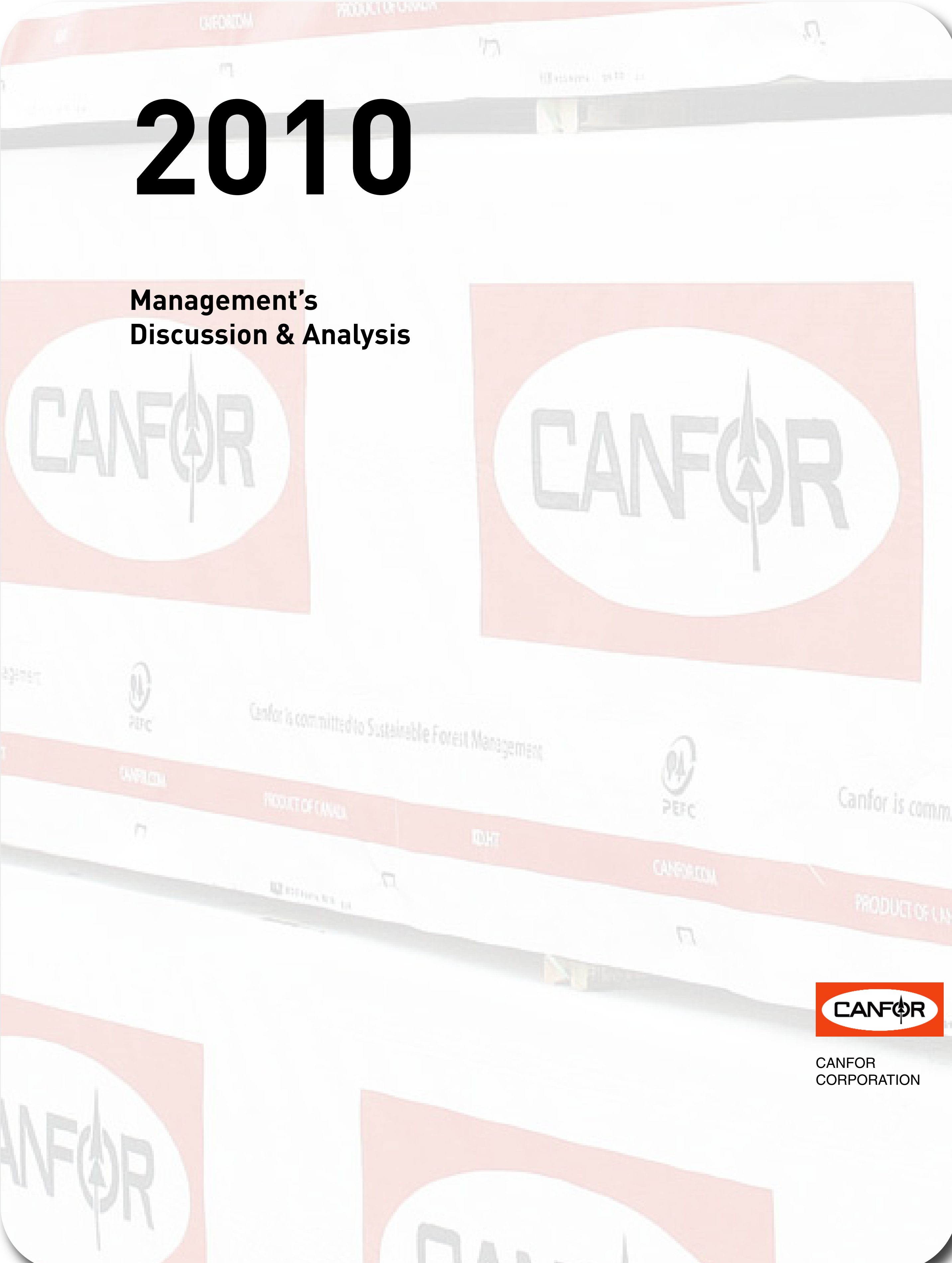
2010

Management's Discussion & Analysis



CANFOR
CORPORATION

2010 MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the year ended December 31, 2010 relative to the year ended December 31, 2009, 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, 2010 and 2009. 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) which Canfor considers to be an important indicator for measuring trends in the performance of each of its operating segments and the Company's ability to generate funds to meet its debt repayment and capital expenditure requirements. Reference is also made to Adjusted Net Income (Loss) (calculated as Net Income (Loss) attributable to equity shareholders less specific items affecting comparability with prior periods – for the full calculation, see reconciliation included in the section "Overview of Consolidated Results – 2010 Compared to 2009") and Adjusted Net Income (Loss) per Share (calculated as Adjusted Net Income (Loss) divided by the weighted average number of shares outstanding in the period). EBITDA, Adjusted Net Income (Loss) and Adjusted Net Income (Loss) per Share are not generally accepted earnings measures and should not be considered as an alternative to net income or cash flows as determined in accordance with Canadian GAAP. As there is no standardized method of calculating these measures, Canfor's EBITDA, Adjusted Net Income (Loss) and Adjusted Net Income (Loss) per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of EBITDA and Adjusted Net Income (Loss) to net income (loss) 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; currency exchange rates; interest rates; changes in law and public policy; the outcome of labour and trade disputes; and opportunities available to or pursued by Canfor.

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 11, 2011.

Forward Looking Statements

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

COMPANY OVERVIEW

Canfor is a leading Canadian integrated forest products company based in Vancouver, British Columbia ("BC"), involved primarily in the lumber business, with production facilities in BC, Alberta, Québec and the United States. Canfor also has a 50.2% interest in the pulp and paper business of Canfor Pulp Limited Partnership ("Canfor Pulp"), a 50% interest in the oriented strand board ("OSB") business of Peace Valley OSB and owns a bleached chemi-thermo mechanical pulp ("BCTMP") mill ("Taylor pulp mill"), all located in BC.

Canfor employs approximately 3,370 people in its wholly owned subsidiaries and 1,320 in jointly owned operations for a total of 4,690 employees.

Lumber

Canfor's lumber operations have a current annual production capacity of approximately 4.8 billion board feet of lumber. The majority of lumber produced by Canfor from its facilities is construction and specialty grade dimension lumber that ranges in size from one by three inches to two by twelve inches and in lengths from six to twenty-four feet. A significant proportion of Canfor's lumber production is comprised of specialty products that command premium prices, including Square Edge lumber for the North American market, J-grade lumber for the Japanese market, and machine stress rated ("MSR") lumber used in engineered applications such as roof trusses and floor joists.

Canfor's lumber operations also include a lumber remanufacturing facility, a finger-joint plant, two lumber treating plants, a whole-log chipping plant and a trucking division. The lumber business segment also includes a 60% interest in Houston Pellet Inc., which has an annual capacity of 219,000 tonnes of wood pellets.

Canfor holds approximately 10.5 million cubic metres of annual harvesting rights for its solid wood operations under various forest tenures located in the interior region of British Columbia and northern Alberta, and harvests logs from those tenures to supply its interior lumber operations. Any shortfalls in mill requirements are made up with wood purchased from those areas. Operations in Québec and North and South Carolina mostly purchase logs.

Canfor markets lumber products throughout North America and overseas, through its sales offices in Vancouver, Canada, Myrtle Beach, South Carolina, Tokyo, Japan and Shanghai, China. In addition to its own production, Canfor also markets lumber produced externally to complement its product line. While the majority of Canfor's product is sold to markets in the United States, the proportion of shipments to offshore markets, particularly China, has risen significantly in recent years. The Company ships substantially all lumber destined for North America by truck and rail, while the vast majority of product sold offshore is transported by container ship.

Pulp and Paper

Canfor's Pulp and Paper segment is comprised of the Canfor Pulp and Taylor pulp mill operations, all of which are located in British Columbia. Canfor Pulp 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 Prince George Pulp and Paper mill.

The Canfor Pulp mills have the capacity to produce over one million tonnes of pulp annually. Over 200,000 tonnes of BCTMP per year can be produced at the Taylor pulp mill. Canfor Pulp's paper machine, located at the Prince George Pulp and Paper mill, has an annual production capacity, at optimum product mix levels, of 140,000 tonnes of kraft paper.

Canfor supplies Canfor Pulp with residual wood chips and hog fuel (principally bark) produced at certain of its specified sawmills in the Prince George region. Prices paid by Canfor Pulp for residual wood chips are based on a pricing formula to reflect market prices and conditions, with hog fuel purchased by Canfor Pulp at market prices. Canfor Pulp also has fibre supply agreements with third parties to supplement its supply of wood chips and hog fuel.

All pulp produced by Canfor Pulp and the Taylor pulp mill is sold by Canfor Pulp's sales offices in Vancouver, Canada, Brussels, Belgium, and Tokyo, Japan, to customers, primarily in North America, Europe and Asia. The significant majority of product sold to North America is shipped by rail, while product sold overseas is transported by container or breakbulk vessels.

Other Operations

The Company's panel operations have a current annual production capacity of approximately 1.7 billion square feet. The Company's only panels facility currently operating is the Peace Valley OSB plant in Fort St. John, BC, which is jointly owned with Louisiana-Pacific Canada Ltd. The Peace Valley OSB mill has an annual capacity of 820 million square feet (3/8" basis). OSB production is primarily performance rated sheathing and flooring, which is used in wall, roof and flooring construction of new homes and in repair and remodeling projects. Canfor also owns an OSB plant ("PolarBoard") and a plywood plant ("Tackama"), both of which are located in Fort Nelson, BC, and are currently indefinitely idled.

Business Strategy

Canfor's general business strategy is to be a lumber industry leader with strong financial performance, accomplished through:

- Achieving and maintaining a low cost structure
- Optimizing the extraction of high-margin products and value from its available fibre sources
- Attaining world class supply chain performance
- Building strong long-term partnerships with valued customers
- Maintaining a strong financial position
- Fully engaging employees and utilizing their experience and expertise to maximize performance
- Capitalizing on attractive growth opportunities.

Canfor is focused on being the preferred supplier of lumber to the building industry around the world, with a particular focus on North America and Asia. The Company is committed to being a major supplier to the retail segment of lumber consumption and expanding its presence in key offshore markets, including China and Japan. This objective includes making higher value structural lumber and specialized products to cater to specific customer requirements.

Canfor Pulp, which on a day-to-day basis operates under a separate Board of Directors and senior management structure, has the following business strategies:

- Preserving its low-cost operating position
- Maintaining the premium quality of its products
- Opportunistically acquiring high quality assets.

OVERVIEW OF 2010

A struggling U.S. economy and a U.S. housing sector plagued by escalating foreclosures and falling home prices continued to present major challenges to the solid wood sector in 2010. Housing starts and residential improvement spending showed little improvement from the record-lows seen in 2009 while home inventories remained at elevated levels. Unlike in 2009, however, there was some good news on the demand side, with China continuing to grow significantly as a major consumer of Western SPF (Spruce/Pine/Fir) lumber in 2010, overtaking Japan as the Company's largest offshore market during the year. Buoyed by this, as well as some favourable supply dynamics early in the year, SPF lumber prices posted solid gains in 2010.

Reflecting continued challenging market conditions, Canfor operated at approximately two-thirds of its lumber capacity and one-third of its panels capacity in 2010, and in September announced the permanent closure of its Clear Lake lumber operation in January 2011. On a more positive note, the Company restarted its Chetwynd sawmill in May 2010 after a two year indefinite shut, as a result of significant cooperation received from employees and other stakeholders.

Canfor retained its strong operational focus in 2010 and continued to find ways of minimizing challenges presented by the Mountain Pine Beetle ("MPB") epidemic in several regions of the BC Interior. In 2010, the Company invested in a number of major sawmill capital projects aimed at significantly improving lumber productivity and cost performance, and the Board of Directors approved a three year capital program aimed at taking the Company's mills to new levels of cost-competitiveness.

Pulp markets saw record-high prices in 2010 as the sector benefited from tighter global supply, in part due to the Chile earthquake in February, and strong global demand, from China in particular. Another positive development for the Company's pulp business was the approval of Green Transformation Program funding from the Canadian federal government toward a $100 million recovery boiler upgrade for the Northwood pulp mill.

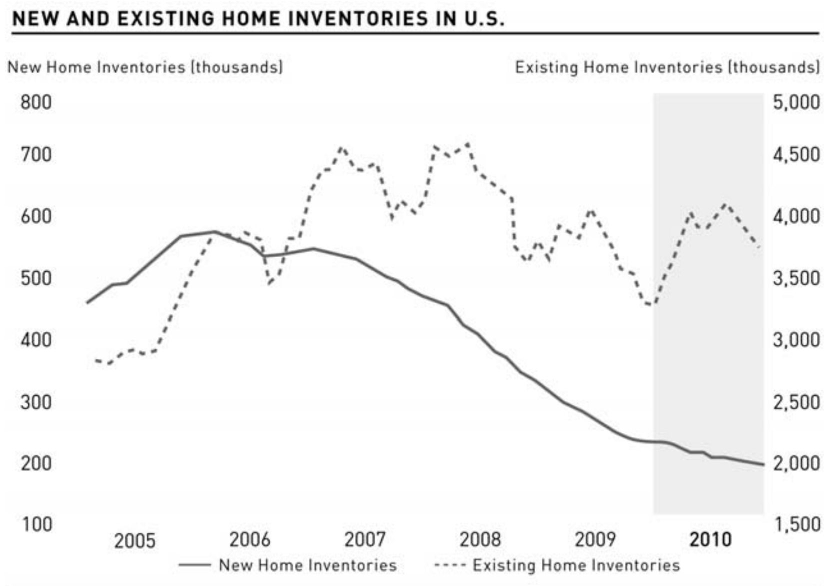
A review of the more significant developments in 2010 follows.

(i) U.S. housing sector remains in severe downturn, Canadian housing sector fares better

The U.S. housing sector struggled to build any positive momentum in 2010. The impact from the U.S. federal government's economic stimulus package, launched in 2009, faded as the year progressed, as weak private sector demand, high unemployment, and rising foreclosure rates all weighed heavily on consumer confidence and the economy.

As a result, U.S. housing activity showed little improvement in 2010. New and existing home sales fell in most states (down overall by 14% and 5% respectively from the previous year), while elevated levels of existing home inventories continued to reflect record-high mortgage delinquency and foreclosure rates. The pronounced impact of the latter is highlighted in Chart 1 (note, but for a temporary moratorium on foreclosures implemented in some states existing home inventories would have been higher for some months in 2010).

Chart 1

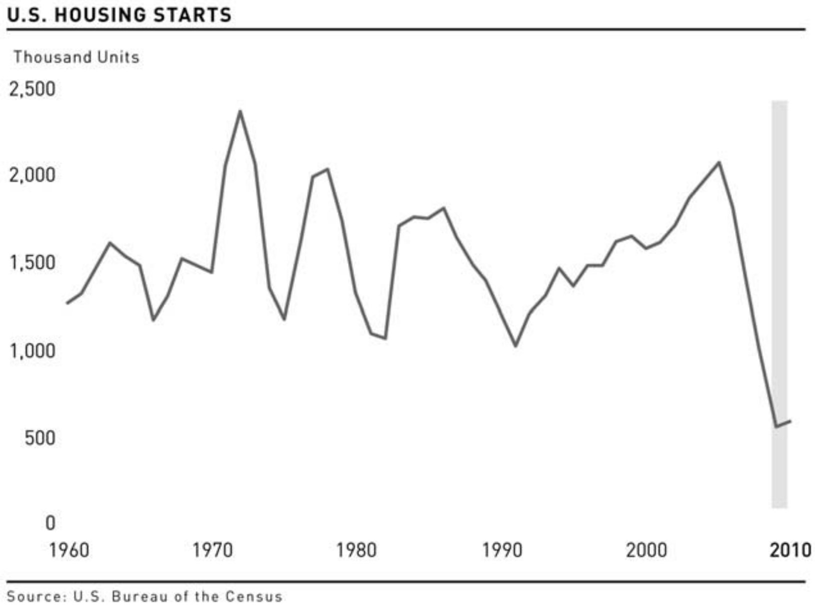


Source: National Association of Home Builders.

