



CANFOR CORPORATION

2007 MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis (MD&A) provides a review of the significant developments that have impacted Canfor's performance during 2007 relative to 2006. Factors that could impact future operations are also discussed. These factors may be influenced by known and unknown risks and uncertainties that could cause the actual results to be materially different from those stated in this discussion. In addition to the risks and uncertainties discussed at the end of this MD&A, factors that could have a material impact on any future oriented statements made herein include, but are not limited to: general economic, market and business conditions; product selling prices; raw material and operating costs; foreign exchange rates; interest rates; changes in law and public policy; the outcome of trade disputes; and opportunities available to or pursued by Canfor.

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

The information in this report is as at February 22, 2008.

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

In this MD&A, Canfor Corporation and its subsidiaries are referred to collectively as "Canfor" or "the Company" unless the context requires otherwise.

OVERVIEW OF 2007

Declining lumber and panel prices and the high value of the Canadian dollar made 2007 a difficult year for the Company and the whole forest industry, despite increasing prices for pulp and kraft paper. The Company responded to the poor market conditions by curtailing production, announcing the partial and indefinite closures of several mills, and sharp reductions in staff costs.

SIGNIFICANT EVENTS

(from January 1, 2007 to February 22, 2008)

MACKENZIE SAWMILL RESTRUCTURING

On May 22, 2007 the Company announced that it would close its Mackenzie sawmill indefinitely once the remaining log inventory at the facility had been processed. The announcement was made as part of a broader cost management program. However, on July 27, 2007 the Company announced that, after working with its employees and unions to improve efficiency at the facility, and with the B.C. Provincial Government to reduce the mill's delivered log costs, it would continue to operate the Mackenzie mill under a modified shift schedule utilizing one of the plant's two production facilities. The decision resulted in the reduction of 150 million board feet of capacity and impacted approximately 130 employees.

PANEL AND FIBRE MILL PERMANENT CLOSURE

On November 9, 2007 the Company announced that it was permanently closing its Panel & Fibre mill effective January 8, 2008, after fibre inventories had been utilized and mill equipment decommissioned. The mill, located in New Westminster, BC employed 100 people and manufactured specialty products including hardwood panels, erosion control wood mulch and baled fibre.

SHIFT RESTRUCTURING AT FOUR MILLS

On November 28, 2007 the Company announced that due to continued poor lumber markets and the high Canadian dollar, it would reduce production from three shifts to two for an indefinite period of time at its Rustad, Clear Lake, Polar, and Mackenzie sawmills effective the last working day prior to Canfor's company-wide holiday curtailment. This resulted in approximately 355 million board feet of annual lumber production being eliminated and impacted approximately 300 employees who are indefinitely laid off.

DARLINGTON SAWMILL ACQUISITION

On November 30, 2007, Canfor completed the acquisition of the assets of Chesterfield Lumber Company, Inc. in Darlington, South Carolina ("Darlington mill"), at a cost of \$18.8 million including transaction costs. The sawmill has an annual capacity of approximately 140 million board feet of southern yellow pine lumber.

CHETWYND SAWMILL INDEFINITE CLOSURE

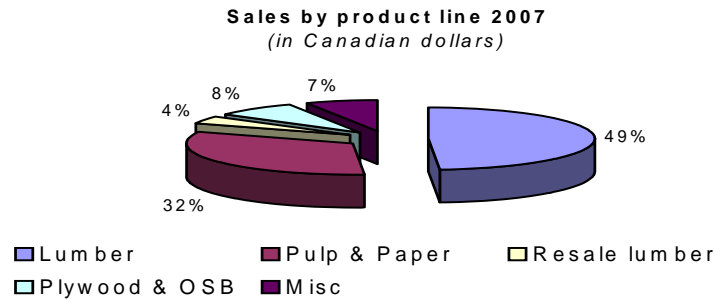
On December 5, 2007 the Company announced that owing to continued poor lumber markets and high Canadian dollar, it would be closing its Chetwynd sawmill indefinitely once existing log inventories had been utilized and finished products shipped. It is expected that by end of February 2008, approximately 164 employees will be impacted by the decision and indefinitely laid off. The mill has an annual capacity of 219 million board feet of production SPF lumber.

POLARBOARD AND TACKAMA MILLS INDEFINITE CLOSURE

On January 18, 2008 the Company announced that due to a high Canadian dollar and record low oriented strand board (OSB) prices, it would close indefinitely its PolarBoard OSB and Tackama plywood mills in Fort Nelson, BC, once existing log inventories are utilized and finished products shipped. This was expected to occur in April 2008 for the Tackama mill and during the summer of 2008 for the PolarBoard operation. Approximately 386 employees would be impacted by the decision. The Tackama mill has an annual capacity of 270 million square feet (3/8" basis) of plywood and the PolarBoard mill has an annual capacity of 640 million square feet (3/8" basis) of OSB production. However, on February 22, 2008, based on a number of cost reduction initiatives undertaken by the mill employees, logging contractors and the provincial government, the Company reconsidered its closure decision regarding the Tackama mill and recommenced winter logging activities.

CANFOR'S BUSINESS

Canfor is a leading integrated forest products company based in Vancouver, British Columbia (BC), with interests in 32 facilities in BC, Alberta, Quebec, Washington State and North and South Carolina. The Company is a major producer of softwood lumber in Canada, also producing OSB, plywood, remanufactured lumber products and specialized wood products. Canfor also owns a 50.2% interest in Canfor Pulp Limited Partnership (CPLP), which is one of the largest producers of northern bleached



softwood kraft (NBSK) pulp in Canada and a leading producer of high-performance kraft paper.

- TENURES**
- 11.4 million cubic metres of allowable annual cut (AAC) under forest tenures
 - 96% certified to the Canadian Standards Association, sustainable forest management standard and the ISO 14001 Standard.
- LUMBER**
- Primary lumber capacity of approximately 5.0 billion board feet
 - 19 sawmills in BC, Alberta, Quebec and North and South Carolina
- PANELS**
- Plywood capacity of 440 million square feet (MMsf) 3/8" basis at 2 plywood plants
 - OSB capacity of 640 MMsf 3/8" basis at Fort Nelson, BC
 - Peace Valley OSB joint venture will add a further 820 MMsf when fully ramped up (Canfor's share is 50%). The plant is anticipated to be capable of operating at its designed capacity in the second half of 2008.
- PULP**
- CPLP owns and operates three mills with annual capacity to produce over one million tonnes of northern softwood market kraft pulp, 90% of which is bleached to become NBSK pulp for sale to the market, and approximately 140,000 tonnes of kraft paper.
 - CPLP markets the pulp production of HSLP and the Taylor mill.

SELECTED ANNUAL INFORMATION ¹

(millions of dollars, except volumes and per share amounts)	2007	2006	2005
Sales volume – major products			
Lumber – millions of board feet	5,007.4	5,677.9	5,096.8
Plywood – millions of square feet, 3/8" basis	385.4	441.5	435.7
Oriented strand board – millions of square feet, 3/8" basis	669.9	722.6	469.3
Pulp – thousands of metric tonnes	1,228.9	1,206.1	1,189.1
Sales by segment			
Lumber	\$ 1,942.7	\$ 2,521.5	\$ 2,544.9
Panels	297.7	367.9	365.7
Pulp and Paper	1,035.2	952.9	876.5
Total sales	\$ 3,275.6	\$ 3,842.3	\$ 3,787.1
Operating income (loss)			
Lumber ²	\$ (301.2)	\$ 585.2	\$ 131.5
Panels	(76.5)	(53.3)	25.4
Pulp and Paper	137.2	141.9	22.2
Corporate and Other	(32.5)	(39.3)	(36.7)
Total operating income (loss)	(273.0)	634.5	142.4
Non-operating income (expense)			
Net interest income (expense) ²	(9.4)	56.2	(42.2)
Gain (loss) on derivative financial instruments	16.0	-	-
Foreign exchange gain on long-term debt and temporary investments	16.2	4.7	10.0
Asset impairments	(268.0)	(19.1)	-
Other income (expense) and unusual items	(11.1)	(10.5)	4.0
Total non-operating income (expense)	(256.3)	31.3	(28.2)
Net income (loss) from continuing operations before income taxes and non-controlling interests	(529.3)	665.8	114.2
Income tax (expense) recovery	234.1	(169.4)	(12.4)
Non-controlling interests	(65.4)	(20.7)	-
Net income (loss) from continuing operations	(360.6)	475.7	101.8
Net income (loss) from discontinued operations, net of taxes	-	(3.9)	(5.8)
Net income (loss)	\$ (360.6)	\$ 471.8	\$ 96.0
Total assets	\$ 3,510.6	\$ 4,679.2	\$ 3,830.5
Total long-term financial liabilities	\$ 481.6	\$ 602.8	\$ 544.5
Net income (loss) from continuing operations per common share			
Basic	\$ (2.53)	\$ 3.34	\$ 0.71
Diluted	\$ (2.53)	\$ 3.34	\$ 0.71
Net income (loss) per common share			
Basic	\$ (2.53)	\$ 3.31	\$ 0.67
Diluted	\$ (2.53)	\$ 3.31	\$ 0.67

2007 COMPARED TO 2006

¹ 2006 information reflects the operating results of New South Companies, Inc. from March 6, 2006. 100% of the results of CPLP are included, with an appropriate deduction, in 2006 and 2007, in the non-controlling interests line.

2007 was a difficult year. Declining lumber and panel prices and the increasing value of the Canadian dollar eroded margins. Lumber prices in Canadian dollars averaged 19% lower in 2007 than in 2006, and OSB prices declined by 30%, although plywood prices increased slightly. As a result of the poor pricing environment, curtailments were taken in the year, reducing production of lumber by 460 million board feet, OSB by 264 million square feet, and plywood by 8.5 million square feet.

In contrast strong pulp markets in 2007 resulted in a successful year for the pulp and paper segment. Pulp prices rose throughout the year, averaging 14% higher in 2007 than in 2006. However, improved pricing in US dollars was more than offset by the stronger Canadian dollar and higher fibre costs.

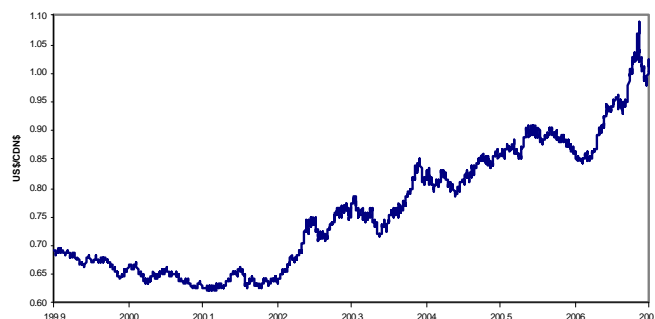
The Company recorded a loss of \$360.6 million in 2007, compared with net income of \$471.8 million in 2006. The 2007 results included an asset impairment charge of \$199.2 million after taxes, while 2006 results included \$551.2 million after taxes of softwood lumber duty refunds.

Exchange Rates and Prices:	2007	2006
Average value of the Canadian dollar against the US dollar	\$ 0.930	\$ 0.882
Year-end closing value of the Canadian dollar against the US dollar	\$ 1.012	\$ 0.858
Average SPF 2x4 Random Lengths #2 & Better lumber price in US dollars	\$ 250	\$ 295
Average SPF lumber price expressed in Canadian dollars *	\$ 269	\$ 334
Average SYP 2x4 #2 lumber price in US dollars	\$ 280	\$ 348
Average SYP lumber price in Cdn dollars	\$ 301	\$ 395
Average Canadian plywood price, delivered to Toronto, in Cdn dollars	\$ 376	\$ 367
Average OSB price, North Central, in US dollars	\$ 161	\$ 217
Average OSB price expressed in Canadian dollars *	\$ 173	\$ 246
Average NBSK pulp list price delivered to the U.S.A. in US dollars	\$ 823	\$ 721
Average NBSK pulp list price expressed in Canadian dollars *	\$ 885	\$ 817

* at the average value of the Canadian dollar for the year, as noted above

The majority of Canfor's sales are denominated in U.S. dollars and, as a result the strengthening of the Canadian dollar has significantly reduced revenues and net income. In 2007, the Canadian dollar averaged US \$0.93 or 5% higher than in 2006.

US\$/CDN\$ Average Exchange Rates



Source: Bank of Canada

² 2006 operating income includes the countervailing and anti-dumping duty refund (\$717.7 million) and net interest income includes the associated interest income (\$97.7 million).

