



**Canfor Corporation**

**Annual Information Form**

**Information in this Annual Information Form  
is as of March 29, 2007 unless otherwise indicated.**

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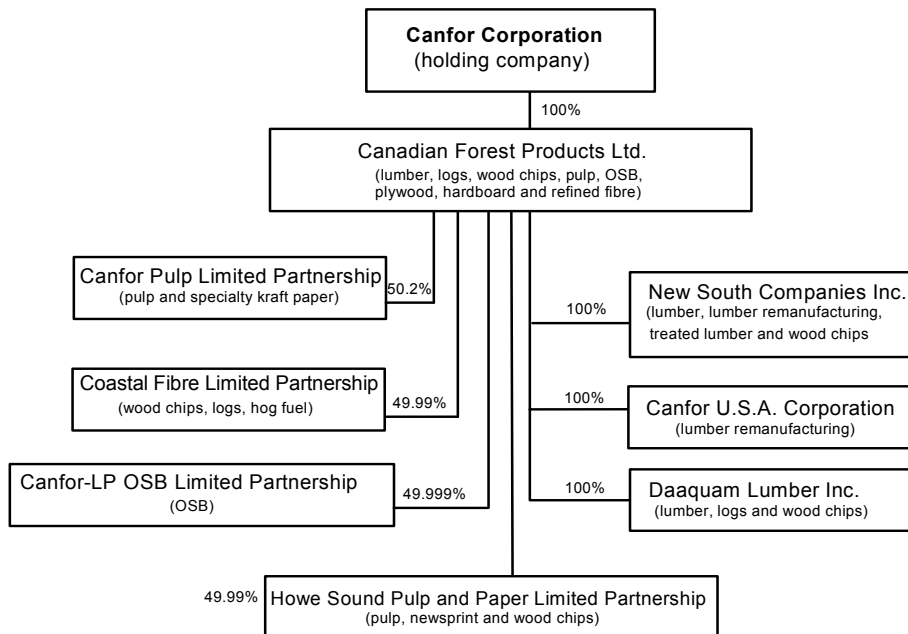
## INCORPORATION

The Company was incorporated on May 17, 1966, under the British Columbia *Company Act* as part of a reorganization of predecessors of the Canfor group of companies, the first of which commenced operations in 1938. The Company is now governed by the British Columbia *Business Corporations Act*, which replaced the *Company Act* in March 2004. In July 1983, Canfor became a public company and the Common Shares of the Company are listed and traded on the Toronto Stock Exchange.

The registered and head office of the Company is located at 100-1700 West 75<sup>th</sup> Avenue, Vancouver, British Columbia. In this Annual Information Form, Canfor Corporation is referred to as the “Company” and, unless otherwise indicated by the context, “Canfor” refers to the Company, its subsidiaries and its interests in the limited partnerships as described under “Corporate Structure” below.

## CORPORATE STRUCTURE

The following chart shows, as at December 31, 2006, the Company's material subsidiaries and its direct or indirect interest in Canfor Pulp Limited Partnership (“Canfor Pulp LP”), Coastal Fibre Limited Partnership (“Coastal Fibre LP”), Howe Sound Pulp and Paper Limited Partnership (“HSLP”) and Canfor – LP OSB Limited Partnership (“OSB LP”), their primary products or activities and the percentage of voting securities or ownership held. All of the companies listed below were incorporated under the laws of British Columbia and are now governed by the British Columbia *Business Corporations Act*, except Canfor U.S.A. Corporation, which is constituted under the Washington *Business Corporation Act*, Daaquam Lumber Inc. (“Daaquam”), which is constituted under the laws of Québec and New South Companies Inc. (“New South”), which is constituted under the laws of the State of South Carolina. HSLP, Coastal Fibre LP and OSB LP are partnerships constituted under the *Partnership Act* of British Columbia. Canfor Pulp LP is a partnership constituted under the laws of Manitoba.



On July 1, 2006, Canfor completed the spinout of its northern bleached softwood kraft pulp and paper business to Canfor Pulp LP, and distributed a 20% indirect interest in that business to its shareholders by way of a return of capital. On November 30, 2006, Canfor distributed a further 29.8% indirect interest in Canfor Pulp LP to its shareholders by way of a dividend in kind, retaining a 50.2% interest in the pulp and paper business. Canfor holds 50.2% of the voting securities of Canfor Pulp Holding Inc., general partner and the holder of a 0.001% general partner interest in Canfor Pulp LP. See “Business of Canfor – General Development” and “Pulp and Paper”.

On March 17, 2006, Canfor completed the sale of its Englewood Logging Operations (the “Englewood Operations”) to Coastal Fibre LP and the subsequent sale of these operations by Coastal Fibre LP to Western Forest Products Inc. (“WFP”) in consideration for, among other things, a long term fibre supply agreement from WFP. See “Business of Canfor – General Development”. Coastal Fibre LP is equally owned by its limited partners, Canfor and Oji Canada. Canfor and Oji each own 50% of the voting securities of Coastal Fibre General Partner Ltd., the general partner and the holder of a 0.02% interest in Coastal Fibre LP.

On March 6, 2006, Canfor completed the acquisition of New South. See “Business of Canfor – General Development”.

Canfor completed the acquisition of all the shares of Slocan on April 1, 2004. On that same day, Slocan was amalgamated with Canfor’s principal operating subsidiary, Canadian Forest Products Ltd., with the continuing entity being called Canadian Forest Products Ltd. as identified in the chart above.

In partnership with Louisiana-Pacific Canada Ltd., Canfor holds a 50% interest in OSB LP, which owns and operates an OSB plant in Fort St. John, British Columbia, which began limited operations in late 2005 and is expected to be operating at its design production capacity in early 2008.

In addition, Canfor has a minority interest in Seaboard General Partnership (“Seaboard”), formerly known as Seaboard Shipping Company Limited. Seaboard, which is owned by a group of British Columbia forest products companies including Canfor, ships Canfor's lumber to overseas customers.

The Company, through a wholly owned holding company, holds a one-third interest in each of Lakeland Mills Ltd. (“Lakeland”) and Winton Global Lumber Ltd. (“Winton Global”). Lakeland and Winton Global operate sawmills in the Prince George region of British Columbia and sell their wood chips to Canfor Pulp LP's Prince George pulp and paper operations.

Canfor's 49.99% interest in HSLP was originally held through its interest in Howe Sound Pulp and Paper Limited (“HSPP”) and was written off in 1998 after management of the Company determined that Canfor would not recover its investment in HSPP. As a result of this write-off, Canfor no longer accounts for its interest in HSLP. See “Howe Sound Pulp and Paper Limited Partnership”. Canfor also owns a 49% interest in HSPP General Partner Ltd., general partner and the holder of a 0.02% interest in HSLP.

## **BUSINESS OF CANFOR**

Canfor is a Canadian integrated forest products company based in Vancouver, British Columbia, involved primarily in the lumber and panels business, with production facilities in British Columbia, Alberta, Québec and the United States. Canfor also has a 50.2% interest in the pulp and paper business owned by Canfor Pulp LP, a 50% interest in the panels business of OSB LP, a 49.99% interest in the pulp and newsprint business of HSLP and owns the Taylor pulp mill.

Canfor is the largest spruce-pine-fir (“SPF”) lumber producer in the world. Softwood lumber production facilities are located in British Columbia, Alberta, Québec and the United States with annual production capacity (including New South) of 5.3 billion board feet of lumber, 440 million square feet of plywood (3/8 inch basis) and one billion square feet of OSB (3/8 inch basis) including the Company’s 50% share of OSB LP. On March 6, 2006, Canfor completed the acquisition of New South, which added three sawmills, one remanufacturing facility and two lumber treating facilities to its operations, with annual production capacity of 430 million board feet of lumber, primarily southern yellow pine. Canfor’s products also include remanufactured and finger-jointed lumber, treated lumber, hardboard, refined fibre, wood chips, wood pellets and logs.

Canfor also holds a 50.2% interest in the pulp and paper business of Canfor Pulp LP, with annual production capacity of over one million tonnes of kraft pulp and 135,000 tonnes of kraft paper, a 50% interest in the OSB business of OSB LP with annual production capacity of 820 million square feet (3/8 inch basis) and a 49.99% interest in the pulp and newsprint business of HSLP with annual production capacity of 400,000 tonnes of kraft pulp and 230,000 tonnes of newsprint.

Canfor also holds approximately 10.9 million cubic metres of annual harvesting rights under its forest tenures, after reflecting the sale of the Englewood Operations with approximately 943,000 cubic metres of harvesting rights in March 2006. See “Business of Canfor - General Development” and “Business of Canfor - Wood Supply – Timber Resources”.

Canfor's products are exported primarily to the United States, Europe and the Far East. Canfor maintains wood products sales offices in Vancouver and Toronto, Canada, Tokyo, Japan and Shanghai, China, and pulp sales offices in Vancouver, Canada, Brussels, Belgium, and Tokyo, Japan, and is represented by sales agents serving various other markets around the world.

## **General Development**

Canfor's objective is to be the preferred supplier of wood products to the building industry around the world. Canfor is focused on increasing its building-products business in global markets, and on making higher-value structural lumber and specialized products for specific customer needs.

Canfor's overall business strategy is to be an industry leader in profit performance, which will be accomplished through:

- achieving and maintaining a low cost structure in all business segments,
- maximizing high-margin products and obtaining maximum value from fibre,
- supply chain excellence,
- targeting customers to grow with through long-term partnerships,
- conservative financial management,
- taking advantage of growth opportunities, and
- its motivated, energized employees.

During the past three financial years, Canfor has invested \$717.7 million in corporate acquisitions and strategic alliances and \$644.1 million in capital expenditures. In addition, Canfor has added new products and rationalized some of its operations.

The most significant events for Canfor over the past three financial years have been the following:

- the implementation of the Softwood Lumber Agreement (“SLA”) effective October 12, 2006, by the governments of Canada and the United States. With this settlement of the softwood lumber dispute, which began in May 2002, the US Department of Commerce revoked all existing antidumping (ADD) and countervailing (CVD) duty orders on softwood lumber shipped to the US from Canada. As a result, Canfor recorded a net duty refund of \$717.7 million and \$97.7 million of associated interest in income in 2006. Under the SLA, the Canadian federal government will collect an export tax on lumber shipped from Canfor's Alberta and British Columbia facilities at a variable rate based on composite lumber prices. For a detailed discussion of the SLA, see the Company's “Management's Discussion and Analysis of Financial Condition and Results of Operations 2006”, in particular the “Overview of 2006” and “Lumber” portions thereof, which are incorporated by reference herein.

- the spinout in July, 2006 of Canfor's northern bleached softwood kraft pulp and paper business, including its Northwood pulp mill, Intercontinental pulp mill and Prince George pulp and paper mill, together with associated management and employees, to Canfor Pulp LP, in exchange for a \$125 million promissory note (the "Note"), 14.254 million Class A Limited Partnership Units and 57.016 million Class B Exchangeable Limited Partnership Units of Canfor Pulp LP. Under the spinout, the Company exchanged its Class A Limited Partnership Units for an equal number of units (the "Fund Units") of Canfor Pulp Income Fund ("CPIF"), which is an unincorporated open-ended limited purpose trust established under the laws of Ontario and all of the then existing Common Shares of the Company were cancelled and the Company's shareholders were entitled to receive in exchange one new Common Share of the Company and 0.1 of a Fund Unit in respect of each share held by them, as a return of capital. On the completion of the spinout, the Company's shareholders owned all of the issued and outstanding Common Shares and all of the issued and outstanding Fund Units, with the outstanding Fund Units representing a 20% indirect interest in the pulp and paper business owned by Canfor Pulp LP. On November 30, 2006, Canfor completed a further distribution to its shareholders by way of an in kind taxable dividend of 1.49 units of CPIF for every 10 outstanding Common Shares of the Company. Following this dividend, Canfor continued to own 35,776 million Class B Exchangeable Limited Partnership Units of Canfor Pulp LP representing a 50.2% interest in the pulp and paper business owned by Canfor Pulp LP. The Class B Exchangeable Limited Partnership Units are exchangeable (together with a proportionate number of common shares of CPLP's general partner) on a one for one basis. The Note was repaid in full in November, 2006. See "Pulp and Paper";
- the transfer in March, 2006 of its Englewood Operations on Northern Vancouver Island, including TFL 37 and certain timber licenses, to a new fibre partnership, Coastal Fibre LP, jointly and equally owned by the Company (through Canadian Forest Products Ltd.) with Oji Paper Canada Ltd. ("Oji Canada"). In return for the transfer, Canfor received a partnership interest in the limited partnership with an agreed value of \$45 million and Oji Canada contributed an equivalent amount of cash. The assets comprising the Englewood Operations and \$35 million cash were then transferred by Coastal Fibre LP to WFP in return for, among other things, a long term fibre supply agreement with WFP pursuant to which WFP will supply fibre for sale by Coastal Fibre LP to HSLP. See "Howe Sound Pulp and Paper Limited Partnership";
- the acquisition in March, 2006 of New South, which operates three sawmills, one remanufacturing facility and two lumber treating facilities located in North and South Carolina in a transaction valued at US\$205 million, including US\$55 million of working capital. The annual production capacity of New South's facilities is 430 million board feet of lumber, primarily southern yellow pine. See "Lumber -Lumber Production Facilities";
- the formation of Premium 1 Papers in 2005, a joint venture partnership between Canfor and Tolko Industries Inc. to market the kraft paper production of the partners;
- the closure of the Hines Creek sawmill operation, the Specialty mill at Quesnel and the Tackama sawmill operation in 2005;
- the sale of Fort St. James, Slocan and Valemount sawmill operations in the second quarter of 2005; and
- the combination with Slocan in April 2004 pursuant to a plan of arrangement, under which Canfor acquired all of the issued and outstanding shares of Slocan in exchange for the issuance of approximately 49.3 million Canfor shares to Slocan shareholders on the basis of 1.3147 Canfor shares for each Slocan share held by them, representing a value of \$9.18 per Slocan share.