After a modest rise in U.S. housing starts early in the year, due mostly to the U.S. federal government's Home Buyers Tax Credit (which expired in April 2010), housing starts slid back to 2009 levels. For 2010 as a whole, housing starts showed a modest gain, at 588,000 starts[1] (2009 - 554,000), but remained some 42% below troughs in previous downturns over the last 60 years, as highlighted in Chart 2. Expenditures on residential improvements also showed little uplift in 2010, as homeowners continued to curb spending on repairs and renovations.

[1] Source: U.S. Bureau of the Census

Chart 2



The Canadian housing market fared better than its U.S. counterpart in 2010. Housing starts averaged over 195,000 units[2] SAAR (Seasonally Adjusted Annual Rates) in the first half of 2010, up 50% from the same period in 2009. However, construction activity slowed considerably late in the year, in part reflecting higher interest rates, and housing starts in the fourth quarter dropped to 179,000 units SAAR, in line with the same period in 2009 (Chart 3).

Chart 3

[2] Canada Mortgage and Housing Corporation ("CMHC")

(ii) Rapid growth in Chinese demand for lumber brings greater geographic market diversification

While U.S. lumber demand remained depressed in 2010, the Company saw its lumber business with China show impressive growth, with shipments doubling those of 2009. As Chart 4 highlights, the second half of 2010 saw shipments surge as demand for SPF lumber products increased in all segments of the market. The Company's Quesnel sawmill supplied a significant part of this volume - after a five month curtailment earlier in the year, the mill was restarted in June exclusively for the Chinese market.

China has now surpassed Japan as Canfor's largest offshore market, with sales volumes to China in 2010 representing 17% of Canfor's total sales compared to 4% just two years earlier (Chart 5). The unprecedented growth of China can be attributed to several factors including:

- The continued rapid growth of the Chinese economy and a booming residential and non-residential construction sector;
- China's increased use of Western Canadian SPF lumber due to economic, environmental and supply concerns related to timber sourced from Russia (traditionally a major supplier to China); and
- Increased acceptance of SPF products, in part reflecting the successful efforts by the BC provincial government and forestry industry leaders, in which Canfor played a prominent role, to promote wood-frame construction and BC lumber products.

Chart 4

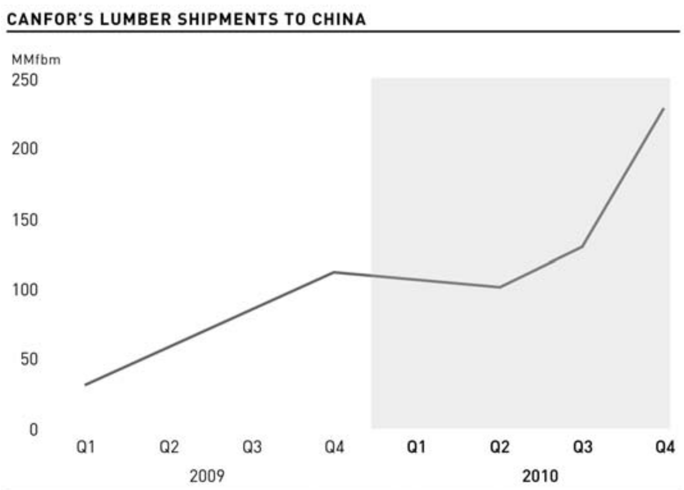
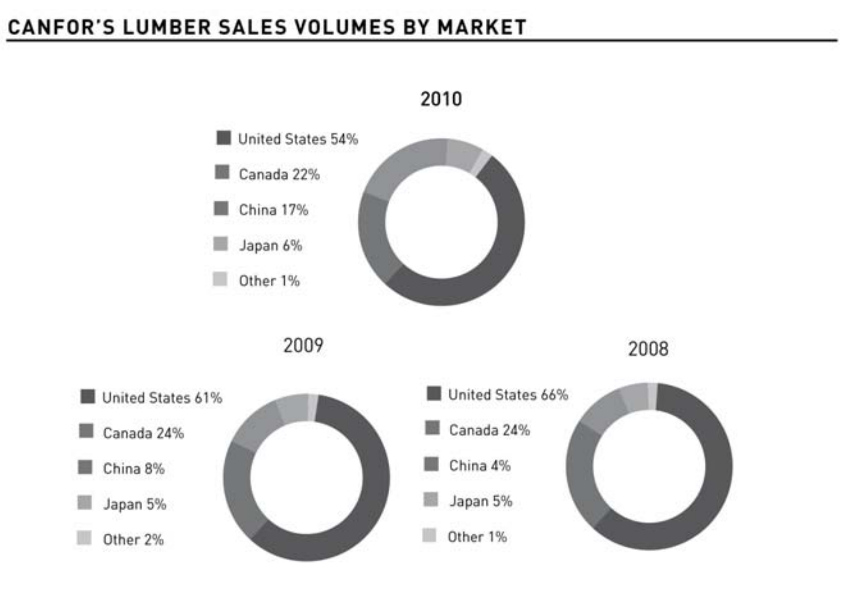


Chart 5



Wood frame construction in China is now beginning to be considered an affordable construction method. In addition, hybrid construction (concrete, steel, & wood) has also served as an impetus for the increase in use of construction grade lumber. Concrete building with wooden roof trusses, as well as lumber products used as partition walls and floors, are now acceptable building practices in China. As China continues to focus its attention on both reducing energy usage, particularly carbon reduction initiatives, and developing a safe building system in earthquake-active areas, potential purchasers are also better understanding the environmental and seismic performance advantages of wood frame construction.

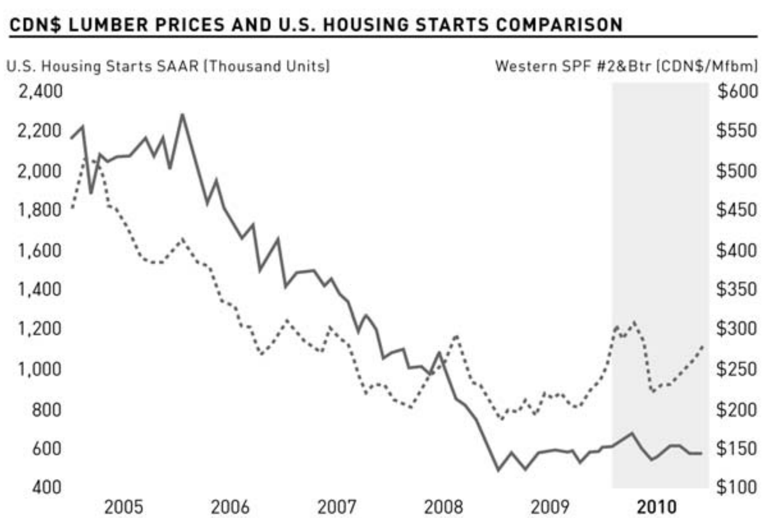
Traditionally China has consumed low grade lumber products (#3 and Economy grades) for concrete forming, scaffolding and remanufacturing. This strong appetite for low grade lumber has favourably impacted low grade lumber prices within North America and has narrowed the traditional price spreads between #2 & Better ("#2&Btr") and #3. However, as its demand for SPF lumber has increased and outstripped the availability of low grade lumber, so has the need to purchase higher value grades to meet its overall requirements. As a result, the percentage of #2&Btr grade volume shipped to China climbed to 44% of total China shipments in 2010, up from 23% in 2009. These higher grades are traditionally consumed in North American markets, and make up a large proportion of Canfor's production.

(iii) Lumber Prices Boosted by Expanding China Demand and Supply Factors

Despite the challenges facing the U.S. housing sector, Western SPF lumber prices moved up in 2010 mostly as a result of the increased lumber demand from China. Supply related factors also played their part during the year, with increased customer inventory replenishment and weather-related log shortages in the Southern U.S. helping to support a 15 week lumber price rally early in the year. The rally ended abruptly in May and June when a combination of weakening demand and higher producer operating rates saw the reversal of earlier gains.

Western SPF prices as measured by 2x4 #2&Btr averaged US$256 per thousand board feet[3] ("Mfbm"), some US$74, or 41%, higher than 2009 when prices fell to their lowest levels in decades. Western SPF lumber 2x4 #2&Btr prices ended the 2010 year strongly at over US$300 per Mfbm. Chart 6, below, highlights the Western SPF 2x4 #2&Btr US dollar price movements in 2010. It also shows the historical relationship between U.S. housing starts and Western SPF 2x4 #2&Btr prices. The positive impact from the emergence of China as a major consumer of Western SPF lumber is evident in the widening gap between housing starts and lumber prices, particularly in 2010. Chart 7 shows the price compression between Western SPF 2x4 #2&Btr and Utility #3 grade that occurred in 2010. This highlights the effect in 2010 of Chinese consumption of the significant majority of available low grade lumber and increased consumption of #2&Btr, and the resulting reduced availability of both grades in the North American market.

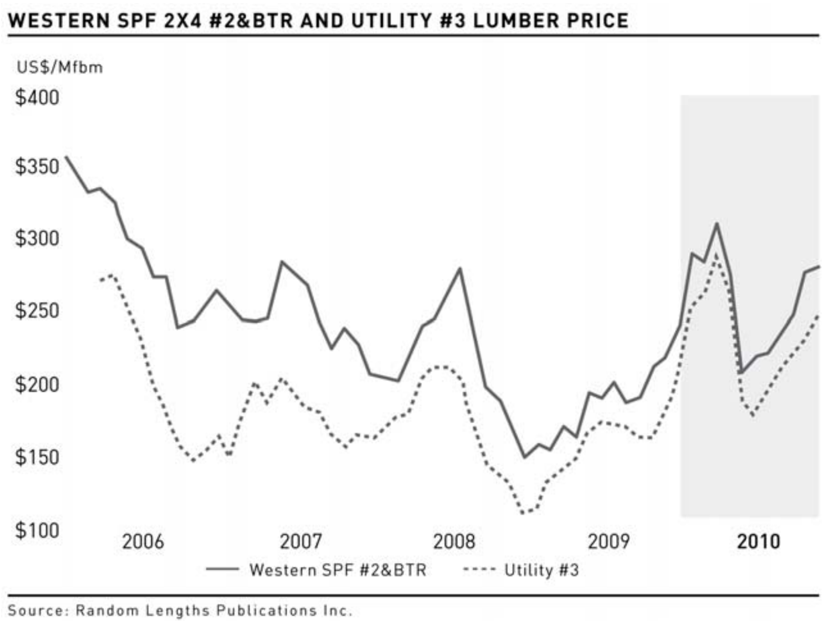
Chart 6



Source: U.S. Bureau of the Census and Random Lengths Publications, Inc.
Note: Canadian price is calculated at the US price multiplied by the average monthly exchange rates per the Bank of Canada.

[3] Random Lengths Publications, Inc.

Chart 7



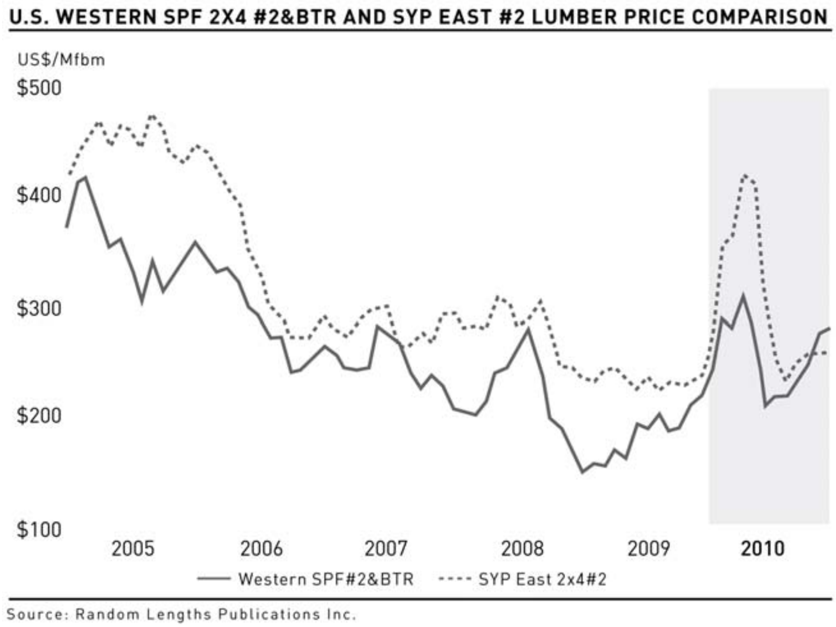
The Canadian dollar remained strong versus its U.S. counterpart through 2010, trading between 95 cents[4] and par for most of the year, and ended the year slightly above par. This was in stark contrast to the significant volatility in 2009, when the Canadian dollar ranged between $0.77 and $0.97 against its U.S. counterpart. Over the 2010 year, the Canadian dollar averaged $0.97, up almost 10 cents, or 11%, compared to 2009.

As a result of the price rally in North American lumber markets in early 2010, Random Length lumber composite prices exceeded specified thresholds stipulated in the Softwood Lumber Agreement. Accordingly the export tax rate on Western SPF lumber for BC shipments dropped from 15% of Canadian dollar sales values to 10% in May and July (Alberta: from 22.5% to 15%) and to 0% for June. For the rest of 2010, the export tax rate from BC to the U.S. remained at 15%, while Alberta's shipments continued to attract a surge rate of 22.5% (for further details, see the Export Tax section in Operating Results by Business Segment – 2010 compared to 2009, Lumber Segment).

Prices for Southern Yellow Pine ("SYP") 2x4 lumber in 2010 were up 29% compared to 2009 at US$301 per Mfbm[5]. As Chart 8 highlights, this was mostly attributable to a sharp rise in prices in the first 5 months of the year, fuelled in part by weather-related log supply constraints, but weakening demand and increased availability of supply led to a pricing collapse in the latter part of the second quarter. Prices showed little improvement through most of the second half of 2010, reflecting a stagnating U.S. housing market.

[4] Bank of Canada
[5] Random Lengths Publications, Inc.

Chart 8



(iv) Canfor continues to adjust solid wood production to match product demand

The Company operated at 66% of lumber capacity in 2010 (2009 – 60%), for the most part reflecting significant market curtailments in response to weak U.S. demand.

As a result of the protracted U.S. housing downturn, the Company's Radium, Rustad and Vavenby sawmill operations in the BC Interior remained indefinitely idled through 2010, while production at the Quesnel sawmill operation was curtailed for 5 months prior to its restart in June. In addition, the Company's Clear Lake lumber operation was permanently closed in mid-January 2011, due to weak prices for stud lumber and a lack of economical long-term fibre available to that mill. Two of the Company's three panels operations continued to be idled through 2010; no plywood was produced in the year and the only OSB plant that operated was the jointly-owned Peace Valley OSB mill in Fort St. John, BC.

The Company's Chetwynd sawmill operation restarted on a single shift in May 2010 after a two year indefinite shut, as a result of cooperation from employees and other stakeholders, before transitioning to a two shift configuration in October. In addition, the Mackenzie sawmill moved from one to two shifts in the first quarter of 2010, having restarted on one shift in mid-2009.

