2008 Management's Discussion & Analysis

2008 MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") provides a review of Canfor's financial performance for the year ended December 31, 2008 relative to the year ended December 31, 2007, and the financial position of the Company. It should be read in conjunction with Canfor's Annual Information Form and its audited consolidated financial statements and accompanying notes for the years ended December 31, 2008 and 2007. The financial information contained in this MD&A has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

Throughout this discussion, reference is also made to EBITDA (calculated as operating income before amortization) and Adjusted EBITDA (calculated as EBITDA less restructuring, mill closure and severance costs), which Canfor considers to be important indicators for measuring trends in the performance of each of its operating segments and the Company's ability to generate funds to meet its debt repayment and capital expenditure requirements. Reference is also made to Adjusted Net Loss (calculated as Net Loss less specific items affecting comparability with prior periods – for the full calculation, see reconciliation included in the section "Overview of Consolidated Loss – 2008 Compared to 2007") and Adjusted Net Loss per Share (calculated as Adjusted Net Loss divided by the weighted average number of shares outstanding in the period). EBITDA, Adjusted EBITDA, Adjusted Net Loss and Adjusted Net Loss per Share are not generally accepted earnings measures and should not be considered as an alternative to net income or cash flows as determined in accordance with Canadian GAAP. As there is no standardized method of calculating these measures, Canfor's EBITDA, Adjusted EBITDA, Adjusted Net Loss and Adjusted Net Loss per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of EBITDA, Adjusted EBITDA and Adjusted Net Loss to net income reported in accordance with GAAP are included in this MD&A.

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. 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.

Certain prior period comparative information throughout this report has been restated for consistency with the presentation in the current period. All financial references are in millions of Canadian dollars unless otherwise noted. The information in this report is as at February 19, 2009.

<u>Forward Looking Statements</u>

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

OVERVIEW OF 2008

2008 was a most difficult year for Canfor's lumber business. With the industry already facing a severe and prolonged U.S. housing market downturn, producers were dealt a further blow later in the year as the emerging crisis in global financial and credit markets and a worsening of the U.S. economy weighed heavily on the sector. By the end of 2008, seasonally adjusted annual U.S. housing starts had plunged to 550,000 units, the lowest level on record, and lumber prices were languishing at the lowest level in decades. Market conditions for oriented strand board ("OSB") and plywood products fared little better in 2008, with prices remaining at depressed levels through much of the year. Pulp markets too, after a strong start to the year, failed to escape the fallout from the financial and credit market upheaval and contraction in demand, with prices falling sharply later in the year as pulp inventories mounted.

Compounding the challenges for Canadian lumber producers was a 15% export tax on shipments to the United States that continued through 2008. The one positive development for Canadian producers was the sharp depreciation of the Canadian dollar relative to its U.S. counterpart in the fourth quarter of 2008 which helped to mitigate the erosion of Canadian dollar sales realizations. The average value of the Canadian dollar in 2008, however, remained relatively unchanged relative to the US dollar compared to 2007.

The Company significantly reduced its solid wood production levels during 2008 to reflect the substantially lower demand, indefinitely idling two lumber mills and two panel plants (one OSB and one plywood) in the British Columbia ("B.C.") Interior, and reducing shifts and operating shortened work weeks at its other operations. Further loss of production resulted from a fire in May of 2008, which destroyed the Company's North Central Plywoods ("NCP") facility.

At year end, the Company was producing at less than 75% of its total lumber production capacity, and at a fraction of its panels capacity. Due to the market conditions and closures, the Company recorded further asset impairment charges on its panel assets at the end of 2008.

Notwithstanding the various market challenges, Canfor recorded a significantly improved operational performance in 2008, and ended the year with one of the strongest balance sheets in the industry. Manufacturing costs were significantly reduced in 2008, mostly through successful performance improvement initiatives and cost control measures. As a result of this improved performance, combined with tight management of working capital and non-essential capital expenditures, the Company ended the year with cash of $362.4 million.

A brief review of the more significant developments in 2008 is presented below.

Depressed Housing Market and Historically-Low Prices

i. Depressed Market Conditions and Prices

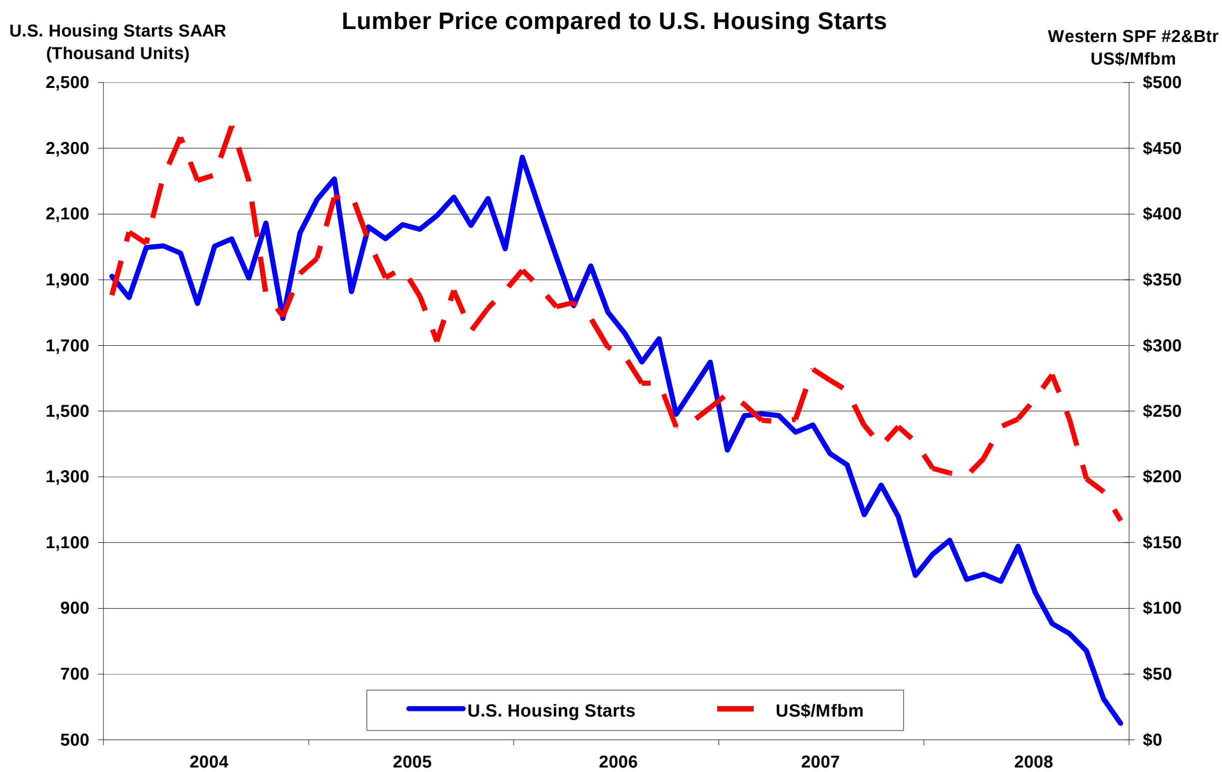
Reflecting the deterioration of the U.S. economy, eroding consumer confidence and spending, and high unsold home inventories, U.S. housing starts plunged in 2008 to the lowest level since records began in 1959. U.S. housing starts in 2008 were 902,000 units[1], a 33% decrease from the 2007 total of 1.341 million units. Most disconcerting, however, was the almost 50% decline in housing starts between the beginning and end of 2008, and the lowest level of housing starts on record at 550,000 (Seasonally Adjusted Annual Rates - SAAR), in December. Inventories of new and used homes available for sale in the U.S. market in December of 2008 were 12.9 months and 9.3 months[2], respectively, well above historical levels. Compared to new home construction, the Repair and Remodeling and Do-It-Yourself sector fared a little better, recording more modest declines in 2008, although demand for lumber fell off sharply towards the end of the year.

For lumber, Western Spruce/Pine/Fir ("SPF") 2x4 #2&Btr prices, which started the year at US$219 per Mfbm, a historically low level, dipped to US$190 per Mfbm in the first quarter before increasing slowly but steadily as supply tightened to reach US$283 Mfbm[3] in August. However, this high was short-lived as prices fell dramatically through the balance of the year in response to the worsening economic climate and resulting slump in demand to end the year at

[1] U.S. Bureau of the Census
[2] NAR – National Association of Realtors

US$168 per Mfbm. The 2008 annual average Random Length price of Western SPF 2x4 #2&Btr was US$222 per Mfbm, an 11% decline compared to the 2007 annual average, while price declines for wider widths were as high as 22%. The average price of Southern Yellow Pine ("SYP") 2x4 East was US$281 per Mfbm[3], almost unchanged from 2007; however, prices for wider width product recorded significant year-over-year decreases, as evidenced by a 16% decline in the average 2X10 Random Length price.

The following chart highlights the significant downward trend in U.S. housing starts and monthly average Western SPF 2x4 #2&Btr benchmark lumber prices in 2008:

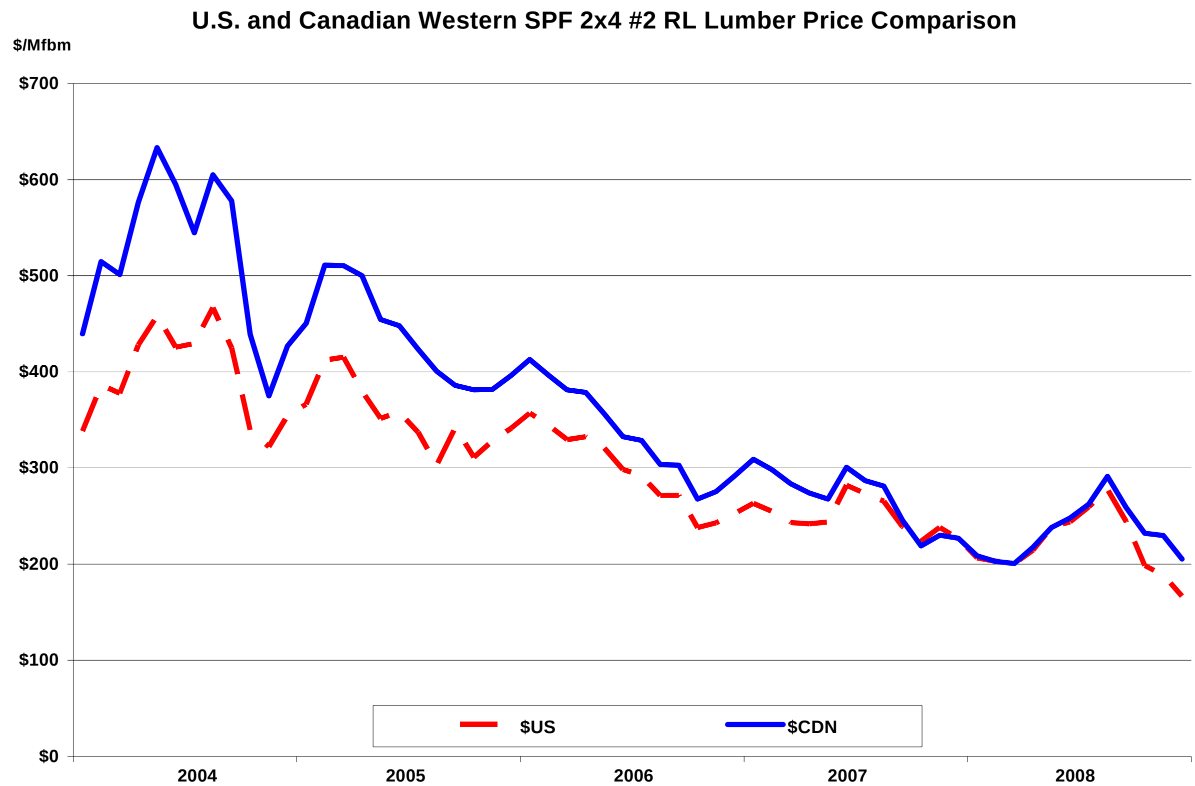


ii. Continued Strong Canadian Dollar and Export Tax

The majority of Canfor's sales are denominated in US dollars, and Canfor's results are therefore impacted by movements in the exchange rate. The average value of the Canadian dollar in 2008 was up marginally (0.8 cents, or 1%) versus its U.S. counterpart compared to 2007. The Canadian dollar remained around par with the U.S. dollar for most of the year; as the global economy worsened, however, it weakened considerably in the final quarter of 2008, ending the year at $0.817, some 19.5 cents, or 19.3%, lower than at the end of 2007.

The following chart depicts the trend in monthly average benchmark Western SPF 2x4 2&Btr lumber prices, with the Canadian dollar prices representing the US dollar price multiplied by the monthly average exchange rate:

[3] Random Lengths



Except for Canfor's Daaquam operation, which, as a border mill, benefits from tax-exempt status under the Softwood Lumber Agreement ("SLA"), and a Third Country Adjustment export tax refund for the last quarter of 2007 and first quarter of 2008, Canfor's lumber exports to the U.S. have been subject to the highest export tax bracket of 15% since the SLA came into effect in October of 2006. The Company has paid export taxes of approximately $188 million from October of 2006 to December of 2008.

Significant Curtailments and Closures

As a result of continued weak demand and low pricing for softwood lumber, OSB and plywood, the Company reduced its production volume significantly in 2008. The downtime took the form of indefinite idling for several operations in the B.C. Interior, and shortened workweeks or reduced shifts at its other operations in B.C., Quebec and the U.S. south-east.

The Company curtailed approximately one quarter of its lumber capacity, and the significant majority of its panels capacity, in 2008. Canfor is not currently producing any plywood and the only panels business currently operating is the jointly owned Peace Valley ("PV") OSB mill in Fort St. John, B.C.

A summary of the lumber and panel operations idled in 2008, and the reduction in annual production capacity is presented below:

Lumber

- Chetwynd (British Columbia) – Indefinite closure in March of 2008, reducing annual SPF lumber capacity by approximately 219 million board feet.
- Mackenzie (British Columbia) – Indefinite closure in June of 2008, reducing annual SPF lumber capacity by approximately 305 million board feet.

Panels

- PolarBoard (Fort Nelson, British Columbia) – Indefinite closure in June of 2008, reducing annual OSB capacity by approximately 640 million square feet (3/8" basis).
- Tackama (Fort Nelson, British Columbia) – Indefinite closure in October of 2008, reducing annual plywood capacity by approximately 270 million square feet (3/8" basis).

