QUARTER 2

FOR THE THREE MONTHS ENDED JUNE 30, 2012

CANFOR

CANFOR CORPORATION
2012 SECOND QUARTER
INTERIM REPORT

2012

To Our Shareholders

Canfor Corporation reported net income attributable to shareholders ("shareholder net income") of $4.5 million, or $0.03 per share, for the second quarter of 2012, compared to a shareholder net loss of $16.2 million, or $0.11 per share, for the first quarter of 2012 and shareholder net income of $2.1 million, or $0.01 per share, for the second quarter of 2011. For the six months ended June 30, 2012, the shareholder net loss was $11.7 million, or $0.08 per share, compared to net income of $9.1 million, or $0.06 per share, for the first half of 2011.

The shareholder net income for the second quarter of 2012 included various items affecting comparability with prior periods, which had an overall net negative impact of $6.6 million, or $0.05 per share. After adjusting for such items, the Company's adjusted shareholder net income for the second quarter of 2012 was $11.1 million, or $0.08 per share, up $33.4 million, or $0.24 per share, from an adjusted shareholder net loss of $22.3 million, or $0.16 per share, for the first quarter of 2012. Adjusted shareholder net income for the second quarter of 2011 was $2.6 million, or $0.02 per share.

The Company reported operating income of $26.0 million for the second quarter of 2012, compared to an operating loss of $21.5 million for the first quarter. The positive variance primarily reflected improved results in the lumber segment, where stronger markets supported higher prices.

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

(millions of dollars, except for per share amounts)	Q2 2012	Q1 2012	YTD 2012	Q2 2011	YTD 2011
Sales	**$ 700.9**	$ 607.6	**$ 1,308.5**	$ 619.1	$ 1,243.1
Operating income (loss)	**$ 26.0**	$ (21.5)	**$ 4.5**	$ 27.4	$ 59.7
Net income (loss) attributable to equity shareholders of Company	**$ 4.5**	$ (16.2)	**$ (11.7)**	$ 2.1	$ 9.1
Net income (loss) per share attributable to equity shareholders of Company, basic and diluted	**$ 0.03**	$ (0.11)	**$ (0.08)**	$ 0.01	$ 0.06
Adjusted shareholder net income (loss)	**$ 11.1**	$ (22.3)	**$ (11.2)**	$ 2.6	$ 2.7
Adjusted shareholder net income (loss) per share	**$ 0.08**	$ (0.16)	**$ (0.08)**	$ 0.02	$ 0.02

Lumber markets showed signs of improvement in the second quarter of 2012, reflecting stronger underlying demand in both North American and offshore markets. U.S. housing activity continued the upward trend seen in the prior quarter, with housing starts for the quarter averaging 739,000 units SAAR (seasonally adjusted annual rate), up over 3% from the previous quarter. Canadian housing starts were also up, increasing 12% from the previous quarter, to almost 230,000 units SAAR. In China, markets improved as inventories returned to more normal levels following the inventory build early in the previous quarter. Japan demand remained solid through the quarter. Pulp markets were relatively balanced heading into the quarter but saw signs of weakness as the quarter progressed.

As a result of the improved markets, lumber prices rallied during the second quarter. The average North American benchmark Western SPF 2x4 #2&Btr price rose 11% to US$295 per Mfbm, with similar increases seen for most other grades, while the spread between Western SPF structural and utility grade pricing also narrowed. Strong prices through May triggered a reduction in the export tax to 10% for the first time this year in June. Southern Yellow Pine ("SYP") prices also saw similar increases over the quarter. As a result, Canfor's lumber sales realizations saw solid gains, with a higher value sales mix also having a positive impact. For Northern Bleached Softwood Kraft ("NBSK") pulp, US dollar sales realizations were up slightly with the average North America list price up US$30 to US$900 per tonne. Canadian dollar sales realizations across all solid wood and pulp products were positively impacted by a 1% weakening of the average Canadian dollar.

Lumber shipments increased significantly from the previous quarter, up 16% to almost 1.2 billion board feet, reflecting the additional contribution of two recently acquired mills in the Kootenay region, as well as continued post-capital project productivity improvements and further operating efficiencies at other mills in the current quarter. Lumber unit manufacturing costs were in line with the previous quarter, with reductions in unit cash conversion costs offset by a small increase in unit log costs. Also, contributing to improved results in the lumber segment was a moderate increase in sawmill residual chip prices.

Pulp shipment and production levels were significantly impacted by scheduled maintenance outages and an unscheduled shutdown at Canfor Pulp, contributing to higher unit manufacturing costs. A maintenance outage was completed at the Intercontinental Pulp Mill, and an extended maintenance outage was commenced at the Prince George Pulp Mill, resulting in approximately 18,000 tonnes of reduced production overall. In addition, an unscheduled shutdown of a recovery boiler at the Northwood Pulp Mill and subsequent repairs resulted in the mill operating at approximately fifty percent of capacity through the period, reducing overall production by approximately 31,000 tonnes.

The Company ended the quarter with an improved liquidity position, reflecting both stronger lumber earnings and favourable working capital movements, resulting principally from a drawdown of log inventory after spring breakup.

On July 18, 2012, the Softwood Lumber Agreement arbitration panel ruled in favour of Canada in connection with a claim by the U.S. that the province of B.C. had misapplied or altered certain components of the timber pricing system. The arbitration panel dismissed the claims of the U.S. in their entirety

Looking ahead, the North American lumber market is projected to show a modest and gradual improvement as housing demand edges higher and U.S. inventories remain at low levels, notwithstanding the fragility of the U.S. economy. With respect to shipments to the U.S., export taxes are 5% in July and will be 10% in August. Offshore lumber shipments are anticipated to remain steady for the rest of the year. The global softwood pulp market is projected to weaken further through the remaining summer months, with producer inventories forecast to rise modestly as there is minimal scheduled maintenance downtime during the summer months.

Ronald L. Cliff
Chairman

Don B. Kayne
President and Chief Executive Officer

Canfor Corporation
Second Quarter 2012
Management's Discussion and Analysis

This interim Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the quarter ended June 30, 2012 relative to the quarters ended March 31, 2012 and June 30, 2011, and the financial position of the Company at June 30, 2012. It should be read in conjunction with Canfor's unaudited interim consolidated financial statements and accompanying notes for the quarters ended June 30, 2012 and 2011, as well as the 2011 annual MD&A and the 2011 audited consolidated financial statements and notes thereto, which are included in Canfor's Annual Report for the year ended December 31, 2011 (available at www.canfor.com). 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 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). 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 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 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 26, 2012.

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 2012 OVERVIEW

Selected Financial Information and Statistics[1]

(millions of dollars, except for per share amounts)	Q2 2012	Q1 2012	YTD 2012	Q2 2011	YTD 2011
Operating income (loss) by segment:					
Lumber	**$ 18.9**	$ (20.1)	**$ (1.2)**	$ (11.3)	$ (13.8)
Pulp and Paper	**$ 11.7**	$ 11.3	**$ 23.0**	$ 48.8	$ 96.7
Unallocated and Other	**$ (4.6)**	$ (12.7)	**$ (17.3)**	$ (10.1)	$ (23.2)
Total operating income (loss)	**$ 26.0**	$ (21.5)	**$ 4.5**	$ 27.4	$ 59.7
Add (deduct):					
Amortization	**$ 46.0**	$ 45.1	**$ 91.1**	$ 40.3	$ 81.8
Working capital movements	**$ 68.4**	$ (79.2)	**$ (10.8)**	$ 24.0	$ (55.2)
Salary pension plan contributions	**$ (9.0)**	$ (9.0)	**$ (18.0)**	$ (9.9)	$ (19.6)
Other operating cash flows, net[2]	**$ (12.3)**	$ 9.4	**$ (2.9)**	$ (12.0)	$ (2.9)
Cash from operating activities	**$ 119.1**	$ (55.2)	**$ 63.9**	$ 69.8	$ 63.8
Add (deduct):					
Drawdown (repayment) of long-term debt	**$ -**	$ 50.1	**$ 50.1**	$ (48.1)	$ (81.9)
Finance expenses paid	**$ (7.4)**	$ (3.1)	**$ (10.5)**	$ (6.1)	$ (9.6)
Distributions paid to non-controlling interests	**$ (8.2)**	$ (4.3)	**$ (12.5)**	$ (25.9)	$ (63.9)
Capital additions, net[3]	**$ (44.0)**	$ (110.6)	**$ (154.6)**	$ (34.0)	$ (73.3)
Proceeds from sale of asset-backed commercial paper ("ABCP")	**$ 12.9**	$ -	**$ 12.9**	$ 0.1	$ 29.8
Other, net	**$ 1.9**	$ 8.9	**$ 10.8**	$ 1.7	$ 4.8
Change in cash / operating loans	**$ 74.3**	$ (114.2)	**$ (39.9)**	$ (42.5)	$ (130.3)
ROIC – Consolidated[4]	**1.3%**	(1.4)%	**(0.1)%**	0.2%	0.6%
Average exchange rate (US$ per C$1.00)[5]	**$ 0.990**	$ 0.999	**$ 0.994**	$ 1.033	$ 1.024

[1] Certain prior period amounts have been restated due to a change in accounting policy for treatment of net interest expense for defined benefit post-retirement plans. Further details can be found in the "Changes in Accounting Policy" section later in this document.
[2] Further information on operating cash flows can be found in the Company's unaudited interim consolidated financial statements.
[3] Additions to property, plant and equipment include the acquisition of assets from Tembec Industries Ltd. ("Tembec") in the first quarter of 2012, and are shown net of amount received under Government funding initiatives in the pulp and paper segment.
[4] Consolidated Return on Invested Capital ("ROIC") is equal to operating income/loss, plus realized gains/losses on derivatives and other income/expense, all net of minority interest, divided by the average invested capital during the year. Invested capital is equal to capital assets, plus long-term investments and net non-cash working capital, all excluding minority interest components.
[5] Source – Bank of Canada (average noon rate for the period).

