

**AINSWORTH LUMBER CO. LTD.  
Interim Consolidated Balance Sheets**

(In thousands of Canadian dollars)  
(Unaudited)

	June 30 2008	December 31 2007
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 28,389	\$ 69,627
Short-term investments	886	835
Accounts receivable, net of allowance for doubtful accounts of \$22 (2007: \$40)	28,821	21,537
Inventories (Note 4)	59,684	73,050
Income taxes receivable	4,845	-
Prepaid expenses	9,481	11,113
Restricted cash	6,975	7,104
Current portion of future income tax assets	653	635
	139,734	183,901
<b>Capital Assets, Net</b>	<b>811,180</b>	<b>830,102</b>
<b>Other Assets</b>	<b>25,755</b>	<b>22,887</b>
<b>Future Income Tax Assets</b>	<b>12,096</b>	<b>11,759</b>
<b>Goodwill</b>	<b>51,970</b>	<b>51,970</b>
	<b>\$ 1,040,735</b>	<b>\$ 1,100,619</b>
<b>LIABILITIES AND SHAREHOLDERS' (DEFICIENCY) EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	\$ 62,625	\$ 38,790
Income taxes payable	-	2,607
Current portion of future income tax liabilities	20,327	23,682
Current portion of long-term debt	10,572	10,122
	93,524	75,201
<b>Accrued Pension Benefit Liability</b>	<b>6,841</b>	<b>6,651</b>
<b>Reforestation Obligation</b>	<b>4,187</b>	<b>4,451</b>
<b>Long-term Debt</b>	<b>990,831</b>	<b>967,250</b>
<b>Future Income Tax Liabilities</b>	<b>55,709</b>	<b>34,327</b>
	1,151,092	1,087,880
<b>Going Concern (Note 1)</b>		
<b>Commitments and Guarantees (Note 5)</b>		
<b>Contingencies (Note 6)</b>		
<b>SHAREHOLDERS' (DEFICIENCY) EQUITY</b>		
<b>Capital Stock</b>	<b>55,827</b>	<b>55,827</b>
<b>(Deficit) Retained Earnings</b>	<b>(66,155)</b>	<b>62,698</b>
<b>Accumulated Other Comprehensive Loss</b>	<b>(100,029)</b>	<b>(105,786)</b>
	(110,357)	12,739
	<b>\$ 1,040,735</b>	<b>\$ 1,100,619</b>

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

Approved by the Board:



Catherine Ainsworth



Allen Ainsworth

# **Ainsworth® Second Quarter 2008**

## **AINSWORTH LUMBER CO. LTD. Interim Consolidated Statements of Operations**

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

	<b>Three months ended June 30</b>		<b>Six months ended June 30</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Sales</b>	<b>\$ 111,428</b>	<b>\$ 157,531</b>	<b>\$ 199,936</b>	<b>\$ 292,566</b>
<b>Costs and Expenses</b>				
Costs of products sold (exclusive of amortization)	<b>91,915</b>	166,052	<b>202,312</b>	306,322
Selling and administration	<b>7,286</b>	7,522	<b>13,941</b>	16,387
Amortization of capital assets	<b>11,614</b>	19,534	<b>22,835</b>	34,673
(Gain) loss on disposal of capital assets (Note 7)	<b>(374)</b>	46	<b>(3,124)</b>	307
Write-off of capital assets	<b>-</b>	-	<b>837</b>	-
Cost of class action lawsuit (Note 6)	<b>172</b>	2,170	<b>318</b>	3,421
	<b>110,613</b>	195,324	<b>237,119</b>	361,110
<b>Operating Earnings (Loss)</b>	<b>815</b>	(37,793)	<b>(37,183)</b>	(68,544)
<b>Finance Expense</b>				
Interest	<b>16,247</b>	17,925	<b>33,866</b>	36,968
Transaction costs (Note 8)	<b>9,624</b>	2,897	<b>13,078</b>	2,897
	<b>25,871</b>	20,822	<b>46,944</b>	39,865
<b>Other Income</b>	<b>691</b>	1,215	<b>1,811</b>	2,917
<b>Foreign Exchange Gain (Loss) on Long-term Debt</b>	<b>6,811</b>	79,615	<b>(29,270)</b>	89,049
<b>Other Foreign Exchange (Loss) Gain</b>	<b>(1,093)</b>	(2,203)	<b>2,566</b>	(4,222)
<b>Realized Currency Translation Loss</b>	<b>-</b>	(3,597)	<b>(1,465)</b>	(4,167)
<b>(Loss) Income Before Income Taxes</b>	<b>(18,647)</b>	16,415	<b>(110,485)</b>	(24,832)
<b>Income Tax Expense (Recovery) (Note 10)</b>	<b>15,555</b>	(11,527)	<b>11,900</b>	(30,008)
<b>Net (Loss) Income</b>	<b>\$ (34,202)</b>	<b>\$ 27,942</b>	<b>\$ (122,385)</b>	<b>\$ 5,176</b>
Basic and diluted (loss) earnings per common share	<b>\$ (2.33)</b>	<b>\$ 1.91</b>	<b>\$ (8.35)</b>	<b>\$ 0.35</b>
Weighted average number of common shares outstanding	<b>14,649,140</b>	14,649,140	<b>14,649,140</b>	14,649,140