In May of 2008, a fire at Canfor's NCP facility, located in Prince George, B.C. destroyed the facility. The Company subsequently decided not to rebuild the plant, but expects to reinvest the insurance proceeds in its existing facilities to improve the cost competitiveness of its operations. NCP had an annual production capacity of plywood of 170 million square feet prior to the fire.

Improved Operational Performance and Tight Cost Control

The Company recorded a much improved operational performance in 2008. The lumber business segment, in particular, saw significant cost reductions and performance improvements, as evidenced by a 14% decrease in year-over-year unit manufacturing costs at the B.C. Interior operations. This improvement was achieved in the face of an additional 700 million board feet of curtailment. Rising losses in the panels business segment were mitigated with the indefinite closures of the PolarBoard and Tackama operations. Canfor Pulp Limited Partnership ("CPLP") and Taylor Pulp recorded solid operational performances in 2008, but the slump in market demand and prices late in the year significantly eroded earnings.

Working capital and capital spending continued to be closely managed in 2008. Capital spending was restricted to essential maintenance-of-business expenditures and selected high-return projects. The latter included the commencement of a new energy system at the Company's Fort St. John facility, and the completion of key capital upgrades at the Company's Conway mill in South Carolina. The more significant pulp capital expenditures related to various upgrades at CPLP's Intercon and Northwood pulp mills and the replacement of a chip screening and in-feed system at CPLP's Prince George Pulp and Paper ("PG Pulp") mill. The latter was required as a result of a fire in early 2008 and was mostly funded by insurance proceeds.

The Company ended the year with cash on hand of $362.4 million, as well as unused available operating lines of credit of $363.4 million, and a net debt to total capitalization ratio of 15%.

OVERVIEW OF CONSOLIDATED RESULTS – 2008 COMPARED TO 2007

Selected Financial Information and Statistics:

(millions of dollars, except for per share amounts)		2008		2007
Sales	$	**2,611.6**	$	3,275.6
EBITDA[4]	$	**13.1**	$	(88.9)
Operating loss [4]	$	**(158.1)**	$	(273.0)
Foreign exchange (loss) gain on long-term debt and investments, net	$	**(100.3)**	$	16.2
(Loss) gain on derivative financial instruments[5]	$	**(88.5)**	$	16.0
Asset impairments	$	**(169.6)**	$	(268.0)
Prince George Pulp & Paper mill fire, net	$	**8.2**	$	-
North Central Plywoods mill fire, net	$	**57.9**	$	-
Net loss [4]	$	**(345.2)**	$	(360.6)
Net loss per share, basic and diluted[4]	$	**(2.42)**	$	(2.53)
Average exchange rate (US$/CDN$)[6]	$	**0.938**	$	0.930
U.S. housing starts (million units SAAR) [7]		**0.902**		1.341

[4] Results for 2008 reflect the Company's retrospective adoption (without prior period restatement) on January 1, 2008 of CICA Handbook Section 3031, *Inventories*, which requires all inventories, including logs, to be valued at the lower of cost or net realizable value. Details of related write-downs and reversals are contained in the following pages. The adjustments affect comparability with prior periods.
[5] Includes gains (losses) from natural gas, diesel, foreign exchange and lumber price derivatives (see "Non-Segmented Items" section for more details).
[6] Source – Bank of Canada (average noon rate for the period)
[7] Source – U.S. Census Bureau, seasonally adjusted annual rate ("SAAR")

Analysis of Specific Items Affecting Comparability of Net Loss

After-tax impact, net of non-controlling interests

(millions of dollars, except for per share amounts)		2008		2007
Net loss as reported	$	**(345.2)**	$	(360.6)
Loss (gain) loss on derivative financial instruments	$	**54.5**	$	(11.6)
New inventory accounting standard	$	**(18.7)**	$	-
Foreign exchange loss (gain) on long-term debt and investments, net	$	**72.2**	$	(6.5)
Prince George Pulp & Paper mill fire, net	$	**(3.4)**	$	-
North Central Plywoods mill fire, net	$	**(45.0)**	$	-
Restructuring, mill closure and severance costs	$	**35.3**	$	27.3
Corporate income tax rate reductions	$	**(9.1)**	$	(37.7)
Asset impairments	$	**131.0**	$	199.2
Other items	$	**0.1**	$	(9.1)
Net impact of above items	$	**216.9**	$	161.6
Net loss, as adjusted	$	**(128.3)**	$	(199.0)
Net loss per share, as reported	$	**(2.42)**	$	(2.53)
Net impact of above items per share	$	**1.52**	$	1.13
Net loss per share, as adjusted	$	**(0.90)**	$	(1.40)

EBITDA

The following table reconciles the Company's net loss, as reported in accordance with GAAP, to EBITDA:

(millions of dollars)		2008		2007
Net loss as reported	**$**	**(345.2)**	$	(360.6)
Add (subtract):				
Non-controlling interests	**$**	**24.0**	$	65.4
Income tax recovery	**$**	**(141.9)**	$	(234.1)
Other (income) expense	**$**	**(12.7)**	$	11.1
Loss (gain) on derivative financial instruments	**$**	**88.5**	$	(16.0)
Asset impairments	**$**	**169.6**	$	268.0
Foreign exchange loss (gain) on long-term debt and investments, net	**$**	**100.3**	$	(16.2)
Prince George Pulp & Paper mill fire, net	**$**	**(8.2)**	$	-
North Central Plywoods mill fire, net	**$**	**(57.9)**	$	-
Interest expense, net	**$**	**25.4**	$	9.4
Amortization	**$**	**171.2**	$	184.1
EBITDA, as reported	**$**	**13.1**	$	(88.9)
Restructuring, mill closure and severance costs	**$**	**53.5**	$	41.3
Adjusted EBITDA	**$**	**66.6**	$	(47.6)
Log inventory recovery resulting from new inventory accounting standard, included in EBITDA	$	**30.4**	$	-

The Company recorded a net loss of $345.2 million ($2.42 per share) for the year ended December 31, 2008, $15.4 million less than the net loss of $360.6 million ($2.53 per share) reported for the year ended December 31, 2007.

After adjusting for significant items affecting comparability with prior periods, the Company's adjusted net loss was $128.3 million ($0.90 per share) for 2008, compared to a similarly adjusted net loss of $199.0 million ($1.40 per share) for 2007.

The Company recorded an operating loss of $158.1 million in 2008, an improvement of $114.9 million compared to 2007. Reported EBITDA was $13.1 million, an improvement of $102.0 million from the previous year. For the most part, the positive variances reflected significantly reduced operating losses for the Company's lumber business which more than offset lower earnings in the pulp and paper business.

For the lumber business, the positive impact of substantially reduced log and conversion costs and, to a lesser extent, a Third Country Adjustment export tax refund and increased residual fibre realizations, more than outweighed lower prices and the slightly higher average Canadian dollar. The Panels business also recorded lower losses in 2008, with the mitigation of losses through curtailments and lower log costs more than offsetting higher restructuring, mill closure and severance costs. Average OSB prices in 2008 showed a modest increase, while plywood prices were down 10%. Corporate costs continued to trend downwards in 2008.

The lower pulp and paper earnings reflected higher fibre, energy, chemical and maintenance costs and a slowing order file in the last quarter of 2008; Canadian dollar pulp price realizations were down slightly year-over-year, as higher freight costs, a lower-value geographical mix and a stronger Canadian dollar (particularly for the first nine months of 2008) more than offset higher average NBSK pulp list and BCTMP prices in 2008.

The 2008 operating results also reflected the Company's adoption of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3031, Inventories, on January 1, 2008, which requires inventories, including logs, to be valued at the lower of cost or net realizable value (previously, the Company valued logs at the higher of net realizable value and replacement cost, if lower than average cost). The adoption of the new accounting standard resulted in an increase in 2008's operating income and net income by $30.4 million and $18.7 million ($0.13 per share), respectively, due principally to a combination of a significant reduction in log costs and volumes through 2008.

A more detailed review of the Company's operational performance and results is provided in "Operating Results by Business Segment – 2008 compared to 2007", which follows this overview of consolidated results.

Reflecting a significant erosion of the value of the Canadian dollar in the last quarter of 2008, the Company recorded a foreign exchange translation loss on its US dollar denominated debt less investments of $100.3 million (2007 - gain of $16.2 million). The weaker Canadian dollar was also a significant contributor to 2008 losses recorded on derivative financial instruments of $88.5 million (2007 - gain of $16.0 million); the significant majority of the losses reflected mark-to-market losses at year end on unrealized forward exchange collars and forward contracts and energy swaps and options.

As a result of the very challenging operating climate and market outlook, the Company recorded asset impairment charges totalling $169.6 million in 2008 (2007 - $268.0 million). The charges comprised the following:

- $89.4 million related to the solid wood business in 2008, principally on the Company's PolarBoard and Tackama indefinitely idled panel assets.
- $70.0 million related to balances owing from Howe Sound Pulp and Paper Limited Partnership ("HSLP") and the Company's investment in Coastal Fibre Limited Partnership ("CFLP"), reflecting weaker B.C. Coastal pulp, paper and fibre market conditions.
- $10.2 million related to the Company's investment in non-bank asset-backed commercial paper ("ABCP").

In connection with the fire at the Company's NCP facility that destroyed the mill, the Company recorded a pre-tax gain of $57.9 million, based on preliminary estimates of net property damage insurance proceeds receivable and costs related to the fire. The insurance property damage receivable was estimated on the basis that the insurance proceeds will be applied towards capital improvements at Canfor's other operations.

OPERATING RESULTS BY BUSINESS SEGMENT – 2008 COMPARED TO 2007

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 consolidated financial statements.

Canfor's operations include the following three operating segments: Lumber, Panels and Pulp and Paper.

Lumber

The Lumber segment consists of logging and forestry operations, which manage approximately 11.3 million cubic metres of allowable annual cut in British Columbia, northern Alberta and Quebec, and own 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 4.9 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 has an annual capacity of 150,000 tonnes of wood pellets. 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 suppliers to complement its product line.

Under the SLA, implemented by the federal governments of Canada and the United States on October 12, 2006, Canadian softwood lumber exporters pay an export tax on lumber shipped to the U.S. when the price of lumber is at or below US$355 per mfbm, as determined by the Random Lengths Framing Lumber Composite Price ("RLCP"). The export tax rate is determined monthly, with the rate being based on the following trigger prices:

Trigger RLCP Price	Tax Rate
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 "Trigger Volume" as defined in the SLA.

In December of 2008, the Company received information from the Canada Revenue Agency indicating it was eligible to claim a Third Country Adjustment refund under the SLA of a third of the 15% export charges paid for the quarters ended December 31, 2007 and March 31, 2008. The claim is based on year-over-year movements in the Canadian and U.S. market share of total U.S. consumption of softwood lumber products and the share of U.S. consumption from imports not originating in Canada. The Company has filed for a refund of $10.8 million for those periods.

Selected Financial Information and Statistics - Lumber

Summarized results for the Lumber segment for 2008 and 2007 are as follows:

(millions of dollars, unless otherwise noted)		2008		2007
Sales	$	**1,490.5**	$	1,942.7
EBITDA[8]	$	**(55.5)**	$	(198.4)
Adjusted EBITDA	$	**(36.8)**	$	(176.7)
EBITDA margin[8]		**(4)%**		(10)%
Adjusted EBITDA margin		**(2)%**		(9)%
Operating loss[8]	$	**(155.0)**	$	(301.2)
Capital expenditures	$	**39.5**	$	47.6
Average SPF 2x4 #2 & Btr lumber price in US$[9]	$	**222**	$	250
Average SPF price in Cdn$	$	**237**	$	269
Average SYP 2x4 #2 lumber price in US$[10]	$	**281**	$	280
Average SYP price in Cdn$	$	**300**	$	301
Production – SPF lumber (MMfbm)		**3,299.4**		4,111.6
Production – SYP lumber (MMfbm)		**388.6**		389.2
Shipments – Canfor-produced SPF lumber (MMfbm) [11]		**3,388.2**		4,233.5
Shipments – Canfor-produced SYP lumber (MMfbm) [11]		**432.7**		448.7
Shipments – wholesale lumber (MMfbm)		**171.0**		325.2

[8] EBITDA and Operating loss for the year ended December 31, 2008 include income of $17.3 million related to the implementation of new log inventory accounting. The income resulted principally from reversal of previously recognized log inventory write-downs at the beginning of the year (recorded through opening retained earnings), as lower log and conversion costs and the weaker Canadian dollar combined to more than offset the impact of lower finished product prices.
[9] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)
[10] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)
[11] Includes shipments of lumber purchased for remanufacture.

Overview

The Lumber segment reported an operating loss of $155.0 million for 2008, an improvement of $146.2 million compared to 2007. Reported EBITDA and Adjusted EBITDA improved $142.9 million and $139.9 million, respectively. Total market-related curtailment in 2008 was approximately 1.2 billion board feet, up 700 million board feet from 2007.

The increase in EBITDA and Adjusted EBITDA reflected significantly reduced unit manufacturing costs and losses mitigated through curtailment, which more than offset weaker prices for both SPF 2x4 and wider SPF and SYP grades. Other contributing factors to the improved performance included higher residual fibre realizations and the Third Country Adjustment export tax refund, which were partly offset by the negative impact on sales realizations of a 1% increase in the average value of the Canadian dollar. Restructuring costs were $18.7 million in 2008, down $3.0 million from the previous year.

Markets

Canfor's total lumber sales volume for 2008 was 3,992 million board feet, down 20% from 2007, with SPF sales and SYP sales making up 89% and 11% of sales, respectively.

In 2008, sales to the U.S. accounted for 72% of total sales revenue, down 3% from 2007, as the Company increased its proportion of sales to Canada and the Far East. A breakdown of lumber sales by country for 2008 and 2007 is provided below:

Lumber Sales by Country (based on dollar values):

	2008	2007
U.S.	**72%**	75%
Canada	**16%**	15%
Far East	**11%**	9%
Other	**1%**	1%
	100%	100%

Lumber markets continued to erode in 2008 as U.S. housing starts plunged to the lowest level on record by the end of the year. Total U.S. housing starts were 902,000 units in 2008[12], a 33% decrease from 1.341 million units in 2007. Starts declined significantly through 2008, ending the year at 550,000 units (SAAR) in December, the lowest level since records began in 1959. Inventories of new and used homes available for sale in the U.S. market at the end of 2008 were 12.9 months and 9.3 months[13], respectively, well above historical levels.

