

 Consolidated Financial  
Statements

December 31, 2009 and 2008



CANFOR  
CORPORATION

## MANAGEMENT'S RESPONSIBILITY

The information and representations in these consolidated financial statements are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements were prepared by management in accordance with accounting principles generally accepted in Canada and, where necessary, reflect management's best estimates and judgments at this time. It is reasonably possible that circumstances may arise which cause actual results to differ. Management does not believe it is likely that any differences will be material.

Canfor maintains systems of internal accounting controls, policies and procedures to provide reasonable assurance as to the reliability of the financial records and the safeguarding of its assets.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out these activities primarily through its Audit Committee.

The Audit Committee is comprised of three Directors who are not employees of the Company. The Committee meets periodically throughout the year with management, external auditors and internal auditors to review their respective responsibilities, results of the reviews of internal accounting controls, policies and procedures and financial reporting matters. The external and internal auditors meet separately with the Audit Committee.

The consolidated financial statements have been reviewed by the Audit Committee, which recommended their approval by the Board of Directors. The consolidated financial statements have been audited by PricewaterhouseCoopers LLP, the external auditors, whose report follows.

February 10, 2010

*"James F. Shepard"*

James F. Shepard  
President and  
Chief Executive Officer

*"Thomas Sitar"*

Thomas Sitar  
Vice-President Finance and  
Chief Financial Officer

## AUDITORS' REPORT

To the Shareholders of Canfor Corporation

We have audited the consolidated balance sheets of Canfor Corporation as at December 31, 2009 and 2008 and the consolidated statements of income (loss), changes in shareholders' equity and comprehensive income (loss) and cash flows for each of the years in the two year period ended December 31, 2009. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for each of the years in the two year period ended December 31, 2009 in accordance with Canadian generally accepted accounting principles.

*"PricewaterhouseCoopers LLP"*

PricewaterhouseCoopers LLP  
Chartered Accountants  
Vancouver, BC  
February 10, 2010

## Canfor Corporation Consolidated Balance Sheets

As at December 31 (millions of dollars)

	2009	2008
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 133.4	\$ 362.4
Accounts receivable		
Trade (Note 3)	137.2	105.9
Other	41.9	93.7
Income taxes recoverable	45.5	47.1
Future income taxes, net (Note 23)	11.4	31.2
Inventories (Note 4)	311.3	404.9
Prepaid expenses	36.4	35.1
<b>Total current assets</b>	<b>717.1</b>	<b>1,080.3</b>
<b>Long-term investments and other</b> (Note 5)	<b>93.7</b>	<b>125.7</b>
<b>Property, plant, equipment and timber</b> (Note 6)	<b>1,676.6</b>	<b>1,798.5</b>
<b>Goodwill</b>	<b>73.3</b>	<b>85.7</b>
<b>Deferred charges</b> (Note 7)	<b>117.1</b>	<b>110.2</b>
	<b>\$ 2,677.8</b>	<b>\$ 3,200.4</b>
<b>LIABILITIES</b>		
<b>Current Liabilities</b>		
Operating loans (Note 8)	\$ 0.6	\$ 25.2
Accounts payable and accrued liabilities (Note 9)	211.4	322.9
Current portion of long-term debt (Note 10)	34.0	168.3
Current portion of deferred reforestation obligation (Note 12)	27.8	32.5
<b>Total current liabilities</b>	<b>273.8</b>	<b>548.9</b>
<b>Long-term debt</b> (Note 10)	<b>333.3</b>	<b>428.7</b>
<b>Long-term accrued liabilities and obligations</b> (Note 11)	<b>209.8</b>	<b>208.8</b>
<b>Future income taxes, net</b> (Note 23)	<b>200.8</b>	<b>242.4</b>
<b>Non-controlling interests</b>	<b>273.3</b>	<b>276.8</b>
	<b>\$ 1,291.0</b>	<b>\$ 1,705.6</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 15)	\$ 1,124.7	\$ 1,124.7
Contributed surplus	31.9	31.9
Retained earnings	246.2	316.7
Accumulated other comprehensive income (loss)	(16.0)	21.5
	<b>\$ 1,386.8</b>	<b>\$ 1,494.8</b>
	<b>\$ 2,677.8</b>	<b>\$ 3,200.4</b>

### Commitments and contingencies (Note 31)

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

APPROVED BY THE BOARD

*"R.S. Smith"*

Director, R.S. Smith

*"J.F. Shepard"*

Director, J.F. Shepard

## Canfor Corporation

### Consolidated Statements of Income (Loss)

Years ended December 31 (millions of dollars)	2009		2008	
<b>Sales</b>	\$	<b>2,120.4</b>	\$	2,611.6
<b>Costs and expenses</b>				
Manufacturing and product costs		<b>1,633.0</b>		1,953.1
Freight and other distribution costs		<b>410.4</b>		476.2
Export taxes		<b>48.7</b>		55.1
Amortization		<b>155.3</b>		171.2
Selling and administration costs		<b>53.5</b>		60.6
Restructuring, mill closure and severance costs (Note 17)		<b>29.9</b>		53.5
		<b>2,330.8</b>		2,769.7
<b>Operating income (loss)</b>		<b>(210.4)</b>		(158.1)
Interest expense, net (Note 18)		<b>(29.3)</b>		(25.4)
Foreign exchange gain (loss) on long-term debt and investments, net		<b>50.4</b>		(100.3)
Gain (loss) on derivative financial instruments (Note 26)		<b>24.4</b>		(88.5)
Gain on sale of mill property (Note 19)		<b>44.6</b>		-
North Central Plywoods mill fire, net (Note 20)		<b>(3.0)</b>		57.9
Prince George Pulp and Paper mill fire, net		<b>-</b>		8.2
Asset impairments (Note 21)		<b>-</b>		(169.6)
Other income (expense), net (Note 22)		<b>(11.4)</b>		12.7
Net income (loss) before income taxes and non-controlling interests		<b>(134.7)</b>		(463.1)
Income tax recovery (Note 23)		<b>71.9</b>		141.9
Non-controlling interests		<b>(7.7)</b>		(24.0)
<b>Net income (loss)</b>	\$	<b>(70.5)</b>	\$	(345.2)
<b>Per common share</b> (in dollars) (Note 24)				
Net income (loss) – Basic and Diluted	\$	<b>(0.50)</b>	\$	(2.42)

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

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

As at December 31 (millions of dollars)

**2009**

**2008**

**Consolidated Statements of Changes in Shareholders' Equity**

**Share capital**

Balance at beginning and end of year (Note 15)	\$	1,124.7	\$	1,124.7
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**Contributed surplus**

Balance at beginning and end of year	\$	31.9	\$	31.9
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**Retained earnings**

Balance at beginning of year	\$	316.7	\$	692.5
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Change in accounting for inventories (Note 2)		-		(30.6)
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Net income (loss) for the year		(70.5)		(345.2)
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Balance at end of year	\$	246.2	\$	316.7
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**Accumulated other comprehensive income (loss)**

Balance at beginning of year	\$	21.5	\$	(32.0)
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Net change in foreign exchange translation adjustment on self-sustaining foreign subsidiaries		(37.6)		54.2
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Reclassification to income of losses on derivative instruments designated as cash flow hedges in prior years		0.1		(0.7)
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Balance at end of year	\$	(16.0)	\$	21.5
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**Total shareholders' equity – Balance at end of year**

	\$	1,386.8	\$	1,494.8
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**Consolidated Statement of Comprehensive Income (Loss)**

Net income (loss) for the year	\$	(70.5)	\$	(345.2)
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**Other comprehensive income (loss)**

Net change in foreign exchange translation adjustment on self-sustaining foreign subsidiaries		(37.6)		54.2
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Reclassification to income of losses on derivative instruments designated as cash flow hedges in prior years		0.1		(0.7)
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Other comprehensive income (loss)		(37.5)		53.5
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**Total comprehensive income (loss)**

	\$	(108.0)	\$	(291.7)
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The accompanying notes are an integral part of the consolidated financial statements.