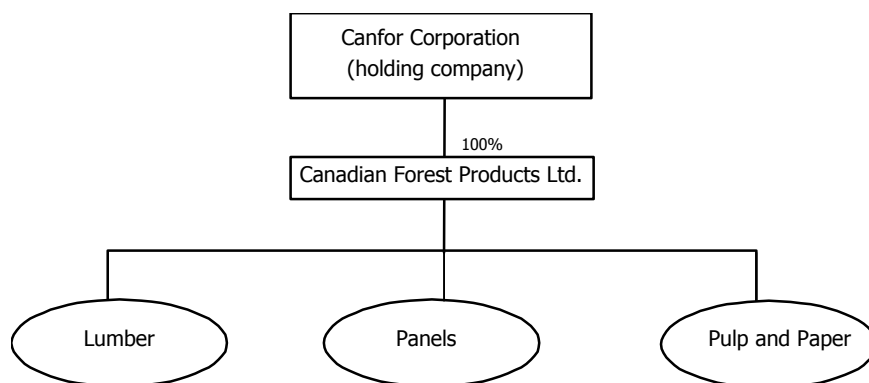
## Trends, Events and Risks and Uncertainties

For additional information regarding changes to the Company's business expected in 2007 and known trends, commitments, events or uncertainties, see the Company's "Management's Discussion and Analysis of Financial Condition and Results of Operations 2006", in particular, the "2007 Outlook" and "Risks and Uncertainties" portions thereof, which are incorporated by reference herein.

## Business Segments

Canfor's business is reported in three segments: "Lumber", "Panels" and "Pulp and Paper". The Lumber segment includes Canfor's sawmilling and remanufacturing operations; the Panels segment includes Canfor's OSB, plywood and panel and fibre operations; and the Pulp and Paper segment includes the kraft pulp and kraft paper business of Canfor Pulp LP, in which Canfor has a 50.2% interest, and 100% of the Taylor Pulp mill, which was excluded from the Canfor Pulp LP transaction.

The following chart outlines Canfor's business segments and their respective principal operations at December 31, 2006 (unless otherwise indicated in the diagram below, Canfor has a 100% interest in the operations referred to in each segment):



- 13 sawmills in British Columbia, one in Alberta and one in Québec, with annual production capacity of 4.8 billion board feet
- Three sawmills located in North and South Carolina with annual production capacity of 430 million board feet
- Finger-jointing and lumber remanufacturing operations
- Woodlands operations with an allowable annual cut of 10.9 million m<sup>3</sup> (9.8 million m<sup>3</sup> in British Columbia)
- Lumber marketing
- Two plywood mills with annual production capacity of 440 million square feet (3/8" basis)
- OSB mill with annual production capacity of 650 million square feet (3/8" basis)
- Panel and Fibre operation (hardboard panels, refined fibre and mat products)
- 50% interest in Peace Valley OSB mill with annual production capacity of 820 million square feet (3/8" basis)
- Plywood and OSB marketing
- 50.2% interest in three pulp mills with annual production capacity of over one million tonnes of kraft pulp, 135,000 tonnes of kraft paper and pulp and paper marketing
- Taylor BCTMP pulp mill (100% interest) with annual production capacity of 213,000 tonnes

The following table sets forth, by business segment, Canfor's sales revenues from continuing operations from its wholly owned and other operations for the last two financial years (including 100% of the revenues of the pulp and paper business now owned by Canfor Pulp LP and 50% of the revenues of the panels business of OSB LP):

	<u>Year ended December 31</u>	
	<u>2006</u> <sup>(1)</sup>	<u>2005</u> <sup>(2)</sup>
	(millions of dollars)	
Lumber.....	\$2,521.5	\$2,544.9
Panels.....	367.9	365.7
Pulp and Paper.....	<u>952.9</u>	<u>876.5</u>
Total sales.....	<u>\$3,842.3</u>	<u>\$3,787.1</u>

Notes: (1) Includes the results of the New South operations from March 6, 2006.  
(2) Certain 2005 figures have been reclassified to conform to the current year's presentation.

The following table indicates the percentage composition of Canfor's consolidated sales revenues by market for the last two financial years (including 100% of the revenues of the pulp and paper business now owned by Canfor Pulp LP and 50% of the revenues of the panels business of OSB LP):

	<u>Year ended</u>	
	<u>December 31</u>	
	<u>2006</u> <sup>(1)</sup>	<u>2005</u> <sup>(2)</sup>
Canada.....	15	12
United States.....	67	67
Europe.....	4	7
Far East and other.....	<u>14</u>	<u>14</u>
Total.....	<u>100%</u>	<u>100%</u>

Notes: (1) Includes the results of the New South operations from March 6, 2006.  
(2) Certain 2005 figures have been reclassified to conform to the current year's presentation.

The foregoing two tables exclude the results of the Slocan, Valemount and Fort St. James facilities which were sold in 2005 and the results of Canfor's former Coastal Operations segment as a result of the sale of the Englewood Operations in March 2006, all of which have been reclassified as discontinued operations. See "Coastal Operations".

## WOOD SUPPLY

### Timber Resources

Canfor harvests timber under forest tenures held by it in British Columbia, northern Alberta and southern Québec, and has a total allowable annual cut ("AAC") of approximately 10.9 million cubic metres. This reflects reductions to Canfor's AAC in British Columbia (including reductions under tenures formerly held by Slocan) in the Spring of 2003 as a result of the significant changes described below to legislation governing the British Columbia forest industry. The total reduction was 2.37 million cubic metres. Reductions came into effect in December 2004 (as to 319,919 cubic metres), March 2005 (as to 1,632,195 cubic metres), December 2005 (as to 45,652 cubic metres) and March 2006 (as to 371,858 cubic metres). Notwithstanding these reductions, Canfor's fibre base continues to be one of the largest in Canada.

Canfor's Canadian wood fibre requirements are also met by open market purchases and exchanges on either a spot or contract basis. Canfor holds several types of forest tenures in the province of British Columbia, Alberta and Québec, which permit the harvesting of Crown timber. The wood fibre requirements of New South are met through long term and open market purchases from private timberland owners in the North and South Carolina regions.

The following table sets forth Canfor's timber resources as at December 31, 2006:

	<b>Productive Area (hectares)</b>	<b>Allowable Annual Cut (cubic metres)</b>
<b>British Columbia</b>		
Tenures having regulated sustained yields <sup>(1)</sup>		
Area-based — Tree Farm Licences <sup>(2)</sup> .....	798,258	925,870
Volume-based — Forest Licences (replaceable) .....	N/A	7,373,950
— Forest Licences (non-replaceable) .....	N/A	415,000
— Pulpwood Agreements (non-replaceable)	N/A	1,110,000
<b>Alberta</b>		
Tenures having regulated sustained yields		
Forest Management Agreement .....	331,187	630,400
Timber Quotas .....	N/A	212,281
<b>Québec</b>		
Tenures having regulated sustained yields		
Forest Management Agreement .....	N/A	190,000
Timber Supply and Forest Management Agreement .....	N/A	30,640
<b>Total</b> .....	<u>1,129,445</u>	<u>10,888,141</u>

Notes:

- (1) For an explanation of “regulated sustained yields”, see the section entitled “Forest Management” below.
- (2) Comprised of TFL 18 (Clearwater), TFL 30 (Sinclair), and TFL 48 (Chetwynd).

Note: N/A denotes Not Applicable.

Canfor obtains additional wood fibre through contractual rights to purchase logs by way of business relationships with First Nations and other licensees.

The Province of British Columbia owns approximately 95% of all timberlands in the province. Pursuant to the provisions of the *Forest Act* (British Columbia) (“Forest Act”), the Minister of Forests (the “Minister”) is empowered to grant various forms of tenure and to regulate forestry operations.

A Tree Farm Licence (“TFL”) requires a licensee to undertake to manage an area of Crown forestland, often in combination with other forestland held by the licensee, to yield an annual cut on a regulated sustained yield basis. TFL's are granted for a 25-year term and, subject to satisfactory levels of performance, will be replaced every five to ten years with a new TFL having a 25-year term. Canfor's currently held TFL's have all been replaced for a 25-year term: TFL 48 (Chetwynd) in 1998 and TFL 30 (Sinclair) and TFL 18 (Clearwater) in 2001.

A Forest Licence is a volume-based tenure which authorizes a right to harvest a specified volume of timber each year within a particular timber supply area (“TSA”) and generally provides for 15-year terms. These licences may be replaced every five to ten years for further 15-year terms, subject to satisfactory levels of performance. Canfor holds 11 replaceable Forest Licences, under which it is continuing to harvest (in addition to two such licences which have no remaining AAC as the result of reductions described below), all of which were replaced between 1998 and 2003. In 2003, the Government of British Columbia passed legislation that delayed the further replacement of all Forest Licences in B.C. until consultation and accommodation of First Nations had been completed. During 2006 the Government of British Columbia offered, and Canfor accepted, the replacement of seven Forest Licences. Canfor expects that the remaining Forest Licences will be replaced during 2007. Canfor holds five non-replaceable Forest Licences, one expiring in each of 2010, 2013 and 2014 and two expiring in 2011. Canfor also holds two non-replaceable Forest Licences under joint venture agreements with West Moberly First Nations which licences expire in 2023.

In addition, Canfor has five Pulpwood Agreements with the Province of British Columbia which grant a holder the right to obtain licences to harvest up to a specified volume of timber within a particular geographic area, subject to

certain conditions. Canfor has the right, if necessary and subject to the terms of the Pulpwood agreements, to supply the requirements of Canfor Pulp LP's three pulp mills at Prince George under Pulpwood Agreement No. 1, which expires in 2018, Pulpwood Agreement No. 3, which expires in 2020, and Pulpwood Agreement No. 7, which expires in 2022. None of these Pulpwood Agreements are replaceable under the *Forest Act* and Canfor has not needed to access timber under these or their predecessor agreements since 1976. Canfor also has the right under Pulpwood Agreement No. 12 to up to 500,000 cubic metres of deciduous timber per year in the Fort St. John TSA in connection with the Taylor Pulp Mill and the Peace Valley OSB mill in Fort St. John and under Pulpwood Agreement No.14 to up to 610,000 cubic metres of deciduous timber per year in the Fort Nelson TSA in connection with the Company's OSB mill in Fort Nelson.

For each Forest Licence and TFL, an AAC is determined. The actual cut in any one year may vary from year to year provided that the actual cut over a five-year period does not exceed 110% of the aggregate AAC for that period. As required by the *Forest Act*, the provincial Chief Forester determines the AAC for each TFL and the total AAC in each TSA (which affects the AAC of Forest Licences in that TSA) in the Province. The Chief Forester is required to repeat such determination every five years, but has the option of postponing a redetermination for a period of up to ten years after the last determination if he concludes that the AAC will not change significantly from the previous determination. The AAC reflects harvesting practices in the previous five years, timber conditions, regional and local economic and social interests and environmental considerations for these licences and areas.

In March 2003, the Government of British Columbia introduced its *Forestry Revitalization Plan* (the "Plan") and related legislation that provided for significant changes to Crown forest policy and to the existing allocation of Crown timber tenures to licensees. The changes prescribed in the Plan include the elimination of minimum cut control requirements, the elimination of existing timber processing requirements and the elimination of restrictions limiting the transfer and subdivision of existing licences. Under the Plan, the government's consideration of changes of control or tenure transfers is limited to the impact of such changes or transfers on competition in the standing timber markets, log markets or chip markets. The Plan also provided that licensees, including Canfor, were required to return 20% of their replaceable tenure to the Crown, approximately half of which would be redistributed to create opportunities for woodlots, community forests and First Nations and the other half would be available for public auction. Canfor received \$57 million in compensation for the return of approximately 2.37 million cubic metres of tenure and a payment of \$5 million for related infrastructure costs such as roads and bridges.

Canfor does not expect that the return of tenure under the Plan, as identified above, will adversely affect its ability to obtain adequate timber supplies for its operations or materially affect the costs of obtaining those supplies.

In northern Alberta, Canfor has a Forest Management Agreement ("FMA") #9900037 under which it undertakes to manage a designated area of Crown forestland. This FMA was renewed in 1999 for a 20-year period. In June 2003, the Government of Alberta approved the Detailed Forest Management Plan for the FMA and determined the coniferous AAC for the term of the FMA (1999-2019) to be 630,400 cubic metres.

The Province of Alberta also grants Timber Quotas having terms of 20 years and containing provisions for renewal. These quotas are intended to provide a continuous supply of timber in perpetuity. As a result of the amalgamation of forest management units by the Province of Alberta during 2004, Canfor now has two Timber Quotas, which expire in 2021 and 2024 respectively.

Canfor's regulated sustained yield tenures in Alberta specify an AAC and an aggregate allowable cut over a five-year period. The actual cut during each five-year period must be at least 60% of the aggregate specified for that period for the tenure to remain in good standing. Canfor would be subject to significant levies if its production were to exceed 110% of the aggregate allowable cut for that period.

In the Province of Québec, the Minister of Natural Resources and Wildlife has a number of tools for allocating timber harvesting rights and associated forest resource management responsibility. They include Timber Supply and Forest Management Agreements ("TSFMA") and Forest Management Agreements ("FMA"). Both require the agreement holder to fulfill management obligations similar to those in British Columbia with regard to planning, monitoring and reporting activities. A TSFMA is a volume-based agreement that authorizes an owner of a wood processing mill to harvest an annual amount of volume from a specified timber supply area. A licence holder is evaluated based on the collective forest management and environmental performance of all operators within the timber

supply area and on the effective utilization of the allocated volume by the individual mill owner. An FMA is a volume based agreement by which a single licensee is responsible for the management of a forest reserve where no TSFMA or Forest Management Contracts (“FMC”) have been granted.