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**

(In thousands of Canadian dollars)

(Unaudited)

	<b>Three months ended June 30</b>		<b>Six months ended June 30</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Net (Loss) Income</b>	<b>\$ (34,202)</b>	<b>\$ 27,942</b>	<b>\$ (122,385)</b>	<b>\$ 5,176</b>
<b>Other Comprehensive (Loss) Income</b>				
Unrealized (loss) gain on translation of self-sustaining foreign operations	(979)	(32,430)	4,292	(36,404)
Realized currency translation loss (reclassified to net income (loss))	-	3,597	1,465	4,167
	<b>(979)</b>	<b>(28,833)</b>	<b>5,757</b>	<b>(32,237)</b>
<b>Comprehensive Loss</b>	<b>\$ (35,181)</b>	<b>\$ (891)</b>	<b>\$ (116,628)</b>	<b>\$ (27,061)</b>

**Interim Consolidated Statements of Changes in Shareholders' (Deficiency) Equity**

(In thousands of Canadian dollars)

(Unaudited)

	<b>Three months ended June 30</b>		<b>Six months ended June 30</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Capital Stock</b>	<b>\$ 55,827</b>	<b>\$ 55,827</b>	<b>\$ 55,827</b>	<b>\$ 55,827</b>
<b>(Deficit) Retained Earnings</b>				
Beginning of period	(31,953)	256,387	62,698	279,153
Transitional adjustment on adoption of new accounting policies (Note 3)	-	-	(6,468)	-
Net (loss) income	(34,202)	27,942	(122,385)	5,176
	<b>(66,155)</b>	<b>284,329</b>	<b>(66,155)</b>	<b>284,329</b>
<b>Accumulated Other Comprehensive Loss on Translation of Self-Sustaining Foreign Operations</b>				
Beginning of period	(99,050)	(60,126)	(105,786)	(56,722)
Net unrealized loss on translation of self-sustaining foreign operations in the period	(979)	(28,833)	5,757	(32,237)
	<b>(100,029)</b>	<b>(88,959)</b>	<b>(100,029)</b>	<b>(88,959)</b>
<b>Total (Deficit) Retained Earnings and Accumulated Other Comprehensive Loss</b>	<b>(166,184)</b>	<b>195,370</b>	<b>(166,184)</b>	<b>195,370</b>
<b>Total Shareholders' (Deficiency) Equity</b>	<b>\$ (110,357)</b>	<b>\$ 251,197</b>	<b>\$ (110,357)</b>	<b>\$ 251,197</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 Cash Flows**

(In thousands of Canadian dollars)

(Unaudited)

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>				
Net (loss) income	\$ (34,202)	\$ 27,942	\$ (122,385)	\$ 5,176
Items not affecting cash				
Amortization of capital assets	11,614	19,534	22,835	34,673
Non-cash portion of interest expense	340	341	674	813
Foreign exchange (gain) loss on long-term debt	(6,811)	(79,615)	29,270	(89,049)
(Gain) loss on disposal of capital assets	(374)	46	(3,124)	307
Write-off of capital assets	-	-	837	-
Change in non-current reforestation obligation	(194)	(166)	(264)	953
Future income taxes	23,065	(12,954)	19,233	(32,892)
Realized currency translation loss	-	3,597	1,465	4,167
Change in non-cash operating working capital (Note 12)	6,931	45,805	11,358	31,297
Cash provided by (used in) operating activities	369	4,530	(40,101)	(44,555)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>				
Proceeds from issue of long-term debt	-	109,750	-	109,825
Repayment of long-term debt	(3,715)	(2,182)	(5,762)	(3,810)
Repayment of capital lease obligations	(75)	(76)	(150)	(157)
Cash (used in) provided by financing activities	(3,790)	107,492	(5,912)	105,858
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Short-term investments	(6)	-	(51)	35,029
Restricted cash	769	6,168	129	50,048
Additions to capital assets	(868)	(14,350)	(4,074)	(55,963)
Increase in other assets	(993)	(2,746)	(622)	(1,703)
Proceeds on disposal of capital assets	3,151	173	6,543	776
Settlement of warranty holdback (Note 13)	2,852	-	2,852	-
Cash provided by (used in) investing activities	4,905	(10,755)	4,777	28,187
Effect of foreign exchange rate changes on cash and cash equivalents	6	4	(2)	(21)
<b>NET CASH INFLOW (OUTFLOW)</b>	<b>1,490</b>	<b>101,271</b>	<b>(41,238)</b>	<b>89,469</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>26,899</b>	<b>62,510</b>	<b>69,627</b>	<b>74,312</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 28,389</b>	<b>\$ 163,781</b>	<b>\$ 28,389</b>	<b>\$ 163,781</b>
<b>SUPPLEMENTAL INFORMATION</b>				
Taxes paid	\$ 105	\$ 1,085	\$ 165	\$ 5,394
Interest paid	\$ 4,626	\$ 14,698	\$ 12,852	\$ 22,103

