

# AINSWORTH LUMBER CO. LTD.

## Interim Consolidated Balance Sheets

(In thousands of Canadian dollars)

(Unaudited)

	June 30 2010	December 31 2009
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 88,321	\$ 92,075
Short-term investments	71,220	61,654
Accounts receivable	20,894	13,730
Inventories (Note 3)	43,509	39,182
Income taxes receivable	-	509
Prepaid expenses	4,854	3,822
Assets held for disposal (Note 4)	321	2,475
	229,119	213,447
<b>Property, Plant and Equipment</b>	<b>529,212</b>	<b>538,787</b>
<b>Intangible Assets</b>	<b>73,952</b>	<b>75,602</b>
<b>Other Assets</b>	<b>16,472</b>	<b>11,276</b>
<b>Assets Held for Disposal (Note 4)</b>	<b>7,042</b>	<b>7,133</b>
	\$ 855,797	\$ 846,245
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	\$ 21,727	\$ 23,475
Income taxes payable	379	-
Current portion of future income tax liabilities	7,619	7,649
Current portion of long-term debt	10,614	10,743
Liabilities related to assets held for disposal (Note 4)	1,487	5,009
	41,826	46,876
<b>Accrued Pension Benefit Liability (Note 12)</b>	<b>2,484</b>	<b>2,484</b>
<b>Reforestation Obligation</b>	<b>2,077</b>	<b>2,072</b>
<b>Long-term Debt</b>	<b>559,512</b>	<b>550,582</b>
<b>Future Income Tax Liabilities</b>	<b>43,007</b>	<b>35,209</b>
<b>Liabilities Related to Assets Held for Disposal (Note 4)</b>	<b>897</b>	<b>885</b>
	649,803	638,108
<b>Commitments and Guarantees (Note 8)</b>		
<b>Contingencies (Note 9)</b>		
<b>SHAREHOLDERS' EQUITY</b>		
Capital Stock	409,880	409,880
Contributed Surplus	1,075	876
Deficit	(204,961)	(202,619)
	205,994	208,137
	\$ 855,797	\$ 846,245

The accompanying Notes to the Interim Consolidated Financial Statements are an integral part of these statements.

Approved by the Board:

/s/ Peter Gordon

**DIRECTOR**

/s/ Gordon Lancaster

**DIRECTOR**

# AINSWORTH LUMBER CO. LTD.

## Interim Consolidated Statements of Operations

(In thousands of Canadian dollars, except share and per share data)

(Unaudited)

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
<b>Sales</b>	<b>\$ 96,147</b>	<b>\$ 70,821</b>	<b>\$ 177,186</b>	<b>\$ 140,029</b>
<b>Costs and Expenses</b>				
Costs of products sold	57,486	67,449	119,043	131,167
Selling and administration	5,362	5,067	10,250	10,109
Amortization of property, plant and equipment and intangible assets	8,864	9,932	17,890	18,519
	<b>71,712</b>	<b>82,448</b>	<b>147,183</b>	<b>159,795</b>
<b>Income (loss) before other items</b>	<b>24,435</b>	<b>(11,627)</b>	<b>30,003</b>	<b>(19,766)</b>
<b>Finance expense (Note 5)</b>	<b>(12,176)</b>	<b>(13,362)</b>	<b>(24,798)</b>	<b>(27,875)</b>
<b>Foreign exchange (loss) gain (Note 6)</b>	<b>(23,117)</b>	<b>46,580</b>	<b>(4,942)</b>	<b>27,001</b>
<b>Gain on derivative financial instrument (Note 11)</b>	<b>649</b>	<b>-</b>	<b>5,679</b>	<b>-</b>
<b>Costs of curtailed operations</b>	<b>(458)</b>	<b>(487)</b>	<b>(1,787)</b>	<b>(755)</b>
<b>Other items (Note 7)</b>	<b>605</b>	<b>6,698</b>	<b>1,907</b>	<b>5,795</b>
<b>(Loss) income before income taxes</b>	<b>(10,062)</b>	<b>27,802</b>	<b>6,062</b>	<b>(15,600)</b>
<b>Income tax expense (recovery) (Note 13)</b>	<b>7,225</b>	<b>(2,022)</b>	<b>7,656</b>	<b>(11,449)</b>
<b>(Loss) income from continuing operations</b>	<b>(17,287)</b>	<b>29,824</b>	<b>(1,594)</b>	<b>(4,151)</b>
<b>Net loss from discontinued operations (Note 4)</b>	<b>(491)</b>	<b>(5,120)</b>	<b>(748)</b>	<b>(25,382)</b>
<b>Net (loss) income</b>	<b>\$ (17,778)</b>	<b>24,704</b>	<b>\$ (2,342)</b>	<b>(29,533)</b>
Basic and diluted net (loss) income per common share (Note 14):				
Continuing operations	\$ (0.17)	\$ 0.30	\$ (0.01)	\$ (0.04)
Discontinued operations	(0.01)	(0.05)	(0.01)	(0.25)
Basic and diluted net loss per common share	<b>\$ (0.18)</b>	<b>\$ 0.25</b>	<b>\$ (0.02)</b>	<b>\$ (0.29)</b>
Weighted average number of common shares outstanding	100,100,000	100,000,000	100,100,000	100,000,000
Effect of dilutive stock options on continuing operations	1,014,646	39,919	497,693	10,709
	<b>101,114,646</b>	<b>100,039,919</b>	<b>100,597,693</b>	<b>100,010,709</b>