SELECTED QUARTERLY FINANCIAL INFORMATION

	Q4 2007	Q3 2007	Q2 2007	Q1 2007	Q4 2006	Q3 2006	Q2 2006	Q1 2006
Sales and Income (millions of dollars)								
Sales	\$ 711.0	\$ 837.4	\$ 876.6	\$ 850.6	\$ 892.0	\$ 927.7	\$1,059.9	\$ 962.7
Operating income (loss)	\$ (124.7)	\$ (52.1)	\$ (38.4)	\$ (57.8)	\$ 656.1	\$ (44.8)	\$ (15.3)	\$ 38.5
Net income (loss) from continuing operations	\$ (237.0)	\$ (42.1)	\$ (38.8)	\$ (42.7)	\$ 466.9	\$ (51.6)	\$ 39.2	\$ 21.2
Net income (loss)	\$ (237.0)	\$ (42.1)	\$ (38.8)	\$ (42.7)	\$ 465.3	\$ (51.6)	\$ 39.2	\$ 18.9
Per common share (dollars)								
Net income (loss) from continuing operations								
Basic	\$ (1.66)	\$ (0.30)	\$ (0.27)	\$ (0.30)	\$ 3.28	\$ (0.36)	\$ 0.28	\$ 0.15
Diluted	\$ (1.66)	\$ (0.30)	\$ (0.27)	\$ (0.30)	\$ 3.27	\$ (0.36)	\$ 0.28	\$ 0.15
Net income (loss)								
Basic	\$ (1.66)	\$ (0.30)	\$ (0.27)	\$ (0.30)	\$ 3.26	\$ (0.36)	\$ 0.28	\$ 0.13
Diluted	\$ (1.66)	\$ (0.30)	\$ (0.27)	\$ (0.30)	\$ 3.26	\$ (0.36)	\$ 0.28	\$ 0.13
Statistics								
Lumber shipments (MMfbm)	1,149	1,301	1,345	1,213	1,352	1,416	1,597	1,313
Plywood shipments (MMsf 3/8")	90	90	119	87	110	103	118	110
OSB shipments (MMsf 3/8")	166	162	168	174	184	193	188	157
Pulp shipments (000 mt)	308	307	309	304	292	308	293	313
Average exchange rate (US\$/Cdn\$)								
	\$1.019	\$ 0.957	\$ 0.911	\$ 0.854	\$0.878	\$ 0.892	\$ 0.891	\$ 0.866
Average Western SPF 2x4 #2&Btr lumber price (US \$)								
	\$ 230	\$ 260	\$ 258	\$ 253	\$ 245	\$ 278	\$ 316	\$ 343
Average SYP (East) 2x4 #2 lumber price (US \$)								
	\$ 277	\$ 273	\$ 292	\$ 279	\$ 272	\$ 304	\$ 380	\$ 435
Average plywood price—Toronto (Cdn \$)								
	\$ 374	\$ 394	\$ 357	\$ 379	\$ 366	\$ 364	\$ 360	\$ 375
Average OSB price—North Central (US \$)								
	\$ 165	\$ 177	\$ 156	\$ 145	\$ 166	\$ 181	\$ 238	\$ 285
Average NBSK pulp list price delivered to the U.S.A. (US\$)								
	\$ 857	\$ 837	\$ 810	\$ 790	\$ 770	\$ 757	\$ 705	\$ 653

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

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

(millions of dollars, after tax and non-controlling interests)	Q4 2007	Q3 2007	Q2 2007	Q1 2007	Q4 2006	Q3 2006	Q2 2006	Q1 2006
Foreign exchange gain (loss) on long-term debt and temporary investments	\$(3.5)	\$5.1	\$10.2	\$(5.3)	\$(9.9)	\$(5.6)	\$20.2	\$(0.8)
Gain (loss) on derivative financial instruments	3.5	6.9	(3.7)	4.9	-	-	-	-
Duty refund and interest ³	-	2.0	-	1.4	551.2	-	-	-
Mill closure and severance costs	(14.2)	(7.3)	(5.8)	-	(4.3)	-	-	-
CEO remuneration on resignation	-	-	-	(3.0)	-	-	-	-
Insurance deductible on fire at PolarBoard OSB plant	-	-	-	-	-	-	(1.4)	-
Corporate development costs related to segregation of pulp and paper business	-	-	-	-	-	-	(2.4)	-
Spinout costs incurred directly by CPLP	-	-	-	-	-	(3.1)	-	-
Change in accounting practice for pulp maintenance costs	-	-	-	-	-	-	2.6	-
Adjustment to prior period's incentive costs	1.5	-	2.3	-	-	-	-	1.1
Corporate income tax rate reductions	35.8	0.9	1.0	-	-	-	43.9	-
Asset impairments	(189.1)	(6.0)	-	(4.1)	(16.2)	-	-	-
Accrual for environmental and related liabilities	(1.9)	-	-	-	-	-	-	-
Prior year tax reassessments and other tax adjustments	0.5	2.2	-	-	0.5	-	(1.0)	-
Dividend income	-	-	-	4.1	-	-	-	-
Net income (loss) from discontinued operations	-	-	-	-	(1.6)	-	-	(2.3)
Net favourable (unfavourable) impact on quarterly earnings	\$ (167.4)	\$ 3.8	\$4.0	\$ (2.0)	\$519.7	\$(8.7)	\$61.9	\$(2.0)

³ The refund of \$717.7 million before tax in 2006 was included in the Lumber segment's operating income and the interest income of \$97.7 million was offset against the interest expense line on the income statement.

Following the spinout of CPLP on July 1, 2006, Canfor is continuing to fully consolidate its results, however, a 20% non-controlling interest was recorded on the income statement beginning in the third quarter of 2006, and a further 29.8% from the end of November, 2006.

FOURTH QUARTER RESULTS

An operating loss of \$124.7 million and a net loss of \$237.0 million were recorded in the fourth quarter of 2007, compared with operating income of \$656.1 million and net income of \$465.3 million in the fourth quarter of 2006. Diluted loss per share was \$1.66 in the fourth quarter of 2007, compared with earnings per share of \$3.26 in the fourth quarter of 2006.

The fourth quarter 2007 results include an asset impairment charge of \$256.0 million (\$189.1 million after taxes). The fourth quarter 2006 results included the CVD and ADD refund of \$717.7 million and related interest income of \$97.7 million, which together amounted to \$551.2 million after tax.

The comparability of the fourth quarter results in 2007 and 2006 was also impacted by the strengthening of the Canadian dollar, which on average was 16% stronger in the fourth quarter of 2007 than in the same period in 2006, and weaker prices for lumber (6% lower), OSB (1% lower), partially offset by a 11% increase in pulp prices.

The fourth quarter results by business segment were as follows:

LUMBER

The Lumber segment reported an operating loss of \$99.5 million in the fourth quarter of 2007, compared to an operating loss of \$72.5 million in fourth quarter of 2006 excluding the duty refund of \$717.7 million. The primary reasons for the higher operating loss were lower prices and the higher Canadian dollar. As a result of the weak market conditions, a number of curtailments were taken in the quarter, primarily over the Christmas period. Production during the fourth quarter was to 866.8 million board feet of SPF lumber (2006 – 1,028.7) and 93.3 million fbm of SYP lumber (2006 – 92.4 million fbm).

A pre-tax impairment charge of \$90 million was recorded in the quarter for those sawmills where the carrying value of assets is not expected to be recoverable from net future cash flows.

PANELS

The Panels segment reported an operating loss of \$34.2 million in the fourth quarter of 2007, compared to an operating loss of \$26.5 million in the fourth quarter of 2006, mainly as a result of low OSB prices. The fourth quarter of 2007 includes restructuring costs of \$14.4 million related to the permanent closure of the Panel and Fibre operation.

OSB production was 167.6 million square feet in the fourth quarter of 2007, compared with 184.8 million square feet in the fourth quarter of 2006.

Plywood production was 93.1 million square feet in the fourth quarter of 2007, as compared with 105.7 million square feet in the fourth quarter of 2006.

Reduced production of both OSB and plywood resulted mainly from increased curtailments over the Christmas period when compared with the previous year. A pre-tax impairment charge of \$141 million was recorded in the quarter for those panelboard operations where the carrying value of assets is not expected to be recoverable from net future cash flows.

PULP AND PAPER

The Pulp and Paper segment earned operating income of \$12.9 million in the quarter, compared to operating income of \$50.1 million in the fourth quarter of 2006, mainly as a result of the stronger Canadian dollar . Pulp production of 313,200 tonnes was 1% higher in the fourth quarter of 2007 than in the fourth quarter of 2006.

CORPORATE COSTS

Corporate costs were \$3.9 million in the fourth quarter of 2007, compared to \$12.7 million in the fourth quarter of 2006. The fourth quarter 2006 expense included additional severance costs related to the integration of Slocan and Canfor, and incentive compensation costs.

NON-OPERATING ITEMS

Net interest expense of \$4.3 million was recorded in the fourth quarter of 2007, compared with net interest income of \$88.6 million in the fourth quarter of 2006. The 2006 quarter included interest income of \$97.7 million on the softwood lumber duty refund.

A write-down of \$10.6 million in the fair value of investments in asset-backed commercial paper (ABCP) was recorded in the fourth quarter. This was in addition to the amount recorded in the third quarter, with the result that a total provision of 20% of the face value of the investments will have been recorded. This impairment charge is based on current estimates and is subject to change.

EBITDA RECONCILIATION

The following table reconciles the Company's net income (loss) from continuing operations, as reported in accordance with GAAP, to EBITDA:

(millions of dollars, except for per share amounts)	Q4 2007	Year 2007	Q4 2006	Year 2006
Net income (loss) from continuing operations	\$ (237.0)	\$ (360.6)	\$ 466.9	\$ 475.7
Add (subtract):				
Non-controlling interests	6.1	65.4	12.3	20.7
Income tax (recovery) expense	(155.3)	(234.1)	232.7	169.4
Other (income) expense	3.3	11.1	1.7	10.5
Asset Impairment	256.0	268.0	19.1	19.1
Gain (loss) on derivative financial instruments	(6.2)	(16.0)	-	-
Foreign exchange (gain) loss on long-term debt and temporary investments	4.1	(16.2)	12.0	(4.7)
Interest (income) expense	4.3	9.4	(88.6)	(56.2)
Amortization	47.2	184.1	47.5	182.6
EBITDA (operating income before amortization)	(77.5)	(88.9)	703.6	817.1
Countervailing and anti-dumping duty refund	-	-	(717.7)	(717.7)
EBITDA excluding duty refund	\$ (77.5)	\$ (88.9)	\$ (14.1)	\$ 99.4

2007 RESULTS BY BUSINESS SEGMENT

The following discussion of Canfor's operating results relates to the operating segments and the non-segmented items as per the Segmented Information note in the Company's Financial Statements. Canfor's operations include the following three operating segments: Lumber, Panels and Pulp and Paper.

LUMBER

The segment consists of logging and forestry operations, which manage approximately 11.4 million cubic metres of allowable annual cut in northern British Columbia, northern Alberta and Quebec in 2007, and operate 13 sawmills in British Columbia, one in Alberta, one in Quebec, three in South Carolina and one in North Carolina. The combined lumber production capacity of these sawmills is approximately 5 billion board feet. Other operations include two lumber remanufacturing facilities, one in British Columbia and one in Washington State, a whole-log chipping plant and a finger-joint mill. The South Carolina operations include two lumber treating plants, a finger joint plant, and a trucking division. The segment also includes Canfor's wood products marketing division, located in Vancouver. Also included is Canfor's 60% interest in the Houston Pellet Plant, which commenced operations late in 2006 and has an annual capacity of 150,000 tonnes of wood pellets.

Summarized results for the Lumber segment for 2007 and 2006 are as follows:

(millions of dollars)	2007	2006 ⁴
Sales	\$ 1,942.7	\$ 2,521.5
Countervailing/anti-dumping duties & export tax expensed	\$ 101.8	\$ 109.7
Countervailing/anti-dumping duties refunded	\$ -	\$ 717.7
Operating income (loss)	\$ (301.2)	\$ 585.2
EBITDA	\$ (198.4)	\$ 686.2
EBITDA before duty refund	\$ (198.4)	\$ (31.5)
EBITDA margin before duty refund	(10)%	(1)%
Capital expenditures	\$ 47.6	\$ 76.9
Lumber shipments (millions of board feet)		
Canfor produced SPF	4,234	4,432
Canfor produced SYP	449	381
Other producers (SPF and SYP)	325	865
Lumber production (millions of board feet)		
SPF	4,112	4,460
SYP	389	341
Average SPF 2x4 #2 & Better lumber price in US \$ ⁵	\$ 250	\$ 295
Average SPF price expressed in Cdn \$	\$ 269	\$ 334
Average SPF composite price in US \$ ⁵	\$ 283	\$ 326
Average SYP 2x4 #2 lumber price in US \$ ⁶	\$ 280	\$ 348
Average SYP price expressed in Cdn \$	\$ 301	\$ 395

⁴ Includes the results of New South from March 6, 2006.