## Canfor Corporation

### Consolidated Cash Flow Statements

Years ended December 31 (millions of dollars)	2009	2008
<b>Cash generated from (used in)</b>		
<b>Operating activities</b>		
Net income (loss) for year	\$ (70.5)	\$ (345.2)
Items not affecting cash:		
Amortization	155.3	171.2
Future income taxes	(22.5)	(94.0)
Long-term portion of deferred reforestation	(2.8)	(2.5)
Gain on sale of mill property (Note 19)	(44.6)	-
North Central Plywoods mill fire, net (Note 20)	3.0	(57.9)
Prince George Pulp & Paper mill fire, net	-	(8.2)
Foreign exchange (gain) loss on translation of long-term debt and investments, net	(50.4)	100.3
Changes in mark-to-market values of derivative financial instruments	(65.5)	79.3
Asset impairments (Note 21)	-	169.6
Employee future benefits	11.4	7.9
Non-controlling interests	7.7	24.0
Other, net	8.0	15.3
	(70.9)	59.8
Net proceeds from replacement of derivative financial instruments	-	11.0
Salary pension plan contributions	(16.4)	(15.9)
Deferred scheduled maintenance spending	(10.5)	(8.7)
Net change in non-cash working capital (Note 25)	29.2	105.6
	(68.6)	151.8
<b>Financing activities</b>		
Repayment of long-term debt (Note 10)	(175.5)	(14.8)
Increase (decrease) in operating loans (Note 8)	(24.6)	25.2
Cash distributions paid to non-controlling interests	(8.9)	(52.3)
Other, net	0.7	(0.5)
	(208.3)	(42.4)
<b>Investing activities</b>		
Additions to property, plant, equipment and timber	(59.0)	(80.2)
Proceeds from disposal of property, plant, equipment and timber	55.3	5.6
Proceeds from North Central Plywoods mill fire claim (Note 20)	33.3	30.0
Proceeds from Prince George Pulp & Paper mill fire claim	-	9.5
Advances to affiliated companies	-	(11.5)
Interest received for restructuring period of asset-backed commercial paper (Note 5)	4.5	-
Proceeds from redemption of asset-backed commercial paper (Note 5)	15.4	-
Other, net	0.1	(1.8)
	49.6	(48.4)
<b>Foreign exchange gain (loss) on cash and cash equivalents of self-sustaining foreign operations</b>	(1.7)	5.9
<b>Increase (decrease) in cash and cash equivalents</b>	(229.0)	66.9
<b>Cash and cash equivalents at beginning of year</b>	362.4	295.5
<b>Cash and cash equivalents at end of year</b>	\$ 133.4	\$ 362.4
<b>Cash receipts (payments) in the year</b>		
Interest, net	\$ (29.5)	\$ (26.6)
Income taxes	\$ 52.0	\$ 137.5

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

# CANFOR CORPORATION

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

### 1. Significant Accounting Policies

These consolidated financial statements of Canfor Corporation are expressed in Canadian dollars and are prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

#### *Basis of Consolidation*

The consolidated financial statements include the accounts of Canfor Corporation and its subsidiaries, hereinafter referred to as "Canfor" or "the Company". Significant subsidiaries include 100% of Canadian Forest Products Ltd., 100% of New South Companies Inc., and 50.2% of Canfor Pulp Limited Partnership ("CPLP"). Investments over which the Company exercises significant influence are accounted for using the equity method, in which the original investment is recorded at cost and is subsequently adjusted for Canfor's share of post-acquisition earnings. Joint ventures, which include Canfor-LP OSB Limited Partnership ("Canfor-LP OSB") and Coastal Fibre Limited Partnership ("CFLP") are proportionately consolidated (Note 28). Investments over which Canfor does not exercise significant influence are accounted for using the cost method, in which the original investment is recorded at cost and investment income distributions are recorded in the Consolidated Statements of Income (Loss).

#### *Use of Estimates*

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Canfor regularly reviews its estimates and assumptions, however, it is possible that circumstances may arise which cause actual results to differ from management estimates, and these differences could be material.

Significant areas requiring the use of management estimates are the allowance for doubtful accounts, income tax provisions, inventory valuations, amortization rates, deferred reforestation costs, asset retirement obligations, environmental remediation costs, provisions for insurance claims, pension and other benefit plan assumptions, and the valuation of goodwill, long-lived assets, and financial instruments, including investments and non-bank asset-backed commercial paper ("ABCP").

#### *Cash and Cash Equivalents*

Cash and cash equivalents include cash in bank accounts and highly liquid money market instruments with maturities of three months or less from the date of acquisition, and are valued at cost, which approximates market value. Interest is earned at variable rates dependent on amount, credit quality and term.

#### *Inventories*

Inventories are valued at the lower of average cost and net realizable value.

#### *Property, Plant, Equipment and Timber*

Costs of major replacements, extensions and improvements to plant and equipment are capitalized, together with related interest incurred on major projects during the construction period.

Property, plant, equipment and timber assets are amortized over the following estimated productive lives:

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Timber – renewable licenses	60 years
Buildings	5 to 50 years
Pulp and kraft paper machinery and equipment	20 years
Sawmill machinery and equipment	5 to 15 years
Plywood machinery and equipment	5 to 15 years
Oriented strand board machinery and equipment	10 to 20 years
Logging roads and bridges	5 to 25 years
Logging machinery and equipment	4 to 20 years
Mobile equipment	5 years

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Amortization of logging and manufacturing assets is calculated on a straight-line basis over the useful productive lives of those assets, based on available operating days.

Amounts capitalized as timber, which comprise tree farm licenses and timber licenses that are renewable with the Provinces of British Columbia and Alberta, are amortized over 60 years. Non-renewable licenses are amortized over the period of the license.

### ***Long-lived Assets***

Long-lived assets are reviewed for impairment when the occurrence of events or changes in circumstances indicate that the carrying value of the assets may not be recoverable, as measured by comparing their net book value to the estimated future cash flows generated by their use and eventual disposition. Impaired assets are recorded at the lower of carrying amount and fair value, determined principally using discounted future cash flows expected from their use and eventual disposition (see Note 21).

### ***Goodwill***

Goodwill is the excess of the purchase price paid for an acquisition of a business over the fair value of the net assets acquired. Goodwill, all of which is denominated in US dollars for Canfor, is not amortized but is assessed annually for impairment, or more frequently if events or circumstances indicate that it may be impaired. The fair value of goodwill is estimated in the same manner as goodwill is determined at the time of acquisition. There was no write-down to goodwill in 2009 or 2008.

### ***Deferred Reforestation Obligation***

Forestry legislation in British Columbia and Alberta requires Canfor to incur the cost of reforestation on its forest, timber and tree farm licenses. Accordingly, Canfor records the fair value of the costs of reforestation in the period in which the timber is cut, with the fair value of the liability determined with reference to the present value of estimated future cash flows using a credit adjusted risk free rate. In periods subsequent to the initial measurement, changes in the liability resulting from the passage of time and revisions to fair value calculations are recognized in the Consolidated Statements of Income (Loss) as they occur. These costs are included in manufacturing and product costs.

### ***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 becomes available 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 reasonably determinable.

### ***Asset Retirement Obligations***

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

### ***Employee Benefit Plans***

Canfor has various defined benefit and defined contribution plans that provide 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.



Canfor accrues the costs and related obligations of the defined benefit pension and other retirement benefit plans using the projected benefit actuarial method prorated on service, and management's best estimates of expected plan investment performance, salary escalation, and other relevant factors. For the purpose of calculating the expected return on plan assets, those assets are valued at fair value. Actuarial gains or losses arise from the difference between the actual and expected long-term rates of return on plan assets for a period or from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net accumulated actuarial gain or loss over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of the active employees. Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the average remaining service period of employees active at the date of the amendment. On January 1, 2000, Canfor adopted the new recommendations of the Canadian Institute of Chartered Accountants relating to the accounting for pensions and other post employment benefits using the prospective application method. Canfor is amortizing the transitional balance on a straight-line basis over the average remaining service period of employees expected to receive benefits under the benefit plan as of January 1, 2000.

Pension expense for the defined contribution plans is based on a percentage of employees' salaries or on a contribution required under collective agreements.

For hourly employees covered by forest industry union defined benefit pension plans, the expense is equal to its contributions required under the collective agreements.

### ***Revenue Recognition***

Canfor's revenues are derived from the following major product lines: lumber, pulp, kraft paper, panel products, residual fibre and logs. Revenue is recognized from product sales when persuasive evidence of a sale exists, the sales price is fixed and determinable, when title has transferred and collectability is reasonably assured. Sales are reported net of discounts, allowances and vendor rebates. Amounts charged to customers for shipping and handling are recognized as revenue, and shipping and handling costs incurred by Canfor are reported as a component of costs and expenses. Lumber export taxes are also recorded as a component of costs and expenses.

### ***Foreign Currency Translation***

The majority of Canfor's sales and long-term debt are denominated in foreign currencies. Foreign currencies, except in respect of Canfor's foreign operations, are translated into Canadian dollars using the temporal method as follows: monetary assets and liabilities at year-end exchange rates; non-monetary assets and liabilities at historical rates; and revenues and expenses at exchange rates prevailing at the time the transaction occurs. Exchange gains and losses are reflected in income immediately.

Canfor's foreign operations are considered to be self-sustaining and the assets and liabilities are translated using the current rate method. The translation gain or loss is included as a component of accumulated other comprehensive income (loss) in shareholders' equity. Canfor's self-sustaining foreign operations include New South Companies, Inc. and Canfor USA, both of which are wholly-owned subsidiaries based in the U.S.