Canfor acquired Daaquam and Anticosti, two lumber and timber harvesting companies based in Québec in May 2003. Anticosti has woodlands and harvesting operations on Anticosti Island located in the Gulf of St. Lawrence and holds an FMA with an AAC of 190,000 cubic metres. The timber is sold on a market price basis with Daaquam having first right of refusal on 40,000 metres. Daaquam maintains a TSFMA near Saint Just-de-Bretenières with an annual harvest allocation of 30,640 cubic metres. The Company secures an additional volume of wood for its Québec operations through procurement contracts with suppliers in Ontario, Québec and the U.S.

Canfor is in substantial compliance with the harvesting terms of all of its tenure agreements in British Columbia, Alberta and Québec.

### **Mountain Pine Beetle**

The infestation of the Mountain Pine Beetle (*Dendroctonus ponderosae*) has reached critical levels in many timber supply areas throughout the interior of British Columbia and in some of Canfor’s operating areas. The impact of this outbreak is expected to affect the long-term timber supply in the interior of British Columbia. Given the nature and extent of the infestation, its long term operational and financial impact on Canfor is not quantifiable at this time, but could be significant. For additional information regarding the beetle infestation and its impact on Canfor and its operations, see the Company’s “Management’s Discussion and Analysis of Financial Condition and Results of Operations 2006”, in particular, the “Risks and Uncertainties – Mountain Pine Beetle” portion thereof, which is incorporated by reference herein.

### **Aboriginal Issues**

The issues relating to Aboriginal rights and title and consultation continue to be heard, developed and resolved by Canadian courts at all levels. Canfor continues to cooperate, communicate and exchange information and views with Aboriginal groups in order to foster good relationships and minimize risks to its tenures, operations and operational plans, and will continue to participate with the Province in its consultations with Aboriginal groups. Due to their complexity, it is not expected that the issues regarding Aboriginal rights and title or consultation will be resolved in the short term and their impact, if any, on the timber supply from Crown lands and Canfor’s tenures and operations is unknown at this time. For additional information regarding the Aboriginal issues and their impact on Canfor and its operations, see the Company’s “Management’s Discussion and Analysis of Financial Condition and Results of Operations 2006”, in particular, the “Aboriginal Issues” portion thereof, which is incorporated by reference herein.

### **Forest Management**

Canfor is responsible for all aspects of forest management on the lands within its TFL's in British Columbia. In Alberta, Canfor is responsible for all aspects of forest management on the lands covered by its FMA's except forest fire protection, which is a responsibility of the Province of Alberta. In Québec, Canfor is responsible for all aspects of forest management on lands specified within its FMA and TSFMA. The lands held under TFL's, FMA's, TSFMA's, Forest Licences and Timber Quotas are managed on a “sustained yield” basis, whereby the volume of timber harvested is regulated according to the productive capacity of the land and the inventory of mature timber available for harvest. In British Columbia, Alberta and Québec, Canfor is responsible for reforestation of areas logged on all of its sustained yield tenures. The overall management of forestlands held under Forest Licences and Timber Quotas is the responsibility of the respective Forest Services of British Columbia and Alberta.

The British Columbia government introduced the Market Pricing System (“MPS”) for the pricing of timber harvested in the British Columbia interior on July 1, 2006. This replaced the long standing target rate driven Comparative Value Pricing (“CVP”) system, which had been in place since October 1, 1987 for timber harvested in the interior of the province. In contrast to the CVP system, MPS uses auction-based prices to derive stumpage rates for license holders in the BC interior. With the expansion of the Mountain Pine Beetle epidemic across the BC Interior, Canfor expects MPS will result in lower average stumpage rates than under the CVP system.

Canfor carries out its forest management responsibilities through a full-time staff of 190 registered professional foresters, technologists and biologists, as well as additional professional staff on part-time and contract basis. This forestry staff is engaged in supervising all aspects of forest development including planning, road development, harvesting methods and forest protection, and in research and development programs to increase the yield of its forestlands and improve the quality of its timber resources. Canfor currently operates, directly or under contract, seed orchards for the genetic improvement of forest seed at Sechelt and Vernon, British Columbia, and at Grande Prairie, Alberta. As part of the 2006 sale of the Englewood Operations, Canfor has sold certain quantities of seed stock from the Sechelt orchard to WFP and has agreed to maintain that orchard for a minimum of three years.

Canfor's forestry staff supervises the reforestation of all harvested areas, which, in 2006, involved the planting of 50 million seedlings on 37,864 hectares and reforestation by natural regeneration on an additional 8,419 hectares. This compares to 42,101 hectares harvested during 2006.

In 2002, the British Columbia government established the Forest Investment Account ("FIA") as a mechanism for promoting sustainable forest management, forest management research, and market and product development in British Columbia. Funding for the program is approved annually by the legislature to authorize certain forest management activities. Canfor has entered into an agreement with the Provincial government under which the government will fund over \$5 million annually for land based investments across Canfor's operating areas within British Columbia. Canfor is responsible for the implementation and delivery of the investments within this program.

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

Canfor retains an International Organization for Standardization ("ISO") 14001 certification of its environmental management system for its forest operations, first obtained in 1999 and re-certified as required for subsequent three-year terms. In addition, Canfor retains certification under the Canadian Standards Association ("CSA") standard for sustainable forest management (CAN/CSA Z809) for its Forest Management Agreement area at Grande Prairie, Alberta, for its Tree Farm Licences at Chetwynd, Prince George and Vavenby, British Columbia, for its Forest Licences at Fort St John, Houston, Prince George, Fort Nelson, Vanderhoof, Vavenby, Quesnel, Radium and Mackenzie, British Columbia and for its Pulpwood Agreements at Fort St John and Fort Nelson, British Columbia.

At present, 86% of Canfor's AAC is certified to the SFM standard (with the balance expected to be certified in 2007 and 2008) and 97% of its forest operations are ISO 14001 certified. Canfor is committed to having sustainable forest management certification in place for all of its tenures.

## **Wood Fibre Supply**

The wood fibre supply for Canfor's lumber, panels and Taylor pulp mill operations is obtained by logging on Canfor's forest tenures and purchasing logs and chips and waste materials from the manufacture of wood products. Logs are purchased from other tenure holders and from farmers, Aboriginal groups and other private landholders. Chips and waste materials are purchased from sawmillers and other wood products producers. Often, Canfor trades logs with these sawmillers and other wood products producers, receiving chips and waste materials in exchange.

As part of the sale of the Englewood Operations, Coastal Fibre LP entered into a long term fibre supply agreement with WFP which will, in turn, be used to supply wood fibre for HSLP's operations. (See "Howe Sound Pulp and Paper Limited Partnership".) As part of the spinout of its pulp and paper business, Canfor entered into residual wood chip and hog fuel agreements with Canfor Pulp LP. See "Pulp and Paper".

The following table sets forth the volume of wood fibre produced and purchased, the volume of wood fibre consumed in Canfor's operations and the volume of wood fibre sold to other wood fibre consumers for the last two financial years:

	<u>Year ended</u> <u>December 31</u>	
	<u>2006</u> <sup>(1)(2)</sup>	<u>2005</u> <sup>(1)</sup>
	('000 cubic metres)	
Production from Canfor's timber tenures		
Coastal British Columbia.....	-	76
Central / Northern Interior of British Columbia .....	10,948	12,060
Northern Alberta.....	963	985
Eastern Region (Québec).....	219	267
United States.....	<u>191</u>	<u>-</u>
Total production.....	<u>12,321</u>	<u>13,388</u>
Purchases		
Logs.....	7,628	6,600
Chips <sup>(3)(4)</sup> .....	<u>4,306</u>	<u>3,909</u>
Total purchases.....	<u>11,934</u>	<u>10,509</u>
Total production and purchases.....	<u>24,255</u>	<u>23,897</u>
Trades and sales		
Logs <sup>(5)</sup> .....	589	709
Chips <sup>(6)</sup> .....	<u>2,641</u>	<u>1,495</u>
Total traded and sales.....	<u>3,230</u>	<u>2,204</u>
Total available for conversion into finished goods.....	<u>21,025</u>	<u>21,693</u>
Total converted by Canfor, Canfor Pulp LP, OSB LP and HSLP into finished goods.....	<u>21,294</u>	<u>21,080</u>

- (1) Excludes the results of and production from the Slocan, Valemount and Fort St. James facilities and related woodlands operations sold in 2005 and the results of and production from Canfor's former Coastal Operations as a result of the sale of the Englewood Operations in March 2006, all of which have been reclassified as discontinued operations.
- (2) Includes the results of and production from New South's operations from March 6, 2006.
- (3) Includes the 546,011 cubic metres of chips acquired by HSLP from Coastal Fibre LP pursuant to the fibre supply agreement between Coastal Fibre LP and WFP (See "Howe Sound Pulp and Paper Limited Partnership").
- (4) Included in chip purchases are 414,843 cubic metres (2005 — 413,298 cubic metres) purchased from Lakeland and Winton Global, in which Canfor owns a one-third interest.
- (5) These sales are primarily coastal logs that are traded to obtain chips and waste materials.
- (6) Included in chip sales are 300,511 cubic metres (2005 — 353,583 cubic metres) of chips sold by the Alberta operations, 153,341 cubic metres (2005 — 152,794 cubic metres) of chips sold by the Québec operations and 1,047,735 cubic metres of chips sold by the United States operations where Canfor does not have pulp mills.
- (7) During 2006, Canfor Pulp LP purchased 4,094,392 cubic metres of chips from Canfor pursuant to the fibre supply agreements between the two companies, which purchases are not included in the above table. See "Pulp and Paper".
- (8) Waste materials used for fuel and hardboard furnish in the Panel and Fibre operation are excluded from this table because of the difficulty in determining a reasonable conversion factor to solid wood equivalent.

Canfor's two whole-log chipping facilities have available capacity to supplement its supply of sawmill residual chips. The chipping facilities are capable of producing 325,000 oven-dried tonnes of chips annually.

Historically, Canfor has competed successfully for the chips required that cannot be supplied by Canfor's own sawmills and timber tenures and does not expect that this situation will change in 2007.

## **First Nations Business Relationships**

Canfor believes in building mutually beneficial and lasting relationships with local First Nations with treaty and Aboriginal rights or whose interests overlap with Canfor's areas of operations. Canfor has also formalized some of its relationships with Aboriginal people through agreements that generally seek to increase First Nations' participation in Canfor's planning and harvesting activities while strengthening Canfor's access to fibre. Canfor also has numerous business relationships ranging from short and long-term contracts with Aboriginal businesses to jointly holding Forest Licenses with local First Nations. Currently, Canfor is in the process of assessing and analyzing its relationships with Aboriginal peoples, and is developing a corporate strategy to monitor, assess, and address risks and further develop opportunities involving First Nations.

Consistent with Canfor's belief in seeking opportunities to improve its relationships with Aboriginal peoples, Canfor has created and filled a permanent position for a Manager of Aboriginal Affairs to advise Canfor and assist in negotiations and strategy development. The Manager of Aboriginal Affairs will also be responsible for helping to ensure that Canfor monitors and fulfills any obligations it has arising out of contracts signed with local Aboriginal peoples.

## **LUMBER**

### **Lumber Production Facilities**

As at December 31, 2006, Canfor operated 13 sawmills in the central and northern interior of British Columbia, one sawmill in northern Alberta, one sawmill in Québec and three sawmills in North and South Carolina. These sawmills have annual production capacity of 5.3 billion board feet of lumber, ranking Canfor as the largest SPF lumber producer in the world. The majority of lumber produced by Canfor from these facilities is construction and specialty grade dimension lumber that ranges in size from one by three inches to two by twelve inches and in lengths from six to twenty-four feet. A growing portion of Canfor's lumber production is comprised of specialty products that command premium prices and include machine stress rated ("MSR") lumber that is used in engineering applications such as roof trusses and floor joists. Other specialty products include Square Edge lumber for the North American market and J-grade lumber for the Japanese market.

Canfor completed the acquisition of New South and its three sawmills, one remanufacturing facility and two lumber treating facilities located in North and South Carolina, in March 2006. The annual production capacity of New South's facilities is 430 million board feet of lumber, primarily southern yellow pine.

As a by-product of Canfor's lumber production facilities, wood chips are produced from the portion of each log not converted into lumber, and these wood chips are sold to pulp mills for use as their raw material, including to the Taylor pulp mill and to Canfor Pulp LP pursuant to fibre supply agreements entered into between Canfor and Canfor Pulp LP in connection with Canfor's spinout of its pulp and paper business on July 1, 2006. See "Pulp and Paper". In addition, Canfor extracts pulpwood from its northern forestry operations and converts this wood to chips for Canfor Pulp LP's pulp and paper operations and its Taylor pulp mill. Canfor also owns and operates two whole-log chipping facilities capable of producing 325,000 oven-dried tonnes of wood chips annually. The facilities are located adjacent to Canfor's sawmills.

Canfor also has the following secondary manufacturing operations: fingerjoint mills at one of its sawmills in the interior of British Columbia and at its Grande Prairie, Alberta sawmill (currently indefinitely closed as of late 2006) and MSR lumber facilities at seven of its sawmills. Canfor also has three lumber remanufacturing operations – one in the lower mainland of British Columbia, one in Bellingham, Washington and one at Marion, South Carolina – that produce a wide range of specialty products and two lumber treating facilities in Conway and Camden, South Carolina. In addition, Canfor directs substantial volumes of lumber to custom remanufacturers in British Columbia and Alberta for processing into higher value products.

Canfor, in a joint venture with Pinnacle Pellet Inc. of Quesnel, BC and the Moricetown First Nations Band, commenced operation in late 2006 of a wood pellet manufacturing facility adjacent to its Houston sawmill with an annual production capacity of 135,100 oven-dried tones of wood pellets. This facility will convert all of the Houston sawmill's sawdust and shavings into wood pellets for the U.S. and Japanese pellet markets.

