative financial instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, lumber prices, pulp prices, energy costs, and floating interest rates on long-term debt.

At June 30, 2014, the fair value of derivative financial instruments was a net liability of $0.1 million (December 31, 2013 - net asset of $0.3 million). The fair value of these financial instruments was determined based on prevailing market rates for instruments with similar characteristics.

The following table summarizes the gain (loss) on derivative financial instruments for the three and six month periods ended June 30, 2014 and 2013:

	3 months ended June 30,		6 months ended June 30,	
(millions of Canadian dollars)	**2014**	2013	**2014**	2013
Foreign exchange collars and forward contracts	**$ 2.5**	$ (5.4)	**$ (0.4)**	$ (4.0)
Energy derivatives	**0.4**	(0.3)	**0.6**	(0.2)
Lumber futures	**0.7**	1.4	**0.8**	3.6
Pulp futures	**(0.4)**	-	**(0.7)**	-
Interest rate swaps	**(0.1)**	1.6	**(0.7)**	1.2
	$ 3.1	$ (2.7)	**$ (0.4)**	$ 0.6

7. Income Taxes

	3 months ended June 30,		6 months ended June 30,	
(millions of Canadian dollars)	**2014**	2013	**2014**	2013
Current	**$ (9.5)**	$ (8.3)	**$ (23.4)**	$ (13.5)
Deferred	**(11.2)**	(37.7)	**(18.5)**	(57.4)
Income tax expense	**$ (20.7)**	$ (46.0)	**$ (41.9)**	$ (70.9)

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

	3 months ended June 30,		6 months ended June 30,	
(millions of Canadian dollars)	**2014**	2013	**2014**	2013
Income tax expense at statutory rate 2014 – 26.0% (2013 – 25.75%)[1]	**$ (22.2)**	$ (41.9)	**$ (42.9)**	$ (65.0)
Add (deduct):				
Non-taxable income related to non-controlling interests in limited partnerships	**0.2**	0.1	**0.3**	0.1
Entities with different income tax rates and other tax adjustments	**1.3**	(3.2)	**0.9**	(4.5)
Permanent difference from capital gains and losses and other non-deductible items	**-**	4.4	**(0.2)**	3.9
Change in substantively enacted tax rate[1]	**-**	(5.4)	**-**	(5.4)
Income tax expense	**$ (20.7)**	$ (46.0)	**$ (41.9)**	$ (70.9)

[1]In the second quarter of 2013, the British Columbia Provincial Government increased the corporate tax rate from 10% to 11%.

In addition to the amounts recorded to net income, a tax recovery of $9.3 million was recorded to other comprehensive income for the three month period ended June 30, 2014 (three months ended June 30, 2013 – tax expense of $10.1 million) in relation to the actuarial gains (losses) on defined benefit employee compensation plans. For the six months ended June 30, 2014, the tax recovery was $17.8 million (six months ended June 30, 2013 – tax expense of $12.0 million)

8. Earnings Per Share and Normal Course Issuer Bid

Basic net income per share is calculated by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the period.

	3 months ended June 30,		6 months ended June 30,	
	2014	2013	**2014**	2013
Weighted average number of common shares	**138,609,515**	142,675,539	**139,252,154**	142,713,773

On March 5, 2014, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 6,995,228 common shares or approximately 5% of its issued and outstanding common shares as of February 28, 2014. The renewed normal course issuer bid is set to expire on March 4, 2015. During the second quarter of 2014, Canfor purchased 4,331,200 common shares for $103.9 million (an average of $23.99 per common share), of which $102.7 million was paid in cash in the period, with the balance paid in early July. Cash paid for share purchases in the second quarter of 2014 of $105.7 million also included payment of $3.0 million for purchases that occurred in the first quarter of 2014. As at July 24, 2014, there were 135,376,993 common shares outstanding.

9. Net Change in Non-Cash Working Capital

(millions of Canadian dollars)	3 months ended June 30, **2014**	3 months ended June 30, 2013	6 months ended June 30, **2014**	6 months ended June 30, 2013
Accounts receivable	**$ (19.6)**	$ 7.4	**$ (33.4)**	$ (40.7)
Inventories	**164.5**	124.5	**(30.4)**	25.0
Prepaid expenses and other assets	**(13.7)**	(12.9)	**(15.9)**	(11.4)
Accounts payable, accrued liabilities and current portion of deferred reforestation obligations	**(38.4)**	(22.1)	**(5.3)**	29.5
Net decrease (increase) in non-cash working capital	**$ 92.8**	$ 96.9	**$ (85.0)**	$ 2.4

10. Segment Information

Canfor has two reportable segments (lumber segment and pulp and paper segment) which offer different products and are managed separately because they require different production processes and marketing strategies.

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

The Company's panels business does not meet the criteria to be reported fully as a separate segment and is included in Unallocated & Other below.