A summary of those lumber and panel operations indefinitely idled at the end of 2010 and their annual production capacities, and the annual production capacity of the Clear Lake operation closed in January 2011, is presented in the following table:

	Date idled / closed	Production capacity
Lumber Mills		(MMfbm)
Radium	July 2009	185
Rustad	July 2009	295
Vavenby	July 2009	235
Clear Lake (permanent closure)	January 2011	170
		885
Panels Operations		MMsf (3/8" basis)
PolarBoard (OSB)	June 2008	640
Tackama (Plywood)	October 2008	270
		910

(v) Pulp prices boosted by tightening supply, strong demand; Green Transformation Program funding approved for Canfor Pulp recovery boiler upgrade

Pulp markets saw record-high NBSK prices in 2010 on the back of tighter global supply, in large part reflecting the after-effects from the Chilean earthquake in February 2010, and strong global demand, particularly from China. NBSK list prices to the U.S. market increased 34% compared to 2009, and similar gains were seen in Europe and China. U.S. list prices breached US$1,000 per tonne[6] in May for the first time on record and reached a high of US$1,020 in June and July before falling back to US$960 by year end. BCTMP prices also showed some gains, but not to the same degree as NBSK pulp. As a result of the elevated prices, as well as a solid year of operational performance, Canfor's pulp and paper segment reported strong financial results in 2010, thereby enabling Canfor Pulp to increase monthly cash distributions to unitholders and announce a supplemental distribution in December.

The following charts show the historically-low global pulp inventory levels and significantly higher US and Canadian dollar prices in 2010 - both highlight the pronounced impact of the Chilean earthquake.

Chart 10

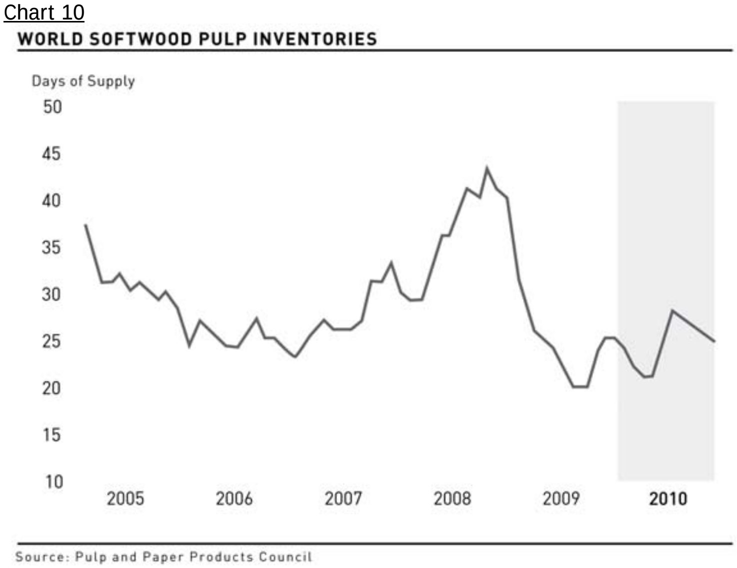
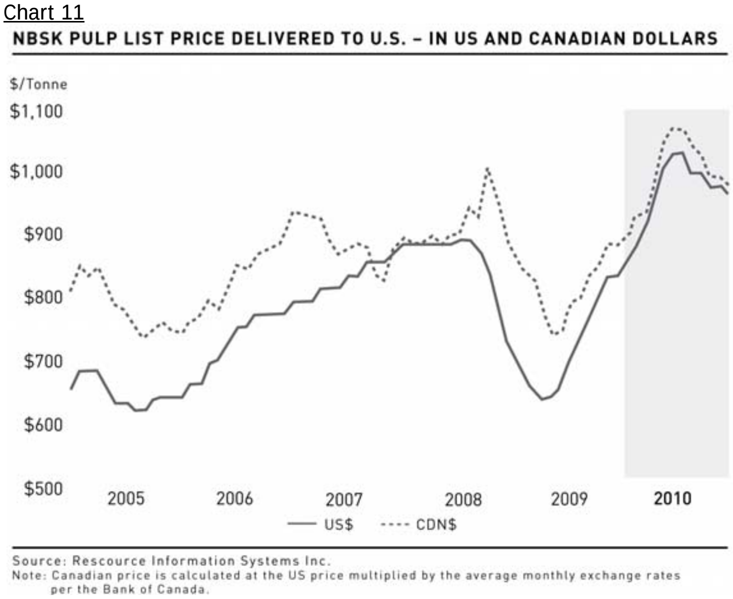


Chart 11



[6] Resource Information Systems, Inc.

In October 2009, the Canadian federal government announced the set up of a Pulp and Paper Green Transformation Program (the "Program") designed to reimburse funds spent by Canadian kraft pulp producers on qualifying energy and environmental capital projects. Canfor Pulp was allocated $122.2 million from this Program. In November 2010, Canfor Pulp received approval under the Program for funding of a $100 million capital upgrade of the recovery boiler at its Northwood pulp mill in Prince George, BC. The project is planned for completion in the fourth quarter of 2011 and is expected to provide economic and environmental benefits to Canfor Pulp's operations. Canfor Pulp also received approval earlier in 2010 for two other qualifying projects totalling $15.6 million.

(vi) Focus on Operational Improvement and preserving strong financial position continues

The Company followed up 2009 with another solid year of cost management in 2010. Total lumber manufacturing costs were down 3% from 2009, mostly as a result of lower SPF and SYP log costs and productivity gains. The Company continued to mitigate the impact of aging MPB infected fibre at its operations, and restricted decreases in lumber recoveries to modest levels. Costs related to indefinitely idled lumber and panels operations continued to be managed closely. In addition to favourable market conditions, the Company's pulp and paper financial results were boosted by strong operational performances, with the Canfor Pulp operation setting several production records during the year.

In the first quarter of 2010, the Company reached a new labour agreement with the United Steelworkers union, which will expire on June 30, 2013. The agreement covers employees at 13 of the Company's operations in British Columbia, and provides some cost relief during periods of low lumber prices, as well as putting into place a profit-based performance incentive plan for the Company's hourly employees.

For the most part, cash flow in 2010 reflected the much improved operating earnings from the lumber and pulp businesses. Inventory levels continued to be closely managed and cash flows were also helped by a $46 million cash income tax refund early in the year and by proceeds from the sale of the Company's investment in Howe Sound Pulp and Paper Limited Partnership in October. In addition to higher levels of capital investment at its lumber operations (more details below) and at Canfor Pulp's mills, the Company made a long-term debt repayment and increased the level of its funding contributions to its defined benefit pension plans. The Company ended 2010 in a very strong financial position with cash on hand of $260 million, well over $400 million of available and unused operating lines of credit and net debt to total capitalization of only 3.3%.

(vii) Canfor continues to mitigate challenges presented by the MPB epidemic, BC Interior's stumpage market pricing system brings changes

The Company continued to process a large volume of dry MPB killed logs at most of its BC Interior sawmills in 2010, and minimize the impact on its operations through further application of new technology and best practices. Notwithstanding, the Company in 2010 continued to see a reduction in both lumber recovery and the proportion of higher-value prime grades (which command a premium to #2&Btr products). The Company plans to continue salvaging dead fibre before the end of its commercial shelf life, which can vary between 3 and 15 years depending on soil moisture levels.

Once the salvage of dead pine is complete, it is anticipated that the current elevated Annual Allowable Cut ("AAC") levels in certain BC Interior regions where the MPB presence is high will be adjusted downward. In some areas, this adjustment will be significant to reflect lower mature inventory levels of surviving pine, offset in part by higher inventories of unaffected non-pine species such as spruce, balsam fir and Douglas-fir stands where strict harvesting limits are currently in force. In 2010, the Chief Forester for the Province of BC commenced AAC reviews for six timber supply areas ("TSAs"), with Canfor having operations in five of these. In January 2011, the Chief Forester released his determinations for the Prince George and Quesnel TSAs. These include AAC reductions of 16% and 24% respectively, with all of the reductions coming from the temporary MPB uplift in AAC. The Company's replaceable licenses in these TSAs are not affected by the AAC reductions, and the Company does not expect that determinations for the remaining TSAs will significantly impact the AAC at its other operations.

On July 1, 2010, the Ministry of Forests and Range implemented changes to the BC Interior market pricing system for timber. These changes dealt with issues raised by the MPB epidemic and included: the introduction of stand-as-a-whole pricing with cruise-based billing for MPB damaged timber; and, from a stumpage distribution perspective, the transition over two years to a system more sensitive to market forces. For stands with 35% or more MPB damaged timber, a single stumpage rate is established with billing based on a cruise measurement (estimate) rather than scaling. For these stands, determination of log grades is no longer necessary. An impact of these changes is to increase the overall market sensitivity of BC Interior timber pricing and to improve the utilization of low value material. These changes are consistent with the 2006 Softwood Lumber Agreement.

(viii) Lumber capital initiatives targeting significant performance improvement at key strategic mills

Reflecting its confidence in the longer-term prospects of the lumber sector, the Company undertook a number of high return capital projects in 2010 and in late 2010 announced a major new 3-year capital program aimed at securing its position in the top tier of competitiveness at its lumber operations.

Capital spending in 2010 totalled $88 million and included work on a $47 million sawmill and planer rebuild of the Company's Fort St. John sawmill, an upgrade of its Chetwynd sawmill, and a new energy system at its Prince George sawmill operation. The Fort St. John rebuild includes installation of a new sawmill canter line, debarker, sorter and trimmer and a completely upgraded planer mill, and will lead to a significant increase in productivity and lumber recoveries. The project is progressing well and remains on budget and on schedule for completion in the first quarter of 2011. The Chetwynd upgrade included new sawmill and planer sorters and a new energy system, and was completed on time and under budget. A number of planer optimizer installations were also completed during the year.

The new capital program announced in December 2010 calls for $300 million of sawmill improvement projects (over and above normal maintenance spending) that will result in increased productivity, higher recoveries, lower energy costs and efficient prime lumber extraction. For the Company's Western SPF mills, capital investment will be focused principally on mills with excellent long-term fibre supply. Approximately $120 million of the $300 million capital spending is currently anticipated to be spent in 2011.

OVERVIEW OF CONSOLIDATED RESULTS – 2010 COMPARED TO 2009

Selected Financial Information and Statistics:

(millions of dollars, except for per share amounts)	2010	2009
Sales	$ 2,430.4	$ 2,075.8
EBITDA	$ 325.3	$ (55.1)
Operating income (loss)	$ 169.3	$ (210.4)
Foreign exchange gain on long-term debt and investments, net	$ 14.7	$ 50.4
Gain on derivative financial instruments[7]	$ 0.1	$ 24.4
Gain on sale of mill property	$ -	$ 44.6
North Central Plywoods mill fire, net	$ -	$ (3.0)
Net income (loss)	$ 161.3	$ (62.8)
Net income (loss) attributable to shareholders of Company[8]	$ 70.0	$ (70.5)
Net income (loss) per share attributable to shareholders of Company, basic and diluted	$ 0.49	$ (0.50)
Average exchange rate (US$/CDN$)[9]	$ 0.971	$ 0.876
U.S. housing starts (million units)[10]	0.588	0.554

[7] Includes gains (losses) from natural gas, diesel, foreign exchange and lumber price derivatives (see "Unallocated and Other Items" section for more details).
[8] Net income (loss) attributable to equity shareholders of Company ("Shareholder Net Income (Loss)") is calculated as net income (loss), less non-controlling interests. For 2010, the income attributable to non-controlling interests amounted to $91.3 million, compared to $7.7 million in 2009.
[9] Source – Bank of Canada (average noon rate for the period)
[10] Source – U.S. Census Bureau

Effective January 1, 2010, the Company has adopted three new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"). These are Handbook Sections 1582 Business Combinations, 1601 Consolidated Financial Statements, and 1602 Non-controlling Interests. Adoption of these Sections reduces the differences between Canadian GAAP and International Financial Reporting Standards ("IFRS").

The main impact of these new standards on the Company's financial statements is to reclassify the non-controlling interests on the balance sheet from long-term liabilities into equity, and to no longer deduct the net income (loss) of non-controlling interests in arriving at the total net income (loss). The "Net income (loss) attributable to equity shareholders of the Company," as disclosed on the consolidated statements of income (loss), is comparable to the "Net income (loss)" reported in previous years. These changes have been applied retrospectively.

More information on this can be found in the "Changes in Accounting Policies" section later in this document.

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

After-tax impact, net of non-controlling interests (millions of dollars, except for per share amounts)		**2010**		**2009**
Shareholder Net Income (Loss)	**$**	**70.0**	$	(70.5)
Foreign exchange gain on long-term debt and investments, net	**$**	**(10.4)**	$	(36.0)
Loss (gain) loss on derivative financial instruments	**$**	**0.5**	$	(19.0)
Gain on sale of operating assets of Howe Sound Pulp and Paper Limited Partnership	**$**	**(4.9)**	$	-
Increase in fair value of asset-backed commercial paper	**$**	**(5.5)**	$	-
Clear Lake permanent closure provision	**$**	**13.4**	$	-
Radium, Rustad and Vavenby indefinite idling provisions	**$**	**-**	$	6.6
Gain on sale of mill property	**$**	**-**	$	(37.8)
North Central Plywoods mill fire, net	**$**	**-**	$	2.0
Corporate income tax rate reductions	**$**	**-**	$	(7.3)
Net impact of above items	**$**	**(6.9)**	$	(91.5)
Adjusted net income (loss)	**$**	**63.1**	$	(162.0)
Shareholder net income (loss) per share, as reported	**$**	**0.49**	$	(0.50)
Net impact of above items per share	**$**	**(0.05)**	$	(0.64)
Adjusted net income (loss) per share	**$**	**0.44**	$	(1.14)

The Company recorded net income attributable to equity shareholders of $70.0 million, or $0.49 per share, for the year ended December 31, 2010, an improvement of $140.5 million, or $0.99 per share, from a net loss of $70.5 million, or $0.50 per share, reported for the year ended December 31, 2009.

After taking account of significant items affecting comparability with prior periods, the Company's 2010 adjusted net income was $63.1 million, or $0.44 per share, up $225.1 million, or $1.58 per share, compared to a similarly adjusted net loss of $162.0 million, or $1.14 per share, for 2009.

EBITDA

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

(millions of dollars)	2010	2009
Net income (loss), as reported	**$ 161.3**	$ (62.8)
Add (subtract):		
Amortization	**$ 156.0**	$ 155.3
Interest expense, net	**$ 25.5**	$ 29.3
Foreign exchange gain on long-term debt and investments, net	**$ (14.7)**	$ (50.4)
Gain on derivative financial instruments	**$ (0.1)**	$ (24.4)
Gain on sale of mill property	**$ -**	$ (44.6)
North Central Plywoods mill fire, net	**$ -**	$ 3.0
Other (income) expense	**$ (8.1)**	$ 11.4
Income tax (recovery) expense	**$ 5.4**	$ (71.9)
EBITDA, as reported	**$ 325.3**	$ (55.1)
Negative (positive) impact of inventory valuation adjustments[11]	**$ (20.2)**	$ (21.2)
Clear Lake permanent closure provision	**$ 17.8**	$ -
Radium, Rustad and Vavenby indefinite idling provisions	**$ -**	$ 8.8
EBITDA excluding impact of inventory valuation adjustments and closure & idling provisions	**$ 322.9**	$ (67.5)

[11] In accordance with Canadian GAAP, Canfor records its log and finished product inventories at the lower of cost and net realizable value. Changes in inventory volumes, market prices, foreign exchange rates and costs over the respective reporting periods can all affect inventory write-downs required at each year end.

Reported EBITDA for 2010 was $325.3 million, up $380.4 million from EBITDA of negative $55.1 million for 2009. Operating income showed a similar increase. The favourable variances reflected much improved financial results for both the lumber and pulp and paper business segments, driven mostly by higher 2010 lumber and pulp sales values. OSB prices also showed improvement but remained at historically low levels.