The following table sets forth Canfor's lumber production and sales for the last two financial years:

	<b>Year ended December 31</b>	
	<b><u>2006</u><sup>(1)(2)</sup></b>	<b><u>2005</u><sup>(1)</sup></b>
	(Mfbm) <sup>(3)</sup>	
<b>Production</b>		
British Columbia.....	4,116,772	4,238,711
Alberta .....	225,275	271,936
Québec .....	117,797	113,847
United States .....	<u>341,387</u>	<u>-</u>
	<u>4,801,231</u>	<u>4,624,494</u>
<b>Sales.....</b>	<u>4,813,372</u>	<u>4,681,065</u>

Notes:

- (1) Excludes the results of the Slocan, Valemount and Fort St. James facilities sold in 2005 and the results of the Coastal Operations as a result of the sale of the Englewood Operations in March 2006, all of which have been reclassified as discontinued operations.
- (2) Includes the results of New South's operations from March 6, 2006.
- (3) Mfbm denotes thousand foot board measure.

Canfor harvests logs from tenures located in the northern interior region of British Columbia and northern Alberta to supply Canfor's interior lumber operations. Canfor's total AAC for these areas was approximately 10.7 million cubic metres, net of the return of tenure under the Plan, with any shortfall in mill requirements being made up with wood purchased from these areas (see "Wood Supply — Timber Resources" above). In March 2006, Canfor transferred its Englewood Operations with an AAC of approximately 943,000 cubic metres to Coastal Fibre LP which subsequently sold those operations to WFP. This coastal fibre was previously sold to supply fibre to HSLP. As part of the transaction with WFP, Coastal Fibre LP has obtained a long term fibre supply agreement with WFP, the fibre from which will be sold to HSLP.

The following table sets forth the log production from the Company's tenures located in the northern interior region of British Columbia and log purchases and wood chip production from that region for the last two financial years:

	<b>Year ended December 31</b>	
	<b><u>2006</u><sup>(1)</sup></b>	<b><u>2005</u><sup>(1)</sup></b>
Log Production (cubic metres) .....	11,910,785	13,043,425
Log Purchases (cubic metres).....	5,598,922	6,141,891
Wood Chip Production (oven-dried tonnes).....	2,211,899	2,246,320

- (1) Excludes the results of the Slocan, Valemount and Fort St. James facilities sold in 2005 and the results of the Coastal Operations as a result of the sale of the Englewood Operations in March 2006, all of which have been reclassified as discontinued operations.

In 2006, New South's three sawmills in North and South Carolina produced 191,240 cubic metres of logs, purchased 1,135,041 cubic metres of logs and produced 394,762 oven-dried tonnes of wood chips. Wood fibre for the New South operations is obtained from long term and open market purchases from private timberland owners in the North and South Carolina regions.

## **Lumber Markets and Distribution**

Canfor markets lumber products throughout North America and overseas. In addition to its own production, Canfor also markets lumber produced from independent mills in North America and offshore countries to complement its product line.

In 2006, approximately 78% of Canfor's lumber sales (excluding New South) were made to United States markets (79% in 2005) and 13% to Canadian markets (13% in 2005). Virtually all lumber destined for North America was shipped by truck and rail. Canfor leases a fleet of 454 railway cars to ensure adequate rail car supply throughout the year. The remaining 9% (8% in 2005) of shipments went offshore, principally to Japan, but also to Korea, China, Taiwan and Europe. Offshore modes of transportation consisted of 85% by container ship (80% in 2005) and 15% by breakbulk (non-container) carrier (20% in 2005).

For detailed discussion of the markets for Canfor's lumber products see the Company's "Management's Discussion and Analysis of Financial Conditions and Results of Operations 2006", in particular, the "Lumber-Markets", "Overview of 2006-Softwood Lumber Agreement (SLA) and Return of Duty Deposits" and "2007 Outlook-Lumber Markets" portions thereof, which are incorporated by reference herein.

## **Human Resources**

Canfor employs approximately 3,815 persons in its lumber operations in British Columbia, 200 persons in Alberta, 207 persons in Québec and 757 persons in the United States. Of these, approximately 67% are covered by collective agreements with the United Steel Workers of America ("USWA"), the Communications, Energy and Paperworkers Union ("CEP") and the Pulp, Paper and Woodworkers of Canada ("PPWC"). The collective agreements with the USWA and the PPWC (which represents the majority of the workers in the British Columbia operations) expire in June 2009. Those agreements provide for wage increases totaling 11% over a six-year term.

The contract with the CEP, which represents workers at Canfor's Grande Prairie, Alberta operation was renewed in early 2005. The agreement is similar to Canfor's B.C. lumber operations agreements and provides for wage increases totaling 11% over a six-year term that expires in February 2010.

## **PANELS**

Canfor operates two OSB plants and two plywood mills in the northern interior of British Columbia and the Panel and Fibre operation located in New Westminster, British Columbia. Canfor's OSB production (including OSB LP) is primarily Performance Rated Sheathing, which is used in wall construction of new homes and in repair and remodeling projects.

The Fort Nelson OSB plant has annual production capacity of 650 million square feet (3/8" basis) of OSB panel product in a variety of thicknesses and sizes. This plant uses primarily aspen timber to produce a consistently high quality product, which is available from only a few other OSB producers in North America.

Canfor, with its partner, Louisiana-Pacific Canada Ltd., completed construction and commenced operation of the OSB LP's Peace Valley OSB plant in Fort St. John, BC in 2005. Production at Peace Valley OSB began late in the fourth quarter of 2005. The annual production capacity of this new plant is 820 million square feet (3/8" basis) of OSB and it is expected to be operating at its design capacity in early 2008.

The combined annual production capacity of Canfor's two plywood mills is 440 million square feet (3/8" basis). The Fort Nelson plywood mill produces products used in industrial, commercial, residential and specialty plywood applications. The primary product of Canfor's plywood operations is sheathing, which is used to frame walls in the construction of new homes. The Prince George plywood mill is certified with respect to Canadian softwood and Douglas fir plywood and for Japanese grading standards. This mill has been modernized over the past few years to automate some of its more labour-intensive production stages and to increase the mill's efficiency when processing smaller diameter logs.

The following table sets forth Canfor's OSB and plywood production and sales (including 50% of OSB LP's OSB production and sales) for the last two financial years:

	<u>Year ended December 31</u>	
	<u>2006</u>	<u>2005</u>
	(Msf 3/8") <sup>(1)</sup>	
Production		
OSB.....	734,434	478,797
Plywood.....	<u>439,192</u>	<u>433,314</u>
	<u>1,173,626</u>	<u>912,111</u>
Sales		
OSB.....	722,601	469,254
Plywood.....	<u>441,459</u>	<u>435,654</u>
	<u>1,164,060</u>	<u>904,908</u>

(1) Msf denotes thousand square feet, 3/8" basis.

### **Panel and Fibre operation**

Canfor produces hardboard paneling, refined fibre and wood fibre composite mat products at its Panel and Fibre operation in New Westminster, British Columbia for building, automotive and industrial uses. The hardboard plant, with an annual operating capacity of 50 million square feet (3/8" basis), is one of two hardboard plants in Canada. Baled dry fibre is produced from wood residues and is used as a raw material for hardboard production, cement board products and in the manufacturing of molded products for the automotive industry. Refined fibre is used to produce products for the hydro-seeding business.

### **Panels Markets and Distribution**

In 2006, approximately 76% of Canfor's OSB sales (excluding OSB LP's sales, which are handled by Louisiana-Pacific) were made to United States markets (78% in 2005) and 24% to Canadian markets (22% in 2005). For plywood, approximately 89% of Canfor's 2006 sales were made to Canadian markets (85% in 2005) and 10% to U.S. markets (14% in 2005). The remaining 1% of shipments went to Japan in both 2005 and 2006. Virtually all panel products destined for North America were shipped by truck and rail. Canfor leases a fleet of railway cars to ensure adequate rail car supply throughout the year. Plywood shipped overseas traveled 35% by container ship and 65% by breakbulk (non-container) carrier.

### **Human Resources**

Canfor employs approximately 998 persons in its Panels operations in British Columbia, including 122 at the Peace Valley OSB plant. Of these, approximately 64% are covered by collective agreements with the USWA and the PPWC. In negotiations with the Panel and Fibre operation, Canfor and the union agreed to accept the terms and annual wage increases of the next two negotiated agreements between the Coast forest industry and the USWA. That agreement provides a total of 6% in wage increases and expires on June 14, 2007. At the time of writing, no discussions between the parties had begun. The collective agreements with the USWA and the PPWC representing the employees at Canfor's plywood operations expire in June 2009. Currently, a total of 129 employees at the Fort Nelson OSB plant and 122 employees at OSB LP are not part of any collective agreement.

## **PULP AND PAPER**

On July 1, 2006, Canfor completed the separation of its pulp and paper business from its wood products business by transferring to Canfor Pulp LP its northern softwood kraft pulp and paper business, including its Northwood pulp mill, Intercontinental pulp mill and Prince George pulp and paper mill, together with associated management and employees. At that time, Canfor distributed a 20% indirect interest in Canfor Pulp LP to Canfor's shareholders and retained an 80% interest. On November 30, 2006, Canfor distributed a further 29.8% indirect interest in Canfor Pulp LP to its shareholders, retaining a 50.2% interest. Canfor Pulp LP now operates as a separate business

from Canfor, with separate management, and in which all of the financing arranged by Canfor Pulp LP is without recourse to the Company. See “Business of Canfor – General Development”.

In connection with the spinout, Canfor entered into a number of significant agreements with Canfor Pulp LP relating to the transfer of the pulp and paper business assets to Canfor Pulp LP, including: an Acquisition Agreement providing for the transfer of assets to, and the assumption of liabilities by, Canfor Pulp LP; an Exchange Agreement providing Canfor the right to exchange its Class B Exchangeable Limited Partnership Units in Canfor Pulp LP for Fund Units; and a Shareholders Agreement relating to, among other things, the appointment of directors and management of Canfor Pulp Holding Inc., the general partner of Canfor Pulp LP, the transfer of shares of the general partner and approval thresholds for certain corporate matters. For a detailed description of these agreements and certain other agreements relating to the spinout, see the section entitled “The Spinout - Transfer of the Pulp Business and Related Agreements” of the Company’s Information Circular dated April 28, 2006, which is incorporated by reference herein.

Canfor’s Taylor pulp mill was not included in the spinout of the NBSK pulp and paper business and remains 100% owned by the Company. See “Taylor Pulp Mill” below.

### **Canfor Pulp LP Pulp and Paper Production Facilities**

Canfor Pulp LP is one of Canada's major producers of northern bleached softwood kraft (“NBSK”) pulp with operations based in the central interior of British Columbia and is a leading global supplier of pulp and paper products. Canfor Pulp LP’s three mills have an annual production capacity of over one million air dried metric tonnes (“ADMTs”) of northern softwood market kraft pulp, approximately 90% of which is bleached to become NBSK pulp for sale to the market, and approximately 135,000 tonnes of kraft paper. Kraft pulp is a raw material for paper manufacturing and is used in the production of printing and other fine paper, tissue, newsprint and paperboard. NBSK pulp imparts strength to the product in which it is used as a result of the length of its fibre. Canfor Pulp LP manufactures bleached kraft pulp at its Intercontinental and Northwood facilities. Unbleached and semi-bleached grades are produced at the Prince George pulp and paper facility, which also produces kraft paper.

The three Prince George based mills are relatively close in proximity to each other, with the Northwood Pulp mill located approximately five kilometres from the Intercontinental pulp and Prince George pulp and paper mills.

In connection with the spinout of the pulp and paper business to Canfor Pulp LP, Canfor entered into fibre supply agreements under which Canfor has agreed to supply Canfor Pulp LP with annual quantities of residual wood chips and hog fuel produced at certain of its specified sawmills in the Prince George region. Prices paid by Canfor Pulp LP for residual wood chips is based on a pricing formula that currently results in Canfor Pulp LP paying market prices for wood chips, subject to adjustment to the formula to reflect market conditions. Prices paid for hog fuel are based on market prices. Canfor Pulp LP is also entitled, on giving three months notice to Canfor, to request Canfor to supply it with pulplogs or other pulpwood harvested from its woodlands operations, at market prices. These fibre supply agreements, together with supplemental agreements by Canfor Pulp LP with third parties for the supply of wood chips and hog fuel, are expected to satisfy all of the anticipated fibre requirements to operate Canfor Pulp LP’s mills at their current levels of operation.

Under arrangements entered into with the Company in connection with the spinout, Canfor Pulp LP also purchases, at cost, a number of administrative, accounting, legal and management services from Canfor under a partnership services agreement, which can be terminated, in whole or in part on twelve months notice by either party.

The following table sets forth pulp production and sales volumes for the Canfor Pulp LP pulp mills for the last two financial years:

	<u>Year ended December 31</u>	
	<u>2006</u>	<u>2005</u>
	(tonnes)	
Pulp production		
Intercontinental Pulp Mill .....	305,249	308,228
Northwood Pulp Mill .....	561,614	549,822
Prince George Pulp and Paper Mill.....	<u>138,803</u>	<u>125,157</u>
	<u>1,015,432</u>	<u>983,207</u>
Pulp sales		
Intercontinental Pulp Mill .....	303,278	305,969
Northwood Pulp Mill .....	559,366	546,158
Prince George Pulp and Paper Mill.....	<u>147,398</u>	<u>129,974</u>
	<u>1,001,447</u>	<u>982,101</u>

The following table sets forth the kraft paper production and sales volumes for Canfor Pulp LP's Prince George mill for the last two financial years:

	<u>Year ended December 31</u>	
	<u>2006</u>	<u>2005</u>
	(tonnes)	
Kraft paper production.....	129,123	127,424
Kraft paper sales .....	124,593	127,252

### **Canfor Pulp LP Pulp and Paper Markets and Distribution**

Canfor Pulp LP has a sales and marketing department staffed by full time marketing professionals who are responsible for global sales of all of the NBSK pulp produced by the mills through three regional offices. Canfor Pulp LP also sells the pulp produced by HSLP and the Taylor pulp mill. Customers in the Americas are serviced through a Vancouver office while European customers are serviced through a Brussels office. Asian customers (excluding Japanese customers) are generally serviced through long-term sales agents who have been granted exclusive territories. These sales agents generally realize a commission of between one and two percent of the net selling price of the NBSK pulp, with the fee varying depending on the selling price, services provided and the tonnage sold.

