To Our Shareholders

Canfor Corporation reported a net loss of $9.6 million for the third quarter of 2011, compared to net income of $26.2 million for the second quarter of 2011 and net income of $37.2 million for the third quarter of 2010. For the nine months ended September 30, 2011, the Company's net income was $48.9 million, compared to $116.4 million for the comparable period in 2010.

The Company's net loss attributable to shareholders ("shareholder net loss") for the third quarter of 2011 was $21.6 million, or $0.15 per share, compared to shareholder net income of $2.1 million, or $0.01 per share, for the second quarter of 2011, and shareholder net income of $9.1 million, or $0.06 per share, for the third quarter of 2010. For the first nine months of 2011, the shareholder net loss was $12.5 million, or $0.09 per share, compared to shareholder net income of $48.5 million, or $0.34 per share, for the first nine months of 2010.

The shareholder net loss for the third quarter of 2011 included several items affecting comparability with prior periods, which had an overall net negative impact of $19.8 million, or $0.14 per share. After adjusting for such items, the Company's adjusted shareholder net loss for the third quarter of 2011 was $1.8 million, or $0.01 per share, compared to adjusted shareholder net income of $2.6 million, or $0.02 per share, for the second quarter of 2011, and adjusted shareholder net income of $14.7 million, or $0.10 per share, for the third quarter of 2010.

The Company reported operating income of $14.5 million for the third quarter of 2011, down $12.0 million from $26.5 million for the second quarter. The decrease principally reflected a decline in the pulp and paper segment's earnings of $10.8 million to $37.3 million, primarily resulting from capital upgrade related downtime and lower pulp market prices. The Lumber segment recorded an operating loss of $11.7 million, which was in line with the previous quarter. The following table summarizes selected financial information for the Company for the comparative periods:

(millions of dollars, except for per share amounts)	**Q3 2011**	Q2 2011	**YTD 2011**	Q3 2010	YTD 2010
Sales	**$ 602.1**	$ 619.1	**$ 1,845.2**	$ 588.7	$ 1,801.3
EBITDA	**$ 54.4**	$ 66.8	**$ 194.1**	$ 74.2	$ 270.9
Operating income	**$ 14.5**	$ 26.5	**$ 72.4**	$ 32.0	$ 145.0
Net income (loss)	**$ (9.6)**	$ 26.2	**$ 48.9**	$ 37.2	$ 116.4
Net income (loss) attributable to equity shareholders of Company	**$ (21.6)**	$ 2.1	**$ (12.5)**	$ 9.1	$ 48.5
Net income (loss) per share attributable to equity shareholders of Company, basic and diluted	**$ (0.15)**	$ 0.01	**$ (0.09)**	$ 0.06	$ 0.34
Adjusted shareholder net income (loss)	**$ (1.8)**	$ 2.6	**$ 0.8**	$ 14.7	$ 59.0
Adjusted shareholder net income (loss) per share	**$ (0.01)**	$ 0.02	**$ 0.01**	$ 0.10	$ 0.41

North American lumber markets remained weak in the third quarter of 2011 reflecting the struggling U.S. economy and housing market. U.S. housing starts for the quarter averaged 615,000 units (seasonally adjusted annual rate), up 8% from of the previous quarter, though the increase substantially reflected higher starts for multifamily units, which use a lower proportion of lumber than single family units. The benchmark Western SPF 2x4 #2&Btr price moved up 3% to US$246 per Mfbm, though most wider SPF products showed moderately higher increases. Prices for SYP products were more mixed, with the 2x4 #2 benchmark price up 3% to US$259 per Mfbm, but wider dimensions saw flat or lower prices. Lumber sales realizations from offshore markets, where prices are negotiated monthly or quarterly in advance, showed a modest decrease from the previous quarter. Northern Bleached Softwood Kraft ("NBSK") pulp markets softened during the quarter, with the average North American price falling US$32 to US$993 per tonne. While the value of the Canadian dollar declined significantly against the US dollar late in the quarter, on average it was down by only 1% compared to the previous quarter.

Shipments and earnings levels for the lumber operations showed little change from the previous quarter, though production was up 3%, principally due to improved productivity. For pulp products, production levels were down 13% reflecting downtime at Canfor Pulp's Northwood pulp mill for its recovery boiler and precipitator upgrade.

Lumber unit manufacturing costs were up slightly from the previous quarter, with the positive impact of higher productivity offset by higher unit log costs, the latter primarily reflecting challenging wet weather conditions. Results for the third quarter of 2011 also included costs associated with the restart of the Vavenby sawmill on one shift in September. Pulp unit manufacturing costs were up 4% from the previous quarter, mostly attributed to the Northwood pulp mill downtime.

Further progress was made during the third quarter on the Company's $300 million, three-year strategic capital investment program at its lumber operations. Significant projects during the quarter included capital upgrades at the recently restarted Vavenby sawmill, and a major planer upgrade at the Polar sawmill. Other high return projects are ongoing, including energy systems at the Plateau and Chetwynd sawmills which are on target for start-up in the fourth quarter.

Looking forward, U.S. lumber consumption is projected to slow in the fourth quarter of 2011 with lower seasonal activity and the continued high volume of home inventories. The Canadian housing market is forecast to follow a similar trend, with demand projected to level off towards the end of the year. Lumber shipments to China are projected to ease somewhat in the fourth quarter, in part reflecting the Chinese New Year early in 2012. Japanese and Korean markets are anticipated to remain stable for the remainder of 2011. In pulp markets, reduced bleached softwood pulp demand has resulted in increased producer inventories and downward pressure on prices.

Ronald L. Cliff
Chairman

Don B. Kayne
President and Chief Executive Officer

Canfor Corporation
Third Quarter 2011
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 September 30, 2011 relative to the quarters ended June 30, 2011 and September 30, 2010, and the financial position of the Company at September 30, 2011. It should be read in conjunction with Canfor's unaudited interim consolidated financial statements and accompanying notes for the quarters ended September 30, 2011 and 2010, as well as the 2010 annual MD&A and the 2010 audited consolidated financial statements and notes thereto, which are included in Canfor's Annual Report for the year ended December 31, 2010 (available at www.canfor.com). The financial information in this interim MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which as of January 1, 2011 is the required reporting framework for Canadian publicly accountable enterprises.

Throughout this discussion, reference is made to EBITDA (calculated as operating income before amortization) which Canfor considers to be a relevant 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 Shareholder Net Income (Loss) (calculated as Shareholder Net income (loss) 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 Shareholder Net Income (Loss)") and Adjusted Shareholder Net Income (Loss) per Share (calculated as Adjusted Shareholder Net Income (Loss) divided by the weighted average number of shares outstanding during the period). EBITDA, Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder 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 IFRS. As there is no standardized method of calculating these measures, Canfor's EBITDA, Adjusted Shareholder Net Income (Loss) and Adjusted Shareholder Net Income (Loss) per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of EBITDA and Adjusted Shareholder Net Income (Loss) to net income (loss) reported in accordance with IFRS 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; currency exchange rates; interest rates; changes in law and public policy; the outcome of labour and trade disputes; and opportunities available to or pursued by Canfor.

2010 prior period comparative financial information throughout this report has been restated, and is shown in accordance with IFRS. All financial references are in millions of Canadian dollars unless otherwise noted. The information in this report is as at October 27, 2011.

Forward Looking Statements

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

THIRD QUARTER 2011 EARNINGS OVERVIEW

Selected Financial Information and Statistics[1]

(millions of dollars, except for per share amounts)	Q3 2011	Q2 2011	YTD 2011	Q3 2010	YTD 2010
Sales	**$ 602.1**	$ 619.1	**$ 1,845.2**	$ 588.7	$ 1,801.3
EBITDA	**$ 54.4**	$ 66.8	**$ 194.1**	$ 74.2	$ 270.9
Operating income	**$ 14.5**	$ 26.5	**$ 72.4**	$ 32.0	$ 145.0
Foreign exchange gain (loss) on long-term debt and investments, net	**$ (16.6)**	$ 2.0	**$ (9.9)**	$ 8.9	$ 4.9
Gain (loss) on derivative financial instruments[2]	**$ (12.1)**	$ 1.3	**$ (6.1)**	$ 2.8	$ (1.7)
Net income (loss)	**$ (9.6)**	$ 26.2	**$ 48.9**	$ 37.2	$ 116.4
Net income (loss) attributable to equity shareholders of Company	**$ (21.6)**	$ 2.1	**$ (12.5)**	$ 9.1	$ 48.5
Net income (loss) per share attributable to equity shareholders of Company, basic and diluted	**$ (0.15)**	$ 0.01	**$ (0.09)**	$ 0.06	$ 0.34
Average exchange rate (US$ per C$1.00)[3]	**$ 1.020**	$ 1.033	**$ 1.023**	$ 0.962	$ 0.966

[1] Prior year amounts have been restated, and are shown in accordance with International Financial Reporting Standards ("IFRS").
[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] Source – Bank of Canada (average noon rate for the period).