For solid wood products, inventory valuation adjustments in 2010 favourably impacted EBITDA and operating income by $20.2 million (2009 - $21.2 million), with higher lumber and residual chip sales values and lower costs through 2010 resulting in minimal write-downs at the end of 2010. Restructuring, mill closure and severance costs of $32.9 million in 2010 were up $3.0 million from the previous year, with the Clear Lake closure provision outweighing lower 2010 costs related to indefinitely idled operations as well as one-time provisions related to the indefinite shut of the Radium, Rustad and Vavenby sawmills in mid-2009.

A more detailed review of the Company's operational performance and results is provided in "Operating Results by Business Segment – 2010 compared to 2009", which follows this overview of consolidated results.

OPERATING RESULTS BY BUSINESS SEGMENT – 2010 COMPARED TO 2009

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 Lumber and Pulp and Paper segments. The results of the panels business are included in the Unallocated & Other segment.

Lumber

Selected Financial Information and Statistics - Lumber

Summarized results for the Lumber segment for 2010 and 2009 are as follows:

(millions of dollars, unless otherwise noted)	2010	2009
Sales	**$ 1,255.2**	$ 1,118.3
Operating income (loss)	**$ 10.2**	$ (171.4)
EBITDA, as reported	**$ 99.8**	$ (81.4)
Negative (positive) impact of inventory valuation adjustments	**$ (21.4)**	$ (16.2)
Clear Lake permanent closure provision	**$ 17.8**	$ -
Radium, Rustad and Vavenby indefinite idling provisions	**$ -**	$ 8.8
EBITDA excluding impact of inventory valuation adjustments and closure & idling provisions	**$ 96.2**	$ (88.8)
Capital expenditures	**$ 88.1**	$ 39.1
Average SPF 2x4 #2&Btr lumber price in US$[12]	**$ 256**	$ 182
Average SPF price in Cdn$	**$ 264**	$ 208
Average SYP 2x4 #2 lumber price in US$[13]	**$ 301**	$ 233
Average SYP price in Cdn$	**$ 310**	$ 266
Production – SPF lumber (MMfbm)	**2,886.7**	2,766.8
Production – SYP lumber (MMfbm)	**355.0**	267.5
Shipments – Canfor-produced SPF lumber (MMfbm)[14]	**2,906.0**	2,914.2
Shipments – Canfor-produced SYP lumber (MMfbm)[14]	**378.9**	317.6
Shipments – wholesale lumber (MMfbm)	**159.8**	165.8

[12] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)
[13] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)
[14] Includes shipments of lumber purchased for remanufacture.

Overview

The Lumber segment reported EBITDA of $99.8 million for 2010, up $181.2 million from EBITDA of negative $81.4 million for 2009. Excluding the impact of inventory valuation adjustments and restructuring costs, EBITDA was up by $185.0 million from the prior year.

For the most part, the improved EBITDA reflected higher SPF and SYP lumber sales realizations and increased residual chip prices, the latter resulting principally from higher NBSK pulp prices.

The Company continued to take significant market curtailment in 2010, operating at approximately 66% of production capacity compared to 60% in the previous year. Unit manufacturing costs showed a 3% decrease compared to 2009. Restructuring, mill closure and severance costs in 2010 included a provision of $17.8 million resulting from the Company's decision to permanently close its Clear lake lumber operation; in 2009, costs included $8.8 million related to the decision to indefinitely idle the Company's Radium, Rustad and Vavenby sawmill operations.

Markets

Canfor's total lumber sales volume for 2010 was 3.4 billion board feet, slightly higher than 2009, with SPF and SYP making up 89% and 11% of total sales, respectively. As highlighted earlier, in part (ii) of the Overview of 2010, increased demand from China in 2010 for SPF low grade and #2&Btr helped to offset continued weak demand in the U.S. Shipments to the U.S. represented 54% of total sales volumes in 2010, down 7% from the prior year, while offshore shipments, particularly to China, were up by a similar amount.

Total U.S. housing starts for 2010 showed only a small improvement, at 588,000 units, from their 2009 historical low level, with both single family and multi-family starts increasing 6% to 471,000 units and 117,000 units respectively. New and existing home sales fell in most states, particularly after the expiry of the U.S. Federal government's Home Buyers Tax Credit in April 2010. Existing home inventories remained at elevated levels, reflecting record-high mortgage delinquency and foreclosure rates, while a decline in inventories in the second half of the year was attributed mostly to a temporary moratorium of foreclosures in a number of states. New home inventories continued to decrease in 2010.

The U.S. Federal government's Home Buyers Tax Credit, which expired in April 2010, spurred much of the housing activity early in the year. The increase in housing demand occurred when lumber inventories were low throughout the entire supply chain. As a result, lumber prices accelerated sharply to a high not seen since 2006. By mid-year however, lumber prices had fallen off sharply as a result of lower demand and weaker supply dynamics. The second round of lumber price appreciation came late in the year, primarily fueled by the strength in offshore demand, particularly from China.

Total Canadian housing starts were 190,000 units in 2010, an increase of 27% from 2009 starts of 149,000 units. Canadian housing starts trended higher through most of 2010 boosted by low interest rates and improved consumer confidence, but construction activity faded later in the year, in part due to rising interest rates, and housing starts fell back to 179,000 starts SAAR in the fourth quarter.

The U.S. repair and remodeling sector had another difficult year in 2010. Residential remodeling spending declined for a third successive year, with weak home prices coupled with tight credit markets contributing to lower sales activities during the year.

Offshore lumber demand increased significantly in 2010, with shipments as a percentage of Western SPF sales increasing from 17% in 2009 to 28% in 2010. This increase was spearheaded mainly by the unprecedented record volumes shipped to China, which doubled over 2009. Shipments to Japan also rebounded from 2009, reflecting in a 21% increase in shipments as 2x4 wooden housing starts improved.

Sales

Canfor's lumber segment sales revenues of $1,255 million for 2010 were up $137 million, or 12%, compared to 2009, for the most part reflecting improved North American and offshore prices. The Western SPF lumber 2x4 #2&Btr Random Lengths price averaged US$256 per Mfbm, up US$74, or 41%, from 2009. SYP 2x4 #2 Random Lengths average prices also showed strong gains compared to 2009, increasing US$68, or 29%, to US$301 per Mfbm.

Price gains in 2010 for wider Western SPF dimensions were more moderate, but still represented a solid improvement compared to the prior year. Wider SYP dimension price increases were significantly less, with prices for some wide dimensions actually trailing 2x4 prices for much of the year, reflecting the low level of new home construction activity in the U.S. The 11% increase in the average value of the Canadian dollar versus the US dollar for 2010 compared to 2009 offset some of the price gains for Canadian SPF producers.

Total residual fibre revenue for 2010 was well up from 2009 levels, boosted by higher residual chip prices reflecting increased NBSK pulp prices, and to a lesser extent, increased revenues for other by-products and higher operating rates.

Export Tax

Under the Softwood Lumber Agreement ("SLA") implemented by the federal governments of Canada and the U.S. in 2006, Canadian softwood lumber exporters pay an export tax on lumber shipped to the U.S. when the price of lumber is at or below US$355 per Mfbm, as determined by the Random Lengths Framing Lumber Composite Price[15] ("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.

For 2009 and most of 2010, the export tax rate on lumber shipments from BC to the U.S. was 15%, while Alberta's shipments attracted a surge rate of 22.5%. The short-lived price rally in North American lumber markets in early 2010 resulted in the export tax rate falling from 15% to 10% on BC shipments for May and July (15% for Alberta) and 0% for June. The average RLCP for 2010 was US$284 per Mfbm, up US$62 from US$222 per Mfbm in 2009.

Total export tax paid by the Company in 2010 was $40.0 million, compared to $48.7 million for 2009.

Operations

Lumber production for 2010 was 3.2 billion board feet, 210 million board feet, or 7%, higher than 2009. For the most part, the higher production reflected productivity improvements as well as additional production at the Company's Chetwynd and Mackenzie sawmills, which more than offset five months of curtailment at the Quesnel sawmill and the idling of its Rustad, Radium and Vavenby sawmills for the whole year. The Chetwynd sawmill operation was restarted on a single shift in May 2010 after being closed for two years, and moved to a two shift configuration later in October. The Mackenzie sawmill moved from one to two shifts in February 2010, after restarting on one shift in mid-2009.

Total unit manufacturing costs were down 3% compared to the prior year, with the major contributing factors being lower purchased wood costs, market stumpage and overhead costs, and improved planer productivity in part reflecting the installation of planer optimizers at several locations. The Company continued to mitigate the effects of processing aging MPB fibre, holding decreases in lumber recoveries to modest levels. Ongoing costs at indefinitely idled facilities continued to be closely managed and were down year-over-year.

In the first quarter of 2010, the Company reached a new labour agreement with the United Steelworkers Union, which will expire on June 30, 2013. The agreement covers employees at 13 of the Company's operations in British Columbia. The agreement includes a profit-based performance incentive plan for the Company's hourly employees.

[15] Random Lengths Publications, Inc.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[16]

(millions of dollars, unless otherwise noted)		**2010**		2009
Sales	**$**	**1,119.6**	$	918.2
Operating income	**$**	**191.6**	$	5.4
EBITDA	**$**	**240.2**	$	55.9
Capital expenditures	**$**	**39.3**	$	17.9
Average pulp price delivered to U.S. - in US$[17]	**$**	**960**	$	718
Average pulp price in Cdn$	**$**	**989**	$	820
Production – pulp (000 mt)		**1,229.0**		1,192.0
Production – paper (000 mt)		**136.7**		131.1
Shipments – Canfor-produced pulp (000 mt)		**1,225.0**		1,243.5
Pulp marketed on behalf of HSLP (000 mt)[18]		**271.9**		322.9
Shipments – paper (000 mt)		**144.7**		135.0

[16] Includes Taylor pulp mill and 100% of Canfor Pulp, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both NBSK pulp and BCTMP.
[17] Per tonne, NBSK pulp list price delivered to U.S. (Resource Information Systems, Inc, - "RISI")
[18] Howe Sound Pulp and Paper Limited Partnership pulp mill

Overview

EBITDA generated by the Pulp and Paper segment for 2010 was $240.2 million, up $184.3 million from 2009. The improved earnings reflected significantly higher prices in 2010 for NBSK pulp and BCTMP products, which more than offset a stronger Canadian dollar. Higher fibre and maintenance costs in 2010 offset lower chemical costs and the favourable impact (on unit fixed costs) of a modest increase in production.

Markets

Tight market conditions through 2010 kept inventories held by producers and customers at levels in a range that is considered to be low to balanced. Price increases were supported through the first half of 2010 as a result of strong printing and writing paper demand and continued tight supply. Pulp and Paper Products Council statistics reported an increase in global demand for printing and writing papers of 6% for 2010 compared to 2009.

The tight supply conditions and low producer inventory levels continued through the second half of 2010 due mostly to the Chilean earthquake on February 27, 2010 that impacted approximately 8% of global softwood pulp supply. In addition, the restarts of several pulp mills idled in 2009 were delayed until late in 2010.

The improvement in consumption and constrained supply resulted in global softwood inventories stabilizing at a relatively low level. At the end of December 2010, World 20[19] producers of bleached softwood pulp inventories stood at 25 days of supply. By comparison, December 2009 inventories stood at 23 days of supply. Market conditions are generally considered balanced when inventories fall in the 27-30 days of supply range.

Sales

Shipments of Canfor-produced pulp for 2010 were largely unchanged from the prior year. Average NBSK pulp list prices were up US$242 per tonne, or 34%, compared to 2009 while BCTMP US dollar prices also moved up over the same period, but not to the same extent. Realized pulp prices in Canadian dollar terms for NBSK pulp were up 25% from 2009 reflecting the increased market prices and a higher-value regional sales mix, partly offset by the stronger Canadian dollar. Paper shipments were up 7% compared to 2009, and realized prices were up 9% in Canadian dollar terms.

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

As a result of the tight market conditions, producers were successful at implementing price increases through the first half of 2010. North American and Northern Europe list prices before discounts peaked in June and July at US$1020 per tonne and US$980 per tonne, respectively. Modest downward pressure was exerted on pricing in the latter half of 2010 with the restarts of Chilean pulp mills and two North American pulp mills. Prices stabilized in the fourth quarter in response to balanced market conditions to end the year at US$960 and US$950 per tonne in both regions. Prices to China, with no discounts, averaged US$816 per tonne in 2010, with price gains tracking those in North America for much of the year; prices ended the year at US$830 per tonne. In Canadian dollar terms the price increases were somewhat mitigated by the stronger Canadian dollar.

Energy sales under the terms of Canfor Pulp's Energy Purchase Agreement with BC Hydro were $5.4 million in 2010, compared to $1.9 million in 2009.

Operations

Pulp production volume was 1.23 million tonnes for 2010, up 37,000 tonnes or 3% compared to the prior year, as higher production rates and the absence of market curtailment at Canfor Pulp's operations in the current year more than offset extended maintenance outages at the Prince George Pulp and Paper mill and Northwood pulp mill.

Unit manufacturing costs were relatively unchanged from the prior year as the impact of higher production volumes and lower chemical costs was offset by higher fibre and maintenance costs. The higher fibre costs were due to an increase in the price of sawmill residual chips partly offset by a reduction in the volume and cost of higher cost whole log chips.

Unallocated and Other Items

(millions of dollars)	**2010**	2009
Operating loss of Panels operations	**$ (7.9)**	$ (23.0)
Corporate costs	**$ (24.6)**	$ (21.4)
Interest expense, net	**$ (25.5)**	$ (29.3)
Foreign exchange gain on long-term debt and investments, net	**$ 14.7**	$ 50.4
Gain on derivative financial instruments	**$ 0.1**	$ 24.4
Gain on sale of mill property	**$ -**	$ 44.6
North Central Plywoods mill fire	**$ -**	$ (3.0)
Other income (expense), net	**$ 8.1**	$ (11.4)

Operating Loss of Panels Operations

Results of the Panels operations in 2010 showed a $15.1 million improvement over 2009 but continued to reflect the challenging market conditions in the U.S. While the average OSB price of US$221[20] per thousand square feet ("Msf"), was up US$58, or 36%, from 2009, the increase was largely attributable to a supply-driven price rally in the early part of the year, during which prices peaked at US$395 per Msf in mid-May. Thereafter, a steep decline in buying saw prices drop off sharply through September when they bottomed out at US$160 per Msf, before a modest recovery in the fourth quarter saw prices end the year at US$200 per Msf. The stronger Canadian dollar partly offset some of the year-over-year price gains. A $5.8 million charge recorded in 2009 in connection with the settlement of the North Central Plywoods ("NCP") mill fire claim and lower costs at the idled Tackama and PolarBoard operations also contributed to the improvement compared to 2009.

Corporate Costs

Corporate costs, which comprise corporate, head office and certain information technology costs, were up $3.2 million in 2010 compared to 2009. This was due primarily to higher share based compensation, reflecting an increase in the Company's share price of 37% over the year, and the reinstatement of Canfor's short term incentive compensation plan in 2010 after its suspension in 2009.

[20] Random Lengths Publications, Inc.

Interest Income and Expense

Net interest expense for 2010 decreased $3.8 million from 2009, mostly as a result of lower long-term debt levels following repayments made in 2009 and 2010, the impact of the stronger average Canadian dollar on US dollar denominated interest payments, and higher cash balances.

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

The Canadian dollar ended 2010 slightly above par compared to the US dollar, and up 5 cents, or 5%, from a year earlier. As a result, the Company recorded a foreign exchange translation gain on its US dollar denominated debt less investments of $14.7 million in 2010 (2009 – $50.4 million).

Gain 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 2010, the Company recorded a net gain of $0.1 million related to its derivative instruments as losses incurred on natural gas swaps were offset by gains recorded on the Company's foreign exchange collars and forward contracts, diesel swaps and lumber futures.

The following table summarizes the amounts of the various components for the comparable periods.