### ***Income Taxes***

Canfor accounts for income taxes using the liability method. Under this method, future income tax assets and liabilities are determined based on the temporary differences between the accounting basis and the tax basis of assets and liabilities. Those temporary differences are measured using the current tax rates and laws expected to apply when the differences reverse. Future tax benefits, such as capital loss carry-forwards, are recognized to the extent that realization of such benefits is considered more likely than not. The effect on future tax assets and liabilities of a change in income tax rates is recognized in earnings in the period that the substantive enactment date of the change occurs.

### ***Financial Instruments***

All financial instruments and derivatives are measured at fair value on initial recognition except for certain related party transactions.

Canfor's cash and cash equivalents and ABCP are classified as held-for-trading and are measured at fair value subsequent to initial recognition. Accounts receivable are classified as loans and receivables and are measured at amortized cost. Operating loans, accounts payable and accrued liabilities, and long-term debt, including interest payable, are classified as other liabilities, all of which are measured at amortized cost.

Derivative instruments are recorded at fair value, including those derivatives that are embedded in financial or non-financial contracts that are not closely related to the host contract. Canfor utilizes derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange and commodity price risk. Canfor's policy is not to utilize derivative financial instruments for trading or speculative purposes.

The Company has chosen not to designate its derivative financial instruments as hedges. Consequently, such derivatives for which hedge accounting is not applied are carried on the Consolidated Balance Sheets at fair value, with changes in (realized and unrealized) fair value being recognized as 'Gain (loss) on derivative financial instruments' in the Consolidated Statements of Income (Loss).

Canfor reviews all assets, including financial instruments, for impairment when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

### ***Stock-based Compensation Plans***

Canfor has three stock-based compensation plans, as described in Note 16. No stock options have been granted since 2002.

Cash consideration received from employees when they exercise the options is credited to share capital. Compensation expense is recognized for Canfor's contributions to the Employee Share or Unit Purchase Plans when they are made.

Compensation expense is recognized for Canfor's Deferred Share Unit Plans when the deferred share units are granted, and changes in market value of the underlying shares are reflected in earnings at the end of each period.

### ***Major Maintenance Costs***

CPLP has adopted the deferral method of accounting for major maintenance costs. Under this method an asset is recorded when qualifying expenditures related to major maintenance are incurred. This asset is then amortized over the period to which the maintenance relates. CPLP has presented the related unamortized expenditures in prepaid expenses and long-term investments and other, as appropriate.

## **2. Changes in Accounting Policies**

### ***Current Year***

Effective January 1, 2009, the Company adopted the Canadian Institute of Chartered Accountants' ("CICA") new Handbook Section 3064 *Goodwill and Intangible Assets*. These requirements have been incorporated into the consolidated financial statements.

This Section replaced Section 3062 *Goodwill and Intangible Assets* and Section 3450 *Research and Development Costs*, and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. On adoption of this new Standard, EIC 27 *Revenues and Expenditures During the Pre-operating Period* was withdrawn and so various pre-production and start-up costs are required to be expensed as incurred. No material adjustments were required upon adoption of this new Standard.

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 used in estimating fair values. These disclosures have been included in Note 26.

### **Prior Year**

Effective January 1, 2008, Canfor adopted the CICA's new Handbook Sections: 1535 *Capital Disclosures*, 3031 *Inventories*, 3862 *Financial Instruments – Disclosures* and 3863 *Financial Instruments – Presentation*. These sections resulted in additional disclosures in the Company's financial statements. The revaluation of inventories on adoption of Section 3031 also resulted in a reduction of opening retained earnings for 2008 of \$30.6 million.

### **Future Changes in Accounting Policy**

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 expects to early adopt the new standards as of January 1, 2010.

Section 1582 will replace CICA Handbook Section 1581 *Business Combinations*, and will bring 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 will have a significant impact on the balance sheet and income statement of Canfor. The non-controlling interest on Canfor's balance sheet will be reclassified from long-term liabilities into equity, and the net income (loss) of non-controlling interests will no longer be deducted in arriving at the total net income (loss) of Canfor. As at December 31, 2009, the effect of applying the new Sections on Canfor's balance sheet would be to reduce long-term liabilities by \$273.3 million, and increase equity by the same amount.

### **3. Trade Accounts Receivable**

(millions of dollars)		2009		2008
Gross receivables	\$	139.3	\$	108.9
Less: Allowance for doubtful accounts		(2.1)		(3.0)
	\$	137.2	\$	105.9

### **4. Inventories**

(millions of dollars)		2009		2008
Logs	\$	39.9	\$	49.1
Finished products		164.7		238.1
Residual fibre		22.3		25.3
Processing materials and supplies		84.4		92.4
	\$	311.3	\$	404.9

The above inventory balances are stated after inventory write-downs from cost to net realizable value, which mostly reflect historically low prices for solid wood products at both reporting dates. The write-downs for the various components of inventory at December 31 were:

(millions of dollars)		2009		2008
Logs	\$	13.0	\$	16.2
Finished products		12.7		30.0
	\$	25.7	\$	46.2

## 5. Long-term Investments and Other

(millions of dollars)	2009		2008	
Non-bank asset-backed commercial paper	\$	41.1	\$	69.3
Other investments		27.3		28.9
Customer agreements		16.8		22.9
Other deposits, loans and advances		8.5		4.6
	\$	93.7	\$	125.7

The non-bank asset-backed commercial paper ("ABCP") of \$41.1 million (US\$39.2 million) is measured at the estimated fair value of Canfor's combined investments in asset-backed commercial paper of four different Canadian trusts with total original principal amount of US\$81.2 million and original maturities between August and September 2007.

In the first half of 2009, the Company received interest related to the restructuring period of its ABCP of \$4.5 million (US\$3.6 million) which was recorded as a reduction in its carrying value. Effective July 1, 2009, all interest received has been credited to the income statement (\$0.2 million for the second half of 2009). In addition, in 2009 the Company received proceeds of \$15.4 million (US\$13.4 million) from the partial redemption of its ABCP, which were also credited against its carrying value. The balance of the movement in the ABCP between December 31, 2008 and December 31, 2009 reflects the impact of the stronger Canadian dollar over the year.

## 6. Property, Plant, Equipment and Timber

(millions of dollars)	2009			2008		
	Cost	Accumulated Amortization and Impairments	Net Book Value	Cost	Accumulated Amortization and Impairments	Net Book Value
Land	\$ 42.0	\$ 4.8	\$ 37.2	\$ 45.2	\$ 4.8	\$ 40.4
Pulp and kraft paper mills	1,350.1	814.9	535.2	1,337.6	765.9	571.7
Sawmills, plywood and oriented strand board plants	1,257.5	788.3	469.2	1,289.4	756.2	533.2
Logging buildings and equipment	10.7	4.5	6.2	12.4	4.8	7.6
Logging roads and bridges	149.5	142.2	7.3	150.1	140.3	9.8
Other equipment and facilities	28.6	17.4	11.2	28.5	15.0	13.5
Timber	840.2	229.9	610.3	838.8	216.5	622.3
	\$ 3,678.6	\$ 2,002.0	\$ 1,676.6	\$ 3,702.0	\$ 1,903.5	\$ 1,798.5

Included in the above costs are assets under construction in the amount of \$10.2 million in 2009 (2008 – \$11.0 million), which were not amortized.

## 7. Deferred Charges

(millions of dollars)	2009		2008	
Prepaid pension benefits	\$	114.8	\$	104.7
Other		2.3		5.5
	\$	117.1	\$	110.2

## 8. Operating Loans

On a consolidated basis, at December 31, 2009, the Company had \$445.6 million of unsecured operating loan facilities (December 31, 2008 - \$432.0 million), of which \$0.6 million was drawn down (December 31, 2008 - \$25.2 million) and an additional \$18.6 million was reserved for several standby letters of credit (December 31, 2008 - \$41.4 million). The Company also had a separate facility to cover a \$16.0 million standby letter of credit at December 31, 2009.

The Company's operating loan facilities include two facilities in the amounts of US\$12.9 million ("Facility A") and US\$34.1 million ("Facility B") at December 31, 2009, which were negotiated in the first quarter of 2009. 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 were \$405.6 million (December 31, 2008 - \$357.0 million) of which \$0.6 million was drawn down (December 31, 2008 - nil) and \$18.1 million (December 31, 2008 - \$17.3 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.

On September 30, 2009 CPLP completed a new \$40.0 million bank credit facility with a maturity date of November 30, 2011, of which \$0.5 million was utilized at December 31, 2009 for standby letters of credit issued for general business purposes. In addition, CPLP has arranged 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. The general terms and conditions of the new 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.