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

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

After-tax impact, net of non-controlling interests (millions of dollars, except for per share amounts)	Q3 2011	Q2 2011	YTD 2011	Q3 2010	YTD 2010
Shareholder Net Income (Loss)	**$ (21.6)**	$ 2.1	**$ (12.5)**	$ 9.1	$ 48.5
Foreign exchange (gain) loss on long-term debt and investments, net	**$ 11.0**	$ (1.4)	**$ 6.5**	$ (6.3)	$ (3.5)
(Gain) loss on derivative financial instruments	**$ 7.0**	$ (0.7)	**$ 3.4**	$ (1.1)	$ 1.0
Decrease in fair value of asset-backed commercial paper	**$ 1.8**	$ -	**$ 0.8**	$ -	$ -
Restructuring costs related to changes in management group	**$ -**	$ 2.6	**$ 2.6**	$ -	$ -
Clear Lake permanent closure provision	**$ -**	$ -	**$ -**	$ 13.0	$ 13.0
Net impact of above items	**$ 19.8**	$ 0.5	**$ 13.3**	$ 5.6	$ 10.5
Adjusted Shareholder Net Income (Loss)	**$ (1.8)**	$ 2.6	**$ 0.8**	$ 14.7	$ 59.0
Shareholder Net Income (Loss) per share (EPS), as reported	**$ (0.15)**	**$** 0.01	**$ (0.09)**	$ 0.06	$ 0.34
Net impact of above items per share	**$ 0.14**	**$** 0.01	**$ 0.10**	$ 0.04	$ 0.07
Adjusted Shareholder Net Income (Loss) per share	**$ (0.01)**	**$** 0.02	**$ 0.01**	$ 0.10	$ 0.41

EBITDA

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

(millions of dollars)	Q3 2011	Q2 2011	YTD 2011	Q3 2010	YTD 2010
Net income (loss), as reported	**$ (9.6)**	$ **26.2**	**$ 48.9**	$ 37.2	$ 116.4
Add (subtract):					
Amortization	**$ 39.9**	$ **40.3**	**$ 121.7**	$ 42.2	$ 125.9
Finance expense, net	**$ 7.0**	$ **4.9**	**$ 18.2**	$ 6.9	$ 22.2
Foreign exchange (gain) loss on long-term debt and investments, net	**$ 16.6**	$ **(2.0)**	**$ 9.9**	$ (8.9)	$ (4.9)
(Gain) loss on derivative financial instruments	**$ 12.1**	$ **(1.3)**	**$ 6.1**	$ (2.8)	$ 1.7
Other (income) expense	**$ (5.2)**	$ **(1.1)**	**$ (4.6)**	$ 3.3	$ 2.9
Income tax (recovery) expense	**$ (6.4)**	$ **(0.2)**	**$ (6.1)**	$ (3.7)	$ 6.7
EBITDA, as reported	**$ 54.4**	$ **66.8**	**$ 194.1**	$ 74.2	$ 270.9
Included in above:					
Negative (positive) impact of inventory valuation adjustments[4]	**$ 0.1**	$ **(1.6)**	**$ 1.4**	$ (2.6)	$ (20.1)
Clear Lake permanent closure provision	**$ -**	$ **-**	**$ -**	$ 17.3	$ 17.3
EBITDA excluding inventory valuation adjustments and closure provision	**$ 54.5**	$ **65.2**	**$ 195.5**	$ 88.9	$ 268.1

[4] In accordance with IFRS, 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.

Reported EBITDA for the third quarter of 2011 was $54.4 million, down $12.4 million from the second quarter. EBITDA of $9.7 million for the lumber segment was in line with the previous quarter, while EBITDA of $51.5 million for the pulp and paper segment was down $11.9 million, and panels results also saw a small decline.

North American lumber markets remained weak in the third quarter of 2011 reflecting the struggling U.S. economy and housing market. U.S. housing starts for the quarter averaged 615,000 units (seasonally adjusted annual rate – SAAR), up 8% from the previous quarter, though the increase substantially reflected higher starts for multifamily units, which use a lower proportion of lumber than single family units. The benchmark Western SPF 2x4 #2&Btr price moved up 3% to US$246 per Mfbm, though wider SPF products showed moderately higher increases. Prices for SYP products were more mixed, with the 2x4 #2 benchmark price up 3% to US$259 per Mfbm, but wider dimensions saw flat or lower prices. Lumber sales realizations from offshore markets, where prices are negotiated monthly or quarterly in advance, showed a modest decrease from the previous quarter. Northern Bleached Softwood Kraft ("NBSK") pulp markets softened during the quarter, with the average North American price falling US$32 to US$993 per tonne. While the value of the Canadian dollar declined significantly against the US dollar late in the quarter, on average it was down by only 1% compared to the previous quarter.

Shipments and earnings levels for the lumber operations showed little change from the previous quarter, though production was up 3%, principally due to improved productivity. For pulp products, production levels were down 13% reflecting downtime at Canfor Pulp's Northwood pulp mill for its recovery boiler and precipitator upgrade ("Northwood upgrade").

Lumber unit manufacturing costs were up slightly from the previous quarter, with the positive impact of higher productivity offset by higher unit log costs, the latter primarily reflecting challenging wet weather conditions. Results for the third quarter of 2011 also included costs associated with the restart of the Vavenby sawmill on one shift in September. Pulp unit manufacturing costs were up 4% from the previous quarter, mostly attributed to the Northwood pulp mill downtime.

Compared to the third quarter of 2010, EBITDA was down $19.8 million. For the lumber segment, excluding costs of $17.3 million related to the permanent closure of the Clear Lake sawmill, EBITDA was up $15.2 million compared to the same quarter of 2010, due to a combination of various factors including higher log costs. For the pulp and paper segment EBITDA was down $18.6 million reflecting the downtime for the Northwood upgrade, and lower pulp sales realizations partly offset by lower fibre costs.

OPERATING RESULTS BY BUSINESS SEGMENT

Lumber

Selected Financial Information and Statistics - Lumber

(millions of dollars unless otherwise noted)	**Q3 2011**	Q2 2011	**YTD 2011**	Q3 2010	YTD 2010
Sales	**$ 331.4**	$ 331.2	**$ 991.2**	$ 308.3	$ 937.2
Operating income (loss)	**$ (11.7)**	$ (11.1)	**$ (25.1)**	$ (13.6)	$ 23.2
EBITDA, as reported	**$ 9.7**	$ 9.6	**$ 37.3**	$ 7.6	$ 85.0
Negative (positive) impact of inventory valuation adjustments	**$ 1.5**	$ 1.1	**$ 2.7**	$ (0.5)	$ (20.7)
Clear Lake closure provision	**$ -**	$ -	**$ -**	$ 17.3	$ 17.3
EBITDA excluding impact of inventory valuation adjustments and closure provision	**$ 11.2**	$ 10.7	**$ 40.0**	$ 24.4	$ 81.6
Average SPF 2x4 #2&Btr lumber price in US$[5]	**$ 246**	$ 240	**$ 261**	$ 223	$ 252
Average SPF price in Cdn$	**$ 241**	$ 232	**$ 255**	$ 232	$ 261
Average SYP 2x4 #2 lumber price in US$[6]	**$ 259**	$ 251	**$ 270**	$ 243	$ 316
Average SYP price in Cdn$	**$ 254**	$ 243	**$ 264**	$ 253	$ 327
U.S. housing starts (million units SAAR) [7]	**0.615**	0.572	**0.590**	0.584	0.600
Production – SPF lumber (MMfbm)	**813.6**	787.6	**2,373.5**	740.9	2,161.6
Production – SYP lumber (MMfbm)	**117.3**	112.8	**324.9**	94.3	272.1
Shipments – SPF lumber (MMfbm)[8]	**812.0**	821.6	**2,348.9**	736.3	2,145.9
Shipments – SYP lumber (MMfbm)[8]	**122.7**	123.6	**337.2**	101.6	285.5
Shipments – wholesale lumber (MMfbm)	**46.1**	39.5	**144.8**	39.5	118.2

[5] Western Spruce/Pine/Fir, per thousand board feet (Source – Random Lengths Publications, Inc.)
[6] Southern Yellow Pine, Eastside, per thousand board feet (Source – Random Lengths Publications, Inc.)
[7] Source – U.S. Census Bureau, seasonally adjusted annual rate ("SAAR")
[8] Canfor-produced lumber, including lumber purchased for remanufacture.

Overview

The operating loss for the lumber segment was $11.7 million for the third quarter of 2011, in line with the previous quarter and a $1.9 million improvement from an operating loss of $13.6 million for the third quarter of 2010. For the nine months ended September 30, 2011, the operating loss was $25.1 million, compared to operating income of $23.2 million for the first nine months of 2010.

Reported EBITDA for the lumber segment was $9.7 million for the third quarter of 2011, in line with the previous quarter. Shipments of Canfor-produced lumber for the third quarter of 2011 were largely unchanged from the previous quarter. The average benchmark Western SPF 2x4 #2&Btr price moved up US$6 to US$246 per Mfbm in the third quarter of 2011, although wider SPF products showed moderately higher increases. Prices for SYP products were more mixed, with the 2x4 benchmark price up US$8 to US$259 per Mfbm, but wider dimensions saw flat or lower prices. Lumber sales realizations from offshore markets, where prices are negotiated monthly or quarterly in advance, showed a modest decrease from the previous quarter.

Unit manufacturing costs were up slightly from the previous quarter as a small reduction in unit cash conversion costs was offset by higher unit log costs, which reflected challenging wet weather conditions and higher hauling rates.

Compared to the third quarter of 2010, EBITDA was up $2.1 million, but excluding the impact of inventory valuation adjustments and the Clear Lake closure provision, EBITDA was down $13.2 million from the comparative period. The lower EBITDA primarily reflected higher log costs, Vavenby start-up costs and generally higher transportation costs, partly offset by improved productivity. Although the benchmark Western SPF 2x4 #2&Btr price increased US$23 per Mfbm, wide dimension price movements were less positive. Gains seen in sales realizations were further limited by the stronger Canadian dollar and increased freight costs.

Markets

During the third quarter of 2011, the U.S. housing market showed modest improvement, though still remained at historically depressed levels, with U.S. housing starts averaging 615,000 units[9] SAAR, an increase of 8% from the previous quarter, and 5% higher than the third quarter of 2010. The increase was substantially due to the relative strength of multifamily starts. Single family starts, which consume a larger proportion of lumber, remained under pressure from the high volume of home foreclosures and a high rate of mortgage delinquencies. Sales of homes have been limited by tightening of lending standards by financial institutions, and compounded by continued high unemployment.

In Canada, lumber consumption increased following an improvement in housing activity. Housing starts averaged 205,000 units[10] SAAR, up 10,000 units or 5% compared to the second quarter of 2011.

Offshore lumber shipments increased by 5% over the previous quarter and up significantly from the same quarter in 2010. During the quarter, the Company's offshore shipments reached new record-high levels, supported by continued strength from the China market as well as steady lumber consumption from Japan and Korea. Offshore shipments as percentage of total lumber sales have grown through 2011, and accounted for 34% of total lumber sales in the current quarter.