Gain (Loss) on Derivative Financial Instruments:

(millions of dollars)		2010		2009
Foreign exchange collars and forward contracts	**$**	**4.0**	$	36.0
Natural gas swaps	**$**	**(5.2)**	$	(16.0)
Diesel options and swaps	**$**	**0.8**	$	1.6
Lumber futures	**$**	**0.5**	$	2.8
	$	**0.1**	$	24.4

Other Income and Expense

Other income for 2010 was $8.1 million, up $19.5 million from an expense of $11.4 million recorded for 2009.

In October 2010, Howe Sound Pulp and Paper Limited Partnership ("HSLP") (now called 6382 Pulp and Paper Limited Partnership), a kraft pulp and newsprint mill operation jointly owned by Canfor and Oji Paper Co. Ltd., completed the sale of all of its operating assets. As a result of the sale, Canfor recorded a gain of $5.5 million, which is included in Other Income. In conjunction with this sale, Canfor also completed the sale of Coastal Fibre Limited Partnership, which had no effect on income.

Other income also included a $6.3 million favourable movement in the fair value of the Company's asset-backed commercial paper and a foreign exchange loss of $4.9 million (2009 - loss of $11.4 million) on US dollar denominated cash, receivables and payables of Canadian operations, reflecting the 5% appreciation of the Canadian dollar over the year.

Income Tax Recovery

The Company recorded an income tax expense of $5.4 million in 2010, compared to a recovery of $71.9 million in 2009, with an overall effective tax rate of 3.2% (2009 – 53.4%). The most significant factors for the 2010 tax rate differing from the Canadian statutory rate of 28.5% are the income attributable to non-taxable non-controlling interests and the non-taxable portion of capital gains, part of which related to HSLP.

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

(millions of dollars)		2010		2009
Net income (loss) before income taxes	**$**	**166.7**	$	(134.7)
Income tax recovery (expense) at statutory rate 2010 – 28.5% (2009 – 30%)	**$**	**(47.5)**	$	40.4
Add (deduct):				
Non-taxable income related to non-controlling interests in limited partnerships		**26.0**		2.3
Change in corporate income tax rates		**-**		7.3
Entities with different income tax rates and other tax adjustments		**1.7**		2.9
Tax recovery at rates other than statutory rate		**2.8**		2.8
Permanent difference from capital gains and losses and other non-deductible items		**11.6**		16.2
Income tax recovery (expense)	**$**	**(5.4)**	$	71.9

SUMMARY OF FINANCIAL POSITION

The following table summarizes Canfor's financial position as at the end of the years 2010 and 2009:

(millions of dollars, except for ratios)		2010		2009
Net cash	**$**	**260.3**	$	133.4
Operating working capital		**286.0**		326.2
Current portion of long-term debt		**(82.5)**		(34.0)
Current portion of deferred reforestation		**(31.6)**		(27.8)
Income taxes recoverable		**-**		45.5
Net working capital		**432.2**		443.3
Long-term investments		**102.2**		93.7
Property, plant, equipment and timber		**1,631.0**		1,676.6
Goodwill		**69.6**		73.3
Deferred charges		**136.3**		117.1
Net assets	**$**	**2,371.3**	$	2,404.0
Long-term debt	**$**	**235.6**	$	333.3
Deferred reforestation obligation		**53.0**		60.3
Other long-term provisions and accruals		**156.3**		149.5
Future income taxes, net		**209.3**		200.8
Non-controlling interests		**269.9**		273.3
Equity attributable to shareholders of Company		**1,447.2**		1,386.8
	$	**2,371.3**	$	2,404.0
Ratio of current assets to current liabilities		**2.1 : 1**		2.6 : 1
Net debt to total capitalization		**3.3%**		12.4%

The ratio of current assets to current liabilities was 2.1:1, compared to 2.6:1 at the end of 2009. Both current assets and current liabilities were higher at the end of 2010 compared to 2009, but the increase in current liabilities was higher, reflecting increased accounts payable and long-term debt repayments due in 2011.

The Company's net debt to capitalization was 3.3% at December 31, 2010, well down from the end of 2009. The is explained by lower net debt balances at year end mostly resulting from higher cash balances (see "Changes in Financial Position" below for more details) and a long-term debt repayment during the year, coupled with the net income attributable to equity shareholders of $70.0 million in 2010.

CHANGES IN FINANCIAL POSITION

At the end of 2010, Canfor had $260.3 million of cash and cash equivalents.

(millions of dollars, except for ratios)	2010	2009
Cash generated from (used in)		
Operating activities	**$ 343.2**	$ (68.6)
Financing activities	**(114.2)**	(208.3)
Investing activities	**(101.0)**	49.6
Foreign exchange gain (loss) on cash and cash equivalents of self-sustaining foreign operations	**(1.1)**	(1.7)
Increase (decrease) in cash and cash equivalents	**$ 126.9**	$ (229.0)

The changes in the components of these cash flows during 2010 are discussed in the following sections:

Operating Activities

In 2010, Canfor generated cash from operations of $343.2 million, up $411.8 million from cash of $68.6 million used in operations in 2009. The significant increase in 2010 reflected the improved operating earnings in the lumber and pulp and paper business segments and lower working capital balances, which partially reflects a $45.9 million refund of cash taxes received in early 2010. Partially offsetting these increases were $13.5 million higher salary pension plan contributions made by the Company in the year. Cash used in 2009 reflected significant operating losses, which were partly offset by reductions in working capital balances principally related to lower operating levels and inventory levels.

Financing Activities

Financing activities in 2010 used net cash of $114.2 million, $94.1 million less than the $208.3 million used in 2009. The decrease reflected a $35.1 million repayment of long-term debt in 2010 compared to $175.5 million of long-term debt repaid in the prior year. In 2009, Canfor Pulp also repaid its operating loan of $25.2 million. Partly offsetting these factors were significantly higher cash distributions of $79.0 million paid to non-controlling interests in 2010 (2009 - $8.9 million) principally as a result of the stronger earnings reported by Canfor Pulp.

Investing Activities

Net cash used for investing activities in 2010 amounted to $101.0 million, compared to $49.6 million generated in 2009. Property, plant and equipment additions for 2010 totaled $105.4 million (2009 - $59.0 million), net of proceeds from the federal government's green transformation program of $20.2 million, of which approximately $70 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.

After several years of restrained capital spending due to the challenging lumber markets, the Company increased its capital spending in 2010. Capital spending for the lumber segment in 2010 was $88.1 million (2009 - $39.1 million) and included work on a $47 million sawmill and planer rebuild of the Company's Fort St. John sawmill, an upgrade of its Chetwynd sawmill, and a new energy system at its Prince George sawmill operation. The Company also completed several planer optimizer installations during the year.

In the pulp segment, capital spending of $39.3 million for 2010 consisted primarily of projects funded by the Green Transformation Program ("Program"), as well as essential maintenance of business projects. Program funding received in 2010 was $20.2 million.

Cash of $4.6 million was received from the partial redemption of asset-backed commercial paper ("ABCP") in 2010. In 2009, the Company received $19.9 million in connection with partial redemptions, and interest income related to the ABCP's restructuring period. In 2009, sales of non-core assets, including the site of the Company's former Panel and Fibre operation, generated cash of $55.3 million, and the Company also received cash of $33.3 million upon final settlement of its NCP mill fire insurance claim (a fire destroyed the mill in 2008).

Changes in Equity

Changes in equity for 2010 comprised the $70.0 million net income attributable to equity shareholders credited to retained earnings, an increase in the other comprehensive loss of $10.3 million reflecting the impact of the stronger Canadian dollar on the translation of the Company's foreign subsidiaries, and a $0.7 million increase in share capital resulting from stock options exercised during the year. In addition, net income attributable to non-controlling interests of $91.3 million was credited to equity, and was more than offset by distributions to non-controlling interests of $94.7 million in the year.

FINANCIAL REQUIREMENTS AND LIQUIDITY

Operating Loans

On a consolidated basis, at December 31, 2010, the Company had $433.5 million of unsecured operating loan facilities, which were undrawn and $17.8 million was reserved for several standby letters of credit. The Company also had a separate facility to cover a $13.2 million standby letter of credit.

On July 30, 2010, the Company amended its main bank credit facility to a $350 million facility with a maturity date of October 31, 2013. The general terms and conditions of the new credit facility are similar to the previous facility and include a new feature which allows for an increase of up to $100 million with existing or new lenders.

In addition, the Company's operating loan facilities include two facilities in the amounts of US$12.8 million ("Facility A") and US$29.8 million ("Facility B") at December 31, 2010. Facility A expires in January 2012, and is non-recourse to the Company under normal circumstances, except for an amount of US$6.7 million. Facility B expired in January 2011 and was non-recourse to the Company under normal circumstances. The ABCP assets of the Company have been pledged as security to support these credit facilities.

Excluding Canfor Pulp, the Company's bank operating lines were $393.5 million, which was undrawn, with $17.3 million was reserved for several standby letters of credit, the majority of which relates to unregistered pension plans.

At December 31, 2010, Canfor Pulp had a $40.0 million bank loan facility with a maturity date of November 30, 2011, of which $0.5 million was utilized for a standby letter of credit issued for general business purposes. In addition, Canfor Pulp has a separate facility with a maturity date of November 30, 2011, to cover a $13.2 million standby letter of credit issued to BC Hydro.

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 circumstances when net debt to total capitalization exceeds a threshold, Canfor (excluding Canfor Pulp) is subject to an interest coverage ratio that requires a minimum amount of EBITDA relative to net interest expense. Canfor is not currently subject to this test.

In addition, Canfor Pulp has leverage and interest coverage ratios calculated by reference to earnings before interest, taxes, depreciation and amortization and other non-cash items.

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, 2010.

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

2011 Projected Capital Spending and Debt Repayments

Based on its current outlook for 2011, assuming no deterioration in market conditions during the year, the Company anticipates that it may invest approximately $275 million in capital projects (of which approximately $84 million is expected to qualify for Green Transformation Program funding), which will consist primarily of various improvement projects as well as maintenance of business expenditures. Scheduled long-term debt repayments in 2011 consist of a US$32.3 million payment due on March 1 and a US$50.0 million payment due on April 1. Canfor intends to finance its planned capital expenditures and scheduled debt repayments from existing cash reserves.

Derivative Financial Instruments

As at December 31, 2010, the Company had the following derivatives:

a. Foreign exchange forward contracts of US$68.4 million. There were unrealized gains of $1.6 million on the foreign exchange derivatives at the end of the year. The contracts in place at the end of 2010 were as follows:

	2010	
	Notional Amount	**Exchange Rates**
US dollar	(millions of US dollars)	(range of rates, per dollar)
US Dollar Forward Sales Contracts 0-12 months	**$ 68.4**	**$ 0.9940 - $ 1.0678**

b. Floating to fixed swaps that fix the price of future natural gas purchases on 1.1 million gigajoules. There were unrealized losses of $4.7 million on the natural gas swaps at the end of the year.

	2010	
	Notional Amount	**Average Rate**
Natural Gas	(millions of gigajoules)	(dollars per gigajoule)
Floating to fixed swaps 0 – 12 months	**1.1**	**$ 8.04**

c. Floating to fixed swaps that fix the price of diesel purchases on 2.6 million gallons. There were unrealized gains of $1.0 million on these swaps at the end of the year. Canfor uses heating oil contracts as proxy to hedge its diesel purchases.

	2010	
	Notional Amount	**Average Rate**
Diesel	(millions of gallons)	(dollars per gallon)
Floating to fixed swaps 0 – 12 months	**2.6**	**$ 2.22**

d. Futures contracts for the sale of lumber with a total notional amount of 68.4 MMfbm. There were unrealized losses of $2.0 million at year end on these contracts.

	2010	
	Notional Amount	**Average Rate**
Lumber	(MMfbm)	(US dollars per Mfbm)
Futures contracts 0 – 12 months	**68.4**	**$ 294.71**

Commitments

The following table summarizes Canfor's financial contractual obligations at December 31, 2010 for each of the next five years and thereafter:

(millions of dollars)	2011	2012	2013	2014	2015	Thereafter	Total
Long-term debt obligations	$ 82.5	$ 51.6	$ 184.0	$ -	$ -	$ -	$ 318.1
Interest payments on long-term debt	$ 15.4	$ 11.3	$ 7.5	$ -	$ -	$ -	$ 34.2
Operating leases	$ 12.8	$ 9.2	$ 6.2	$ 3.0	$ 1.4	$ 1.1	$ 33.7
	$ 110.7	$ 72.1	$ 197.7	$ 3.0	$ 1.4	$ 1.1	$ 386.0

Other contractual obligations not included in the table above are:

- Contractual commitments totaling $32.9 million, principally related to the construction of capital assets. This relates in part to the Fort St. John sawmill and planer rebuild, a new energy system at the Prince George sawmill and expenditures at Canfor Pulp in relation to projects funded by the Green Transformation Program.
- 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 $84.6 million has been recorded at December 31, 2010 (2009 – $88.1 million). The reforestation liability is a fluctuating obligation, based on the area harvested. The future cash outflows are a function of the actual costs of silviculture programs and of harvesting and are based on, among other things, the location of the harvesting and the activities necessary to adequately stock harvested areas and achieve a "free-to-grow" state.
- Obligations to pay pension and other post-employment benefits, for which the funded deficit for accounting purposes at September 30, 2010 (the measurement date for accounting purposes) was $286.3 million (September 30, 2009 - $185.1 million).
- Canfor Pulp has an energy agreement with BC Hydro which provides for the sale of electrical power production that exceeds an amended commitment of the original cogeneration project at the Prince George Pulp and Paper Mill. The obligation to produce power is 338 GWh per year, extending to August 2020. Under the agreement, Canfor Pulp is required to post a standby letter of credit as security in annually decreasing amounts as the minimum required amount of electricity is generated. At December 31, 2010, Canfor Pulp had no repayment obligation under the terms of the agreement and a standby letter of credit in the amount of $13.2 million had been issued to BC Hydro as security for future power generation commitments.

Pension Obligations

As a result of a new funding valuation as of December 31, 2009, the Company increased its funding contributions to its defined benefit salary pension plans in 2010 by $13.5 million to $29.9 million (2009 - total contributions $16.4 million). The Company is currently committed to annual payments in relation to its main salary pension plan of $30.7 million for the next four years, or until such a time as a new funding valuation may lead to a reduction in the amount of required payments.

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.

Transactions with Howe Sound Pulp and Paper Limited Partnership ("HSLP") for the period up until the sale in October 2010 included $11.9 million of chip and log sales from Coastal Fibre Limited Partnership to HSLP, and $1.8 million of commission earned from the marketing of HSLP pulp. At December 31, 2010 there were no significant balances outstanding with HSLP (2009 – total net receivable, after impairments, of $21.2 million).

Other related party transactions include the purchase of pulp chips and lumber, at market value, from Lakeland Mills Ltd., in which Canfor holds a one-third equity interest. In addition, Canfor obtained shipping services from Seaboard International Shipping Company ("Seaboard"), in which Canfor held a minority interest. Seaboard ceased operation during 2010.

Additional details on related party transactions are contained in note 26 to Canfor's 2010 consolidated financial statements.