A joint venture marketing company, Canfor April Corporation, owned equally by Canfor Pulp LP and Asia Pacific Resources International Holdings Ltd. ("April") is responsible for selling in Japan the market pulp produced by the mills and by APRIL's Riaupulp mill in Indonesia.

In 2006, the approximate geographic distribution of Canfor Pulp LP's mills' kraft pulp sales was 18% to the European market, 34% to Asia and 48% to the Americas (29%, 31% and 40% respectively in 2005).

A sales and marketing partnership, Premium 1 Papers, owned equally by Canfor Pulp LP and Tolko Marketing and Sales Ltd. ("Tolko") is responsible for marketing all bleached and unbleached kraft paper products produced by Prince George and Tolko's unbleached kraft paper mill in The Pas, Manitoba. Premium 1 Papers has approximately 14 full time marketing professionals.

The approximate geographic distribution of kraft paper sales in 2006 was 76% in North America, 4% to Asia and 20% to Europe (70%, 4% and 26% respectively in 2005).

Canfor Pulp LP uses various modes of surface transportation to distribute its pulp and kraft paper products. In the case of pulp, nearly all is shipped from the mills by rail and each of the mills is serviced by at least one dedicated rail spur. In the case of kraft paper, due to the smaller average order size, a much higher percentage is shipped by truck, with the balance being shipped by rail. Products destined for overseas customers are loaded at one of three terminals in Vancouver, and are then transported by breakbulk cargo vessel for European customers, and either breakbulk or container cargo vessels for Asian customers, depending on which mode is most cost effective.

For a detailed discussion of the markets for Canfor Pulp LP’s pulp and paper products, see the Company’s “Management Discussion and Analysis of Financial Conditions and Results of Operations 2006”, in particular, the “Pulp and Paper – Markets” and “2007 Outlook – Pulp and Paper Markets” portions thereof, which are incorporated by reference herein.

### **Canfor Pulp LP Human Resources**

Canfor Pulp LP employs approximately 1,250 people in its operations and approximately 75% of these employees are hourly employees covered by collective agreements with the CEP and PPWC unions. The collective agreements between Canfor Pulp LP and its two unions are in effect until April 30, 2008 and provide for wage increases totaling 11% over their five-year term.

### **Taylor Pulp Mill**

The Taylor pulp mill, which was acquired by Canfor as part of the combination with Slocan in 2004, produces both hardwood and softwood bleached chemi-thermal mechanical pulp (“BCTMP”) using wood chips from northern white spruce softwood and aspen hardwood species. The mill is located near Taylor, British Columbia. The Taylor pulp mill was not included in the Canfor Pulp LP transaction.

### **Taylor Production and Sales**

The Taylor pulp mill has an annual production capacity of 213,000 tonnes. The following table sets forth the pulp production and sales volumes for the Taylor pulp mill for the last two financial years:

	<u>Year ended December 31</u>	
	<u>2006</u>	<u>2005</u>
	(tonnes)	
BCTMP pulp production .....	194,389	205,906
BCTMP pulp sales .....	196,053	206,987

### **Taylor Pulp Markets and Distribution**

BCTMP pulp is marketed to customers through Canfor Pulp LP’s global sales force.

Similar to kraft pulp, the BCTMP market is global. However, Asia, not Europe is the largest consuming market of BCTMP and is also the fastest growing. Asia is also the Taylor pulp mills’ largest market, accounting for nearly 88% of all sales made in 2006. China, India, Korea and the United States are the top four markets.

The production of the Taylor pulp mill is loaded in rail cars – for transport direct to the customer (in North America) or to terminals in Vancouver and Squamish, British Columbia, where the products are transferred to vessels to be sent overseas.

### **Taylor Human Resources**

Canfor employs approximately 106 persons in the Taylor pulp mill operation, none of which are currently part of any collective agreement.

## COASTAL OPERATIONS

Up to December 15, 2005, Canfor's Coastal Operations were comprised of its Coastal logging operations (primarily the Englewood Operations) and the Coast Fibre Supply operation. On March 17, 2006, Canfor completed the transfer of the Englewood Operations to Coastal Fibre LP. The assets comprising the Englewood Operations were then transferred by Coastal Fibre LP to WFP in return for, among other things, a long term fibre supply agreement with WFP pursuant to which WFP will supply fibre to Coastal Fibre LP, which the partnership intends to use to supply HSLP.

For financial statement purposes, as a consequence of the transfer of the Englewood Operations, the Company's "Coastal Operations" segment has been reclassified as a discontinued operation and all comparative figures restated.

## HOWE SOUND PULP AND PAPER LIMITED PARTNERSHIP

Howe Sound Pulp and Paper Limited Partnership (HSLP) is 49.99% owned by each of Canfor and Oji Paper Co., Ltd. ("Oji Paper"), a leading Japanese producer and marketer of paper, including newsprint.

HSLP operates a kraft pulp mill and newsprint mill at Port Mellon, British Columbia with an annual production capacity of 400,000 tonnes of kraft pulp and 230,000 tonnes of newsprint. HSLP has its own management and operates as a separate business in which all of the financing arranged by HSLP is without recourse to either Canfor or Oji Paper.

Until March 2006, under agreements which HSLP had with Canfor and Oji Paper, Canfor obtained and supplied fibre for HSLP's mills at market prices. Although these agreements have been terminated on the sale of Canfor's Englewood Operations, Coastal Fibre LP (which is also equally owned by Canfor and Oji Paper) has entered into a long-term fibre supply agreement with WFP, which will be used to supply fibre to HSLP. See "Coastal Operations". HSLP manages its own fibre acquisitions but has Canfor Pulp LP market its kraft pulp on a commission basis and has Canfor provide certain management services for a fee related to cost. Oji Paper provides HSLP with limited administrative services, also for a fee related to cost. HSLP markets its own newsprint primarily in North America, with some product going to south east Asia.

The following table sets forth HSLP's pulp and newsprint production and sales for the last two financial years:

	<u>Year ended December 31</u>	
	<u>2006</u>	<u>2005</u>
	(tonnes)	
Pulp production.....	378,422	372,197
Pulp sales .....	374,565	372,922
Newsprint production .....	215,742	206,462
Newsprint sales.....	221,164	204,901

As part of a reorganization in 2001, Howe Sound Pulp and Paper ("HSPP") was amalgamated with Canadian Forest Products Ltd., the Company's principal operating subsidiary, and, with ongoing operations of HSLP, approximately \$643 million of tax losses of HSPP at that time became available to reduce the future taxable income of the amalgamated company. Also, as part of the reorganization, Canadian Forest Products Ltd. made a payment of \$60.2 million to HSLP, which was applied to reduce the long-term debt of HSPP assumed by HSLP. As a result of utilizing these tax losses, Canadian Forest Products Ltd. made further payments to HSLP of \$5.0 million in 2002 and \$7.0 million in 2004. A final payment was made to HSLP on January 2, 2005 of \$50.0 million.

Canfor wrote off its investment in the joint venture in 1998 and no longer reflects its share of HSLP's assets, liabilities, cash flows and results in its earnings.

## ENVIRONMENT

Canfor is committed to the responsible stewardship of the environment throughout its operations. Canfor meets this commitment by: practicing forest management that recognizes ecological processes and diversity and supports integrated use of the forest; designing and operating its facilities to comply with or surpass legal requirements; setting environmental objectives and targets to reduce the risk of pollution and continue to achieve improvements in environmental performance; and promoting environmental awareness throughout Canfor's operations.

Canfor has implemented a program of regular audits of its Environmental Management System ("EMS") and compliance with government regulations and industry practices at all operations. Canfor's management believes it has sound environmental management programs established in all operations. These programs are continually being improved to help ensure that Canfor is exercising due diligence and is fulfilling its environmental commitments and responsibilities.

At present, 86% of Canfor's AAC is certified to the Canadian Standards Association sustainable forest management standard (with the balance expected to be certified in 2007 and 2008) and 97% of its forest operations are ISO 14001 certified.

Canfor Pulp LP's Prince George Pulp and Paper and Intercontinental Pulp mills and the HSLP mill were among the first mills in North America to achieve ISO 14001 registrations in early 1998. The Northwood Pulp mill achieved ISO 14001 registration in June 2001. These mills were all successful in retaining registration following audits by the registrar for these standards in 2003 and 2006. Canfor's wood products operations have been implementing an ISO 14001-based EMS, but are not seeking ISO 14001 registration at this time. The Rustad sawmill EMS attained ISO 14001 registration in the fourth quarter of 2002.

As of the end of 2006, Canfor has seven wood residue burners at its sawmills in BC including two Tier 1 burners. Canfor also is one of three companies utilizing a cooperative Tier 1 burner in Quesnel for disposal of surplus wood residues. Under the *B.C. Wood Residue Burner and Incinerator Regulations*, Tier 1 burners are required to cease operation by December 31, 2007. Commissioning of Canadian Gas & Electric's 25 megawatt ("MW") electricity cogeneration facility adjacent to the Grande Prairie sawmill began in late 2004 and allowed for the closure of Canfor's one remaining Alberta burner in early 2005. A wood residue fuelled 48 MW cogeneration facility at the Prince George Pulp and Paper mill in Prince George, which started up in June 2005, allowed for the shut down of the Polar sawmill Tier 1 burner in mid 2005. The Isle Pierre Tier 2 sawmill burner will also be supplying the cogeneration facility, and is being retained for periodic operation as necessary for pulp mill wood residue inventory control. The Quesnel Tier 1 burner operated approximately one week out of four in 2006, and with increased local demand for wood residue for energy purposes, should not need to be operated beyond 2007. Canfor, in a joint venture with Pinnacle Pellet Inc. of Quesnel, BC and the Moricetown First Nations Band, commenced operation in late 2006 of a wood pellet manufacturing facility adjacent to its Houston sawmill, which will convert all of Houston's sawdust and shavings into wood pellets for the US and Japanese pellet markets. A bark fired energy system under construction at the Houston sawmill will burn all the mill's bark and supply heat for the pellet plant sawdust drier and sawmill lumber dry kilns. Start-up of the Houston energy system, scheduled for March 2007, together with the pellet plant joint venture, will result in the shut down of Houston sawmill's Tier 1 burner well before the current regulatory deadline. Canfor is also continuing to evaluate alternatives to create value from surplus wood residues and to be in a position to shut down its Fort St. John sawmill Tier 1 burner. Options being considered include a bark fuelled sawmill energy system, third party utilization of surplus bark and whitewood, and wood pellet manufacture.

During 2006, Canfor's operations were in substantial compliance with environmental requirements, except for the matter described below and except for incidents which have not had, nor are they expected to have, a material effect on Canfor or its operations.

In October 2006, Canfor Pulp LP observed dark ponded water in an area on the banks of the Fraser River and reported the dark ponded water to the appropriate regulatory agencies. Canfor Pulp LP also undertook certain remedial work and investigations to determine the source of the dark ponded water. Canfor Pulp LP's experts have concluded that the source is likely a leak from its Intercontinental pulp mill ash pond.

Canfor Pulp LP, in conjunction with the BC Ministry of Environment, is considering and developing remedial options. The cost to remediate the ash pond and surrounding area cannot be determined at this time, but the Company believes it will not have a material effect on its or Canfor Pulp LP's financial condition.

## **COMPETITIVE POSITION**

Each of the markets in which Canfor sells lumber, panels, pulp, paper and newsprint products is highly competitive with many major firms in each market. Canfor's competitive position is influenced by the availability, quality and cost of its raw materials, energy and labour, and its plant efficiencies and productivity in relation to its competitors. Like the rest of the Canadian forest products industry, Canfor (including Canfor Pulp LP, OSB LP and HSLP) compete in an international market and is therefore subject to the impact of currency fluctuations and global business conditions. Many of Canfor's lumber and panel products also compete with substitutes for wooden building materials of various kinds.

## **RESEARCH AND DEVELOPMENT**

Through Canfor's own Research & Development group and through contributions to and participation in industry research organizations, Canfor conducts and is committed to research and development in the areas of fibre analysis, manufacturing processes, quality control and product development. Also, Canfor's own R & D group is an important conduit for industry research and technical information between various associations, universities, research institutes, suppliers and customers.

## **DIRECTORS AND OFFICERS**

### **Directors**

The names and municipalities, province and country of residence of the Directors of the Company, their principal occupations and the periods during which they have been Directors of the Company are as follows:

<u>Name and Municipality, Province and Country of Residence</u>	<u>Principal Occupation and Background</u>	<u>Director Since</u>
P. J. G. Bentley, O.C., LL.D. <sup>(4),(6)</sup> Vancouver, British Columbia Canada	Chairman of the Board of Directors of the Company Background: Peter J. G. Bentley is Chairman of the Board of the Company and of the Company's principal subsidiary, Canadian Forest Products Ltd., and Co-chairman and a director of HSPP General Partner Ltd. Mr. Bentley is a director of Canfor Pulp Holding Inc., the general partner of Canfor Pulp Limited Partnership. After working in several positions throughout Canfor, Mr. Bentley became Executive Vice-President in 1970, President in 1975, and Chairman and Chief Executive Officer in 1985, a position he held until April 24, 1995. Mr. Bentley was reappointed to the position of President and Chief Executive Officer of the Company on July 25, 1997, but relinquished the position of President and Chief Executive Officer of the Company on January 1, 1998. Mr. Bentley is President and a director of Sierra Mountain Minerals Inc., a member of the Board of the	1966

Canadian Institute for Advanced Research, a member of the Advisory Board of BuildDirect.com, and Chair Emeritus of the VGH and UBC Hospital Foundation. He also served for many years as a director of Bank of Montreal and Shell Canada Ltd. Mr. Bentley is Chancellor of the University of Northern British Columbia. Mr. Bentley holds an Honorary Doctorate of Laws degree from the University of B.C.

