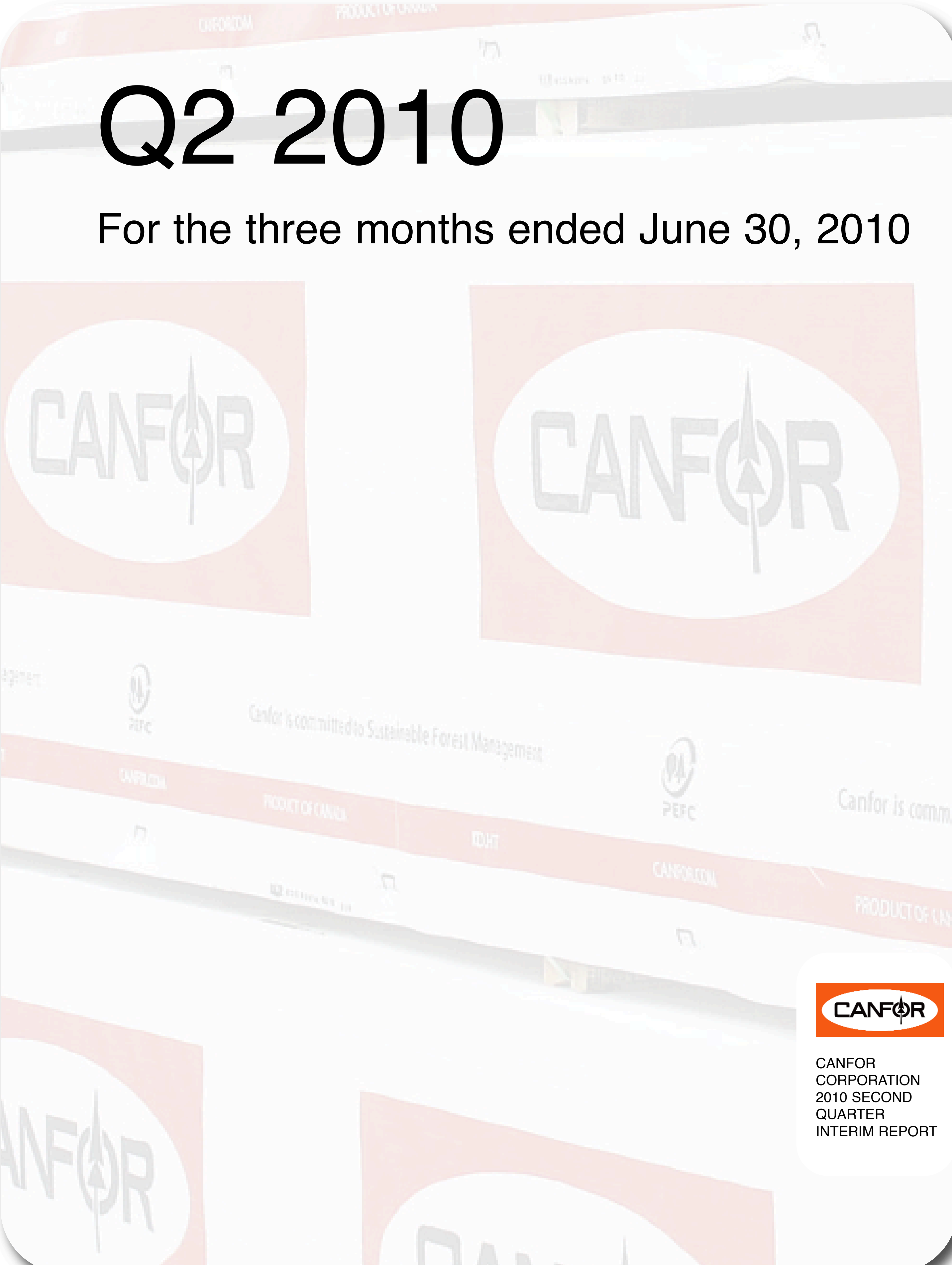
Q2 2010

For the three months ended June 30, 2010



CANFOR
CORPORATION
2010 SECOND
QUARTER
INTERIM REPORT

To Our Shareholders

Canfor Corporation reported total net income of $40.4 million for the second quarter of 2010, compared to $32.5 million for the first quarter of 2010 and $12.1 million for the second quarter of 2009. For the six months ended June 30, 2010, the Company's net income was $72.9 million, compared to a loss of $57.8 million for the comparable period in 2009. As a result of the Company's adoption in 2010 of a new accounting standard requiring the reclassification of non-controlling interests from long-term liabilities into equity, Canfor's reported total net income now comprises both net income attributable to equity shareholders and non-controlling interests. The comparative periods in the prior year have been adjusted and are shown on the same basis.

The Company's net income attributable to its equity shareholders was $18.1 million, or $0.13 per share, for the second quarter of 2010, up from $15.6 million, or $0.11 per share, for the first quarter of 2010 and an improvement of $7.6 million from $10.5 million, or $0.07 per share, reported for the second quarter of 2009. For the first half of 2010, shareholder net income was $33.7 million, or $0.24 per share, compared to a net loss of $48.3 million, or $0.34 per share, in the first half of 2009.

Shareholder net income for the second quarter of 2010 included several items affecting comparability with prior periods, which had an overall negative impact on net income of $10.1 million, or $0.07 per share. After taking account of all items affecting comparability, the Company's adjusted shareholder net income for the second quarter of 2010 was $28.2 million, or $0.20 per share, compared to adjusted net income of $10.4 million, or $0.07 per share, for the first quarter of 2010 and an adjusted net loss of $24.5 million, or $0.17 per share, for the second quarter of 2009. For the six months ended June 30, 2010, adjusted shareholder net income was $38.6 million, or $0.27 per share, compared to an adjusted net loss of $106.9 million, or $0.75 per share, for the same period in 2009.

The solid wood price rally that commenced in early 2010 came to an abrupt end mid-way through the second quarter. After peaking at their highest levels in several years in April and early May, Western SPF and SYP lumber prices fell off sharply over the balance of the quarter as a combination of higher industry production, slowing inventory replenishment orders and a stalling U.S. housing recovery weighed heavily on the sector. By the end of the quarter, the benchmark price for Western SPF 2x4 #2&Btr had fallen below US$200 per thousand board feet for the first time this year, after peaking at US$320 earlier in the quarter. The higher lumber market prices in March, April and early May resulted in export tax rates on Canadian lumber shipments to the U.S declining from 15% on B.C. shipments to 10% in May and 0% in June. Prices to offshore markets, the majority of which are negotiated quarterly in advance, showed solid quarter-over-quarter gains. Average Northern Bleached Softwood Kraft ("NBSK") pulp prices continued to benefit from tight global supply, and list pulp prices for U.S. delivery exceeded US$1,000 per tonne for the first time on record during the second quarter.

Lumber production in the second quarter of 2010 continued to reflect significant mill curtailments, with the Company operating at two-thirds of capacity in the quarter. The Company restarted its Chetwynd and Quesnel sawmill operations in May and June, respectively, with production for the latter being dedicated to the China market.

EBITDA reported by the Company for the second quarter of 2010 was $102.5 million, up $24.7 million from the first quarter of 2010. Excluding the impact from inventory write-down movements, which were significant in the first quarter, EBITDA was up $53.2 million. For the most part, the improvement reflected the record-high NBSK pulp prices, higher lumber sales realizations, in part due to lower export taxes, and improved sawmill residual chip prices. The Company ended the second quarter of 2010 with a cash balance of $226.9 million, and $426.5 million of available undrawn operating lines of credit.

Looking ahead, North American lumber demand is projected to improve slightly as the seasonal fall building season gets underway in August and September. However, mortgage delinquencies, home foreclosures and continued weak U.S. employment are expected to continue to hinder the U.S. housing recovery. The resilience of the offshore market is expected to persist as strong lumber demand continues in China and Japan for both housing construction and remanufacturing and Do-It-Yourself markets. For pulp, the supply/demand balance of global softwood pulp is still in favour of producers, but there is currently downward pressure on market prices, particularly from China. A reduction in market pulp consumption from Asia, combined with a typical seasonal slowdown during the summer months, may exert further pressure on NBSK pulp prices over the next three to six months.

Ronald L. Cliff
Chairman

James F. Shepard
President and Chief Executive Officer

Canfor Corporation
Second Quarter 2010
Management's Discussion and Analysis

This interim Management's Discussion and Analysis ("MD&A") provides a review of Canfor Corporation's ("Canfor" or "the Company") financial performance for the quarter ended June 30, 2010 relative to the quarters ended March 31, 2010 and June 30, 2009, and the financial position of the Company at June 30, 2010. It should be read in conjunction with Canfor's unaudited interim consolidated financial statements and accompanying notes for the quarters ended June 30, 2010 and 2009, as well as the 2009 annual MD&A and the 2009 audited consolidated financial statements and notes thereto, which are included in Canfor's Annual Report for the year ended December 31, 2009 (available at www.canfor.com). The financial information in this interim MD&A has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

Throughout this discussion, reference is 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 "Analysis of Specific Items Affecting Comparability of Net Income (Loss) Attributable to Equity Shareholders") and Adjusted Net Income (Loss) per Share (calculated as Adjusted Net Income (Loss) divided by the weighted average number of shares outstanding during 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 both known and unknown risks and uncertainties that could cause the actual results to be materially different from those stated in this discussion. Factors that could have a material impact on any future oriented statements made herein include, but are not limited to: general economic, market and business conditions; product selling prices; raw material and operating costs; foreign 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 July 28, 2010.