⁵ Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)

⁶ Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)

The segment's operating income before duty refund fell \$169 million from 2006. Driven largely by the drop in U.S. housing starts, SPF lumber experienced a 15% drop in average US\$ 2x4 price. This, in combination with a 5% rise in the Canadian dollar relative to the US dollar from 2006, accounted for over \$218 million in unfavorable earnings change from the prior year.

In May, the company undertook a cost reduction strategy that provided the bulk of the initiatives taken to offset these extreme market and exchange conditions. These actions included organizational restructuring, fixed cost reductions, working capital reductions and short-term mill curtailments. Also announced in the fourth quarter was a proportional response to both observed and forecast US Housing start reductions, which included reduced shift configuration at several sawmills and the indefinite closure of the Chetwynd sawmill. The resulting one-time restructuring costs related to the cost reduction initiatives, severance costs and Chetwynd closure were \$21.7 million, and are reflected in fourth quarter results.

SOFTWOOD LUMBER AGREEMENT (SLA) & RETURN OF DUTY DEPOSITS

Effective October 12, 2006, the governments of Canada and the United States implemented an agreement for the settlement of the softwood lumber dispute, which began in May 2002. The Softwood Lumber Agreement (SLA), which received formal approval by the Canadian Parliament on December 14, 2006, has a term of seven years and provides for an extension of two years. Either government can give notice to terminate the SLA after 18 months, with a six month notice period. If the US terminates the agreement the SLA calls for a 12 month standstill period after termination before a new countervailing duty case could be launched.

Under the terms of the SLA, the US Department of Commerce revoked all existing antidumping (ADD) and countervailing (CVD) duty orders on softwood lumber shipped to the US from Canada. Approximately 81% of deposits paid, together with accumulated interest, were returned to Canadian lumber producers. The remaining 19% (US \$1 billion) was retained by the US government for distribution to the US forest industry petitioners and for use in funding "meritorious activities" such as disaster relief, the promotion of sustainable forestry management and low income housing. Approximately US \$40 million is being utilized for a joint US/Canada committee designed to strengthen and build the North American forest products market.

NEW EXPORT TAX STRUCTURE UNDER THE SLA

The SLA requires that, effective October 12, 2006, an export tax on lumber shipped to the US be collected by the government of Canada and returned to the province of origin of the lumber. The Province of BC had the right to choose between an export charge only (Option A) or a lower export charge with a quota (Option B) for each of the BC Coast and BC Interior regions. The Province of BC chose Option A for both the BC Coast and the BC Interior and will have the opportunity to change options on January 1, 2010 and January 1, 2013.

The export tax rate is determined monthly, and is based on the "Random Lengths Framing Lumber Composite Price" as follows:

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

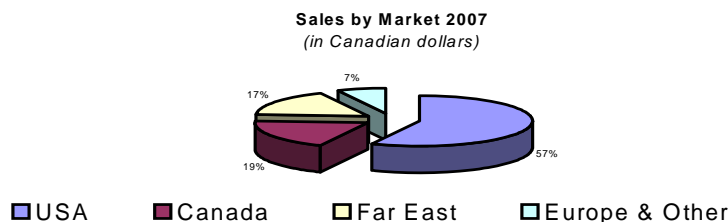
The SLA also includes a "Surge Mechanism", which increases the export tax rate for the month by 50% when the monthly volume of exports from a region exceeds a certain "Trigger Volume" as defined in the SLA. The U.S. Coalition for Fair Lumber Imports has alleged that the U.S. consumption figures that are

used in calculating the allowable exports in a month, should not be the estimated or expected consumption but should be the actual consumption based on a 12-month rolling average. Canada maintains that the U.S. is wrongly interpreting the point at which the surge clause is triggered. Under the terms of the agreement, the U.S. has requested binding arbitration and the issue is now before the London Court of International Arbitration. Three European panelists held a hearing in December 2007. The panel plans to issue its decision, which cannot be appealed, during the first quarter of 2008. Although the Government of Canada is committed to defending its position, there is some potential that Canfor will have an additional cumulative export tax liability to December 31, 2007 of approximately \$16 million.

With the exception of Daaquam, which, as a border mill, benefits from tax-exempt status under the SLA, Canfor's exports to the US have been subject to the highest export tax bracket of 15% (with no applicable surge increase) since the agreement began as a result of the current low composite pricing levels. Canfor expensed export taxes of \$101.8 million in 2007 and \$22.0 million in 2006, subsequent to the implementation of the SLA.

MARKETS

Canfor markets lumber products throughout North America as well as overseas. In addition to its own products, Canfor also markets lumber products from independent mills and offshore countries to complement its product line. In 2007, approximately 70% of Canfor's lumber sales were in the U.S., compared to 78% in 2006, while 19% was sold to Canadian markets. The remaining 11% was sold to offshore markets, predominantly Japan and China. Other offshore markets consisted of Taiwan, Korea, Europe, and the Middle East. Canfor increased its Canadian sales by 32% from 2007 over 2006, and its offshore sales by 15%. Offshore modes of transportation consisted of 85% by container ship and 15% by breakbulk vessel.



Canfor's total lumber sales for 2007 were 4,682 million fbm, down 3% from 2006's total sales. Included in the total was 449 million fbm of Southern Yellow Pine. The remaining 90% was SPF lumber.

Lumber markets continued to erode from 2006 as housing starts steadily decreased throughout 2007. Total US housing starts were 1.3 million units in 2007⁷. This is a 28% decrease from the 2006 total of 1.8 million units. By the end of November 2007, the inventory of new and used homes available for sale in the US market was 10 months, double the normal average inventory over the past two decades⁸. These inventory levels resulted from mortgages being reset, causing a significant increase in foreclosures. The tightening of mortgage lending standards, combined with high home prices dramatically increased the supply of unsold homes in the market.

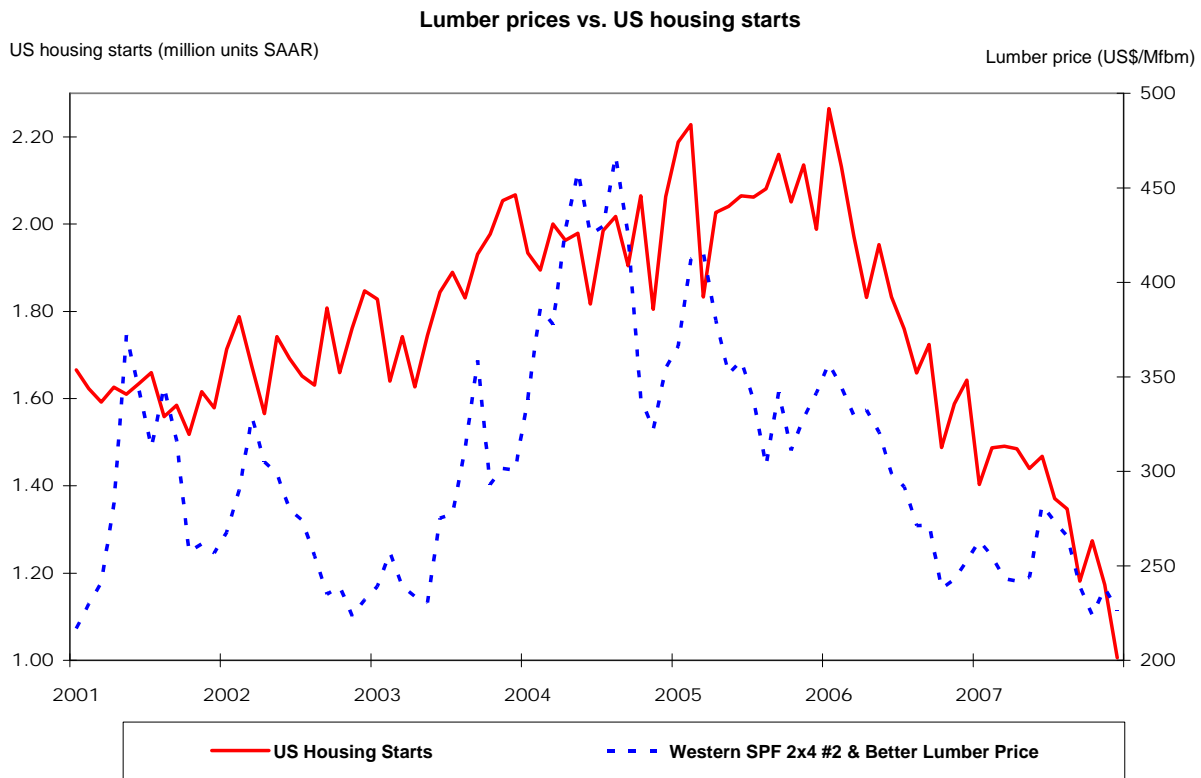
⁷ US Bureau of the Census

⁸ NAR – National Association of Realtors

The Canadian housing market remained fairly strong during 2007. Total Canadian housing starts were 228,343 units⁹ up slightly from the 2006 total of 227,395 units.

The U.S. Repair and Remodeling¹⁰ sector declined slightly in 2007 compared to the previous year. The decline in existing home sales during 2007 resulted in fewer expenditures in this sector, particularly during the second half of the year. Canfor's sales to Home Centre customers were equivalent to the level of sales in 2006 to these customers.

The price of SPF lumber steadily declined throughout 2007. The yearly average of 2x4 #2 Btr was US \$250 per Mfbm, a 15% decline from the level recorded in 2006. The average price of Southern Yellow Pine 2x4 East was US \$280 per Mfbm, down 20% from the 2006 level of US \$348 per Mfbm.



Offshore lumber sales for 2007 varied by geographic market. Total offshore sales were 500 million fbm, a record for Canfor and 16% higher than offshore sales in 2006.

⁹ CMHC

¹⁰ RISI

Sales to Japan stalled during the third quarter as a result of a revision to the Building Standards Law that took effect on June 20, 2007. This law resulted in new housing permits taking a much longer time to be reviewed and approved, particularly during the third quarter when total starts declined 34% over the second quarter of 2007. Total Japanese housing starts for 2007 were 1.061 million, a decline of 18% over 2006. Western style 2x4 housing starts totaled 99,000, a decline of 7% over the level reached in 2006. In response to reduced market demand Canfor's sales to Japan for 2007 were down 15% from 2006.

OPERATING PERFORMANCE

Despite positive trends in productivity and efficiency, SPF lumber production was down 8% from the prior year as a result of market curtailments, affecting the majority of our facilities and totaling 460 million fbm in 2007.

Sawmills realized gains in both cost and operational efficiency during the year despite the challenges posed by market-related curtailments and reduced log quality. In addition to normal market-driven reduction in stumpage, a focus on cost reduction lowered cash conversion costs. Lumber recovery was also improved as a better understanding of the processes and technology required to manage drier logs was gained.

The New South operations produced 389 million fbm of SYP in 2007. Production from the Darlington, SC sawmill has been included from November 30, 2007, the date of purchase.

The increase in SYP production over 2006 reflects a full year of reported production for the New South facilities in 2007, acquired in March 2006 as well as the addition of the Darlington sawmill in the fourth quarter of 2007.

During the fourth quarter the company announced the indefinite closure of its Chetwynd sawmill due to market conditions. The closure will take effect in the first quarter of 2008 once all log inventories have been depleted. The facility has an annual capacity of 219 million fbm of lumber.

Capital expenditures in the segment for the year were \$48 million compared to \$77 million in 2006. Major expenditures incurred in 2007 were for the acquisition of the Darlington mill in South Carolina, upgrades to our Graham facility in North Carolina and completion of the Houston energy system.

PANELS

The Panels segment includes two plywood plants, one in Prince George and one in Fort Nelson, British Columbia, with a combined annual production capacity of 440 million square feet (3/8" basis). The segment also includes an OSB facility, PolarBoard, located in Fort Nelson, with an annual production capacity of 640 million square feet (3/8" basis) of OSB and Peace Valley OSB in Fort St. John, B.C. which is jointly owned with Louisiana Pacific Corporation, and has an annual capacity of 820 million square feet (3/8" basis) of OSB, of which Canfor's share is 50%.

In January 2008 the Company announced the indefinite closure of the PolarBoard OSB mill which is expected to occur during the summer.