The accompanying Notes to the Interim Consolidated Financial Statements are an integral part of these statements.

# AINSWORTH LUMBER CO. LTD.

## Interim Consolidated Statements of Comprehensive (Loss) Income

(In thousands of Canadian dollars)

(Unaudited)

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
<b>Net (loss) income</b>	\$ (17,778)	\$ 24,704	\$ (2,342)	\$ (29,533)
<b>Other Comprehensive Income</b>				
Realized currency translation adjustment	-	251	-	251
	-	251	-	251
<b>Comprehensive (Loss) Income</b>	\$ (17,778)	\$ 24,955	\$ (2,342)	\$ (29,282)

## Interim Consolidated Statements of Changes in Shareholders' Equity

(In thousands of Canadian dollars)

(Unaudited)

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
<b>Capital Stock</b>	\$ 409,880	\$ 409,613	\$ 409,880	\$ 409,613
<b>Contributed Surplus</b>				
Beginning of period	939	-	876	-
Fair value of stock options recorded in the period (Note 10)	136	711	199	711
	1,075	711	1,075	711
<b>Deficit</b>				
Beginning of period	(187,183)	(235,221)	(202,619)	(180,984)
Net (loss) income	(17,778)	24,704	(2,342)	(29,533)
	(204,961)	(210,517)	(204,961)	(210,517)
<b>Accumulated Other Comprehensive Loss on Translation of Self-Sustaining Foreign Operations</b>				
Beginning of period	-	(2,478)	-	(2,478)
Realized currency translation adjustment	-	251	-	251
	-	(2,227)	-	(2,227)
<b>Total Deficit and Accumulated Other Comprehensive Loss</b>	(204,961)	(212,744)	(204,961)	(212,744)
<b>Total Shareholders' Equity</b>	\$ 205,994	\$ 197,580	\$ 205,994	\$ 197,580

The accompanying Notes to the Interim Consolidated Financial Statements are an integral part of these statements.

# AINSWORTH LUMBER CO. LTD.

## Interim Consolidated Statements of Cash Flows

(In thousands of Canadian dollars)

(Unaudited)