As at December 31, 2009, and during 2009, the Company was in compliance with all covenants relating to its operating lines of credit.

## 9. Accounts Payable and Accrued Liabilities

(millions of dollars)	2009	2008
Trade payables	\$ 97.6	\$ 127.5
Accrued payroll and related liabilities	67.9	73.8
Derivative financial instruments	5.4	67.5
Restructuring, mill closure and severance costs	13.7	19.5
Interest payable	8.5	11.5
Other	18.3	23.1
	<b>\$ 211.4</b>	<b>\$ 322.9</b>

## 10. Long-term Debt

Canfor has the following long-term debt, all of which is unsecured:

### *Summary of Long-term Debt*

(millions of dollars)	2009	2008
Privately placed senior notes		
Canfor Corporation		
US\$45 million, interest at 7.98%, repayable March 1, 2009	\$ -	\$ 55.1
US\$97 million, interest at 8.03%, repayable in 3 equal annual installments commencing March 1, 2009	67.7	118.8
US\$60 million, interest at 5.66%, repayable April 1, 2009	-	73.5
US\$50 million, interest at 6.18%, repayable April 1, 2011	52.3	61.2
US\$50 million, interest at 6.33%, repayable February 2, 2012	52.3	61.2
US\$75 million, interest at 5.42%, repayable April 1, 2013	78.5	91.9
Canfor Pulp Limited Partnership		
US\$110 million, interest at 6.41%, repayable November 30, 2013	115.1	134.7
Other long-term obligations	1.4	0.6
	<b>367.3</b>	597.0
Less: current portion	<b>(34.0)</b>	(168.3)
	<b>\$ 333.3</b>	\$ 428.7

On March 2, 2009, the Company repaid \$99.7 million (US\$77.3 million) of privately placed senior notes (US\$45.0 million at 7.98% interest rate and US\$32.3 million at 8.03% interest rate). On April 1, 2009, the Company repaid \$75.8 million (US\$60.0 million) of 5.66% interest rate privately placed senior notes.

Canfor's debt agreements include a restriction on the distribution of the Company's retained earnings, with dividends restricted to an amount calculated under the terms of the debt agreements, and based upon earnings and dividends paid in previous periods.

### *Fair Value of Total Long-term Debt*

The fair value of total long-term debt at December 31, 2009 was \$377.4 million (2008 - \$578.1 million). The fair value was determined using prevailing market rates for long-term debt with similar characteristics and risk profiles.

### *Scheduled Long-term Debt Repayments and Interest Payments*

Long-term debt repayments and interest payments are payable in the next four years as follows:

(millions of dollars)	Debt repayments	Interest Payments
2010	\$ 34.0	\$ 21.4
2011	87.4	16.2
2012	52.3	11.9
2013	193.6	7.8
	<b>\$ 367.3</b>	<b>\$ 57.3</b>

## 11. Long-term Accrued Liabilities and Obligations

(millions of dollars)	2009	2008
Deferred reforestation obligation (Note 12)	\$ 60.3	\$ 63.1
Accrued pension obligations (Note 13)	19.6	20.0
Accrued pension bridge benefit obligations (Note 13)	9.1	8.7
Other post-employment benefits (Note 13)	103.5	98.3
Asset retirement obligations (Note 14)	4.8	4.7
Other	12.5	14.0
	\$ 209.8	\$ 208.8

## 12. Deferred Reforestation Obligation

The following table provides a reconciliation of the deferred reforestation obligation for the 2008 and 2009 years:

(millions of dollars)	2009	2008
Reforestation obligation – beginning of year	\$ 95.6	\$ 100.0
Expense for year	17.9	30.1
Accretion expense	3.4	3.6
Changes in estimated future reforestation expenditures	(6.1)	(8.5)
Paid during the year	(22.7)	(29.6)
Reforestation obligation – end of year	\$ 88.1	\$ 95.6
Less: current portion	(27.8)	(32.5)
Long-term portion (Note 11)	\$ 60.3	\$ 63.1

The total undiscounted amount of the estimated cash flows required to settle the obligation at December 31, 2009 was \$98.9 million (2008 - \$105.7 million) with payments spread over 16 years. The estimated cash flows have been adjusted for inflation and discounted using credit-adjusted risk-free rates ranging from 4% to 9%.

## 13. Employee Future Benefits

Canfor has several funded and unfunded defined benefit plans, as well as defined contribution plans, that provide pension, other retirement and post-employment benefits to substantially all salaried employees and certain hourly employees. The defined benefit plans are based on years of service and final average salary. Canfor's other post-employment benefit plans are non-contributory and include a range of health care and other benefits.

Total cash payments for employee future benefits for 2009 were \$47.5 million (2008 - \$50.3 million), consisting of cash contributed by Canfor to its funded pension plans, cash payments directly to beneficiaries for its unfunded other benefit plans, cash contributed to its defined contribution plans, and cash contributed to its forest industry union defined benefit plans.

### ***Defined Benefit Plans***

Canfor measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at September 30 of each year. In 2009, Canfor had six registered defined benefit plans, for which actuarial valuations are performed every three years. The most recent actuarial valuation for funding purposes of Canfor's single largest pension plan was as of December 31, 2006. The required plan valuation as of December 31, 2009 is currently being prepared.

Information about Canfor's defined benefit plans, in aggregate, is as follows:

### Defined Benefit Plan Assets

(millions of dollars)	2009		2008	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Fair market value of plan assets				
Beginning of year	\$ 476.8	\$ -	\$ 571.1	\$ -
Actual gain (loss) on plan assets	2.1	-	(76.5)	-
Canfor contributions	24.8	4.4	22.3	3.4
Employee contributions	0.9	-	1.1	-
Benefit payments	(39.2)	(4.4)	(38.7)	(3.4)
Net transfer out	(1.9)	-	-	-
Settlement of Taylor sawmill plan	-	-	(2.5)	-
End of year	\$ 463.5	\$ -	\$ 476.8	\$ -

Plan assets consist of the following:

	2009	2008
Asset category	Percentage of Plan Assets	
Equity securities	58%	61%
Debt securities	41%	38%
Other	1%	1%
	100%	100%

### Defined Benefit Plan Obligations

(millions of dollars)	2009		2008	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Accrued benefit obligation				
Beginning of year	\$ 510.6	\$ 103.6	\$ 570.2	\$ 146.7
Current service cost	10.1	1.5	13.3	2.6
Interest cost	32.8	6.9	31.2	8.1
Employee contributions	0.9	-	1.1	-
Benefit payments	(39.2)	(4.4)	(38.7)	(3.4)
Settlement of Taylor sawmill plan	-	-	(2.5)	-
Net transfer out	(1.9)	-	-	-
Plan amendments	-	(0.1)	-	-
Curtailment gain	-	(0.6)	-	-
Actuarial (gain) loss	17.0	11.4	(64.0)	(50.4)
End of year	\$ 530.3	\$ 118.3	\$ 510.6	\$ 103.6



**Reconciliation of the Funded Status of the Benefit Plans to the Amounts Recorded in the Financial Statements**

(millions of dollars)	2009		2008	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Fair market value of plan assets	\$ 463.5	\$ -	\$ 476.8	\$ -
Accrued benefit obligation	(530.3)	(118.3)	(510.6)	(103.6)
Funded status of plan – surplus (deficit)	(66.8)	(118.3)	(33.8)	(103.6)
Employer contributions after measurement date	6.2	1.1	7.2	1.1
Unamortized transitional amount	(13.8)	11.8	(17.5)	13.9
Unamortized past service costs	2.6	0.7	3.0	1.2
Unamortized net actuarial (gain) loss	169.0	1.2	128.6	(10.9)
Accrued benefit asset (liability)	97.2	(103.5)	87.5	(98.3)
Valuation allowance	(2.8)	-	(2.8)	-
Accrued benefit asset (liability), net of valuation allowance	\$ 94.4	\$ (103.5)	\$ 84.7	\$ (98.3)
The accrued benefits asset (liability) is included in Canfor's balance sheet as follows:				
Deferred charges	\$ 114.0	\$ -	\$ 104.7	\$ -
Long-term accrued liabilities and obligations (Note 11)	(19.6)	(103.5)	(20.0)	(98.3)
End of year	\$ 94.4	\$ (103.5)	\$ 84.7	\$ (98.3)

Excluded from the above tables are amounts relating to a defined benefit pension plan of New South Companies, Inc., which was curtailed in 2003, and Canfor USA. The accrued benefit assets of these plans at December 31, 2009 totaled \$0.8 million (2008 - \$0.3 million).