Summarized results for the Panels segment for 2007 and 2006 are as follows:

(millions of dollars)	2007	2006
Sales	\$ 297.7	\$ 367.9
Operating income (loss)	\$ (76.5)	\$ (53.3)
EBITDA	\$ (53.5)	\$ (27.3)
EBITDA margin	(18)%	(7)%
Capital expenditures	\$ 15.7	\$ 11.0
Plywood shipments (millions of square feet – 3/8" basis)	385	442
Plywood production (millions of square feet – 3/8" basis)	385	439
OSB shipments (millions of square feet – 3/8" basis)	670	723
OSB production (millions of square feet – 3/8" basis)	673	734
Average plywood price – Cdn \$ ¹¹	\$ 376	\$ 367
Average OSB price – US \$ ¹²	\$ 161	\$ 217
Average OSB price expressed in Canadian dollars	\$ 173	\$ 246

Operating income in the Panels segment declined by \$23.2 million in 2007, primarily as a result of the sharp decline in OSB prices, combined with the impact of the strengthened Canadian dollar.

MARKETS

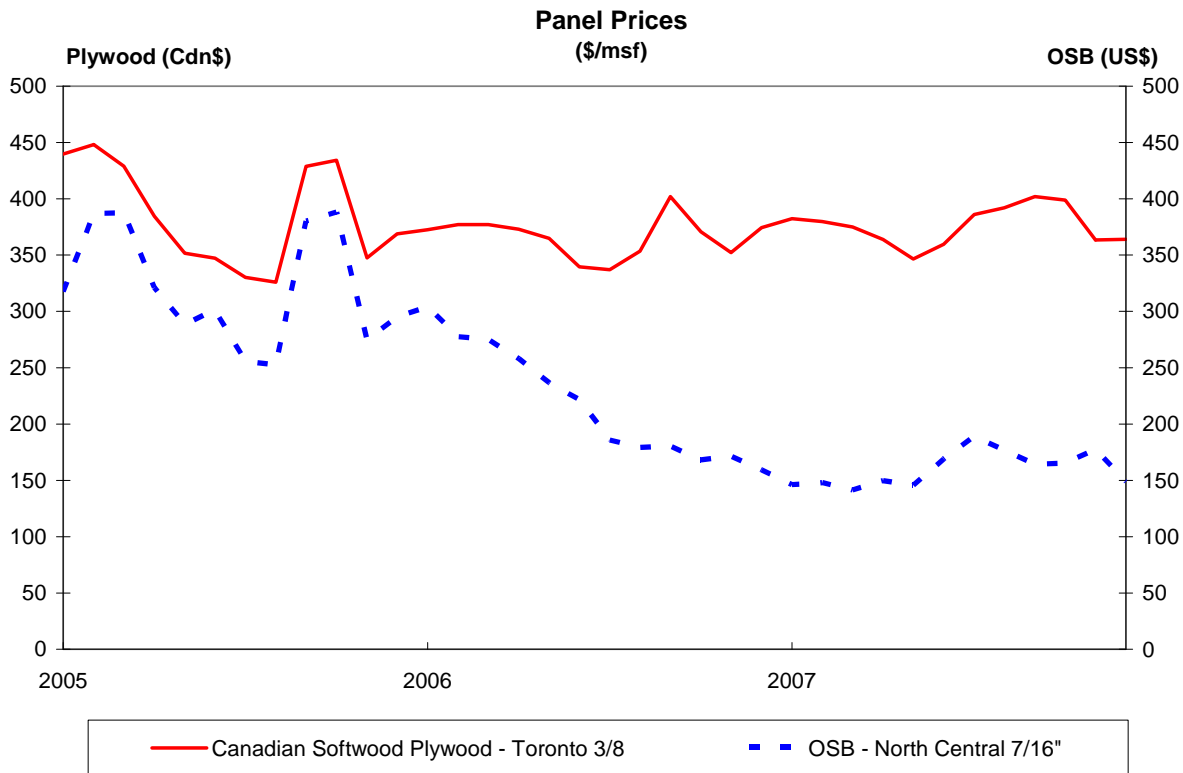
The OSB that Canfor produces is largely performance rated sheathing, used in wall construction of new homes and in Repair and Remodeling projects. Canfor's plywood is primarily sheathing, used to frame walls in new homes. The majority of Canfor's OSB sales are to the US market. Canada is the largest market for Canfor's plywood. Virtually all panel products destined for North American markets were shipped either by rail or truck.

The North American structural panel market was affected by the same factors as the lumber market. The huge reduction in US housing starts dramatically affected OSB prices, particularly during the second half of the year. Considerable new OSB capacity has started up in the past three years and although there was significant mill curtailment during the second half of 2007, there was still surplus supply on the market. As a result, the 2007 price of OSB averaged US \$161 per Msf, 7/16" North Central, 26% below the US \$217 per Msf experienced in 2006.

In contrast to OSB prices, Canadian plywood prices held up remarkably well in 2007, supported by the strong Canadian housing construction market. The average 2007 CSP price was \$376 per Msf for 3/8" delivered Toronto, up slightly from the \$367 experienced in 2006.

¹¹ Canadian softwood plywood, per Msf 3/8" basis, delivered to Toronto (Source – C.C. Crowe Publications, Inc.)

¹² Oriented strand board, per Msf 7/16" North Central (Source – Random Lengths Publications, Inc.)



OSB shipments totaled 670 million square feet in 2007, compared with 723 million square feet shipped in 2006. However, there were significant gains in OSB sales to the Home Centre segment. Nearly two thirds of Canfor's production is sold directly to the Pro Dealer, Home Centre and Industrial segments. The remainder is sold through wholesale distribution.

Plywood shipments were 385 million square feet in 2007, down from 442 million square feet in 2006. The proportion of sales to direct customers, as opposed through wholesalers, continued to climb in 2007.

OPERATING PERFORMANCE

The segment's operating income fell \$23 million from 2006, mainly in OSB where average Canadian dollar realized prices dropped by 30%.

PLYWOOD – Total volume was down from 2006 levels as a result of modified shifting at Tackama. Better pricing levels combined with productivity gains contributed to a 15% improvement in plywood earnings over the prior year.

The difficult market conditions led to the decision to reduce working hours at both the Tackama plywood and PolarBoard OSB facilities in Fort Nelson. Despite this, both facilities experienced gains in productivity and panel recovery. The Peace Valley Joint Venture performed at expected levels along its projected start-up curve.

OSB – Earnings were down 41%, primarily as a result of the ongoing decline in price. Despite ongoing improvements in productivity, total production of OSB was down as a result of both market-related downtime and a modified shifting schedule implemented at PolarBoard in the first quarter, which reduced operating hours by 40%. Offsetting the reduced hours was the ongoing progress achieved at the Peace Valley Joint Venture. The mill was operating at expected levels at the end of 2007 and is anticipated to be capable of operating at its designed production capacity in the second half of 2008.

Also included in the Panels segment is the Panel and Fibre operation, which produced hardboard, panelboard and erosion control products. In the fourth quarter of 2007, the Company announced the permanent closure of this facility, which resulted in a restructuring provision of \$14.4 million, consisting of severance, inventory disposal and closure related costs.

PULP AND PAPER

Canfor's Pulp and Paper segment is comprised of the Canfor Pulp Limited Partnership (CPLP) and the Taylor pulp mill. CPLP produces NBSK Pulp and Specialty Paper. NBSK is primarily a bleached product; however, unbleached and semi-bleached grades are also produced at the Prince George Pulp mill. All of the mills are located within five kilometres of each other in Prince George, British Columbia with the exception of Taylor, which is located near Fort St John, British Columbia. The pulp mills have the annual capacity to produce over one million tonnes of NBSK pulp. Over 200,000 tonnes of bleached chemi-thermo mechanical pulp (BCTMP) are produced at the Taylor mill. The paper machine, located at the Prince George Pulp and Paper mill, has the capacity, at optimum product mix levels, to produce 140 thousand tonnes of kraft paper. CPLP's pulp marketing division is located in Vancouver. All pulp produced by CPLP, Taylor and the Howe Sound Limited Partnership (discussed under Related Party Transactions) is sold by CPLP's sales and marketing group to customers primarily in North America, Europe and Asia. The kraft paper produced by CPLP is sold by a 50% owned general partnership to customers in North America and Europe.

COMPLETION OF SPINOUT OF THE PULP INCOME FUND

On July 1, 2006, Canfor completed the transfer of its Prince George NBSK pulp and paper business (the Pulp Business) to CPLP in exchange for a \$125 million promissory note, 14.254 million Class A Limited Partnership Units and 57.016 million Class B Exchangeable Limited Partnership Units (the Spinout). Canfor exchanged its Class A Limited Partnership Units for an equal number of Fund Units of Canfor Pulp Income Fund (CPIF). Upon the completion of the Spinout, the existing Common Shares of Canfor were cancelled and Canfor shareholders were entitled to receive one new Common Share of Canfor and 0.1 of a Fund Unit of CPIF, with the distribution of the Fund Units being structured as a return of capital on the Canfor Shares. As a result, on the date of the Spinout, Canfor Shareholders owned all of the issued and outstanding new Common Shares and all of the issued and outstanding Fund Units, with the outstanding Fund Units representing a 20% indirect interest in the Pulp Business.

On November 30, 2006, Canfor completed a distribution to its shareholders consisting of an in-kind taxable dividend of 1.49 Fund Units of CPIF for every 10 shares of Canfor Corporation held. Following this dividend, Canfor owned 35.494 million Class B Exchangeable Limited Partnership Units.

Through its interest in CPLP, which is indirectly exchangeable for Fund Units, Canfor retains a 50.2% interest in the Pulp Business and continues to consolidate CPLP in its financial statements, with a provision for non-controlling interests.

Summarized results of the Pulp and Paper segment for 2007 and 2006 are as follows:

(millions of dollars)	2007	2006
Sales	\$ 1,035.2	\$ 952.9
Operating income	\$ 137.2	\$ 141.9
EBITDA	\$ 190.5	\$ 190.7
EBITDA margin	18%	20%
Capital expenditures	\$ 24.2	\$ 18.2
Average NBSK pulp list price – delivered to USA (US\$ per tonne)	\$ 823	\$ 721
Average NBSK pulp list price expressed in Canadian dollars	\$ 885	\$ 817
Pulp shipments (thousands of tonnes)	1,229	1,206
Pulp production (thousands of tonnes)	1,245	1,210
Specialty Kraft paper shipments (thousands of tonnes)	130	128
Specialty Kraft paper production (thousands of tonnes)	132	129

Operating income of the Pulp and Paper segment decreased by \$4.7 million when compared to 2006 results. The impact of the stronger Canadian dollar and substantially higher fibre costs more than offset increased NBSK US\$ list prices and higher sales volumes for pulp. Pulp realized prices in Canadian dollar terms improved by 9% when compared to the prior year as a 14% improvement in NBSK list price was partially offset by the stronger Canadian dollar. The impact of the stronger Canadian dollar was approximately \$33 million when compared to the prior year. Shipments of NBSK market pulp increased by 21,000 tonnes when compared to the prior year. Fibre costs increased by 44% when compared to 2006, directly related to higher prices for sawmill residual chips and an increase in higher cost whole log chip volume. Realized prices for paper increased by 5% in Canadian dollar terms in 2007. Taylor's operating income improved by \$1.4 million year over year..

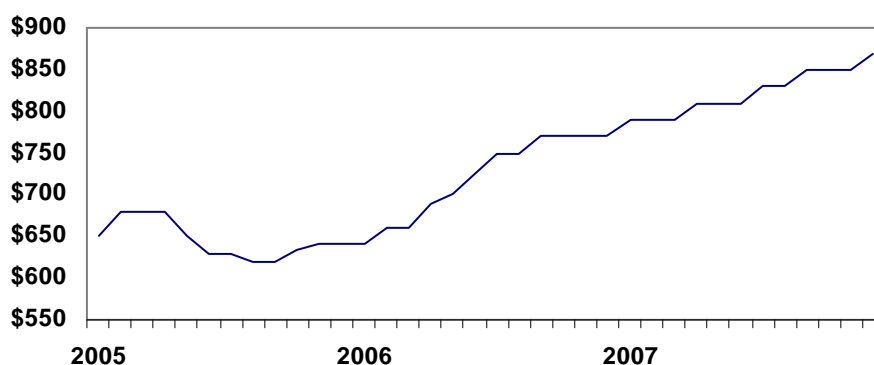
MARKETS

NBSK pulp market conditions during 2007 remained strong. The Pulp and Paper Products Council (PPPC) reported market pulp inventories (World 19 Producers) ended December at 29 days of supply for all grades. Softwood Kraft market pulp inventories were at 27 days of supply. Generally 30 days of supply of inventory is considered representative of a balanced market. Market pulp shipments for the year were up 3.4% for all grades, but only up 0.9% for softwood pulp. BCTMP also experienced strong markets.

There is still significant supply uncertainty for buyers of northern softwood Kraft market pulp. This is primarily due to the impact on Canadian and European producers of the cost and availability of fibre and the weakness of the US dollar. Canadian pulp mills that are reliant on residual woodchips from sawmills are facing supply issues due to the large amount of downtime in the sawmilling sector. In Europe producers also face fibre shortages and competition with biomass energy producers for wood chips.