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

After-tax impact, net of non-controlling interests (millions of dollars, except for per share amounts)	Q2 2012	Q1 2012	YTD 2012	Q2 2011	YTD 2011
Shareholder Net Income (Loss)	**$ 4.5**	$ (16.2)	**$ (11.7)**	$ 2.1	$ 9.1
Foreign exchange (gain) loss on long-term debt and investments, net	**$ 2.4**	$ (2.7)	**$ (0.3)**	$ (1.4)	$ (4.4)
(Gain) loss on derivative financial instruments	**$ 4.2**	$ (5.1)	**$ (0.9)**	$ (0.7)	$ (3.6)
Increase in fair value of ABCP	**$ -**	$ (1.1)	**$ (1.1)**	$ -	$ (1.0)
Costs related to Tembec acquisition	**$ -**	$ 2.8	**$ 2.8**	$ -	$ -
Restructuring charges for management changes	**$ -**	$ -	**$ -**	$ 2.6	$ 2.6
Net impact of above items	**$ 6.6**	$ (6.1)	**$ 0.5**	$ 0.5	$ (6.4)
Adjusted Shareholder Net Income (Loss)	**$ 11.1**	$ (22.3)	**$ (11.2)**	$ 2.6	$ 2.7
Shareholder Net Income (Loss) per share (EPS), as reported	**$ 0.03**	$ (0.11)	**$ (0.08)**	$ 0.01	$ 0.06
Net impact of above items per share	**$ 0.05**	$ (0.05)	**$ -**	$ 0.01	$ (0.04)
Adjusted Shareholder Net Income (Loss) per share	**$ 0.08**	$ (0.16)	**$ (0.08)**	$ 0.02	$ 0.02

The Company reported operating income of $26.0 million for the second quarter of 2012, compared to an operating loss of $21.5 million for the first quarter. The positive variance primarily reflected improved results in the lumber segment, where stronger markets supported higher prices.

Lumber markets showed signs of improvement in the second quarter of 2012, reflecting stronger underlying demand in both North American and offshore markets. U.S. housing activity continued the upward trend seen in the prior quarter, with housing starts for the quarter averaging 739,000 units SAAR (seasonally adjusted annual rate), up over 3% from the previous quarter. Canadian housing starts were also up, increasing 12% from the previous quarter, to almost 230,000 units SAAR. In China, markets improved as inventories returned to more normal levels following the inventory build early in the previous quarter. Japan demand remained solid through the quarter. Pulp markets were relatively balanced heading into the quarter but saw signs of weakness as the quarter progressed.

As a result of the improved markets, lumber prices rallied during the second quarter. The average North American benchmark Western SPF 2x4 #2&Btr price rose 11% to US$295 per Mfbm, with similar increases seen for most other grades, while the spread between Western SPF structural and utility grade pricing also narrowed. Strong prices through May triggered a reduction in the export tax to 10% for the first time this year in June. Southern Yellow Pine ("SYP") prices also saw similar increases over the quarter. As a result, Canfor's lumber sales realizations saw solid gains, with a higher value sales mix also having a positive impact. For Northern Bleached Softwood Kraft ("NBSK") pulp, US dollar sales realizations were up slightly with the average North America list price up US$30 to US$900 per tonne. Canadian dollar sales realizations across all solid wood and pulp products were positively impacted by a 1% weakening of the average Canadian dollar.

Lumber shipments increased significantly from the previous quarter, up 16% to almost 1.2 billion board feet, reflecting the additional contribution of two recently acquired mills in the Kootenay region, as well as continued post-capital project productivity improvements and further operating efficiencies at other mills in the current quarter. Lumber unit manufacturing costs were in line with the previous quarter, with reductions in unit cash conversion costs offset by a small increase in unit log costs. Also, contributing to improved results in the lumber segment was a moderate increase in sawmill residual chip prices.

Pulp shipment and production levels were significantly impacted by scheduled maintenance outages and an unscheduled shutdown at Canfor Pulp, contributing to higher unit manufacturing costs. A maintenance outage was completed at the Intercontinental Pulp Mill, and an extended maintenance outage was commenced at the Prince George Pulp Mill, resulting in approximately 18,000 tonnes of reduced production overall. In addition, an unscheduled shutdown of a recovery boiler at the Northwood Pulp Mill and subsequent repairs resulted in the mill operating at approximately fifty percent of capacity through the period, reducing overall production by approximately 31,000 tonnes.

The Company ended the quarter with an improved liquidity position, reflecting both stronger lumber earnings and favourable working capital movements, resulting principally from a drawdown of log inventory after spring breakup.

Compared to the second quarter of 2011, operating income was down $1.4 million, with a decrease of $37.1 million in the pulp and paper segment, primarily driven by significantly lower prices for NBSK pulp products and the impact of the maintenance outages and unscheduled shutdown in the current quarter, substantially offset by an increase of $30.2 million in the lumber segment, reflecting the improved markets offset in part by increased unit log costs.

OPERATING RESULTS BY BUSINESS SEGMENT

Lumber

Selected Financial Information and Statistics – Lumber

(millions of dollars unless otherwise noted)	Q2 2012	Q1 2012	YTD 2012	Q2 2011	YTD 2011
Sales	**$ 443.5**	$ 343.7	**$ 787.2**	$ 331.2	$ 659.8
Operating income (loss)	**$ 18.9**	$ (20.1)	**$ (1.2)**	$ (11.3)	$ (13.8)
Negative (positive) impact of inventory valuation adjustments[6]	**$ (2.9)**	$ (10.2)	**$ (13.1)**	$ 1.1	$ 1.2
Costs related to Tembec acquisition	**$ -**	$ 2.5	**$ 2.5**	$ -	$ -
Operating income (loss) excluding impact of inventory valuation adjustments and unusual items	**$ 16.0**	$ (27.8)	**$ (11.8)**	$ (10.2)	$ 28.8
Average SPF 2x4 #2&Btr lumber price in US$[7]	**$ 295**	$ 266	**$ 281**	$ 240	$ 268
Average SPF price in Cdn$	**$ 298**	$ 266	**$ 283**	$ 232	$ 262
Average SYP 2x4 #2 lumber price in US$[8]	**$ 325**	$ 298	**$ 312**	$ 251	$ 276
Average SYP price in Cdn$	**$ 328**	$ 298	**$ 314**	$ 243	$ 270
U.S. housing starts (thousand units SAAR)[9]	**739**	715	**727**	573	578
Production – SPF lumber (MMfbm)	**994.4**	903.7	**1,898.1**	787.6	1,559.9
Production – SYP lumber (MMfbm)	**124.4**	114.3	**238.7**	112.8	207.6
Shipments – SPF lumber (MMfbm)[10]	**1,008.3**	852.3	**1,860.6**	821.6	1,536.9
Shipments – SYP lumber (MMfbm)[10]	**135.0**	117.6	**252.6**	123.6	214.5
Shipments – wholesale lumber (MMfbm)	**14.3**	24.5	**38.8**	27.7	78.9

[6] In accordance with IFRS, Canfor records its log and finished product inventories at the lower of cost and net realizable value ("NRV"). Changes in inventory volumes, market prices, foreign exchange rates and costs over the respective reporting periods can all affect inventory write-downs required at each period end.
[7] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)
[8] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)
[9] Source – U.S. Census Bureau, seasonally adjusted annual rate ("SAAR")
[10] Canfor-produced lumber, including lumber purchased for remanufacture.