R. L. Cliff, C.M., F.C.A.<sup>(1),(5)</sup>  
West Vancouver, British Columbia  
Canada

Chairman of the Board, Heathcliff Properties Ltd.  
Background: Mr. Cliff is Chairman of Heathcliff Properties Ltd. He is also President of the Heathcliff Foundation. Mr. Cliff was Chairman and a director of BC Gas Inc. (now Terasen Inc.) from 1972 to 2002. Mr. Cliff is Chair of the Vancouver Police Foundation; a Member of the Dean's Advisory Board to the Sauder School of Business at UBC; a Trustee and Treasurer of VGH & UBC Hospital Foundation; and the Chairman of the Vancouver Symphony Foundation. Mr. Cliff received his Commerce Degree from the University of B.C. and qualified as a Chartered Accountant in 1954.

1983

S. A. Jarislowsky, O.C., C.P.Q., LL.D.<sup>(2),(6)</sup>  
Montreal, Québec  
Canada

Chairman and Chief Executive Officer, Jarislowsky Fraser Limited  
Background: Mr. Jarislowsky is Chairman and Chief Executive Officer of Jarislowsky Fraser Limited. He is a Director of Canadian Coalition for Good Governance; Chairman of the Board of Goodfellow Inc. and President of each of Growth Oil & Gas Investment Fund, C.D. Howe Research Institute and the Québec Prostate Cancer Foundation. Mr. Jarislowsky received a B.Sc. from Cornell, a Masters of Business Administration from Harvard Graduate School of Business Administration, a Masters from the University of Chicago and Honorary Doctorate of Laws Degrees from Queen's University, University of Montreal, University of Alberta, McMaster University, Laval University, Concordia University and the University of Windsor.

2004

M. J. Korenberg<sup>(1),(3),(6)</sup>  
West Vancouver, British Columbia  
Canada

Managing Director, Vice-Chairman of The Jim Pattison Group  
Background: Mr. Korenberg is a director of Jim Pattison Group Inc. (and its affiliates), a trustee of Westshore Terminals Income Fund, and an adjunct professor, Faculty of Law, University of British Columbia.

2003

B. C. Louie, F.C.A., LL.D.<sup>(3),(5)</sup>  
West Vancouver, British Columbia  
Canada

Vice Chairman of the Board, Canfor; President and Chief Executive Officer, H.Y. Louie Co. Limited and Chairman and Chief Executive Officer of London Drugs Limited.  
Background: Mr. Louie is President and Chief

2004

Executive Officer of H. Y. Louie Co. Limited and Chairman and Chief Executive Officer of London Drugs Limited. Mr. Louie is Chancellor of Simon Fraser University and past chair and a member of the Board of Governors. He is a governor of the Vancouver Board of Trade, World Trade Centre, B.C. Business Council and the World Economic Forum, Food & Beverage Industry. Mr. Louie is a director of The Royal Bank of Canada, Historica Foundation of Canada, Food Marketing Institute, NeuroScience Canada Partnership and Foundation, Duke Heart Center and Duke Medical Center and a member of the Dean's Advisory Council for the John F. Kennedy School of Government, Harvard University. He is a past director of Canada Life Assurance Company, IBM Canada Limited (Advisory Board), North American Life Assurance Co. and British Columbia Lottery Corporation. Mr. Louie received a Commerce Degree from the University of British Columbia and an Honorary Doctorate of Laws Degree from Simon Fraser University.

E. P. Newell, O.C., LL.D.<sup>(2),(3),(4),(6)</sup>  
Edmonton, Alberta  
Canada

Chancellor, University of Alberta and a member of the Board of Governors.

1999

Background: Mr. Newell retired as Chairman and C.E.O. of Syncrude Canada Limited in December 2003. He is Chancellor of the University of Alberta, a director of Nexen Inc., Chair of *CAREERS...The Next Generation* Foundation and a director of the Alberta Energy Research Institute, the C.D. Howe Institute and the Alberta Heart Institute. He is Policy Advisor to the Learning Partnership and Honorary Chair of the Centre for Family Literacy. Mr. Newell received a degree in Chemical Engineering from the University of British Columbia and a Masters in Management Studies from the University of Birmingham, U.K. He holds Honorary Doctorate of Laws degrees from the University of British Columbia, the University of Alberta, the University of Lethbridge and Athabasca University.

J. A. Pattison, O.C., O.B.C.<sup>(2)</sup>  
West Vancouver, British Columbia  
Canada

President, Managing Director, Chief Executive Officer and Chairman, The Jim Pattison Group.

2003

Background: Mr. Pattison is a director of Jim Pattison Group Inc. (and its affiliates), BCE Inc., Canaccord Capital Inc., Bell Canada, Telesat Canada and a Trustee of the Board of the Ronald Reagan Presidential Foundation.

M. E. J. Phelps, O.C., LL.M., LL.D.<sup>(2),(3),(5)</sup>  
West Vancouver, British Columbia  
Canada

Chairman, Dornoch Capital Inc.

1990

Background: Mr. Phelps is Chairman of Dornoch Capital Inc., a private investment company. He is also Chairman of the Board of the GLOBE Foundation of Canada, Kodiak Exploration Limited and Chairman of the Committee to Nominate the Canada Pension

Plan Investment Board. Mr. Phelps is a director of Duke Energy Corporation, Canadian Pacific Railway and Fairborne Energy Ltd., Inco Limited and the Vancouver Organizing Committee for 2010 Olympic and Paralympic Games. He also serves on the Board of the VGH & UBC Hospital Foundation and is a Senior Advisor to Deutsche Bank AG, Canada. The Federal Government appointed Mr. Phelps as Chairman of “The Wise Persons' Committee”, a panel developed to review Canada's system of securities regulation. Mr. Phelps was the Chairman (1992-2002) and C.E.O. (1988-2002) of Westcoast Energy Inc. Mr. Phelps received his Law Degree from the University of Manitoba and his Masters of Law from the London School of Economics and Political Science, and Honorary Doctorate of Laws degrees from the University of Winnipeg and Simon Fraser University.

D. C. Selman, F.C.A.<sup>(1),(5)</sup>  
 Richmond, British Columbia  
 Canada

Senior Partner, Wolrige Mahon  
 Background: Mr. Selman is a senior consultant with Wolrige Mahon, a firm of chartered accountants and is a chartered business valuator. He obtained his C.A. designation in 1958 and a Law Degree from the University of British Columbia in 1960. He is a director of Sun-Rype Products Ltd.

2004

J. A. Shepherd, P.Eng.  
 Surrey, British Columbia  
 Canada

President and Chief Executive Officer, Canfor  
 Background: Mr. Shepherd was appointed President, April 1, 2004, and C.E.O., April 30, 2004, of the Company. From February 1999 to July 2000, Mr. Shepherd was the President and Chief Operating Officer of Slocan Forest Products Ltd. and was appointed Chief Executive Officer of Slocan in July 2000. Prior to this appointment, he was the President and Chief Operating Officer of Crestbrook Forest Industries Ltd. and President of Finlay Forest Industries Limited. Mr. Shepherd received his Mechanical Engineering degree from Queen’s University. Mr. Shepherd is a director of Council of Forest Industries, B.C. Progress Board, Canadian Lumber Trade Alliance Incorporated, North American Competitiveness Council, Vancouver Board of Trade, The Center for Paper Business and Industry Studies, Canadian Council of Chief Executives and University of Northern British Columbia and Chairman of the Forest Products Association of Canada.

2004

- (1) Member of the Audit Committee.
- (2) Member of the Management Resources and Compensation Committee.
- (3) Member of the Corporate Governance Committee.
- (4) Member of the Environmental, Health and Safety Committee.
- (5) Member of the Pension Committee.
- (6) Member of the Capital Expenditure Committee.

Mr. Paul Tellier, who became a director in 2006, resigned as a director of the Company effective March 16, 2007.

The term of office of each Director expires on the date of the next Annual General Meeting of the Company to be held on May 4, 2007.

## Officers

The names and municipalities, province and country of residence of the executive officers of the Company and the offices held by them are as follows:

<u>Name</u>	<u>Municipality of Residence</u>	<u>Office and Principal Occupation</u>
P. J. G. Bentley .....	Vancouver, British Columbia, Canada	Chairman
B. C. Louie .....	West Vancouver, British Columbia, Canada	Vice-Chairman President and Chief Executive Officer, H.Y. Louie Co. Limited and Chairman and Chief Executive Officer of London Drugs Limited
J. A. Shepherd .....	Surrey, British Columbia, Canada	President and Chief Executive Officer
P. Bonkemeyer .....	Surrey, British Columbia, Canada	Senior Vice-President, Operations
D. M. Calabrigo .....	Surrey, British Columbia, Canada	Vice-President, Corporate Development, General Counsel and Corporate Secretary
K. O. Higginbotham .....	Surrey, British Columbia, Canada	Vice-President, Forestry and Environment
C. T. James .....	West Vancouver, British Columbia, Canada	Vice-President, Human Resources
D. B. Kayne .....	Tsawwassen, British Columbia, Canada	Vice-President, Wood Products Marketing and Sales
M. Palmiere .....	Vancouver, British Columbia, Canada	Vice-President and Regional Manager, West Region
S. R. Wilson .....	Vancouver, British Columbia, Canada	Vice-President, Finance and Chief Financial Officer

All of the above directors and officers have had the same or similar principal occupations with the organizations indicated for the last five years except that: prior to April 2002, Mr. Cliff was Chairman of BC Gas Inc., now Terasen Inc. (1972-2002); prior to December 2003, Mr. Newell was Chairman (1994) and Chief Executive Officer (1989) of Syncrude Canada Ltd.; prior to December 2002, Mr. Phelps was Chairman (1992-2002) and President and Chief Executive Officer (1988-2002) of Westcoast Energy Inc.; prior to August 2006, Mr. Bonkemeyer was General Manager, Engineered Wood Products (2002-2006) of Louisiana Pacific Corporation; prior to April 2004, Mr. Calabrigo was Vice-President, Human Resources, General Counsel and Corporate Secretary of the Company and

prior to July 2003, was General Counsel and Corporate Secretary; prior to April 2004, Mr. Shepherd was President (from February 1999) and Chief Executive Officer (from July 2000) of Slocan; prior to April 2004, Mr. James was Vice-President, Human Resources of Slocan; prior to August 31, 2006, Mr. Palmiere was Vice-President, Solid Wood Operations, West and prior to March 1, 2005, Vice-President/Director Customer Supply Management of Weldwood of Canada Ltd. and Resident Manager, Cariboo Pulp (2001-2003) and General Manager, Babine Forest Products (2000-2001) of Weldwood of Canada Ltd.; and prior to July 29, 2005, Mr. Wilson was Senior Vice-President and Controller of Enbridge Inc. and Vice-President, Finance (2001 and 2003) and Vice-President and Treasurer/Assistant Treasurer/Treasurer (1995-2001) of Enbridge Inc.

### **Interest of Management and Others in Material Transactions**

To the knowledge of Canfor, no director or executive officer of the Company, or any of their associates, has or had any material interest, directly or indirectly, in any transaction within the three most recently completed financial years of the Company that has materially affected or will materially affect the Company, other than in connection with the combination of the Company and Slocan on April 1, 2004 as follows: Great Pacific Industries Inc. or its affiliates, each of which are companies beneficially owned by James A. Pattison, held approximately 20% of the outstanding shares of Slocan at the time of the combination; and Jarislowsky Fraser Limited, of which Stephen A. Jarislowsky is Chairman and Chief Executive Officer, held approximately 20% of the outstanding shares of Slocan at the time of the combination. Other former officers and directors of Slocan who are now officers and/or directors of Canfor were also shareholders of Slocan at the time of the combination.

### **Conflicts of Interests**

To the knowledge of the Company, no director or executive officer of the Company has an existing or potential conflict of interest with Canfor.

### **Description of Capital Structure**

The authorized share capital of the Company consists of 1,010,000,000 shares divided into 1,000,000,000 Common Shares without par value and 10,000,000 Preferred shares with a par value of \$25 each. At March 20, 2007 there were 142,563,797 Common Shares issued and outstanding and no Preferred shares issued and outstanding.

Holders of the Common Shares are entitled to vote at all meetings of shareholders of the Company, except meetings at which only the holders of Preferred shares would be entitled to vote. The Common Shareholders are entitled to receive dividends, as and when declared on the Common Shares.

Holders of Preferred shares are not generally entitled as such to receive notice of, or to attend or vote at, general meetings of shareholders of the Company. Preferred shareholders are entitled to preference over the Common Shares with respect to the payment of dividends and upon any distribution of assets in the event of liquidation, dissolution and winding-up of the Company.

Under the plan of arrangement in connection with the spinout of Canfor's pulp and paper business to Canfor Pulp LP, the previously existing "Common Shares" of the Company were redesignated as "Class A Common Shares", the authorized capital of the Company was increased to authorize the issuance of up to 1,000,000,000 new Common Shares and special rights and restrictions were added to the redesignated Class A Common Shares. As part of the arrangement, each Canfor shareholder received one Common Share and 0.1 Fund Units in exchange for each Class A Common Share held by them and all of the outstanding Class A Common Shares were then cancelled by the Company. Upon completion of the spinout, Canfor shareholders owned all of the issued and outstanding Common Shares and all of the issued and outstanding Fund Units and the authorized capital of the Company was subsequently reduced to delete the 1,000,000,000 Class A Common Shares, none of which were then issued and outstanding. See "Business of Canfor – General Development".