Global demand for sack Kraft paper remained strong through the end of the year with continued upward price movement. Export markets show continued strength heading into 2008. The US market has been impacted by the slowdown in US housing starts with sack paper demand off by 6% during 2007. Offsetting the decrease in sack paper demand was reduced supply of paper imports from Europe as a result of eroding margins due to increased freight rates and the strengthening of the Euro relative to the US dollar.

NBSK Pulp Prices delivered to USA (US \$ per tonne)



OPERATING PERFORMANCE

In 2007 the pulp mills produced a record level of tonnes surpassing the previous record set in 2006 by 31,400 tonnes. The back to back production records for total tonnes in 2006 and 2007 represent an increase of 51,400 tonnes when compared to the old record set in 2004. Individual mill production records were achieved at the Northwood mill, 589,000 tonnes in 2007 versus 562,000 in 2006 and Prince George Pulp and Paper Mill, 280,000 tonnes in 2007 versus prior record of 279,000 set in 2000. A total of 30 days of scheduled maintenance downtime was taken at the pulp mill facilities, the same number of days as the prior year. Paper production improved by 2,500 tonnes. BCTMP production at the Taylor pulp mill was 200,000 tonnes in 2007 compared with 194,000 tonnes in 2006.

2008 OUTLOOK

The pricing environment is expected to remain very difficult for Canfor's solid wood products in 2008. Although U.S. demand for solid wood products in 2007 was much reduced from levels seen during 2006, Canfor's strategic customer base has proved to be fairly resilient during these times. Canfor will continue to focus efforts on cost control, improving productivity and in increasing penetration in the Canadian market and growing offshore markets.

LUMBER MARKETS

U.S. housing starts remain the key indicator for lumber and panel demand and we anticipate new starts in 2008 will be less than the total number of new homes constructed in 2007. While the inventory of both new and used homes remains at very high levels, it will likely take at least the first half of 2008 for house prices to decline and consumers to become more confident about purchasing these houses. Until that happens, new housing starts in the U.S. will continue to be low. Canadian housing starts are also predicted to decline from the level experienced in 2007, but the reduction should be modest. The Canadian economy is still relatively strong, interest rates are projected to decline and the environment for new housing is still positive.

Demand from the Repair and Remodeling sector is also expected to decline, although not to the same degree as from the new house construction sector. Repair and remodeling projects generally follow existing home sales and until that activity picks up, there will be fewer projects initiated.

Offshore markets, particularly in Asia, are projected to remain relatively strong in 2008. Demand for Western style 2x4 housing continues to grow in Japan and Korea. By the fourth quarter of 2007, housing permit registrations in Japan had increased, which bodes well for housing starts during the first part of 2008.

PANEL MARKETS

Panel markets are affected by the same factors as lumber markets. There is still a significant oversupply of OSB in North America as a result of new capacity and reduced demand from new U.S. house construction. As a result, prices are expected to remain at low levels during 2008. Canadian plywood markets are expected to remain at current levels.

PULP AND PAPER MARKETS

The demand and price for market pulp are expected to remain strong through the first half of 2008. The seasonal decline in demand in the December to February period is typically followed by a surge in demand in the spring. The U.S. election and the summer Olympics in China are expected to bolster demand for pulp throughout much of 2008. Furthermore, the supply of market pulp is curtailed each spring as mills in the northern hemisphere shut down for annual maintenance. Combined, these market dynamics are expected to keep the pulp market balanced and allow for flat or slightly higher prices over the first half of the year.

Heading into 2008, kraft paper price increases in the offshore, and to a lesser extent the North American markets are expected. A US\$50 per tonne increase is expected to be fully implemented by the end of the first quarter. Continued supply and demand balance for both white and brown grades leads to a favourable outlook for 2008.

2007 NON-SEGMENTED ITEMS

CORPORATE & OTHER COSTS

Corporate and other costs of \$32.5 million, which are comprised of corporate, head office and information technology costs, decreased by \$6.8 million in 2007 compared to 2006, as a result of an aggressive cost reduction program.

INTEREST INCOME (EXPENSE)

The \$9.4 million expense in 2007 is net of interest income of \$34.7 million. Long-term debt interest of \$44.1 million was expensed in 2007, \$5.7 million less than in 2006 as a result of principal reductions and the impact of the stronger Canadian dollar on US dollar interest payments. Interest income of \$32.5 million was earned on the cash deposits and other interest bearing investments resulting from the softwood lumber duty refunds received late in 2006. Net interest income of \$56.2 million in 2006 includes \$97.7 million in interest income related to the duty refunds.

GAIN ON DERIVATIVE FINANCIAL INSTRUMENTS

On January 1, 2007, Canfor adopted the Canadian Institute of Chartered Accountants' new standards for financial instruments, comprehensive income and hedging. Canfor elected not to apply hedge accounting to its derivative financial instruments that were outstanding at December 31, 2006. As a result, these derivatives, which were previously not recorded in the financial statements until they were exercised, were recorded at their fair value on January 1, 2007 as an adjustment to opening "Accumulated Other Comprehensive Income". The derivatives were revalued to fair market value at December 31, 2007, resulting in a gain of \$16.0 million being recorded for the year.

ASSET IMPAIRMENTS

2007 results include an asset impairment charge of \$268.0 million. See attached description under "CRITICAL ACCOUNTING ESTIMATES – Asset Impairments" on page 29.

OTHER INCOME (EXPENSE)

Other expenses amounted to \$11.1 million in 2007, compared to \$10.5 million in 2006. These expenses in 2007 relate mainly to gains and losses on translation of current asset and liability balances denominated in US dollars.

INCOME TAXES

An income tax recovery of \$234.1 million was recorded in 2007 (2006 – expense of \$(169.4) million).

This is comprised of a current income tax recovery totalling \$140.8 million and a future income tax recovery totalling \$93.3 million. The most significant factors contributing to the future income tax recovery are the tax impact of the asset impairment charge and impact of revaluing the future income tax liability balances for the reduction in federal corporate income tax rates enacted in 2007, which give rise to favourable adjustments totalling \$68.8 million and \$21.5 million, respectively.

Note 21 of the accompanying consolidated financial statements provides a reconciliation of the income tax recovery (expense) at the statutory income tax rate to the income tax recovery (expense) recorded on the income statement.

TRANSACTIONS WITH RELATED PARTIES

HOWE SOUND PULP AND PAPER LIMITED PARTNERSHIP (HSLP)

HSLP is jointly owned by Canfor and Oji Paper Co., Ltd and operates the Port Mellon kraft pulp and newsprint mill. Canfor no longer reflects its share of HSLP's results in its financial statements, as the investment was written off in 1998. As discussed under Discontinued Operations, the transfer of the Englewood logging operations and associated tenures to WFP in exchange for a long-term fibre supply agreement is resulting in lower fibre costs for HSLP, which, in conjunction with other marketing and debt restructuring, should assist the mill's efforts to return to sustainable profitability in the future.

On February 5, 2008, HSLP restructured its term bank debt pursuant to an agreement among HSLP, Canfor, Oji and a consortium of Japanese banks (the "Banks"). The restructuring resulted in a portion of the outstanding term bank debt being subordinated for repayment after June 30, 2013. The remaining debt and an unsecured amount of \$33.3 million owed to Canfor is due to be repaid prior to June 30, 2013 from the free cash flow of HSLP.

As a consequence of the restructuring, Canfor contributed additional funds to HSLP in 2007 of \$7.3 million and a further \$11.5 million on closing ("the New Funds"). These funds are secured by the assets of HSLP, subject to other security granted to the Banks and Oji. The repayment of the New Funds has priority to all other repayments, except a minimum debt repayment, from the annual free cash flow of HSLP.

At December 31, 2007, Canfor had an unsecured receivables balance outstanding with HSLP of \$26.1 million.

CPLP markets, on behalf of Canfor, the pulp production of HSLP, for which in 2007 it received commissions of \$2.9 million under the terms of its agency sales agreement¹³. At December 31, 2007, Canfor had prepaid \$36.0 million to HSLP in advance of the due date of receivables for pulp marketed, or to be marketed, and collected on its behalf. This agreement provides for Oji to prepay up to a maximum amount of \$60 million and Canfor up to a maximum of \$50 million, which is used as short-term operating funds by HSLP. Canfor charges HSLP a market rate of interest for the period of prepayment, which amounted to \$2.8 million in 2007 and the prepayment is covered by the assignment of current and future accounts receivable. In addition, Canfor has granted extended credit terms to HSLP up to a maximum of \$10 million.

In 2007 Canfor purchased \$18.8 million of pulp logs for resale to HSLP at Canfor's cost, to meet HSLP's future requirements. There was a balance outstanding of \$7.4 million at December 31, 2007 for these logs. Canfor charged HSLP a market rate of interest for this service

Under a long-term fibre agreement with WFP (discussed in Discontinued Operations), CFLP purchases chips for resale to HSLP, which amounted to \$15.8 million in 2007. There was a balance outstanding of \$15.8 million at December 31, 2007. CFLP charges HSLP a commission for this service. These amounts have been proportionately consolidated in Canfor's financial statements.

Canfor provides management, fibre supply and other services to HSLP at cost, for which it charged \$0.6 million in fees for 2007. There was a balance outstanding of \$0.4 million at December 31, 2007 with respect to these fees and other receivables.

LAKELAND AND WINTON GLOBAL

Canfor purchases pulp chips and lumber, at market value, from Lakeland Mills Ltd. and Winton Global Lumber Ltd., in which it holds a one-third equity interest. In 2007, Canfor purchased \$11.5 million in pulp chips and \$8.7 million in lumber from these mills. Canfor earned commission income of \$0.3 million on lumber sales in 2007.

KYAHWOOD FOREST PRODUCTS

In 2007, Kyahwood, a joint venture operated by Canfor and the Moricetown First Nation, provided remanufacturing services, at market value, to Canfor in the amount of \$4.2 million.

OTHER

Canfor holds a minority interest in Seaboard General Partnership, which provided shipping services to Canfor through Seaboard International Shipping Company amounting to \$5.3 million in 2007.

¹³ Following the Spinout, as of July 1, 2006, HSLP and Canfor have appointed CPLP as the sales representative for HSLP's pulp marketing activities. The figures quoted above reflect transactions before and after the Spinout.

SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's financial position as at the end of the years 2007 and 2006 and the cash flow related to the changes in financial position for those years.

(millions of dollars, except for ratios)	2007	2006
Net cash	\$ 295.5	\$ 1,023.8
Operating working capital	432.6	511.0
Current portion of long-term debt	(15.2)	(87.5)
Current portion of deferred reforestation	(34.4)	(39.6)
Income taxes recoverable (payable)	136.7	(235.4)
Net working capital	815.2	1,172.3
Long-term investments	170.4	115.3
Property, plant, equipment and timber	1,959.4	2,254.9
Goodwill	69.2	81.6
Deferred charges	90.0	91.8
Net assets	\$ 3,104.2	\$ 3,715.9
Long-term debt	\$ 481.6	\$ 602.8
Deferred reforestation obligation	65.6	70.9
Other long-term provisions and accruals	137.9	102.4
Future income taxes – net	299.5	415.4
Non-controlling interests	302.5	296.7
Common shareholders' equity	1,817.1	2,227.7
Total capitalization	\$ 3,104.2	\$ 3,715.9
Ratio of current assets to current liabilities	3.0 : 1	2.2 : 1
Ratio of net debt to capitalization ratio	10.0%	(25.9)%

Canfor's ratio of current assets to current liabilities, at 3.0:1 at the end of 2007, was slightly higher than the 2006 ratio of 2.2:1, mainly due to income taxes recoverable of \$136.7 million (compared to \$235.4 million income taxes payable in 2006).

Due to the duty refund received in late 2006, Canfor had cash in excess of its debt at the end of 2006, resulting in a negative net debt to capitalization ratio of 25.9% compared to a ratio of 10.0% at the end of 2007.

CHANGES IN FINANCIAL POSITION

(millions of dollars, except for ratios)	2007	2006
Cash generated from (used in)		
Operating activities	\$ (482.5)	\$ 1,140.2
Financing activities	(174.3)	(14.3)
Investing activities	(71.5)	(417.6)
Discontinued Operations	-	16.6
Increase (decrease) in cash and cash equivalents	\$ (728.3)	\$ 724.9

At the end of 2007, Canfor had \$295.5 million of cash and cash equivalents. The changes in the components of these cash flows during 2007 are discussed below:

OPERATING ACTIVITIES

In 2007, Canfor consumed cash from operations of \$482.5 million. In 2006 \$1,140.2 million was generated from operating activities driven by the receipt of duty refunds and an increase in accounts payable and accrued liabilities. The main reason for the change is a decrease in non-cash working capital, which generated a negative \$438.9 million of cash, compared to a cash generation of \$447.7 million in 2006. Operating earnings before amortization (EBITDA) duty refunds also decreased \$188.3 million.