Included in the above pension and other benefit provisions and fair value of plan assets at year-end are the following amounts in respect of plans that are not fully funded:

(millions of dollars)	2009		2008	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Fair market value of plan assets	\$ 434.3	\$ -	\$ 395.2	\$ -
Accrued benefit obligation	(510.0)	(118.3)	(440.2)	(103.6)
End of year	\$ (75.7)	\$ (118.3)	\$ (45.0)	\$ (103.6)

Of the \$75.7 million of pension plan deficit at December 31, 2009, \$25.5 million relates to unregistered plans for which funding is not required (2008 - \$25.1 million). Unregistered pension liabilities at December 31, 2009 include \$12.9 million (2008 - \$12.7 million) which are secured by a letter of credit.

"Other benefit plans" are not funded, except when expenditures are incurred.

Canfor's expense for company-sponsored benefit plans is as follows:

(millions of dollars)	2009			2008		
	Incurring in Year	Matching Adjustments <sup>a</sup>	Recognized in Year	Incurring in Year	Matching Adjustments <sup>a</sup>	Recognized in Year
<b>Pension Benefit Plans</b>						
Current service cost	\$ 10.1	\$ -	\$ 10.1	\$ 13.3	\$ -	\$ 13.3
Interest cost	32.8	-	32.8	31.2	-	31.2
(Return) loss on plan assets	(2.1)	(32.2)	(34.3)	76.5	(117.4)	(40.9)
Settlement/Curtailment loss	-	-	-	0.3	-	0.3
Plan amendments	-	0.4	0.4	-	0.4	0.4
Actuarial (gain) loss	17.0	(8.3)	8.7	(64.0)	67.0	3.0
Valuation allowance provided against accrued benefit asset	-	-	-	-	0.3	0.3
Amortization of transitional asset	-	(3.7)	(3.7)	-	(3.7)	(3.7)
	\$ 57.8	\$ (43.8)	\$ 14.0	\$ 57.3	\$ (53.4)	\$ 3.9
<b>Other Benefit Plans</b>						
Current service cost	\$ 1.5	\$ -	\$ 1.5	\$ 2.6	\$ -	\$ 2.6
Interest cost	6.9	-	6.9	8.1	-	8.1
Plan amendments	(0.1)	0.4	0.3	-	0.1	0.1
Curtailment gain	(0.6)	-	(0.6)	-	-	-
Actuarial (gain) loss	11.4	(12.0)	(0.6)	(50.4)	52.6	2.2
Amortization of transitional obligation	-	2.1	2.1	-	2.0	2.0
	\$ 19.1	\$ (9.5)	\$ 9.6	\$ (39.7)	\$ 54.7	\$ 15.0

<sup>a</sup> Matching adjustments are accounting adjustments to allocate costs to different periods so as to recognize the long-term nature of employee future benefits.

Canfor also provides pension bridge benefits to certain eligible former employees. At December 31, 2009, the actuarially determined obligation for those benefits was \$15.9 million (2008 - \$15.4 million). The accrued benefit liability for those benefits at December 31, 2009 was \$9.1 million (2008 - \$8.7 million) (Note 11) and the related expense recognized in 2009 was \$1.7 million (2008 - \$2.2 million).

### Significant assumptions

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

(weighted average assumptions)	2009		2008	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Accrued benefit obligation as of December 31:				
Discount rate	6.25%	6.75%	6.60%	6.70%
Rate of compensation increase	3.00%	n/a	3.00%	n/a
Benefit costs for year ended December 31:				
Discount rate	6.60%	6.70%	5.60%	5.50%
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

(weighted average assumptions)	2009	2008
Initial health care cost trend rate	7.15%	5.83%
Ultimate health care trend rate	4.20%	4.40%
Year ultimate rate is reached	2029	2014

## Sensitivity analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the other benefit plans. A one percentage-point change in assumed health care cost trend rates would have the following effects for 2009:

	1% Increase	1% Decrease
Accrued benefit obligation	\$ 20.0	\$ 16.3
Total of service and interest cost	\$ 1.4	\$ 1.1

## Defined contribution and other plans

The total cost recognized in 2009 for Canfor's defined contribution plans was \$3.5 million (2008 - \$3.6 million).

Canfor contributes to various forest industry union defined benefit pension plans providing both pension and other retirement benefits. These plans are accounted for as defined contribution plans. Contributions to these plans, not included in the cost recognized for defined contribution plans above, amounted to \$14.5 million in 2009 (2008 - \$17.4 million).

## 14. Asset Retirement Obligations

(millions of dollars)	2009	2008
Balance, beginning of year	\$ 4.7	\$ 13.2
Accretion expense	0.3	0.4
Paid during the year	-	(1.2)
Gain on settlement	-	(0.9)
Change in estimate	(0.2)	(6.8)
Balance, end of year (Note 11)	\$ 4.8	\$ 4.7

Canfor's asset retirement obligations include \$3.0 million in relation to landfill closure costs at CPLP. These obligations represent estimated undiscounted future payments of \$40.6 million to remediate the landfills at the end of their useful lives. The payments are expected to occur at periods ranging from 32 to 40 years and have been discounted at rates from 5.8% to 6.3%.

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

It is possible that changes in future conditions in the near term could require a material change in the recognized amount of the asset retirement obligations.

## 15. Share Capital

Authorized:

10,000,000 preferred shares, with a par value of \$25 each

1,000,000,000 common shares without par value

Issued:

(millions of dollars, except number of shares)	2009		2008	
	Number of Shares	Amount	Number of Shares	Amount
Common shares, beginning and end of year	142,589,297	\$ 1,124.7	142,589,297	\$ 1,124.7

## 16. Stock-based Compensation

Canfor has three stock-based compensation plans, which are described below.

### *Stock Option Performance Plan*

The Company has a stock option performance plan pursuant to which stock options were granted to selected officers and senior managers. No new stock options were granted in 2009 or 2008. The stock option performance plan provided for the issuance of up to a maximum of 5.8 million common shares at an exercise price equal to the market price of the Company's common shares on the date of grant. However, there are various criteria that limit the amount of options exercisable during each option year within the option period. The options are for a term of ten years and vest equally over three years. All granted options have fully vested. A summary of the status of the plan as of December 31, 2009 and 2008, and changes during the years ending on those dates, is presented below:

	2009		2008	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding at the beginning of year	200,468	\$ 9.34	213,801	\$ 9.39
Expired	-	-	(13,333)	10.18
Outstanding at the end of the year	200,468	\$ 9.34	200,468	\$ 9.34

The following table summarizes information about stock options outstanding at December 31, 2009:

	Options outstanding			Options exercisable	
Range of Exercise Prices	Number of Options Outstanding	Weighted Average Remaining Life (years)	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Exercise Price
\$8.30	63,800	1.1	\$ 8.30	63,800	\$ 8.30
\$9.80 to \$10.10	136,668	2.1	9.82	136,668	9.82
Outstanding at the end of the year	200,468	1.8	\$ 9.34	200,468	\$ 9.34

### *Employee Share and Unit Purchase Plans*

The Company has a share purchase plan, which is available to all employees, other than CPLP and New South employees. Purchases of common shares under this plan occur on the open market. Under the plan, employees can purchase up to 10% of their base salary or wage. Up to June 2007, the Company matched 30% of the first 5% of the amount contributed by the employee and paid the plan's brokerage fees. During 2009 and 2008, the Company has not made any contributions towards the purchase of its shares under the plan.

CPLP has a unit purchase plan, which is available to all CPLP employees. Purchases of Canfor Pulp Income Fund units under this plan occur on the open market. Under the plan the employees can purchase up to 10% of their base salary or wage. CPLP matches 30% of the first 5% of the amount contributed by the employee and pays the plan's brokerage fees. In 2009, CPLP made contributions of \$0.6 million towards the purchase of the units of Canfor Pulp Income Fund under the plan (2008 - \$0.6 million).

### *Deferred Share Unit Plans*

On January 1, 2002, the Company implemented a Deferred Share Unit Plan for non-employee directors of the Company. A Deferred Share Unit ("DSU") is a right granted to a non-employee director to receive one common share of the Company, purchased on the open market, or the cash equivalent, on a deferred payment basis. The maximum number of DSUs outstanding under the plan is 1,000,000, and currently each non-employee director is entitled to 2,500 DSUs per year. The value of the DSUs, when redeemed, is equal to the market value of the shares on the redemption date, including the value of dividends paid on the Company's common shares, if any, as if they had been reinvested in additional DSUs on each payment date. The DSUs may only be redeemed upon a director's retirement from the Company. The value of the outstanding DSUs at December 31, 2009 was \$0.8 million (2008 - \$0.7 million).