## Ratings

The credit rating agency listed below has assigned the following rating to the senior notes issued by Canfor under the February Note Agreement and the April Note Agreement (see “Material Contracts”):

Dominion Bond Rating Service Ltd. (“DBRS”)	BBB (low)	(the fourth ranking category out of ten granted by DBRS for long-term debt)
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A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the rating organization. The foregoing DBRS rating was not requested by Canfor and is based, as specified by DBRS in its rating report, on publicly available information about the Company. Canfor did not participate with or provide information to DBRS in connection with this rating. Accordingly, Canfor cannot comment on the accuracy of the rating or of the appropriateness of the factors considered by DBRS in preparing the rating.

The following information about DBRS credit ratings is taken from publicly available information provided by DBRS on its website. DBRS credit ratings are on a long-term debt rating scale that ranges from AAA to D, which represents the range from highest to lowest quality of such securities rated and is meant to give an indication of the risk that a borrower will not fulfill its obligations in a timely manner. Every DBRS rating is based on quantitative and qualitative considerations relevant to the borrower. According to the DBRS rating system, an obligation rated BBB is defined as of adequate credit quality, where the degree of protection afforded interest and principal is considered acceptable, but the borrower is fairly susceptible to adverse changes in financial and economic conditions or there may be other adverse conditions present which reduce the strength of the borrower’s rated securities. The ratings from AA to CCC may be modified by the addition of a high or low modifier to show relative standing within the major rating categories. The lack of one of these designations indicates a rating which is essentially in the “middle” of the category.

## Dividends

The declaration and payment of dividends is at the discretion of the Company's Board of Directors. The following dividends (per share) were paid in the years ended December 31:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Common shares .....	In kind <sup>(1)</sup>	\$0.00	\$0.00

(1) Includes an eligible taxable dividend in kind of 1.49 Fund Units for every 10 Common Shares of the Company. The dividend consisted of 21,239,537 Fund Units, after taking into account the payment of cash for fractional units. See “Business of Canfor – General Development”.

The amount of dividends the Company is permitted to pay under its term loan agreements is determined by reference to consolidated net earnings less certain restricted payments. As at December 31, 2006, the Company would be permitted under these agreements to pay up to \$831 million or \$5.83 per share in dividends on its Common Shares. The agreements do not restrict payment of dividends on Preferred shares or dividends paid in Common Shares of the Company.

## Shareholder Rights Plan

On November 19, 1999, the Board of Directors of the Company (the “Board”) approved the adoption, effective as at November 23, 1999, of a shareholder rights plan (the “Shareholder Rights Plan”). The purpose of this Shareholder Rights Plan was to discourage discriminatory or unfair takeover offers for the Company and provide the Board with time, if appropriate, to pursue alternatives to maximize shareholder value in the event of an unsolicited takeover bid for the Company.

This Shareholder Rights Plan was approved at the Annual General Meeting of shareholders held on April 28, 2000 and was reconfirmed and extended by the Company's shareholders for a three year term at its Annual General Meeting held on April 29, 2003. Pursuant to the terms of the Shareholder Rights Plan, the Plan had to be reconfirmed by more than 50% of the votes cast at the Annual General Meeting of the shareholders of the Company held on April 28, 2006. Pursuant to the Shareholder Rights Plan, if it was not reconfirmed, the plan would terminate at the end of that Meeting.

For the reasons described in the “Shareholder Rights Plan Policy” section of the Company’s Information Circular dated March 21, 2006, which is incorporated herein by reference, the Board submitted for approval, and recommended as an alternative to the Shareholder Rights Plan, a Shareholder Rights Plan Policy designed to provide shareholders of the Company with a means of obtaining protections similar to those in the Shareholder Rights Plan in the event of a formal takeover bid for the Common Shares of the Company as further described in that Circular. The Shareholder Rights Plan Policy was approved by the Company’s shareholders at the April 28, 2006 Annual General Meeting and the then existing Shareholder Rights Plan was terminated.

On December 22, 2006, after review of the Shareholder Rights Plan Policy by the Company’s Corporate Governance Committee and in light of increases in the ownership of the Company’s Common Shares since the policy’s introduction, on the recommendation of the Committee, the Company’s Board of Directors adopted a new shareholder rights plan which is consistent with the terms of the Shareholder Rights Plan that expired in April 2006.

In order to continue in effect, the new shareholder rights plan must be reconfirmed by more than 50% of the votes cast at the Annual General and Special Meeting of the Company to be held May 4, 2007 by shareholders present or voting by proxy. If the Plan is not reconfirmed, it will terminate at the end of the meeting. The new Shareholder Rights Plan (and the listing of the rights thereunder) has been conditionally accepted by the Toronto Stock Exchange (“TSX”). In order for the plan to be fully accepted by the TSX, it must also be approved by more than 50% of the votes cast at the meeting by shareholders present or voting by proxy, excluding any “grandfathered persons”, being persons holding in excess of 20% of the Company’s Common Shares. Pursuant to a voting agreement between Great Pacific, Third Avenue and Matthews-Cartier (each as defined and as described in “Shareholdings of Directors and Executive Officers” below), these shareholders have agreed to vote against the confirmation of the Shareholder Rights Plan at the Meeting.

#### **Shareholdings of Directors and Executive Officers**

As at March 20, 2007, the Directors and executive officers of the Company, as a group, beneficially owned, directly or indirectly, or exercised control or direction over, 36,580,022 Common Shares representing approximately 25.67% of the outstanding Common Shares.

In addition, as at March 20, 2007, James A. Pattison beneficially owned 35,722,605 Common Shares, which are held by subsidiaries wholly owned by Mr. Pattison, and represent approximately 25.06% of the outstanding Common Shares of the Company. Jarislowsky, Fraser Limited, an investment management firm with which Stephen A. Jarislowsky is associated, owned 26,117,153 Common Shares representing approximately 18.32% of the outstanding Common Shares of the Company.

On March 12, 2007, James A. Pattison announced that Great Pacific Industries Inc., Great Pacific Capital Corp. and 4123221 Canada Inc. (collectively, “Great Pacific”), all of which are wholly-owned by him, had entered into a voting agreement with Third Avenue Management LLC (“Third Avenue”) and Matthews-Cartier Holdings Limited (“Matthews-Cartier”), a holding company controlled by the Company’s founding Bentley and Prentice families, with respect to the Common Shares of the Company controlled by each of them. The announcement reported that, collectively, Great Pacific, Third Avenue and Matthews-Cartier (collectively, the “Shareholders”) currently own or control 74,636,313 of the Company’s Shares, or approximately 52% of the outstanding Common Shares.

According to the announcement, under the voting agreement, each of the Shareholders has agreed to vote for a mutually agreed slate of directors at the Meeting and withhold from voting in favour of any other individual nominated for election as a Company director. In addition, each of the Shareholders has agreed to vote against confirmation of the Company’s shareholder rights plan adopted by the board of directors of the Company on December 22, 2006 (see “Shareholder Rights Plan” herein). The announcement also states that the voting agreement shall expire immediately following the Annual General and Special Meeting to be held on May 4, 2007.

## Markets for Securities

The Common Shares are listed and traded on the TSX under the symbol CFP. The main operating company is Canadian Forest Products Ltd., from which the name Canfor is derived.

## Trading Price and Volume

The following table presents the high and low closing prices for the Company's Common Shares and the average daily trading volume of those shares, on a monthly basis, on the TSX for 2006.

Month of 2006	High	Low	Average Daily Trading Volume
January	\$14.82	\$13.36	781,264
February	\$14.00	\$12.96	667,808
March	\$14.65	\$13.31	564,893
April	\$15.20	\$13.80	839,254
May	\$14.65	\$12.70	596,103
June	\$13.15	\$12.06	637,540
July	\$13.10	\$10.85	222,829
August	\$12.15	\$10.50	462,399
September	\$11.48	\$11.00	369,188
October	\$12.05	\$10.85	420,479
November	\$12.10	\$9.54	623,700
December	\$11.00	\$9.90	343,320

## Normal Course Issuer Bid

In 2005, the Board of Directors authorized the Company to conduct a normal course issuer bid (the "2005 Issuer Bid"). The 2005 Issuer Bid commenced on November 15, 2005 and terminated on November 14, 2006. The Company did not purchase any shares under the 2005 Issuer Bid.

In 2004, the Board of Directors authorized the Company to conduct a normal course issuer bid (the "2004 Issuer Bid"). The 2004 Issuer Bid commenced on October 15, 2004 and terminated on October 14, 2005. Prior to the termination of the 2004 Issuer Bid, the Company purchased a total of 1,104,800 Common Shares, at an average price of \$13.91 per share, all of which have been returned to the treasury of the Company for cancellation.

## Security

The Company's operating lines of credit and term indebtedness are unsecured.

## Material Contracts

Canfor and Canadian Forest Products Ltd. entered into a revolving credit agreement dated for reference June 8, 2006 with Royal Bank of Canada and other institutional lenders to amend and restate its existing credit facilities and to remove Canadian Forest Products Ltd. as a borrower. The new credit agreement provides for an unsecured and committed \$325 million revolving credit facility to replace the existing credit facility of the same aggregate amount. This facility is for a term of five years and provides for floating rates of interest.

Canfor entered into a note purchase agreement dated February 2, 2004 with The Prudential Investment Management, Inc. and other purchasers providing financing of up to US \$160 million (the "February Note Agreement"). Canfor also entered into a note purchase agreement on April 1, 2004 with John Hancock Life Insurance Company, Investors Partner Life Insurance Company, John Hancock Insurance Company of Vermont and The Maritime Life Assurance Company providing financing of up to US \$75 million (the "April Note Agreement").

On February 4, 2004, Canfor issued US \$50 million of senior notes under the February Note Agreement for general operating purposes and capital expenditures. On April 1, 2004, Canfor issued US \$110 million of senior notes under the February Note Agreement and US \$75 million under the April Note Agreement for the repayment of \$160 million of long term debt existing at the time of acquisition of Slocan. Certain of the funds under the February Note Agreement and the April Note Agreement were also used to pay a make-whole payment on Slocan's outstanding indebtedness at the time of acquisition and for general corporate purposes.

The senior notes issued under the February Note Agreement and the April Note Agreement have the following interest rates and maturities: US \$60 million at 5.66% (February 2, 2009), US \$50 million at 6.18% (February 2, 2011), US \$50 million at 6.33% (February 2, 2012), and US \$75 million at 5.24% (April 1, 2013).

All of the foregoing note agreements and credit facility are unsecured but require compliance with certain covenants that could in certain circumstances restrict the ability of Canfor or its subsidiaries to incur additional indebtedness, to encumber or dispose of their assets, or to make certain payments or distributions.

Canfor and Canfor Pulp LP each entered into a number of material contracts in connection with the spinout of the northern bleached softwood kraft pulp and paper business by Canfor to Canfor Pulp LP on July 1, 2006, including an Acquisition Agreement, an Exchange Agreement and a Shareholders Agreement. For a description of these contracts see "Pulp and Paper" and the section entitled "The Spinout - Transfer of the Pulp Business and Related Agreements" of the Company's Information Circular dated April 28, 2006, which is incorporated by reference herein.

### **Cease Trade Orders, Bankruptcies, Penalties, Sanctions**

To the knowledge of the Company, no director, executive officer or a shareholder holding a sufficient number of securities of the Company to affect materially control of the Company: (1) is at the date hereof or was within the last 10 years of the date of this Annual Information Form, a director or executive officer of a company that, while acting in that capacity, (i) was subject to a cease trade or similar order or an order that denied the Company access to any exemption under securities legislation for a period of 30 consecutive days; (ii) was subject to an event that resulted, after the director or executive officer ceased in such capacity, in a cease trade or similar order or an order that denied the Company access to any exemption under securities legislation for a period of 30 consecutive days; or (iii) within a year of ceasing to act in such capacity became bankrupt, made a proposal under legislation relating to bankruptcy or insolvency or was subject to any proceedings, arrangement or compromise with creditors or had a receiver or trustee appointed to hold its assets, other than Mr. James A. Pattison who, from May 1997 to September 1999, was a director of Livent Inc., which in November 1998 filed for protection from creditors under the *Companies' Creditors Arrangement Act* (Canada) and in September 1999 filed for protection from creditors under Chapter 11 of the *U.S. Bankruptcy Code* in the United States; or (2) has, within the last 10 years of the date of this Annual Information Form, become bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency, or become subject to or instituted any proceedings, arrangement or compromise with creditors, or had a receiver, receiver manager or trustee appointed to hold the assets of the director, officer or shareholder.

### **Experts**

The auditors of the Company are PricewaterhouseCoopers LLP, Chartered Accountants, of Vancouver, British Columbia. PricewaterhouseCoopers LLP, Chartered Accountants, report that they are independent of the Company in accordance with the rule of professional conduct in British Columbia, Canada.

### **Transfer Agent and Registrar**

CIBC Mellon Trust Company is the Company's transfer agent and registrar with registers of transfers in Vancouver and Toronto.

## Audit Committee Information

*Audit Committee Terms of Reference – See Appendix A*

### *Composition of Audit Committee*

The Audit Committee is composed entirely of independent directors all of whom are financially literate as defined in Multilateral Instrument form 52-110F1. Mr. Cliff, the Chairman of the Committee is a Chartered Accountant and received a commerce degree from the University of British Columbia. Mr. Selman is a Chartered Accountant and a senior partner with Wolrige Mahon, a national accounting firm, and is a chartered business valuator. Mr. Korenberg is the Vice-Chairman of the Jim Pattison Group and an adjunct professor of the Faculty of Law, University of British Columbia.

The Audit Committee has adopted a policy for the engagement of non-audit services whereby the external auditor of the Company is not entitled to provide any non-audit services to the company exceeding \$50,000 in value without the Audit Committee Chairman's prior approval and any such services exceeding \$100,000 are to be approved by the Audit Committee. All such engagements are reported to the Audit Committee.