Forward Looking Statements

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

SECOND QUARTER 2010 EARNINGS OVERVIEW

Selected Financial Information and Statistics[1]

(millions of dollars, except for per share amounts)	Q2 2010	Q1 2010	YTD 2010	Q2 2009	YTD 2009
Sales	**$ 634.7**	$ 577.9	**$ 1,212.6**	$ 530.3	$ 1,005.0
EBITDA	**$ 102.5**	$ 77.8	**$ 180.3**	$ 7.3	$ (77.3)
Operating income (loss)	**$ 64.0**	$ 39.0	**$ 103.0**	$ (31.2)	$ (155.4)
Foreign exchange gain (loss) on long-term debt and investments, net	**$ (12.8)**	$ 8.8	**$ (4.0)**	$ 29.1	$ (16.2)
Gain (loss) on derivative financial instruments[2]	**$ (3.3)**	$ (1.2)	**$ (4.5)**	$ 25.7	$ 4.4
Gain on sale of mill property	**$ -**	$ -	**$ -**	$ -	$ 44.6
North Central Plywoods mill fire, net	**$ -**	$ -	**$ -**	$ (3.0)	$ (3.0)
Net income (loss)	**$ 40.4**	$ 32.5	**$ 72.9**	$ 12.1	$ (57.8)
Net income (loss) attributable to equity shareholders of Company[3]	**$ 18.1**	$ 15.6	**$ 33.7**	$ 10.5	$ (48.3)
Net income (loss) per share attributable to equity shareholders of Company, basic and diluted	**$ 0.13**	$ 0.11	**$ 0.24**	$ 0.07	$ (0.34)
Average exchange rate (US$/CDN$)[4]	**$ 0.973**	$ 0.961	**$ 0.967**	$ 0.858	$ 0.829
U.S. housing starts (million units SAAR)[5]	**0.602**	0.617	**0.610**	0.541	0.534

[1] Certain amounts in prior periods have been reclassified to conform to the presentation in the current period.
[2] Includes gains (losses) from natural gas, diesel, foreign exchange and lumber future derivative financial instruments (see "Unallocated and Other" section for more details).
[3] Net income (loss) attributable to equity shareholders of Company ("Shareholder Net Income (Loss)") is calculated as net income (loss), less non-controlling interests. For Q2 2010, the income attributable to non-controlling interests amounted to $22.3 million, compared to $16.9 million in Q1 2010 and a $1.6 million in Q2 2009.
[4] Source – Bank of Canada (average noon rate for the period).
[5] Source – U.S. Census Bureau, seasonally adjusted annual rate ("SAAR").

The Company's shareholder net income (loss) and adjusted net income (loss), together with the related adjustments, are detailed in the table below:

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)	Q2 2010	Q1 2010	YTD 2010	Q2 2009	YTD 2009
Shareholder Net Income (Loss)	**$ 18.1**	**$** 15.6	**$ 33.7**	$ 10.5	$ (48.3)
Foreign exchange (gain) loss on long-term debt and investments, net	**$ 9.0**	**$** (6.2)	**$ 2.8**	$ (19.7)	$ (10.6)
(Gain) loss on derivative financial instruments	**$ 1.1**	**$** 1.0	**$ 2.1**	$ (17.3)	$ (4.9)
Gain on sale of mill property	**$ -**	**$** -	**$ -**	$ -	$ (37.8)
North Central Plywoods mill fire, net	**$ -**	**$** -	**$ -**	$ 2.0	$ 2.0
Corporate income tax rate reductions	**$ -**	**$** -	**$ -**	$ -	$ (7.3)
Net impact of above items	**$ 10.1**	**$** (5.2)	**$ 4.9**	$ (35.0)	$ (58.6)
Adjusted Net Income (Loss)	**$ 28.2**	**$** 10.4	**$ 38.6**	$ (24.5)	$ (106.9)
Net income (loss) per share (EPS), as reported	**$ 0.13**	**$** 0.11	**$ 0.24**	$ 0.07	$ (0.34)
Net impact of above items per share	**$ 0.07**	**$** (0.04)	**$ 0.03**	$ (0.24)	$ (0.41)
Adjusted Net Income (Loss) per share	**$ 0.20**	**$** 0.07	**$ 0.27**	$ (0.17)	$ (0.75)

EBITDA

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

(millions of dollars)	Q2 2010	Q1 2010	YTD 2010	Q2 2009	YTD 2009
Net income (loss), as reported	**$ 40.4**	$ 32.5	**$ 72.9**	$ 12.1	$ (57.8)
Add (subtract):					
Amortization	**$ 38.5**	$ 38.8	**$ 77.3**	$ 38.5	$ 78.1
Interest expense, net	**$ 6.7**	$ 7.0	**$ 13.7**	$ 7.0	$ 15.3
Foreign exchange (gain) loss on long-term debt and investments, net	**$ 12.8**	$ (8.8)	**$ 4.0**	$ (29.1)	$ (16.2)
(Gain) loss on derivative financial instruments	**$ 3.3**	$ 1.2	**$ 4.5**	$ (25.7)	$ (4.4)
Gain on sale of mill property	**$ -**	$ -	**$ -**	$ -	$ (44.6)
North Central Plywoods mill fire, net	**$ -**	$ -	**$ -**	$ 3.0	$ 3.0
Other expense (income)	**$ (3.3)**	$ 2.9	**$ (0.4)**	$ 2.5	$ -
Income tax expense (recovery) expense	**$ 4.1**	$ 4.2	**$ 8.3**	$ (1.0)	$ (50.7)
EBITDA, as reported	**$ 102.5**	$ 77.8	**$ 180.3**	$ 7.3	$ (77.3)
Included in above:					
Negative (positive) impact of inventory valuation adjustments[6]	**$ 5.5**	$ (23.0)	**$ (17.5)**	$ (52.2)	$ (22.4)
EBITDA excluding impact of inventory valuation adjustments	**$ 108.0**	$ 54.8	**$ 162.8**	$ (44.9)	$ (99.7)

[6] 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, respectively. In periods where market prices are depressed and NRVs are below cost, this movement in log inventory volumes can result in large swings in inventory write-down amounts recorded in those periods. In addition, changes in market prices, foreign exchange rates, and costs over the respective reporting periods affect inventory write-downs.

The solid wood price rally that commenced in early 2010 came to an abrupt end mid-way through the second quarter. After peaking at their highest levels in several years in April and early May, lumber and OSB prices fell off sharply over the balance of the quarter as a combination of higher production, slowing inventory replenishment orders and a stalling U.S. housing recovery weighed heavily on the sector. Contributing to weaker housing demand was the expiry of the U.S. federal government's home buyer tax credit at the end of April.

North American prices across most Western Spruce/Pine/Fir ("SPF") products peaked in late April, when benchmark prices for 2x4 #2&Btr reached US$320 per thousand board feet ("Mfbm"), before weakening significantly over the second part of the quarter to end the period below US$200 per Mfbm for the first time in 2010. Prices for Southern Yellow Pine ("SYP"), particularly 2x4 #2 grade lumber, also performed strongly in the first part of the quarter and while prices fell off sharply in the latter part of May and June, the average SYP 2x4 #2 benchmark price was still up 15% from the previous quarter. Prices to offshore markets, the majority of which are negotiated quarterly in advance, showed solid quarter-over-quarter gains. The average value of the Canadian dollar was up slightly compared to the US dollar.

Reflecting higher lumber market prices in March, April and early May, export tax rates on Canadian lumber shipments to the U.S declined from 15% on B.C. shipments (22.5% for Alberta shipments) to 10% in May and 0% in June.

The Company operated at two-thirds of lumber capacity in the quarter. Production was up 5% compared to the first quarter, primarily reflecting higher operating rates at the Company's Mackenzie sawmill, and the restarts in May and June of its Chetwynd and Quesnel sawmill operations.

Average Northern Bleached Softwood Kraft ("NBSK") pulp prices continued to benefit from tight global supply, and list pulp prices for U.S. delivery exceeded US$1,000 per tonne for the first time on record during the second quarter.

EBITDA reported by the Company for the second quarter of 2010 was $102.5 million, up $24.7 million from the first quarter of 2010. Excluding the impact from inventory write-down movements, which were significant in the prior quarter, EBITDA was up $53.2 million. For the most part, the improvement reflected higher lumber sales realizations, in part due to lower export taxes, the record-high NBSK pulp prices and improved sawmill residual chip prices.

The Company ended the second quarter of 2010 with a cash balance of $226.9 million, and $426.5 million of available undrawn operating lines of credit.

OPERATING RESULTS BY BUSINESS SEGMENT

Lumber

Selected Financial Information and Statistics - Lumber

(millions of dollars unless otherwise noted)	Q2 2010	Q1 2010	YTD 2010	Q2 2009	YTD 2009
Sales	**$ 336.9**	$ 292.0	**$ 628.9**	$ 287.8	$ 551.6
Operating income (loss)	**$ 17.0**	$ 11.8	**$ 28.8**	$ (12.0)	$ (104.3)
EBITDA, as reported	**$ 38.9**	$ 34.0	**$ 72.9**	$ 10.6	$ (58.2)
Negative (positive) impact of inventory valuation adjustments	**$ 2.2**	$ (22.4)	**$ (20.2)**	$ (43.1)	$ (18.8)
EBITDA excluding impact of inventory valuation adjustments	**$ 41.1**	$ 11.6	**$ 52.7**	$ (32.5)	$ (77.0)
Average SPF 2x4 #2&Btr lumber price in US$[7]	**$ 266**	$ 268	**$ 267**	$ 174	$ 165
Average SPF price in Cdn$	**$ 273**	$ 279	**$ 276**	$ 203	$ 198
Average SYP 2x4 #2 lumber price in US$[8]	**$ 379**	$ 329	**$ 354**	$ 236	$ 236
Average SYP price in Cdn$	**$ 390**	$ 342	**$ 366**	$ 275	$ 284
U.S. housing starts (million units SAAR)	**0.602**	0.617	**0.610**	0.541	0.534
Production – SPF lumber (MMfbm)	**724.7**	696.0	**1,420.7**	759.3	1,461.2
Production – SYP lumber (MMfbm)	**92.8**	85.0	**177.8**	58.6	121.0
Shipments – SPF lumber (MMfbm) [9]	**736.9**	672.7	**1,409.6**	764.5	1,449.4
Shipments – SYP lumber (MMfbm) [9]	**98.3**	85.6	**183.9**	69.1	135.8
Shipments – wholesale lumber (MMfbm)	**39.9**	38.8	**78.7**	50.1	89.1

[7] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)
[8] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)
[9] Canfor-produced lumber, including lumber purchased for remanufacture.