Overview

Operating income for the lumber segment was $18.9 million for the second quarter of 2012, an increase of $39.0 million compared to the operating loss of $20.1 million in the previous quarter, and a $30.2 million improvement from the operating loss reported for the second quarter of 2011. Results in each of the quarters were impacted by inventory valuation adjustments, principally reflecting changes in market prices for lumber products, as well as restructuring costs recorded in the first quarter of 2012. Excluding these items, operating income was $16.0 million for the second quarter of 2012, an improvement of $43.8 million from the previous quarter and up $26.2 million from the second quarter of 2011.

The stronger results compared to the previous quarter were largely the result of improved sales realizations, with higher prices seen for most products in both North American and offshore markets. In addition, lumber shipments were well up from the previous quarter, reflecting the contribution of the two south-east Kootenay region mill operations acquired at the end of the first quarter of 2012, as well as continued post-capital project productivity and other efficiency improvements. Lumber unit manufacturing costs were broadly similar to the previous quarter, with reductions in unit cash conversion costs offset by a small increase in unit log costs.

The improvement in operating income compared to the second quarter of 2011 in large part reflected higher market prices and increased lumber shipments. Partially offsetting these impacts, unit manufacturing costs showed a modest increase, as higher log costs, due in part to increased hauling costs and higher market stumpage, more than offset a reduction in unit cash conversion costs resulting from improved productivity. In addition, sawmill residual chip prices were well down compared to the same quarter of 2011, reflecting a steep decline in NBSK pulp sales realizations over the period.

Markets

During the second quarter of 2012, U.S. lumber demand continued to improve as historical low mortgage rates, seasonal factors and a gradual strengthening in housing markets helped to keep home construction activity edging upwards. Total U.S. housing starts averaged 739,000 units[11] SAAR, an increase of over 3% from the previous quarter and up 29% from the second quarter of 2011. Single-family starts, which use a higher volume of lumber than multi-family starts, climbed 7% to 519,000 SAAR, the highest level in more than two years. The repair and remodeling sector also gained from the overall increase in housing activity.

In Canada, lumber consumption was also strong reflecting improved weather and housing demand. Canadian housing starts averaged 229,000 units[12] SAAR for the quarter, up 24,000 units, or 12%, compared to the first quarter of 2012, and up 18% from the comparable quarter in 2011 when starts were at 195,000 units SAAR.

Canfor's offshore lumber shipments increased by 13% compared to the previous quarter and were 20% higher than the second quarter of 2011. For the first half of 2012, shipments to China and Japan were in excess of the same period in the prior year.

Sales

Sales revenues for the lumber segment for the second quarter of 2012 were $443.5 million, compared to $343.7 million in the previous quarter and $331.2 million in the second quarter of 2011. The significant increase from both comparative periods reflected the impact of higher shipment levels and improved pricing. Compared to the prior quarter this was offset in part by seasonally lower log sales. Total shipments in the second quarter of 2012 were almost 1.2 billion board feet, up 16% from the previous quarter, and up 19% from the second quarter of 2011. The increase reflects higher production from various capital upgrades and other efficiency improvements, as well as from the mill operations acquired at the end of the previous quarter.

Sales realizations experienced solid gains in the quarter, with North American sales realizations benefiting from the continued upward trend in pricing coupled with a higher value sales mix, in part reflecting the processing of a higher quality fibre mix. For sales to North America, the Random Lengths Western SPF 2x4 #2&Btr price was up 11% to US$295 per Mfbm, with similar increases seen in most other widths and dimensions during the quarter. Sales realizations for SYP products also benefited from solid price gains, with the benchmark SYP 2x4 #2 price at US$325 per Mfbm, up 9% from the previous quarter, and wider dimensions seeing higher increases. Sales realizations for offshore products experienced strong gains in the current quarter, particularly in China where market inventories returned to more normal levels following the inventory build early in the previous quarter. Offshore prices, which are largely negotiated monthly or quarterly in advance, caught up to some of the gains seen in North America in the first quarter.

Compared to the second quarter of 2011, the benchmark North American Random Lengths Western SPF 2x4 #2&Btr price was up US$55 per Mfbm, or 23%, with marked increases seen in all widths and dimensions. SYP products followed a similar trend, with the benchmark SYP 2x4 #2 price up 30%. Increases for offshore sales realizations for similar products were more modest, in part reflecting the quarterly and monthly nature of pricing to most offshore markets.

The average value of the Canadian dollar compared to the US dollar in the second quarter was down just under 1% from the previous quarter, contributing to the improved sales realizations. Compared to the second quarter of 2011, realizations benefited from a 4 cent, or 4%, weaker Canadian dollar.

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

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

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

The RLCP price averaged US$324 per Mfbm for the second quarter of 2012, up US$36, or 13%, compared to the previous quarter. Strong prices through May triggered a reduction in the export tax to 10% for the first time this year in June. The RLCP averaged US$264 per Mfbm for the second quarter of 2011, well below the trigger price required to reduce the export tax rate from 15%.

Total residual fibre revenue was up from the first quarter of 2012, reflecting higher production volumes and residual chip prices in the quarter. Compared to the second quarter of 2011, residual fibre revenue was well up, again reflecting higher production volumes, partially offset by reduced residual chip prices.

Operations

Lumber production, at just over 1.1 billion board feet, was up 10% from the previous quarter, reflecting the contribution of the recently acquired mill operations, as well as continued post-capital project productivity improvements and improved performance at other mills in the quarter, in part due to improved weather conditions compared to the first quarter of 2012. Compared to the second quarter of 2011 production was up 24%, again largely reflecting the recent acquisition, coupled with increased productivity following various capital improvement projects in 2011 and the restart of the Vavenby sawmill in the third quarter of 2011.

Overall lumber unit manufacturing costs were broadly similar to the previous quarter, with reductions in unit cash conversion costs offset by a small increase in unit log costs. The improvement in unit cash conversion costs largely reflected the higher production levels in the current quarter. Log costs for most operations remained stable, though higher costs associated with the high value fibre mix processed at the recently acquired south-east Kootenay mills contributed to a small increase in unit log costs, and adverse weather hampered log harvesting in some regions during the quarter.

Compared to the second quarter of 2011, unit manufacturing costs showed a small increase, again reflecting higher unit log costs partially offset by reduced unit cash conversion costs. The increase in unit log costs resulted largely from increased hauling costs stemming from tight trucker availability and higher diesel costs, as well as higher market stumpage. The reduced unit cash conversion costs principally reflected increased production, in part due to improved productivity performance from various capital improvement projects undertaken since the second quarter of 2011 and other efficiency improvements.

Pulp and Paper

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

(millions of dollars unless otherwise noted)	Q2 2012	Q1 2012	YTD 2012	Q2 2011	YTD 2011
Sales	**$ 239.4**	$ 249.4	**$ 488.8**	$ 277.0	$ 560.0
Operating income	**$ 11.7**	$ 11.3	**$ 23.0**	$ 48.8	$ 96.7
Average pulp price delivered to U.S. – US$[14]	**$ 900**	$ 870	**$ 885**	$ 1,025	$ 998
Average price in Cdn$	**$ 909**	$ 871	**$ 890**	$ 992	$ 975
Production – pulp (000 mt)	**263.1**	315.9	**579.0**	314.7	631.6
Production – paper (000 mt)	**30.0**	32.9	**62.9**	31.8	66.3
Shipments –pulp (000 mt)	**282.1**	327.8	**609.9**	303.7	622.1
Shipments – paper (000 mt)	**36.8**	29.6	**66.4**	32.7	65.3

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 northern bleached softwood kraft ("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 $11.7 million for the second quarter of 2012, in line with the previous quarter and down $37.1 million from the second quarter of 2011. Results in the current quarter were significantly impacted by scheduled maintenance outages and an unscheduled shutdown at the Company's operations, which resulted in lower production levels and higher unit manufacturing costs.

US dollar NBSK pulp prices increased slightly from the previous quarter, with prices to North America up US$30 to US$900 per tonne. Sales realizations were also positively impacted by the weaker average Canadian dollar compared to the previous quarter. The significantly lower production levels in the current quarter led to an increase in unit conversion costs, while unit fibre costs declined modestly compared to the previous quarter.

Lower operating earnings compared to the second quarter of 2011 reflected a significant reduction in NBSK pulp prices, with North America prices down US$125 per tonne and larger price reductions in Europe and China. Unit conversion costs increased, with production levels down almost 17%, though fibre costs decreased significantly, reflecting a drop in the prices paid for sawmill residual chips (linked to NBSK market pulp prices).

Markets

Global softwood pulp markets were balanced for the first part of the second quarter before showing signs of weakness heading into the seasonally slower summer months. Producer inventories remained in the balanced range through the quarter as reduced demand was offset by reductions in supply due to spring maintenance downtime.

PPPC[15] statistics reported an increase in shipments of bleached softwood sulphate pulp of 1.4% for the first five months of 2012 as compared to the same period in 2011. However markets weakened as the second quarter progressed, with reductions in demand from Europe and North America. PPPC reported global demand for printing and writing papers decreased 1.5% for the first five months of 2012 as compared to 2011.