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
<b>Cash Flows Used in Operating Activities</b>				
Net (loss) income	\$ (17,778)	\$ 24,704	\$ (2,342)	\$ (29,533)
Items not affecting cash				
Amortization of property, plant and equipment and intangible assets	8,864	9,932	17,890	18,519
Non-cash portion of interest expense	4,560	4,850	9,182	10,300
Non-cash stock based compensation (Note 10)	136	711	199	711
Foreign exchange loss (gain) on long-term debt	24,772	(50,448)	5,484	(28,721)
Gain on derivative financial instrument	(649)	-	(5,679)	-
Gain on disposal of property, plant and equipment	(82)	(2,114)	(114)	(2,294)
Write-down of long-term wood deposits	-	-	648	-
Adjustment to accrued pension benefit liability	41	-	12	-
Impairment of property, plant and equipment of discontinued operations	-	-	-	14,303
Write-down of property, plant and equipment held for sale	-	8,219	-	8,219
Change in non-current reforestation obligation	(105)	(298)	5	(556)
Future income taxes	7,358	(8,132)	7,768	(17,902)
Unrealized foreign exchange loss	(514)	2,536	(188)	1,772
	26,603	(10,040)	32,865	(25,182)
Change in non-cash operating working capital (Note 15)	1,709	8,518	(14,839)	(11,534)
Cash provided by (used in) operating activities	28,312	(1,522)	18,026	(36,716)
<b>Cash Flows Used in Financing Activities</b>				
Repayment of long-term debt	(3,576)	(3,315)	(5,685)	(5,023)
Repayment of capital lease obligations	(90)	(93)	(179)	(193)
Cash used in financing activities	(3,666)	(3,408)	(5,864)	(5,216)
<b>Cash Flows Used in Investing Activities</b>				
Short-term investments	(9,471)	25	(9,566)	10
Additions to property, plant and equipment	(3,435)	(636)	(6,528)	(1,909)
Proceeds on disposal of property, plant and equipment	90	4,241	153	4,530
Decrease (increase) in other assets	36	2,035	(163)	2,116
Cash (used in) provided by investing activities	(12,780)	5,665	(16,104)	4,747
Effect of foreign exchange rate changes on cash and cash equivalents	514	(2,727)	188	(1,879)
<b>Net Cash Inflow (Outflow)</b>	<b>12,380</b>	<b>(1,992)</b>	<b>(3,754)</b>	<b>(39,064)</b>
<b>Cash and Cash Equivalents, Beginning of Period</b>	<b>75,941</b>	<b>160,856</b>	<b>92,075</b>	<b>197,928</b>
<b>Cash and Cash Equivalents, End of Period</b>	<b>\$ 88,321</b>	<b>\$ 158,864</b>	<b>\$ 88,321</b>	<b>\$ 158,864</b>
Cash and cash equivalents	\$ 76,369	\$ 154,527	\$ 76,369	\$ 154,527
Restricted cash	11,952	4,337	11,952	4,337
	\$ 88,321	\$ 158,864	\$ 88,321	\$ 158,864
<b>SUPPLEMENTAL INFORMATION</b>				
Taxes paid	\$ -	\$ 104	\$ 23	\$ 110
Interest paid	13,958	14,582	15,757	16,586

The accompanying Notes to the Interim Consolidated Financial Statements are an integral part of these statements.

# **AINSWORTH LUMBER CO. LTD.**

## **Notes to the Interim Consolidated Financial Statements**

(Figures are in thousands of Canadian dollars unless indicated otherwise)

(Unaudited)

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### **1. BASIS OF PRESENTATION**

#### **Consolidation**

These consolidated financial statements include the accounts of Ainsworth Lumber Co. Ltd. and all of its wholly-owned subsidiaries and partnerships which include Ainsworth Engineered Corp., Ainsworth Engineered, LLC, Ainsworth Corp., Ainsworth Engineered New York, Inc. (formerly Chatham Forest Products, Inc.), Ainsworth Engineered Canada Limited Partnership, 0737562 B.C. Ltd., Ainsworth GP Ltd., and The Ainsworth Charitable Trust. The Company follows the recommendations in Accounting Guideline 15, Consolidation of Variable Interest Entities, which establishes the application of consolidation principles to entities that are subject to control on a basis other than ownership of voting interests. The Company has determined that it does not have any variable interest entities.

The Company accounts for its 50% interest in the High Level Project on a proportionate consolidation basis.

#### **Plan of Arrangement**

On June 17, 2008, Ainsworth Lumber Co. Ltd. (the "Predecessor") announced a proposed recapitalization transaction (the "Plan"). Details of the Plan were provided in an information circular dated June 24, 2008 distributed to noteholders and existing shareholders. On July 24, 2008, the Plan was approved by noteholders and existing shareholders.

On July 29, 2008, the Predecessor implemented the Plan having the following key elements:

- Conversion of \$834 million Senior Unsecured Notes into \$154 million (U.S.\$150 million) rollover Senior Unsecured Notes and equity of the Company.
- All outstanding common shares as at July 29, 2008 were cancelled and new common shares in the recapitalized company were issued.
- Noteholders received 96% of the new common shares and, for some noteholders, warrants exercisable into new common shares: 46% of the new common shares were allocated pro rata to all noteholders, 35% of the new common shares were allocated to noteholders who subscribed for U.S.\$200 million new Senior Unsecured Notes, 15% of the new common shares were allocated to noteholders who backstopped new Senior Unsecured Notes.
- Existing shareholders received 4% of the new common shares and 8,695,634 warrants to acquire common shares of the Company.

The Company's balance sheet as at July 29, 2008 was prepared under the provisions of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section "HB" 1625, "Comprehensive Revaluation of Assets and Liabilities" ("fresh start accounting"). Under fresh start accounting, the Company was required to determine its enterprise value. The enterprise value of \$410 million was determined based on the fair value of the unsecured debt (based on market trading prices) converted into equity and of the issuance of common shares and cashless warrants to the shareholders of the Predecessor.