Sales

Sales for the lumber segment for the third quarter of 2011 were $331.4 million, in line with the previous quarter and up 7% from $308.3 million for the third quarter of 2010.

Total shipments for the third quarter of 2011 were 981 million board feet, in line with the previous quarter and up 12% from the third quarter of 2010, reflecting higher offshore volumes. Offshore shipments were up 5% from the previous quarter and were up almost 70% from the levels seen in the third quarter of 2010.

Average North American Random Lengths Western SPF 2x4 #2&Btr and SYP 2x4 #2 lumber prices edged upwards in the third quarter of 2011, with both moving up 3% from the previous quarter, to US$246 per Mfbm and US$259 per Mfbm, respectively. Several wider Western SPF dimensions saw larger increases, with benchmark 2x6 prices and 2x10 prices rising 10% and 13%, respectively. Price movements for wider SYP products were less positive, remaining flat or showing small decreases. Sales realizations from offshore markets showed modest decreases compared to the previous quarter.

Canadian dollar sales realizations were positively impacted by the lower average value of the Canadian dollar compared to the US dollar in the third quarter (down just over 1 cent, or 1%, from the previous quarter).

Compared to the third quarter of 2010, sales realizations were impacted by a 6% increase in the average value of the Canadian dollar and higher freight costs. Price movements in US dollar terms were mixed. The benchmark Random Lengths Western SPF 2x4 #2&Btr price was up 10%, and 2x6 products also showed healthy increases, but wider dimension price movements were less positive. SYP prices fared slightly worse, with the benchmark 2x4 #2 price up 7% but decreases were seen for all other dimensions. Offshore prices saw modest reductions from the third quarter of 2010.

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

[9] U.S. Census Bureau
[10] CMHC – Canada Mortgage and Housing Corporation

The RLCP averaged US$266 per Mfbm for the third quarter of 2011, well below the trigger price required to reduce the export tax rate from 15%. The export tax rate was also at 15% for all of the previous quarter. In July 2010, however, the export tax for the month dropped to 10% for B.C. shipments (15% for Alberta shipments), before returning to the higher rate of 15% (22.5% for Alberta shipments) in August and September 2010.

Total residual fibre revenue was in line with both the second quarter of 2011 and the third quarter of 2010, as higher volumes of sawmill residual chips produced offset lower prices, reflecting lower NBSK Canadian-dollar pulp prices.

<u>Operations</u>

The Company operated at 74% of lumber capacity in the third quarter, up from 72% in the second quarter; lumber production was approximately 930 million board feet, up slightly from the previous quarter, which for the most part reflected productivity improvements. Compared to the third quarter of 2010, lumber production was up 11%, principally resulting from significantly higher productivity, reflecting efficiency improvements and various recently completed capital upgrades, partially offset by the permanent closure of the Clear Lake sawmill in early 2011.

Overall, the Company's lumber unit manufacturing costs were up 2% from the previous quarter, with a slight reduction in unit cash conversion costs, largely reflecting productivity improvements, being more than offset by a modest increase in unit log costs. The increase in log costs compared to the previous quarter reflected the impact of severe wet weather on logging operations in the quarter, as well as higher hauling costs.

Compared to the third quarter of 2010, unit manufacturing costs were up slightly, with lower cash conversion costs offset by increased log costs. The improved unit cash conversion costs reflected the closure of the higher cost Clear Lake sawmill and the overall higher levels of production in the current quarter, while the higher unit log costs reflected the challenges in the current quarter from wet weather and higher hauling rates, the latter in part due to higher diesel costs.

Restructuring, mill closure and severance costs in the current quarter were $4.9 million, up $1.2 million from the previous quarter, with increased costs prior to the restart of Vavenby in September being partially offset by one-time costs in the second quarter relating to the change in Company management in early May. Restructuring costs were down $13.9 million from the third quarter of 2010, when the decision was made to permanently close the Clear Lake sawmill.

Pulp and Paper

<u>Selected Financial Information and Statistics – Pulp and Paper</u>[11]

(millions of dollars unless otherwise noted)	**Q3 2011**	Q2 2011	**YTD 2011**	Q3 2010	YTD 2010
Sales	**$ 260.5**	$ 277.0	**$ 820.5**	$ 269.0	$ 818.8
Operating income	**$ 37.3**	$ 48.1	**$ 132.6**	$ 53.3	$ 142.7
EBITDA	**$ 51.5**	$ 63.4	**$ 178.9**	$ 70.1	$ 193.6
Average pulp price delivered to U.S. – US$[12]	**$ 993**	$ 1,025	**$ 996**	$ 1,000	$ 958
Average price in Cdn$	**$ 974**	$ 992	**$ 974**	$ 1,040	$ 992
Production – pulp (000 mt)	**273.9**	314.7	**905.5**	285.7	908.4
Production – paper (000 mt)	**36.7**	31.8	**103.0**	34.7	102.0
Shipments – Canfor-produced pulp (000 mt)	**291.2**	303.7	**913.3**	276.9	893.9
Pulp marketed on behalf of HSLP (000 mt)[13]	**-**	-	**-**	85.2	271.9
Shipments – paper (000 mt)	**32.1**	32.7	**97.4**	33.6	105.7

[11] Includes the Taylor pulp mill and 100% of Canfor Pulp Limited Partnership ("CPLP"), which is consolidated in Canfor's results. Pulp production and shipment volumes presented are for both northern bleached softwood kraft ("NBSK") and bleached chemi-thermo mechanical pulp ("BCTMP").
[12] Per tonne, NBSK pulp list price delivered to U.S. (Resource Information Systems, Inc.).
[13] Howe Sound Pulp and Paper Limited Partnership pulp mill.

<u>Overview</u>

Operating income for the pulp and paper segment was $37.3 million for the third quarter of 2011, down $10.8 million from the previous quarter and down $16.0 million from the third quarter of 2010. For the nine months ended September 30, 2011, operating income was $132.6 million, down $10.1 million from $142.7 million for the comparable period in 2010.

EBITDA for the pulp and paper segment for the third quarter of 2011 was $51.5 million, down $11.9 million from the prior quarter and down $18.6 million from the third quarter of 2010. For the nine months ended September 30, 2011 EBITDA was $178.9 million, down $14.7 million from the comparable period in 2010.

Compared to the previous quarter, pulp production was down 13%, substantially reflecting downtime for the Northwood upgrade. The lower production impacted unit cash conversion costs, which were up 4% compared to the previous quarter. US dollar pulp prices saw moderate declines, though this was tempered somewhat by the weakening of the Canadian dollar. EBITDA from the paper operation improved by $2.5 million compared to the previous quarter, reflecting increased realized paper prices and lower unit manufacturing costs.

The lower earnings compared to the third quarter of 2010 were primarily attributable to the impact of the stronger Canadian dollar on NBSK pulp and BCTMP sales realizations, and higher unit manufacturing costs, offset in part by an improved sales mix and lower fibre costs. The higher unit manufacturing costs again principally reflected the impact of the Northwood upgrade in the current quarter. EBITDA from the paper operation was up $3.0 million compared to the third quarter of 2010, again reflecting increased realized paper prices and lower unit manufacturing costs.

<u>Markets</u>

Global softwood pulp markets weakened during the third quarter of 2011 due to seasonally slow demand during the summer months from Europe and North America, and some destocking by China. According to the latest published World 20[14] report, global bleached softwood pulp shipments for September were 4% higher when compared to the same period in 2010, and for the first nine months of 2011 were 6% higher than the same period in 2010. PPPC[15] statistics reported a decrease in global demand for printing and writing papers of 1% for the first eight months of 2011 as compared to the same period in 2010.

Reduced bleached softwood pulp demand has resulted in increased producer inventories and downward pressure on prices. At the end of September 2011, World 20 producers' bleached softwood pulp inventories were at 32 days of supply, an increase of 4 days from June 2011. A range of 27-30 days is generally considered a balanced market.

<u>Sales</u>

Shipments of Canfor-produced pulp in the third quarter of 2011 were 291,000 tonnes, down 13,000 tonnes, or 4%, from the previous quarter, reflecting lower market demand. Shipments were up 5% from the third quarter of 2010 when the Northwood pulp mill took an extended scheduled maintenance outage and market curtailment was taken at the Taylor pulp mill.

During the quarter, rising producer inventories put downward pressure on NBSK pulp list prices. Average NBSK pulp list prices to the U.S. fell US$32 to US$993 per tonne, with prices to Europe down US$37 to US$980 per tonne. Slower demand from China also led to a drop in CPLP's NBSK list price to China, which fell from an average of US$930 per tonne in the second quarter to US$850 in the third quarter. These price movements were partially offset by a 1% weakening of the Canadian dollar. BCTMP sales realizations were up compared to the prior quarter, reflecting a modest increase in market prices as well as the impact of the weaker Canadian dollar.

Average NBSK pulp list prices saw little change from the third quarter of 2010, with prices to the U.S. down US$7 per tonne and the price to Europe unchanged at US$980 per tonne. CPLP's China list price was also unchanged at US$850 per tonne. Sales realizations were positively impacted by an improved sales mix and less non-contract business, but this was more than offset by the 6% strengthening of the Canadian dollar quarter over quarter. BCTMP sales realizations were well down from the third quarter of 2010, in part reflecting the stronger Canadian dollar.

<u>Operations</u>

Pulp production in the third quarter of 2011 was 274,000 tonnes, down 41,000 tonnes, or 13%, from the previous quarter reflecting the impact of the Northwood upgrade. Compared to the third quarter of 2010, production was down 12,000 tonnes, or 4%, with the current quarter Northwood downtime being partially offset by an extended maintenance shut at Northwood and market curtailment at the Taylor pulp mill in the comparative period.

[14] 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.
[15] Pulp and Paper Products Council ("PPPC").

Unit manufacturing costs were up 4% compared to the previous quarter, reflecting increased cash conversion and fibre costs. The increased unit cash conversion costs reflected the extended outage due to the Northwood upgrade and related maintenance costs. Higher fibre costs reflected increased deliveries of higher-cost whole log chips.