Overview

Reported EBITDA for the Lumber segment was $38.9 million for the second quarter of 2010, an improvement of $4.9 million compared to EBITDA of $34.0 million reported for the first quarter of 2010, and up $28.3 million compared to the second quarter of 2009. For the six months ended June 30, 2010, EBITDA was $72.9 million, up $131.1 million from the same period in 2009.

Excluding the impact of inventory write-down adjustments, EBITDA for the second quarter of 2010 was $41.1 million, an improvement of $29.5 million from the first quarter of 2010 and up $73.6 million compared to the second quarter of 2009.

Shipments of Canfor-produced lumber for the second quarter of 2010 totaled 835 million board feet, up 10% from the prior quarter and substantially unchanged from the second quarter of 2009. For the most part, the increase reflected a modest pickup in demand compared to the first quarter of 2010.

North American lumber prices for most grades and widths continued to climb into the second quarter of 2010, with benchmark prices for certain grades of Western SPF and SYP lumber reaching their highest levels for several years during the quarter. However, prices dropped off significantly in the back half of the quarter and the average benchmark Western SPF 2x4 #2&Btr price for the quarter was comparable to the previous quarter. The SYP 2x4 #2 benchmark price was up 15% over the same period. Compared to the same quarter of 2009, US dollar lumber prices were well up, however these gains were mitigated by the 13% strengthening of the Canadian dollar over the same period.

Reflecting the increased lumber prices during the quarter, the rate of export taxes payable under the Softwood Lumber Agreement between Canada and the U.S. fell below its maximum level of 15% for the first time since it was implemented. The export tax rate on all U.S. bound shipments for May and June dropped to 10% and 0%, respectively.

Overall unit manufacturing costs were in line with the previous quarter, and were down 3% from the second quarter of 2009, mostly as a result of cost reduction initiatives and lower market stumpage rates. Residual chip prices moved up in line with higher Canadian dollar pulp sales realizations in the quarter.

Markets

Early in the second quarter of 2010, a modest increase in softwood lumber demand occurred at the same time that lumber inventories were at historical low levels throughout the supply chain. This resulted in lumber prices surging to a level not seen since 2006, but prices then plummeted over the balance of the quarter as supply chain inventories were replenished and more lumber supply became available.

Although U.S. housing construction is up from a year ago, new starts have leveled off, in part due to the expiry of the U.S. home buyer tax credit on April 30. In addition, a significant number of homes are projected to go into foreclosure this year. Total U.S. housing starts averaged 602,000 units[10] SAAR for the second quarter, a 2% decrease from the previous quarter. Single family starts declined by 6% compared to the first quarter to 491,000 units SAAR. However, compared to the same period last year total housing starts increased by 12% and single family starts increased by 16%.

Average Canadian housing starts remained in line with the previous quarter at 197,000 units SAAR[11], however these dropped off through the quarter after a strong start in April. Compared to the second quarter of 2009, average housing starts in Canada were up 69,000 units SAAR, or 54%. Offshore lumber shipments in the second quarter of 2010 were also strong, equaling the levels of the first quarter of 2010.

Sales

Sales for the lumber segment in the second quarter of 2010 were $336.9 million, up $44.9 million, or 15%, from the previous quarter, and $49.1 million, or 17%, compared to the second quarter of 2009. Offshore sales revenues for the second quarter of 2010 represented 23% of total lumber sales, in line with the first quarter, and up from 17% in the second quarter of 2009.

Total shipments of Canfor-produced lumber for the second quarter of 2010 were 835 million board feet, up 77 million board feet, or 10%, compared to the first quarter. The increase compared to the first quarter of 2010 primarily reflected the modest improvement in market conditions. Compared to the second quarter of 2009, shipment levels were substantially unchanged.

North American lumber prices for most grades and widths continued to climb into the second quarter of 2010. The average benchmark prices for Western SPF 2x4 #2&Btr and SYP 2x4 #2 reached 4-year highs of US$320 per Mfbm[12] $446 per Mfbm, respectively. The subsequent drop in prices in the back half of the quarter kept the average Western SPF 2x4 #2&Btr price for the quarter comparable to the previous quarter at US$266 per Mfbm. Average second quarter prices for wider dimension SPF lumber showed modest declines compared to the previous quarter. Prices to offshore markets, the majority of which are negotiated quarterly in advance, showed solid quarter-over-quarter gains. Prices for all of Canfor's SPF and SYP grades and widths were well up compared to the same quarter of 2009.

The average value of the Canadian dollar compared to the US dollar in the second quarter of 2010 was up marginally from the previous quarter, but compared to the second quarter of 2009 it strengthened 13%, offsetting some of the improvements in US dollar pricing.

[10] U.S. Census Bureau
[11] CMHC – Canada Mortgage and Housing Corporation
[12] Random Lengths Publications, Inc.

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

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

During the second quarter of 2010, the RLCP exceeded certain trigger levels, resulting in the export tax rate on all U.S. bound shipments for May and June dropping to 10% and 0%, respectively. In addition, July's shipments to the U.S. have been subject to an export tax rate of 10%.

Total residual fibre revenue was up compared to the previous quarter and also the second quarter of 2009, reflecting the increase in Canadian dollar pulp sales realizations relative to both periods.

Operations

The Company operated at 67% of capacity in the second quarter of 2010. Lumber production was 818 million board feet, 37 million board feet, or 5% higher than the prior quarter, and in line with the second quarter of 2009. The increase compared to the first quarter of 2010 primarily reflected additional production at the Company's Mackenzie sawmill, which operated on two shifts through the quarter (having moved to this configuration in late February) and the restart in May and June of the Chetwynd and Quesnel sawmills. The second quarter of 2009 included production at the Company's Radium, Rustad and Vavenby sawmills, which were subsequently indefinitely idled.

Overall, the Company's lumber unit manufacturing (log and conversion) costs were comparable to the previous quarter, with the positive impact from lower natural gas costs offset by restart costs at Chetwynd and Quesnel. Compared to the second quarter of 2009, unit manufacturing costs were down 3%, principally reflecting cost reduction initiatives and lower market stumpage rates.

Due to the significant fall in lumber market prices towards the end of the quarter, the Company recorded an inventory write-down of $2.2 million to reduce the value of its inventory to net realizable value. This was in contrast to the prior quarter when earnings were positively impacted by $22.4 million due to the recovery of previously recorded write-downs as a result of improving market prices in the first quarter. In the second quarter of 2009, inventory write-down adjustments positively impacted pre-tax earnings by $43.1 million, principally due to reduced log inventory levels following the spring break up period.

Restructuring costs in the current quarter were $4.8 million, similar to those for the previous quarter. Restructuring costs of $9.6 million in the second quarter of 2009 reflected the Company's decision to indefinitely idle its Radium, Rustad and Vavenby sawmills.

Pulp and Paper

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

(millions of dollars unless otherwise noted)	Q2 2010	Q1 2010	YTD 2010	Q2 2009	YTD 2009
Sales	$ 280.1	$ 269.7	$ 549.8	$ 232.4	$ 437.7
Operating income (loss) [14]	$ 54.5	$ 33.9	$ 88.4	$ (6.8)	$ (24.1)
EBITDA[14]	$ 66.8	$ 45.8	$ 112.6	$ 5.7	$ 0.7
Average pulp price delivered to U.S. – US$[15]	$ 993	$ 880	$ 937	$ 645	$ 659
Average price in Cdn$	$ 1,021	$ 916	$ 969	$ 752	$ 795
Production – pulp (000 mt)	315.6	307.1	622.7	299.1	569.1
Production – paper (000 mt)	36.3	31.0	67.3	30.7	59.1
Shipments – Canfor-produced pulp (000 mt)	301.4	315.6	617.0	344.4	621.0
Pulp marketed on behalf of HSLP (000 mt)[16]	95.2	91.5	186.7	81.9	152.8
Shipments – paper (000 mt)	34.4	37.7	72.1	34.3	59.5

[13] Includes the Taylor Pulp mill and 100% of Canfor Pulp Limited Partnership, which is consolidated in Canfor's operating results. Pulp production and shipment volumes presented are for both northern bleached softwood kraft ("NBSK") and bleached chemi-thermo mechanical pulp ("BCTMP").
[14] Earnings for Q2 2010 include a negative impact from inventory write-down adjustments of $0.1 million, compared to a negative impact of $0.2 million in Q1 2010 and positive impact of $5.5 million in Q2 2009.
[15] Per tonne, NBSK pulp list price delivered to U.S. (Resource Information Systems, Inc.).
[16] Howe Sound Pulp and Paper Limited Partnership pulp mill.

Overview

The Pulp and Paper segment's EBITDA for the second quarter of 2010 was $66.8 million, up $21.0 million from the first quarter of 2010, principally as a result of higher NBSK pulp sales realizations. Higher fibre costs, resulting from higher sawmill residual chip prices, were partly offset by lower energy costs.

Compared to the same quarter of 2009, EBITDA for the current quarter was up $61.1 million, in large measure due to significantly higher Canadian dollar pulp sales realizations. NBSK pulp list US dollar prices were up by more than 50% from a year earlier, more than offsetting a 13% increase in the value of the Canadian dollar compared to the US dollar over the same period. Higher freight costs and lower shipment volumes in the current period partly offset the improved sales realizations.

Markets

Softwood pulp markets remained tight through the second quarter of 2010 as steady demand and the continued tight supply of global softwood pulp supported further price increases. The tight supply conditions continued as a result of maintenance downtime in the second quarter of 2010, the prolonged impact of the Chilean earthquake on February 27, 2010, and the delayed restarts of idled mills.

Global printing and writing paper demand remained strong. The printing and writing paper manufacturing sector experienced improved demand through May 2010 (the latest published information available), with demand up 10.3%[17] over May 2009. For May year-to-date, printing and writing paper demand is up 9.9% versus the same period in 2009.

The steady improvement in consumption coupled with the supply side reductions have resulted in very low global pulp inventory levels. At the end of June 2010, World 20[18] producers inventories of bleached softwood pulp were 21 days of supply, a decrease of 2 days since March 2010. By comparison, June 2009 inventories were 26 days of supply. Market conditions are generally considered balanced when inventories fall in the 27-30 days of supply range.