The Canadian housing market remained fairly stable for most of 2008, before tapering off towards the end of the year. Total Canadian housing starts were 211,000 units[14], a decrease of 8% from the 2007 total of 228,300 units.

Repair and Remodeling sales in the U.S. also declined in 2008 compared to the previous year, albeit at a slower pace than new home sales. The Company's sales to Home Centre customers as a proportion of sales in 2008 were in line with 2007.

The SPF lumber 2x4 #2&Btr price reached a short-lived high of US$283 per mfbm[15] in August of 2008, before declining rapidly through the balance of the year. Average prices across all SPF and SYP grades were down compared to the prior year, except for SYP 2x4 #2&Btr, where the yearly average price was largely unchanged.

Total Japanese housing starts for 2008 were 1.1 million, an increase of 3% over 2007[16] with western style 2x4 housing starts up 9% over the same period. As a result of a highly competitive market place, Canfor's sales to Japan for 2008 decreased from 2007, but in contrast sales to China in 2008 showed a 30% increase compared to 2007.

Sales

Lumber sales revenues for 2008 were down $452.2 million, or 23%, compared to 2007, reflecting the 20% decline in shipments and price erosion across almost all grades in 2008. 2008 shipments were down 1,016 million board feet compared to 2007, as the Company responded to weaker demand with significantly increased production curtailment. The average price for SPF benchmark 2x4 #2&Btr was down US$28 per Mfbm, or 11%, compared to the prior year, while average prices for SYP lumber, measured by 2x4 #2&Btr, were almost unchanged. More significantly, however, prices for wider SPF and SYP grades fell sharply in 2008, as evidenced by year-over-year SPF and SYP 2X10 price declines of 22% and 16%, respectively. The 1% decrease in the US dollar versus the Canadian dollar also contributed to lower Canadian dollar sales realizations in 2008.

Total residual fibre revenue for 2008 was well down from 2007 levels, reflecting significantly lower sawmill operating rates, but the average unit chip prices showed a modest increase in 2008, primarily as a result of higher average NBSK pulp prices.

[12] U.S. Bureau of the Census
[13] NAR – National Association of Realtors
[14] CMHC
[15] Random Lengths
[16] Japanese Ministry of Land, Infrastructure, Transport and Tourism

Operations

Lumber production for 2008 was 3,688 million board feet, 813 million board feet, or 18%, lower than for 2007. This lower production reflected the indefinite closures of the Mackenzie (June) and Chetwynd (March) sawmills, as well as a combination of reduced shifts and shortened work weeks at the Company's other operations. Production in 2008 included the Darlington sawmill in South Carolina, which was acquired in late 2007.

Despite the challenges presented by curtailments to its operations, the Company made significant headway in reducing its controllable costs in 2008. Total unit manufacturing costs were down at the majority of the Company's operations, and at its B.C. Interior operations unit costs were down 14% compared to the prior year. Major contributing factors to the improved cost performance were reduced unit log costs, achieved through reduced operating and overhead costs, and lower unit conversion costs that for the most part reflected improved sawmill and planer productivity and reduced overhead costs.

The Company's export tax expense in 2008 was $55.1 million (2007 - $101.8 million). While the export tax on shipments remained at 15% through 2008, lower shipments to the U.S. in 2008 and the Third Country Adjustment refund resulted in the lower expense compared to 2007.

Panels

The Panels segment includes the Tackama plywood plant, with an annual production capacity of 270 million square feet (3/8" basis), and the PolarBoard OSB facility, with an annual production capacity of 640 million square feet (3/8" basis), both of which are currently indefinitely closed. Also included in this segment is the Peace Valley OSB ("PV OSB") mill, which is jointly owned with Louisiana Pacific Corporation, of which Canfor's share is 50%. The PV OSB mill has an annual capacity of 820 million square feet (3/8" basis). Prior to the NCP fire in May of 2008 the Panels segment also included this mill's annual plywood production capacity of 170 million square feet. This capacity has now been permanently removed following the Company's decision not to rebuild the facility.

The OSB that Canfor produces is largely performance rated sheathing and flooring, used in wall, roof and flooring 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 U.S. market. Canada is the largest market for Canfor's plywood. Substantially all panel products destined for North American markets were shipped either by rail or truck.

Selected Financial Information and Statistics - Panels

(millions of dollars, unless otherwise noted)		2008		2007
Sales	**$**	**170.3**	$	297.7
EBITDA[17]	**$**	**(40.8)**	$	(53.5)
Adjusted EBITDA	**$**	**(6.3)**	$	(39.0)
EBITDA margin[17]		**(24)%**		(18)%
Adjusted EBITDA margin		**(4)%**		(13)%
Operating loss [17]	**$**	**(56.9)**	$	(76.5)
Capital expenditures	**$**	**0.8**	$	15.7
Average plywood price in Cdn$ [18]	**$**	**338**	$	376
Average OSB in US$[19]	**$**	**172**	$	161
Average OSB price in Cdn$	**$**	**183**	$	173
Production – plywood (MMsf 3/8")		**233.4**		385.0
Production – OSB (MMsf 3/8")		**434.8**		673.2
Shipments – plywood (MMsf 3/8")		**264.1**		385.4
Shipments – OSB (MMsf 3/8")		**462.9**		669.9

[17] EBITDA and Operating loss for the year ended December 31, 2008 include income of $13.1 million related to the implementation of new log inventory accounting. The majority of income resulted from the consumption in 2008 of December 31, 2007 log inventory volumes (on which write-downs to net realizable value were recorded through opening retained earnings) and significantly reduced log inventory volumes at the end of 2008.
[18] Canadian softwood plywood, per Msf 3/8" basis, delivered to Toronto (Source – C.C. Crowe Publications, Inc.)
[19] OSB, per Msf 7/16" North Central (Source – Random Lengths Publications, Inc.)

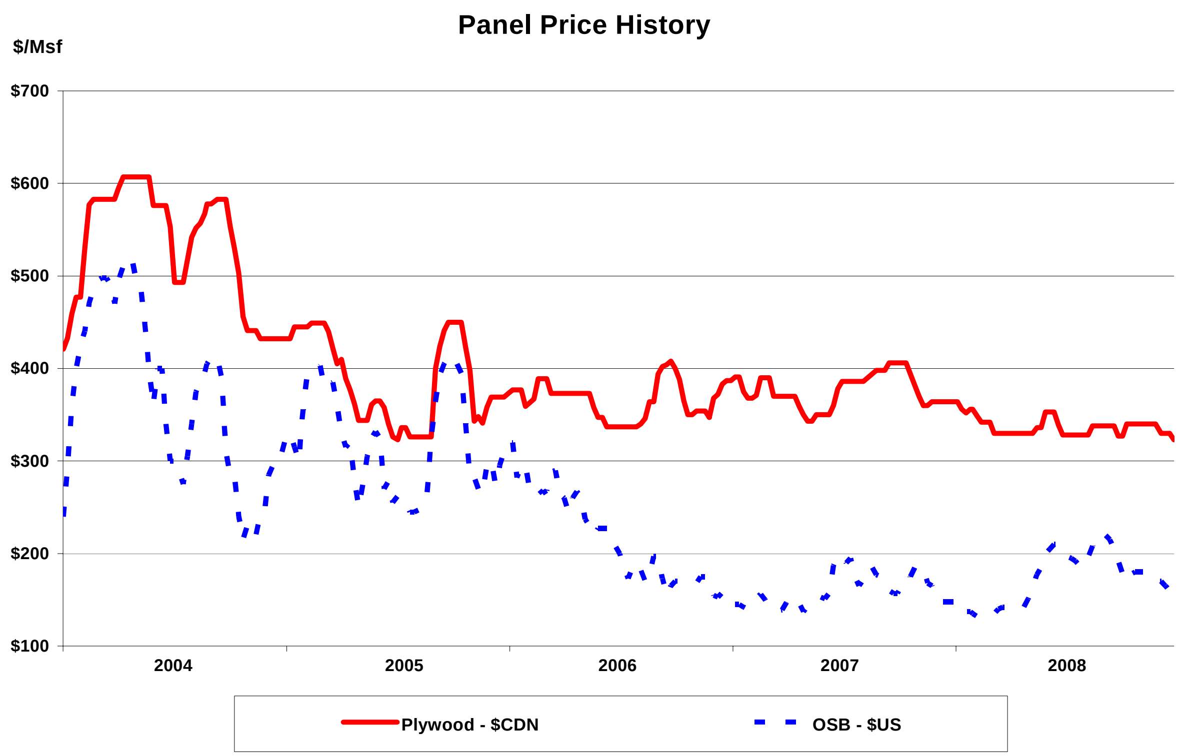
Overview

The Panels segment recorded an operating loss of $56.9 million for 2008, $19.6 million less than the operating loss reported for 2007.

The 2008 and 2007 operating losses included restructuring, mill closure and severance costs of $34.5 million and $14.4 million, respectively. Costs for 2008 reflected the indefinite closures of PolarBoard (June) and Tackama (October), as well as the permanent closure of NCP following the May fire that destroyed the facility. The 2007 costs reflected the permanent closure of the Company's Panel & Fibre operation in December of 2007. Adjusted EBITDA for 2008 was up $32.8 million compared to 2007, and reflected reduced losses arising from the Company's decision to curtail most of its production, the impact of the new log inventory accounting standard in 2008, and lower log costs.

Markets

The North American structural panel market in 2008 was affected by the same factors as the lumber market, with the substantial reduction in U.S. housing starts placing significant downward pressure on panel prices throughout the year. The 2008 price of OSB averaged US$172 per thousand square feet ("Msf"), 7/16" North Central[20] an increase of 7% above 2007 average price of US$161 per Msf, although prices fell off sharply later in the year, ending 2008 at US$153 per Msf. Canadian plywood prices averaged $338 per Msf, a decrease of 10% from 2007 for Canadian softwood plywood delivered to Toronto. Prices ended the year at $323 per Msf.



Sales

OSB Canadian dollar sales realizations were up slightly for 2008 compared to 2007. Modest increases in OSB prices outweighed the slightly stronger Canadian dollar, but were offset by the lower plywood prices in 2008. Total shipment volumes were down 328 million square feet, or 31%, reflecting the NCP mill permanent closure in 2008, the indefinite closures of PolarBoard and Tackama, and also, to a lesser extent, curtailment at the PV OSB mill in the final quarter of 2008.

[20] Random Lengths

Operations

Production volumes in 2008 were down 390 million feet, or 37%, in 2008 compared to 2007, as a result of the significantly reduced operating rates. Total unit manufacturing costs showed a modest improvement in 2008, mostly due to lower log costs and higher press productivity, which more than offset higher unit overhead costs linked to the large declines in production.

Pulp and Paper

Canfor's Pulp and Paper segment is comprised of Canfor Pulp Limited Partnership ("CPLP") and the Taylor Pulp mill ("Taylor"). CPLP produces northern bleached softwood kraft ("NBSK") Pulp and Specialty Paper. NBSK pulp is primarily a bleached product, although unbleached and semi-bleached grades are also produced at the PG Pulp mill. All of the operations 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 CPLP pulp mills have the capacity to produce over one million tonnes of NBSK pulp annually. Over 200,000 tonnes of bleached chemi-thermo mechanical pulp ("BCTMP") per year can be produced at the Taylor mill. The paper machine, located at the PG Pulp mill, has an annual 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.

Selected Financial Information and Statistics – Pulp and Paper[21]

(millions of dollars, unless otherwise noted)		**2008**		**2007**
Sales	**$**	**950.8**	$	1,035.2
EBITDA	**$**	**125.6**	$	190.5
EBITDA margin		**13%**		18%
Operating income	**$**	**76.8**	$	137.2
Capital expenditures	**$**	**39.9**	$	24.2
Average pulp price delivered to U.S. - in US$[22]	**$**	**857**	$	823
Average pulp price in Cdn$	**$**	**914**	$	885
Production – pulp (000 mt)		**1,124.6**		1,244.5
Production – paper (000 mt)		**132.6**		131.6
Shipments – Canfor-produced pulp (000 mt)		**1,088.0**		1,228.9
Pulp marketed on behalf of HSLP (000 mt)[23]		**313.1**		366.6
Shipments – paper (000 mt)		**124.8**		129.5

[21] Includes Taylor and 100% of CPLP, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.
[22] Per tonne, NBSK pulp list price delivered to U.S. (RISI)
[23] Howe Sound Pulp and Paper Limited Partnership Pulp mill

Overview

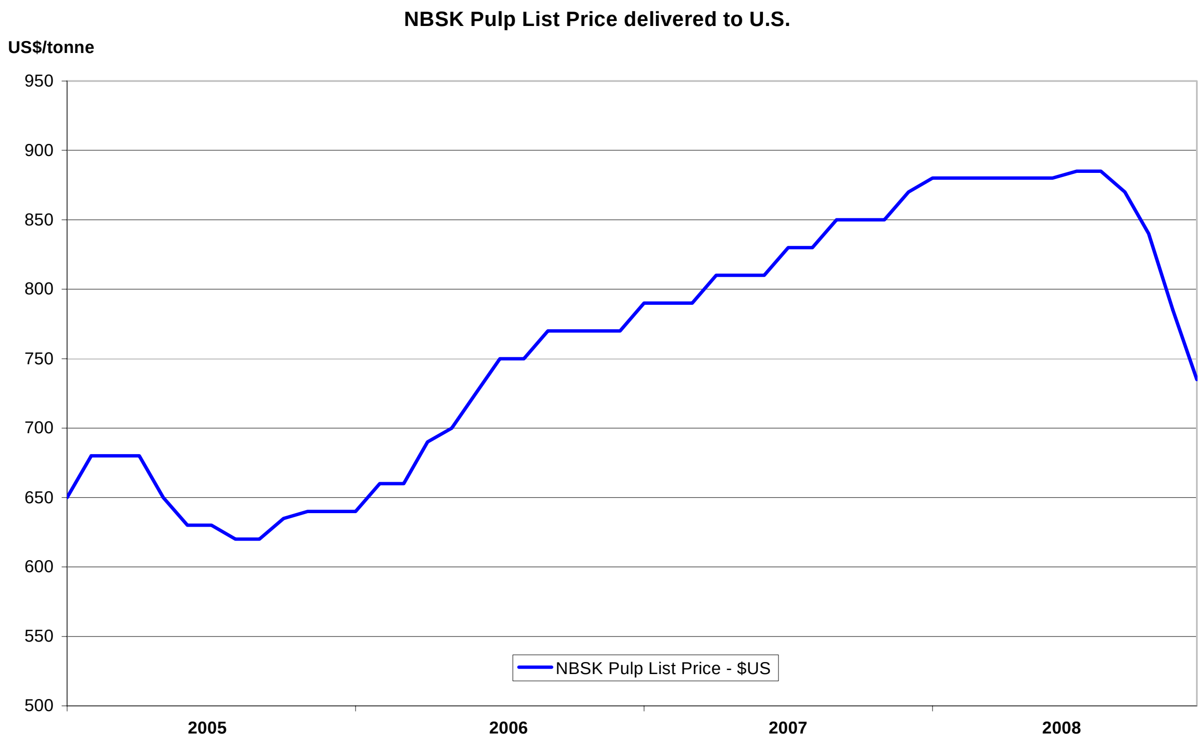
Operating income and EBITDA in the Pulp and Paper segment for 2008 were down $60.4 million and $64.9 million, respectively, from the prior year. The unfavourable variances were primarily attributable to higher fibre, energy, chemical and freight costs, higher scheduled maintenance outages, and the rapid deterioration of market conditions later in the year which resulted in market downtime in the fourth quarter. Overall realized pulp prices in Canadian dollar terms were largely unchanged in 2008, as higher BCTMP transaction prices helped to offset slight decreases in both the value of the U.S. dollar and realized NBSK pulp prices, where a higher percentage of spot sales into Asia at lower than published list prices, particularly in the later part of the year, offset higher average list prices.