In May 2007, the Company implemented a Deferred Share Unit Plan (the "CEO Plan") for the Company's President and Chief Executive Officer ("CEO"). Pursuant to the terms of the plan, the CEO receives his annual salary in DSU units, which are allocated on a monthly basis. The value of the DSUs when redeemed will be equal to the market value of the shares on the redemption date, including the value of dividends paid on the Company's common shares, if any, as if they had been reinvested in additional DSUs on each payment date. The DSUs under the CEO Plan may only be redeemed on the date the CEO ceases, for whatever reason, to be employed by the Company. The value of the outstanding CEO DSUs at December 31, 2009 was \$1.4 million (2008 - \$0.7 million).

## 17. Restructuring, Mill Closure and Severance Costs

Restructuring, mill closure and severance costs represent costs associated with the indefinite or permanent closures of facilities and staff reductions. The expense for the year ended December 31, 2009 amounted to \$29.9 million (2008 - \$53.5 million) and substantially resulted from the indefinite closures of the Radium, Rustad and Vavenby sawmills, as well as the on-going closure costs of the Company's PolarBoard and Tackama panels operations.

The following table provides a breakdown of the restructuring, mill closure and severance costs by business segment:

(millions of dollars)	<b>2009</b>		2008	
Lumber	\$	<b>20.9</b>	\$	18.7
Unallocated and Other		<b>9.0</b>		34.8
	\$	<b>29.9</b>	\$	53.5

The following table provides a reconciliation of the restructuring, mill closure and severance liability for the 2008 and 2009 years:

(millions of dollars)	<b>2009</b>		2008	
Accrued liability at beginning of year	\$	<b>23.3</b>	\$	29.8
Costs accrued in the year <sup>a</sup>		<b>29.9</b>		39.8
Paid during the year		<b>(34.1)</b>		(46.3)
Accrued liability at end of year	\$	<b>19.1</b>	\$	23.3

<sup>a</sup> Excluding non-cash expenses and recoveries related to provisions for capital asset and inventory write-downs resulting from indefinite and permanent mill closures.

## 18. Interest Income (Expense)

(millions of dollars)	<b>2009</b>		2008	
Interest expense	\$	<b>(33.3)</b>	\$	(38.7)
Less: Interest income		<b>4.0</b>		13.3
Interest expense, net	\$	<b>(29.3)</b>	\$	(25.4)

Interest expense, net is comprised of:

(millions of dollars)	<b>2009</b>		2008	
Short-term interest income (expense), net	\$	<b>(1.6)</b>	\$	9.5
Long-term interest income (expense), net		<b>(27.7)</b>		(34.9)
Interest expense, net	\$	<b>(29.3)</b>	\$	(25.4)

For the year ended December 31, 2009, short-term interest expense, net is comprised of interest expense on operating loans and letter of credit charges of \$5.3 million (2008 - \$3.7 million), offset by interest income on cash and cash equivalents and other receivables of \$3.7 million (2008 - \$13.2 million). Long-term interest expense, net relates substantially to interest expense on long-term debt.

## 19. 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.

## **20. 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 Company received cash advances of \$30.0 million from its insurer in 2008 and the remaining amount of \$33.3 million in the second quarter of 2009. The final settlement resulted in a pre-tax loss of \$8.8 million 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 are no conditions attached to the use of the proceeds.

## **21. Asset Impairments**

### ***Capital Assets***

Canfor reviews the carrying values of its long-lived assets on a regular basis as events or changes in circumstances may warrant. Where the carrying value of assets is not expected to be recoverable from future cash flows, they are written down to fair value. A review of the carrying values of Canfor's sawmill and panelboard operations and various other assets was undertaken in 2008 and 2009 as a result of operating losses in both years and difficult market conditions.

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

Estimates of future cash flows used to test the recoverability of Canfor's long-lived assets generally include key assumptions related to forecast prices and exchange rates. Other significant assumptions are the estimated useful life of the long-lived assets, and the impacts of both the 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 Resource Information Systems, Inc. publications.

As a result of its review, no impairment charges were recorded in relation to Canfor's capital assets in 2009 (2008 – \$77.2 million).

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

Canfor holds a 49.99% interest in Howe Sound Pulp and Paper Limited Partnership ("HSLP") and a 50% interest in Coastal Fibre Limited Partnership ("CFLP"), an entity which supplied chips and logs and related services to HSLP. An impairment charge on assets related to HSLP and CFLP of \$70.0 million was recorded in 2008, reflecting fair value based on estimated future cash flows. No such impairments were recorded in 2009.

### ***Non-Bank Asset-Backed Commercial Paper***

In 2008, an impairment of \$10.2 million (US\$ 8.4 million) was recorded in relation to the Company's investment in non-bank asset-backed commercial paper ("ABCP"). These investments had failed to make payment on maturity and were subject to a restructuring plan, which was completed in January, 2009. The ABCP was impaired to estimated fair value at December 31, 2008. No further impairments have been recorded in 2009.

### ***Other***

An amount of \$12.2 million was recognized for the year ended December 31, 2008 in relation to other investments and spare parts inventory at indefinitely idled operations.

## 22. Other Income (Expense)

(millions of dollars)	2009		2008	
Foreign exchange gain (loss) on translation of working capital	\$	(11.4)	\$	17.3
Sawmill fire-related costs		(3.4)		-
Gain on sale of surplus property		4.7		-
Other, net		(1.3)		(4.6)
	\$	(11.4)	\$	12.7

## 23. Income Taxes

The tax effects of the significant components of temporary differences that give rise to future income tax assets and liabilities are as follows:

(millions of dollars)	2009		2008	
	Current	Long-term	Current	Long-term
Future income tax assets				
Accruals not currently deductible	\$ 12.4	\$ 18.6	\$ 23.2	\$ 22.9
Derivative financial instruments	0.7	0.4	21.2	1.0
Non-capital loss carryforwards <sup>a</sup>	-	34.6	-	18.4
Investments	-	1.5	0.2	2.5
Post employment benefits	-	27.1	-	27.5
Other	-	6.8	0.2	8.4
	\$ 13.1	\$ 89.0	\$ 44.8	\$ 80.7
Future income tax liabilities				
Depreciable capital assets	\$ -	\$ (244.9)	\$ -	\$ (270.8)
Deferred pension and other costs	-	(33.1)	-	(33.2)
Unrealized foreign exchange gains on debt	(1.7)	(8.2)	-	(7.1)
Income from limited partnerships	-	-	(13.2)	-
Other	-	(3.6)	(0.4)	(12.0)
	\$ (1.7)	\$ (289.8)	\$ (13.6)	\$ (323.1)
Future income taxes, net	\$ 11.4	\$ (200.8)	\$ 31.2	\$ (242.4)

<sup>a</sup> Non-capital loss carryforwards expire on dates between 2027 and 2029.

The components of income tax recovery are as follows:

(millions of dollars)	2009		2008	
Current	\$	49.4	\$	47.9
Future		22.5		94.0
	\$	71.9	\$	141.9

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

(millions of dollars)	2009		2008	
Net loss before income taxes and non-controlling interests	\$	(134.7)	\$	(463.1)
Income tax recovery at statutory tax rate	\$	40.4	\$	143.6
Add (deduct):				
Non-controlling interests		2.3		7.4
Change in corporate income tax rates		7.3		9.1
Entities with different income tax rates and other tax adjustments		2.9		4.4
Tax recovery at rates other than statutory rate		2.8		3.5
Permanent difference from capital gains and losses and other non-deductible items		16.2		(26.1)
Income tax recovery	\$	71.9	\$	141.9

## 24. 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 Canfor'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.

	2009	2008
Weighted average number of common shares	142,589,297	142,589,297
Incremental shares from potential exercise of stock options <sup>a</sup>	-	1,778
Diluted number of common shares <sup>a</sup>	142,589,297	142,589,297

<sup>a</sup> 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 have not been included in the total common shares outstanding for purposes of the calculation of diluted net income (loss) per share.

## 25. Net Change in Non-Cash Working Capital

(millions of dollars)	2009	2008
Accounts receivable	\$ (24.7)	\$ 89.6
Income taxes recoverable	1.6	89.6
Inventories	89.7	2.9
Prepaid expenses	(1.5)	(0.6)
Accounts payable, accrued liabilities and current portion of deferred reforestation obligation	(35.9)	(75.9)
Net (increase) decrease in working capital	\$ 29.2	\$ 105.6

## 26. Financial Instruments

### *Classification and Measurement of Financial Instruments*

Canfor's accounts receivable, other deposits, loans and advances, operating loans, accounts payable and accrued liabilities, and long-term debt are measured at amortized cost subsequent to initial recognition.

Cash and cash equivalents, ABCP and derivative instruments are measured at fair value. CICA Handbook Section 3862 *Financial Instruments – Disclosures* requires classification of these items within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly;

Level 3 – Inputs that are not based on observable market data.