In 2007, the major changes in non-cash working capital were a \$371.9 million decrease in income taxes payable, a \$274.9 million decrease in accounts payable, a \$166.8 million decrease in inventories, and a \$38.0 million increase in accounts receivable. The change in income taxes payable reflects the taxes payable on the duty refund and associated interest received in 2006. Current year income tax recoverable is \$136.7 million. The decrease in accounts payable is due to the payment of \$190.0 million for the special duty assessment accrual in 2006 and due to the timing of payments. The decrease in inventories is mainly as a result of the sawmill curtailments during the Christmas period and a conscious effort to reduce inventory at year end, while the increase in accounts receivable at year-end is primarily due to the effect of the weaker Canadian dollar on US dollar receivables.

FINANCING ACTIVITIES

In 2007, financing activities consumed \$174.3 million of cash, mainly comprised of scheduled long-term debt payments of \$99.4 million, \$1.1 million of net repayments on operating bank loans and \$74.2 million distributions paid by CPLP to non-controlling interests.

Long-term debt repayments in 2006 were \$100.2 million, and repayments on operating bank loans were \$23.0 million. A total distribution paid by CPLP to non-controlling interests in 2006 was \$17.6 million.

INVESTING ACTIVITIES

Cash used in investing activities amounted to \$71.5 million in 2007. The main cash outflows were relating to \$90.6 million of capital expenditures, \$16.8 million for the acquisition of Darlington sawmill (\$18.8 million less \$2.0 million unpaid at December 31, 2007). An increase in temporary investments of \$124.5 million was reduced by a requirement to transfer a portion of these investments (\$85.9 million) to the long-term category as they were non-bank asset-backed commercial paper (ABCP) which will have longer term maturities.

In 2006, cash used in investing activities amounted to \$417.6 million. The main cash outflows were \$206.1 million for the acquisition of New South, \$119.0 million for the purchase of short-term investments following the receipt of the duty refund, and capital expenditures of \$107.1 million. These outflows were partially offset by \$2.8 million from the sale of property, plant and equipment and the receipt of an \$11.4 million final incentive payment related to the electrical co-generation project at the Prince George pulp mill.

Of the \$90.6 million that Canfor invested in capital assets in 2007, \$40.8 million was to improve the Company's cost position, productivity and production capacity. The other \$49.8 million was to maintain the existing productive capacity of the operations or to ensure Canfor's safety and environmental performance. The largest investments in the year included the energy (\$9.8 million), pellet plant (\$2.9 million) and the two shift expansion (\$8.5 million) at the Graham sawmill in North Carolina.

Of the \$107.1 million that Canfor invested in capital assets in 2006, \$48.0 million was to improve the Company's cost position, productivity and production capacity. The other \$59.0 million was to maintain the existing productive capacity of the operations or to ensure Canfor's safety and environmental performance. The largest investments in the year included the energy (\$19.1 million), pellet plant (\$12.8 million) and planer (\$2.5 million) projects at the Houston operation, \$8.7 million for the Plateau project and \$2.3 million for Peace Valley OSB.

FINANCIAL REQUIREMENTS AND LIQUIDITY

At the end of 2007, Canfor had \$409.0 million of bank operating lines available, of which \$40.1 million were reserved for several standby letters of credit.

Provisions contained in Canfor's long-term borrowing agreements limit the amount of indebtedness that the Company may incur and the amount of dividends it may pay on its Common Shares. The amount of dividends the Company is permitted to pay under its long-term borrowing agreements is determined by reference to consolidated net earnings less certain restricted payments.

On January 31, 2007, Canfor paid US \$164.0 million to the government of Canada with respect to the special assessment arising from the duty refunds. Income tax payments of \$230.5 million relating to 2006 were made in 2007, and a refund of \$136.7 million relating to the 2007 taxation year is expected in 2008.

In 2008, Canfor plans to invest approximately \$85 million on capital projects, consisting of maintenance of business and improvement projects.

In 2008, \$15.2 million is required for scheduled long-term debt repayments.

Canfor intends to finance its planned capital expenditures and scheduled debt repayments from existing cash reserves.

The company did not enter into any new financing in 2007.

On November 30, 2006, CPLP completed a debt financing by private placement of US \$110 million of unsecured notes (the Notes). The Notes bear interest at 6.41% and are repayable in full on their maturity date of November 30, 2013. The proceeds from the issuance of the Notes were used to repay the \$125 million promissory note to Canfor. CPLP also entered into a 3-year \$75 million syndicated unsecured revolving bank credit facility (the Revolving Facility) with \$30.6 million of the Revolving Facility reserved for a standby letter of credit. The Revolving Facility bears interest and fees at rates that vary depending on the ratio of net debt to operating earnings before interest, taxes, depreciation and amortization and which may be based on lenders' Canadian prime rate, banker's acceptances, US base rate or US LIBOR rate.

On December 31, 2007, New South cancelled its US\$50 million line of credit.

The following table summarizes Canfor's financial contractual obligations at December 31, 2007 for each of the next five years and thereafter:

(Cdn \$ millions)	Total	2008	2009	2010	2011	2012	Thereafter
Long-term debt and capital lease obligations	\$ 496.8	\$ 15.2	\$ 136.1	\$ 31.9	\$ 81.4	\$ 49.4	\$ 182.8
Operating leases	\$ 64.8	\$ 27.1	\$ 18.7	\$ 10.6	\$ 4.4	\$ 2.3	\$ 1.7
	\$ 561.6	\$ 42.3	\$ 154.8	\$ 42.5	\$ 85.8	\$ 51.7	\$ 184.5

Other contractual obligations not included above are:

- Purchase obligations and contractual obligations in the normal course of business. For example, purchase obligations of a more substantial dollar amount generally relate to the pulp business and are subject to "force majeure" clauses. In these instances, actual volumes purchased may vary significantly from contracted amounts depending on Canfor's requirements in any given year.
- Deferred reforestation, for which a liability of \$100.0 million has been recorded at December 31, 2007 (2006 – \$110.5 million). The reforestation liability is a fluctuating obligation, based on the volume of timber harvested. The future cash outflows are a function of the actual costs of silviculture programs and of harvesting at the time and are based on, among other things, the location of the harvesting.
- Obligations to pay pension and other post-employment benefits, for which liability of \$114.0 has been recorded at December 31, 2007 (2006 - \$97.8 million).
- Capital expenditures, no significant contractual obligations are in place at December 31, 2007.

CRITICAL ACCOUNTING ESTIMATES

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

EMPLOYEE FUTURE BENEFITS

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

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

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

	2007		2006	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
(weighted average assumptions)				
Accrued benefit obligation as of December 31:				
Discount rate	5.6 %	5.5%	5.25 %	5.25 %
Rate of compensation increase	3.0 %	n/a	3.0 %	3.0 %
Benefit costs for year ended December 31:				
Discount rate	5.25 %	5.25%	5.25 %	5.25%
Expected long-term rate of return on plan assets	7.0 %	n/a	7.0 %	n/a
Rate of compensation increase	3.0 %	n/a	3.0 %	3.0 %

Assumed health care cost trend rates were as follows:

(weighted average assumptions)	2007	2006
Initial health care cost trend rate	5.62%	5.87%
Ultimate health care trend rate	4.27%	4.27
Year ultimate rate is reached	2011	2011

Assumed health care cost trend rates have a significant effect on the amounts reported for the other post-retirement benefit plans. A one-percentage-point change in assumed health care cost trend rates would have had the following impact on the amounts recorded in 2007:

	1% Increase	1% Decrease
Increase (decrease) in accrued benefit obligation	\$ 26.3	\$ (21.0)
Increase (decrease) in total service and interest cost	\$ 2.7	\$ (2.0)

DEFERRED REFORESTATION

Canfor accrues an estimate, in current dollars, of its future liability to perform forestry activities, defined to mean those silviculture treatments or activities that are carried out to ensure the establishment of a free-growing stand of young trees, including logging road rehabilitation. An estimate is recorded in the financial statements based on the number of hectares of timber harvested in the period. The actual costs that will be incurred in the future may vary based on, among other things, the actual costs at the time.

FUTURE INCOME TAXES

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

ASSET RETIREMENT OBLIGATIONS

Canfor records the estimated fair value of a liability for asset retirement obligations, such as landfill closures, in the period when a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and amortized over its useful life. The liability is accreted over time through changes to earnings and reduced by actual costs of settlement. Payments relating to landfill closure and site remediation costs are expected to occur at periods ranging up to 25 years.

ENVIRONMENTAL REMEDIATION COSTS

Costs associated with environmental remediation obligations are accrued and expensed when such costs are probable and can be reasonably estimated. Such accruals are adjusted as further information develops or circumstances change. Costs of future expenditures for environmental remediation obligations are discounted to their present value when the amount and timing of expected cash payments are reliably determinable.

IMPAIRMENT OF GOODWILL

Goodwill, which is the excess of the purchase price paid for an acquisition over the fair value of the net assets acquired, is not amortized but is assessed annually for impairment, or more frequently if events or circumstances indicate that it may be impaired.

ASSET IMPAIRMENTS

(millions of dollars)	2007	2006
Capital assets	\$ 231.4	\$ -
Non-bank asset backed commercial paper (ABCP)	16.2	-
Other	20.4	19.1
Total asset impairments	\$ 268.0	\$ 19.1

Capital Assets

Canfor reviews the carrying values of its long-lived assets on a regular basis as events or changes in circumstances may warrant. Where the carrying value of assets is not expected to be recoverable from net future cash flows, they are written down to fair value. In view of the ongoing operating losses and expected market conditions, including exchange rates going forward, a review of the carrying value of all its sawmills and panelboard operations and various other assets was undertaken.

The first step in this process was to determine for each operation whether projected undiscounted net future cash flows from operations exceeded the net carrying amount of the assets as of the assessment date. For those operations where an impairment was indicated, the second step was to calculate fair values using discounted net future cash flows expected from their use and eventual disposition.

Estimates of future cash flows used to test the recoverability of Canfor's long-lived assets generally include key assumptions related to forecast prices and exchange rates over the next ten years. Other significant assumptions are the estimated useful life of the long-lived assets, and the impacts of both the Softwood Lumber Agreement with the United States and the Mountain Pine Beetle epidemic. Price forecasts beyond 2008 were determined with reference to Resource Information Systems, Inc. (RIS) publications, and forecast exchange rates were based on forecasts from various recognized authorities. Given the importance of the US\$/Cdn\$ exchange rate in Canfor's business, where most sales are denominated in U.S. dollars and most costs incurred in Canadian dollars, probabilities were assigned to the likelihood of occurrence of several exchange rate scenarios, and a weighted average used in determining impairments to be recorded.

As a result of its assessment, Canfor recognized asset write-downs of \$231.4 million related to property, plant, equipment and timber, of which \$90.0 million related to assets in the Lumber segment, and \$141.4 million to the Panels segment.

Non-Bank Asset-Backed Commercial Paper

The non-bank asset-backed commercial paper (ABCP) of \$64.0 million, after an impairment charge of \$16.2 million, is the estimated fair value of combined investments in asset-backed commercial paper of four different Canadian trusts ("the Trusts") with total original principal amount of US\$81.2 million (CDN\$80.2 million at December 31, 2007) and original maturities between August and September 2007. At the dates the Company acquired these investments they were rated R1 (High) by Dominion Bond Rating Service ("DBRS"), the highest credit rating issued for commercial paper and backed by R1 (High) rated assets and liquidity arrangements.

Since August of 2007, the market for ABCP has experienced significant liquidity problems. The demand for such paper has disappeared following the decline in credit markets and concerns regarding the quality and nature of underlying assets. The Trusts have failed to make payment at maturity and, along with 16 other ABCP conduits, are subject to restructuring under the Pan Canadian Investors Committee for the Third Party Asset Backed Commercial Paper (the "Pan Canadian Investors Committee".)

On December 23, 2007, the Pan Canadian Investors Committee announced an agreement in principle to restructure the ABCP issued by 20 trusts, including the Trusts. Under the proposal, holders of ABCP will exchange their paper for floating rate notes that have maturities based on the maturities of the assets underlying the ABCP. The notes are to be designed so that all available cash flow in the trusts will be paid to note holders.