As a result of these tight market conditions, producers were successful at implementing further price increases each month in the second quarter of 2010. The NBSK pulp list price in North America during June 2009 was US$660 per tonne with successive price increases through March 2010 resulting in a price of US$910 per tonne. Monthly price increases in the second quarter of 2010 resulted in a price for June 2010 of US$1,020 per tonne.

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

Sales

At 301,000 tonnes, shipments of Canfor-produced pulp for the second quarter of 2010 were down slightly from the previous quarter, primarily due to the timing of shipping orders to the U.S. and Asia. The higher shipments for the second quarter of 2009 reflected abnormally high shipments to China in that period.

With product availability in tight supply, pulp producers implemented further price increases through the second quarter of 2010. Average NBSK market pulp list prices for U.S. delivery increased US$113, or 13%, to US$993 per tonne, compared to the first quarter of 2010. June NBSK pulp prices before discounts in the U.S. and Northern Europe markets were US$1,020 and US$980 per tonne respectively. Average BCTMP prices also saw solid gains compared to the prior quarter, but came under pressure towards the end of the period. Partly offsetting the higher pulp prices were increased freight costs resulting from higher container rates into Asia and, to a lesser extent, the stronger Canadian dollar.

Compared to the second quarter of 2009, both NBSK pulp list prices to the U.S. and Europe were up approximately US$350 per tonne. BCTMP prices and realizations also saw strong gains over the comparative period. The pricing gains were partly offset by the 13% increase in the value of the Canadian dollar and significantly higher freight costs.

Operations

Pulp production for the second quarter of 2010 was 316,000 tonnes, up slightly from the previous quarter primarily due to record-high production levels at Canfor Pulp Limited Partnership's ("CPLP") operations and CPLP's Prince George Pulp and Paper mill maintenance outage in the first quarter, which more than offset a scheduled maintenance outage at CPLP's Intercontinental pulp mill in the second quarter of 2010. Production was up 6% from the same quarter of 2009, primarily reflecting higher production rates in the current period.

Unit manufacturing costs for the second quarter of 2010 were in line with the previous quarter as higher fibre and maintenance costs offset lower energy and chemical costs. The increase in fibre costs reflected higher priced sawmill residual chips. Lower energy costs reflected seasonally lower natural gas usage and lower natural gas prices.

Compared to the second quarter of 2009, unit manufacturing costs were down slightly primarily as a result of lower chemical costs, which more than offset higher fibre costs. The latter resulted from higher sawmill residual chip prices, which were partly offset by a reduction in higher-cost whole log chipping.

Inventory write-down movements positively impacted operating results by $5.5 million in the second quarter of 2009 as a result of reduced inventory levels and the recovery of pulp prices from the lows of the prior quarter. Inventory write-down adjustments were minimal in both quarters of 2010.

Unallocated and Other Items

(millions of dollars)	**Q2 2010**	Q1 2010	**YTD 2010**	Q2 2009	YTD 2009
Operating loss of Panels operations[19]	**$ (2.7)**	$ (0.5)	**$ (3.2)**	$ (6.3)	$ (15.7)
Corporate costs	**$ (4.8)**	$ (6.2)	**$ (11.0)**	$ (6.1)	$ (11.3)
Interest expense, net	**$ (6.7)**	$ (7.0)	**$ (13.7)**	$ (7.0)	$ (15.3)
Foreign exchange gain (loss) on long-term debt and investments, net	**$ (12.8)**	$ 8.8	**$ (4.0)**	$ 29.1	$ 16.2
Gain (loss) on derivative financial instruments	**$ (3.3)**	$ (1.2)	**$ (4.5)**	$ 25.7	$ 4.4
Gain on sale of mill property	**$ -**	$ -	**$ -**	$ -	$ 44.6
North Central Plywoods mill fire, net	**$ -**	$ -	**$ -**	(3.0)	$ (3.0)
Other income (expense), net	**$ 3.3**	$ (2.9)	**$ 0.4**	$ (2.5)	$ -

[19] 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 $2.7 million for the second quarter, compared to a loss of $0.5 million in the previous quarter. Early in the quarter, a combination of a modest upturn in demand coupled with low product availability resulted in OSB prices reaching almost US$400 per thousand square feet ("Msf") for the first time in 5 years. However, this was followed by a strong contraction in demand and prices fell off sharply through the balance of the quarter. As a result of weaker prices at the end of the quarter, inventory write-downs of $3.2 million were recorded. Compared to the second quarter of 2009, the current quarter's results reflected generally more favourable market conditions, partly offset by the stronger Canadian dollar. Operating results for the second quarter of 2009 also included a positive inventory write-down adjustment which largely offset a $5.8 million charge related to the settlement of an insurance claim in connection with the North Central Plywoods ("NCP") facility, which was closed down after a fire destroyed the mill in May 2008.

Corporate costs were $4.8 million for the second quarter of 2010, down $1.4 million from the first quarter of 2010 and for the most part reflecting lower share based compensation and consulting costs. Compared to the second quarter of 2009, corporate costs were lower by $1.3 million, mostly as a result of lower compensation costs linked to share price movements and severance costs in 2009 arising from cost reduction initiatives.

Net interest expense of $6.7 million for the second quarter of 2010 was substantially unchanged from the previous quarter and the second quarter of 2009.

The Company recorded a foreign exchange translation loss on its US dollar denominated debt, net of investments, of $12.8 million for the second quarter of 2010, which resulted from a 4% decrease in the value of the Canadian dollar against the US dollar at the respective quarter ends. For the first quarter of 2010 and second quarter of 2009, the Company recorded gains of $8.8 million and $29.1 million, respectively, reflecting 3% and 8% increases in the value of the 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 second quarter of 2010, the Company recorded a net loss of $3.3 million related to all its derivative instruments, as losses attributable to the weaker Canadian dollar and, to a lesser extent, lower market diesel prices were partially offset by mark-to-market gains recorded on lumber futures related to lower market prices. The following table summarizes the gains (losses) on derivative financial instruments for the comparable periods.

(millions of dollars)	**Q2 2010**	Q1 2010	**YTD 2010**	Q2 2009	YTD 2009
Foreign exchange collars and forward contracts	**$ (9.5)**	$ 5.8	**$ (3.7)**	$ 27.3	$ 16.5
Natural gas swaps	**$ 0.2**	$ (3.7)	**$ (3.5)**	$ (3.5)	$ (13.0)
Diesel options and swaps	**$ (1.0)**	$ 0.4	**$ (0.6)**	$ 2.4	$ 1.0
Lumber futures	**$ 7.0**	$ (3.7)	**$ 3.3**	$ (0.5)	$ (0.1)
	$ (3.3)	$ (1.2)	**$ (4.5)**	$ 25.7	$ 4.4

Other income, net of $3.3 million for the second quarter of 2010 represented an improvement of approximately $6 million from both the first quarter of 2010 and second quarter of 2009, and was principally attributable to favourable foreign exchange movements on US dollar denominated cash, receivables and payables of Canadian operations in the current quarter, in contrast to the comparable quarters when the Canadian dollar strengthened against the US dollar.

SUMMARY OF FINANCIAL POSITION

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

(millions of dollars)	Q2 2010	Q1 2010	YTD 2010	Q2 2009	YTD 2009
Increase (decrease) in cash and cash equivalents	**$ 132.8**	$ (39.3)	**$ 93.5**	$ (2.4)	$ (209.6)
Operating activities	**$ 171.9**	$ 15.9	**$ 187.8**	$ 38.9	$ (88.1)
Financing activities	**$ (16.5)**	$ (44.8)	**$ (61.3)**	$ (79.2)	$ (189.6)
Investing activities	**$ (22.9)**	$ (10.2)	**$ (33.1)**	$ 37.7	$ 67.7
Foreign exchange gain (loss) on cash and cash equivalents of self-sustaining foreign operations	**$ 0.3**	$ (0.2)	**$ 0.1**	$ 0.2	$ 0.4
Ratio of current assets to current liabilities			**2.2 : 1**		2.4 : 1
Ratio of net debt to capitalization			**6.3%**		13.8%
ROCE - Consolidated[20]	**1.4%**	1.2%	**2.7%**	0.8%	(2.2)%
ROCE - Canfor solid wood business[21]	**0.1%**	0.5%	**0.7%**	1.3%	(1.9)%

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

Changes in Financial Position

Operating activities generated cash of $171.9 million in the second quarter of 2010 compared to $15.9 million in the previous quarter. The drawdown of log inventories during the Canadian spring break-up period had a significant positive cash flow impact in the second quarter of 2010, in contrast to the cash used in the previous quarter in the related inventory build-up. Increased cash earnings in the current quarter also contributed to the positive movement in the quarter. These factors were partly offset by lower income tax refunds received in the current quarter. Compared to the second quarter of 2009, cash from operating activities was up $133.0 million, primarily as a result of improved cash operating earnings.

Financing activities used cash of $16.5 million in the second quarter of 2010, compared to $44.8 million used in the previous quarter and $79.2 million used in the second quarter of 2009. The current quarter's outflows were comprised principally of cash distributions paid to non-controlling interests of $16.1 million, up $4.9 million from the previous quarter and $14.6 million from the second quarter of 2009. Financing activities in the first quarter of 2010 and second quarter of 2009 included long-term debt repayments of $33.7 million (US$32.3 million) and $75.8 million (US$60.0 million), respectively. In the second quarter of 2009, CPLP also decreased its operating loans by $1.8 million.

Investing activities in the second quarter of 2010 used net cash of $22.9 million compared to $10.2 million used in the previous quarter and $37.7 million generated in the second quarter of 2009. The increase relative to the first quarter of 2010 was mostly related to the completion of capital upgrades to the Chetwynd sawmill and planer prior to its restart in May. Capital spending in the second quarter of 2009 was limited to $7.5 million due to the very challenging market conditions at that time. Investing activities in the second quarter of 2009 also reflected final proceeds from the NCP insurance claim settlement of $33.3 million and proceeds from the partial redemption of the Company's investment in asset-backed commercial paper of $10.4 million.