Compared to the third quarter of 2010, unit manufacturing costs were up by 3%, again reflecting the impact of the Northwood upgrade and related maintenance costs, as well as higher chemical costs, partially offset by lower fibre costs. The lower fibre costs reflected lower prices for sawmill residual chips, which are tied to the price of pulp, and reductions in the cost of whole log chips.

Unallocated and Other Items

(millions of dollars)		Q3 2011		Q2 2011		YTD 2011		Q3 2010		YTD 2010
Operating loss of Panels operations[16]	**$**	**(4.9)**	$	(4.2)	**$**	**(14.8)**	$	(1.9)	$	(5.1)
Corporate costs	**$**	**(6.2)**	$	(6.3)	**$**	**(20.3)**	$	(5.8)	$	(15.8)
Finance expense, net	**$**	**(7.0)**	$	(4.9)	**$**	**(18.2)**	$	(6.9)	$	(22.2)
Foreign exchange gain (loss) on long-term debt and investments, net	**$**	**(16.6)**	$	2.0	**$**	**(9.9)**	$	8.9	$	4.9
Gain (loss) on derivative financial instruments	**$**	**(12.1)**	$	1.3	**$**	**(6.1)**	$	2.8	$	(1.7)
Other income (expense), net	**$**	**5.2**	$	1.1	**$**	**4.6**	$	(3.3)	$	(2.9)

[16] The Panels operations include the Peace Valley OSB (Oriented Strand Board) 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 $4.9 million for the third quarter of 2011, compared to a loss of $4.2 million for the previous quarter. Excluding the impact of inventory valuation adjustments, the operating loss of panels operations decreased $1.1 million. The lower loss principally related to a modest increase in OSB market prices, which were up US$12 per thousand square foot ("msf") to US$184[17] per msf. Compared to the third quarter of 2010, excluding inventory valuation adjustments, the operating loss worsened by $1.8 million, reflecting weaker market conditions.

Corporate costs were $6.2 million for the third quarter of 2011, in line with the second quarter. In the prior quarter a significant positive adjustment relating to share-based compensation was offset by severance costs following changes to the Company's management team announced in May. Compared to the third quarter of 2010, corporate costs were up $0.4 million.

Net finance expense for the third quarter of 2011 was $7.0 million, up $2.1 million from the previous quarter, principally reflecting costs recorded in the current quarter relating to the extension of the Company's main operating line of credit. Compared to the third quarter of 2010, finance expense was up $0.1 million, with the current quarter operating line extension costs mostly offset by reduced interest expense due to lower debt levels.

The Company recorded a foreign exchange translation loss on its US dollar denominated debt, net of investments, of $16.6 million for the third quarter of 2011 as a result of the significant weakening of the Canadian dollar against the US dollar, falling 7% between the respective quarter ends. The $2.0 million dollar gain in the second quarter of 2011 reflected a 1% increase in the value of the Canadian dollar over the period, and the $8.9 million gain in the third quarter of 2010 reflected a 3% increase in the Canadian dollar's value.

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs and lumber prices. During the third quarter of 2011, the Company entered into various additional derivative financial instrument contracts, including foreign exchange collars with a total notional amount of US$324 million and weighted average protection and topside rates of $0.96 and $1.07 per US dollar, respectively. The contracts cover the period from October 2011 to December 2012.

For the third quarter of 2011, the Company recorded a net loss of $12.1 million related to its derivative instruments, principally reflecting unrealized losses attributable to the weaker Canadian dollar, offset in part by gains on lumber futures. The following table summarizes the gains (losses) on derivative financial instruments for the comparable periods:

[17] Oriented Strand Board, North Central price, 7/16" (Source – Random Lengths Publications, Inc.)

(millions of dollars)	Q3 2011	Q2 2011	YTD 2011	Q3 2010	YTD 2010
Foreign exchange collars and forward contracts	**$ (14.9)**	$ 1.0	**$ (12.0)**	$ 4.4	$ 0.7
Natural gas swaps	**$ -**	$ (0.1)	**$ (0.2)**	$ (1.7)	$ (5.2)
Diesel collars and swaps	**$ (0.9)**	$ (0.2)	**$ (0.1)**	$ 0.7	$ 0.1
Lumber futures	**$ 3.7**	$ 0.6	**$ 6.2**	$ (0.6)	$ 2.7
	$ (12.1)	$ 1.3	**$ (6.1)**	$ 2.8	$ (1.7)

Other income, net of $5.2 million for the third quarter of 2011 includes favourable foreign exchange movements on US dollar denominated cash, receivables and payables of Canadian operations of $7.2 million. This compares to a loss for the previous quarter of $0.7 million and a loss for the third quarter of 2010 of $3.1 million. The current quarter gain was partially offset by a $2.0 million decrease in the fair value of the Company's investment in asset-backed commercial paper.

Other Comprehensive Income (Loss)

The following table summarizes Canfor's Other Comprehensive Income (Loss) for the comparable periods:

(millions of dollars)	Q3 2011	Q2 2011	YTD 2011	Q3 2010	YTD 2010
Foreign exchange translation differences for foreign operations	**$ 14.6**	$ 0.3	**$ 8.7**	$ (8.7)	$ (5.0)
Defined benefit actuarial losses, net of tax	**$ (56.6)**	$ (6.6)	**$ (61.0)**	$ (0.4)	$ (73.8)
Other comprehensive income (loss), net of tax	**$ (42.0)**	$ (6.3)	**$ (52.3)**	$ (9.1)	$ (78.8)

In the third quarter of 2011, the Company recorded an after-tax charge to other comprehensive income of $56.6 million in relation to changes in the valuation of its defined benefit post-employment compensation plans. The charge reflected a loss on the plan assets during the quarter, compared to an expected gain, as well as a reduction of 0.5% and 0.35% in the discount rates used to value the accrued benefit obligations for the pension and non-pension benefit plans, respectively. In the previous quarter and the third quarter of 2010, when movements in the rate of return and discount rate were less significant, the after-tax charge was $6.6 million and $0.4 million, respectively.

In addition, the company also recorded other comprehensive income of $14.6 million for foreign exchange translation differences for foreign operations, reflecting the 7% weakening of the Canadian dollar over the quarter. This compared to a $0.3 million gain in the previous quarter, and a loss of $8.7 million in the third quarter of 2010 when the Canadian dollar strengthened over the period.

SUMMARY OF FINANCIAL POSITION

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

(millions of dollars)	Q3 2011	Q2 2011	YTD 2011	Q3 2010	YTD 2010
Increase (decrease) in cash and cash equivalents	**$ (28.7)**	$ (42.5)	**$ (159.0)**	$ (3.8)	$ 89.7
Operating activities	**$ 60.9**	$ 69.8	**$ 125.0**	$ 66.9	$ 281.3
Financing activities	**$ (18.7)**	$ (80.1)	**$ (173.8)**	$ (27.7)	$ (102.2)
Investing activities	**$ (70.9)**	$ (32.2)	**$ (109.9)**	$ (42.3)	$ (88.8)
Ratio of current assets to current liabilities			**1.7 : 1**		2.1 : 1
Net debt to capitalization			**9.2%**		7.0%
ROCE – Consolidated[18]	**(1.3)%**	0.3%	**(0.1)%**	1.1%	4.7%
ROCE - Canfor solid wood business[19]	**(3.0)%**	(1.3)%	**(4.6)%**	(1.2)%	0.5%

[18] Consolidated Return on Capital Employed ("ROCE") is equal to shareholder net income for the period plus finance expense, 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.

[19] 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 and pulp and paper operations, including CPLP and the Taylor pulp mill.

Changes in Financial Position

Cash generated from operating activities was $60.9 million for the third quarter of 2011, compared to cash generated of $69.8 million for the previous quarter. Cash earnings were slightly lower in the third quarter, and net working capital movements, while positive in the quarter, were less favourable than in the seasonally strong second quarter (reflecting spring break up). Compared to the third quarter of 2010, cash generated from operating activities was slightly down, with lower cash earnings in the current quarter largely offset by more positive working capital movements.

Financing activities used cash of $18.7 million in the third quarter of 2011, compared to $80.1 million in the second quarter and $27.7 million in the third quarter of 2010. The current quarter's cash flows included cash distributions to non-controlling interests of $15.7 million (Q2 2011: $25.9 million; Q3 2010: $23.5 million). Finance expenses paid in the current quarter were $3.1 million and included fees paid in relation to the extension of the Company's main operating line of credit. Overall finance charges paid were down $3.0 million from the previous quarter, due to the timing of payments, and down $0.9 million from the third quarter of 2010, partly reflecting lower debt levels. Cash flows in the previous quarter also included the repayment of long-term debt of $48.1 million.

Investing activities used cash of $70.9 million in the third quarter of 2011, compared to $32.2 million in the second quarter and $42.3 million in the third quarter of 2010. Cash used in investing activities in the third quarter of 2011 included $12.2 million paid into escrow in connection with the purchase of a biomass energy generation facility in Grande Prairie, which completed on October 1. Cash used for capital additions was $79.4 million in the current quarter, a significant increase from both comparable periods. Capital additions for lumber operations in the current quarter of $43.8 million included payments in relation to a major planer upgrade at the Company's Polar sawmill and work carried out at the Vavenby sawmill in preparation for its restart in September, as well as energy systems at the Plateau and Chetwynd sawmills.

Capital expenditures for the pulp and paper segment for the third quarter of 2011 were $35.2 million, with $24.1 million of this for projects related to the Green Transformation Program (the "Program"). CPLP received cash of $19.2 million in the third quarter as reimbursement for capital additions under the Program. Overall, CPLP has been allocated $122.2 million under the Program to proceed with four projects. As of September 30, 2011 CPLP had incurred qualifying expenditures of $122.1 million and received reimbursements totaling $70.6 million, with the balance of $51.5 million receivable as at September 30, 2011.