The fair value of the ABCP was determined based on the management's judgment using available information and expectation of the assumptions market participants would use in pricing such ABCP as at the balance sheet date. Canfor reviewed information provided by the Pan Canadian Investors Committee and DBRS including current investment ratings, composition and valuation estimates of underlying assets; the estimate of the extent of leverage in the Trusts; the progress of the restructuring efforts, and general economic conditions in considering the fair value of this investment. In estimating fair value, Canfor used a valuation approach based on high likelihood of successful restructuring of the investment. It is estimated that of the US\$81.2 million of ABCP which Canfor has invested:

- US\$14.1 million is represented by traditional securitized assets that will, on restructuring, be replaced with long-term floating rate notes that are expected to receive a AAA rating from two investment rating agencies;
- US\$21.1 million is represented by a combination of synthetic and traditional securitized assets and collateralized debt obligations that will, on restructuring, be pooled with similar assets from other trusts and be replaced with a senior and subordinated floating rate notes. The senior note is expected to receive a AAA rating from two investment rating agencies while the subordinated note is not expected to be rated;
- US\$8.5 million is represented by assets that have exposure to US sub-prime assets or home equity loan mortgages that will, on restructuring, be replaced with long-term floating rate notes that may or may not be rated;
- US\$37.5 million is represented by assets of the Ironstone Trust that has a rating of AAA by DBRS, reaffirmed on January 9, 2008. On restructuring the assets will be replaced with a long-term floating rate note that may or may not be rated.

Based on this assessment of fair value as at December 31, 2007, Canfor recorded in income an impairment loss of \$16.2 million related to this investment in 2007, representing 20% of the face value.

It is possible that further information becomes available on the actual composition of the referenced assets. A change in the estimate of the composition of the referenced assets would effect the valuation. In addition, if sales of the restructured senior or subordinated notes occur in the future, these sales might represent observable market transactions that could appropriately be used to determine the fair value of the investment.

CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2007:

FINANCIAL INSTRUMENTS

The CICA issued three new Handbook Sections which applied to Canfor as of January 1, 2007: Section 3855 "Financial Instruments", Section 3865 "Hedges" and Section 1530 "Comprehensive Income." Section 3855 prescribes when a financial instrument should be recognized on the balance sheet and at what amount. It also specifies how to present financial instrument gains and losses. Section 3865, which is optional, provides alternative treatments to Section 3855 for when qualifying transactions are designated as hedges for accounting purposes. Section 1530 introduces new requirements for situations when certain gains and losses must be temporarily presented outside of net income in a new Statement of Comprehensive Income, which will be presented with equal prominence to the regular Income Statement.

Canfor has elected not to utilize hedge accounting on its existing derivative financial instruments. As a result, these instruments which were previously not recognized in the financial statements until they were exercised, were classified as held-for-trading and were measured at fair value through opening AOCI at January 1, 2007. The opening adjustments to AOCI were a reduction of \$3.9 million to record the fair value of hedging relationships existing prior to adopting Section 3855, partially offset by adjustments for future income taxes and non-controlling interests amounting to \$2.0 million, and a credit of \$3.0 million to reclassify the "Foreign Exchange Translation Adjustment" that was previously presented as a separate line item within Shareholders' Equity.

Opening retained earnings were reduced by \$13.2 million as a result of the implementation of these new standards. This amount was comprised of a \$14.2 million deferred unrealized foreign exchange loss on long-term debt arising from a previous hedging relationship and \$2.8 million of deferred financing costs that were written off, partially offset by a \$3.8 million adjustment to the associated liabilities for future income taxes and non-controlling interests.

LOG INVENTORIES

In October 2007 the CICA issued Handbook Section 3031 "Inventories". It recommends that inventories be measured at the lower of cost and net realizable value, and disallows the use of replacement cost. Canfor had previously valued log inventories at "the greater of net realizable value and replacement cost if lower than average cost". On January 1, 2008 Canfor adopted the new recommendations on a prospective basis. In accordance with this change in accounting policy, the opening log inventory as at that date has been devalued by \$46.5 million. The opening retained earnings adjustment resulting from the implementation of this new policy is \$30.6 million, net of future income taxes.

ASSET RETIREMENT OBLIGATIONS

In accordance with CICA Handbook Section 3110 "Asset Retirement Obligations", Canfor recognizes the fair value of a liability for an asset retirement obligation in the period in which it is incurred when a reasonable estimate of fair value can be made and a legal obligation exists. The asset retirement costs equal to the fair value of the retirement obligations are capitalized as part of the cost of the related long-lived asset and allocated to amortization expense on a basis consistent with the expected useful life of the related asset. The liability is increased or accreted to full value with the passage of time based on the credit adjusted risk free interest rate with a periodic accretion expense charge to operating income. The liability will be adjusted for revisions to the timing or amount of the original estimate of undiscounted cash flows to discharge the liability.

Canfor maintains a number of landfills. In 2007, Canfor adopted a policy of recognizing asset retirement obligations in respect of landfill closure and post-closure monitoring costs. The change reflects new information on all sites as to the estimated timing of closure and closure alternatives. As a result, Canfor has recorded an obligation based on the fair value of landfill closure costs of \$11.0 million, with a corresponding capital addition to the related assets. This estimate is based on expected closure of the respective mill landfills occurring in periods ranging from 5 to 25 years. Canfor also recorded an accretion expense, increasing the asset retirement obligation by \$0.1 million.

In 2007 an environmental containment liability was identified at the Intercon pulp mill site arising from the normal operation of the ash pond. As a result, Canfor has recorded an obligation based on the fair value of the containment estimate of \$2.4 million, with a corresponding capital addition to the related asset. The ash pond was decommissioned and remediation work commenced in the fourth quarter.

Canfor has certain assets that have indeterminable useful lives and, therefore, there is an indeterminable settlement date for the related asset retirement obligation. As a result, no asset retirement obligations are recorded for these assets. These assets include, for example, wastewater and effluent ponds that will have to be drained once the related operating facility is closed and storage sites for which removal of chemicals, fuels and other related materials will be required once the related operating facility is closed. Once the useful life of these assets becomes determinable and an estimate of fair value can be made, an asset retirement obligation will be recorded.

RISKS AND UNCERTAINTIES

Risks and uncertainties fall into the general business areas of markets, international commodity prices, competition, currency exchange rates, environmental issues, forest land base, government regulations and policy reform, and, for Canadian companies, a history of trade disputes and issues and Aboriginal land claims. The future impact of the various uncertainties and potential risks described in the following paragraphs (together with the risks and uncertainties identified under each of the Company's business segments listed above) cannot be quantified or predicted with certainty. However, Canfor does not foresee unmanageable adverse effects on its business operations from, and believes that it is well positioned to deal with, such matters as may arise.

ABORIGINAL ISSUES

Canadian judicial decisions have recognized the continued existence in the country of Aboriginal title and rights to lands continuously used or occupied by Aboriginal groups. Although, Aboriginal groups have claimed Aboriginal title and rights over substantial portions of British Columbia, including areas where Canfor's forest tenures and other operations are situated, no Aboriginal title has yet been determined. While these decisions have added to uncertainty regarding property rights in Canada (including forest tenure and other resource rights), particularly in those areas where treaties have not been concluded with Aboriginal groups, such as much of British Columbia, the Government of British Columbia has provided greater certainty for the forest industry by reaching agreements on forest resources with many bands. The courts have also confirmed that a duty to consult with Aboriginal groups when the Crown has knowledge of the potential existence of an Aboriginal right or title and contemplates conduct that might adversely impact. The courts have not extended this duty to third parties, such as forest companies.

As issues relating to Aboriginal rights, title and consultation continue to be heard, developed and resolved in Canadian courts, Canfor will continue to cooperate, communicate and exchange information and views with Aboriginal groups and government in order to foster good relationships and minimize risks to its enures and operational plans, and will continue to participate with the Crown in its consultation processes including Aboriginal groups. Due to their complexity, it is not expected that the issues regarding Aboriginal rights and title or consultation will be finally resolved in short term and, accordingly, the impact

of these issues on the timber supply from Crown lands and Canfor's tenures and on Canfor's operations is unknown at this time.

Canfor believes in building mutually beneficial and lasting relationships with local First Nations with treaty or Aboriginal rights or whose interests are overlapping 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 hold Forest Licenses with local First Nations or to manage and purchase the timber from Forest Licenses held by local First Nations.

CHIP REVENUES

Wood chips are a by-product of Canfor's lumber manufacturing process and are primarily sold to CPLP. These chips are the principal raw material utilized by CPLP in its pulp manufacturing operations. Canfor has a Fibre Supply Agreement with CPLP, which contains a pricing formula that currently results in CPLP paying Canfor market prices for wood chips and also contains a provision to adjust the pricing formula to reflect market conditions. Canfor currently provides approximately 66% of CPLP's chip requirements. If lumber market conditions are such that Canfor is unable to provide the current volume of chips to CPLP as a result of sawmill closures, whether temporary or permanent, CPLP's financial results could be materially affected. Similarly, if CPLP were to cease pulp operations for an extended period of time, Canfor would have a limited market for its chip supply and this could affect its ability to run the sawmills economically.

ENVIRONMENTAL ISSUES

The Species at Risk Act (SARA) was proclaimed by the Government of Canada in June 2003. The purpose of the Act is to prevent the extinction or extirpation of wildlife species present in Canada for at least 50 years, to provide for the recovery of wildlife species that are extirpated, endangered or threatened as a result of human activity, and encourage the management of other species to prevent them from becoming at risk. The economic implications of SARA are potential reductions in timber harvests and increases in harvesting costs, that cannot be estimated at this time. .

In December 2002 the Government of Canada ratified the Kyoto Agreement. The Climate Change Plan for Canada, which set out Canada's Kyoto implementation strategy, indicated that federal and provincial energy and environment ministers endorsed the principle that companies that had taken early action should not be disadvantaged by an output-based emissions regime. Canfor was an early signatory to the Climate Change Voluntary Challenge and Registry Program, a federal program introduced in 1997 to encourage companies to inventory and track their greenhouse gas ("GHG") emissions and take actions to stabilize and reduce those emissions. Canfor has implemented projects that have improved energy efficiency and displaced purchased fossil fuel energy with renewable biomass energy, thereby reducing GHG emissions both on absolute and per unit of production bases. Canfor has opportunities to further reduce GHG emissions particularly through increased utilization of sawmill wood residuals.

In November 2003, the Forest Products Association of Canada (FPAC), on behalf of Canfor and other forest products companies, signed a "Memorandum of Understanding Respecting Action on Climate Change" (MOU) with the Federal Government. The MOU established a framework for expected upcoming negotiations of a Pulp and Paper Sector covenant with the Federal Government. The MOU specified that, "the Government of Canada will work with FPAC Parties and other industries to design a system that will not disadvantage those firms that have taken early action to reduce GHG emissions". Despite the MOU signed between FPAC and the then Liberal Government the Conservative Government issued a Notice of Intent (NOI) in October 2006 to regulate priority air pollutants and GHGs under a Clean Air Act to protect the health of Canadians and the environment. The NOI establishes short (2010 – 2015), medium (2020 – 2025) and long-term (after 2050) time frames for the regulation of GHGs and priority

pollutants. The forest products sector was named in the NOI as one of the targeted sectors for regulation. On May 1, 2007 the Federal Government issued its 'Regulatory Framework for Air Emissions', which included preliminary emission reduction targets for both the pulp and paper, and wood products sub-sectors. For pulp and paper, there were emission reduction targets for GHGs, Particulate Matter and Sulphur Dioxide and for wood products for Particulate Matter and Volatile Organic Compounds (VOCs).

FPAC provided submissions to Environment Canada outlining the industry's position and significant concerns with the initial Federal Government's proposals on reduction targets contained in the NOI. These submissions resulted in many of the industries concerns being addressed.

For pulp and paper, GHG intensity targets require an 18% emission intensity reduction by 2010 and 2% per year or 26% reduction by 2015. The target allocation scheme preferred by the vast majority of pulp and paper companies, including Canfor, which benefits companies that have made past GHG emission reductions, is the scheme also preferred by Environment Canada and likely to be adopted. Under this scheme, CPLP would not be required to make any GHG reductions until the 2015 deadline, and Taylor Pulp would be required to make reductions beginning at the 2010 deadline. In addition, there is potential that favourable treatment of biomass cogeneration may place CPLP in a net positive position with respect to GHG emission credits.

The pulp and paper emission targets for Particulate Matter and Sulphur Dioxide are essentially those developed by the industry during the Pulp and Paper Air Quality Forum process that took place between the industry and Environment Canada in 2005 and 2006. Under the targets CPLP's Prince George and Intercontinental Pulp mills will likely need to make SO₂ emission reductions, and the Northwood Pulp mill may have to make particulate emission reductions by 2015.

For wood products, Environment Canada has agreed to largely fund and embark with the industry on a data gathering exercise over 2008 to establish a future emission reduction target for combustion system particulate matter. Wood products facilities will not be regulated for GHGs under the federal regulatory process. As a result GHG reductions made at those facilities may be available as offsets to meet pulp and paper targets or for sale when a market for offsets is established.