Changes in Equity

In addition to the net income of $40.4 million for the second quarter of 2010 which was credited to equity, accumulated other comprehensive income increased $11.7 million, due substantially to the impact of the 4% decrease in the value of the Canadian dollar on the translation of the Company's foreign subsidiaries at quarter end. Distributions to non-controlling interests of $18.9 million were also charged to equity.

Liquidity and Financial Requirements

At June 30, 2010, the Company on a consolidated basis had cash and cash equivalents of $226.9 million and $444.3 million of bank operating lines of credit, of which nil was drawn down and $17.8 million was reserved for several standby letters of credit. In addition, CPLP had a separate credit facility to cover a $16.0 million standby letter of credit issued to BC Hydro.

The Company's consolidated net debt to capitalization ratio at the end of second quarter of 2010 was 6.3%.

The Company remained in compliance with the covenants relating to its operating lines of credit and long-term debt during the quarter, and expects to remain so for the foreseeable future.

Agreement for Sale of Howe Sound Pulp and Paper

On July 15, 2010, the Company announced that Howe Sound Pulp and Paper Limited Partnership, which is jointly owned by Canfor and Oji Paper Co., Ltd. of Japan, had entered into an agreement for the sale of all its assets to Paper Excellence B.V. The transaction is subject to customary closing conditions, and closing is expected during the third quarter of 2010.

OUTLOOK

Lumber

North American lumber demand is expected to improve slightly as the seasonal fall building season gets underway in August and September. However, mortgage delinquencies, home foreclosures and a continued weak employment market are expected to continue to hinder the housing recovery. Lumber supply is expected to decline in response to lower demand as indicated by a number of announced summer sawmill shutdowns. In Canada, lumber consumption is expected to ease during the second half of the year as interest rates rise as a result of a strong Canadian dollar and continued strength of the general economy.

The resilience of the offshore market is expected to persist as strong lumber demand continues in China and Japan for both housing construction and remanufacturing and DIY markets.

Pulp and Paper

Global softwood inventories held by producers and customers are at low levels compared to what is considered a balanced market. However, global hardwood inventories are more balanced due to the ramp up of new hardwood capacity in Latin America and the restart of Chilean mills. Through the first six months of 2010 softwood shipments increased 2.9% and hardwood shipments increased 0.3% when compared to the same period last year.

Although the supply/demand balance of global softwood pulp is still in favour of producers, there is currently downward pressure on market prices, particularly from China. A reduction in market pulp consumption from Asia, combined with a typical seasonal slowdown during the summer months, may exert further pressure on NBSK pulp prices over the next three to six months.

A scheduled maintenance outage is planned for the Northwood Pulp Mill in the third quarter of 2010 with an estimated 10,000 tonnes of reduced production. No maintenance outages are planned for the fourth quarter of 2010.

OUTSTANDING SHARES

At July 28, 2010, there were 142,623,347 common shares outstanding.

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

CHANGES IN ACCOUNTING POLICIES

The Canadian Institute of Chartered Accountants ("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 has adopted the new standards as of January 1, 2010.

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 will impact Canfor's financial statements should a business combination, such as a merger or an acquisition, occur 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 attributable to equity shareholders of the Company," as disclosed on the statements of income (loss), is comparable to "Net income (loss)" reported in previous years. These changes have been adopted retrospectively.

CONVERSION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

For interim and annual periods in 2011 and beyond, Canfor will be required to prepare financial statements in accordance with International Financial Reporting Standards ("IFRS"). In order to ensure accurate and efficient reporting under IFRS, the Company developed a conversion implementation plan in 2008, which was designed to identify differences between Canadian GAAP and IFRS that affect Canfor and any required changes to accounting processes and controls (including information technology systems).

A number of differences between Canadian GAAP and IFRS were identified that are expected to have a significant impact on Canfor's financial statements, and these are summarized in the following section. The Company is currently in the process of quantifying these differences in order to prepare an opening balance sheet under IFRS as of January 1, 2010 and comparative information throughout the remainder of the year.

No significant impacts were identified in relation to the Company's information systems or day-to-day accounting processes and controls. Canfor is reviewing its disclosure controls and procedures and will update these as required to ensure that they are appropriate for reporting under IFRS during 2011. Various training sessions have been carried out for those employees impacted by the transition to IFRS, with further training to be provided as required prior to the changeover in 2011.

Significant accounting impacts of conversion to IFRS for Canfor

The areas that are expected to have a significant impact on Canfor are explained below. Since the process of finalizing the accounting impacts of the conversion to IFRS is still ongoing, and the accounting standards will continue to evolve through 2011, it is possible that further differences may arise that could have a significant impact on the Company's financial statements under IFRS.

<u>IFRS 1 "First time adoption of International Financial Reporting Standards"</u>

As a first-time adopter of IFRS, the Company is required to apply IFRS 1 "First time adoption of International Financial Reporting Standards". IFRS 1 provides a number of optional exemptions to first-time adopters. The exemptions which are significant to Canfor, and that it currently plans to take, are included in the sections which follow.

<u>Property, plant and equipment</u>

There are differences in the methodology used to determine if an asset should be impaired under IFRS compared to that under Canadian GAAP. The Canadian GAAP rules provide 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. This difference may result in an impairment being recorded under IFRS, but not under Canadian GAAP, and therefore require an opening balance sheet adjustment under IFRS. If an impairment is required under IFRS, the future annual amortization expense would be reduced due to the lower base value of the assets.

In addition under IFRS, timber licenses will no longer be grouped with Property, plant and equipment, but will be classified separately as an intangible asset on the balance sheet.

One further adjustment to the opening balance sheet is expected to be the reclassification of major inspection and overhaul expenses at CPLP’s pulp mills to Property, plant and equipment, where such amounts occur at regular intervals over the life of the asset and those intervals are longer than one year. This adjustment would result in the related expenses being reclassified to capital assets and a higher amortization expense being recorded going forward. This would have a positive impact on the Company’s EBITDA under IFRS compared to Canadian GAAP.

Employee future benefits

IFRS 1 provides an exemption that allows a company transitioning to IFRS to recognize all unamortized actuarial gains and losses in its opening balance sheet on transition. This adjustment would impact retained earnings at the opening balance sheet date. Canfor plans to take this exemption.

IFRS also provides different options for the treatment of these actuarial gains and losses going forward than those available under Canadian GAAP. One of these options is to recognize the full amounts of such gains and losses in the Company’s balance sheet each year, with the adjustment recorded to Other Comprehensive Income, rather than recognizing these amounts through the income statement over a number of years. Canfor plans to take this option.

In addition, under IFRS past service costs associated with defined benefit plans that have fully vested are required to be expensed immediately. Under Canadian GAAP, these may be amortized on a straight-line basis over the average remaining service period of active employees. This will have an impact on Canfor’s opening balance sheet and future employee benefit expense.

Joint ventures

Canadian GAAP allows for the use of proportional consolidation in the accounting for joint ventures. This is also currently allowed under IFRS, however it is expected that future changes may remove this option and permit only the equity method of accounting for such interests. This would affect a number of Canfor’s balance sheet and income statement line items, specifically in relation to the Company’s interest in the Peace Valley OSB joint venture, as these items would be presented as one line item on each of these statements.

Presentation of financial statements, including presentation of non-controlling interests

IFRS requires that non-controlling interests be treated as a component of equity, rather than as a liability, in the Company’s balance sheet, with the related income (loss) no longer deducted in arriving at net income (loss), but disclosed separately on the face of the income statement. Canfor has elected to early adopt this change under Canadian GAAP during 2010.

In addition to the other changes noted in this section, a number of other reclassifications between line items on the financial statements are expected under IFRS.

Business combinations

IFRS 1 provides an exemption that allows companies transitioning to IFRS not to restate business combinations entered into prior to the date of transition. Canfor plans to take this exemption. In addition, the Company has elected to early adopt a new standard under Canadian GAAP from January 1, 2010 which would align the accounting for business combinations under Canadian GAAP to IFRS, should any such combinations occur in 2010.

Foreign exchange

IFRS 1 provides an exemption that allows a Company to reset its cumulative translation account to zero at the date of transition, with the balance being transferred to opening retained earnings. Canfor plans to take this exemption.

Provisions

The threshold for recognition of provisions under IFRS is lower than that under Canadian GAAP. Under IFRS, a provision must be recorded where required payment is “probable”, which is a lower threshold than “likely” under Canadian GAAP. This could result in additional provisions being required on transition to IFRS. The measurement of those provisions may also be adjusted, with IFRS requiring the mid-point in a range of potential outcomes to be used, whereas Canadian GAAP permits use of an amount at the low end of the range where no amount within the range of outcomes is indicated as a better estimate than any other. Measurement of provisions may also be affected by differences in the required calculation, such as the determination of the discount rate to be used.

Income taxes

A number of the adjustments noted in the sections above are expected to have an impact on taxes, resulting in differences between the tax amounts recorded under IFRS and Canadian GAAP.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ended June 30, 2010, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

RISKS AND UNCERTAINTIES

A comprehensive discussion of risks and uncertainties is included in the Company's 2009 annual statutory reports which are available on www.canfor.com or www.sedar.com.