### *External Auditor Service Fees (By Category)*

The aggregate fees billed by PricewaterhouseCoopers LLP, the auditor of the Company for the last two years, was \$5,420,000. Of this amount \$3,917,000 was for audit, tax and financial services and \$1,503,000 was for consulting services.

<b>External Auditor Service Fees</b>	<b>2006</b>	<b>2005</b>
Audit <sup>(1)</sup>	\$1,005,000	\$1,106,000
Audit related <sup>(2)</sup>	558,000	562,000
Tax <sup>(3)</sup>	422,000	264,000
Other <sup>(4)</sup>	1,174,000	329,000
<b>Total</b>	<b>\$3,159,000</b>	<b>\$2,261,000</b>

- (1) For the audit of the Company's annual financial statements and services normally provided by the principal auditor in connection with the Company's statutory and regulatory filings.
- (2) For assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements and are not reported in (1), including accounting consultations and various agreed upon procedures.
- (3) For tax compliance services.
- (4) For tax and other consulting services other than the fees reported in (1) to (3). The above increase is due to two major transactions that occurred in 2006.

Note: Certain 2005 figures have been reclassified to conform to the current year's presentation.

## Additional Information

Additional financial information regarding Canfor is provided in the Company's "Management's Discussion and Analysis of Financial Condition and Results of Operations 2006" and "Consolidated Financial Statements" for the year ended December 31, 2006, which are incorporated by reference herein. Additional information, including Directors' and Officers' remuneration and indebtedness, principal holders of the Company's securities, options to purchase securities and interests of insiders in material transactions, where applicable, and securities authorized for issuance under equity compensation plans, is contained in the Information Circular for the Annual General Meeting of the Company held on April 28, 2006 and in the Information Circular for the Annual General and Special Meeting of the Company to be held on May 4, 2007.

The Company will provide upon request to the Secretary of the Company, 100-1700 West 75<sup>th</sup> Avenue, Vancouver, British Columbia V6P 6G2:

- a) at no cost when the securities of the Company are in the course of a distribution under a short form prospectus or a preliminary short form prospectus,
  - (i) one copy of this Annual Information Form, together with one copy of any document, or the pertinent pages of any document, incorporated by reference in this Annual Information Form;
  - (ii) one copy of the comparative financial statements of the Company for its most recently completed financial year together with the accompanying report of the auditor and one copy of any interim financial statements of the Company that have been filed, if any, for every period subsequent to the financial statements for its most recently completed financial year;
  - (iii) one copy of the Information Circular of the Company in respect of its most recent annual meeting of shareholders that involved the election of Directors or one copy of any annual filing prepared in lieu of that Information Circular, as appropriate, and;
  - (iv) one copy of any other documents that are incorporated by reference into the preliminary short form prospectus or the short form prospectus and are not required to be provided under (i) to (iii) above; or
- b) at any other time, one copy of any other documents referred to in (a)(i), (ii) and (iii) above, provided the Company may require the payment of a reasonable charge if the request is made by a person who is not a security holder of the Company.

Additional information about Canfor is available on its web site at [www.canfor.com](http://www.canfor.com) and on SEDAR (System for Electronic Document Analysis and Retrieval) at [www.sedar.com](http://www.sedar.com). In addition, all documents identified in this Annual Information Form as being incorporated by reference herein are available on SEDAR at [www.sedar.com](http://www.sedar.com).

## **Appendix A – Audit Committee Terms of Reference**

### **1. Purpose**

The Audit Committee is appointed by the Board to assist the Board in fulfilling its oversight responsibilities. The Audit Committee will:

- (a) Review the financial reports and other financial information provided by the Company to its shareholders;
- (b) Monitor the integrity of the financial reporting process and the system of internal controls that management and the Board have established;
- (c) Monitor the management of the principal risks that could impact the financial performance of the Company;
- (d) Review and receive the Audit Plan, process, results and performance of the Company's independent external auditors and the Internal Audit Services department while providing an open avenue of communication between the external auditors, the internal auditors, management and the Board; and
- (e) Monitor the management of risk by the Company generally.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities and it has direct access to the external auditors as well as anyone in the organization. The Audit Committee has the authority to retain, at the Company's expense, special legal, accounting and other consultants or experts it deems necessary in the performance of its duties.

## **2. Audit Committee Composition and Meetings**

All members of the Audit Committee must be Independent Directors.

All Audit Committee members must be financially literate with the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements. At least one Audit Committee member should have accounting or related financial expertise, including:

- an understanding of financial statements and accounting principles used by the Company to prepare its financial statements;
- the ability to assess the general application of such accounting principles in connection with accounting for estimates, accruals and reserves;
- experience preparing, auditing, analyzing or evaluating financial statements, or experience supervising the preparation, audit, analysis or evaluation of financial statements, that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements;
- an understanding of internal controls and procedures for financial reporting; and
- an understanding of audit committee functions.

A Chair shall be appointed by the Board annually from among the members of the Audit Committee.

The Audit Committee shall schedule regular meetings and shall meet at least four times annually, or more frequently as deemed necessary by the Chair. The Chair shall prepare and/or approve an agenda in advance of each meeting. The Audit Committee shall meet privately at least annually with management, the director of the Internal Audit department and the external auditors to discuss any matters that the Audit Committee or each of these groups believe should be discussed.

The Chief Executive Officer, the Chief Financial Officer, the manager of the Internal Audit department ("the Internal Auditor") and the external auditors shall be given notice of, and have the right to appear before and to be heard at, every meeting of the Audit Committee, and shall appear before the Audit Committee when requested to do so by the Committee.

## **3. Primary Duties and Responsibilities**

To fulfill its primary duties and responsibilities, the Audit Committee shall adhere to the following terms:

### **(a) Review and Reporting Procedures**

- (i) The Audit Committee is authorized to review and/or investigate any financial, internal control, or risk management related issue or activity of the Company. The Audit Committee shall report to the Board at its next regular meeting all such action it has taken since the previous report.
- (ii) The Audit Committee is authorized to request the presence, at any meeting, of a representative from the external auditors, senior management, internal audit, legal counsel or anyone else who could contribute to the subject of a meeting.
- (iii) The Audit Committee will review and reassess these Terms of Reference at least annually to determine whether revisions are necessary. The Audit Committee shall periodically self-assess its performance and effectiveness in fulfilling its role.

- (iv) Supporting schedules and information reviewed by the Committee will be available for examination by any director of the Audit Committee upon request to the Secretary of the Audit Committee.

**(b) Internal Controls and Risk Management Processes**

- (i) To assure itself that the Company has appropriate controls in place to achieve the following objectives:
- Effectiveness and efficiency of operations (including safeguarding of assets);
  - Reliability of internal and external reporting;
  - Compliance with applicable laws and regulations and internal policies.
- (ii) To ensure the Company has appropriate processes in place to manage the principal risks of its businesses, the Audit Committee shall:
- Consider and review internal processes for managing the principal risks of the Company's businesses, including a review of insurance coverage.
  - Obtain assurance from both management and the Internal Auditor regarding the adequacy of risk management processes.
  - Review with management, Internal Auditor and the external auditor:
    - The adequacy of the Company's internal controls including computerized information systems, controls and security.
    - Any related significant internal control findings and recommendations of the external auditor and/or Internal Auditor together with management's responses thereto.
    - The Company's compliance or adherence to debt covenants, terms or conditions.

**(c) Financial Reporting**

In order to satisfy itself that the Company's annual financial statements are fairly presented in accordance with generally accepted accounting principles ("GAAP") and in a form sufficient for the Audit Committee's recommendation for approval by the Board, and that the financial information contained in the Company's financial statements, Annual Report to Shareholders, Annual Information Form and other financial disclosure documents such as Management's Discussion and Analysis, is complete and accurate in all material respects, the Audit Committee shall:

- (i) General
- Review significant accounting and reporting issues, including recent professional and regulatory pronouncements, and understand their impact on the financial statements.
- (ii) Interim Financial Statements
- Review the Company's interim financial statements with management prior to their release or distribution. This review will include a detailed reporting of quarterly and year-to-date results, variance against budget and prior year and a discussion with the external auditor. Upon satisfactory completion of the review, the Audit Committee shall recommend to the Board approval of the financial statement release.
  - Review any significant proposed changes to the Company's accounting principles or policies, or financial reporting practices.

- Review the financial statement impact of any significant, unusual event or transaction.
- Review news releases containing financial information disclosure and Management's Discussion and Analysis.

(iii) Annual Financial Statements and Other Financial Information

- Obtain draft annual financial statements in advance of the Committee meeting and assess, on a preliminary basis, the reasonableness of the financial statements in light of the analyses provided by management.
- Review any material changes in accounting policies, GAAP, or financial reporting requirements that may affect the current year's financial statements.
- Obtain and review summaries of significant or unusual transactions, and other potentially complex matters whose treatment in the annual financial statements merits advance consideration.
- Review a summary provided by the Company's legal counsel of the status of any material pending or threatened litigation, claims and assessments.
- Review and discuss the annual financial statements and the external auditor's report thereon in detail with management and the external auditors.
- Through discussion with management, the Internal Auditor and the external auditors, obtain assurance that the risk of material misstatement of the financial statements is acceptably low.
- Review the financial information included in the Management's Discussion and Analysis, and consider whether the information is adequate and consistent with the Audit Committee members' knowledge of the Company.
- Review the tax status of the Company and understand the status of any related tax reserves, potential reassessments or other matters which could affect the annual financial statements.
- Review and assess the quality and appropriateness of the Company's accounting and reporting principles and policies.
- Provide to the Board a recommendation as to whether the annual financial statements should be approved.
- Review the news release announcing the annual financial results of the Company.
- Review the annual financial disclosure contained in the Annual Information Form.

(iv) Prospectus and Information Circular

- Review the financial information included in any prospectus or information circular prior to their release and, as appropriate, recommend to the Board whether such prospectus or information circular should be approved by the Board.

(d) **External Audit**

The external auditors are accountable to the Audit Committee and the Board as representatives of the shareholders.

In order to assure itself that the external audit function has been effectively carried out and that any matters that the external auditors consider appropriate to bring to the attention of the Board have been addressed, the

Audit Committee shall:

- (i) Recommend to the Board the selection (retention or replacement) of the external auditors, considering independence and effectiveness, and approve the fees and other compensation to be paid to the external auditors. On an annual basis, the Audit Committee should review and discuss with the external auditors all significant relationships its accountants have with the Company to confirm their independence. If there is a recommendation to change auditors, review all the issues to change and the steps planned for an orderly transition.
- (ii) Review the external auditor's Audit Plan and engagement letter with management and the external auditors, including audit scope and approach.
- (iii) Meet with the external auditor and management in separate private sessions to discuss any matters that the Audit Committee or these groups believe should be discussed privately with the Audit Committee.
- (iv) Review any non-audit services that have been rendered by the external auditor.
- (v) Review and assess the performance of the external auditor, including consideration of demonstrated external audit judgment and application and adherence to accounting policy and standards.
- (vi) Review the external auditor's policy on partner rotation.

(e) **Internal Audit**

In order to assure itself that the internal audit function has been effectively carried out and that any matter that the Internal Auditor considers appropriate to bring to the attention of the Board has been addressed, the Audit Committee shall:

- (i) Be advised of and concur with the appointment, replacement, reassignment or dismissal of the Internal Auditor and consider resource requirements.
- (ii) Review and approve Internal Audit Services Terms of Reference, including scope, organization structure and mandate.
- (iii) Confirm and assure the independence of the Internal Auditor.
- (iv) Review jointly with the Internal Auditor and the external auditor the coordination of audit effort to assure completeness of coverage, reduction of redundant efforts, and the effective use of audit resources.
- (v) Review with management and the Internal Auditor the annual Audit Plan and monitor any changes required in the scope of the plan.
- (vi) Meet with the Internal Auditor and management in separate private sessions to discuss any matters that the Audit Committee or these groups believe should be discussed privately with the Audit Committee.
- (vii) Review significant internal audit reports together with management's response and follow-up actions, including any problems or issues encountered in the course of an audit.
- (viii) Review and assess the performance of the Internal Auditor.

(f) **Finance**

The Audit Committee is authorized to review and approve for recommendation to the Board:

- (i) the Company's annual financing plan and any amendments thereto from time to time;

- (ii) any proposed financings;
- (iii) the method by which the Company measures financial results or performance.

#### **4. Other Duties**

##### **(a) Legal and Regulatory Compliance**

To provide assurance of Company compliance with all legal and regulatory requirements, the Audit Committee shall:

- (i) In areas in which it has oversight responsibility, monitor the Company's compliance and obtain management's assurance of compliance with applicable laws, regulations and internal policies in all jurisdictions where the Company does business. The Audit Committee will consider the financial statement implications of applicable laws and regulations, including the laws and regulations overseen by other Committees of the Board.
- (ii) Receive and review copies of legal letters provided to the external auditors by in-house and outside counsel regarding claims and possible claims against the Company.
- (iii) Make inquiries of management, the external auditors and Internal Auditor, to ensure that all material legal matters have been brought to the attention of the Audit Committee.
- (iv) On at least an annual basis, review with the Company's counsel any legal matters that could have a significant impact on the organization's financial statements or risk profile, the Company's compliance with applicable laws and regulations, and inquiries received from regulators or governmental agencies.
- (v) Ensure that all annual and interim financial statement filings are personally certified by the Chief Executive Officer and the Chief Financial Officer if and as required by applicable law.

##### **(b) Officer Expenses**

Review policies and procedures with respect to the Chairman of the Board and President and Chief Executive Officer's expense accounts and perquisites, including the use of corporate assets.

Periodically review major expenses incurred by the office of the Chairman of the Board and President and Chief Executive Officer.

##### **(c) Other Duties**

The Audit Committee will perform such other functions as assigned by law or regulation or as required by the Board.

The Audit Committee will receive reports from the Canfor Pulp Holding Inc. audit committee at such times that the Chairman considers appropriate, detailing such matters, issues and circumstances of a financial nature that may impact the Company or be of interest to the Audit Committee.



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