At the end of May 2012, World 20[16] producers of bleached softwood pulp inventories were at 30 days of supply. By comparison, March 2012 inventories were at 29 days of supply. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

Sales

Pulp shipments in the second quarter of 2012 were just over 280,000 tonnes, down 46,000 tonnes, or 14%, from the previous quarter, reflecting the lower production levels due to the maintenance outages and unscheduled shutdown, and decreased 22,000 tonnes, or 7%, from the second quarter of 2011.

Steady demand and reduced supply due to spring maintenance early in the quarter led to increased prices in some regions in April, but prices came under pressure thereafter in part reflecting a seasonal slowdown in market demand. North America NBSK pulp list prices averaged US$900 per tonne for the quarter, up US$30 from the previous quarter. Canfor Pulp's average list price to China increased modestly to US$700 per tonne, but fell through May and June, ending the quarter at US$680 per tonne. The list price to Europe fell through the quarter, but on average was in line with the first quarter at US$837 per tonne. Sales realizations were positively impacted by the weaker average Canadian dollar compared to the prior quarter. BCTMP sales realizations were also modestly up from the previous quarter, reflecting a slight increase in market pricing and the weaker Canadian dollar.

Compared to the second quarter of 2011, pulp sales realizations were well down as NBSK pulp list prices to all markets decreased. The average NSBK pulp list price for North America decreased US$125 per tonne, while prices to Europe and China decreased US$180 and US$240 per tonne, respectively. The price reductions were offset in part by the 4 cent weaker Canadian dollar compared to the US dollar in the current quarter. In contrast to NBSK products, BCTMP sales realizations were up compared to the second quarter of 2011, reflecting higher market pricing.

Operations

Pulp production in the second quarter of 2012 was 263,000 tonnes, down approximately 53,000 tonnes, or 17%, from the previous quarter and the second quarter of 2011. The maintenance outage at the Intercontinental pulp mill reduced market pulp production by 12,000 tonnes, while the maintenance outage at the Prince George pulp mill, which had an impact of 6,000 tonnes in the second quarter, was extended into the third quarter to complete the final project under the Green Transformation Program and a partial rebuild of the recovery boiler. The unscheduled shutdown at the Northwood pulp mill had on estimated impact on current quarter production of 31,000 tonnes, though the impact of this shutdown was partially offset by an accrual for an anticipated business interruption insurance recovery. The Company's BCTMP Taylor pulp mill also took a five day scheduled maintenance shutdown in the current quarter.

[15] Pulp and Paper Products Council ("PPPC").

[16] World 20 data is based on twenty producing countries representing 80% of world chemical market pulp capacity and is based on information compiled and prepared by the PPPC.

Pulp unit manufacturing costs increased from the previous quarter, reflecting the significantly lower production levels in the quarter, as well as higher maintenance and operating costs relating to the maintenance outages. However, fibre costs decreased modestly due to the consumption of lower cost chips from opening inventories and a reduction in usage of higher cost whole log chips, partially offset by higher prices paid for sawmill residual (linked to NBSK market pulp prices) and whole log chips.

Compared to the second quarter of 2011, unit cash conversion costs increased, with the lower production levels again being the main driver for the increase. Pulp unit manufacturing costs were positively impacted however by a reduction in fibre costs, principally resulting from lower-cost sawmill residual chips, for which prices are linked to NBSK pulp sales realizations.

Unallocated and Other Items

(millions of dollars)		**Q2 2012**		Q1 2012		**YTD 2012**		Q2 2011		YTD 2011
Operating income (loss) of Panels operations[17]	**$**	**2.0**	$	(4.8)	**$**	**(2.8)**	$	(4.2)	$	(9.9)
Corporate costs	**$**	**(6.6)**	$	(7.9)	**$**	**(14.5)**	$	(5.9)	$	(13.3)
Finance expense, net	**$**	**(6.2)**	$	(6.2)	**$**	**(12.4)**	$	(5.8)	$	(13.0)
Foreign exchange gain (loss) on long-term debt and investments, net	**$**	**(3.8)**	$	4.0	**$**	**0.2**	$	2.0	$	6.7
Gain (loss) on derivative financial instruments	**$**	**(6.3)**	$	7.4	**$**	**1.1**	$	1.3	$	6.0
Other income (expense), net	**$**	**2.6**	$	(0.2)	**$**	**2.4**	$	1.1	$	(0.6)

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

The panels operations reported operating income of $2.0 million for the second quarter of 2012, compared to a loss of $4.8 million for the previous quarter. Excluding the impact of inventory valuation adjustments, the panels operations showed an operating loss of $1.7 million in the second quarter of 2012, compared to $3.1 million in the first quarter of 2012, with the lower loss principally reflecting an uptick in OSB markets driven by the increased housing activity, as evidenced by a US$33 per thousand square feet ("msf") increase in the benchmark OSB price to US$235 per msf[18]. Compared to the second quarter of 2011, excluding inventory valuation adjustments, results for the panel operations improved by $5.1 million, also largely reflecting the considerably stronger market prices, with the benchmark OSB price up by US$63 per msf, or 37%.

Corporate costs were $6.6 million for the second quarter of 2012, down $1.3 million from the previous quarter, largely reflecting costs recorded in the previous quarter related to the acquisition of assets from Tembec. Corporate costs were higher by $0.7 million compared to the second quarter of 2011, in part reflecting integration related costs.

Net finance expense for the second quarter of 2012 was $6.2 million, in line with the previous quarter. Compared to the second quarter of 2011, finance expense showed a marginal increase, reflecting reduced interest income as a result of lower cash balances and a higher average debt level through the quarter, partially offset by a lower accretion expense on the deferred reforestation obligation.

The Company recorded a foreign exchange translation loss on its US dollar denominated debt of $3.8 million for the second quarter of 2012, as a result of the weakening of the Canadian dollar against the US dollar, which fell 2% between the respective quarter ends. The $4.0 million gain in the first quarter of 2012 and $2.0 million gain in the second quarter of 2011, resulted from a strengthening of the Canadian dollar in the previous periods.

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs, lumber prices and interest rates. For the second quarter of 2012, the Company recorded a net loss of $6.3 million related to its derivative financial instruments, largely reflecting realized and unrealized losses on the US dollar forward contracts and collars, related to the weakening of the Canadian dollar, and unrealized losses on energy hedges and interest rate swaps.

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

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

(millions of dollars)	Q2 2012	Q1 2012	YTD 2012	Q2 2011	YTD 2011
Foreign exchange collars and forward contracts	**$ (2.5)**	$ 2.9	**$ 0.4**	$ 1.0	$ 2.9
Energy derivatives	**$ (1.8)**	$ 1.2	**$ (0.6)**	$ (0.3)	$ 0.6
Lumber futures	**$ (0.4)**	$ 3.0	**$ 2.6**	$ 0.6	$ 2.5
Interest rate swaps	**$ (1.6)**	$ 0.3	**$ (1.3)**	$ -	$ -
	$ (6.3)	$ 7.4	**$ 1.1**	$ 1.3	$ 6.0

Other expense, net of $2.6 million principally reflected favourable exchange movements on US dollar denominated cash, receivables and payables of Canadian operations of $1.7 million, compared to a loss in the previous quarter of $1.2 million and a loss of $0.7 million in the second quarter of 2011 resulting from the strengthening of the Canadian dollar during those periods. Other income in the current quarter also includes a $0.9 million positive fair value adjustment related to a royalty agreement associated with the sale of the operating assets of Howe Sound Pulp and Paper Limited Partnership in late 2010, while other income in the first quarter of 2012 and second quarter of 2011 included $1.3 million and $0.6 million, respectively, for a change in fair value of the Company's investment in ABCP.

Other Comprehensive Income (Loss)

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

(millions of dollars)	Q2 2012	Q1 2012	YTD 2012	Q2 2011	YTD 2011
Foreign exchange translation differences for foreign operations	**$ 4.1**	$ (3.6)	**$ 0.5**	$ 0.3	$ (5.9)
Defined benefit actuarial loss, net of tax	**$ (22.7)**	$ (5.3)	**$ (28.0)**	$ (6.6)	$ (4.4)
Other comprehensive income (loss), net of tax	**$ (18.6)**	$ (8.9)	**$ (27.5)**	$ (6.3)	$ (10.3)

In the second quarter of 2012, the Company recorded an after-tax charge to other comprehensive income of $22.7 million in relation to changes in the valuation of its defined benefit post-employment compensation plans. The charge reflects a reduction in the discount rate used to value the plans, and a lower than expected rate of return for the period. In the previous quarter a charge of $5.3 million was recorded, reflecting a reduction in the discount rate, offset in part by a gain on plan assets due to a higher than expected gain for the quarter. An after-tax loss of $6.6 million was recorded in the second quarter of 2011.