SELECTED QUARTERLY FINANCIAL INFORMATION

	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008
Sales and income (millions of dollars)								
Sales	**$ 634.7**	$ 577.9	$ 549.6	$ 521.3	$ 530.3	$ 474.7	$ 576.9	$ 654.9
Operating income (loss)	**$ 64.0**	$ 39.0	$ (23.6)	$ (31.4)	$ (31.2)	$ (124.2)	$ (74.2)	$ 12.8
Net income (loss)	**$ 40.4**	$ 32.5	$ (9.1)	$ 4.1	$ 12.1	$ (69.9)	$ (242.4)	$ (88.8)
Shareholder net income (loss)	**$ 18.1**	$ 15.6	$ (17.0)	$ (5.2)	$ 10.5	$ (58.8)	$ (229.8)	$ (94.2)
Per common share (dollars)								
Shareholder net income (loss) – basic and diluted	**$ 0.13**	$ 0.11	$ (0.12)	$ (0.04)	$ 0.07	$ (0.41)	$ (1.61)	$ (0.66)
Statistics								
Lumber shipments (MMfbm)	**875**	797	887	837	884	791	956	906
OSB shipments (MMsf 3/8")	**72**	73	63	69	61	30	56	91
Pulp shipments (000 mt)	**301**	316	315	307	344	277	236	284
Average exchange rate – US$/Cdn$	**$ 0.973**	$ 0.961	$ 0.947	$ 0.912	$ 0.858	$ 0.803	$ 0.825	$ 0.960
Average Western SPF 2x4 #2&Btr lumber price (US$)	**$ 266**	$ 268	$ 205	$ 191	$ 174	$ 155	$ 190	$ 263
Average SYP (East) 2x4 #2 lumber price (US$)	**$ 379**	$ 329	$ 231	$ 230	$ 236	$ 235	$ 258	$ 289
Average OSB price – North Central (US$)	**$ 295**	$ 214	$ 172	$ 178	$ 145	$ 154	$ 172	$ 202
Average NBSK pulp list price delivered to U.S. (US$)	**$ 993**	$ 880	$ 820	$ 733	$ 645	$ 673	$ 787	$ 880

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 last quarter of 2008 and the 2009 year reflect the impact of a global economic slowdown.

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

After-tax impact, net of non-controlling interests (millions of dollars, except for per share amounts)	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008
Shareholder net income (loss), as reported	**$ 18.1**	$ 15.6	$ (17.0)	$ (5.2)	$ 10.5	$ (58.8)	$ (229.8)	$ (94.2)
Foreign exchange (gain) loss on long-term debt and investments, net	**$ 9.0**	$ (6.2)	$ (5.8)	$ (19.6)	$ (19.7)	$ 9.1	$ 52.2	$ 11.3
(Gain) loss on derivative financial instruments	**$ 1.1**	$ 1.0	$ (1.4)	$ (12.7)	$ (17.3)	$ 12.4	$ 50.3	$ 21.4
Gain on sale of mill property	**$ -**	$ -	$ -	$ -	$ -	$ (37.8)	$ -	$ -
North Central Plywoods mill fire, net	**$ -**	$ -	$ -	$ -	$ 2.0	$ -	$ -	$ -
Asset impairments	**$ -**	$ -	$ -	$ -	$ -	$ -	$ 74.1	$ 56.9
Corporate income tax rate reductions	**$ -**	$ -	$ -	$ -	$ -	$ (7.3)	$ -	$ -
Other items	**$ -**	$ -	$ -	$ -	$ -	$ -	$ 0.2	$ -
Net impact of above items	**$ 10.1**	$ (5.2)	$ (7.2)	$ (32.3)	$ (35.0)	$ (23.6)	$ 176.8	$ 89.6
Adjusted net income (loss)	**$ 28.2**	$ 10.4	$ (24.2)	$ (37.5)	$ (24.5)	$ (82.4)	$ (53.0)	$ (4.6)
Shareholder net income (loss) per share (EPS), as reported	**$ 0.13**	$ 0.11	$ (0.12)	$ (0.04)	$ 0.07	$ (0.41)	$ (1.61)	$ (0.66)
Net impact of above items per share	**$ 0.07**	$ (0.04)	$ (0.05)	$ (0.22)	$ (0.24)	$ (0.17)	$ 1.24	$ 0.63
Adjusted net income (loss) per share	**$ 0.20**	$ 0.07	$ (0.17)	$ (0.26)	$ (0.17)	$ (0.58)	$ (0.37)	$ (0.03)

Canfor Corporation
Consolidated Balance Sheets

(millions of dollars, unaudited)		**As at June 30, 2010**		As at December 31, 2009
ASSETS				
Current Assets				
Cash and cash equivalents	**$**	**226.9**	$	133.4
Accounts receivable				
Trade		**178.3**		137.2
Other		**40.7**		41.9
Income taxes recoverable		**-**		45.5
Future income taxes, net		**8.8**		11.4
Inventories (Note 2)		**322.6**		311.3
Prepaid expenses		**44.7**		36.4
Total current assets		**822.0**		717.1
Long-term investments and other (Note 3)		**89.2**		93.7
Property, plant, equipment and timber		**1,648.4**		1,676.6
Goodwill		**74.5**		73.3
Deferred charges		**115.4**		117.1
	$	**2,749.5**	$	2,677.8
LIABILIITES				
Current Liabilities				
Operating loans (Note 4 (a))	**$**	**-**	$	0.6
Accounts payable and accrued liabilities		**253.0**		211.4
Current portion of long-term debt (Note 4 (b))		**88.0**		34.0
Current portion of deferred reforestation obligation		**27.7**		27.8
Total current liabilities		**368.7**		273.8
Long-term debt (Note 4 (b))		**252.6**		333.3
Long-term accrued liabilities and obligations (Note 5)		**215.2**		209.8
Future income taxes, net		**206.6**		200.8
	$	**1,043.1**	$	1,017.7
EQUITY				
Share capital – 142,623,347 common shares outstanding	**$**	**1,125.0**	$	1,124.7
Contributed surplus		**31.9**		31.9
Retained earnings		**279.9**		246.2
Accumulated other comprehensive income (loss)		**(12.3)**		(16.0)
Total equity attributable to shareholders of Company		**1,424.5**		1,386.8
Non-controlling interests (Note 1 (b))		**281.9**		273.3
Total equity	**$**	**1,706.4**	$	1,660.1
	$	**2,749.5**	$	2,677.8

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

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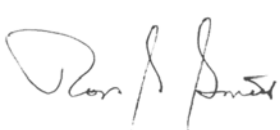
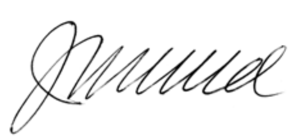


Director, R.S. Smith



Director, J.F. Shepard

Canfor Corporation
Consolidated Statements of Income (Loss)

(millions of dollars, unaudited)	3 months ended June 30, 2010	3 months ended June 30, 2009	6 months ended June 30, 2010	6 months ended June 30, 2009
Sales	**$ 634.7**	$ 530.3	**$ 1,212.6**	$ 1,005.0
Costs and expenses				
Manufacturing and product costs	**392.1**	373.6	**757.7**	804.1
Freight and other distribution costs	**109.3**	107.9	**210.5**	205.2
Export taxes	**8.4**	13.3	**20.0**	24.2
Amortization	**38.5**	38.5	**77.3**	78.1
Selling and administration costs	**16.6**	16.8	**32.7**	31.0
Restructuring, mill closure and severance costs	**5.8**	11.4	**11.4**	17.8
	570.7	561.5	**1,109.6**	1,160.4
Operating income (loss)	**64.0**	(31.2)	**103.0**	(155.4)
Interest expense, net	**(6.7)**	(7.0)	**(13.7)**	(15.3)
Foreign exchange gain (loss) on long-term debt and investments, net	**(12.8)**	29.1	**(4.0)**	16.2
Gain (loss) on derivative financial instruments (Note 12)	**(3.3)**	25.7	**(4.5)**	4.4
Gain on sale of mill property (Note 6)	**-**	-	**-**	44.6
North Central Plywoods mill fire, net (Note 7)	**-**	(3.0)	**-**	(3.0)
Other income (expense), net	**3.3**	(2.5)	**0.4**	-
Net income (loss) before income taxes	**44.5**	11.1	**81.2**	(108.5)
Income tax recovery (expense) (Note 9)	**(4.1)**	1.0	**(8.3)**	50.7
Net income (loss)	**$ 40.4**	$ 12.1	**$ 72.9**	$ (57.8)
Net income (loss) attributable to: (Note 1 (b))				
Equity shareholders of Company	**$ 18.1**	$ 10.5	**$ 33.7**	$ (48.3)
Non-controlling interests	**22.3**	1.6	**39.2**	(9.5)
	$ 40.4	$ 12.1	**$ 72.9**	$ (57.8)
Net income (loss) per common share: (in dollars) (Note 10)				
Attributable to equity shareholders of Company				
– Basic and Diluted	**$ 0.13**	$ 0.07	**$ 0.24**	$ (0.34)

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

Canfor Corporation
Consolidated Statements of Changes in Equity and Comprehensive Income (Loss)

(millions of dollars, unaudited)	3 months ended June 30, 2010	3 months ended June 30, 2009	6 months ended June 30, 2010	6 months ended June 30, 2009
Consolidated Statements of Changes in Equity				
Share capital				
Balance at beginning of period	**$ 1,124.7**	$ 1,124.7	**$ 1,124.7**	$ 1,124.7
Common shares issued on exercise of stock options	**0.3**	-	**0.3**	-
Balance at end of period	**$ 1,125.0**	$ 1,124.7	**$ 1,125.0**	$ 1,124.7
Contributed surplus				
Balance at beginning and end of period	**$ 31.9**	$ 31.9	**$ 31.9**	$ 31.9
Retained earnings				
Balance at beginning of period	**$ 261.8**	$ 257.9	**$ 246.2**	$ 316.7
Net income (loss) attributable to equity shareholders of Company for period	**18.1**	10.5	**33.7**	(48.3)
Balance at end of period	**$ 279.9**	$ 268.4	**$ 279.9**	$ 268.4
Accumulated other comprehensive income (loss)				
Balance at beginning of period	**$ (24.0)**	$ 24.6	**$ (16.0)**	$ 21.5
Net change in foreign exchange translation adjustment on self-sustaining foreign subsidiaries	**11.7**	(21.0)	**3.7**	(17.9)
Balance at end of period	**$ (12.3)**	$ 3.6	**$ (12.3)**	$ 3.6
Non-controlling interests (Note 1 (b))				
Balance at beginning of period	**$ 278.5**	$ 263.6	**$ 273.3**	$ 276.8
Net income (loss) attributable to non-controlling interests	**22.3**	1.6	**39.2**	(9.5)
Distributions to non-controlling interests	**(18.9)**	(1.6)	**(30.6)**	(3.7)
	$ 281.9	$ 263.6	**$ 281.9**	$ 263.6
Total equity – Balance at end of period	**$ 1,706.4**	$ 1,692.2	**$ 1,706.4**	$ 1,692.2
Consolidated Statement of Comprehensive Income (Loss)				
Net income (loss) for period	**$ 40.4**	$ 12.1	**$ 72.9**	$ (57.8)
Other comprehensive income (loss)				
Net change in foreign exchange translation adjustment on self-sustaining foreign subsidiaries	**11.7**	(21.0)	**3.7**	(17.9)
Total comprehensive income (loss)	**$ 52.1**	$ (8.9)	**$ 76.6**	$ (75.7)
Total comprehensive income (loss) attributable to: (Note 1 (b))				
Equity shareholders of Company	**$ 29.8**	$ (10.5)	**$ 37.4**	$ (66.2)
Non-controlling interests	**22.3**	1.6	**39.2**	(9.5)
	$ 52.1	$ (8.9)	**$ 76.6**	$ (75.7)