Liquidity and Financial Requirements

On August 22, 2011, the Company amended its main $350 million bank credit facility, extending the maturity of the facility to October 31, 2015 from October 31, 2013. The general terms and conditions of the new facility are similar to the previous facility.

At September 30, 2011, the Company on a consolidated basis had cash and cash equivalents of $101.3 million and $447.5 million of bank operating lines of credit, which were undrawn, with $30.8 million reserved for several standby letters of credit. The Company and CPLP remained in compliance with the covenants relating to their operating lines of credit and long-term debt during the quarter, and expect to remain so for the foreseeable future.

The Company's consolidated net debt to total capitalization at the end of the third quarter of 2011 was 9.2%.

Scheduled debt repayments in the first half of 2011 included US$32.3 million, which was paid on March 1, and US$50.0 million, which was paid on April 1. The next scheduled debt repayment is US$50 million on February 2, 2012.

Softwood Lumber Agreement ("SLA") Update

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

As the arbitration is a state-to-state international dispute under the SLA, Canada is preparing a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. In August 2011, the U.S. filed a detailed statement of claim with the arbitration panel. Canada is expected to deliver its response to the U.S. claim in November 2011, which will be followed by additional responses by the U.S. and then Canada. A hearing before the arbitration panel is currently expected in early 2012. It is not possible at this time to predict the outcome or the value of the final claim, and accordingly no provision has been recorded by the Company.

OUTLOOK

Lumber

U.S. lumber consumption is projected to slow in the fourth quarter of 2011 with lower seasonal activity and the continued high volume of home inventories. The Canadian housing market is forecast to follow a similar trend with demand projected to level off towards the end of the year. Lumber shipments to China are projected to ease somewhat in the fourth quarter, in part reflecting the Chinese New Year early in 2012. Japanese and Korean markets are anticipated to remain stable for the remainder of 2011.

Pulp and Paper

Global softwood pulp producer inventories have risen through the third quarter of 2011. However, extended fall maintenance downtime in Canada due to several large capital projects funded under the Green Transformation Program should mitigate inventory growth in the short term. CPLP announced an NBSK pulp list price decrease in October of US$50 per tonne to US$790 per tonne for China. An NBSK pulp list price decrease was announced in October of US$20 per tonne for North America.

The start-up of one line at CPLP's Northwood pulp mill to complete work and commissioning of the recovery boiler upgrade project has been delayed, resulting in approximately 20,000 tonnes of reduced production in the fourth quarter of 2011. There are no additional maintenance outages planned for the fourth quarter of 2011.

OUTSTANDING SHARES

At October 27, 2011, there were 142,705,764 common shares outstanding.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with International Financial Reporting Standards 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 and deferred reforestation 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.

CONVERSION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

For interim and annual periods in 2011 and beyond, Canfor is required to prepare financial statements in accordance with International Financial Reporting Standards ("IFRS"). The Company's financial statements for the first quarter of 2011 were the first to be prepared in accordance with IFRS, and a number of additional disclosures were included in those financial statements in relation to the impact of transition. Certain disclosures have been included in the financial statements for the current period to reconcile comparative financial information for the third quarter of 2010 under IFRS to the information presented under previous Canadian generally accepted accounting principles ("GAAP"). These disclosures are included in note 13 to the financial statements.

Reporting in accordance with IFRS has now been embedded into the Company's systems and procedures.

NEW ACCOUNTING PRONOUNCEMENTS

In the first half of 2011, the International Accounting Standards Board ("IASB") issued a number of new and revised accounting standards which are effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. These new and revised accounting standards have not yet been adopted by Canfor.

The following new or revised standards are not expected to have a material impact on the amounts recorded in the financial statements of Canfor:

- IFRS 9, *Financial Instruments;*
- IFRS 10, *Consolidated Financial Statements*;
- IAS 27, *Separate Financial Statements*; and
- IFRS 13, *Fair Value Measurement*.

The Company is still in the process of assessing the impact, if any, of the following new or revised standards:

- IFRS 11, *Joint Arrangements*;
- IFRS 12, *Disclosure of Interests in Other Entities*;
- Amended IAS 19, *Employee Benefits;* and
- Amended IAS 28, *Investments in Associates and Joint Ventures*.

In June 2011, the IASB also issued amended IAS 1, *Presentation of Financial Statements*, which is effective for annual periods beginning on or after July 1, 2012. The Company is still in the process of assessing the impact on the financial statements of this revised standard.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ended September 30, 2011, 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 2010 annual statutory reports which are available on www.canfor.com or www.sedar.com.

SELECTED QUARTERLY FINANCIAL INFORMATION

	International Financial Reporting Standards[20]							Previous Canadian GAAP[20]
	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010	Q1 2010	Q4 2009
Sales and income (millions of dollars)								
Sales	**$ 602.1**	$ 619.1	$ 624.0	$ 629.1	$ 588.7	$ 634.7	$ 577.9	$ 549.6
Operating income (loss)	**$ 14.5**	$ 26.5	$ 31.4	$ 41.7	$ 32.0	$ 69.1	$ 43.9	$ (23.6)
Net income (loss)	**$ (9.6)**	$ 26.2	$ 32.3	$ 55.4	$ 37.2	$ 43.7	$ 35.5	$ (9.1)
Shareholder net income (loss)	**$ (21.6)**	$ 2.1	$ 7.0	$ 31.4	$ 9.1	$ 21.1	$ 18.3	$ (17.0)
Per common share (dollars)								
Shareholder net income (loss) – basic and diluted	**$ (0.15)**	$ 0.01	$ 0.05	$ 0.22	$ 0.06	$ 0.15	$ 0.13	$ (0.12)
Statistics								
Lumber shipments (MMfbm)	**981**	985	865	895	877	875	797	887
OSB shipments (MMsf 3/8")	**62**	69	63	57	58	72	72	63
Pulp shipments (000 mt)	**291**	303	318	331	277	301	316	315
Average exchange rate – US$/Cdn$	**$ 1.020**	$ 1.033	$ 1.014	$ 0.987	$ 0.962	$ 0.973	$ 0.961	$ 0.947
Average Western SPF 2x4 #2&Btr lumber price (US$)	**$ 246**	$ 240	$ 296	$ 269	$ 223	$ 266	$ 268	$ 205
Average SYP (East) 2x4 #2 lumber price (US$)	**$ 259**	$ 251	$ 302	$ 256	$ 243	$ 379	$ 329	$ 231
Average OSB price – North Central (US$)	**$ 184**	$ 172	$ 199	$ 191	$ 178	$ 295	$ 214	$ 172
Average NBSK pulp list price delivered to U.S. (US$)	**$ 993**	$ 1,025	$ 970	$ 967	$ 1,000	$ 993	$ 880	$ 820

[20] Financial information for 2010 has been restated to be shown in accordance with IFRS. Financial information for 2009 has not been restated, and is shown above in accordance with previous Canadian GAAP.

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 manufacturing facilities. 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 for the last quarter of 2009 reflect the impact of a global economic slowdown.

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

After-tax impact, net of non-controlling interests	International Financial Reporting Standards[21]							Previous Canadian GAAP[21]
(millions of dollars, except for per share amounts)	**Q3 2011**	**Q2 2011**	**Q1 2011**	**Q4 2010**	**Q3 2010**	**Q2 2010**	**Q1 2010**	**Q4 2009**
Shareholder net income (loss), as reported	**$ (21.6)**	$ 2.1	$ 7.0	$ 31.4	$ 9.1	$ 21.1	$ 18.3	$ (17.0)
Foreign exchange (gain) loss on long-term debt and investments, net	**$ 11.0**	$ (1.4)	$ (3.0)	$ (6.9)	$ (6.3)	$ 9.0	$ (6.2)	$ (5.8)
(Gain) loss on derivative financial instruments	**$ 7.0**	$ (0.7)	$ (2.9)	$ (0.5)	$ (1.1)	$ 1.1	$ 1.0	$ (1.4)
Decrease (increase) in fair value of asset-backed commercial paper	**$ 1.8**	$ -	$ (1.0)	$ (5.5)	$ -	$ -	$ -	$ -
Restructuring costs related to changes in management group	**$ -**	$ 2.6	$ -	$ -	$ -	$ -	$ -	$ -
Gain on sale of operating assets of Howe Sound Pulp and Paper Limited Partnership	**$ -**	$ -	$ -	$ (4.9)	$ -	$ -	$ -	$ -
Clear Lake permanent closure provision	**$ -**	$ -	$ -	$ -	$ 13.0	$ -	$ -	$ -
Net impact of above items	**$ 19.8**	$ 0.5	$ (6.9)	$ (17.8)	$ 5.6	$ 10.1	$ (5.2)	$ (7.2)
Adjusted shareholder net income (loss)	**$ (1.8)**	$ 2.6	$ 0.1	$ 13.6	$ 14.7	$ 31.2	$ 13.1	$ (24.2)
Shareholder net income (loss) per share (EPS), as reported	**$ (0.15)**	$ 0.01	$ 0.05	$ 0.22	$ 0.06	$ 0.15	$ 0.13	$ (0.12)
Net impact of above items per share	**$ 0.14**	$ 0.01	$ (0.05)	$ (0.12)	$ 0.04	$ 0.07	$ (0.04)	$ (0.05)
Adjusted shareholder net income (loss) per share	**$ (0.01)**	$ 0.02	$ 0.00	$ 0.10	$ 0.10	$ 0.22	$ 0.09	$ (0.17)

[21] Financial information for 2010 has been restated to be shown in accordance with IFRS. Financial information for 2009 has not been restated, and is shown above in accordance with previous Canadian GAAP.