SELECTED QUARTERLY FINANCIAL INFORMATION

	Q4 2010	Q3 2010	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009
Sales and income (millions of dollars)								
Sales	**$ 629.1**	$ 588.7	$ 634.7	$ 577.9	$ 549.6	$ 521.3	$ 530.3	$ 474.7
Operating income (loss)	**$ 39.7**	$ 26.6	$ 64.0	$ 39.0	$ (23.6)	$ (31.4)	$ (31.2)	$ (124.2)
Net income (loss)	**$ 54.9**	$ 33.5	$ 40.4	$ 32.5	$ (9.1)	$ 4.1	$ 12.1	$ (69.9)
Shareholder net income (loss)	**$ 30.7**	$ 5.6	$ 18.1	$ 15.6	$ (17.0)	$ (5.2)	$ 10.5	$ (58.8)
Per common share (dollars)								
Shareholder net income (loss) – basic and diluted	**$ 0.21**	$ 0.04	$ 0.13	$ 0.11	$ (0.12)	$ (0.04)	$ 0.07	$ (0.41)
Statistics								
Lumber shipments (MMfbm)	**895**	877	875	797	859	846	898	795
OSB shipments (MMsf 3/8")	**57**	58	72	73	63	69	61	30
Pulp shipments (000 mt)	**331**	277	301	316	315	307	344	277
Average exchange rate – US$/Cdn$	**$ 0.987**	$ 0.962	$ 0.973	$ 0.961	$ 0.947	$ 0.912	$ 0.858	$ 0.803
Average Western SPF 2x4 #2&Btr lumber price (US$)	**$ 269**	$ 223	$ 266	$ 268	$ 205	$ 191	$ 174	$ 155
Average SYP (East) 2x4 #2 lumber price (US$)	**$ 256**	$ 243	$ 379	$ 329	$ 231	$ 230	$ 236	$ 235
Average OSB price – North Central (US$)	**$ 191**	$ 178	$ 295	$ 214	$ 172	$ 178	$ 145	$ 154
Average NBSK pulp list price delivered to U.S. (US$)	**$ 967**	$ 1,000	$ 993	$ 880	$ 820	$ 733	$ 645	$ 673

In addition to exposure to changes in product prices and foreign exchange, the Company's financial results are impacted by seasonal factors such as weather and building activity. Adverse weather conditions can cause logging curtailments, which can affect the supply of raw materials to sawmills, 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 products, is generally stronger in the spring and summer months. These factors, along with global supply and demand conditions, affect the Company's shipment volumes. Also, operating losses in the 2009 year reflect the impact of a global economic slowdown.

THREE-YEAR COMPARATIVE REVIEW

(millions of dollars, except per share amounts)		2010		2009		2008
Sales	**$**	**2,430.4**	$	2,075.8	$	2,663.6
Net income (loss)	**$**	**161.3**	$	(62.8)	$	(321.2)
Shareholder net income (loss)	**$**	**70.0**	$	(70.5)	$	(345.2)
Total assets	**$**	**2,778.3**	$	2,677.8	$	3,200.4
Total long-term financial liabilities	**$**	**235.6**	$	333.3	$	428.7
Shareholder net income (loss) per share, basic and diluted	**$**	**0.49**	$	(0.50)	$	(2.42)

QUARTER ENDED DECEMBER 31, 2010 VS. QUARTER ENDED DECEMBER 31, 2009

Overview of Operating Results

The Company recorded EBITDA of $79.0 million and net income of $54.9 million for the fourth quarter of 2010, compared to EBITDA of $15.2 million and a net loss of $9.1 million in the fourth quarter of 2009. Shareholder net income (which excludes income attributable to non-controlling interests) was $30.7 million in the fourth quarter of 2010, compared to a loss of $17.0 million in the fourth quarter of 2009. Shareholder net income per share (basic and diluted) was $0.21 for the fourth quarter of 2010, compared to a loss per share of $0.12 in the fourth quarter of 2009.

An overview of the results by business segment for the fourth quarter of 2010 compared to the last quarter of 2009 follows.

Lumber

Selected Financial Information and Statistics - Lumber

Summarized results for the Lumber segment for the fourth quarter of 2010 and 2009 were as follows:

(millions of dollars, unless otherwise noted)		Q4 2010		Q4 2009
Sales	**$**	**318.0**	$	285.3
Operating income (loss)	**$**	**(0.6)**	$	(30.8)
EBITDA, as reported	**$**	**22.1**	$	(8.6)
Negative (positive) impact of inventory write-downs	**$**	**(0.7)**	$	0.1
EBITDA excluding impact of inventory write-downs and restructuring	**$**	**21.4**	$	(8.5)
Average SPF 2x4 #2 & Btr lumber price in US$[21]	**$**	**269**	$	205
Average SPF price in Cdn$	**$**	**273**	$	216
Average SYP 2x4 #2 lumber price in US$[22]	**$**	**256**	$	231
Average SYP price in Cdn$	**$**	**259**	$	244
Production – SPF lumber (MMfbm)		**725.1**		691.7
Production – SYP lumber (MMfbm)		**82.9**		76.0
Shipments – Canfor-produced SPF lumber (MMfbm) [23]		**760.1**		750.1
Shipments – Canfor-produced SYP lumber (MMfbm) [23]		**93.4**		88.4
Shipments – wholesale lumber (MMfbm)		**41.6**		20.6

[21] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)
[22] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)
[23] Includes shipments of lumber purchased for remanufacture.

Overview

Reported EBITDA for the lumber segment was $22.1 million for the fourth quarter of 2010, an improvement of $30.7 million compared to the fourth quarter of 2009. The improvement in EBITDA principally reflected the improved market prices, with improved sales realizations across all products and regions. The impact from these price increases was partially offset by a 3% increase in unit manufacturing costs, reflecting the impact of downtime for capital projects in the current quarter, as well as increased log costs, due in part to higher diesel prices.

Markets

During the fourth quarter of 2010, the U.S. housing market weakened to levels not seen since early 2009, with total U.S. housing starts averaging 538,000 units SAAR (Seasonally Adjusted Annual Rate) for the fourth quarter, a decrease of 22,000, or 4%, compared to the same quarter last year. Single family starts were down 10% and multi-family starts up 32% over the same period. Inventories of existing homes at the end of 2010 were up compared to the end of 2009, though reductions were seen for new home inventories.

Canadian housing starts eased in the fourth quarter of 2010, resulting from slower economic growth, higher interest rates and increased concern over housing affordability. Housing starts averaged 179,000 units SAAR, in line with the fourth quarter of 2009.

Canfor's offshore lumber shipments continued to set new volume records in the fourth quarter of 2010. Increased lumber demand from China and Japan led to a rise of approximately 50% in offshore volume from the fourth quarter of 2009. China continued to lead all offshore shipment volumes, with shipments including an increased proportion of #2&Btr grade.

Sales

Sales for the lumber segment in the fourth quarter of 2010 were $318.0, up $32.7 million, or 11%, compared to the fourth quarter of 2009.

Total shipments for the fourth quarter of 2010 were 895 million board feet, up 3% compared to the same quarter in 2009, reflecting increased China volume and also increased shipments to the U.S.

Compared to the fourth quarter of 2009, SPF prices were well up for all but the widest dimensions, and the average Western SPF 2x4 #2&Btr price increased US$64 per Mfbm to US$269. Over the same period, SYP prices were more mixed, with the benchmark 2x4 #2 price up US$25 per Mfbm to US$256, but most wider dimensions saw price reductions. Prices to offshore markets were up significantly from the comparative period. Higher freight costs in the current quarter partly offset the pricing gains.

The average value of the Canadian dollar compared to the US dollar in the fourth quarter was up 4 cents, or 4%, compared to the fourth quarter of 2009, further offsetting some of the improvements in US dollar pricing for Western SPF lumber products.

The Random Lengths Framing Lumber Composite price averaged US$271 per Mfbm for the fourth quarter of 2010, below the trigger price of US$315 that is required to reduce the export tax rate on all U.S. bound shipments below the current rate of 15%.

Total residual fibre revenue was up reflecting significantly higher pulp prices and, to a lesser extent, higher sawmill production.

Operations

The Company's lumber mills operated at approximately 65% of capacity in the fourth quarter of 2010. Lumber production was 808 million board feet, up 40 million board feet, or 5%, compared to the fourth quarter of 2009. The lower production in the fourth quarter of 2009 primarily reflected both the idling of the Chetwynd sawmill and the Mackenzie sawmill operating on only one shift in that period.

Compared to the same period in the prior year unit manufacturing costs were up 3%. The increased costs reflected the capital downtime in the current period, as well as higher unit log costs that reflected higher hauling rates, road costs and purchased wood prices.

Restructuring, mill closure and severance costs in the current quarter were $1.4 million, compared to $4.3 million in the fourth quarter of 2009, which also included costs in relation to the Chetwynd and Mackenzie sawmills.

Pulp and Paper

Selected Financial Information and Statistics – Pulp and Paper[24]

Summarized results for the Pulp and Paper segment for the fourth quarter of 2010 and 2009 were as follows:

(millions of dollars, unless otherwise noted)	Q4 2010	Q4 2009
Sales	**$ 300.8**	$ 253.3
Operating income	**$ 50.4**	$ 16.5
EBITDA	**$ 62.6**	$ 29.3
Average pulp price delivered to U.S. – US$[25]	**$ 967**	$ 820
Average price in Cdn$	**$ 980**	$ 866
Production – pulp (000 mt)	**320.6**	307.3
Production – paper (000 mt)	**34.7**	38.4
Shipments – Canfor-produced pulp (000 mt)	**331.1**	315.4
Pulp marketed on behalf of HSLP (000 mt)[26]	**-**	68.2
Shipments – paper (000 mt)	**39.0**	38.1

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

Overview

The Pulp and Paper segment's EBITDA for the last quarter of 2010 was $62.6 million, up $33.3 million from the fourth quarter of 2009, in large measure due to higher market pulp prices. NBSK pulp US dollar list prices were up by 18% from the comparative quarter. The improved prices, along with a 5% increase in shipments, were partly offset by a 4% stronger Canadian dollar, and higher fibre and administrative costs.

Markets

Strong global softwood pulp demand in the fourth quarter of 2010, led by China, allowed inventories held by producers and customers to decrease to levels in a range that is considered to be tight. According to the World 20 report, world pulp shipments hit an all time high in December 2010 and were 15% stronger than in December 2009. According to the Pulp and Paper Products Council, global demand for printing and writing papers increased 6% for 2010 as compared 2009.

Sales

Shipments of Canfor-produced pulp for the fourth quarter of 2010 were 331,000 tonnes, up 5% from the fourth quarter of 2009.

Compared to the fourth quarter of 2009, NBSK list pulp prices to the U.S. were up US$147, or 18%, reflecting the overall improvement in pulp markets in that period. The increase was partially offset by a 4% increase in the value of the Canadian dollar compared to the US dollar.

Operations

Pulp production in the fourth quarter of 2010 was 321,000 tonnes, up 4% from the fourth quarter of 2009 reflecting in part the impact of a scheduled maintenance outage completed at Canfor Pulp's Northwood pulp mill in the fourth quarter of 2009.

Compared to the fourth quarter of 2009, unit manufacturing costs showed a small increase with higher fibre costs offsetting the impact of higher production volumes and reduced natural gas consumption. The higher fibre costs resulted from higher sawmill residual chip prices partly offset by reductions in the costs and volume of higher-cost whole log chipping. Higher costs in the current quarter also reflected increased short-term incentive compensation costs and expenses related to the conversion of Canfor Pulp Income Fund to a public corporation (Canfor Pulp Products Inc.) on January 1, 2011.

Unallocated and Other Items

(millions of dollars)		Q4 2010		Q4 2009
Operating loss of Panels operations[27]	**$**	**(2.8)**	$	(3.5)
Corporate costs	**$**	**(7.3)**	$	(5.8)
Interest expense, net	**$**	**(5.6)**	$	(7.1)
Foreign exchange gain on long-term debt and investments, net	**$**	**9.8**	$	8.0
Gain on derivative financial instruments	**$**	**1.8**	$	2.3
Other income (expense), net	**$**	**11.0**	$	(2.7)

[27] The Panels operations include the Peace Valley OSB joint venture, the only facility currently operating, and the Company's Tackama plywood and PolarBoard OSB plants, both of which are currently indefinitely idled.

The panels operations reported an operating loss of $2.8 million for the fourth quarter of 2010, compared to a loss of $3.5 million for the fourth quarter of 2009. Excluding inventory write-down adjustments, operating results for the panels operations improved $2.0 million, due mostly to higher prices, the gain on sale of non-core assets and other positive one-time adjustments, which more than offset a stronger Canadian dollar and higher unit manufacturing costs.

Corporate costs were $7.3 million in the fourth quarter of 2010, up $1.5 million from the fourth quarter of 2009. The increased costs reflected higher share-based compensation and the reinstatement in 2010 of the Company's short term incentive compensation plan for salaried employees.

Net interest expense of $5.6 million for the fourth quarter of 2010 was down $1.5 million compared to the fourth quarter of 2009, attributable principally to lower long-term debt and higher cash balances in the period, as well as the positive impact from the stronger Canadian dollar.

The Company recorded a foreign exchange translation gain on its US dollar denominated debt, net of investments, of $9.8 million for the fourth quarter of 2010 as a result of a 4% increase in the value of the Canadian dollar against the US dollar at the respective quarter ends. This gain is slightly higher than the gain recorded in the comparable period in 2009, which also saw a strengthening Canadian dollar.

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. For the fourth quarter of 2010, the Company recorded a net gain of $1.8 million related to all it derivative instruments, with gains attributable to the stronger Canadian dollar and, to a lesser extent, higher market diesel prices partially offset by losses on lumber futures.

Other income, net of $11.0 million for the fourth quarter of 2010 included $6.3 million in relation to a change in fair value of the Company's investment in asset-backed commercial paper and $5.5 million related to a gain on the sale of the operating assets of Howe Sound Pulp and Paper Limited Partnership. These and other smaller items were offset in part by a net foreign exchange loss of $3.7 million on US dollar denominated cash, receivables and payables of Canadian operations.

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 2010	Q3 2010	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009
Net income (loss), as reported	**$ 54.9**	**$ 33.5**	**$ 40.4**	**$ 32.5**	$ (9.1)	$ 4.1	$ 12.1	$ (69.9)
Add (subtract):								
Amortization	**$ 39.3**	**$ 39.4**	**$ 38.5**	**$ 38.8**	$ 38.8	$ 38.4	$ 38.5	$ 39.6
Interest expense, net	**$ 5.6**	**$ 6.2**	**$ 6.7**	**$ 7.0**	$ 7.1	$ 6.9	$ 7.0	$ 8.3
Foreign exchange loss (gain) on long-term debt and temporary investments, net	**$ (9.8)**	**$ (8.9)**	**$ 12.8**	**$ (8.8)**	$ (8.0)	$ (26.2)	$ (29.1)	$ 12.9
Loss (gain) on derivative financial instruments	**$ (1.8)**	**$ (2.8)**	**$ 3.3**	**$ 1.2**	$ (2.3)	$ (17.7)	$ (25.7)	$ 21.3
Gain on sale of mill property	**$ -**	**$ -**	**$ -**	**$ -**	$ -	$ -	$ -	$ (44.6)
North Central Plywoods mill fire, net	**$ -**	**$ -**	**$ -**	**$ -**	$ -	$ -	$ 3.0	$ -
Other (income) expense	**$ (11.0)**	**$ 3.3**	**$ (3.3)**	**$ 2.9**	$ 2.7	$ 8.7	$ 2.5	$ (2.5)
Income tax (recovery) expense	**$ 1.8**	**$ (4.7)**	**$ 4.1**	**$ 4.2**	$ (14.0)	$ (7.2)	$ (1.0)	$ (49.7)
EBITDA, as reported	**$ 79.0**	**$ 66.0**	**$ 102.5**	**$ 77.8**	$ 15.2	$ 7.0	$ 7.3	$ (84.6)
Negative (positive) impact of inventory write-downs[28]	**$ (0.1)**	**$ (2.6)**	**$ 5.5**	**$ (23.0)**	$ (0.5)	$ 1.7	$ (52.2)	$ 29.8
Clear Lake permanent closure provision	**$ -**	**$ 17.8**	**$ -**	**$ -**	$ -	$ -	$ -	$ -
Radium, Rustad and Vavenby indefinite idling provision	**$ -**	**$ -**	**$ -**	**$ -**	$ -	$ -	$ 8.8	$ -
EBITDA excluding impact of inventory write-downs and closure & idling provisions	**$ 78.9**	**$ 81.2**	**$ 108.0**	**$ 54.8**	$ 14.7	$ 8.7	$ (36.1)	$ (54.8)

[28] In accordance with Canadian GAAP, Canfor records its log and finished product inventories at the lower of cost and net realizable value ("NRV"). Significant movements in inventory volumes occur due to the seasonal build and drawdown of logs in the first and second quarters each year. Where NRV is below cost this can result in large swings in inventory write-down amounts recorded in those periods. In addition to inventory volumes, the level of inventory write-downs recorded in a reporting period reflects changes in market prices, foreign exchange rates, and costs over the respective reporting periods.