Markets

After a strong start to 2008, pulp market conditions started to weaken during the third quarter before plummeting in the final quarter of the year as the financial and credit market crisis and worsening global economic conditions took their toll. At the end of the year, market pulp inventories of softwood kraft market pulp were at 40 days of supply[24] which represented an increase of 13 days compared to the end of 2007. Inventories of 30 days are generally considered to be representative of a balanced market. The Pulp and Paper Products Council ("PPPC") reported total Global 100 chemical market pulp shipments at a rate of 87% in 2008, compared to 92% for 2007.

While the average NBSK pulp list price delivered to the U.S. was US$857 per tonne, up about 4% from 2007, list prices at year end were US$730 per tonne, US$150 per tonne, or 17%, lower than twelve months earlier. Price erosion was even more significant in European markets, where list prices fell US$245 per tonne over the same period, and also in Asia where spot sales prices fell off sharply, particularly in the latter part of 2008.

The following chart highlights the significant downward trend in NBSK Pulp List Price delivered to the U.S in the second half of 2008:



Sales

Shipments of Canfor-produced pulp were down 11% compared to the prior year. Sales volumes were down 199,000 tonnes when compared to the prior year due to a combination of a fire that destroyed CPLP's PG Pulp mill's chip screening and in-feed system in the first quarter, increased scheduled maintenance outages and market related downtime in 2008, the latter precipitated by the reduction in global paper demand later in the year. Realized pulp prices in Canadian dollar terms were largely unchanged in 2008, as higher prices, particularly for BCTMP products, offset a 1% strengthening of the Canadian dollar and weaker NBSK pulp prices, particularly in the second half of 2008, which reflected a higher proportion of spot sales to Asian markets and significantly slower demand. Specialty paper prices showed a moderate improvement over 2007. Freight costs on shipments of finished product were also up significantly in 2008.

[24] Pulp and Paper Products Council ("PPPC")

Operations

Production volume for 2008 was down 119,000 tonnes, or 9%, when compared to the prior year, mainly due to a fire at PG Pulp mill's chip screening and in-feed system in the first quarter of 2008, higher scheduled maintenance downtime and NBSK and BCTMP market curtailment taken late in the year. Higher unit manufacturing costs reflected reduced operating rates and higher scheduled maintenance costs as well as increased energy, chemical and fibre costs. The increase in fibre costs in part resulted from a higher proportion of whole log chipping due to a significant reduction in sawmill residual chips due to poor lumber markets, as well as higher in-bound freight costs. Higher chemical and energy costs were attributable to commodity price inflation. Offsetting the impact of the PG Pulp mill's fire were business interruption insurance recoveries of $19.1 million.

Non-Segmented Items

(millions of dollars)		2008		2007
Corporate and other costs	**$**	**(23.0)**	$	(32.5)
Interest expense, net	**$**	**(25.4)**	$	(9.4)
Foreign exchange (loss) gain on long-term debt and investments, net	**$**	**(100.3)**	$	16.2
(Loss) gain on derivative financial instruments	**$**	**(88.5)**	$	16.0
Asset impairments	**$**	**(169.6)**	$	(268.0)
Prince George Pulp & Paper mill fire, net	**$**	**8.2**	$	-
North Central Plywoods mill fire, net	**$**	**57.9**	$	-
Other income (expense), net	**$**	**12.7**	$	(11.1)

Corporate and Other Costs

Corporate and other costs, which comprise corporate, head office and certain information technology costs, decreased by $9.5 million in 2008 compared to 2007, due primarily to reduced staffing and other cost reduction initiatives, as well as costs associated with the resignation of the Company's former chief executive officer recorded in 2007.

Interest Income and Expense

Net interest expense for the third quarter was $25.4 million, up $16.0 million compared to 2007. The increase primarily related to higher average net indebtedness in 2008.

Foreign Exchange Gain (Loss) on Translation of Long-Term Debt and Investments

As a result of a 24% appreciation of the US dollar (relative to the Canadian dollar) through 2008, most of which occurred in the last quarter of the year, the Company recorded a foreign exchange translation loss on its US dollar denominated debt less investments of $100.3 million, in contrast to a gain of $16.2 million recorded in 2007.

Gain (Loss) on Derivative Financial Instruments

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in natural gas and diesel costs, foreign exchange rates and lumber prices. In 2008, the Company recorded a loss of $88.5 million related to its derivative instruments, which reflected a sharp decline in the value of the Canadian dollar and energy prices in the last part of the year. The following table summarizes the amounts of the various components for the comparable periods.

Gain (Loss) on Derivative Financial Instruments:

(millions of dollars)		2008		2007
Foreign exchange collars and forward contracts	**$**	**(86.1)**	$	14.3
Natural gas swaps	**$**	**1.0**	$	(9.1)
Diesel options and swaps	**$**	**(3.4)**	$	9.1
Commodity futures	**$**	**-**	$	1.7
	$	**(88.5)**	$	16.0

Asset Impairments

The Company recorded asset impairment charges totalling $169.6 million in 2008 (2007 - $268.0 million), which consisted of the following:

- $89.4 million related to the downturn in the solid wood business in 2008, principally related to the Company's Tackama and PolarBoard operations, both of which were indefinitely idled during the year.
- $70.0 million related to balances owing from HSLP and the Company's 50% interest in CFLP, an entity which supplies fibre and related services to HSLP. The impairment reflected the continuing deterioration of B.C. Coastal pulp, paper and fibre market conditions.
- $10.2 million related to the Company's investment in ABCP. This resulted from the estimated fair value of the ABCP at year end, which took into account all information available to Canfor related to its specific holdings of ABCP. It also assumed a high likelihood of success for an ABCP restructuring plan which was approved by regulators in 2008. The restructuring plan was subsequently completed on January 21, 2009.

More information on the asset impairments is contained under "Critical Accounting Estimates – Asset Impairments".

Prince George Pulp and Paper Mill Fire

A gain of $8.2 million was recorded by CPLP in 2008, arising from the fire that destroyed a chip screening and in-feed system at its PG Pulp mill in the first quarter.

NCP Mill Fire

In May of 2008, a fire at the Company's NCP facility completely destroyed the mill. The mill was insured for equivalent replacement value. At the end of 2008, the Company had not reached a final settlement with its insurer, and accordingly, estimated the insurance property damage amount receivable using preliminary engineering estimates and other information available. Based on estimated insurance proceeds, net of an aggregate policy deductible of $2.4 million, and costs related to the fire, the Company recorded a pre-tax gain of $57.9 million. The estimates are subject to adjustments in future periods. The Company received cash advances of $30.0 million from its insurer by the end of 2008. The insurance property damage receivable was estimated on the basis that the insurance proceeds will be applied towards capital improvements at Canfor's other operations.

Other Income and Expense

Other income amounted to $12.7 million in 2008, compared to an expense of $11.1 million in 2007. In both years, the significant majority of these amounts reflected foreign exchange movements on US dollar denominated cash, receivables and payables of Canadian operations.

Income Tax Recovery

The Company recorded an income tax recovery of $141.9 million in 2008, compared to a recovery of $234.1 million in 2007.

The 2008 recovery is comprised of a current income tax recovery of $47.9 million and a future income tax recovery of $94.0 million. The most significant factors contributing to the future income tax recovery are the impact of the asset impairment charge, which gave rise to a recovery of $36.7 million, the impact of the loss on the derivative financial instruments, which gave rise to a recovery of $28.4 million, and the impact of the unrealized foreign exchange losses on translation of long-term debt and investments, which gave rise to a recovery of $13.5 million.

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

(millions of dollars)		**2008**	2007
Net loss before income taxes and non-controlling interests	**$**	**(463.1)**	(529.3)
Income tax recovery at statutory rate		**143.6**	180.5
Add (deduct):			
Non-controlling interests		**7.4**	22.3
Change in corporate income tax rates		**9.1**	21.5
Entities with different income tax rates and other tax adjustments		**4.4**	12.4
Tax recovery at rates other than statutory rate		**3.5**	-
Permanent difference from capital gains and losses and other non-deductible items		**(26.1)**	(2.6)
Income tax recovery	**$**	**141.9**	234.1

SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's financial position as at the end of the years 2008 and 2007:

(millions of dollars, except for ratios)		**2008**		2007
Net cash	**$**	**362.4**	$	295.5
Operating working capital		**322.7**		432.6
Current portion of long-term debt		**(168.3)**		(15.2)
Current portion of deferred reforestation		**(32.5)**		(34.4)
Income taxes recoverable		**47.1**		136.7
Net working capital		**531.4**		815.2
Long-term investments		**125.7**		170.4
Property, plant, equipment and timber		**1,798.5**		1,959.4
Goodwill		**85.7**		69.2
Deferred charges		**110.2**		90.0
Net assets	**$**	**2,651.5**	$	3,104.2
Long-term debt	**$**	**428.7**	$	481.6
Deferred reforestation obligation		**63.1**		65.6
Other long-term provisions and accruals		**145.7**		137.9
Future income taxes – net		**242.4**		299.5
Non-controlling interests		**276.8**		302.5
Shareholders' equity		**1,494.8**		1,817.1
Total capitalization	**$**	**2,651.5**	$	3,104.2
Ratio of current assets to current liabilities		**2.0 : 1**		3.0 : 1
Ratio of net debt to capitalization ratio		**15%**		10%

Canfor's ratio of current assets to current liabilities was 2.0:1 at the end of 2008, down from 3.0:1 at the end of 2007, mostly due to the reclassification of $168.3 million (2007 - $15.2 million) of long-term debt to current liabilities, and to a lesser extent, an increased drawdown of CPLP's operating loan, lower trade receivable and inventory levels (mostly reflecting weaker market conditions at the 2008 year end), and lower income taxes recoverable.

The Company's net debt to capitalization ratio was 15% at the end of 2008, up from 10% at the end of 2007, primarily due to the operating losses, asset impairments charges, foreign exchange translation losses on US dollar debt and losses on derivative financial instruments recorded in 2008. Shareholders' Equity in 2008 included other comprehensive income of $53.5 million, substantially all of which related to foreign exchange gains on Canfor's self-sustaining foreign operations. In addition to the foreign exchange translation losses on US dollar debt, and the increased operating loan balance, net debt at the end of 2008 reflected positive cash flow from operating activities, which more than offset capital spending and cash distributions paid to non-controlling interests in 2008.

CHANGES IN FINANCIAL POSITION

At the end of 2008, Canfor had $362.4 million of cash and cash equivalents.

(millions of dollars, except for rations)		**2008**		2007
Cash generated from (used in)				
Operating activities	**$**	**157.7**	$	(483.1)
Financing activities		**(42.4)**		(174.3)
Investing activities		**(48.4)**		(70.9)
Increase (decrease) in cash and cash equivalents	**$**	**66.9**	$	(728.3)

The changes in the components of these cash flows during 2008 are discussed below:

Operating Activities

In 2008, Canfor generated cash from operations of $157.7 million, compared to using $483.1 million in 2007. Cash generated in 2008 reflected reduced operating losses and a reduction in working capital balances, which included an income tax refund of $137.5 million related to previous period losses and lower trade receivables balances, partly offset by restructuring, mill closure and severance payments in 2008. The significant amount of cash used in operating activities in 2007 principally reflected the payment of income taxes and a special charge on duty refund monies and related interest, which were received by the Company in late 2006 following the implementation of the SLA. This was partly offset by a decrease in inventories in 2007.

Financing Activities

Financing activities in 2008 used net cash of $42.4 million in 2008 (2007 - $174.3 million). Payments included $52.3 million of CPLP distributions paid to non-controlling interests (2007 - $74.2 million) and the repayment of long-term debt of $14.8 million (2007 - $99.4 million). Partly offsetting these outflows was an increase of $25.2 million in CPLP's operating bank loan (2007 - decrease of $1.1 million).

Investing Activities

Cash used in investing activities amounted to $48.4 million in 2008 (2007 - $70.9 million). Property, plant and equipment additions were $80.2 million, of which approximately $30 million was spent to improve the Company's cost position, production and capacity. The balance was to maintain the existing productive capacity of the operations or to ensure Canfor's safety and environmental performance. Project spending in 2008 included work on fibre and energy optimization projects at the Company's Fort St. John mill, upgrades to the Conway mill in South Carolina, a replacement chip screening and in-feed system at CPLP's PG Pulp mill (mostly funded by insurance proceeds), and various upgrades at CPLP's Northwood and Intercon pulp mills. The Company received $30.0 million of initial advances from its insurer in relation to the NCP fire. Other outflows included an advance of $11.5 million to HSLP as part of a debt restructuring completed in early 2008.

In 2007, the Company's major investing activities were capital expenditures of $90.6 million and $16.8 million paid to acquire the Darlington sawmill. Temporary investments in 2007 increased by a net $38.6 million.

FINANCIAL REQUIREMENTS AND LIQUIDITY

Operating Loans

At the end of 2008, the Company had $430.0 million of unsecured operating lines available (2007 - $409.0 million), of which $25.2 million was drawn down (2007 – nil) and $41.4 million was reserved for several standby letters of credit (2007 - $40.1 million).