The following table summarizes Canfor's financial instruments at December 31, 2008 and 2009, and shows the level within the fair value hierarchy in which they have been classified (for financial instruments measured at fair value):

(millions of dollars)	Fair Value Hierarchy Level	2009	2008
<b>Financial assets</b>			
Held for trading			
Cash and cash equivalents	Level 1	\$ 133.4	\$ 362.4
ABCP	Level 2	41.1	69.3
Derivative financial instruments	Level 2	1.9	2.1
Loans and receivables			
Accounts receivable	n/a	179.1	199.6
Other deposits, loans and advances	n/a	8.5	4.6
Available for sale			
Cost-accounted investments in other entities	n/a	27.3	28.9
		<b>\$ 391.3</b>	<b>\$ 666.9</b>
<b>Financial liabilities</b>			
Held for trading			
Derivative financial instruments	Level 2	\$ 7.7	\$ 71.4
Other liabilities			
Operating loans	n/a	0.6	25.2
Accounts payable and accrued liabilities (excluding derivatives)	n/a	206.0	255.4
Long-term debt	n/a	367.3	597.0
		<b>\$ 581.6</b>	<b>\$ 949.0</b>

### ***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 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. The cash and cash equivalents balance at December 31, 2009 is \$133.4 million.

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, 2009 is \$137.2 million, net of an allowance for doubtful accounts of \$2.1 million. At December 31, 2009, approximately 97% 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, 2009, Canfor has operating loans of \$0.6 million, accounts payable and accrued liabilities of \$211.4 million and current debt obligations of \$34.0 million (US\$32.3 million), all of which fall due for payment within one year of the balance sheet date.

(c) *Market risk:*

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

(i) Interest Rate risk:

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

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

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

(ii) Currency risk:

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

An increase (decrease) in the value of the Canadian dollar by US\$0.01 would result in a pre-tax: (i) loss (gain) of approximately \$0.5 million in relation to working capital balances denominated in US dollars at year end (including cash, accounts receivable and accounts payable); (ii) loss (gain) of approximately \$0.4 million in relation to the ABCP denominated in US dollars at year end; (iii) gain (loss) of approximately \$3.2 million in relation to long-term debt denominated in US dollars at year end.

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 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.

Canfor had the following foreign exchange derivatives at December 31, 2009 and 2008:

	2009		2008	
	Notional Amount	Exchange Rates	Notional Amount	Exchange Rates
<b>US dollar collars</b>	(millions of US dollars)	(protection / topside, per dollar)	(millions of US dollars)	(protection / topside, per dollar)
<i>0-12 months</i>				
US Dollar Collars	\$ 12.0	\$ 1.0500 / \$ 1.2200	\$ 397.0	\$ 0.9800 / \$ 1.1328
<b>US dollar forward sales contracts</b>	(millions of US dollars)	(range of rates, per dollar)	(millions of US dollars)	(range of rates, per dollar)
<i>0-12 months</i>				
US Dollar Forward Contracts	\$ 86.0	\$ 1.0302 - \$ 1.0723	\$ 95.8	\$ 1.1963 - \$ 1.2618

An increase (decrease) in the value of the Canadian dollar by US\$0.01 would result in a pre-tax gain (loss) of approximately \$0.9 million in relation to the foreign exchange forward contracts held at year end.

(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, Canfor uses heating oil contracts to hedge its exposure.

Canfor had the following energy derivatives at December 31, 2009 and 2008:

	2009		2008	
	Notional Amount	Average Rate	Notional Amount	Average Rate
<b>Natural Gas</b>	(millions of gigajoules)	(dollars per gigajoule)	(millions of gigajoules)	(dollars per gigajoule)
Floating to fixed swap				
0 – 12 months	2.1	\$ 7.53	4.2	\$ 7.58
13 – 36 months	1.1	\$ 8.04	2.7	\$ 7.76
<b>Diesel</b>	(millions of gallons)	(dollars per gallon)	(millions of gallons)	(dollars per gallon)
Floating to fixed swap				
0 – 12 months	1.8	\$2.49	5.3	\$ 2.76
13 – 36 months	0.2	\$2.12	1.2	\$ 2.70
Call option				
0 – 12 months	-	-	3.0	\$ 3.55

An increase (decrease) in the market price of natural gas of \$0.10 per gigajoule would result in a pre-tax gain (loss) of approximately \$0.3 million in relation to the natural gas swaps held at year end.

An increase (decrease) in the market price of diesel of \$0.10 per gallon would result in a pre-tax gain (loss) of approximately \$0.2 million in relation to the diesel swaps held at year end.

(iv) Commodity Price risk:

Canfor is exposed to commodity price risk related to 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.

	2009		2008	
	Notional Amount	Average Rate	Notional Amount	Average Rate
<b>Lumber</b>	(MMfbm)	(US dollars per Mfbm)	(MMfbm)	(US dollars per Mfbm)
Future sales contracts				
0 – 12 months	55.8	\$ 242.30	-	-

An increase (decrease) in the futures market price of lumber of US\$10 per Mfbm would result in a pre-tax loss (gain) of approximately \$0.6 million in relation to the lumber futures held at year end.

**Derivative Instruments**

Canfor 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 December 31, 2009, the fair value of outstanding commodity and exchange financial instruments was a net liability of \$5.8 million (2008 - net liability of \$69.3 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 years ended December 31, 2009 and 2008:

(millions of dollars)	2009	2008
Foreign exchange collars and forward contracts	\$ 36.0	\$ (86.1)
Natural gas swaps	(16.0)	1.0
Diesel options and swaps	1.6	(3.4)
Lumber futures	2.8	-
Gain (loss) on derivative financial instruments	\$ 24.4	\$ (88.5)

The following table summarizes the fair market value of the derivative financial instruments included in the balance sheet at December 31, 2009 and 2008:

(millions of dollars)	2009	2008
Foreign exchange collars and forward contracts	\$ 1.6	\$ (53.2)
Natural gas swaps	(6.8)	(6.5)
Diesel options and swaps	(0.9)	(9.6)
Lumber futures	0.3	-
	\$ (5.8)	\$ (69.3)
Less: current portion	(3.5)	(67.5)
Long-term portion	\$ (2.3)	\$ (1.8)

## 27. Related Party Transactions

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

### *Howe Sound Pulp and Paper Limited Partnership*

Howe Sound Pulp and Paper Limited Partnership ("HSLP") is jointly owned by Canfor and Oji Paper Co. Ltd. ("Oji") and operates a kraft pulp and newsprint mill at Port Mellon, British Columbia.

At December 31, 2009, Canfor recorded a total net receivable from HSLP, after impairments, of \$21.2 million (2008 - \$11.3 million). Canfor's transactions with HSLP during 2008 and 2009, as well as various receivable balances that are included in this net receivable balance, are set out below:

- (a) Under a long-term fibre agreement with Western Forest Products Inc., CFLP purchases chips and logs for resale to HSLP at CFLP's cost. In 2009, these purchases totaled \$9.8 million and \$11.2 million respectively (2008 - \$18.5 million, \$21.8 million) and the balance receivable at December 31, 2009 was \$21.3 million (2008 - \$19.1 million). CFLP charges HSLP a commission for this service, which amounted to \$0.1 million in 2009 (2008 - \$0.3 million) and at December 31, 2009, there was a balance receivable of \$0.9 million (2008 - \$0.8 million). These amounts have been proportionately consolidated in Canfor's financial statements.
- (b) Canfor and Oji, the partners of HSLP, and HSLP have a prepayment agreement whereby the partners prepay HSLP in advance of the due date for receivables for pulp marketed, or to be marketed, and collected on their behalf. Canfor charges a market rate of interest to HSLP for the period paid in advance and the prepayment is partially covered by the assignment of current or future accounts receivable. The agreement provides for Canfor and Oji to prepay up to a maximum amount of \$60.0 million each, which is used as short-term operating funds by HSLP. Canfor, through CPLP, markets the pulp production of HSLP for which it receives commissions under the terms of its agency sales agreement. Canfor provides management, fibre supply and other services to HSLP at cost. At December 31, 2009, Canfor has a balance of \$41.4 million owing from HSLP (2008 - \$31.4 million).

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

The transactions with HSLP in 2009 and 2008 are summarized below:

(millions of dollars)	<b>2009</b>		2008	
Chips purchased for resale to HSLP by CFLP (Canfor's portion)	\$	4.9	\$	9.3
Pulp logs purchased for resale to HSLP by CFLP (Canfor's portion)		5.6		10.9
Interest		1.0		3.1
Commission earned from marketing of HSLP pulp		2.4		2.6
Other		0.3		0.3
	\$	14.2	\$	26.2

### ***Other Related Parties***

Canfor purchases chips and lumber from Lakeland Mills Ltd. and Winton Global Lumber Ltd., in which Canfor has a 33.3% interest. In 2009, Canfor purchased \$3.9 million in chips and \$0.9 million in lumber (2008 - \$6.0 million and \$1.5 million respectively). The balance outstanding at December 31, 2009 was \$0.4 million (2008 - \$0.2 million).