In addition, the Company recorded $4.1 million of other comprehensive income in the quarter for foreign exchange differences for foreign operations, reflecting the weakening of the Canadian dollar by almost 1% over the quarter. This compared to a charge of $3.6 million in the previous quarter, with the Canadian dollar strengthening over the period, and $0.3 million of other comprehensive income in the second quarter of 2011.

SUMMARY OF FINANCIAL POSITION

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

(millions of dollars)	Q2 2012	Q1 2012	YTD 2012	Q2 2011	YTD 2011
Increase (decrease) in cash and cash equivalents	**$ (2.7)**	$ (20.2)	**$ (22.9)**	$ (42.5)	$ (130.3)
Operating activities	**$ 119.1**	$ (55.2)	**$ 63.9**	$ 69.8	$ 63.8
Financing activities	**$ (92.6)**	$ 137.0	**$ 44.4**	$ (80.1)	$ (155.1)
Investing activities	**$ (29.2)**	$ (102.0)	**$ (131.2)**	$ (32.2)	$ (39.0)
Ratio of current assets to current liabilities			**1.4 : 1**		2.2 : 1
Net debt to capitalization			**18.8%**		6.2%
ROIC – Consolidated	**1.3%**	(1.4)%	**(0.1)%**	0.2%	0.6%
ROCE - Canfor solid wood business[19]	**0.2%**	(1.6)%	**(1.4)%**	(1.3)%	(1.6)%

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

Changes in Financial Position

Cash generated from operating activities was $119.1 million in the second quarter of 2012, compared to cash used of $55.2 million in the previous quarter. The significant drawdown of logs during the Canadian spring break-up period had a significant positive cash flow impact in the second quarter, in contrast to the cash used in the previous quarter in the related inventory build-up, while higher cash earnings in the current quarter also had a positive impact. Partially offsetting these gains were property tax payments made at the end of the second quarter, and increased accounts receivable balances, reflecting higher sales levels and prices. The second quarter of 2012 also included seasonally higher reforestation-related payments. Compared to the second quarter of 2011, cash generated from operating activities was up by over $49.3 million reflecting higher cash earnings and improved working capital movements.

Financing activities used cash of $92.6 million in the current quarter, compared to cash generated of $137.0 million in the previous quarter and cash used of $80.1 million in the second quarter of 2011. The current quarter's cash flows included a $77.0 million repayment on the Company's outstanding operating lines of credit, while $94.0 million was drawn in the previous quarter. The previous quarter also included $100.0 million of new term debt, partially offset by a $49.9 million (US$50.0 million) repayment of term debt. A term debt repayment was also made in the second quarter of 2011, in the amount of $48.1 million (US$50.0 million). Cash distributions to non-controlling interests were $8.2 million in the second quarter of 2012 (Q1 2012: $4.3 million; Q2 2011: $25.9 million). Finance expenses paid in the current quarter were $7.4 million, up $4.3 million from the previous quarter, principally reflecting timing of scheduled payments, and was up slightly from the second quarter of 2011.

Investing activities used cash of $29.2 million in the second quarter of 2012, compared to $102.0 million in the first quarter of 2012 and $32.2 million in the second quarter of 2011. Cash used for capital additions was $44.4 million, down $9.2 million from the first quarter of 2012, and down $11.2 million from the second quarter of 2011. Capital additions for lumber operations in the current quarter reflected in part improvement projects at the Kootenay region sawmills. In the pulp segment, current quarter capital expenditures were $19.3 million, principally related to capital and major maintenance expenditure at the Company's Prince George pulp and paper mill. Partially offsetting the cash spent on capital additions during the quarter was $12.9 million in net proceeds realized on the sale of the Company's ABCP in early April. Investing activities in the previous quarter included $65 million for the acquisition of Tembec Industries Ltd.'s southern British Columbia Interior wood product assets (including working capital).

Liquidity and Financial Requirements

At June 30, 2012, the Company on a consolidated basis had cash of $6.0 million, with $17.0 million drawn on its operating lines of credit, and an additional $28.9 million reserved for several standby letters of credit. Total remaining available operating lines of credit were $365.2 million. The Company and Canfor Pulp remained in compliance with the covenants relating to their operating lines of credit and long-term debt during the quarter, and expect to remain so for the foreseeable future.

During the first quarter of 2012, the Company issued new term debt of $100.0 million to fund a US$50.0 million term debt repayment on February 1, 2012 and the acquisition of assets from Tembec. The new debt is in the form of an unsecured non-revolving term loan, with a maturity date of February 13, 2017. Interest rates are floating based on the lenders' Canadian prime rate or bankers acceptances. During the first quarter of 2012, the Company also put in place $75.0 million of floating to fixed interest rate swaps, with an additional $25.0 million put in place in early April 2012.

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

The Company's consolidated net debt to total capitalization at the end of the second quarter of 2012 was 18.8%. For Canfor, excluding Canfor Pulp, net debt to capitalization at the end of the first quarter was 15.3%.

Softwood Lumber Agreement ("SLA") Update

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

As the arbitration is a state-to-state international dispute under the SLA, Canada prepared a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. After numerous representations from both sides, a hearing was held before the arbitration panel in the first quarter of 2012.

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

Canfor Pulp Collective Agreements with Labour Unions

Canfor Pulp's collective labour agreements expired on April 30, 2012. The CEP (Communications, Energy and Paperworkers Union) has ratified a new five year collective agreement and Canfor Pulp is continuing discussions with the PPWC (Pulp, Paper and Woodworkers of Canada).

CPPI Share Exchange

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

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

OUTLOOK

Lumber

For the third quarter of 2012, the North American lumber market is projected to show a modest and gradual improvement as housing demand edges higher and U.S. inventories remain at low levels, notwithstanding the fragility of the U.S. economy. With respect to shipments to the U.S., export taxes are 5% in July and will be 10% in August. Repair and remodeling activity is forecast to be stable through the next quarter. Offshore lumber shipments are anticipated to be steady for the rest of the year.

Pulp and Paper

The global softwood pulp market is projected to weaken further through the remaining summer months. Producer inventories remained in the balanced range through to the end of May 2012 but are forecast to rise modestly as there is minimal scheduled maintenance downtime during the summer months. For the month of July, Canfor Pulp projects NBSK pulp list prices to decrease US$20 per tonne in all regions with further price reductions projected in the third quarter.

OUTSTANDING SHARES

At July 26, 2012, there were 142,752,431 common shares outstanding.

CRITICAL ACCOUNTING ESTIMATES

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

CHANGES IN ACCOUNTING POLICY

Effective January 1, 2012, the Company retroactively changed its accounting policy for the presentation of interest expense and expected rate of return on assets of defined benefit post-retirement plans. The net expense has been reclassified from operating income, included in manufacturing and product costs and in selling and administration costs, to net finance expense. Management considers the classification of net pension interest expense as a finance expense more accurately reflects the nature of this cost. The effect on the three months ended June 30, 2011 and six months ended June 30, 2011 is an increase in operating income and an increase in net finance expense of $0.9 million and $1.8 million, respectively. There is no impact on amounts recorded in the consolidated balance sheet or opening equity as at January 1, 2012.

NEW ACCOUNTING PRONOUNCEMENTS

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

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

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

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

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

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

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

INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

RISKS AND UNCERTAINTIES

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

SELECTED QUARTERLY FINANCIAL INFORMATION[20]

	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010
Sales and income (millions of dollars)								
Sales	**$ 700.9**	$ 607.6	$ 576.2	$ 602.1	$ 619.1	$ 624.0	$ 629.1	$ 588.7
Operating income (loss)	**$ 26.0**	$ (21.5)	$ (63.1)	$ 15.4	$ 27.4	$ 32.3	$ 43.9	$ 34.2
Net income (loss)	**$ 7.0**	$ (10.9)	$ (38.1)	$ (9.6)	$ 26.2	$ 32.3	$ 55.4	$ 37.2
Shareholder net income (loss)	**$ 4.5**	$ (16.2)	$ (44.1)	$ (21.6)	$ 2.1	$ 7.0	$ 31.4	$ 9.1
Per common share (dollars)								
Shareholder net income (loss) – basic and diluted	**$ 0.03**	$ (0.11)	$ (0.31)	$ (0.15)	$ 0.01	$ 0.05	$ 0.22	$ 0.06
Statistics								
Lumber shipments (MMfbm)	**1,158**	994	974	969	973	857	885	865
OSB shipments (MMsf 3/8")	**72**	65	75	62	69	63	57	58
Pulp shipments (000 mt)	**282**	328	275	291	303	318	331	277
Average exchange rate – US$/Cdn$	**$ 0.990**	$ 0.999	$ 0.977	$ 1.020	$ 1.033	$ 1.014	$ 0.987	$ 0.962
Average Western SPF 2x4 #2&Btr lumber price (US$)	**$ 295**	$ 266	$ 238	$ 246	$ 240	$ 296	$ 269	$ 223
Average SYP (East) 2x4 #2 lumber price (US$)	**$ 325**	$ 298	$ 260	$ 259	$ 251	$ 302	$ 256	$ 243
Average OSB price – North Central (US$)	**$ 235**	$ 202	$ 190	$ 184	$ 172	$ 199	$ 191	$ 178
Average NBSK pulp list price delivered to U.S. (US$)	**$ 900**	$ 870	$ 920	$ 993	$ 1,025	$ 970	$ 967	$ 1,000