Canfor Corporation
Condensed Consolidated Balance Sheets

(millions of dollars, unaudited)		As at September 30, 2011		As at December 31, 2010
ASSETS				
Current assets				
Cash and cash equivalents	**$**	**101.3**	$	260.3
Cash held in escrow (Note 12)		**12.2**		-
Accounts receivable - Trade		**157.7**		146.9
- Other		**91.1**		54.2
Inventories (Note 2)		**327.6**		325.8
Prepaid expenses		**41.6**		28.1
Total current assets		**731.5**		815.3
Property, plant and equipment		**1,103.9**		1,049.1
Timber licenses		**534.4**		546.7
Goodwill and other intangible assets		**85.7**		84.5
Long-term investments and other (Note 3)		**61.2**		89.1
Total assets	**$**	**2,516.7**	$	2,584.7
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities	**$**	**340.7**	$	292.9
Current portion of long-term debt (Note 4(b))		**51.9**		82.5
Current portion of deferred reforestation obligation		**31.5**		31.6
Total current liabilities		**424.1**		407.0
Long-term debt (Note 4(b))		**192.5**		235.6
Retirement benefit obligations		**326.0**		272.2
Deferred reforestation obligations		**52.9**		54.3
Other long-term liabilities		**14.0**		16.4
Deferred income taxes, net		**98.4**		123.7
Total liabilities	**$**	**1,107.9**	$	1,109.2
EQUITY				
Share capital	**$**	**1,125.7**	$	1,125.4
Contributed surplus		**31.9**		31.9
Retained earnings		**11.8**		79.0
Accumulated foreign exchange translation differences		**(1.6)**		(10.3)
Total equity attributable to equity holders of the Company		**1,167.8**		1,226.0
Non-controlling interests		**241.0**		249.5
Total equity	**$**	**1,408.8**	$	1,475.5
Total liabilities and equity	**$**	**2,516.7**	$	2,584.7

Contingency (Note 11)
Subsequent Event (Note 12)

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

APPROVED BY THE BOARD

Director, R.S. Smith

Director, R.L. Cliff

Canfor Corporation
Condensed Consolidated Statements of Income (Loss)

(millions of dollars, unaudited)	3 months ended September 30, **2011**	3 months ended September 30, 2010	9 months ended September 30, **2011**	9 months ended September 30, 2010
Sales	**$ 602.1**	$ 588.7	**$ 1,845.2**	$ 1,801.3
Costs and expenses				
Manufacturing and product costs	**400.2**	364.6	**1,208.3**	1,106.9
Freight and other distribution costs	**117.9**	103.8	**354.3**	314.3
Export taxes	**10.1**	9.7	**30.3**	29.7
Amortization	**39.9**	42.2	**121.7**	125.9
Selling and administration costs	**13.7**	16.4	**42.7**	48.1
Restructuring, mill closure and severance costs	**5.8**	20.0	**15.5**	31.4
	587.6	556.7	**1,772.8**	1,656.3
Operating income	**14.5**	32.0	**72.4**	145.0
Finance expense, net	**(7.0)**	(6.9)	**(18.2)**	(22.2)
Foreign exchange gain (loss) on long-term debt and investments, net	**(16.6)**	8.9	**(9.9)**	4.9
Gain (loss) on derivative financial instruments (Note 6)	**(12.1)**	2.8	**(6.1)**	(1.7)
Other income (expense), net	**5.2**	(3.3)	**4.6**	(2.9)
Net income (loss) before income taxes	**(16.0)**	33.5	**42.8**	123.1
Income tax recovery (expense) (Note 7)	**6.4**	3.7	**6.1**	(6.7)
Net income (loss)	**$ (9.6)**	$ 37.2	**$ 48.9**	$ 116.4
Net income (loss) attributable to:				
Equity shareholders of Company	**$ (21.6)**	$ 9.1	**$ (12.5)**	$ 48.5
Non-controlling interests	**12.0**	28.1	**61.4**	67.9
Net income (loss)	**$ (9.6)**	$ 37.2	**$ 48.9**	$ 116.4
Net income (loss) per common share: (in dollars)				
Attributable to equity shareholders of Company				
- Basic and diluted (Note 8)	**$ (0.15)**	$ 0.06	**$ (0.09)**	$ 0.34

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

Canfor Corporation
Condensed Consolidated Statements of Other Comprehensive Income (Loss)

(millions of dollars, unaudited)	3 months ended September 30, **2011**	3 months ended September 30, 2010	9 months ended September 30, **2011**	9 months ended September 30, 2010
Net income (loss)	**$ (9.6)**	$ 37.2	**$ 48.9**	$ 116.4
Other comprehensive income (loss)				
Foreign exchange translation differences for foreign operations	**14.6**	(8.7)	**8.7**	(5.0)
Defined benefit plan actuarial losses (Note 5)	**(73.6)**	(0.2)	**(79.4)**	(95.1)
Income tax recovery (expense) on defined benefit plan actuarial losses (Note 7)	**17.0**	(0.2)	**18.4**	21.3
Other comprehensive income (loss), net of tax	**(42.0)**	(9.1)	**(52.3)**	(78.8)
Total comprehensive income (loss)	**$ (51.6)**	$ 28.1	**$ (3.4)**	$ 37.6
Total comprehensive income (loss) attributable to:				
Equity shareholders of Company	**$ (57.9)**	$ 0.9	**$ (58.5)**	$ (20.7)
Non-controlling interests	**6.3**	27.2	**55.1**	58.3
Total comprehensive income (loss)	**$ (51.6)**	$ 28.1	**$ (3.4)**	$ 37.6

Condensed Consolidated Statements of Changes in Equity

(millions of dollars, unaudited)	3 months ended September 30, **2011**	3 months ended September 30, 2010	9 months ended September 30, **2011**	9 months ended September 30, 2010
Share capital				
Balance at beginning of period	**$ 1,125.7**	$ 1,125.0	**$ 1,125.4**	$ 1,124.7
Common shares issued on exercise of stock options	**-**	-	**0.3**	0.3
Balance at end of period	**$ 1,125.7**	$ 1,125.0	**$ 1,125.7**	$ 1,125.0
Contributed surplus				
Balance at beginning and end of period	**$ 31.9**	$ 31.9	**$ 31.9**	$ 31.9
Retained earnings				
Balance at beginning of period	**$ 84.3**	$ 14.9	**$ 79.0**	$ 40.2
Net income (loss) attributable to equity shareholders of Company	**(21.6)**	9.1	**(12.5)**	48.5
Defined benefit plan actuarial gains (losses), net of tax	**(50.9)**	0.5	**(54.7)**	(64.2)
Balance at end of period	**$ 11.8**	$ 24.5	**$ 11.8**	$ 24.5
Accumulated foreign exchange translation differences				
Balance at beginning of period	**$ (16.2)**	$ 3.7	**$ (10.3)**	$ -
Foreign exchange translation differences for foreign operations	**14.6**	(8.7)	**8.7**	(5.0)
Balance at end of period	**$ (1.6)**	$ (5.0)	**$ (1.6)**	$ (5.0)
Total equity attributable to equity holders of Company	**$ 1,167.8**	$ 1,176.4	**$ 1,167.8**	$ 1,176.4
Non-controlling interests				
Balance at beginning of period	**$ 245.7**	$ 259.8	**$ 249.5**	$ 259.3
Net income attributable to non-controlling interests	**12.0**	28.1	**61.4**	67.9
Defined benefit plan actuarial losses attributable to non-controlling interests	**(5.7)**	(0.9)	**(6.3)**	(9.6)
Distributions to non-controlling interests	**(11.0)**	(25.3)	**(63.6)**	(55.9)
Balance at end of period	**$ 241.0**	$ 261.7	**$ 241.0**	$ 261.7
Total equity	**$ 1,408.8**	$ 1,438.1	**$ 1,408.8**	$ 1,438.1

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

Canfor Corporation
Condensed Consolidated Statements of Cash Flows

(millions of dollars, unaudited)	3 months ended September 30, **2011**	3 months ended September 30, 2010	9 months ended September 30, **2011**	9 months ended September 30, 2010
Cash generated from (used in):				
Operating activities				
Net income (loss)	**$ (9.6)**	$ 37.2	**$ 48.9**	$ 116.4
Items not affecting cash:				
Amortization	**39.9**	42.2	**121.7**	125.9
Income tax expense (recovery)	**(6.4)**	(3.7)	**(6.1)**	6.7
Long-term portion of deferred reforestation obligation	**(9.3)**	(5.2)	**(3.2)**	(7.0)
Clear Lake closure provision	**-**	17.3	**-**	17.3
Foreign exchange (gain) loss on long-term debt and investments, net	**16.6**	(8.9)	**9.9**	(4.9)
Changes in mark-to-market value of derivative financial instruments	**11.8**	(3.6)	**7.2**	2.6
Employee future benefits	**1.2**	1.0	**2.0**	4.7
Net finance expense	**7.0**	6.9	**18.2**	22.2
Other, net	**0.4**	-	**(8.1)**	0.4
Salary pension plan contributions	**(9.6)**	(2.0)	**(29.2)**	(5.2)
Income taxes recovered (paid), net	**(0.3)**	-	**(0.3)**	45.6
Net change in non-cash working capital (Note 9)	**19.2**	(14.3)	**(36.0)**	(43.4)
	60.9	66.9	**125.0**	281.3
Financing activities				
Repayment of long-term debt (Note 4(b))	**-**	-	**(81.9)**	(33.7)
Finance expenses paid	**(3.1)**	(4.0)	**(12.7)**	(17.2)
Cash distributions paid to non-controlling interests	**(15.7)**	(23.5)	**(79.6)**	(50.8)
Other, net	**0.1**	(0.2)	**0.4**	(0.5)
	(18.7)	(27.7)	**(173.8)**	(102.2)
Investing activities				
Additions to property, plant and equipment	**(79.4)**	(44.7)	**(183.9)**	(94.9)
Reimbursements from Government under Green Transformation Program	**19.2**	1.1	**50.4**	1.1
Proceeds from redemption of asset-backed commercial paper (Note 3)	**-**	1.3	**29.8**	3.9
Amounts paid to escrow (Note 12)	**(12.2)**	-	**(12.2)**	-
Other, net	**1.5**	-	**6.0**	1.1
	(70.9)	(42.3)	**(109.9)**	(88.8)
Foreign exchange gain (loss) on cash and cash equivalents of subsidiaries with different functional currency	**-**	(0.7)	**(0.3)**	(0.6)
Increase (decrease) in cash and cash equivalents	**(28.7)**	(3.8)	**(159.0)**	89.7
Cash and cash equivalents at beginning of period	**130.0**	226.9	**260.3**	133.4
Cash and cash equivalents at end of period	**$ 101.3**	$ 223.1	**$ 101.3**	$ 223.1

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

1. Basis of preparation and transition to International Financial Reporting Standards ("IFRS")

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim financial reporting*, and include the accounts of Canfor Corporation and its subsidiary entities, hereinafter referred to as "Canfor" or "the Company".