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

Canfor Corporation
Consolidated Cash Flow Statements

(millions of dollars, unaudited)	3 months ended June 30, 2010	3 months ended June 30, 2009	6 months ended June 30, 2010	6 months ended June 30, 2009
Cash generated from (used in)				
Operating activities				
Net income (loss) for period	**$ 40.4**	$ 12.1	**$ 72.9**	$ (57.8)
Items not affecting cash				
Amortization	**38.5**	38.5	**77.3**	78.1
Future income taxes	**4.1**	10.9	**8.5**	(17.8)
Long-term portion of deferred reforestation	**(10.4)**	(9.7)	**(1.8)**	(0.2)
Gain on sale of mill property (Note 6)	**-**	-	**-**	(44.6)
North Central Plywoods mill fire, net (Note 7)	**-**	3.0	**-**	3.0
Foreign exchange (gain) loss on long-term debt and investments, net	**12.8**	(29.1)	**4.0**	(16.2)
Changes in mark-to-market values of derivative financial instruments	**5.6**	(40.7)	**6.2**	(38.3)
Deferred maintenance amortization	**2.1**	0.6	**6.5**	1.5
Employee future benefits	**4.7**	3.0	**8.5**	6.3
Other, net	**1.9**	(6.3)	**1.8**	(1.5)
Salary pension plan contributions	**(1.5)**	(4.5)	**(3.2)**	(8.5)
Deferred scheduled maintenance spending	**(3.4)**	(2.6)	**(5.8)**	(2.6)
Net change in non-cash working capital (Note 11)	**77.1**	63.7	**12.9**	10.5
	171.9	38.9	**187.8**	(88.1)
Financing activities				
Repayment of long-term debt (Note 4 (b))	**-**	(75.8)	**(33.7)**	(175.5)
Increase (decrease) in operating bank loans	**(0.7)**	(1.8)	**(0.6)**	(9.3)
Cash distributions paid to non-controlling interests	**(16.1)**	(1.5)	**(27.3)**	(4.7)
Other	**0.3**	(0.1)	**0.3**	(0.1)
	(16.5)	(79.2)	**(61.3)**	(189.6)
Investing activities				
Additions to property, plant, equipment and timber	**(23.6)**	(7.5)	**(36.7)**	(26.3)
Proceeds from disposal of property, plant, equipment and timber	**0.3**	0.8	**0.5**	47.0
Proceeds from North Central Plywoods mill fire claim (Note 7)	**-**	33.3	**-**	33.3
Interest received for restructuring period of asset-backed commercial paper	**-**	1.0	**-**	4.5
Proceeds from redemption of asset-backed commercial paper	**0.9**	10.4	**2.6**	10.4
Other, net	**(0.5)**	(0.3)	**0.5**	(1.2)
	(22.9)	37.7	**(33.1)**	67.7
Foreign exchange gain (loss) on cash and cash equivalents of self - sustaining foreign operations	**0.3**	0.2	**0.1**	0.4
Increase (decrease) in cash and cash equivalents	**132.8**	(2.4)	**93.5**	(209.6)
Cash and cash equivalents at beginning of period	**94.1**	155.2	**133.4**	362.4
Cash and cash equivalents at end of period	**$ 226.9**	$ 152.8	**$ 226.9**	$ 152.8
Cash (payments) receipts in period				
Interest, net	**$ (5.1)**	$ (10.3)	**$ (12.9)**	$ (15.4)
Income taxes	**$ 16.9**	$ 17.6	**$ 45.6**	$ 48.3

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

Notes to the Consolidated Interim Financial Statements
(unaudited, in millions of dollars unless otherwise noted)

1. Significant Accounting Policies and Changes in Accounting Policies

(a) Basis of Presentation

These interim financial statements do not include all of the disclosures required by Canadian generally accepted accounting principles ("GAAP") for annual financial statements and, accordingly, should be read in conjunction with the financial statements and notes included in Canfor Corporation's ("Canfor" or "the Company") Annual Report for the year ended December 31, 2009 available at www.canfor.com or www.sedar.com. These interim financial statements follow the same accounting policies and methods of computation as used in the 2009 consolidated financial statements, except as noted below.

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

(b) Changes in Accounting Policies

The Canadian Institute of Chartered Accountants ("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 has adopted the new standards as of January 1, 2010.

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 will impact Canfor's financial statements should a business combination, such as a merger or an acquisition, occur 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 statements of income (loss), is comparable to the "Net income (loss)" reported in previous years. These changes have been applied retrospectively.

2. Inventories

(millions of dollars)	**As at June 30, 2010**	As at December 31, 2009
Logs	**$ 37.8**	$ 39.9
Finished products	**173.6**	164.7
Residual fibre	**28.6**	22.3
Processing materials and supplies	**82.6**	84.4
	$ 322.6	$ 311.3

The above inventory balances are stated after inventory write-downs from cost to net realizable value. Inventory write-downs at June 30, 2010 totaled $5.9 million (December 31, 2009 – $25.7 million).

3. Long-Term Investments and Other

(millions of dollars)		As at June 30, 2010		As at December 31, 2009
Non-bank asset-backed commercial paper ("ABCP")	**$**	**38.9**	$	41.1
Other investments		**26.2**		27.3
Customer agreements		**15.7**		16.8
Other deposits, loans and advances		**8.4**		8.5
	$	**89.2**	$	93.7

4. Operating Loans and Long-Term Debt

(a) Operating Loans

On a consolidated basis, at June 30, 2010, the Company had $444.3 million of unsecured operating loan facilities (December 31, 2009 – $445.6 million), of which nil was drawn down (December 31, 2009 – $0.6 million) and $17.8 million was reserved for several standby letters of credit (December 31, 2009 – $18.6 million). The Company also had a separate facility to cover a $16.0 million standby letter of credit at June 30, 2010 and December 31, 2009.

The Company's operating loan facilities include two facilities in the amounts of US$12.9 million ("Facility A") and US$32.5 million ("Facility B") at June 30, 2010. Facility A expires in January 2012, with the option of four one-year extensions, and is non-recourse to the Company under normal circumstances, except for an amount of US$6.7 million. Facility B expires in January 2011 and is 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 Limited Partnership ("CPLP"), the Company's bank operating lines at June 30, 2010 were $404.3 million (December 31, 2009 - $405.6 million) of which nil was drawn down (December 31, 2009 – $0.6 million) and $17.3 million (December 31, 2009 – $18.1 million) was reserved for several standby letters of credit, the majority of which relates to unregistered pension plans. Except for Facility A and Facility B, interest is payable at floating rates based on lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin that varies with the Company's net debt to total capitalization ratio. Facility A and Facility B have similar terms, except that their interest rate is plus or minus a margin. Other than Facility A and Facility B, substantially all of the bank operating lines expire in June 2011.

At June 30, 2010, CPLP had a $40.0 million bank credit facility (December 31, 2009 - $40.0 million) 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 (December 31, 2009 - $0.5 million). The terms of this financing include interest payable at floating rates that vary depending on the ratio of net debt to operating earnings before interest, taxes, depreciation, amortization and certain other non-cash items, and is based on lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin. In addition, CPLP has a separate facility with a maturity date of November 30, 2011, to cover a $16.0 million standby letter of credit issued to BC Hydro.

As at June 30, 2010, the Company was in compliance with all covenants relating to its operating lines of credit.

(b) Long-Term Debt

On March 1, 2010, the Company repaid $33.7 million (US$32.3 million) of privately placed senior notes with an interest rate of 8.03%.

At June 30, 2010, the fair value of the Company's long-term debt, which was measured at its amortized cost of $340.6 million, was $357.1 million. The fair value of long-term debt was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

5. Long-term Accrued Liabilities and Obligations

(millions of dollars)		As at June 30, 2010		As at December 31, 2009
Deferred reforestation obligation	**$**	**58.5**	$	60.3
Accrued pension obligations		**19.4**		19.6
Accrued pension bridge benefit obligations		**9.1**		9.1
Other post-employment benefits		**106.8**		103.5
Asset retirement obligations		**4.9**		4.8
Other		**16.5**		12.5
	$	**215.2**	$	209.8

6. Sale of Mill Property

In February 2009, the Company completed the sale of a property located in New Westminster, British Columbia, for net proceeds of $46.0 million. The property was the site of the Company's former Panel and Fibre operation, which was permanently closed at the beginning of 2008. The sale transaction resulted in a pre-tax gain of $44.6 million.

7. Settlement of North Central Plywoods Mill Fire Insurance Claim

In April 2009, the Company reached a final settlement of the North Central Plywoods mill fire claim for gross proceeds of $65.5 million, less a deductible of $2.2 million, for net proceeds of $63.3 million. The balance of the settlement proceeds of $33.3 million was received from the insurer in the second quarter of 2009. The final settlement resulted in a pre-tax loss of $8.8 million ($6.0 million after-tax) in the second quarter of 2009 of which $5.8 million was recorded to manufacturing and product costs and $3.0 million was recorded to North Central Plywoods mill fire, net. Under the terms of the settlement, there were no conditions attached to the use of the proceeds.