Specific Items Affecting Comparability of Shareholder Net Income (Loss)

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

After-tax impact, net of non-controlling interests (millions of dollars, except per share amounts)	Q4 2010	Q3 2010	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009
Shareholder net income (loss), as reported	**$ 30.7**	$ 5.6	$ 18.1	$ 15.6	$ (17.0)	$ (5.2)	$ 10.5	$ (58.8)
Foreign exchange (gain) loss on long-term debt and investments, net	**$ (6.9)**	$ (6.3)	$ 9.0	$ (6.2)	$ (5.8)	$ (19.6)	$ (19.7)	$ 9.1
(Gain) loss on derivative financial instruments	**$ (0.5)**	$ (1.1)	$ 1.1	$ 1.0	$ (1.4)	$ (12.7)	$ (17.3)	$ 12.4
Gain on sale of operating assets of Howe Sound Pulp and Paper Limited Partnership	**$ (4.9)**	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Increase in fair value of asset-backed commercial paper	**$ (5.5)**	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Clear Lake permanent closure provision	**$ -**	$ 13.4	$ -	$ -	$ -	$ -	$ -	$ -
Radium, Rustad and Vavenby indefinite idling provision	**$ -**	$ -	$ -	$ -	$ -	$ -	$ 6.6	$ -
Gain on sale of mill property	**$ -**	$ -	$ -	$ -	$ -	$ -	$ -	$ (37.8)
North Central Plywoods mill fire, net	**$ -**	$ -	$ -	$ -	$ -	$ -	$ 2.0	$ -
Corporate income tax rate reductions	**$ -**	$ -	$ -	$ -	$ -	$ -	$ -	$ (7.3)
Net impact of above items	**$ (17.8)**	$ 6.0	$ 10.1	$ (5.2)	$ (7.2)	$ (32.3)	$ (28.4)	$ (23.6)
Adjusted net income (loss)	**$ 12.9**	$ 11.6	$ 28.2	$ 10.4	$ (24.2)	$ (37.5)	$ (17.9)	$ (82.4)
Shareholder net income (loss) per share (EPS), as reported	**$ 0.21**	$ 0.04	$ 0.13	$ 0.11	$ (0.12)	$ (0.04)	$ 0.07	$ (0.41)
Net impact of above items per share	**$ (0.12)**	$ 0.04	$ 0.07	$ (0.04)	$ (0.05)	$ (0.22)	$ (0.20)	$ (0.17)
Adjusted net income (loss) per share	**$ 0.09**	$ 0.08	$ 0.20	$ 0.07	$ (0.17)	$ (0.26)	$ (0.13)	$ (0.58)

OUTLOOK

Lumber Markets

The North American lumber market is expected to see a mild improvement from the projected continued recovery in the U.S. economy in 2011. Demand in the residential construction market is forecast to gradually trend higher in the second half of the year with new home inventories moving closer to more normalized levels and foreclosure activity easing. The repair and remodeling market is expected to show some recovery in 2011, following three years of decline.

The Canadian housing market is expected to remain relatively steady in the short term. Housing activity may pull back later in 2011 should interest rates increase.

The strength of the offshore market is expected to continue through 2011. Growth in China's lumber demand is likely to persist as consumption increases in all sectors of the Chinese lumber market. In Japan, 2x4 based housing starts are expected to continue at a healthy level, while the growth in hybrid (traditional post and beam with 2x4 components) home construction will continue to yield more opportunities for SPF lumber.

Pulp and Paper Markets

The global softwood pulp market is expected to remain balanced through the first quarter of 2011 with inventory levels in a range that is expected to support current pricing levels. Demand remains solid with continued strong shipments into China and sustained demand in the North America Printing and Writing paper sector. Pulp mill operating rates are expected to increase in February with minimal scheduled downtime and as previously idled mills reach full capacity. In the second quarter of 2011 however, annual maintenance downtime coupled with extended outages due to several large capital projects in Canada funded under the Federal Government Green Transformation Program should tighten supply. Any relative weakness of the US dollar versus the Canadian dollar and the Euro is expected to exert upward pressure on US dollar list prices.

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)	2010 Pension Benefit Plans	2010 Other Benefit Plans	2009 Pension Benefit Plans	2009 Other Benefit Plans
Accrued benefit obligation as of December 31:				
Discount rate	**5.25%**	**5.50%**	6.25%	6.75%
Rate of compensation increase	**3.00%**	**n/a**	3.00%	n/a
Benefit costs for year ended December 31:				
Discount rate	**6.25%**	**6.75%**	6.60%	6.70%
Expected long-term rate of return on plan assets	**7.50%**	**n/a**	7.50%	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)	2010	2009
Initial health care cost trend rate	**6.95%**	7.15%
Ultimate health care trend rate	**4.20%**	4.20%
Year ultimate rate reached	**2029**	2029

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 in each year would have had the following impact on the amounts recorded in 2010:

	1% Increase	1% Decrease
Accrued benefit obligation	$ 25.2	$ 20.4
Total service and interest cost	$ 1.8	$ 1.4

See "Financial Requirements and Liquidity – Pension Obligations" section for further discussion regarding the funding position of Canfor's pension plans.

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 on its forestry tenures in BC, Alberta and Quebec. 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 reforestation are expected to occur over periods of up to 15 years (the significant majority occurring in the first seven years) and have been discounted accordingly at rates of 3% to 8%. The actual costs that will be incurred in the future may vary based on, among other things, the actual costs at the time of silviculture activities.

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 Canfor Pulp'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 product 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 2010 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

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 future cash flows, they are written down to fair value. A review of the carrying values of Canfor's sawmill and panel operations and various other assets was undertaken in 2009 and 2010 as a result of operating losses and difficult market conditions.

The first step in this process is to determine for each operation whether projected undiscounted future cash flows from operations exceed the net carrying amount of the assets as of the assessment date. For those operations where impairment is indicated, the second step is to calculate fair values using discounted 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 product prices and exchange rates. Other significant assumptions are the estimated useful life of the long-lived assets, and the impacts of both the Softwood Lumber Agreement with the U.S. and Mountain Pine Beetle epidemic. Price and foreign exchange forecasts for 2010 and beyond were determined with reference to RISI publications.

As a result of its review, no impairment charges were required in relation to Canfor's capital assets in 2010 or 2009.

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 exchange 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 2010, the inventory balances included total write-downs of $3.2 million.

Allowance for Doubtful Accounts

An allowance for doubtful accounts of $2.5 million has been recorded at December 31, 2010 which reflects management's assessment of risks attached to the collection of receivable balances. While significant bad debts have not been experienced in prior years, the provision is considered appropriate due to the continued downturn in the U.S. which may affect the ability of certain customers to pay amounts owed to the Company.

CHANGES IN ACCOUNTING POLICIES

Business Combinations, Consolidated Financial Statements and Non-controlling Interests

The CICA has issued three new inter-related accounting standards, Handbook Sections 1582 Business Combinations, 1601 Consolidated Financial Statements, and 1602 Non-controlling Interests. Prospective application of these new Sections is mandatory for annual reporting periods beginning on or after January 1, 2011, with earlier adoption permitted. The CICA requires all three Sections to be adopted concurrently. Canfor adopted the new standards as of January 1, 2010, and the change in accounting policy has been made in accordance with the transitional provisions of the standards.

Section 1582 replaces CICA Handbook Section 1581 Business Combinations, and brings the accounting for business combinations under Canadian GAAP in line with the accounting under International Financial Reporting Standards ("IFRS"). This would have impacted Canfor's financial statements if a business combination, such as a merger or an acquisition, had occurred during the year.

Sections 1601 and 1602 replace CICA Handbook Section 1600 Consolidated Financial Statements. Adoption of these Sections also reduces the differences between Canadian GAAP and IFRS. The adoption of Section 1602 has had a significant impact on the consolidated balance sheets and consolidated statements of income (loss) of Canfor. The non-controlling interests on Canfor's balance sheet have been reclassified from long-term liabilities into equity, and the net income (loss) of non-controlling interests is no longer deducted in arriving at the total net income (loss) of Canfor. The "Net income (loss) attributable to equity shareholders of the Company," as disclosed on the consolidated statements of income (loss), is comparable to the "Net income (loss)" reported in previous years. These changes have been applied retrospectively.

Financial Instruments

During 2009, the CICA amended Handbook Section 3862 Financial Instruments – Disclosures to require enhanced disclosures about the relative reliability of the data that an entity uses to measure the fair values of its financial instruments. Additional disclosures as required by this amendment include the classification of financial instruments measured at fair value at one of three levels according to the relative reliability of the inputs uses in estimating fair values. These disclosures have been included in Note 25 to the financial statements.

INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

For interim and annual periods in 2011 and beyond, Canfor will be required to prepare financial statements in accordance with IFRS. In order to ensure accurate and efficient reporting under IFRS, the Company has identified the differences between Canadian GAAP applicable in 2010 and IFRS that affect Canfor and made the required changes to accounting processes and controls (including information technology systems).

The differences identified are detailed in the following sections, which include a reconciliation of the Company's closing balance sheet under previous Canadian GAAP in 2009 with its provisional opening balance sheet under IFRS on January 1, 2010. This opening balance sheet may be adjusted before the issuance of Canfor's audited 2011 IFRS financial statements if new pronouncements are issued by the IFRS oversight body, or different interpretations are adopted. Reconciliations for the year ended December 31, 2010 will be provided in the Company's first quarter 2011 financial statements.

The accounting changes resulting from the transition to IFRS do not impact the Company's compliance with any of its maintenance covenants on its debt obligations.

Optional exemptions from full retrospective application followed by the Company

IFRS 1 sets out a number of optional exemptions from full retrospective application of IFRS that may be elected by a Company on transition. Canfor expects to apply the following of these exemptions:

(a) Business combinations exemption

Canfor has applied the business combinations exemption and accordingly has not restated business combinations that took place prior to the January 1, 2010 transition date.

(b) Employee benefits exemption

Canfor has elected to recognize all cumulative actuarial gains and losses on its various defined benefit pension and post-retirement non-pension plans as at January 1, 2010.

(c) Cumulative translation differences exemption

Canfor has elected to set its cumulative translation amount to zero at January 1, 2010. Under previous Canadian GAAP, this amount was included in Accumulated Other Comprehensive Income (Loss). This exemption has been applied to all foreign subsidiaries with functional currency other than Canadian dollars.

(d) Share-based payment transaction exemption

The Company has elected to apply the share-based payment exemption. IFRS 2 *Share-based Payment* has not been applied to the options granted under the Stock Option Performance Plan as these were all fully vested as at January 1, 2010.

In addition to these optional exemptions, Canfor has also ensured that all estimates at January 1, 2010 are consistent with estimates made at the same date under previous GAAP, as required by IFRS 1.

Presentation of non-controlling interests

Under previous GAAP, the Company adopted, as of January 1, 2010, three new inter-related accounting standards issued by the CICA. These were Handbook Sections 1582 Business Combinations, 1601 Consolidated Financial Statements, and 1602 Non-controlling Interests.

The adoption of Section 1602 resulted in the reclassification of non-controlling interests on Canfor's balance sheet from long-term liabilities into equity. As this adjustment was made under previous GAAP as of January 1, 2010, it is not included in the opening balance sheet reconciliation included below, but should be taken into account when comparing the December 31, 2009 financial statements to the opening IFRS balance sheet as at January 1, 2010.

Reconciliation of provisional opening balance sheet as at January 1, 2010

Explanatory notes are provided in the section following this reconciliation.

As at January 1, 2010 (millions of dollars, unaudited)	Canadian GAAP	Note	Effect of transition to IFRS	**IFRS**
ASSETS				
Current assets				
Cash and cash equivalents	$ 133.4		$ -	**$ 133.4**
Accounts receivable - Trade	137.2		-	**137.2**
- Other	41.9		-	**41.9**
Income taxes recoverable	45.5		-	**45.5**
Future income taxes, net	11.4	a	(11.4)	**-**
Inventories	311.3	c	(0.8)	**310.5**
Prepaid expenses	36.4	b	(15.4)	**21.0**
Total current assets	717.1		(27.6)	**689.5**
Non-current assets				
Long term investments and other		b	(5.4)	
		d	(16.8)	
	93.7		(22.2)	**71.5**
Property, Plant and Equipment		b	20.8	
		c	(9.4)	
		d	(610.3)	
	1,676.6		(598.9)	**1,077.7**
Timber licenses		c	(46.6)	
		d	610.3	
	-		563.7	**563.7**
Goodwill and other intangible assets		e	(110.6)	
		d	16.8	
	190.4		(93.8)	**96.6**
Total non-current assets	1,960.7		(151.2)	**1,809.5**
Total assets	$ 2,677.8		$ (178.8)	**$ 2,499.0**
LIABILITIES				
Current liabilities				
Operating bank loans	$ 0.6		$ -	**$ 0.6**
Accounts payable and accrued liabilities	211.4		-	**211.4**
Current portion of long-term debt	34.0		-	**34.0**
Current portion of deferred reforestation obligation	27.8		-	**27.8**
Total current liabilities	273.8		-	**273.8**

As at January 1, 2010 (millions of dollars, unaudited)		Canadian GAAP	Note		Effect of transition to IFRS		**IFRS**
Non-current liabilities							
Long-term debt		333.3			-		**333.3**
Retirement benefit obligations			e		132.2		
			e		101.3		
		-			233.5		**233.5**
Deferred reforestation			f		60.3		
			f		(1.3)		
		-			59.0		**59.0**
Other long-term liabilities			f		(60.3)		
			e		(132.2)		
		209.8			(192.5)		**17.3**
Future income taxes, net			a		(11.4)		
			c		(14.2)		
			e		(49.5)		
			f		0.3		
		200.8			(74.8)		**126.0**
Total non-current liabilities		743.9			25.2		**769.1**
Total liabilities	$	1,017.7		$	25.2	**$**	**1,042.9**
EQUITY							
Share capital	$	1,124.7		$	-	**$**	**1,124.7**
Contributed surplus		31.9			-		**31.9**
Retained earnings			c		(42.6)		
			e		(148.4)		
			f		1.0		
			g		(16.0)		
		246.2			(206.0)		**40.2**
Accumulated other comprehensive income (loss)		(16.0)	g		16.0		**-**
Total equity attributable to equity holders of the Company		1,386.8			(190.0)		**1,196.8**
Non-controlling interests		273.3	e		(14.0)		**259.3**
Total equity	$	1,660.1		$	(204.0)	**$**	**1,456.1**
Total liabilities and equity	$	2,677.8		$	(178.8)	**$**	**2,499.0**

Explanatory notes

The following explanations of adjustments on transition to IFRS are referenced in the reconciliation above:

(a) Classification of all future income taxes as non-current assets (liabilities)

International Accounting Standard 1 ("IAS 1") requires that all future income tax balances be presented as non-current assets or liabilities on the balance sheet under IFRS. Previous GAAP required amounts to be shown as current assets or liabilities depending on the classification of the assets and liabilities to which the future income tax balances relate.