### **2. SIGNIFICANT ACCOUNTING POLICIES**

These unaudited interim consolidated financial statements do not include all disclosures normally provided in annual financial statements and accordingly, should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2009. The Company's accounting policies are in accordance with Canadian generally accepted accounting principles and are consistent with those outlined in the 2009 audited financial statements. In management's opinion, these unaudited interim consolidated financial statements include all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly such information. The results of operations for the interim periods are not necessarily indicative of the results to be expected in future periods.

# AINSWORTH LUMBER CO. LTD.

## Notes to the Interim Consolidated Financial Statements

(Figures are in thousands of Canadian dollars unless indicated otherwise)

(Unaudited)

### 3. INVENTORIES

The carrying value of logs and panel products, valued at net realizable value, and materials, supplies and consumable spares valued at lower of cost and replacement cost, is set out in the following table:

	<b>June 30</b>	December 31
	<b>2010</b>	2009
Logs	\$ 11,649	\$ 12,046
Panel products	13,911	9,786
Materials, supplies and spares	17,949	17,350
	<b>\$ 43,509</b>	<b>\$ 39,182</b>

All inventories are pledged as security for loans.

### 4. LONG-LIVED ASSETS HELD FOR DISPOSAL AND DISCONTINUED OPERATIONS

The following tables present selected financial information related to discontinued operations and long-lived assets held for sale:

	<b>Three months ended June 30</b>		<b>Six months ended June 30</b>	
	<b>2010</b>	2009	<b>2010</b>	2009
Sales	\$ 28	\$ 10,154	\$ 403	\$ 22,145
Gain on disposal of property, plant and equipment	61	1,627	85	1,886
Impairment of property, plant and equipment	-	(8,219)	-	(22,522)
Write-down of inventory	-	(4,267)	-	(4,267)
Loss before income taxes	(359)	(11,229)	(637)	(30,600)
Income tax expense (recovery)	132	(6,109)	111	(5,218)
Net loss from discontinued operations	<b>\$ (491)</b>	<b>\$ (5,120)</b>	<b>\$ (748)</b>	<b>\$ (25,382)</b>

# AINSWORTH LUMBER CO. LTD.

## Notes to the Interim Consolidated Financial Statements

(Figures are in thousands of Canadian dollars unless indicated otherwise)

(Unaudited)

### 4. LONG-LIVED ASSETS HELD FOR DISPOSAL AND DISCONTINUED OPERATIONS (Continued)

	June 30 2010	December 31 2009
<b>ASSETS</b>		
Current Assets of Discontinued Operations		
Accounts receivable	\$ 122	\$ 819
Inventories	45	262
Income taxes receivable	7	557
Prepaid expenses	147	837
	<b>321</b>	<b>2,475</b>
Property, Plant and Equipment	-	91
Property, Plant and Equipment Under Lease and Held for Sale	<b>7,042</b>	<b>7,042</b>
	<b>7,042</b>	<b>7,133</b>
<b>Total Assets Held for Disposal</b>	<b>\$ 7,363</b>	<b>\$ 9,608</b>
<b>LIABILITIES</b>		
Current Liabilities of Discontinued Operations		
Accounts payable and accrued liabilities	\$ 1,487	\$ 5,009
Accrued Pension Benefit Liability	897	885
<b>Total Liabilities Held for Disposal</b>	<b>\$ 2,384</b>	<b>\$ 5,894</b>

### 5. FINANCE EXPENSE

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Cash interest	\$ (7,353)	\$ (8,149)	\$ (15,090)	\$ (17,099)
Payment-in-kind interest	(4,823)	(5,213)	(9,708)	(10,776)
	<b>\$ (12,176)</b>	<b>\$ (13,362)</b>	<b>\$ (24,798)</b>	<b>\$ (27,875)</b>

### 6 FOREIGN EXCHANGE (LOSS) GAIN

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Foreign exchange (loss) gain on long-term debt	\$ (24,772)	\$ 50,448	\$ (5,484)	\$ 28,721
Other foreign exchange gain (loss)	1,655	(3,868)	542	(1,720)
	<b>\$ (23,117)</b>	<b>\$ 46,580</b>	<b>\$ (4,942)</b>	<b>\$ 27,001</b>

### 7. OTHER ITEMS

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Gain on disposal of property, plant and equipment	\$ 21	\$ 327	\$ 29	\$ 862
Net legal proceeds	12	6,412	1,149	4,361
Other income (loss)	572	(41)	729	572
	<b>\$ 605</b>	<b>\$ 6,698</b>	<b>\$ 1,907</b>	<b>\$ 5,795</b>

# **AINSWORTH LUMBER CO. LTD.**

## **Notes to the Interim Consolidated Financial Statements**

(Figures are in thousands of Canadian dollars unless indicated otherwise)

(Unaudited)

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### **7. OTHER ITEMS (Continued)**

During the first quarter of 2010, the Company reached a settlement of a claim relating to a dispute over discrepancies in the pricing calculation outlined in a chip agreement. Pursuant to the recapitalization, the Company is required to pay out a portion of the settlement proceeds, net of legal costs, to the former shareholders. The proceeds of the settlement were received in April 2010.