8. Employee Future Benefits Expense

	3 months ended June 30,				6 months ended June 30,			
(millions of dollars)		**2010**		2009		**2010**		2009
Defined benefit pension plans	**$**	**4.3**	$	3.5	**$**	**8.6**	$	7.0
Other employee future benefit plans		**3.3**		3.0		**6.6**		5.9
Defined contribution pension plans and 401(k) plans		**0.8**		0.9		**1.7**		1.8
Contributions to forest industry union plans		**3.6**		3.9		**7.3**		7.6
	$	**12.0**	$	11.3	**$**	**24.2**	$	22.3

9. Income Taxes

	3 months ended June 30,				6 months ended June 30,			
(millions of dollars)		**2010**		2009		**2010**		2009
Current	**$**	**-**	$	11.9	**$**	**0.2**	$	32.9
Future		**(4.1)**		(10.9)		**(8.5)**		17.8
Income tax recovery (expense)	**$**	**(4.1)**	$	1.0	**$**	**(8.3)**	$	50.7

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

(millions of dollars)	3 months ended June 30, **2010**	3 months ended June 30, 2009	6 months ended June 30, **2010**	6 months ended June 30, 2009
Income tax recovery (expense) at statutory rate 2010 - 28.5% (2009 - 30%)	**$ (12.6)**	$ (3.3)	**$ (23.1)**	$ 32.6
Add (deduct):				
Non-taxable income related to non-controlling interests in limited partnerships	**6.4**	0.4	**11.2**	(2.9)
Change in corporate income tax rates	**-**	-	**-**	7.3
Entities with different income tax rates and other tax adjustments	**(0.2)**	1.1	**(0.3)**	2.3
Tax recovery (expense) at rates other than statutory rate	**0.9**	(1.3)	**1.5**	3.1
Permanent difference from capital gains and losses and other non-deductible items	**1.4**	4.1	**2.4**	8.3
Income tax recovery (expense)	**$ (4.1)**	$ 1.0	**$ (8.3)**	$ 50.7

10. Net Income (Loss) Per Share

Basic net income (loss) per share is calculated by dividing the net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is calculated by dividing the net income (loss) available to common shareholders by the weighted average number of common shares during the period using the treasury stock method. Under this method, proceeds from the potential exercise of stock options are assumed to be used to purchase the Company's common shares. When there is a net loss, the exercise of stock options would result in a calculated diluted net loss per share that is anti-dilutive.

	3 months ended June 30, **2010**	3 months ended June 30, 2009	6 months ended June 30, **2010**	6 months ended June 30, 2009
Weighted average number of common shares	**142,605,632**	142,589,297	**142,597,510**	142,589,297
Incremental shares from potential exercise of options [a]	**5,021**	-	**3,371**	-
Diluted number of common shares [a]	**142,610,653**	142,589,297	**142,600,881**	142,589,297

[a] Where the addition of share options to the total shares outstanding has an anti-dilutive impact on the diluted net income (loss) per share calculation, those share options are not included in the total common shares outstanding for purposes of the calculation of diluted net income (loss) per share.

11. Net Change in Non-Cash Working Capital

(millions of dollars)	3 months ended June 30, **2010**	3 months ended June 30, 2009	6 months ended June 30, **2010**	6 months ended June 30, 2009
Accounts receivable	**$ (2.4)**	$ 5.4	**$ (40.4)**	$ (25.3)
Income taxes recoverable	**16.0**	4.0	**45.5**	15.3
Inventories	**78.1**	109.3	**(10.9)**	60.2
Prepaid expenses	**(7.9)**	(8.4)	**(8.3)**	(5.2)
Accounts payable, accrued liabilities and current portion of deferred reforestation obligation	**(6.7)**	(46.6)	**27.0**	(34.5)
Net (increase) decrease in working capital	**$ 77.1**	$ 63.7	**$ 12.9**	$ 10.5

12. Derivative Financial Instruments

The Company uses a variety of derivative financial instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, lumber prices and energy costs. At June 30, 2010, the fair value of derivative financial instruments was a net liability of $7.5 million (December 31, 2009 – net liability of $5.8 million). The fair value of these financial instruments was determined based on prevailing market rates for instruments with similar characteristics.

The following table summarizes the gain (loss) on derivative financial instruments for the three and six month periods ended June 30, 2010 and 2009:

(millions of dollars)	3 months ended June 30, **2010**	3 months ended June 30, 2009	6 months ended June 30, **2010**	6 months ended June 30, 2009
Foreign exchange collars and forward contracts	**$ (9.5)**	$ 27.3	**$ (3.7)**	$ 16.5
Natural gas swaps	**0.2**	(3.5)	**(3.5)**	(13.0)
Diesel options and swaps	**(1.0)**	2.4	**(0.6)**	1.0
Lumber futures	**7.0**	(0.5)	**3.3**	(0.1)
	$ (3.3)	$ 25.7	**$ (4.5)**	$ 4.4

The following table summarizes the fair value of the derivative financial instruments included in the balance sheet at June 30, 2010 and December 31, 2009:

(millions of dollars)	**As at June 30, 2010**	As at December 31, 2009
Foreign exchange collars and forward contracts	**$ (2.1)**	$ 1.6
Natural gas swaps	**(6.9)**	(6.8)
Diesel options and swaps	**(0.4)**	(0.9)
Lumber futures	**1.9**	0.3
	$ (7.5)	$ (5.8)
Less: current portion	**(6.2)**	(3.5)
Long-term portion	**$ (1.3)**	$ (2.3)

13. Segmented Information

Operating segments are reported in a manner consistent with the internal reporting provided to the Chief Executive Officer ("CEO") and the executive management team, who operate as Canfor's chief operating decision maker. The CEO and executive management team are responsible for allocating resources and assessing performance of the operating segments.

Canfor has two reportable segments, as described below, which offer different products and are managed separately because they require different production processes and marketing strategies. The following summary describes the operations of each of the Company's reportable segments:

- *Lumber* - Includes logging operations, and manufacture and sale of various grades and widths of lumber products.
- *Pulp and paper* – Includes purchase of residual fibre, and production and sale of pulp and paper products, including northern bleached softwood kraft ("NBSK") and bleached chemi-thermo mechanical pulp ("BCTMP"). This segment includes 100% of Canfor Pulp Limited Partnership and the Taylor Pulp mill.

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

Sales in the panels business (which does not meet the criteria to be a separate reportable segment) for the three months ended June 30, 2010 were $17.7 million (three months ended June 30, 2009 - $10.1 million) and $33.9 million for the six months ended June 30, 2010 (six months ended June 30, 2009 - $15.7 million).

(millions of dollars)	Lumber	Pulp & Paper	Unallocated & Other	Elimination Adjustment	Consolidated
3 months ended June 30, 2010					
Sales to external customers	**$ 336.9**	**280.1**	**17.7**	**-**	**$ 634.7**
Sales to other segments	**$ 34.3**	**-**	**-**	**(34.3)**	**$ -**
Operating income (loss)	**$ 17.0**	**54.5**	**(7.5)**	**-**	**$ 64.0**
Amortization	**$ 21.9**	**12.3**	**4.3**	**-**	**$ 38.5**
Capital expenditures	**$ 16.4**	**4.9**	**2.3**	**-**	**$ 23.6**
3 months ended June 30, 2009					
Sales to external customers	$ 287.8	232.4	10.1	-	$ 530.3
Sales to other segments	$ 28.2	-	-	(28.2)	$ -
Operating income (loss)	$ (12.0)	(6.8)	(12.4)	-	$ (31.2)
Amortization	$ 22.6	12.5	3.4	-	$ 38.5
Capital expenditures	$ 5.2	2.2	0.1	-	$ 7.5
6 months ended June 30, 2010					
Sales to external customers	**$ 628.9**	**549.8**	**33.9**	**-**	**$ 1,212.6**
Sales to other segments	**$ 69.8**	**-**	**-**	**(69.8)**	**$ -**
Operating income (loss)	**$ 28.8**	**88.4**	**(14.2)**	**-**	**$ 103.0**
Amortization	**$ 44.1**	**24.2**	**9.0**	**-**	**$ 77.3**
Capital expenditures	**$ 27.2**	**7.2**	**2.3**	**-**	**$ 36.7**
Identifiable assets	**$ 1,379.2**	**910.4**	**459.9**	**-**	**$ 2,749.5**
6 months ended June 30, 2009					
Sales to external customers	$ 551.6	437.7	15.7	-	$ 1,005.0
Sales to other segments	$ 57.1	-	0.1	(57.2)	$ -
Operating income (loss)	$ (104.3)	(24.1)	(27.0)	-	$ (155.4)
Amortization	$ 46.1	24.8	7.2	-	$ 78.1
Capital expenditures	$ 17.7	8.5	0.1	-	$ 26.3
Identifiable assets	$ 1,379.5	867.0	570.4	-	$ 2,816.9

Sales to external customers in the lumber segment include the following sales of lumber not produced by Canfor:

(millions of dollars)	3 months ended June 30, **2010**	3 months ended June 30, 2009	6 months ended June 30, **2010**	6 months ended June 30, 2009
Sales of lumber not produced by Canfor	**$ 42.9**	$ 45.4	**$ 87.1**	$ 91.9

Geographic Information

(millions of dollars)	3 months ended June 30, **2010**	3 months ended June 30, 2009	6 months ended June 30, **2010**	6 months ended June 30, 2009
Sales by location of customer				
Canada	**$ 73.5**	$ 69.3	**$ 148.6**	$ 137.1
United States	**315.8**	267.5	**593.7**	520.9
Asia	**181.7**	148.8	**343.8**	259.5
Europe	**54.1**	37.3	**105.4**	72.9
Other	**9.6**	7.4	**21.1**	14.6
	$ 634.7	$ 530.3	**$ 1,212.6**	$ 1,005.0

(millions of dollars)	**As at June 30, 2010**	As at December 31, 2009
Capital assets and goodwill by location		
Canada	**$ 1,571.0**	$ 1,598.1
United States	**151.7**	151.7
Asia and Other	**0.2**	0.1
	$ 1,722.9	$ 1,749.9

14. Comparative Figures

Certain comparative information has been reclassified to conform to the presentation in the current period.