Canfor Corporation's available operating line at December 31, 2008 was $355.0 million of which $17.3 million was reserved for several standby letters of credit, the majority of which related to unregistered pension plans. CPLP's available operating line was $75.0 million of which $25.2 million was drawn down and $24.1 million was reserved for a standby letter of credit issued to BC Hydro in connection with a 15 year electrical cogeneration agreement. These operating lines expire in June of 2011 and November of 2009, respectively.

On January 30, 2009, Canfor entered into two new operating loan facilities in the amounts of US$16.7 million ("Facility A") and US$43.7 million ("Facility B"). Facility A expires in January of 2012, with the option of four one-year extensions, and is non-recourse to Canfor, except for US$6.7 million. Facility B expires in January of 2011, with the option of five one-year extensions, and is non-recourse to Canfor under normal circumstances. The ABCP assets of the Company have been pledged as security to support these credit facilities.

Debt Covenants

Canfor has certain financial covenants on its debt obligations that stipulate maximum net debt to total capitalization ratios and minimum net worth amounts based on total shareholders' equity. The net debt to total capitalization is calculated by dividing total debt, less cash and cash equivalents, by shareholders' equity plus total debt less cash and cash equivalents. Debt obligations are held by various entities within the Canfor group and the individual debt agreements specify the entities within the group that are to be included in the covenant calculations.

In certain circumstances, when net debt to total capitalization exceeds a certain threshold, Canfor is subject to an interest coverage ratio that requires a minimum amount of EBITDA relative to net interest expense.

In addition, CPLP has leverage and interest coverage ratios calculated by reference to operating earnings before interest, taxes, depreciation and amortization.

Provisions contained in Canfor's long-term borrowing agreements also 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.

Management reviews results and forecasts to monitor the Company's compliance with these covenant requirements. Canfor was in compliance with all its debt covenants for the year ended December 31, 2008.

2009 Projected Capital Spending and Debt Repayments

In 2009, depending on market conditions, Canfor anticipates that it may invest approximately $100 to $110 million in capital projects, which will consist of maintenance of business and improvement projects, several of which will be funded by the insurance proceeds from its NCP property damage claim. In March and April of 2009, $168.3 million (US$137.3 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.

Commitments

The following table summarizes Canfor's financial contractual obligations at December 31, 2008 for each of the next five years and thereafter:

(millions of dollars)	2009	2010	2011	2012	2013	Thereafter	Total
Long-term debt and capital lease obligations	$ 168.3	$ 40.1	$ 100.8	$ 61.2	$ 226.6	$ -	$ 597.0
Operating leases	$ 22.4	$ 13.8	$ 6.6	$ 4.7	$ 2.7	$ 1.8	$ 52.0
	$ 190.7	$ 53.9	$ 107.4	$ 65.9	$ 229.3	$ 1.8	$ 649.0

Other contractual obligations not included in the table 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 $95.6 million has been recorded at December 31, 2008 (2007 – $100.0 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 a liability of $127.0 million has been recorded at December 31, 2008 (2007 - $114.0 million).

Sale of Panel and Fibre Mill Property

On February 13, 2009, Canfor completed the sale of a property located at New Westminster, British Columbia, for gross proceeds of $47.5 million. The property was the site of Canfor's former Panel and Fibre operation, which was permanently closed at the beginning of 2008. The transaction will result in a pre-tax gain of approximately $44 million.

Pension Obligations

The global financial and credit crisis has resulted in a sharp drop in the market value of equity investments around the world and also in the market value of Canfor's pension plan assets. For accounting purposes, the date at which the accrued benefit obligation and the fair value of the plan assets are measured (the "Measurement Date') is September 30th of each year. The declines in the value of the pension plan assets up until that date are included in the Company's funded deficit of $33.8 million as shown in the notes to the Company's 2008 consolidated financial statements. In accordance with Canadian GAAP the 2009 pension expense for accounting purposes will reflect plan assets and obligations and various assumptions, including estimated plan rates of return and discount rates, at the Measurement Date.

In the period between the Measurement Date and December 31, 2008, the value of the Company's pension plan assets declined a further 10% (approximately $43 million), and the discount rate increased over the same period. While these movements do not have any impact on the Company's 2008 year end balance sheet or the 2009 pension expense, the 2010 pension expense will be impacted as a result of the changes in market value of plan assets between measurement dates. A new funding valuation is currently scheduled to be performed as of December 31, 2009 when any changes to cash contributions required from 2010 onwards will be determined. The impact on required cash contributions to the plans could be material.

TRANSACTIONS WITH RELATED PARTIES

The Company undertakes transactions with various related entities. These transactions are in the normal course of business and are generally on the same terms as those accorded to unrelated third parties, except where noted otherwise.

Howe Sound Pulp and Paper Limited Partnership ("HSLP")

HSLP is jointly owned by Canfor and Oji Paper Co., Ltd ("Oji") and operates the Port Mellon kraft pulp and newsprint mill. Canfor does not reflect its share of HSLP's results in its financial statements, as its investment in HSLP has been written off.

Canfor and Oji have a prepayment agreement with HSLP whereby the partners prepay HSLP in advance of the due date for receivables for pulp marketed, or to be marketed, and collected on their behalf. Canfor charges a market rate of interest to HSLP for the period paid in advance and the prepayment is covered by the assignment of current or future accounts receivable. The agreement provides for Oji to prepay up to a maximum amount of $60.0 million and Canfor to a maximum of $50.0 million, which is used as short-term operating funds by HSLP. In addition, Canfor has granted extended credit terms to HSLP up to a maximum of $10.0 million. Canfor, through CPLP, also markets the pulp production of HSLP for which it receives commissions under the terms of an agency sales agreement. Canfor also provides management, fibre supply and other services to HSLP at cost. At the end of 2008, Canfor had an unsecured receivables balance outstanding with HSLP of $31.4 million.

Coastal Fibre Limited Partnership ("CFLP"), jointly owned by Canfor and Oji, purchases chips for resale to HSLP under a long-term fibre agreement with Western Forest Products Limited ("WFP"), for which CFLP charges HSLP a commission. The related transactions and balances outstanding are proportionately consolidated in Canfor's financial statements. At year end, Canfor's share of the outstanding balance owing by HSLP was $9.5 million. In January of 2009, WFP defaulted on its three year rolling average minimum chip volume supply obligation, and subsequently entered into negotiations with CFLP to resolve this matter.

As a consequence of a debt restructuring agreement among HSLP, Canfor, Oji and a consortium of Japanese banks (the "Banks") in February of 2008, Canfor contributed additional funds to HSLP of $18.8 million, which were still outstanding at year end. These funds are secured by the assets of HSLP, subject to other security granted to the Banks and Oji. The repayment of these funds has priority over all other repayments, except a minimum bank debt repayment, from the annual free cash flow of HSLP.

Other

Other related party transactions include:

1. The purchase of pulp chips and lumber, at market value, from Lakeland Mills Ltd. and Winton Global Lumber Ltd., in which Canfor holds a one-third equity interest; and
2. Shipping services provided to Canfor by Seaboard International Shipping Company, in which Canfor holds a minority interest.

Additional details are contained in note 26 to Canfor's 2008 consolidated financial statements.

SELECTED QUARTERLY FINANCIAL INFORMATION

	Q4 2008	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Sales and income (millions of dollars)								
Sales	**$ 588.7**	**$ 668.0**	**$ 706.4**	**$ 648.5**	$ 711.0	$ 837.4	$ 876.6	$ 850.6
Operating (loss) income	**$ (74.2)**	**$ 12.8**	**$ 20.8**	**$ (117.5)**	$ (124.7)	$ (52.1)	$ (38.4)	$ (57.8)
Net (loss) income	**$ (229.8)**	**$ (94.2)**	**$ 64.2**	**$ (85.4)**	$ (237.0)	$ (42.1)	$ (38.8)	$ (42.7)
Per common share (dollars)								
Net (loss) income– basic and diluted	**$ (1.61)**	**$ (0.66)**	**$ 0.45**	**$ (0.60)**	$ (1.66)	$ (0.30)	$ (0.27)	$ (0.30)
Statistics								
Lumber shipments (MMfbm)	**956**	**906**	**1,107**	**1,023**	1,149	1,301	1,345	1,213
Plywood shipments (MMsf 3/8”)	**28**	**54**	**96**	**86**	90	90	119	87
OSB shipments (MMsf 3/8”)	**56**	**91**	**153**	**164**	166	162	168	174
Pulp shipments (000 mt)	**236**	**284**	**289**	**279**	308	307	309	304
Average exchange rate – US$/Cdn$	**$ 0.825**	**$ 0.960**	**$ 0.990**	**$ 0.996**	$ 1.019	$ 0.957	$ 0.911	$ 0.854
Average Western SPF 2x4 #2&Btr lumber price (US$)	**$ 190**	**$ 263**	**$ 230**	**$ 205**	$ 230	$ 260	$ 258	$ 253
Average SYP (East) 2x4 #2 lumber price (US$)	**$ 258**	**$ 289**	**$ 294**	**$ 285**	$ 277	$ 273	$ 292	$ 279
Average plywood price – Toronto (Cdn$)	**$ 336**	**$ 333**	**$ 337**	**$ 347**	$ 374	$ 394	$ 357	$ 379
Average OSB price – North Central (US$)	**$ 172**	**$ 202**	**$ 174**	**$ 138**	$ 165	$ 177	$ 156	$ 145
Average NBSK pulp list price delivered to U.S. (US$)	**$ 787**	**$ 880**	**$ 880**	**$ 880**	$ 857	$ 837	$ 810	$ 790

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.

THREE-YEAR COMPARATIVE REVIEW

(millions of dollars, except per share amounts)	2008	2007	2006
Sales	**$ 2,611.6**	$ 3,275.6	$ 3,842.3
Net (loss) income before discontinued items	**$ (345.2)**	$ (360.6)	$ 475.7
Net (loss) income	**$ (345.2)**	$ (360.6)	$ 471.8
Total assets	**$ 3,200.4**	$ 3,507.8	$ 4,663.5
Total long-term financial liabilities	**$ 428.7**	$ 481.6	$ 602.8
Net (loss) income before discontinued items per share, basic and diluted	**$ (2.42)**	$ (2.53)	$ 3.34
Net (loss) income per share, basic and diluted	**$ (2.42)**	$ (2.53)	$ 3.31

QUARTER ENDED DECEMBER 31, 2008 VS. QUARTER ENDED DECEMBER 31, 2007

Overview of Operating Results

The Company recorded an operating loss of $74.2 million and a net loss of $229.8 million for the fourth quarter of 2008, compared with an operating loss of $124.7 million and a net loss of $237.0 million in the fourth quarter of 2007. The loss per share (basis and diluted) was $1.61 in the fourth quarter of 2008, compared to a loss per share of $1.66 in the fourth quarter of 2007.

The fourth quarter 2008 results include an asset impairment charge of $99.6 million ($74.1 million after taxes). An asset impairment charge of $256.0 million ($189.1 million after taxes) was recorded in the fourth quarter of 2007.

An overview of the results by business segment for the fourth quarter of 2008 compared to the last quarter of 2007 follows.

Lumber

Selected Financial Information and Statistics - Lumber

Summarized results for the Lumber segment for the fourth quarter of 2008 and 2007 were as follows:

(millions of dollars, unless otherwise noted)		Q4 2008		Q4 2007
Sales	**$**	**363.9**	$	395.3
EBITDA[25]	**$**	**(24.1)**	$	(73.9)
Adjusted EBITDA	**$**	**(20.4)**	$	(66.9)
EBITDA margin[25]		**(7)%**		(19)%
Adjusted EBITDA margin		**(6)%**		(17)%
Operating loss [25]	**$**	**(50.8)**	$	(99.5)
Average SPF 2x4 #2 & Btr lumber price in US$[26]	**$**	**190**	$	230
Average SPF price in Cdn$	**$**	**230**	$	226
Average SYP 2x4 #2 lumber price in US$[27]	**$**	**258**	$	277
Average SYP price in Cdn$	**$**	**313**	$	272
Production – SPF lumber (MMfbm)		**791.6**		866.8
Production – SYP lumber (MMfbm)		**78.6**		93.3
Shipments – Canfor-produced SPF lumber (MMfbm) [28]		**834.3**		988.4
Shipments – Canfor-produced SYP lumber (MMfbm) [28]		**86.2**		103.3
Shipments – wholesale lumber (MMfbm)		**35.7**		57.2

[25] EBITDA and Operating loss for the fourth quarter of 2008 include a log inventory write-down expense of $1.5 million, which resulted primarily from lower prices.
[26] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)
[27] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)
[28] Includes shipments of lumber purchased for remanufacture.

Overview

The Lumber segment reported an operating loss of $50.8 million for the fourth quarter of 2008, an improvement of $48.7 million compared to an operating loss of $99.5 million for the fourth quarter of 2007. Adjusted EBITDA improved by $46.5 million over the same period.

The improvement in Adjusted EBITDA reflected significantly lower unit manufacturing costs, achieved in the face of increased downtime in the current period. The fall in US dollar lumber prices between both quarters was offset by the decrease in the value of the Canadian dollar compared to the US dollar in the fourth quarter of 2008. Adjusted EBITDA was also positively impacted by the $10.8 million SLA Third Country Adjustment export tax refund receivable recorded in the fourth quarter of 2008.

Markets

Demand for lumber in the U.S. continued to decline during the fourth quarter of 2008, with total U.S. housing starts dropping to 550,000 units SAAR[29] in December, the lowest level since the U.S. Bureau of the Census began recording in 1959. U.S. housing starts were down 495,000 units SAAR, or 43%, compared to the fourth quarter of 2007. Single family starts continued to fall sharply during the quarter, and were down 44% compared to the same quarter of 2007.

Inventories of new homes for sale at the end of the fourth quarter of 2008 were 12.9 months, up 3.1[29] months, compared to the fourth quarter of 2007 of 9.8 months; however inventories of existing homes were at 9.3[30] months, down slightly from 9.7 months at the end of 2007.

Canadian housing starts steadily declined throughout the quarter, averaging 190,000 units[31] SAAR, down 24,000 units, or 11%, compared to the fourth quarter of 2007.

Offshore demand remained relatively stable throughout the quarter. In Japan, a modest increase in 2x4 housing starts helped to offset an overall decline in construction activity.

Sales

Lumber sales revenue for the fourth quarter of 2008 was down $31.4 million, or 8%, compared to the fourth quarter of 2007. Shipments were down 193 million board feet, or 17%, reflecting significant additional market-related curtailment in the fourth quarter of 2008.