In November 2007, British Columbia passed into law targets requiring a minimum 33% reduction in absolute GHG emissions for the Province by 2020 and announced its intention to develop regulations for 2012 and 2016 targets by the end of 2008. The Minister has the ability to regulate sources of GHGs and emission offsets. A task force representing the B.C. pulp and paper and wood products industries is in active consultation with the B.C. Climate Change Secretariat, which is leading the GHG target and regulation setting process for the provincial government. It is uncertain at this time how reduction requirements will be allocated to the B.C. forest products sector and how such allocation may impact Canfor.

In the February 2007 throne speech, the Government of British Columbia proposed an initiative to eliminate Tier 2 beehive burners in the Province, with no explicit time frame provided. There are approximately 40 remaining 'Tier 2' burners in B.C. most of which are in rural or more remote locations. Through the Council of Forest Industries, Canfor and other companies with Tier 2 burners are working with the Ministry of Environment to develop a schedule and time frame for elimination of the burners that recognizes there must be economically viable alternatives to facilitate burner phase out. Canfor has a total of six Tier 2 burners located at its Tackama, Plateau, Isle Pierre, Clear Lake, Vavenby and Mackenzie operations.

FINANCIAL MARKET RISK

Demand for forest products, both wood products and pulp and paper, is closely related to global business conditions and tends to be cyclical in nature. Product prices can be subject to volatile change. Canfor, like the majority of the Canadian forest products industry, competes in a global market and the majority of its products are sold in US dollars. Consequently, changes in foreign currency relative to the Canadian dollar can impact Canfor's revenues and earnings.

FINANCIAL INSTRUMENTS – Subject to risk management policies approved by its Board of Directors, Canfor, from time to time, uses derivative instruments, such as forward exchange contracts and option contracts to hedge future movements of exchange rates and futures and forward contracts to hedge commodity prices.

At December 31, 2007, Canfor had in place foreign exchange forward contracts and collars of \$476.7 million (\$5.1 million in 2006). There were unrealized gains of \$14.3 million (\$0.3 million unrealized loss in 2006) on the foreign exchange derivatives at the end of the period.

At December 31, 2007, Canfor had in place floating to fixed swaps that hedge future natural gas purchases of 10.1 million gigajoules (7.4 million gigajoules in 2006). There were unrealized losses of \$5.7 million (unrealized losses of \$1.7 million in 2006) on the natural gas swaps at the end of the period.

At December 31, 2007, Canfor had in place floating to fixed swaps that hedge future diesel purchases of 13.3 million gallons (9.0 million gallons in 2006). There were unrealized gains of \$7.9 million (unrealized losses of \$1.2 million in 2006) on the diesel swaps at the end of the period.

At December 31, 2007, Canfor had in place futures contracts to hedge future lumber purchases of 34.1 million board feet (0 in 2006). There were unrealized gains of \$0.7 million (0 in 2006) on the lumber futures at the end of the period.

At December 31, 2006, Canfor had in place floating to fixed swaps that hedge future pulp purchases of 7,500 tonnes (0 in 2007). There were unrealized losses of \$0.7 million (0 in 2007) on the pulp swaps at the end of the period.

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

	Impact on annual after-tax earnings (millions of dollars)
Canadian dollar - US \$0.01 change per Canadian dollar	\$ 8
Lumber (SPF) – US \$10 change per Mfbm	18
Plywood – Cdn \$10 change per msf 3/8"	1
OSB – US \$10 change per Msf 3/8"	3
NBSK pulp – US \$10 change per tonne (Canfor's 50.2% share)	4

GOVERNMENT REGULATION

Canfor is subject to a wide range of general and industry-specific environmental, health and safety and other laws and regulations imposed by federal, provincial and local authorities, including those governing the use, storage, handling, generation, treatment, emission, release, discharge and disposal of certain hazardous materials and wastes, the remediation of contaminated soil and ground water and the health and safety of employees. If Canfor is unable to extend or renew a material approval, licence or permit required by such laws, or if there is a delay in renewing any material approval, licence or permit, Canfor's

business, financial condition, results of operations and cash flows could be materially adversely affected. Future events such as any changes in these laws and regulations or any change in their interpretation or enforcement, or the discovery of currently unknown conditions, may give rise to additional expenditures or liabilities.

INCOME TRUST TAXATION

On October 31, 2006 the Canadian Federal Government announced plans to apply a tax on distributions from publicly traded income trusts, such as the Canfor Pulp Income Fund. For existing income trusts, the government provided a four-year transition period, until the 2011 taxation year, before the tax would be applicable.

LABOUR AGREEMENTS AND COMPETITION FOR PROFESSIONAL AND SKILLED LABOUR

Any labour disruptions and any costs associated with labour disruptions at Canfor's mills could have a material adverse effect on its production levels and results of operations. Canfor's various collective agreements with the USWA (United Steelworkers of America), the CEP (Communications, Energy and Paperworkers Union) and PPWC (Pulp, Paper and Woodworkers of Canada) have terms expiring in April 2008 and June 2009. Any future inability to negotiate acceptable contracts could result in a strike or work stoppage by the affected workers and increased operating costs as a result of higher wages or benefits paid to unionized workers.

Market conditions may cause shortages of both professional and skilled labour, which could have an adverse impact on the operation and management of Canfor's facilities.

MAINTENANCE OBLIGATIONS AND FACILITY DISRUPTIONS

Canfor's manufacturing processes are vulnerable to operational problems that can impair Canfor's ability to manufacture its products. Canfor could experience a breakdown in any of its machines, or other important equipment, and from time to time, planned or unplanned maintenance outages that cannot be performed safely or efficiently during operations must be conducted. Such disruptions could cause a significant loss of production, which could have a material adverse effect on Canfor's business, financial condition and operating results.

MOUNTAIN PINE BEETLE

In 2007 the BC government reported that the Mountain Pine Beetle has attacked approximately 530 million cubic meters of lodgepole pine. This represents approximately 40% of the merchantable lodgepole pine volume and 12% of the total provincial merchantable volume on the provinces timber harvesting land base. The government also projected that up to 78% of the lodgepole pine volume or up to 23% of the total volume on the provinces timber harvesting land base could be affected by the mountain pine beetle by 2015.

The infestation also threatens Alberta's pine forests, however government surveys conducted in 2007 suggest that the populations of mountain pine beetle in the NW portion of the province are actually decreasing or remain static. The Alberta government reports that this is due primarily to last winters cold weather and ongoing control efforts by the forest industry and government.

In response to the infestation, BC's provincial government increased the allowable annual cut (AAC) levels in the heavily affected timber supply areas. The increase is designed to salvage as much of the dead and damaged lodgepole pine timber as possible, and to redirect harvesting in an attempt to reduce the spread of the beetle. As a result, Canfor has also significantly increased its harvest of dead pine within its Vanderhoof, Quesnel and Prince George operating areas.

A recent timber supply study conducted by the Council of Forest Industries (COFI) analyzed the general trends of the Mountain Pine Beetle outbreak and forecasts the expected impacts on AAC. The study predicts that the timber supply areas surrounding Vanderhoof and Quesnel will experience a significant reduction in AAC in the next 10 to 15 years. This reduction is expected because these timber supplies consist of over 60% mature lodgepole pine that is either dead or at risk of attack and the remaining stands of Spruce, Balsam fir and Douglas fir are insufficient to support historic harvest levels. The timber supplies surrounding Prince George and Mackenzie have the advantage of larger log diameter and a large inventory of non-pine species. As a result, there is more flexibility in these timber supply areas to harvest other stands while the pine sites recover from the infestation. The study also predicts that most of the damaged pine volume in these areas could be recovered, which may in turn mitigate the need for a significant reduction in harvest levels. As a result, the study predicts that in 10 to 15 years the AAC in the Prince George timber supply areas will likely reduce to slightly below historic levels, and in the Mackenzie areas the AAC will remain unchanged. Other timber supply areas where Canfor has operating areas, such as in Fort Nelson, Fort St John, and Chetwynd, are not expected to experience a reduction in harvest levels resulting from the current Mountain Pine Beetle infestation.

A major assumption about the impact on harvest levels is the shelf life of the dead lodgepole pine. Shelf life represents the length of time the timber is commercially viable for sawlogs. Once the shelf life has passed for sawlogs, the volume may still be useable for chips or other non sawlog products. One of the determining factors that contribute to shelf life is the moisture content of the log and the moisture condition of the area where the timber is located. The impact of moisture variability on the shelf life of timber is still being studied, but indications are that sawlog shelf-life can vary from 3 to over 15 years depending on moisture levels. For the alternative products the shelf life is expected to be much longer. The reality about shelf life however, is that it is also largely a function of economic factors.

In the short term, the impact of the infestation on Canfor is manageable. By applying new technology and best practices the company will continue to operate in the dead stands. However, given the nature and extent of the infestation, the long-term operational and financial impact on Canfor may be significant.

OBLIGATIONS TO BC HYDRO

In 2003, Canfor entered into an agreement with BC Hydro to build an electrical cogeneration facility at the Prince George Pulp and Paper Mill. Under the agreement, BC Hydro contributed \$45.8 million of the project costs, with Canfor contributing the balance. The agreement was assigned to CPLP effective July 1, 2006, with incentive payments totaling \$11.4 million outstanding. The final incentive payment of \$11.4 million was received August 9, 2006, and transferred to Canfor. The total incentive payments of \$45.8 million were accounted for as a credit to property plant and equipment of CPLP. The agreement entails a 15 year commitment with BC Hydro for power displacement at the cogeneration facility, whereby a proportionate repayment is required should the facility not generate the minimum of 390 gigawatt hours of electricity per year. Under the agreement, CPLP is required to post a letter of credit as security in annually decreasing amounts as minimum required amount of electricity is generated.

As of December 31, 2007, CPLP has no repayment obligation under the terms of the agreement and a standby letter of credit in the amount of \$27.4 million was issued to BC Hydro.

STUMPAGE RATES

The British Columbia government introduced a Market Pricing System (MPS) for the BC Interior on July 1, 2006. Canfor is actively participating in discussions on MPS with the Ministry of Forests, which is scheduled for its third annual update on July 1, 2008. Canfor will continue to seek to manage and reduce the stumpage costs for its interior operations under the stumpage appraisal system. The near-term imperative is to ensure that the stumpage system accurately reflects the market value of timber and is responsive to the deteriorating quality of the beetle-impacted fibre.

SURGE TAX

The SLA includes a "Surge Mechanism", which increases the export tax rate for the month by 50% when the monthly volume of exports from a region exceeds a certain "Trigger Volume" as defined in the SLA. The U.S. Coalition for Fair Lumber Imports has alleged that the US consumption figures that are used in calculating the allowable exports in a month, should not be the estimated or expected consumption but should be the actual consumption based on a 12-month rolling average. Canada maintains that the U.S. is wrongly interpreting the point at which the surge clause is triggered. Under the terms of the agreement, the U.S. has requested binding arbitration and the issue is now before the London Court of International Arbitration. Three European panelists held a hearing in December 2007. The panel plans to issue its decision, which cannot be appealed, during the first quarter of 2008. Although the Government of Canada is committed to defending its position, the outcome is not determinable. However, if Canada was to have an unfavourable decision, the additional cumulative export tax liability to December 31, 2007 would be approximately \$16 million.

TRANSPORTATION SERVICES

Canfor relies primarily on third parties for transportation of its products, as well as delivery of raw materials, a significant portion of which are transported by railroad, trucks and ships. If any of Canfor's third party transportation providers were to fail to deliver the raw materials or products or distribute them in a timely manner, Canfor may be unable to sell those products at full value, or at all, or unable to manufacture its products in response to customer demand, which could have a material adverse effect on Canfor's financial condition and operating results. In addition, if any of these third parties were to cease operations or cease doing business with Canfor, Canfor may be unable to replace them at reasonable cost.

OUTSTANDING SHARE DATA

At February 22, 2008, there were 142,589,312 common shares issued and outstanding. In addition, at February 22, 2008, there were 212,801 stock options outstanding with exercise prices ranging from \$7.57 to \$11.80 per share.

DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Board and the Audit Committee. The Company's chief executive officer (CEO) and chief financial officer (CFO) have evaluated and are satisfied with the effectiveness of these disclosure controls and procedures for the period ending December 31, 2007.

The CEO and CFO acknowledge responsibility for the design of internal control over financial reporting (ICFR), and confirm that there were no changes in these controls that occurred during the most recent interim period ended December 31, 2007 which materially affected, or are reasonably likely to materially affect, the Company's ICFR.

Additional information about the Company, including its 2007 Annual Information Form, is available at www.sedar.com or at www.canfor.com.