(millions of Canadian dollars)		Lumber	Pulp & Paper	Unallocated & Other	Elimination Adjustment		Consolidated
3 months ended June 30, 2014							
Sales to external customers	**$**	**614.5**	**292.8**	**-**	**-**	**$**	**907.3**
Sales to other segments	**$**	**34.4**	**-**	**-**	**(34.4)**	**$**	**-**
Operating income (loss)	**$**	**74.1**	**30.9**	**(7.7)**	**-**	**$**	**97.3**
Amortization	**$**	**28.1**	**15.7**	**0.2**	**-**	**$**	**44.0**
Capital expenditures[2]	**$**	**39.1**	**20.2**	**3.7**	**-**	**$**	**63.0**
3 months ended June 30, 2013							
Sales to external customers	$	586.8	255.5	0.9	-	$	843.2
Sales to other segments	$	35.4	-	-	(35.4)	$	-
Operating income (loss)	$	115.5	18.6	(5.9)	-	$	128.2
Amortization	$	29.9	19.4	0.3	-	$	49.6
Capital expenditures[2]	$	37.7	8.7	2.4	-	$	48.8
6 months ended June 30, 2014							
Sales to external customers	**$**	**1,110.2**	**539.0**	**-**	**-**	**$**	**1,649.2**
Sales to other segments	**$**	**69.9**	**-**	**-**	**(69.9)**	**$**	**-**
Operating income (loss)	**$**	**130.5**	**67.4**	**(16.2)**	**-**	**$**	**181.7**
Amortization	**$**	**56.0**	**32.2**	**0.3**	**-**	**$**	**88.5**
Capital expenditures[2]	**$**	**78.7**	**30.3**	**7.1**	**-**	**$**	**116.1**
Identifiable assets	**$**	**1,770.1**	**789.9**	**172.9**	**-**	**$**	**2,732.9**
6 months ended June 30, 2013							
Sales to external customers	$	1,129.1	499.0	1.4	-	$	1,629.5
Sales to other segments	$	66.6	-	-	(66.6)	$	-
Operating income (loss)	$	203.9	37.5	(13.2)	-	$	228.2
Amortization	$	57.2	38.8	0.5	-	$	96.5
Capital expenditures[2]	$	75.7	15.7	3.8	-	$	95.2
Identifiable assets	$	1,602.3	782.2	246.5	-	$	2,631.0

[2] Capital expenditures represent cash paid for capital assets during the periods. Pulp & Paper includes capital expenditures by CPPI that were partially financed by government grants.

11. Phased Purchase of Scotch & Gulf Lumber, LLC

On August 9, 2013, the Company completed the first phase of the purchase of Scotch Gulf for $29.5 million, representing an initial 25% interest in Scotch Gulf, plus transaction closing costs and a proportionate share of working capital. Canfor's initial 25% interest will increase over a 3 year period to 33% after twelve months, 50% after eighteen months and 100% at the end of the term. Scotch Gulf has an option under the purchase agreement to accelerate the final closing of the phased purchase to a date earlier than August 2016 under certain conditions. The aggregate purchase price for Scotch Gulf is US$80.0 million, plus working capital.

As part of the transaction, Scotch Gulf borrowed $34.0 million from Canfor in the form of a term loan that will be repaid from the distribution of cash earnings over the course of the phased purchase agreement with any net outstanding amount at August 2016 applied against the final phase purchase price payment. The term loan has an interest rate equal to the floating rate on Canfor's principal operating loans plus 1.0% and is secured by Scotch Gulf's operating assets. At June 30, 2014, $28.5 million was outstanding on the term loan receivable which is included in Long-Term Investments and Other on the balance sheet (Note 3).

12. Sale of Canfor-LP OSB Joint Venture

On May 31, 2013, the Company completed the sale of its 50% share in Canfor-LP OSB, which owns the Peace Valley OSB mill, to Louisiana-Pacific Corporation ("LP") for cash proceeds of $77.9 million including working capital. A pre-tax gain on sale of $38.3 million was recorded in the second quarter of 2013 which included recognition of Canfor's share of the operating income for the first half of 2013.

As part of the sale, Canfor may receive additional annual consideration over a 3 year period, starting June 1, 2013, contingent on Peace Valley OSB's annual adjusted earnings before interest, tax, depreciation and amortization. At June 30, 2014, the fair value of the contingent consideration is $6.1 million, and is presented in Long-Term Investments and Other (Note 3). During the second quarter of 2014, Canfor recognized a $6.1 million negative fair value adjustment on the contingent consideration in other expense. The first year of the three year contingent consideration earn-out period ended on May 31, 2014 and no amounts were paid to Canfor under the contingent consideration arrangement as minimum earnings thresholds were not met.

13. Sale of Daaquam Sawmill

On March 28, 2014, the Company completed the sale of its Daaquam Sawmill. Total gross proceeds related to the disposition of the Daaquam operation approximated $25.0 million, of which $22.9 million was received in the second quarter of 2014. A pre-tax gain of $2.2 million was recorded in the first quarter of 2014 in Other Income.