The effect of this reclassification on the Company's opening balance sheet is to move $11.4 million of future income taxes included within current assets to be offset against future income taxes in non-current liabilities.

(b) Reclassification of deferred maintenance costs to Property, Plant and Equipment

Canfor Pulp carries out scheduled major maintenance shutdowns at its mills at regular intervals where the period between shuts can be longer than 12 months. Under previous GAAP, the costs of such shutdowns were initially recorded as prepaid expense (with current and long term components) and amortized over the period until the next scheduled major shutdown. Under IFRS, these costs are considered to be a part of property, plant and equipment, and are also amortized over the period between shutdowns.

The effect of this on the Company's opening balance sheet is to reclassify $20.8 million into property, plant and equipment, with $15.4 million being removed from prepaids, and the $5.4 million from long-term investments and other (reflecting the long-term portion).

(c) Recognition of impairment provisions against property, plant and equipment and timber licenses

There are differences in the methodology used to determine if an asset should be impaired under IFRS compared to that under previous GAAP. The previous GAAP rules provided for a two-step test, with no impairment being required if the undiscounted future expected cash flows relating to an asset are higher than the carrying value of that asset. Under IFRS, the undiscounted cash flows are not considered and an impairment is recorded where the recoverable amount (defined as the higher of 'value in use' and 'fair value less costs to sell') is below the asset's carrying value. As a result, impairments were required for certain assets under IFRS that were not recorded under previous GAAP.

The effect at the date of transition was to decrease the book value of certain sawmill assets included within property, plant and equipment by $9.4 million and timber licenses by $46.6 million. An impairment of $0.8 million was also recorded against capital spares inventory. A corresponding adjustment to future income taxes of $14.2 million was also recorded, with the net amount of $42.6 million being charged to opening equity.

(d) Reclassification of timber licenses and customer agreements

Under previous GAAP, the Company reported its timber licenses as a component of property, plant, equipment and timber. This is inconsistent with the IFRS, and accordingly these balances have been reclassified to intangible assets. As a result of this reclassification, $610.3 million (before the above impairment) has been moved from property, plant, equipment and timber to timber licenses in the opening balance sheet.

In addition, customer agreements of $16.8 million in the opening balance sheet have been reclassified from long term investments and other to intangible assets.

(e) Recognition of unamortized actuarial losses at date of transition to IFRS into equity

Under IFRS, the Company's accounting policy is to recognize all actuarial gains and losses, arising on its defined benefit pension plans and other non-pension post retirement benefit plans, immediately in other comprehensive income. At the date of transition, all previously unrecognized cumulative actuarial gains and losses were recognized in retained earnings.

This resulted in a charge to retained earnings in the opening balance sheet of $148.4 million, and a charge to non-controlling interests of $14.0 million reflecting non-controlling interests in Canfor Pulp. Pension assets recorded under previous GAAP of $110.6 million were removed, and liabilities of $101.3 million were recorded to reflect the actual funding position of the defined benefit pension plans. The long-term future income tax liability was reduced by $49.5 million as result of these adjustments. In addition, $132.2 million was reclassified from other long-term liabilities into the retirement benefit obligations line item on the balance sheet, reflecting liabilities in relation to non-pension post-retirement plans.

(f) Reclassification of long-term deferred reforestation to separate balance sheet line item

The Company has chosen to present the long-term deferred reforestation provision as a separate item on the balance sheet under IFRS. Previously, this was included in other long-term liabilities. In addition, the amount of this provision of $60.3 million has been reduced in the opening balance sheet by $1.3 million due to a change in discount rate used to value the obligation under IFRS as compared to previous GAAP.

(g) <u>Reset of the cumulative translation account to zero at transition</u>

In accordance with IFRS 1, the Company has elected to deem all foreign currency translation differences that arose prior to the date of transition in respect of entities with functional currencies other than the Canadian dollar to be nil at the date of transition. This resulted in a credit of $16.0 million to Accumulated Other Comprehensive Income (Loss) and a charge of the same amount to retained earnings.

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, public policy and labour disputes, 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) 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 BC no Aboriginal right or 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, the Government of BC 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. The Company continues to communicate frequently with Aboriginal groups in the areas that is operates and, where appropriate, to develop business relationships, especially in the areas of timber harvesting and silviculture.

Canada has, as of November 2010, endorsed the United Nations Declaration of Rights of Indigenous People (UNDRIP) adopted by the UN General Assembly in September 2007. A declaration is not legally binding but carries moral weight because it is adopted by the international community. This endorsement by Canada is not binding on the Provinces but does indicate a shift in the Federal direction on First Nations given that the Canadian Government took 3 years to endorse the UNDRIP. It is not anticipated that Canada's endorsement of UNDRIP will have any negative impact on Canfor tenures.

Employee Future Benefits

Canfor has several defined benefit plans, which provide pension benefits to certain salaried employees. Benefits are based on a combination of years of service and final average salary. The cash payments required to fund the plan are determined by actuarial valuation completed at least once every three years, with the most recent actuarial valuation for the largest plan being completed as at December 31, 2009.

The funded surplus (deficit) of each defined benefit plan is calculated as the difference between the fair market value of plan assets and an actuarial estimate of future liabilities. Any deficit in the registered plans determined following an actuarial valuation must be funded in accordance with regulatory requirements, normally over 5 or 10 years. Some of the unregistered plans are also partially funded.

Through its pension funding requirements, Canfor is exposed to the risk of fluctuating market values for the securities making up the plan assets, and to changes in prevailing interest rates which determine the discount rate used in calculating the estimated future liabilities.

For the Company's main Salary Pension Plan, a one percentage point increase in the rate of return on plan assets over one year would reduce the funded deficit by an estimated $3.8 million. A one percentage point increase in the discount rate used in calculating the actuarial estimate of future liabilities would reduce the funded deficit by an estimated $49.1 million. These changes would only impact the Company's funding requirements in years where a new actuarial funding valuation was performed and approval for a change in annual funding contributions was obtained from the regulator.

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 systems in place to identify, account for and appropriately address potential environmental liabilities. The Company also has governance in place including an Environmental, Health and Safety Committee of the Board, a Corporate Environmental Management Committee including Officers of the Company, and environmental professionals on staff to manage potential risks, issues and liabilities.

Canfor has in place internal policies and procedures under which all its forestry and manufacturing operations are regularly audited for compliance with laws and accepted standards and with its management system requirements. Canfor's woodlands operations in Canada are third-party certified to internationally-recognized sustainable forest management standards and the ISO 14001 Environmental Management System Standard. 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.

On November 25, 2009, the BC Ministry of Environment released new greenhouse gas ("GHG") reporting regulations under the Greenhouse Gas Reduction Act, requiring any facilities emitting more than 10,000 tonnes of CO_2 equivalents annually to report 2010 emissions in 2011. Based on this new regulation, a small number of Canfor's sawmills and all of the pulp mills (including Canfor Pulp's pulp mills) will have to register and report GHG emissions provincially in 2011. GHG emission reporting has been required federally and in Alberta for several years, with Canfor Pulp's facilities meeting the requirements for federal reporting. A combined approach is being established for provincial and federal reporting going forward. Canfor's Taylor pulp mill and the Canfor Pulp operations will also be regulated under the BC GHG Cap and Trade System expected to come into effect in 2012 for facilities emitting more than 25,000 tonnes of CO2 equivalents annually. Negotiations are ongoing on allocation of GHG emission allowances for facilities that will be regulated under the BC Cap and Trade System.

Canfor is currently a participant in the carbon offset market in Alberta, selling offset credits tied to its purchase of renewable heat and power from a biomass cogeneration facility in Grande Prairie. Both Canfor and Canfor Pulp are participants in this market in BC, selling offset credits from renewable heat and energy projects.

Fibre Cost and Availability

The Company's fibre costs are affected by a number of different factors which could have a significant impact on operating results. These include logging and hauling costs, stumpage and road and reforestation costs.

In addition, the Company's ability to harvest fibre for use in its operations could be adversely impacted by natural events such as forest fires, severe weather conditions or insect infestations. In the event that sufficient volumes of economically viable fibre cannot be provided to an operation, it may be necessary to close that operation for a period of time, or even permanently. Such closures could result in significant costs to the Company. The Company is not insured for loss of standing timber.

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.

(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, letters of credit and self-insurance to manage the risk associated with trade receivables. Approximately 65% of the outstanding trade receivables are covered by credit insurance. Canfor's trade receivable balance at December 31, 2010 is $149.4 million, before an allowance for doubtful accounts of $2.5 million. At December 31, 2010, approximately 99% of the trade accounts receivable 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 maintaining in good standing adequate committed operating bank loan facilities.

At December 31, 2010, Canfor has accounts payable and accrued liabilities (excluding derivatives) of $286.2 million and current debt obligations of $82.5 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. Part of the remaining exposure is at times 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 may be 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.

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 and energy costs. See section "Financial Requirements and Liquidity" for details of Canfor's derivative financial instruments outstanding at year end.

Earnings Sensitivities

Estimates of the sensitivity of Canfor's pre-tax results to currency fluctuations and prices for its principal products, based on 2011 Business Plan forecast production and year end foreign exchange rates, are set out in the following table:

(millions of dollars)	Impact on annual pre-tax earnings
SPF lumber – US$10 change per Mfbm[29, 30]	$ 27
SYP lumber – US$10 change per Mfbm[29, 30]	$ 4
Pulp – US$10 change per tonne [29, 30, 31]	$ 13
Canadian dollar – US$0.01 change per Canadian dollar:	
Operations[31]	$ 13
US dollar denominated debt[31]	$ 3

[29] Based on sales of Canfor-produced product.
[30] Excluding potential change in fibre costs.
[31] Includes 100% of Canfor Pulp.

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 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.

Labour Agreements and Competition for Professional Skilled Labour

Canfor's collective agreement with the USWA (United Steelworkers of America) expires in June 2013 and its collective agreement with the PPWC (Pulp, Paper and Woodworkers of Canada) expires in June 2014. The Company's collective agreement with the CEP (Communications, Energy and Paperworkers Union) for its Grande Prairie lumber operation expired in February 2010. The Company reached a tentative agreement with the CEP in early February 2011, which is subject to a membership vote that is expected to take place in mid-February 2011.

Any inability to negotiate acceptable contracts with the unions as they expire 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.

In addition, Canfor Pulp's collective agreements with the CEP and PPWC have terms expiring on April 30, 2012.

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 its 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

As noted earlier in this document (Section (vii) of the Overview of 2010), timber affected by the Mountain Pine Beetle continued to be a focus for Canfor harvesting activities in BC in 2010. The impact of the infestation on Canfor's operations continues to be manageable in the short term and the Company plans to continue harvesting MPB infected fibre. However, given the nature and extent of the infestation, the longer term operational and financial impact on Canfor could be significant.

In the long term, the volume of fibre available to Canfor is impacted by the length of time that the dead pine remains of sufficient quality to produce commercially viable sawlogs. Current indications are that this period can vary from 3 to 15 years, depending on soil moisture levels. One approach taken to increase utilization of MPB infected fibre has been to adjust harvesting processes to allocate more of this timber to pulping operations.

In Alberta, the Mountain Pine Beetle outbreak, which is significantly less wide-spread than in the BC Interior, also continues to impact the quality of fibre. Monitoring of MPB populations in 2010 indicated that mortality from winter weather was beneficial to reducing the spread of the beetle in all except the northern portion of Alberta. Licensees continue to focus harvest activities in Northern Alberta on "green" attacked and susceptible timber types. The Alberta government continues to fund MPB programs, focusing on monitoring, which helps with forest planning, and some single tree removal in isolated areas.

Residual Fibre Revenues

Wood chips are a residual product of Canfor's lumber manufacturing process and are primarily sold to Canfor Pulp. These chips are the principal raw material utilized by Canfor Pulp in its pulp manufacturing operations. Canfor has a Fibre Supply Agreement with Canfor Pulp, which contains a pricing formula that currently results in Canfor Pulp paying Canfor a price for wood chips based on pulp markets and Canfor Pulp's product mix. Canfor currently provides approximately 56% of Canfor Pulp's chip requirements. If market conditions caused Canfor Pulp 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 its sawmills economically. Similarly, if lumber market conditions were such that Canfor is unable to provide the current volume of chips to Canfor Pulp as a result of sawmill closures, whether temporary or permanent, Canfor Pulp's financial results could be materially affected.

Softwood Lumber Agreement

The Softwood Lumber Agreement ("SLA"), in effect from October 2006, provides both Canada and the U.S. with rights to terminate the agreement. In order to terminate under all circumstances except one, the U.S. must provide a six month notice period, and cannot launch a new countervailing duty ("CVD") or anti-dumping duty ("ADD") investigation for 12 months after termination. The exception is that the U.S. may terminate immediately and launch new CVD or ADD cases without the 12 month standstill if Canada is accused of an egregious breach of the SLA. Canada may terminate at any time with six months notice.

Any early termination of the SLA would likely result in the U.S. initiating a new CVD and ADD investigation, potentially leading to duties imposed on the Canadian lumber producers, including the Company.

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

As the arbitration is a state-to-state international dispute under the SLA, Canada is preparing a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. It is not possible at this time to predict the outcome or the value of the claim, and accordingly no provision has been recorded by the Company.

In addition to the above, 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 2010, the Company paid surge tax of $0.8 million on shipments from Alberta. The Company has attempted to minimize the impact of the surge tax by directing shipments from the Company's Alberta operation to domestic or offshore markets where possible.

The total export tax paid since the implementation of the SLA is approximately $277 million.

Stumpage Rates

The BC government introduced a Market Pricing System ("MPS") for the BC Interior on July 1, 2006. On July 1, 2010 the Ministry of Forests and Range (the "Ministry") implemented changes to the interior market pricing system for timber. These changes dealt with issues raised by the MPB epidemic. These changes included the introduction of "stand-as-a-whole" pricing with cruise-based billing for MPB damaged timber and, from a stumpage distribution perspective, transition over two years to a system more sensitive to market forces. For stands with 35% or more MPB damaged timber a single stumpage rate is established with billing based on the cruise rather than scaling. For these stands, determination of log grades is no longer necessary. An impact of these changes is to increase the overall market sensitivity of interior timber pricing and to improve the utilization of low value material. These changes are consistent with the 2006 SLA.

Canfor is actively participating in discussions on MPS with the Ministry, which is scheduled for its fifth annual update on July 1, 2011. 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. Further changes to the stumpage system and resultant stumpage rates could have a material impact on Canfor's business.

For the Company's operations in North and South Carolina, the Company does not directly own timberlands or have any lease rights to timber. There is therefore a risk that traditional sellers of timber may discontinue selling logs to our mills.

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, suffer labour-related disruptions, or cease doing business with Canfor, the Company's operations or cost structure may be adversely impacted. The protracted downturn in the U.S. economy is adversely affecting the availability of trucks throughout North America. If market conditions in the trucking industry continue to worsen, competition for trucking assets could affect Canfor's ability to move its logs, lumber and wood chips at market competitive prices.

OUTSTANDING SHARE DATA

At February 11, 2011, there were 142,678,097 common shares issued and outstanding. In addition, at February 11, 2011, there were 85,668 stock options outstanding with exercise prices ranging from $9.80 to $10.10 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 of Directors 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 year ending December 31, 2010, 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 year ended December 31, 2010 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, 2010, the CEO and CFO have concluded that these controls are operating effectively.

As IFRS requires more judgment with respect to various accounting treatments, additional or modified processes and controls have been put in place. These changes to financial reporting controls will ensure that the Company is making the appropriate judgments and adhering to the IFRS accounting policies selected.

Additional information about the Company, including its 2010 Annual Information Form, is available at www.sedar.com or at www.canfor.com.