Canfor's transition date to IFRS was January 1, 2010. Various reconciliations between previous Canadian generally accepted accounting principles ("previous GAAP") and IFRS related to the transition and subsequent reporting periods are set out in note 13, together with explanatory notes.

These interim financial statements do not include all of the disclosures required by IFRS for annual financial statements. Additional disclosures relevant to the understanding of these interim financial statements, including the accounting policies applied, can be found in Canfor's first quarter 2011 interim financial statements and notes, with further relevant information also in the Company's Annual Report for the year ended December 31, 2010, prepared in accordance with previous GAAP, available at www.canfor.com or www.sedar.com.

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, are generally stronger in the spring and summer months. Shipment volumes are affected by these factors as well as by global supply and demand conditions.

The currency of presentation for these financial statements is the Canadian dollar.

Accounting standards issued and not applied

In the first half of 2011, the International Accounting Standards Board ("IASB") issued a number of new and revised accounting standards which are effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. These new and revised accounting standards have not yet been adopted by Canfor.

The following new or revised standards are not expected to have a material impact on the amounts recorded in the financial statements of Canfor:

- IFRS 9, *Financial Instruments;*
- IFRS 10, *Consolidated Financial Statements*;
- IAS 27, *Separate Financial Statements*; and
- IFRS 13, *Fair Value Measurement*.

The Company is still in the process of assessing the impact, if any, of the following new or revised standards:

- IFRS 11, *Joint Arrangements*;
- IFRS 12, *Disclosure of Interests in Other Entities*;
- Amended IAS 19, *Employee Benefits;* and
- Amended IAS 28, *Investments in Associates and Joint Ventures*.

In June 2011, the IASB also issued amended IAS 1, *Presentation of Financial Statements*, which is effective for annual periods beginning on or after July 1, 2012. The Company is still in the process of assessing the impact on the financial statements of this revised standard.

2. Inventories

(millions of dollars)		As at September 30, 2011		As at December 31, 2010
Logs	$	30.6	$	53.9
Finished products		192.7		169.7
Residual fibre		16.5		17.4
Processing materials and supplies		87.8		84.8
	$	327.6	$	325.8

The above inventory balances are stated after inventory write-downs from cost to net realizable value. Write-downs at September 30, 2011 totaled $4.6 million (December 31, 2010 - $3.2 million).

3. Long-term Investments and Other

(millions of dollars)		As at September 30, 2011		As at December 31, 2010
Asset-backed commercial paper ("ABCP")	$	11.5	$	40.9
Other investments		24.0		26.5
Investment tax credits		8.6		6.4
Defined benefit plan assets		5.1		3.4
Other deposits, loans and advances		12.0		11.9
	$	61.2	$	89.1

During the third quarter of 2011, a pre-tax loss of $2.0 million was recorded to "Other income (expense), net" due to a decrease in the fair value of the ABCP assets. In addition, during the first quarter of 2011, net proceeds of $29.7 million were received from the redemption/sale of certain ABCP assets. The remaining movement in this balance over the period relates to foreign exchange and previous fair value adjustments.

4. Operating Lines and Long-Term Debt

(a) Available Operating Lines

(millions of dollars)		As at September 30, 2011		As at December 31, 2010
Canfor (excluding CPLP)				
Principal operating line	$	350.0	$	350.0
Facility A		13.2		12.7
Facility B		-		29.7
Other		1.1		1.1
Total operating lines - Canfor (excluding CPLP)		364.3		393.5
Letters of credit (principally unregistered pension plans)		(17.1)		(17.3)
Total available operating lines – Canfor (excluding CPLP)	$	347.2	$	376.2
CPLP				
Main bank loan facility	$	40.0	$	40.0
Bridge loan credit facility		30.0		-
Facility for BC Hydro letter of credit		13.2		13.2
Total operating lines - CPLP		83.2		53.2
Letters of credit (for general business purposes)		(0.5)		(0.5)
BC Hydro letter of credit		(13.2)		(13.2)
Total available operating lines - CPLP	$	69.5	$	39.5
Consolidated				
Total operating lines	$	447.5	$	446.7
Total available operating lines	$	416.7	$	415.7

In August 2011, the Company extended the maturity of its principal operating line from October 31, 2013 to October 31, 2015. The general terms and conditions of the new facility are similar to the previous facility. 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, which was for US$12.7 million at September 30, 2011, expires in January 2012, and is non-recourse to the Company under normal circumstances, except for an amount of US$6.7 million. The ABCP assets of the Company have been pledged as security to support this credit facility. Facility A has similar terms to the other operating lines, except that the interest rate is plus or minus a margin.

The terms of CPLP's principal bank loan facility 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. The maturity date of this facility is November 30, 2013.

CPLP also has a $30.0 million bridge loan credit facility with a maturity date of December 31, 2012 to fund timing differences between expenditures and reimbursements for projects funded under the Canadian Federal Government Green Transformation Program. The bridge facility terms are similar to CPLP's main facility, with interest and other costs at prevailing market rates. CPLP also has a separate facility with a maturity date of November 30, 2013 to cover a $13.2 million standby letter of credit issued to BC Hydro.

As at September 30, 2011, the Company and CPLP were in compliance with all covenants relating to their operating lines of credit and no significant amounts were drawn on the Company's or CPLP's available operating lines.

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

(b) Long-Term Debt

In the first half of 2011, the Company repaid $31.5 million (US$32.3 million) of 8.03% interest rate privately placed senior notes and $48.1 million (US$50.0 million) of 6.18% interest rate privately placed senior notes, as well as $2.3 million of other long-term debt obligations.

At September 30, 2011, the fair value of the Company's long-term debt, which was measured at its amortized cost of $244.4 million, was $252.8 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. Employee Future Benefits

Canfor measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. At the end of each interim reporting period, the Company estimates movements in its accrued benefit liabilities based upon movements in discount rates and the rates of return on plan assets, as well as any significant changes to the plans. Adjustments are also made for payments made and current service and interest costs.

For the nine months ended September 30, 2011, $79.4 million (before tax) was charged to other comprehensive income. The charge reflected an actual rate of return on plan assets of (2.50)%, which is 8.13% lower than the expected rate of 5.63%, as well as reductions of 0.50% and 0.35% in discount rates used to value the accrued benefit plan obligations for the pension and non-pension benefits plans, respectively, partially offset by the impact of the merging of two of the Company's smaller defined benefit pension plans in the first quarter. For the three months ended September 30, 2011, the amount charged was $73.6 million (before tax). For the nine months ended September 30, 2010 a pre-tax amount of $95.1 million was charged to other comprehensive income, reflecting a 1.00% reduction in the discount rate used to value the accrued benefit obligations during the period, an actual rate of return on plan assets slightly lower than the expected rate for the period and the impact of the curtailment of one of the Company's plans in the third quarter. For the three months ended September 30, 2010 the pre-tax charge was $0.2 million.

The assumptions used to estimate the changes in net accrued benefit liabilities were as follows:

(weighted average assumptions)	
Pension Benefit Plans	
Discount rate	
September 30, 2011	**5.00%**
June 30, 2011	5.50%
December 31, 2010	5.50%
September 30, 2010	5.25%
June 30, 2010	5.50%
January 1, 2010	6.25%
Rate of return on plan assets	
9 months ended September 30, 2011	**(2.50)%**
6 months ended June 30, 2011	1.80%
9 months ended September 30, 2010	5.30%
6 months ended June 30, 2010	(2.20)%
Other Benefit Plans	
Discount rate	
September 30, 2011	**5.40%**
June 30, 2011	5.75%
December 31, 2010	5.75%
September 30, 2010	5.50%
June 30, 2010	5.75%
January 1, 2010	6.75%

6. 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 September 30, 2011, the fair value of derivative financial instruments was a net liability of $11.3 million (December 31, 2010 – net liability of $4.1 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 nine month periods ended September 30, 2011 and 2010:

	3 months ended September 30,		9 months ended September 30,	
(millions of dollars)	**2011**	2010	**2011**	2010
Foreign exchange collars and forward contracts	**$ (14.9)**	$ 4.4	**$ (12.0)**	$ 0.7
Natural gas swaps	**-**	(1.7)	**(0.2)**	(5.2)
Diesel collars and swaps	**(0.9)**	0.7	**(0.1)**	0.1
Lumber futures	**3.7**	(0.6)	**6.2**	2.7
	$ (12.1)	$ 2.8	**$ (6.1)**	$ (1.7)

The following table summarizes the fair value of the derivative financial instruments included in the balance sheet at September 30, 2011 and December 31, 2010:

(millions of dollars)	**As at September 30, 2011**	As at December 31, 2010
Foreign exchange collars and forward contracts	**$ (12.3)**	$ 1.6
Natural gas swaps	**(0.4)**	(4.7)
Diesel collars and swaps	**(0.8)**	1.0
Lumber futures	**2.2**	(2.0)
Total asset (liability)	**(11.3)**	(4.1)
Less: current portion	**(10.7)**	(4.1)
Long-term portion	**$ (0.6)**	$ -

7. Income taxes

(millions of dollars)	3 months ended September 30, **2011**	2010	9 months ended September 30, **2011**	2010
Current	**$ -**	$ 0.4	**$ (0.3)**	$ 0.6
Deferred	**6.4**	3.3	**6.4**	(7.3)
Income tax recovery (expense)	**$ 6.4**	$ 3.7	**$ 6.1**	$ (6.7)

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 September 30, **2011**	2010	9 months ended September 30, **2011**	2010
Income tax recovery (expense) at statutory rate 2011 – 26.5% (2010 – 28.5%)	**$ 4.3**	$ (9.5)	**$ (11.3)**	$ (35.1)
Add (deduct):				
Non-taxable income related to non-controlling interests in limited partnerships	**3.2**	8.0	**16.3**	19.4
Entities with different income tax rates and other tax adjustments	**0.5**	0.9	**1.1**	0.4
Tax recovery (expense) at rates other than statutory rate	**(0.3)**	0.2	**(0.1)**	2.0
Permanent difference from capital gains and losses and other non-deductible items	**(1.3)**	4.1	**0.1**	6.6
Income tax recovery (expense)	**$ 6.4**	$ 3.7	**$ 6.1**	$ (6.7)

In addition to the amounts recorded to net income, a tax recovery of $17.0 million was recorded to other comprehensive income for the three month period ended September 30, 2011 (three months ended September 30, 2010 – expense of $0.2 million) in relation to the actuarial losses on defined benefit employee compensation plans. For the nine months ended September 30, 2011 the tax recovery was $18.4 million (nine months ended September 30, 2010 – recovery of $21.3 million).