The net settlement proceeds were adjusted in the second quarter of 2010 to reflect the actual costs incurred with respect to the claim.

### **8. COMMITMENTS AND GUARANTEES**

The Company has entered into an agreement to purchase machinery, equipment, engineering and management support services totaling approximately \$0.8 million (December 31, 2009: \$4.2 million) in relation to a dryer optimization project which is expected to improve environmental compliance and reduce energy consumption.

The Company has long-term purchase contracts with annual minimum volume commitments. All contracts are at market prices and on normal business terms.

The Company is a party to contracts in which it agrees to indemnify third parties for product liabilities that arise out of or relate to sales contracts. The Company cannot estimate the potential amount of future payments under these agreements until events arise that would trigger the liability.

By agreement with the co-owner of the jointly operated High Level, Alberta OSB facility, if the co-owner does not pay its share of accounts payable and accrued liabilities, the Company may pay such amounts and recover them from the co-owner's share of production. The co-owner's share of accounts payable and accrued liabilities as at June 30, 2010 is \$1.1 million (December 31, 2010: \$1.3 million). The co-owner filed for CCAA protection in Ontario on June 25, 2009. At June 30, 2010, the co-owner had met all of its obligations to the joint venture.

### **9. CONTINGENCIES**

In the normal course of its business activities, the Company is subject to claims and legal actions that may be made by customers, suppliers and others. While the final outcome with respect to actions outstanding or pending as at June 30, 2010 cannot be predicted with certainty, the Company believes the resolution will not have a material effect on the Company's financial position, results of operations or cash flows.

### **10. STOCK-BASED COMPENSATION**

The Company has a single stock option plan designed to provide equity-based compensation to directors, executives and key senior management. The plan provides for the issuance of options to acquire a maximum of 9,000,000 common shares with terms of up to 10 years. The fair value of options granted is calculated using the Black-Scholes model on the date of grant. Adoption of the plan was approved by the Company's shareholders on May 13, 2009.

# AINSWORTH LUMBER CO. LTD.

## Notes to the Interim Consolidated Financial Statements

(Figures are in thousands of Canadian dollars unless indicated otherwise)

(Unaudited)

### 10. STOCK-BASED COMPENSATION (Continued)

The table below outlines the significant assumptions used during the period to estimate the fair value of options:

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Weighted average assumptions:				
Risk-free interest rate	1.82%	2.94%	3.09%	2.94%
Expected volatility	51.00%	40.00%	51.00%	40.00%
Dividend yield	0%	0%	0%	0%
Expected option life (years)	3.26	9.36	3.79	9.36

The table below outlines the status of the Company's stock option plan:

	Three months ended June 30			
	2010		2009	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Stock options at beginning of period	2,177,222	\$ 1.87	-	\$ -
Stock options granted during the period	274,934	3.98	1,252,222	1.57
Stock options outstanding at end of period	2,452,156	\$ 2.11	1,252,222	\$ 1.57
Options exercisable at end of period	1,038,113		985,555	
Weighted average fair value per option granted during the period	\$ 1.10		\$ 0.93	

	Six months ended June 30			
	2010		2009	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Stock options at beginning of period	1,252,222	\$ 1.56	-	\$ -
Stock options granted during the period	1,199,934	2.69	1,252,222	1.57
Stock options outstanding at end of period	2,452,156	\$ 2.11	1,252,222	\$ 1.57
Options exercisable at end of period	1,038,113		985,555	
Weighted average fair value per option granted during the period	\$ 1.05		\$ 0.93	

No stock options were exercised during the period.