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

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

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

After-tax impact, net of non-controlling interests[21] (millions of dollars, except for per share amounts)	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010
Shareholder net income (loss), as reported	**$ 4.5**	$ (16.2)	$ (44.1)	$ (21.6)	$ 2.1	$ 7.0	$ 32.9	$ 9.1
Foreign exchange (gain) loss on long-term debt and investments, net	**$ 2.4**	$ (2.7)	$ (3.3)	$ 11.0	$ (1.4)	$ (3.0)	$ (6.9)	$ (6.3)
(Gain) loss on derivative financial instruments	**$ 4.2**	$ (5.1)	$ (6.7)	$ 7.0	$ (0.7)	$ (2.9)	$ (0.5)	$ (1.1)
Decrease (increase) in fair value of asset-backed commercial paper	**$ -**	$ (1.1)	$ (0.5)	$ 1.8	$ (0.5)	$ (1.0)	$ (5.5)	$ -
Costs recorded in relation to Tembec acquisition	**$ -**	$ 2.8	$ -	$ -	$ -	$ -	$ -	$ -
Mill closure provisions	**$ -**	$ -	$ 17.0	$ -	$ -	$ -	$ -	$ 13.0
Asset impairment charges	**$ -**	$ -	$ 5.5	$ -	$ -	$ -	$ -	$ -
Restructuring costs related to changes in management group	**$ -**	$ -	$ -	$ -	$ 2.6	$ -	$ -	$ -
Gain on sale of operating assets of Howe Sound Pulp and Paper Limited Partnership	**$ -**	$ -	$ -	$ -	$ -	$ -	$ (4.9)	$ -
Net impact of above items	**$ 6.6**	$ (6.1)	$ 12.0	$ 19.8	$ -	$ (6.9)	$ (17.8)	$ 5.6
Adjusted shareholder net income (loss)	**$ 11.1**	$ (22.3)	$ (32.1)	$ (1.8)	$ 2.1	$ 0.1	$ 15.1	$ 14.7
Shareholder net income (loss) per share (EPS), as reported	**$ 0.03**	$ (0.11)	$ (0.31)	$ (0.15)	$ 0.01	$ 0.05	$ 0.23	$ 0.06
Net impact of above items per share	**$ 0.05**	$ (0.05)	$ 0.09	$ 0.14	$ 0.00	$ (0.05)	$ (0.12)	$ 0.04
Adjusted net income (loss) per share	**$ 0.08**	$ (0.16)	$ (0.22)	$ (0.01)	$ 0.01	$ 0.00	$ 0.11	$ 0.10

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

Canfor Corporation
Condensed Consolidated Balance Sheets

(millions of Canadian dollars, unaudited)		**As at June 30, 2012**		As at December 31, 2011
ASSETS				
Current assets				
Cash and cash equivalents	**$**	**6.0**	$	28.9
Accounts receivable - Trade		**137.3**		105.1
- Other		**66.6**		65.7
Inventories (Note 2)		**359.3**		348.3
Prepaid expenses		**39.3**		20.4
Total current assets		**608.5**		568.4
Property, plant and equipment		**1,148.1**		1,139.2
Timber licenses		**564.4**		530.1
Goodwill and other intangible assets		**81.6**		83.0
Long-term investments and other (Note 3)		**47.2**		62.8
Deferred income taxes, net		**50.0**		18.1
Total assets	**$**	**2,499.8**	$	2,401.6
LIABILITIES				
Current liabilities				
Operating loans (Note 4(a))	**$**	**17.0**	$	-
Accounts payable and accrued liabilities		**296.0**		290.5
Current portion of long-term debt (Note 4(b))		**76.4**		50.9
Current portion of deferred reforestation obligations		**37.8**		31.6
Total current liabilities		**427.2**		373.0
Long-term debt (Note 4(b))		**212.1**		188.1
Retirement benefit obligations		**317.8**		298.3
Deferred reforestation obligations		**77.6**		65.0
Other long-term liabilities		**15.1**		13.8
Deferred income taxes, net		**154.6**		103.3
Total liabilities	**$**	**1,204.4**	$	1,041.5
EQUITY				
Share capital	**$**	**1,126.2**	$	1,125.9
Contributed surplus		**31.9**		31.9
Retained earnings		**(61.3)**		(24.6)
Accumulated foreign exchange translation differences		**(5.4)**		(5.9)
Total equity attributable to equity holders of the Company		**1,091.4**		1,127.3
Non-controlling interests		**204.0**		232.8
Total equity	**$**	**1,295.4**	$	1,360.1
Total liabilities and equity	**$**	**2,499.8**	$	2,401.6

Contingency (Note 11)

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

APPROVED BY THE BOARD

Director, R.S. Smith

Director, R.L. Cliff

Canfor Corporation
Condensed Consolidated Statements of Income (Loss)

(millions of Canadian dollars, unaudited)	3 months ended June 30, 2012	3 months ended June 30, 2011	6 months ended June 30, 2012	6 months ended June 30, 2011
Sales	**$ 700.9**	$ 619.1	**$ 1,308.5**	$ 1,243.1
Costs and expenses				
Manufacturing and product costs	**465.2**	398.4	**894.8**	806.9
Freight and other distribution costs	**133.0**	123.8	**255.4**	236.4
Export taxes	**13.9**	9.4	**25.1**	20.2
Amortization	**46.0**	40.3	**91.1**	81.8
Selling and administration costs	**14.9**	12.9	**30.9**	28.4
Restructuring, mill closure and severance costs	**1.9**	6.9	**6.7**	9.7
	674.9	591.7	**1,304.0**	1,183.4
Operating income	**26.0**	27.4	**4.5**	59.7
Finance expense, net	**(6.2)**	(5.8)	**(12.4)**	(13.0)
Foreign exchange gain (loss) on long-term debt and investments, net	**(3.8)**	2.0	**0.2**	6.7
Gain (loss) on derivative financial instruments (Note 6)	**(6.3)**	1.3	**1.1**	6.0
Other (expense) income, net	**2.6**	1.1	**2.4**	(0.6)
Net income (loss) before income taxes	**12.3**	26.0	**(4.2)**	58.8
Income tax recovery (expense) (Note 7)	**(5.3)**	0.2	**0.3**	(0.3)
Net income (loss)	**$ 7.0**	$ 26.2	**$ (3.9)**	$ 58.5
Net income (loss) attributable to:				
Equity shareholders of the Company	**$ 4.5**	$ 2.1	**$ (11.7)**	$ 9.1
Non-controlling interests	**2.5**	24.1	**7.8**	49.4
Net income (loss)	**$ 7.0**	$ 26.2	**$ (3.9)**	$ 58.5
Net income (loss) per common share: (in dollars)				
Attributable to equity shareholders of the Company				
- Basic and diluted (Note 8)	**$ 0.03**	$ 0.01	**$ (0.08)**	$ 0.06

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, **2012**	3 months ended June 30, 2011	6 months ended June 30, **2012**	6 months ended June 30, 2011
Net income (loss)	**$ 7.0**	$ 26.2	**$ (3.9)**	$ 58.5
Other comprehensive income (loss)				
Foreign exchange translation differences for foreign operations	**4.1**	0.3	**0.5**	(5.9)
Defined benefit plan actuarial losses (Note 5)	**(30.6)**	(8.8)	**(37.5)**	(5.8)
Income tax recovery on defined benefit plan actuarial losses (Note 7)	**7.9**	2.2	**9.5**	1.4
Other comprehensive income (loss), net of tax	**(18.6)**	(6.3)	**(27.5)**	(10.3)
Total comprehensive income (loss)	**$ (11.6)**	$ 19.9	**$ (31.4)**	$ 48.2
Total comprehensive income (loss) attributable to:				
Equity shareholders of the Company	**$ (12.3)**	$ (3.7)	**$ (36.2)**	$ (0.6)
Non-controlling interests	**0.7**	23.6	**4.8**	48.8
Total comprehensive income (loss)	**$ (11.6)**	$ 19.9	**$ (31.4)**	$ 48.2