The average price for all grades and widths of SPF and SYP lumber fell sharply compared to the fourth quarter of 2007. Lumber SPF prices, as measured by Western SPF 2x4 #2&Btr, were down US$40 per Mfbm, or 17%, compared to the fourth quarter of 2007 and average prices for SYP lumber, as measured by 2x4 #2&Btr, were down US$19 per Mfbm, or 7%, over the same period. Similar declines were recorded for wider widths. Canadian dollar sales realizations were positively impacted by a 19% increase in the average value of the US dollar compared to the same quarter a year ago.

The Random Lengths Framing Lumber Composite price averaged US$223 per Mfbm for the fourth quarter of 2008 (down US$41 per Mfbm compared to the comparative quarter in 2007), remaining well below the trigger price of US$315 per Mfbm required to reduce the export tax rate on all U.S. bound shipments below the current rate of 15%. In the fourth quarter of 2008, the Company recorded a recovery of $10.8 million in connection with the SLA Third Country Adjustment refund claim.

Total residual fibre sales revenue was in line with the fourth quarter of 2007, with a decrease in sales volumes being offset by an increase in chip prices.

Operations

Lumber production for the fourth quarter was 870 million board feet, 90 million board feet, or 9%, lower than for the same quarter in 2007. Production for the current period reflected the indefinite closures of the Mackenzie and Chetwynd sawmills, as well as a reduced number of shifts. Production in the fourth quarter of 2008 also included the Darlington sawmill in South Carolina, which was acquired in late 2007.

Conversion costs were 7% lower than the same quarter of 2007, mainly due to increased productivity and cost reduction initiatives carried out in 2008. Log costs were also down significantly compared to the final quarter of 2007, primarily due to lower operating and overhead costs. Overall, the Company's unit cash manufacturing costs were down 12% relative to the fourth quarter of 2007.

[29] U.S. Census Bureau
[30] National Association of Realtors
[31] CMHC

Panels

Selected Financial Information and Statistics - Panels

Summarized results for the Panels segment for the fourth quarter of 2008 and 2007 were as follows:

(millions of dollars, unless otherwise noted)		Q4 2008		Q4 2007
Sales	**$**	**20.5**	$	70.5
EBITDA[32]	**$**	**(10.9)**	$	(28.8)
Adjusted EBITDA	**$**	**(4.2)**	$	(14.4)
EBITDA margin[32]		**(53)%**		(41)%
Adjusted EBITDA margin		**(20)%**		(20)%
Operating loss [32]	**$**	**(15.2)**	$	(34.2)
Average plywood price in Cdn$[33]	**$**	**336**	$	374
Average OSB price in US$[34]	**$**	**172**	$	165
Average OSB price in Cdn$	**$**	**209**	$	162
Production – plywood (MMsf 3/8")		**13.8**		93.1
Production – OSB (MMsf 3/8")		**56.8**		167.6
Shipments – plywood (MMsf 3/8")		**28.2**		90.3
Shipments – OSB (MMsf 3/8")		**55.7**		166.3

[32] EBITDA and Operating loss for the fourth quarter of 2008 include a log inventory write-down expense of $2.1 million, which resulted from higher log inventory volumes at the PV OSB mill at the end of the year.
[33] Canadian softwood plywood, per Msf 3/8" basis, delivered to Toronto (Source – C.C. Crowe Publications, Inc.)
[34] OSB, per Msf 7/16" North Central (Source – Random Lengths Publications, Inc.)

Overview

The Panels segment recorded an operating loss of $15.2 million for the fourth quarter, an improvement of $19.0 million compared to the fourth quarter of 2007. Adjusted EBITDA was up $10.2 million, primarily due to lower losses resulting from the indefinite idling of the PolarBoard and Tackama operations, as well as the increase in the average OSB price, which was up 29% in Canadian dollar terms compared to the fourth quarter of 2007.

Restructuring, mill closure and severance costs of $6.7 million were recorded in the Panels segment in the fourth quarter, principally as a result of the indefinite closure of Tackama. The fourth quarter of 2007's results reflected restructuring costs of $14.4 million related to the permanent closure of the Company's Panel and Fibre operation announced in late 2007.

Markets

Panel markets were weak in the fourth quarter of 2008, with sluggish activity reflecting the falloff in demand. OSB prices declined through the fourth quarter and ended the year at US$153 per Msf[35].

Sales

OSB prices averaged US$172 per Msf for the fourth quarter of 2008, up 4% from the fourth quarter of 2007, with Canadian softwood plywood 3/8" delivered Toronto price down $38, or 10%, over the same period. Total shipment volumes were down 67% compared to the fourth quarter of 2007, principally as a result of the NCP fire, the permanent closure of the Panel and Fibre operations in January, the indefinite closures of PolarBoard in June and Tackama in October, and curtailments at the PV OSB mill in the fourth quarter of 2008.

[35] Random Lengths

Operations

Production in the fourth quarter reflected significantly lower operating rates due to curtailment and closures, with volumes down 73% versus the fourth quarter of 2007. Unit cash manufacturing costs were up compared to the fourth quarter of 2007, reflecting the much lower operating rates. Increased wax and resin costs in 2008 also had a significant impact on costs when compared to the fourth quarter of 2007.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[36]

Summarized results for the Pulp and Paper segment for the fourth quarter of 2008 and 2007 were as follows:

(millions of dollars, unless otherwise noted)		Q4 2008		Q4 2007
Sales	$	204.3	$	245.2
EBITDA	$	8.9	$	27.7
EBITDA margin		4%		11%
Operating (loss) income	$	(2.2)	$	12.9
Average pulp price delivered to U.S. – US$[37]	$	787	$	857
Average price in Cdn$	$	954	$	841
Production – pulp (000 mt)		256.1		313.2
Production – paper (000 mt)		30.1		33.1
Shipments – Canfor-produced pulp (000 mt)		235.6		308.3
Pulp marketed on behalf of HSLP (000 mt)[38]		52.6		93.3
Shipments – paper (000 mt)		24.3		32.4

[36] Includes the Taylor Pulp mill and 100% of CPLP, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.
[37] Per tonne, NBSK pulp price delivered to U.S. (RISI)
[38] Howe Sound Pulp and Paper Limited Partnership Pulp mill

Overview

Compared to the same quarter of 2007, operating income and EBITDA were down $15.1 million and $18.8 million respectively. The significantly weaker Canadian dollar resulted in higher Canadian dollar sales realizations, but this benefit was more than offset by lower sales volumes, weaker global prices, increased scheduled maintenance outage costs, and higher freight and fibre costs in the fourth quarter of 2008.

Markets

World pulp markets continued to weaken through the fourth quarter. PPPC[39] reported total Global 100 chemical market pulp shipments in December of 2008 were at a rate of 88% of capacity compared to 94% for December of 2007. For NBSK market pulp, the shipment rate in December of 2008 was 83% of capacity compared to 95% for the same month in 2007.

As a result of the lower shipments, producer market pulp inventories increased during the fourth quarter of 2008, from 44 days to 46 days of supply for total chemical market pulp and from 36 days to 40 days of supply for softwood market pulp. By comparison, producer inventories at the end of 2007 were 29 days for total chemical pulp and 27 days of supply for softwood market pulp.

The decline in market pulp shipments was mainly caused by decreased demand for printing and writing papers, the largest consuming segment of market pulp. In particular, demand for printing and writing papers in North America declined by 19% compared to the fourth quarter of 2007.

[39] Pulp and Paper Products Council ("PPPC")

As a result of the rapid decline in pulp demand, list prices in North American and European markets declined from US$875 per tonne and US$870 per tonne, respectively, at the end of 2007, to US$730 per tonne and US$635 per tonne at the end of 2008.

Sales

Shipments of Canfor-produced pulp were 236 million tonnes, down 73 million tonnes, or 24%, compared to shipments in the final quarter of 2007, for the most part reflecting the significantly lower sales activity in the fourth quarter of 2008. Realized Canadian dollar pulp prices showed a modest increase compared to the fourth quarter of 2007, primarily due to the impact of the weaker Canadian dollar, which more than offset lower global prices in US dollars.

Operations

NBSK production during the fourth quarter was 42,000 tonnes lower than the fourth quarter of 2007. The reduced production primarily resulted from scheduled maintenance outages and market curtailment in the current quarter.

Compared to the same quarter of 2007, unit manufacturing costs were up significantly, principally due to lower production volumes, scheduled maintenance outage costs and higher fibre costs. The higher fibre costs resulted from increased prices for sawmill residual chips and a higher percentage of whole log chipping. Freight costs were also up over the fourth quarter of 2007.

Non-Segmented Items

(millions of dollars)		Q4 2008		Q4 2007
Corporate costs	**$**	**(6.0)**	$	(3.9)
Interest expense, net	**$**	**(7.7)**	$	(4.3)
Foreign exchange loss on long-term debt and investments, net	**$**	**(72.0)**	$	(4.1)
(Loss) gain on derivative financial instruments	**$**	**(81.7)**	$	6.2
Asset impairments	**$**	**(99.6)**	$	(256.0)
Other income (expense), net	**$**	**12.9**	$	(3.5)

Corporate costs were $6.0 million in the fourth quarter of 2008, compared to $3.9 million in the fourth quarter of 2007, primarily due to the reversal of $2.3 million of long-term incentive compensation expense at the end of 2007.

Net interest expense of $7.7 million was recorded in the fourth quarter of 2008, compared with net interest expense of $4.3 million in the fourth quarter of 2007, reflecting higher net indebtedness in 2008.

A foreign exchange translation loss on the Company's US dollar denominated debt, net of investments, of $72.0 million was recorded in the fourth quarter of 2008 as a result of a 16.5 cent, or 16%, fall in the value of the Canadian dollar against the US dollar over the quarter.

The Company also recorded an $81.7 million loss related to the Company's derivative financial instruments in the fourth quarter of 2008. For the most part, this was due to the significant weakening of the Canadian dollar, but unrealized losses were also recorded on natural gas and diesel derivatives.

An asset impairment charge of $99.6 million was recorded in the fourth quarter of 2008. Of this amount, $83.4 million related substantially to impairment charges on the indefinitely idled Tackama and PolarBoard operations. The balance related to long-term investments, including a $10.2 million charge for the Company's non-bank asset-backed commercial paper. In the fourth quarter of 2007, the Company recorded an asset impairment charge of $256.0 million mostly related to capital assets in the Panels and Lumber segments.

EBITDA RECONCILIATION AND SPECIFIC ITEMS AFFECTING COMPARABILITY

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)	Q4 2008	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Net (loss) income, as reported	**$ (229.8)**	**$ (94.2)**	**$ 64.2**	**$ (85.4)**	$ (237.0)	$ (42.1)	$ (38.8)	$ (42.7)
Add (subtract):								
Non-controlling interests	**$ (12.6)**	**$ 5.4**	**$ 9.2**	**$ 22.0**	$ 6.1	$ 16.9	$ 18.1	$ 24.3
Income tax (recovery) expense	**$ (80.2)**	**$ (30.0)**	**$ 24.0**	**$ (55.7)**	$ (155.3)	$ (27.2)	$ (25.6)	$ (26.0)
Other (income) expense	**$ (12.9)**	**$ (0.1)**	**$ 1.5**	**$ (1.2)**	$ 3.3	$ 9.3	$ 13.7	$ (15.3)
Asset impairments	**$ 99.6**	**$ 70.0**	**$ -**	**$ -**	$ 256.0	$ 7.0	$ -	$ 5.0
Prince George Pulp & Paper mill fire, net	**$ 0.3**	**$ -**	**$ -**	**$ (8.5)**	$ -	$ -	$ -	$ -
North Central Plywoods mill fire, net	**$ -**	**$ -**	**$ (57.9)**	**$ -**	$ -	$ -	$ -	$ -
Loss (gain) on derivative financial instruments	**$ 81.7**	**$ 38.8**	**$ (26.0)**	**$ (6.0)**	$ (6.2)	$ (8.9)	$ 7.7	$ (8.5)
Foreign exchange loss (gain) on long-term debt and temporary investments, net	**$ 72.0**	**$ 16.2**	**$ 0.1**	**$ 12.0**	$ 4.1	$ (9.5)	$ (16.8)	$ 6.0
Interest expense, net	**$ 7.7**	**$ 6.7**	**$ 5.7**	**$ 5.3**	$ 4.3	$ 2.4	$ 3.3	$ (0.6)
Amortization	**$ 44.0**	**$ 42.2**	**$ 41.5**	**$ 43.5**	$ 47.2	$ 45.6	$ 43.5	$ 47.8
EBITDA, as reported	**$ (30.2)**	**$ 55.0**	**$ 62.3**	**$ (74.0)**	$ (77.5)	$ (6.5)	$ 5.1	$ (10.0)
Restructuring, mill closure and severance costs	**$ 10.3**	**$ 5.4**	**$ 34.0**	**$ 3.8**	$ 21.5	$ 11.1	$ 8.7	$ -
Adjusted EBITDA,	**$ (19.9)**	**$ 60.4**	**$ 96.3**	**$ (70.2)**	$ (56.0)	$ 4.6	$ 13.8	$ (10.0)
Log inventory (expense) recovery resulting from new inventory accounting standard included in EBITDA	**$ (3.9)**	**$ 3.9**	**$ 72.4**	**$ (42.0)**	$ -	$ -	$ -	$ -

Specific Items Affecting Comparability of Net Loss

Factors that impact the comparability of the quarters are noted below:

After-tax impact, net of non-controlling interests

(millions of dollars, except for per share amounts)	Q4 2008	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Net (loss) income, as reported	**$ (229.8)**	**$ (94.2)**	**$ 64.2**	**$ (85.4)**	$ (237.0)	$ (42.1)	$ (38.8)	$ (42.7)
Foreign exchange loss (gain) on long-term debt and temporary investments, net	**$ 52.2**	**$ 11.3**	**$ -**	**$ 8.7**	$ 3.5	$ (5.1)	$ (10.2)	$ 5.3
Loss (gain) on derivative financial instruments	**$ 50.3**	**$ 21.4**	**$ (14.5)**	**$ (2.7)**	$ (3.5)	$ (6.9)	$ 3.7	$ (4.9)
North Central Plywoods mill fire, net	**$ -**	**$ -**	**$ (45.0)**	**$ -**	$ -	$ -	$ -	$ -
Prince George Pulp & Paper mill fire, net	**$ 0.2**	**$ -**	**$ -**	**$ (3.6)**	$ -	$ -	$ -	$ -
Asset impairments	**$ 74.1**	**$ 56.9**	**$ -**	**$ -**	$ 189.1	$ 6.0	$ -	$ 4.1
New inventory accounting standard	**$ 2.6**	**$ (2.5)**	**$ (47.8)**	**$ 29.0**	$ -	$ -	$ -	$ -
Restructuring, mill closure and severance costs	**$ 6.8**	**$ 3.6**	**$ 22.3**	**$ 2.6**	$ 14.2	$ 7.3	$ 5.8	$ -
Corporate income tax rate reductions	**$ -**	**$ -**	**$ -**	**$ (9.1)**	$ (35.8)	$ (0.9)	$ (1.0)	$ -
Other items	**$ 0.1**	**$ -**	**$ -**	**$ -**	$ (0.1)	$ (4.2)	$ (2.3)	$ (2.5)
Net impact of above items	**$ 186.3**	**$ 90.7**	**$ (85.0)**	**$ 24.9**	$ 167.4	$ (3.8)	$ (4.0)	$ 2.0
Net loss, as adjusted	**$ (43.5)**	**$ (3.5)**	**$ (20.8)**	**$ (60.5)**	$ (69.6)	$ (45.9)	$ (42.8)	$ (40.7)
Net (loss) income per share (EPS), as reported	**$ (1.61)**	**$ (0.66)**	**$ 0.45**	**$ (0.60)**	$ (1.66)	$ (0.30)	$ (0.27)	$ (0.30)
Net impact of above items per share	**$ 1.31**	**$ 0.64**	**$ (0.60)**	**$ 0.18**	$ 1.17	$ (0.03)	$ (0.03)	$ 0.01
Net loss per share, as adjusted	**$ (0.30)**	**$ (0.02)**	**$ (0.15)**	**$ (0.42)**	$ (0.49)	$ (0.33)	$ (0.30)	$ (0.29)

OUTLOOK

Lumber and Panel Markets

A turnaround in housing starts will remain the key indicator for improved demand for wood products. Although Canfor's business was initially impacted by the fall in U.S. housing starts, the global economic slowdown has started to affect lumber demand in all of Canfor's other major markets. A slow recovery of the U.S. housing industry is not projected before 2010, as homebuilders struggle to reduce their inventory of new homes. Housing prices must stabilize in order for consumer confidence to be restored. Canadian housing starts began to be affected by the global economic downturn towards the end of 2008, and starts below 185,000 are projected for 2009, compared to 211,000 for 2008.

The Repair and Remodeling and Do-It-Yourself sector is projected to be more negatively impacted in 2009 than it was in 2008 as home prices continue to fall and credit remains inaccessible to many homeowners or prospective buyers.

In Japan, housing starts are projected to decline in 2009. Demand from other offshore markets is also anticipated to slow down in the coming year. The Company anticipates its percentage of sales to China to continue to increase in 2009.

Similar to lumber, the panels market is projected to remain under pressure for 2009 due to the low housing start forecast and ongoing global economic declines.

In January, the Company took a further 29 million board feet of market curtailment and subsequently announced a further curtailment of 83 million board feet to occur in February, in addition to elimination of shifts at two of its sawmills for an indefinite period. Curtailment was also announced in February at the joint venture Peace Valley OSB mill.

Pulp and Paper Markets

Weak pulp markets are projected to continue through the first quarter of 2009 and to remain challenging for at least the first half of 2009.

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:

(weighted average assumptions)	2008 Pension Benefit Plans	2008 Other Benefit Plans	2007 Pension Benefit Plans	2007 Other Benefit Plans
Accrued benefit obligation as of December 31:				
Discount rate	6.60%	6.70%	5.60%	5.50%
Rate of compensation increase	3.00%	n/a	3.00%	n/a
Benefit costs for year ended December 31:				
Discount rate	5.60%	5.50%	5.25%	5.25%
Expected long-term rate of return on plan assets	7.50%	n/a	7.00%	n/a
Rate of compensation increase	3.00%	n/a	3.00%	n/a

Assumed health care cost trend rates were as follows:

(weighted average assumptions)	2008	2007
Initial health care cost trend rate	**5.83%**	5.62%
Ultimate health care trend rate	**4.40%**	4.27%
Year ultimate rate reached	**2014**	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 2008:

	1% increase	1% Decrease
Increase (decrease) in accrued benefit obligation	$ 16.7	$ (13.6)
Increase (decrease) in total service and interest cost	$ 2.3	$ (1.8)

See "Financial Requirements and Liquidity – Pension Obligations" section for discussion regarding the impact of the global financial and credit crisis on Canfor's pension plans and how this may affect Canfor's results and cash flows going forward.

Deferred Reforestation

Canfor accrues an estimate 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 and the estimated costs of fulfilling Canfor's obligation. Payments in relation to deforestation are expected to occur over periods of up to 18 years (the significant majority occurring in the first seven years) and have been discounted accordingly at rates of 4% to 7%. The actual costs that will be incurred in the future may vary based on, among other things, the actual costs at the time of harvesting.

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. For CPLP's landfill closure costs, the fair value is determined using estimated closure costs discounted over the estimated useful life. Payments relating to landfill closure costs are expected to occur at periods ranging from 32 to 40 years and have been discounted at rates ranging from 5.8% to 6.3%. The actual closure costs and periods of payment may differ from the estimates used in determining the year end liability. 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.

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.

In order to assess the goodwill for impairment, an analysis of the future expected discounted cash flows of the assets to which the goodwill relates is prepared as and when required. As part of this process, assumptions are made in relation to forecast prices and exchange rates. Price forecasts are determined with reference to Resource Information Systems, Inc. ("RISI") publications and management estimates, and forecast exchange rates are based on forecasts from various recognized authorities. Given the inherent uncertainty regarding longer term prices and foreign exchange rates, management considers various possible scenarios and assigns probabilities to the likelihood of occurrence of each of these. The net present value of the future expected cash flows is compared to the carrying value of the Company's investment in these assets, including goodwill, at year end.

Based upon the analysis performed in 2008 the net present value of the estimated future discounted cash flows exceeded the value of the investment, and therefore no impairments to goodwill were required. However, if the U.S. and global economic downturn were to be longer or more severe than anticipated in the forecast assumptions, there is a possibility that an impairment of goodwill may be required in future periods.

Asset Impairments

As previously indicated, Canfor recorded the following asset impairment charges in 2008:

(millions of dollars)		**2008**		2007
Capital assets	**$**	**77.2**	$	231.4
Assets related to Howe Sound Pulp and Paper Limited Partnership and Coastal Fibre Limited Partnership	**$**	**70.0**	$	14.0
Non-bank asset-backed commercial paper	**$**	**10.2**	$	16.2
Other	**$**	**12.2**	$	6.4
Total asset impairments	**$**	**169.6**	$	268.0

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 of the Company's 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 the 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. Other significant assumptions are the estimated useful life of the long-lived assets, and the impacts of both the SLA with the U.S. and the Mountain Pine Beetle epidemic. Price forecasts beyond 2009 were determined with reference to RISI, 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 US 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 of these was used in determining the impairments to be recorded.

In some cases the future of these mills is uncertain (for example, whether they will be re-opened, sold or permanently shut-down). To account for this, management developed cash flows for each different scenario identified and applied a weighted average to determine the impairment to be recorded.

As a result of its assessment, Canfor recognized capital asset write-downs of $77.2 million related to property, plant and equipment and timber, all of which relates to the Panels segment. However, if the U.S. and global economic downturn were to be longer or more severe than anticipated in the forecast assumptions, there is a possibility that further impairment of capital assets may be required in future periods.

Assets related to Howe Sound Limited Pulp and Paper Limited Partnership and Coastal Fibre Limited Partnership

For the year ended December 31, 2008, an asset impairment charge of $70.0 million was recorded on assets related to HSLP and CFLP, which reflected current fair value, based on estimated future cash flows. Canfor's investments include a 50% interest in CFLP, an entity which supplies fibre and related services to HSLP. The impairment reflected the deterioration of B.C. Coastal pulp, paper and fibre market conditions.

Non-Bank Asset-Backed Commercial Paper

The ABCP of $69.3 million (US$56.6 million) is measured at the estimated fair value of Canfor's combined investments in asset-backed commercial paper of four different Canadian trusts (the "Trusts") with total original principal amount of US$81.2 million and original maturities between August and September of 2007.

Since August of 2007, there has been no active market for ABCP. The Trusts failed to make payment at maturity and, along with 16 other ABCP conduits, are subject to restructuring under the Pan-Canadian Investors Committee for Third Party structured Asset-Backed Commercial Paper (the "Pan-Canadian Investors Committee").

On March 17, 2008 the Pan-Canadian Investors Committee filed with the Ontario Superior Court of Justice a comprehensive arrangement pursuant to the Companies' Creditors Arrangement Act to restructure the affected trusts. The final restructuring plan was approved on January 12, 2009 and completed on January 21, 2009.

In the fourth quarter, an additional impairment of $10.2 million (US$8.4 million) was recorded on the ABCP based on the estimated fair value at year end, which took into account information available to Canfor related to its specific holdings of ABCP, and assumed a high likelihood of success for the proposed ABCP restructuring plan. The book value at December 31, 2008 reflected the impact of a weaker Canadian dollar on the US dollar denominated ABCP. No changes to fair value resulted from the completion of the restructuring plan after year end.

Other

For the year ended December 31, 2008, other asset impairments of $12.2 million were recorded related to certain other investments and write-downs of spare parts inventory at indefinitely idled operations.

Valuation of Log and Finished Product Inventories

Solid wood inventories are written down to the lower of cost and net realizable value, which is determined by taking into account forecast prices and rates for the period over which the inventories are expected to be sold. Forecast prices are determined using RISI forecasts and management's estimates as at the year end, and may differ from the actual prices at which the inventories are sold. At the end of December of 2008, the inventory balances included total write-downs of $46.2 million.

Allowance for Doubtful Accounts

An allowance for doubtful accounts of $3.0 million has been recorded at December 31, 2008 (2007 - $0.4 million), which reflects management's assessment of risks attached to specific receivable balances. While significant bad debts have not been experienced in prior years, the additional provision is considered appropriate due to the current recession in the U.S. which may affect the ability of certain customers to pay amounts owed to the Company.

Insurance Proceeds

The Company estimated the insurance property damage receivable in connection with the NCP fire in May using preliminary engineering estimates and other information available. This receivable was estimated on the basis that the insurance proceeds will be applied towards capital improvements at Canfor's other operations. Based on estimated insurance proceeds, net of an aggregate policy deductible of $2.4 million, and costs related to the fire, the Company recorded a pre-tax gain of $57.9 million. It is possible that future events, including the final negotiation of the insurance proceeds to be paid, may give rise to changes in the gain recorded in relation to these insurance claims.

CPLP estimated insurance property amounts receivable in connection with the PG Pulp mill fire using management's best estimates at year end of the final costs to complete construction of a replacement chip screening and in-feed system. In addition, amounts accrued for business interruption insurance receivable reflected management's best estimates with regards to the financial impact of lost production and other incremental costs covered under the policy. CPLP recorded a receivable of $12.2 million in relation to property damage, of which $11.2 million had been received, and $19.1 million in relation to business interruption, of which $15.2 million had been received. It is possible that future events, including the final negotiation of the insurance proceeds to be paid, may give rise to changes in the amounts recorded in relation to this.

CHANGES IN ACCOUNTING POLICIES

Capital Disclosures

Effective January 1, 2008, the Company adopted the CICA's new Handbook Section 1535 "Capital Disclosures". This Section establishes the standards for disclosing information about an entity's capital and how it is managed. Under this Section the Company is required to disclose qualitative information about its objectives, policies and processes for managing capital, quantitative data about what it regards as capital, whether it has complied with any externally imposed capital requirements and, if not, the consequences of such non-compliance.

Inventories – Logs and Capital Spares

The CICA issued a new Handbook Section 3031 "Inventories" which applied to Canfor as of January 1, 2008, and has been applied on retrospectively, without prior period restatement. This Section provides significantly more guidance on the measurement of inventories, with an expanded definition of cost, and the requirement that inventories must be measured at the lower of cost and net realizable value. Canfor had previously valued log inventories at the greater of net realizable value and replacement cost, if lower than average cost. In addition, the Section sets out additional disclosure requirements, including accounting policies, carrying values, and the amount of any inventory write-downs or reversal of any write-downs. In conjunction with Section 3061, "Property, Plant and Equipment", it also provides guidance on the classification of major spare parts and stand-by equipment.

As a result of implementing these standards, inventories decreased by $60.6 million (log inventories by $46.5 million, processing materials and supplies by $14.1 million), property, plant and equipment increased by $14.1 million, future income tax liabilities decreased by $15.9 million and opening retained earnings were reduced by $30.6 million.

Financial Instruments

The CICA issued two new Handbook Sections relating to financial instruments that were effective as of January 1, 2008. These are Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation".

Section 3862 requires entities to provide disclosure of quantitative and qualitative information in their financial statements that enable the users to evaluate: (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and management's objectives, policies and procedures for managing such risks.

Section 3863 establishes standards for the presentation of financial instruments and non-financial derivatives.

As a result of these new standards, Canfor has provided additional disclosures in the financial statements.

Goodwill and Deferred Start-Up Costs

In February of 2008, the CICA issued a new accounting standard, Handbook Section 3064 "Goodwill and Intangible Assets". This Section replaces Handbook Section 3062 "Goodwill and Intangible Assets" and Section 3450 "Research and Development Costs" and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Upon adoption of this new Standard, EIC 27 – "Revenues and Expenditures During the Pre-operating Period" is withdrawn and so various pre-production and start-up costs are required to be expensed as incurred. This Standard will be applicable to the Company for annual and interim periods beginning on January 1, 2009. The Company does not expect that this Section will have a material impact on its consolidated financial statements.

International Financial Reporting Standards

In February of 2008, the Accounting Standards Board announced that publicly accountable entities will be required to prepare financial statements in accordance with International Financial Reporting Standards ("IFRS") for interim and annual periods in fiscal years beginning on or after January 1, 2011. More information on the adoption of IFRS can be found under "Conversion to International Financial Reporting Standards".

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. The risks and uncertainties are set out in alphabetical order.