# AINSWORTH LUMBER CO. LTD.

## Notes to the Interim Consolidated Financial Statements

(Figures are in thousands of Canadian dollars unless indicated otherwise)

(Unaudited)

### 10. STOCK-BASED COMPENSATION (Continued)

The following table summarizes the weighted average exercise prices and weighted average remaining contractual life of the stock options outstanding at June 30, 2010:

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number of Options	Weighted Average Remaining Contractual Life (yrs)	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	
\$0 - 2	1,252,222	8.48	\$ 1.56	985,555	\$ 1.67	
2 - 4	1,025,000	9.71	2.40	-	-	
4 - 6	174,934	6.95	4.38	52,558	4.48	
	2,452,156	8.88	\$ 2.11	1,038,113	\$ 1.81	

The table below outlines the Company's stock based compensation expense:

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Stock-based compensation expense	\$ 136	\$ 711	\$ 199	\$ 711

### 11. GAIN ON DERIVATIVE FINANCIAL INSTRUMENT

The Company has a derivative financial instrument related to the call options embedded in the Senior Unsecured Notes, whereby the Company has the right to repurchase the Notes. Changes in the value of this derivative are reflected in operations and within other assets on the balance sheet. The Company engaged an independent third party expert to perform a valuation of the call options. Changes in the risk-free rate, the credit spread and cash interest rate resulted in a gain on the derivative financial asset in the first three and six months of 2010 (June 30, 2009: nil).

### 12. PENSION EXPENSE

Pension expense and contributions related to the Company's defined benefit plans was as follows:

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Continuing Operations:				
Pension expense	\$ 496	\$ 428	\$ 918	\$ 856
Contributions	1,258	869	2,081	1,949
Discontinued Operations:				
Pension expense	\$ 80	\$ 84	\$ 156	\$ 140
Contributions	-	-	-	1,928

Effective April 1, 2010, all new Canadian employees have been enrolled into a Canadian defined contribution plan. The Company's total defined contribution plan cost for the three and six months ended June 30, 2010 was \$1.6 thousand (three and six months ended June 30, 2009: \$nil).

# AINSWORTH LUMBER CO. LTD.

## Notes to the Interim Consolidated Financial Statements

(Figures are in thousands of Canadian dollars unless indicated otherwise)

(Unaudited)

### 13. INCOME TAXES

During the second quarter of 2010, as a result of a change in shareholdings, a change of control occurred for tax purposes, resulting in the expiry of certain previously recognized tax assets of \$5.7 million and certain unrecognized net capital losses. Certain permanent differences, such as the non-taxable portion of the foreign exchange (loss) gain on debt and the expected reversal of certain future income tax assets and liabilities at lower effected tax rates also impacted the resulting income tax expense or recovery.

### 14. EARNINGS (LOSS) PER SHARE

Basic earnings per share is calculated by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted earnings per share is based on the weighted average number of common shares and dilutive warrants and stock options outstanding at the beginning of or granted during the period, calculated using the treasury stock method. Under this method, the proceeds from the exercise of the options are assumed to be used to repurchase the Company's shares on the open market. The difference between the number of shares assumed purchased and the number of options assumed exercised is added to the actual number of shares outstanding to determine diluted shares outstanding for purposes of calculating diluted earnings per share. Therefore, the number of shares in the diluted earnings per share calculation will increase as the average share price increases.

At June 30, 2010 there were 274,934 (June 30, 2009: 1,002,222) stock options which were not taken into account in the calculation of diluted earnings per share for each period presented because their effect was anti-dilutive.

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Net (loss) income from continuing operations	\$ (17,287)	\$ 29,824	\$ (1,594)	\$ (4,151)
Net loss from discontinued operations	(491)	(5,120)	(748)	(25,382)
Net (loss) income	\$ (17,778)	\$ 24,704	\$ (2,342)	\$ (29,533)
Weighted average common shares outstanding	100,100,000	100,000,000	100,100,000	100,000,000
Effect of dilutive stock options	1,014,646	39,919	497,693	10,709
	101,114,646	100,039,919	100,597,693	100,010,709
<b>Basic and diluted earnings per share:</b>				
Net (loss) income from continuing operations	\$ (0.17)	\$ 0.30	\$ (0.01)	\$ (0.04)
Net loss from discontinued operations	(0.01)	(0.05)	(0.01)	(0.25)
Net (loss) income	\$ (0.18)	\$ 0.25	\$ (0.02)	\$ (0.29)

# AINSWORTH LUMBER CO. LTD.

## Notes to the Interim Consolidated Financial Statements

(Figures are in thousands of Canadian dollars unless indicated otherwise)

(Unaudited)

### 15. CHANGE IN NON-CASH OPERATING WORKING CAPITAL

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Accounts receivable	\$ 127	\$ (5,585)	\$ (6,361)	\$ (6,745)
Inventories	9,439	22,858	(4,302)	10,517
Income taxes receivable/payable	826	2,174	1,438	1,505
Prepaid expenses	(333)	(2,907)	(342)	(2,779)
Accounts payable and accrued liabilities	(8,350)	(8,022)	(5,272)	(14,032)
	\$ 1,709	\$ 8,518	\$ (14,839)	\$ (11,534)

### 16. SEGMENTED INFORMATION

Sales from continuing operations attributed to countries based on location of customer are as follows:

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
North America	\$ 89,027	\$ 62,233	\$ 162,366	\$ 122,246
Overseas	7,120	8,588	14,820	17,783
	\$ 96,147	\$ 70,821	\$ 177,186	\$ 140,029

Property, plant and equipment are located in Canada.