Condensed Consolidated Statements of Changes in Equity

(millions of Canadian dollars, unaudited)	3 months ended June 30, **2012**	3 months ended June 30, 2011	6 months ended June 30, **2012**	6 months ended June 30, 2011
Share capital				
Balance at beginning of period	**$ 1,126.2**	$ 1,125.7	**$ 1,125.9**	$ 1,125.4
Common shares issued on exercise of stock options	**-**	-	**0.3**	0.3
Balance at end of period	**$ 1,126.2**	$ 1,125.7	**$ 1,126.2**	$ 1,125.7
Contributed surplus				
Balance at beginning and end of period	**$ 31.9**	$ 31.9	**$ 31.9**	$ 31.9
Retained earnings				
Balance at beginning of period	**$ (44.9)**	$ 82.8	**$ (24.6)**	$ 73.5
Net income (loss) attributable to equity shareholders of the Company	**4.5**	2.1	**(11.7)**	9.1
Defined benefit plan actuarial losses, net of tax	**(20.9)**	(6.1)	**(25.0)**	(3.8)
Balance at end of period	**$ (61.3)**	$ 78.8	**$ (61.3)**	$ 78.8
Accumulated foreign exchange translation differences				
Balance at beginning of period	**$ (9.5)**	$ (16.5)	**$ (5.9)**	$ (10.3)
Foreign exchange translation differences for foreign operations	**4.1**	0.3	**0.5**	(5.9)
Balance at end of period	**$ (5.4)**	$ (16.2)	**$ (5.4)**	$ (16.2)
Total equity attributable to equity holders of the Company	**$ 1,091.4**	$ 1,220.2	**$ 1,091.4**	$ 1,220.2
Non-controlling interests				
Balance at beginning of period	**$ 211.5**	$ 247.0	**$ 232.8**	$ 249.5
Net income attributable to non-controlling interests	**2.5**	24.1	**7.8**	49.4
Defined benefit plan actuarial losses attributable to non-controlling interests	**(1.8)**	(0.5)	**(3.0)**	(0.6)
Distributions to non-controlling interests	**(8.2)**	(24.9)	**(8.6)**	(52.6)
Share exchange (Note 13)	**-**	-	**(25.0)**	-
Balance at end of period	**$ 204.0**	$ 245.7	**$ 204.0**	$ 245.7
Total equity	**$ 1,295.4**	$ 1,465.9	**$ 1,295.4**	$ 1,465.9

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, **2012**	3 months ended June 30, 2011	6 months ended June 30, **2012**	6 months ended June 30, 2011
Cash generated from (used in):				
Operating activities				
Net income (loss)	**$ 7.0**	$ 26.2	**$ (3.9)**	$ 58.5
Items not affecting cash:				
Amortization	**46.0**	40.3	**91.1**	81.8
Income tax (recovery) expense	**5.3**	(0.2)	**(0.3)**	0.3
Long-term portion of deferred reforestation obligations	**(11.3)**	(6.0)	**2.1**	6.1
Change in fair value of long-term investment	**-**	(0.6)	**(1.3)**	(1.8)
Foreign exchange (gain) loss on long-term debt and investments, net	**3.8**	(2.0)	**(0.2)**	(6.7)
Changes in mark-to-market value of derivative financial instruments	**7.7**	(0.9)	**1.7**	(4.6)
Employee future benefits	**(0.4)**	(0.5)	**(2.3)**	(1.0)
Net finance expense	**6.2**	5.8	**12.4**	13.0
Other, net	**(1.3)**	(7.1)	**(2.0)**	(7.0)
Salary pension plan contributions	**(9.0)**	(9.9)	**(18.0)**	(19.6)
Income taxes recovered (paid), net	**(3.3)**	0.7	**(4.6)**	-
Net change in non-cash working capital (Note 9)	**68.4**	24.0	**(10.8)**	(55.2)
	119.1	69.8	**63.9**	63.8
Financing activities				
Change in operating bank loans (Note 4(a))	**(77.0)**	-	**17.0**	-
Proceeds from long-term debt (Note 4(b))	**-**	-	**100.0**	-
Repayment of long-term debt (Note 4(b))	**-**	(48.1)	**(49.9)**	(81.9)
Finance expenses paid	**(7.4)**	(6.1)	**(10.5)**	(9.6)
Cash distributions paid to non-controlling interests	**(8.2)**	(25.9)	**(12.5)**	(63.9)
Other, net	**-**	-	**0.3**	0.3
	(92.6)	(80.1)	**44.4**	(155.1)
Investing activities				
Additions to property, plant and equipment	**(44.4)**	(55.6)	**(98.0)**	(104.5)
Reimbursements from Government under Green Transformation Program	**1.1**	21.6	**9.0**	31.2
Acquisition of Tembec assets (Note 12)	**(0.7)**	-	**(65.6)**	-
Share exchange (Note 13)	**-**	-	**6.8**	-
Proceeds from redemption of asset-backed commercial paper (Note 3)	**12.9**	0.1	**12.9**	29.8
Other, net	**1.9**	1.7	**3.7**	4.5
	(29.2)	(32.2)	**(131.2)**	(39.0)
Increase (decrease) in cash and cash equivalents	**(2.7)**	(42.5)	**(22.9)**	(130.3)
Cash and cash equivalents at beginning of period	**8.7**	172.5	**28.9**	260.3
Cash and cash equivalents at end of period	**$ 6.0**	$ 130.0	**$ 6.0**	$ 130.0

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

1. Basis of Preparation

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

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

Change in accounting policy

Effective January 1, 2012, the Company retroactively changed its accounting policy for the presentation of interest expense and expected rate of return on assets of defined benefit post-retirement plans. The net expense has been reclassified from operating income, included in manufacturing and product costs and in selling and administration costs, to net finance expense. Management considers the classification of net pension interest expense as a finance expense more accurately reflects the nature of this cost. The effect on the three months ended June 30, 2011 and six months ended June 30, 2011 is an increase in operating income and an increase in net finance expense of $0.9 million and $1.8 million, respectively. There is no impact on amounts recorded in the consolidated balance sheet or opening equity as at January 1, 2012.

Accounting standards issued and not applied

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

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

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

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

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

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

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

2. Inventories

(millions of Canadian dollars)		As at June 30, 2012		As at December 31, 2011
Logs	**$**	**47.2**	$	55.9
Finished products		**197.0**		186.3
Residual fibre		**22.0**		17.3
Processing materials and supplies		**93.1**		88.8
	$	**359.3**	$	348.3

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

3. Long-term Investments and Other

(millions of Canadian dollars)		As at June 30, 2012		As at December 31, 2011
Asset-backed commercial paper ("ABCP")	**$**	**-**	$	11.8
Other investments		**23.6**		24.3
Investment tax credits		**8.6**		8.6
Defined benefit plan assets		**3.0**		3.0
Other deposits, loans and advances		**12.0**		15.1
	$	**47.2**	$	62.8

On April 2, 2012, the Company sold the ABCP assets for net proceeds of $12.9 million.

4. Operating Lines and Long-Term Debt

(a) Available Operating Lines

(millions of Canadian dollars)		As at June 30, 2012		As at December 31, 2011
Canfor (excluding CPLP)				
Principal operating lines	**$**	**350.0**	$	350.0
Facility A		**-**		12.9
Total operating lines - Canfor (excluding CPLP)		**350.0**		362.9
Drawn		**(17.0)**		-
Letters of credit (principally unregistered pension plans)		**(17.7)**		(17.2)
Total available operating lines - Canfor (excluding CPLP)	**$**	**315.3**	$	345.7
CPLP				
Main bank loan facility	**$**	**40.0**	$	40.0
Bridge loan credit facility (maximum $30.0 million)		**10.7**		19.7
Facility for BC Hydro letter of credit		**10.4**		10.4
Total operating lines - CPLP		**61.1**		70.1
Letters of credit (for general business purposes)		**(0.8)**		(0.5)
BC Hydro letter of credit		**(10.4)**		(10.4)
Total available operating lines - CPLP	**$**	**49.9**	$	59.2
Consolidated:				
Total operating lines	**$**	**411.1**	$	433.0
Total available operating lines	**$**	**365.2**	$	404.9

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

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

CPLP also has a maximum $30.0 million bridge loan credit facility with a maturity date of December 31, 2012 to fund timing differences between expenditures and reimbursements for projects funded under the Canadian Federal Government Green Transformation Program, with the amount available at a point in time equal to the outstanding unreimbursed expenditures. The bridge facility terms are similar to CPLP's main facility, with interest and other costs at prevailing market rates. CPLP also has a separate facility with a maturity date of November 30, 2013 to cover a $10.4 million standby letter of credit issued to BC Hydro.

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

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

(b) Long-Term Debt

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

During the first quarter of 2012, the Company also issued new term debt totaling $100.0 million which was used to fund the above debt repayment and the acquisition of assets from Tembec (Note 12). The new debt is in the form of an unsecured non-revolving term loan, with a maturity date of February 13, 2017. Interest rates are floating based on the lenders' Canadian prime rate or bankers acceptances. In addition, during the first quarter of 2012, the Company put in place $75.0 million of floating to fixed interest rate swaps, with an additional $25.0 million put in place in early April 2012.