In 2009, shipping services provided by Seaboard International Shipping Company ("Seaboard"), in which Canfor has a 20% interest, amounted to \$0.6 million (2008 - \$3.4 million). There was no balance outstanding at December 31, 2009 or 2008. In addition, the Seaboard General Partnership, which owns Seaboard, declared a cash distribution to its partners during 2009, of which Canfor's share was \$2.9 million.

On December 29, 2009 Canfor received a loan of \$1.1 million from the Seaboard General Partnership by way of a demand, non-interest bearing promissory note payable on or before January 4, 2010. On January 4, 2010, Seaboard General Partnership declared an income distribution to its partners of which Canfor's share was \$1.1 million. The distribution was received by way of offset against the non-interest bearing promissory note of the same amount.

Louisiana-Pacific Canada Ltd. performs the sales and receivable functions for Peace Valley OSB, an oriented strand board mill located in Fort St. John, British Columbia (Note 28). In 2009, Louisiana-Pacific Canada Ltd. sold \$79.0 million of Peace Valley OSB inventory (2008 - \$110.7 million). Louisiana-Pacific Canada Ltd. charges a fee for this service, which amounted to \$2.6 million in 2009 (2008 - \$3.1 million). There was a net receivable from Louisiana-Pacific Canada Ltd. of \$0.4 million at December 31, 2009 (2008 - net payable of \$0.1 million). These amounts have been proportionately consolidated in Canfor's financial statements.

## **28. Joint Ventures**

### ***Canfor-Louisiana Pacific OSB Limited Partnership***

Canfor and Louisiana-Pacific Canada Ltd. jointly own Peace Valley OSB ("Canfor-LP OSB"), a limited partnership. Canfor has agreed to supply 330,000 cubic metres of timber annually to the joint venture from its existing timber tenure in the area where the mill is located. In 2009, Canfor made capital contributions of \$0.8 million to Canfor-LP OSB (2008 - \$3.5 million).

The following balances, which represent Canfor's 50% ownership interest in Canfor-LP OSB, have been proportionately consolidated in Canfor's consolidated financial statements:

(millions of dollars)	2009		2008	
<b>Balance sheet</b>				
Cash	\$	2.2	\$	2.8
Other current assets		3.0		3.0
Property, plant and equipment		99.4		106.5
Accounts payable and accrued liabilities		(2.9)		(3.6)
Net assets	\$	101.7	\$	108.7
<b>Statement of income (loss)</b>				
Sales	\$	38.9	\$	54.8
Costs and expenses		(46.7)		(69.1)
Net loss	\$	(7.8)	\$	(14.3)
<b>Cash flow statement</b>				
Cash from (used in) operating activities	\$	(1.3)	\$	(3.5)
Cash from (used in) investing activities		0.7		3.1
Net decrease in cash	\$	(0.6)	\$	(0.4)

### ***Coastal Fibre Limited Partnership***

In March 2006, Canfor completed the transfer of its Englewood logging operation and associated timber licenses ("Englewood operations") to a new limited partnership, Coastal Fibre Limited Partnership ("CFLP"), jointly owned with Oji Paper Canada Ltd., which contributed cash of equal value. In consideration of the transfer Canfor received a partnership interest valued at \$45.0 million, which approximated the book value of the assets transferred. On the same day, CFLP transferred the Englewood operations and cash of \$35.0 million to Western Forest Products Inc. ("WFP") in return for a long-term agreement with WFP to supply CFLP with fibre, which CFLP will then supply to HSLP. The majority of CFLP's assets were written off in Canfor's balance sheet in 2008, and Canfor's share of CFLP's income and expenses were not significant in 2009 or 2008.

## **29. Segmented Information**

Operating segments are reported in a manner consistent with the internal reporting provided to the 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 sale of residual fibre from the lumber segment to the pulp and paper segment for use in their pulp production process.

Effective January 1, 2009, the operating results, capital expenditures and identifiable assets of the Company's panels business are no longer reported separately as an operating segment. With the exception of the Peace Valley OSB Limited Partnership, of which the Company owns a 50% share, all panel operations are currently indefinitely idled. Operating results, capital expenditures and identifiable assets of the panels business are now included in the Unallocated & Other segment. Sales of panels for the 2009 year were \$39.3 million (2008 - \$170.3 million).

(millions of dollars)	Lumber <sup>(a)</sup>	Pulp & Paper	Unallocated & Other	Elimination Adjustment	Consolidated
<b>Year ended December 31, 2009</b>					
Sales to external customers	\$ 1,162.9	918.2	39.3	-	\$ 2,120.4
Sales to other segments	\$ 78.9	-	0.1	(79.0)	\$ -
Operating income (loss)	\$ (171.4)	5.4	(44.4)	-	\$ (210.4)
Amortization	\$ 90.0	50.5	14.8	-	\$ 155.3
Capital expenditures	\$ 39.1	17.9	2.0	-	\$ 59.0
Identifiable assets	\$ 1,279.3	861.8	536.7	-	\$ 2,677.8

Year ended December 31, 2008

Sales to external customers	\$ 1,490.5	950.8	170.3	-	\$ 2,611.6
Sales to other segments	\$ 96.0	-	3.6	(99.6)	\$ -
Operating income (loss)	\$ (155.0)	76.8	(79.9)	-	\$ (158.1)
Amortization	\$ 99.5	48.8	22.9	-	\$ 171.2
Capital expenditures	\$ 39.5	39.9	0.8	-	\$ 80.2
Identifiable assets <sup>(b)</sup>	\$ 1,434.4	906.6	859.4	-	\$ 3,200.4

a. Sales include sales of Canfor-produced lumber of \$949.6 million in 2009 (2008 – \$1,214.3 million).

b. Identifiable assets in 2008 are presented net of an impairment charge of \$169.6 million, of which \$2.2 million related to the Lumber segment and \$167.4 million to Unallocated and Other.

### Geographic Information

(millions of dollars)	2009	2008
Sales by location of customer		
Canada	\$ 319.5	\$ 505.3
United States	1,043.0	1,378.3
Asia	556.0	522.7
Europe	168.3	174.5
Other	33.6	30.8
	\$ 2,120.4	\$ 2,611.6
Capital assets and goodwill by location		
Canada	\$ 1,598.1	\$ 1,697.9
United States	151.7	186.1
Asia and Other	0.1	0.2
	\$ 1,749.9	\$ 1,884.2

### 30. Capital Disclosures

Canfor's objectives when managing capital are to maintain a strong balance sheet and a globally competitive cost structure that ensures adequate liquidity to maintain and develop the business throughout the commodity price cycle.

Canfor's capital is comprised of net debt and shareholders' equity:

(millions of dollars)	2009	2008
Total debt (including operating loans)	\$ 367.9	\$ 622.2
Less: Cash and cash equivalents	(133.4)	(362.4)
Net debt	234.5	259.8
Total shareholders' equity	1,386.8	1,494.8
Total capitalization	\$ 1,621.3	\$ 1,754.6
Net debt to total capitalization percentage	14.5%	14.8%

The Company has certain financial covenants in 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.

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

Canfor's strategy is to ensure it remains in compliance with all of its existing covenants, so as to ensure continuous access to capital, and management reviews results and forecasts to monitor Canfor's compliance. Canfor was in compliance with all its debt covenants for the years ended December 31, 2009 and 2008.

### **31. Commitments and Contingencies**

#### ***Operating Lease Commitments***

Canfor has committed to operating leases for property, plant and equipment. As at December 31, 2009, the future minimum lease payments under these operating leases were as follows:

<i>(millions of dollars)</i>		
2010	\$	15.1
2011		10.1
2012		6.7
2013		4.1
2014		1.6
Thereafter		0.7
<b>Total minimum lease payments</b>	<b>\$</b>	<b>38.3</b>

#### ***Letters of Credit***

Canfor and CPLP have several letters of credit which are summarized in Note 8, Operating Loans.

#### ***Other Contractual Commitments***

Contractual commitments at December 31, 2009 totaled \$30.2 million (2008 - nil), and related principally to the construction of capital assets.

### **32. Pulp and Paper Green Transformation Program**

On October 9, 2009 the Canadian federal government announced the allocation of credits from the billion dollar Pulp and Paper Green Transformation Program ("the Program", which was originally announced on June 17, 2009). The Program is designed as a reimbursement of funds to be spent on qualifying energy and environmental capital projects. Credits may be used until the program end date of March 31, 2012. CPLP has been allocated \$122.2 million from this Program.

### **33. Comparative Figures**

Certain 2008 figures have been reclassified to conform to the current year's presentation.