### 17. MANAGEMENT OF CAPITAL

Capital is defined as working capital, long-term debt and equity, as reflected in these interim financial statements. The Company manages capital by adjusting the amount of dividends paid to shareholders, purchasing shares for cancellation pursuant to normal course issuer bids, issuing new shares and warrants, issuing new debt, and/or issuing new debt to replace existing debt with different characteristics. Under its existing debt indentures, the Company is restricted in managing capital and must conform with the indentures' provisions, which govern capital components such as dividends, asset sales and debt incurrence.

### 18. FINANCIAL INSTRUMENTS AND RISKS

The Company undertakes transactions in a range of financial instruments including cash and cash equivalents, short-term investments, trade and other receivables, trade and other payables and various forms of borrowings, including secured borrowings, Senior Unsecured Notes with an embedded derivative arising from call options, bank loans and a capital lease.

#### a) Financial Risks

The Company's activities result in exposure to a number of financial risks, including credit risk, liquidity risk and market risk. Management's policies for minimizing these risks are set out below.

#### Credit Risk

Credit risk is the risk that a contracting entity will not complete its obligations under a financial instrument and cause a financial loss. The Company is exposed to credit risk on cash and cash equivalents, accounts receivable and short-term investments. The Company's maximum exposure to credit risk related to receivables and short-term investments is the gross carrying amount of these assets net of any allowance for doubtful accounts or impairment loss as reflected in these interim financial statements. As at June 30, 2010, the amount of accounts receivable past due was nominal. Credit risk associated with short-term investments is minimized by ensuring that the Company only invests in liquid securities and with counterparties that have a high credit rating. Concentration of

# AINSWORTH LUMBER CO. LTD.

## Notes to the Interim Consolidated Financial Statements

(Figures are in thousands of Canadian dollars unless indicated otherwise)

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### 18. FINANCIAL INSTRUMENTS AND RISKS (Continued)

credit risk with respect to trade receivables is limited due to the Company's credit evaluation process and the dispersion of a large number of customers across many geographic areas.

#### Liquidity Risk

Liquidity risk is the risk that the Company encounters difficulty in meeting its obligations associated with financial liabilities. Liquidity risk includes the risk that, as a result of operational liquidity requirements, the Company will not have sufficient funds to settle a transaction on the due date; will be forced to sell financial assets at a value which is less than what they are worth; or may be unable to settle or recover a financial asset at all. Liquidity risk arises from accounts payable, long-term debt, commitments and financial guarantees. Under current market conditions, the Company continues to focus on maintaining adequate liquidity to meet cash interest and principal repayments, operating working capital requirements, including seasonal log inventory builds in the first and fourth quarters, and capital expenditures.

As global debt and equity markets can be volatile, we continue to monitor discretionary capital expenditures carefully. The Company's U.S. dollar Senior Secured Term Loan matures in 2014 and the U.S. dollar Senior Unsecured Notes mature in 2015. In the event that debt or equity capital is not available on acceptable terms to the Company in the future, the Company may need to explore other strategic alternatives.

The contractual maturity of the Company's liabilities, long-term debt and commitments are shown in the following table. These amounts represent the future undiscounted principal and interest cash flows and therefore do not equate to the carrying values shown in the balance sheet.

	Less than 1 month	1 to 3 months	4 to 12 months	1 to 5 years
Senior Unsecured Notes	\$ -	\$ -	\$ 25,179	\$ 114,274
Senior Secured Term Loan	514	1,011	4,523	127,333
Equipment loan	789	1,572	6,974	17,356
Deutsche Bank equipment loan	-	-	1,776	6,873
Capital lease obligations	86	172	773	4,120
Operating lease obligations	94	188	766	2,693
Accounts payable and accrued liabilities	20,661	114	2,439	-
Reforestation obligation	-	-	-	2,712
Purchase commitments	831	1,662	2,567	595
	\$ 22,975	\$ 4,719	\$ 44,996	\$ 275,956

#### Market Risk

##### Interest rate risk

Interest rate risk refers to the risk that the value of a financial instrument or cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Company is exposed to interest risk on its floating rate debt. Unfavourable changes in the applicable interest rates may result in an increase in interest expense. The Company manages its exposure to interest rate risk by maintaining a combination of floating rate debt and fixed rate debt. The Company does not use derivative instruments to hedge its exposure to interest rate risk. At June 30, 2010, if interest rates had been 50 basis points higher/lower and all other variables were held constant, the Company's after-tax net loss would decrease/increase by approximately \$0.5 million on an annual basis (December 31, 2009: \$0.5 million).