8. Earnings 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 September 30, **2011**	2010	9 months ended September 30, **2011**	2010
Weighted average number of common shares	**142,705,764**	142,623,347	**142,696,217**	142,606,227
Incremental shares from potential exercise of options	**1,760**	-	**7,181**	2,135
Diluted number of common shares	**142,707,524**	142,623,347	**142,703,398**	142,608,362

9. Net Change in Non-Cash Working Capital

(millions of dollars)	3 months ended September 30, **2011**	2010	9 months ended September 30, **2011**	2010
Accounts receivable	**$ (3.3)**	$ 2.1	**$ (34.5)**	$ (38.3)
Inventories	**(7.0)**	(11.7)	**(0.8)**	(22.6)
Prepaid expenses	**(1.1)**	(8.7)	**(12.3)**	(14.6)
Accounts payable, accrued liabilities and current portion of deferred reforestation obligation	**30.6**	4.0	**11.6**	32.1
Net decrease (increase) in non-cash working capital	**$ 19.2**	$ (14.3)	**$ (36.0)**	$ (43.4)

10. Segment information

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, widths and lengths 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.

The Company's panels business does not meet the criteria to be reported fully as a separate segment. Sales for panels operations for the three months ended September 30, 2011 were $10.2 million (three months ended September 30, 2010 - $11.4 million) and $33.5 million for the nine months ended September 30, 2011 (nine months ended September 30, 2010 - $45.3 million).

(millions of dollars)		Lumber	Pulp & Paper	Unallocated & Other	Elimination Adjustment		Consolidated
3 months ended September 30, 2011							
Sales to external customers	**$**	**331.4**	**260.5**	**10.2**	**-**	**$**	**602.1**
Sales to other segments	**$**	**34.4**	**-**	**-**	**(34.4)**	**$**	**-**
Operating income (loss)	**$**	**(11.7)**	**37.3**	**(11.1)**	**-**	**$**	**14.5**
Amortization	**$**	**21.4**	**14.2**	**4.3**	**-**	**$**	**39.9**
Capital expenditures*	**$**	**43.8**	**35.2**	**0.4**	**-**	**$**	**79.4**
3 months ended September 30, 2010							
Sales to external customers	$	308.3	269.0	11.4	-	$	588.7
Sales to other segments	$	31.9	-	-	(31.9)	$	-
Operating income (loss)	$	(13.6)	53.3	(7.7)	-	$	32.0
Amortization	$	21.2	16.8	4.2	-	$	42.2
Capital expenditures	$	31.8	12.8	0.1	-	$	44.7
9 months ended September 30, 2011							
Sales to external customers	**$**	**991.2**	**820.5**	**33.5**	**-**	**$**	**1,845.2**
Sales to other segments	**$**	**96.3**	**-**	**-**	**(96.3)**	**$**	**-**
Operating income (loss)	**$**	**(25.1)**	**132.6**	**(35.1)**	**-**	**$**	**72.4**
Amortization	**$**	**62.4**	**46.3**	**13.0**	**-**	**$**	**121.7**
Capital expenditures*	**$**	**93.8**	**89.3**	**0.8**	**-**	**$**	**183.9**
Identifiable assets	**$**	**1,390.9**	**903.5**	**222.3**	**-**	**$**	**2,516.7**
9 months ended September 30, 2010							
Sales to external customers	$	937.2	818.8	45.3	-	$	1,801.3
Sales to other segments	$	101.7	-	-	(101.7)	$	-
Operating income (loss)	$	23.2	142.7	(20.9)	-	$	145.0
Amortization	$	61.8	50.9	13.2	-	$	125.9
Capital expenditures	$	61.3	33.5	0.1	-	$	94.9
Identifiable assets	$	1,325.3	903.8	361.9	-	$	2,591.0

* Includes capital expenditures by CPLP that are financed by the government-funded Green Transformation Program.

11. Contingency

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

As the arbitration is a state-to-state international dispute under the SLA, Canada is preparing a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. In August 2011, the U.S. filed a detailed statement of claim with the arbitration panel. Canada is expected to deliver its response to the U.S. claim in November 2011, which will be followed by additional responses by the U.S. and then Canada. A hearing before the arbitration panel is currently expected in early 2012. It is not possible at this time to predict the outcome or the value of the final claim, and accordingly no provision has been recorded by the Company.

12. Subsequent event

On July 27, 2011, the Company entered into an agreement to purchase the Grande Prairie Ecopower Centre, a biomass energy generation facility, from TransAlta for $12.2 million. Cash of $12.2 million was held in escrow as at September 30, 2011, prior to closing on October 1, 2011.

13. Transition to International Financial Reporting Standards ("IFRS")

For 2011, the Company is preparing its financial statements in accordance with IFRS for the first time. In preparing comparative information for 2010, the Company has adjusted amounts previously reported in financial statements prepared in accordance with previous Canadian GAAP ("previous GAAP").

The Company's transition date to IFRS was January 1, 2010 and a provisional opening IFRS balance sheet was prepared as at that date. A full reconciliation of the opening balance sheet to amounts reported under previous GAAP can be found in the Company's condensed consolidated interim financial statements for the first quarter of 2011, along with the balance sheet as at December 31, 2010.

Certain of the differences are also summarized in the following sections, which include reconciliations of total comprehensive income from previous GAAP to IFRS for the three month and nine month periods ending September 30, 2010, and a reconciliation of equity as at September 30, 2010.

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

(i) Reconciliation of comprehensive income for three and nine month periods ended September 30, 2010

(millions of dollars, unaudited)	Note (section iii)		**3 months ended September 30, 2010**		**9 months ended September 30, 2010**
Net income					
Previous Canadian GAAP		$	33.5	$	106.4
Lower amortization of property, plant and equipment and timber licenses in period, net of tax	a		1.3		3.7
Lower pension expense for period, net of tax	b		2.4		6.3
Net income under IFRS		$	37.2	$	116.4
Other comprehensive income (loss)					
Previous Canadian GAAP		$	(8.7)	$	(5.0)
Actuarial gains (losses) on defined benefit plans during the period, net of tax	b		(0.4)		(73.8)
Other comprehensive income (loss) under IFRS		$	(9.1)	$	(78.8)

(ii) Reconciliation of equity at September 30, 2010

(millions of dollars, unaudited)	Note (section iii)		As at September 30, 2010
Previous Canadian GAAP – Total equity		$	1,705.9
Recognition of impairment provisions at date of transition	a		(42.6)
Lower amortization of property, plant and equipment and timber licenses for nine months ended September 30, 2010, net of tax	a		3.7
Recognition of unamortized actuarial losses at date of transition	b		(162.4)
Lower pension expense for nine months ended September 30, 2010, net of tax	b		6.3
Actuarial gains (losses) on defined benefit plans for nine months ended September 30, 2010, net of tax	b		(73.8)
Effect of change in discount rate for deferred reforestation obligation recognized on transition	c		1.0
IFRS – Total equity		$	1,438.1

(iii) Explanatory notes for reconciliations

The following explanations are referenced in the reconciliations in sections (i) and (ii) of this note:

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

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

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

These impairments had the impact of reducing the overall amortization expense by $1.3 million for the three months ended September 30, 2010, and $3.7 million for the nine months ended September 30, 2010.

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

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

This resulted in a charge to retained earnings in the opening balance sheet of $148.4 million, and a charge to non-controlling interests of $14.0 million reflecting non-controlling interests in CPLP. Pension assets recorded under previous GAAP of $110.6 million were removed, and liabilities of $101.3 million were recorded to reflect the actual funding position of the defined benefit pension plans. The long-term deferred income tax liability was reduced by $49.5 million as a result of these adjustments.

Under previous GAAP, actuarial gains and losses were deferred and taken through the income statement over a number of years. As Canfor has elected to recognize these immediately through other comprehensive income under IFRS, the defined benefit expense in the income statement is reduced by $2.4 million for the third quarter of 2010 and $6.3 million for the year to date. The after-tax charge through other comprehensive income was $0.4 million in the third quarter of 2010, and $73.8 million for the year to date.

(c) Change in discount rate for deferred reforestation obligation

The amount of this provision of $60.3 million at January 1, 2010 was reduced in the opening balance sheet by $1.0 million after-tax due to a change in discount rate required to value the obligation under IFRS as compared to previous GAAP.

(iv) Explanation of material adjustments to the statement of cash flows

The impact of the transition to IFRS on the statement of cash flows is to reclassify certain items between cash flow categories. One of the main reclassifications relates to interest payments and receipts which were classified as operating activities under previous GAAP, but are shown as financing and investing activities, respectively, under IFRS.

In addition, the reclassification of certain of CPLP's major maintenance costs to property, plant and equipment under IFRS has an impact on the statement of cash flows. Under previous GAAP these costs were shown under operating activities as deferred maintenance spending, whereas under IFRS they are included in additions to property, plant and equipment under investing activities.