At June 30, 2012, the fair value of the long-term debt, measured at its amortized cost of $288.5 million, was $296.0 million. The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

5. Employee Future Benefits

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

For the six months ended June 30, 2012, $37.5 million (before tax) was charged to other comprehensive income. The charge reflected losses on retirement benefit plan liabilities due to a reduction in the discount rate coupled with an actual return on plan assets which was lower than the expected gain. For three months ended June 30, 2012, the charge was $30.6 million (before tax). For the six months ended June 30, 2011 a pre-tax amount of $5.8 million was charged to other comprehensive income, relating to a rate of return on plan assets which was lower than the expected rate of return. For the three months ended June 30, 2011 the pre-tax charge was $8.8 million.

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

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

Pension Benefit Plans	
Discount rate	
June 30, 2012	**4.65%**
March 31, 2012	4.80%
December 31, 2011	5.00%
June 30, 2011	5.50%
March 31, 2011	5.50%
December 31, 2010	5.50%
Rate of return on plan assets	
6 months ended June 30, 2012	**2.60%**
3 months ended March 31, 2012	4.30%
6 months ended June 30, 2011	1.80%
3 months ended March 31, 2011	1.65%
Other Benefit Plans	
Discount rate	
June 30, 2012	**4.90%**
March 31, 2012	5.00%
December 31, 2011	5.30%
June 30, 2011	5.75%
March 31, 2011	5.75%
December 31, 2010	5.75%

6. Derivative Financial Instruments

The Company uses a variety of derivative financial instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, lumber prices, energy costs, electricity sales and floating interest rates on certain long-term debt. At June 30, 2012, the fair value of derivative financial instruments was a net liability of $1.8 million (December 31, 2011 – net liability of $0.2 million). The fair value of these financial instruments was determined based on prevailing market rates for instruments with similar characteristics.

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

	3 months ended June 30,		6 months ended June 30,	
(millions of Canadian dollars)	**2012**	2011	**2012**	2011
Foreign exchange collars and forward contracts	**$ (2.5)**	$ 1.0	**$ 0.4**	$ 2.9
Energy derivatives	**(1.8)**	(0.3)	**(0.6)**	0.6
Lumber futures	**(0.4)**	0.6	**2.6**	2.5
Interest rate swaps	**(1.6)**	-	**(1.3)**	-
	$ (6.3)	$ 1.3	**$ 1.1**	$ 6.0

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

(millions of Canadian dollars)	**As at June 30, 2012**	As at December 31, 2011
Foreign exchange collars and forward contracts	**$ 0.5**	$ (0.4)
Energy derivatives	**(1.1)**	(0.2)
Lumber futures	**-**	0.4
Interest rate swaps	**(1.2)**	-
Total asset (liability)	**(1.8)**	(0.2)
Less: current portion	**0.5**	0.2
Long-term portion	**$ (1.3)**	$ -

7. Income Taxes

(millions of Canadian dollars)	3 months ended June 30, **2012**	2011	6 months ended June 30, **2012**	2011
Current	**$ 0.6**	$ (0.1)	**$ (2.2)**	$ (0.3)
Deferred	**(5.9)**	0.3	**2.5**	-
Income tax (expense) recovery	**$ (5.3)**	$ 0.2	**$ 0.3**	$ (0.3)

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

(millions of Canadian dollars)	3 months ended June 30, **2012**	2011	6 months ended June 30, **2012**	2011
Income tax expense at statutory rate 2012 – 25.0% (2011 – 26.5%)	**$ (3.0)**	$ (6.9)	**$ 1.1**	$ (15.6)
Add (deduct):				
Non-taxable income related to non-controlling interests in limited partnerships	**0.1**	6.4	**1.3**	13.1
Entities with different income tax rates and other tax adjustments	**(2.1)**	0.5	**(2.2)**	0.6
Tax recovery at rates other than statutory rate	**0.2**	-	**0.2**	0.2
Permanent difference from capital gains and losses and other non-deductible items	**(0.5)**	0.2	**(0.1)**	1.4
Income tax (expense) recovery	**$ (5.3)**	$ 0.2	**$ 0.3**	$ (0.3)

In addition to the amounts recorded to net income, a tax recovery of $7.9 million was recorded to other comprehensive income for the three month period ended June 30, 2012 (three months ended June 30, 2011 – $2.2 million) in relation to the actuarial losses on defined benefit employee compensation plans. For the six months ended June 30, 2012, the tax recovery was $9.5 million (six months ended June 30, 2011 - $1.4 million).

8. Earnings Per Share

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

	3 months ended June 30, **2012**	2011	6 months ended June 30, **2012**	2011
Weighted average number of common shares	**142,751,442**	142,705,764	**142,745,724**	142,691,365
Incremental shares from potential exercise of options	**-**	7,495	**-**	10,124
Diluted number of common shares	**142,751,442**	142,713,259	**142,745,724**	142,701,489

9. Net Change in Non-Cash Working Capital

(millions of Canadian dollars)	3 months ended June 30, 2012	3 months ended June 30, 2011	6 months ended June 30, 2012	6 months ended June 30, 2011
Accounts receivable	**$ (24.1)**	$ (16.8)	**$ (32.3)**	$ (31.2)
Inventories	**104.5**	83.6	**16.0**	6.2
Prepaid expenses	**(16.3)**	(13.5)	**(13.8)**	(11.2)
Accounts payable, accrued liabilities and current portion of deferred reforestation obligations	**4.3**	(29.3)	**19.3**	(19.0)
Net increase (decrease) in non-cash working capital	**$ 68.4**	$ 24.0	**$ (10.8)**	$ (55.2)

10. Segment Information

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

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

The Company's panels business does not meet the criteria to be reported fully as a separate segment and is included in Unallocated & Other below. Sales for panels operations for the three months ended June 30, 2012 were $18.0 million (three months ended June 30, 2011 - $10.9 million) and $32.5 million for the six months ended June 30, 2012 (six months ended June 30, 2011 - $23.3 million).

(millions of Canadian dollars)		Lumber	Pulp & Paper	Unallocated & Other	Elimination Adjustment		Consolidated
3 months ended June 30, 2012							
Sales to external customers	**$**	**443.5**	**239.4**	**18.0**	**-**	**$**	**700.9**
Sales to other segments	**$**	**29.2**	**-**	**-**	**(29.2)**	**$**	**-**
Operating income (loss)	**$**	**18.9**	**11.7**	**(4.6)**	**-**	**$**	**26.0**
Amortization	**$**	**26.5**	**15.1**	**4.4**	**-**	**$**	**46.0**
Capital expenditures[1]	**$**	**25.1**	**19.3**	**-**	**-**	**$**	**44.4**
3 months ended June 30, 2011							
Sales to external customers	$	331.2	277.0	10.9	-	$	619.1
Sales to other segments	$	32.4	-	-	(32.4)	$	-
Operating income (loss)	$	(11.3)	48.8	(10.1)	-	$	27.4
Amortization	$	20.7	15.3	4.3	-	$	40.3
Capital expenditures[1]	$	24.4	30.8	0.4	-	$	55.6
6 months ended June 30, 2012							
Sales to external customers	**$**	**787.2**	**488.8**	**32.5**	**-**	**$**	**1,308.5**
Sales to other segments	**$**	**58.4**	**-**	**-**	**(58.4)**	**$**	**-**
Operating income (loss)	**$**	**(1.2)**	**23.0**	**(17.3)**	**-**	**$**	**4.5**
Amortization	**$**	**49.7**	**32.8**	**8.6**	**-**	**$**	**91.1**
Capital expenditures[1]	**$**	**52.0**	**46.0**	**-**	**-**	**$**	**98.0**
Identifiable assets	**$**	**1,519.1**	**822.2**	**158.5**	**-**	**$**	**2,499.8**
6 months ended June 30, 2011							
Sales to external customers	$	659.8	560.0	23.3	-	$	1,243.1
Sales to other segments	$	61.9	-	-	(61.9)	$	-
Operating income (loss)	$	(13.8)	96.7	(23.2)	-	$	59.7
Amortization	$	41.0	32.1	8.7	-	$	81.8
Capital expenditures[1]	$	50.0	54.1	0.4	-	$	104.5
Identifiable assets	$	1,347.0	842.7	256.6	-	$	2,446.3

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

11. Contingency

Softwood Lumber Agreement ("SLA")

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

As the arbitration is a state-to-state international dispute under the SLA, Canada prepared a defense to the claim with the assistance of the BC provincial government and the BC lumber industry. After numerous representations from both sides, a hearing was held before the arbitration panel in the first quarter of 2012.

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

12. Acquisition of Tembec Assets

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

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

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

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

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

13. Share Exchange

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

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

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