Aboriginal Issues

Canadian judicial decisions have recognized the continued existence in the country of Aboriginal rights, including title, to lands continuously used or occupied by Aboriginal groups. Although Aboriginal groups have claimed Aboriginal rights over substantial portions of B.C. no Aboriginal right nor title has yet been determined in areas overlapping with Canfor's forest tenures and other operations. While uncertainty regarding property rights in Canada (including forest tenure and other resource rights) continues to exist, particularly in those areas where treaties have not been concluded with Aboriginal groups, such as much of B.C., the Government of B.C. has provided greater certainty for the forest industry by reaching agreements on forest resources with many bands. As a means of protecting treaty and aboriginal rights, as well as undetermined aboriginal rights, Canadian courts continue to confirm a duty to consult with Aboriginal groups when the Crown has knowledge of existing rights or the potential existence of an Aboriginal right, such as title, and contemplates conduct that might adversely impact them. The courts have not extended this duty to third parties, such as forest companies.

As issues relating to Aboriginal and treaty rights 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, and participate with the Crown in its consultation processes with Aboriginal groups in order to foster good relationships and minimize risks to its tenures and operational plans. Due to their complexity, it is not expected that the issues regarding Aboriginal and treaty rights or consultation will be finally resolved in the 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 whose treaty rights or potential Aboriginal rights overlap with Canfor's areas of operations. Some of these relationships with Aboriginal people have been formalized through agreements that generally seek to increase First Nations' participation in Canfor's planning and harvesting activities while strengthening Canfor's access to fibre. Some relationships include support through Canfor scholarship programs, as well as mentoring opportunities and employment at our manufacturing and forestry operations. Canfor also has numerous business relationships ranging from short and long-term contracts with Aboriginal businesses to agreements to manage and purchase the timber from Forest Licenses held by local First Nations to jointly held Forest Licenses with local First Nations.

Environmental Issues

Canfor's operations are subject to environmental regulation by federal, provincial, state and local authorities, including specific environmental regulations relating to air emissions and pollutants, wastewater (effluent) discharges, solid waste, landfill operations, forestry practices, site remediation and the protection of endangered species and critical habitat. Canfor has incurred, and will continue to incur, capital expenditures and operating costs to comply with environmental laws and regulations. No assurance can be given that changes in these laws and regulations or their application will not have a material adverse effect on Canfor's business, operations, financial condition and operational results. Similarly, no assurance can be given that capital expenditures necessary for future compliance with existing and new environmental laws and regulations could be financed from Canfor's available cash flow. In addition, Canfor may discover currently unknown environmental issues, contamination, or conditions relating to its past or present operations. This may require site or other remediation costs to maintain compliance or correct violations or result in governmental or private claims for damage to person, property or the environment, which could have a material adverse effect on Canfor's business, financial condition and operational results.

Canfor has in place internal policies and procedures under which all its forestry and manufacturing operations are audited for compliance with laws and accepted standards and with its management systems. Canfor's woodlands operations in Canada are third-party certified to internationally-recognized sustainable forest management standards. Canfor's operations and its ability to sell its products could be adversely affected if those operations did not, or were perceived by the public as failing to, comply with applicable laws and standards, including responsible environmental and sustainable forestry standards.

Financial Risk Management and Earnings Sensitivities

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 Risk Management

Canfor is exposed to a number of risks as a result of holding financial instruments. These risks include credit risk, liquidity risk and market price risk.

Canfor's Risk Management Committee manages risk in accordance with a Board approved Price Risk Management Controls Policy. This policy provides the framework for risk management related to commodity price, foreign exchange, interest rate and counterparty credit risk of Canfor.

(a) Credit risk:

Credit risk is the risk of financial loss to Canfor if a customer or third party to a derivative instrument fails to meet its contractual obligations.

Financial instruments that are subject to credit risk include cash and cash equivalents, accounts receivable and long-term investments and other. Cash and cash equivalents includes cash held through major Canadian and international financial institutions and temporary investments with an original maturity date of three months or less.

Canfor utilizes a combination of credit insurance and self-insurance to manage the risk associated with trade receivables. Approximately 50% of the outstanding trade receivables are covered by credit insurance. Canfor's trade receivable balance at December 31, 2008 is $105.9 million, net of an allowance for doubtful accounts of $3.0 million. At December 31, 2008, approximately 98% of the trade accounts balance was within Canfor's established credit terms.

(b) Liquidity risk:

Liquidity risk is the risk that Canfor will be unable to meet its financial obligations on a current basis. Canfor manages liquidity risk through regular cash-flow forecasting in conjunction with an adequate committed operating bank loan facility.

At December 31, 2008, Canfor has operating loans of $25.2 million, accounts payable and accrued liabilities of $322.9 million and current debt obligations of $168.3 million (US$137.3 million), all of which fall due for payment within one year of the balance sheet date.

(c) Market risk:

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates, foreign currency and commodity prices.

(i) Interest Rate risk:

Canfor is exposed to interest rate risk through its current financial assets and financial obligations bearing variable interest rates. Canfor's cash and cash equivalents include term deposits with original maturity dates of three months or less.

Changes in the market interest rates do not have a significant impact on Canfor's results of operations due to the short-term nature of the respective financial assets and obligations and because all long-term debt is based on fixed rates of interest.

Canfor currently does not use derivative instruments to reduce its exposure to interest rate risk.

(ii) Currency risk:

Canfor is exposed to foreign exchange risk primarily related to the US dollar, as Canfor's products are sold principally in US dollars and all long- term debt is denominated in US dollars. In addition, Canfor holds financial assets and liabilities primarily related to New South Companies Inc. based in South Carolina, in US dollars.

A portion of the currency risk associated with US dollar denominated sales is naturally offset by US dollar denominated expenses and the US dollar denominated debt. The majority of the remaining exposure is covered by option contracts (foreign exchange collars) that effectively limit the minimum and maximum Canadian dollar recovery related to the sale of those US dollars (See "Derivative Financial Instruments" section below).

(iii) Energy Price risk:

Canfor is exposed to energy price risk relating to purchases of natural gas and diesel oil for use in its operations.

The exposure is hedged up to 100% through the use of floating to fixed swap contracts or option contracts with maturity dates up to a maximum of three years. In the case of diesel oil, Canfor uses heating oil contracts to hedge its exposure (See "Derivative Financial Instruments" section below).

(iv) Commodity Price risk:

Canfor is exposed to commodity price risk related to the sale of lumber, pulp, paper, and oriented strand board. From time to time, Canfor enters into futures contracts on the Chicago Mercantile Exchange for lumber and forward contracts direct with customers for pulp. Under the Price Risk Management Controls Policy, up to 15% of lumber sales and 5% of pulp sales may be sold in this way.

Canfor had no futures contracts at December 31, 2008.

Derivative 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. As December 31, 2008, the Company has the following derivatives:

- Foreign exchange forward contracts and collars of US$492.8 million (2007 - US$476.7 million). There were unrealized losses of $53.2 million (2007 - gains of $15.0 million) on the foreign exchange derivatives at the end of the year.
- Floating to fixed swaps that hedge future natural gas purchases of 6.9 million gigajoules (2007 - 10.1 million gigajoules). There were unrealized losses of $6.5 million (2007 - $5.7 million) on the natural gas swaps at the end of the year.
- Floating to fixed swaps that hedge future diesel purchases of 6.5 million gallons (2007 - 13.3 million gallons), plus a call option of 3.0 million gallons (2007 – nil). There were unrealized losses of $9.6 million (2007 - unrealized gains of $7.9 million) on the diesel swaps at the end of the year.

Sensitivities

Estimates of the sensitivity of Canfor's pre-tax results to currency fluctuations and prices for its principal products, based on 2009 forecast production and 2008 year end foreign exchange rates, are set out in the following table:

	Impact on annual pre-tax earnings (millions of dollars)
Lumber (SPF) – US$10 change per Mfbm[40]	$ 34
Lumber (SYP) – US$10 change per Mfbm[40]	$ 5
OSB – US$10 change per Msf 3/8" [40]	$ 3
Pulp – US$10 change per tonne [40, 41]	$ 9
Canadian dollar – US$0.01 change per Canadian dollar:	
Operations[41]	$ 10
US dollar denominated debt[41]	$ 6

[40] Based on sales of Canfor-produced product.
[41] Includes Canfor's 50.2% interest in CPLP.

Market Conditions

Prices for lumber and panels in 2007 and 2008 have reached historically low levels, which has resulted in significant operating losses and asset impairments incurred by the Company in those years. Should there be a protracted U.S. and global economic slowdown, there exists a risk that the Company may not remain in compliance with its debt covenants and would have to renegotiate the terms of its covenants with lenders.

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 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 PPWC (Pulp, Paper and Woodworkers of Canada) and the CEP (Communications, Energy and Paperworkers Union) have terms expiring in June of 2009 (USW-Interior B.C.), January of 2010 (USW-Uneeda) and February of 2010 (CEP) respectively. 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 could 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

On May 7, 2008 the government of B.C. released a document entitled Provincial-Level Projection of the Current Mountain Pine Beetle Outbreak. The B.C. government reported that the Mountain Pine Beetle has attacked approximately 620 million cubic metres of lodgepole pine. This represents approximately 46% of total merchantable pine volume on the Timber Harvesting Land Base (1.35 billion m3). The government also projected that up to 76% of the pine volume in the "pine units" will be killed by 2015 if the infestation continues to behave as it has over the past eight years.

Government 2008 aerial survey results indicate that progress has been made in managing Mountain Pine Beetle in the central and northern areas of Alberta, particularly within the leading edge zone of the infestation. While pockets of high beetle populations continue to exist in Alberta, infestations are generally on the decline in northern areas. This is not the case for the southern portions of the province, where populations are still increasing.

The Alberta government has indicated its intention to continue providing emergency funding for Mountain Pine Beetle management programs in 2009.

In response to the infestation, B.C.'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 analyzed the general trends of the Mountain Pine Beetle outbreak and forecasted 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.

The Chief Forester for the Province of B.C. determines how much wood can be harvested in each of the province's 37 timber supply areas and 33 tree farm licences at least once every five years. The Prince George Timber supply review is presently being undertaken by the Province's Chief Forester.

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 PG Pulp 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 the minimum required amount of electricity is generated.

As of December 31, 2008, CPLP has no repayment obligation under the terms of the agreement and a standby letter of credit in the amount of $24.1 million was issued to BC Hydro.

Residual Fibre 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 64% 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.

Softwood Lumber Agreement – Surge Mechanism

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. In 2008, the Company paid surge tax of $0.3 million on shipments from Alberta, Canada.

In 2007, the U.S. Coalition for Fair Lumber Imports alleged that U.S. consumption figures used in calculating the allowable exports in a month should not be the estimated or expected consumption but rather the actual consumption based on a 12-month rolling average. On that basis, Canfor would have been liable under the surge mechanism to pay approximately $16 million of additional cumulative export tax. Canada maintained that the U.S. was wrongly interpreting the point at which the surge clause is triggered. In early 2008, the London Court of International Arbitration ruled in favour of Canada and determined that no additional cumulative export tax liability was payable.

Stumpage Rates

The B.C. government introduced a Market Pricing System ("MPS") for the B.C. Interior on July 1, 2006. Canfor is actively participating in discussions on MPS with the Ministry of Forests, which is scheduled for its fourth annual update on July 1, 2009. 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.

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 19, 2009, there were 142,589,312 common shares issued and outstanding. In addition, at February 19, 2009, there were 200,468 stock options outstanding with exercise prices ranging from $8.30 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 the effectiveness of these disclosure controls and procedures for the period ending December 31, 2008, and have concluded that they are effective.

The CEO and CFO acknowledge responsibility for the design of internal controls 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, 2008 which materially affected, or are reasonably likely to materially affect, the Company's ICFR. Based upon their evaluation of these controls for the year ended December 31, 2008, the CEO and CFO have concluded that these controls are operating effectively.

CONVERSION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

In February of 2008, the Accounting Standards Board announced that publicly accountable entities will be required to prepare financial statements in accordance with International Financial Reporting Standards ("IFRS") for interim and annual periods in fiscal years beginning on or after January 1, 2011.

The Company has developed a conversion implementation plan to ensure that differences between Canadian GAAP and IFRS that affect Canfor are identified, and any required changes to accounting processes and controls (including information technology systems) are made in a timely manner to ensure a smooth transition to IFRS on January 1, 2010.

The key elements of the conversion implementation plan are as follows:

Project Structure

The Company has appointed a dedicated project manager to lead the conversion to IFRS. The project manager is working with other members of the finance team to execute the elements of the implementation plan. An implementation team is working closely with senior management in a number of different business areas to ensure that the impacts of the conversion throughout the business are managed in a timely and efficient manner. A steering committee has been established to oversee the project.

Process and Timing

The process of converting to IFRS has been divided into a number of different stages, many of which will run concurrently. The planning phase has now been completed, as has an initial diagnostic. A detailed review of the impact of IFRS on Canfor's consolidated financial statements, and other areas of the Company, is underway.

It is currently anticipated that the detailed diagnostic will be completed by mid-2009. Any changes required to systems and controls (including information technology systems) will be identified as the project progresses; these are currently projected to be designed and tested by the end of the third quarter of 2009. The implementation of any significant changes to systems and controls, as well as related training, is currently scheduled for the second half of 2009.

A draft opening balance sheet prepared under IFRS at the date of transition (January 1, 2010) is currently planned to be completed in the first half of 2010. Draft financial statements and disclosure information will be prepared for each quarter in 2010 (to be used for comparative purposes in 2011) and reporting under IFRS will commence for interim and annual periods in 2011.

Progress to Date

At December 31, 2008, the Company has completed the planning phase of the project and the initial diagnostic between Canadian GAAP and IFRS. While the effects of IFRS have not yet been fully determined, the Company has identified a number of key areas where it is likely to be impacted by changes in accounting policy. These include:

- Employee future benefits
- Property, plant, equipment and timber
- Intangible assets
- Impairment of assets
- Provisions, including deferred reforestation obligations and asset retirement obligations
- Presentation of financial statements, including presentation of minority interests

A detailed diagnostic is underway, and no decisions have yet been made with regard to accounting policy choices.

As a first-time adopter of IFRS, the Company is required to apply IFRS 1 "First time adoption of International Financial Reporting Standards". A number of exemptions are available under this Standard which the Company is currently evaluating. The more significant exemptions include: recognizing through opening retained earnings all cumulative actuarial gains and losses on employee benefit plans, and cumulative translation adjustments on self sustaining operations; avoiding a retroactive restatement of previous business combinations under IFRS; and electing to use fair value at the transition date as deemed cost for capital assets in certain circumstances.

Additional information about the Company, including its 2008 Annual Information Form, is available at www.sedar.com or at www.canfor.com.