# AINSWORTH LUMBER CO. LTD.

## Notes to the Interim Consolidated Financial Statements

(Figures are in thousands of Canadian dollars unless indicated otherwise)

(Unaudited)

### 18. FINANCIAL INSTRUMENTS AND RISKS (Continued)

The Company is also exposed to interest risk on the derivative financial instrument that arises from the call option embedded in the Senior Unsecured Notes. As the risk-free interest rate and the credit spread increase, the value of the derivative financial asset decreases. Conversely, a decrease in the risk-free interest rate and the credit spread increases the value of the derivative financial asset. Changes in the value of this derivative financial asset are reflected in operations. During the six month period ended June 30, 2010, changes in the risk-free rate and the credit spread resulted in a \$0.7 million unrealized gain on the derivative financial asset.

#### *Currency risk*

Currency risk refers to the risk that the value of a financial commitment, recognized asset or liability will fluctuate due to changes in foreign currency rates. The Company's functional currency is the Canadian dollar, but it is exposed to foreign currency risk primarily arising from U.S. dollar denominated long-term debt, cash, accounts receivable and accounts payable. In addition, the majority of the Company's sales are transacted in U.S. dollars.

At June 30, 2010, if the Canadian dollar had weakened/strengthened one cent against the U.S. dollar with all other variables held constant, after-tax net loss for the year would have been \$4.0 million higher/lower on an annual basis (December 31, 2009: \$3.7 million).

The U.S. dollar is the only foreign currency to which the Company has significant exposure. The Company does not use derivative instruments to hedge its exposure to foreign currency risk.

#### *Commodity price risk*

The Company's financial performance is principally dependent on the demand for and selling prices of its products. Both are subject to significant fluctuations. The markets for panel products are cyclical and are affected by factors such as global economic conditions including the strength of the U.S. housing market, changes in industry production capacity, changes in world inventory levels and other factors beyond the Company's control. At this time, the Company has elected not to enter into derivative contracts to hedge its exposure to commodity price risk.

### b) Fair Values

The fair value of financial instruments, with the exception of senior notes and term loan, is estimated to approximate their carrying value at June 30, 2010 due to the immediate or short-term maturity of these financial instruments.

The fair value of long-term debt is determined using quoted ask prices for the Company's Senior Unsecured Notes and Senior Secured Term Loan. The estimated fair value may differ from the amount which could be realized in an immediate settlement. The carrying values and fair values of the long-term debt are as follows:

	June 30, 2010		December 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Senior notes	\$ 416,330	\$ 355,484	\$ 401,758	\$ 236,726
Term loan	109,268	103,804	107,872	107,872
Equipment financing	34,897	34,897	42,006	42,006
Capital leases	9,631	9,631	9,689	9,689
	\$ 570,126	\$ 503,816	\$ 561,325	\$ 396,293

# **AINSWORTH LUMBER CO. LTD.**

## **Notes to the Interim Consolidated Financial Statements**

(Figures are in thousands of Canadian dollars unless indicated otherwise)

(Unaudited)

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### **18. FINANCIAL INSTRUMENTS AND RISKS (Continued)**

The term loan is secured by accounts receivable and inventory having a carrying value of \$64.4 million. In the event that the accounts receivable and inventory security for the term loan is deficient, the term loan holders have an additional security charge (the "floating deficiency charge") in an OSB facility. The maximum of the floating deficiency charge is U.S.\$50 million, which is less than the carrying value of the asset. Equipment financing of U.S.\$23.5 million is secured by certain capital assets.

The value of the call option embedded in the Senior Unsecured Notes as at June 30, 2010 was \$5.7 million (December 31, 2009: \$Nil).

### **19. RELATED PARTY TRANSACTIONS**

During the six months ended June 30, 2010, the Company paid legal fees of \$23 thousand (June 30, 2009: \$nil) to a law firm of which a director of the Company is a Partner. The transaction was measured and recorded at the exchange amount which is equivalent to fair value. Fair value is defined as the transaction amount with unrelated parties under similar terms and conditions.