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

# ***Ainsworth***® **Second Quarter 2008**

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## **AINSWORTH LUMBER CO. LTD.**

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

#### **Three and six month periods ended June 30, 2008 and 2007**

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

(Unaudited)

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#### **1. GOING CONCERN**

The unaudited interim consolidated financial statements are presented in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") on the assumption that the Company continues as a going concern. The going concern basis of presentation assumes that the Company will continue operations for the foreseeable future and will be able to realize assets and discharge liabilities and commitments in the normal course of business. If the going concern assumption was not appropriate for these financial statements, adjustments would have to be made to the carrying value of assets and liabilities, reported revenues and expenses and balance sheet classifications.

There is reasonable doubt about the appropriateness of using the going concern assumption because of the Company's current liquidity position and forecasted operating cash flows and capital requirements for the next twelve months. The decline in demand for OSB in the U.S. residential housing market and the significant long-term appreciation of the Canadian dollar against the U.S. dollar led to negative operating margins.

On June 17, 2008 the Company announced a proposed recapitalization transaction. In the event that this transaction is not approved by the Shareholders, the Noteholders and the Court, the Company may not be able to continue as a going concern (Note 17).

#### **2. BASIS OF PRESENTATION**

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, 2007. The Company's accounting policies are in accordance with Canadian GAAP. These accounting policies are consistent with those outlined in the 2007 annual audited financial statements, except as noted in Note 3. 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.

#### **3. CHANGES IN ACCOUNTING POLICIES**

Effective January 1, 2008 the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") for capital disclosures, inventories and financial instruments presentation and disclosure.

##### *Section 1535 – Capital Disclosures*

This section establishes standards for disclosures about an entity's capital and how it is managed. Under this standard, the Company is required to disclose qualitative information about its objectives, policies and processes for managing capital; to disclose quantitative data about what it regards as capital; and to disclose whether an entity has complied with any externally imposed capital requirements and, if not, the consequences of such non-compliance.

# **Ainsworth® Second Quarter 2008**

**AINSWORTH LUMBER CO. LTD.**

**Notes to the Interim Consolidated Financial Statements**

**Three and six month periods ended June 30, 2008 and 2007**

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

(Unaudited)

## **3. CHANGES IN ACCOUNTING POLICIES (Continued)**

### *Section 3031 - Inventories*

The Company has applied Section 3031 on a prospective basis, with opening inventory adjustments recorded against opening retained earnings. Under the new requirements, inventory must be valued at the lower of cost and net realizable value. Inventory write-downs may be reversed (to the extent of the original write-down) if circumstances change in subsequent periods. Cost of panel products is defined as all costs that relate to bringing the inventory to its present location and condition under normal operating conditions and includes manufacturing costs, such as raw materials, labour and production overhead and amortization costs. Inventory cost is determined using the three month weighted average cost of production. Cost of logs is defined as all costs that relate to purchasing, harvesting and delivery of the logs to their present location, including labour, overhead and amortization. Materials, supplies and consumable spares are valued at the lower of cost and replacement cost, which approximates net realizable value, and are expensed when introduced into the production process. As at January 1, 2008, capital spares in the amount of \$1.2 million have been reclassified to capital assets and are amortized over the estimated remaining life of the related mill. The adjustment to opening inventory and retained earnings on adoption of Section 3031 was \$6.5 million, net of tax of \$1.2 million.

### *Section 3862 – Financial Instruments – Disclosures*

This section requires entities to provide disclosure of quantitative and qualitative information that enables users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and management's objectives, policies and procedures for managing such risks.

### *Section 3863 – Financial Instruments – Presentation*

This section establishes standards for presentation of financial instruments and non-financial derivatives.

## **New Accounting Pronouncements**

### *International Financial Reporting Standards*

On February 13, 2008, the Canadian Accounting Standards Board confirmed that International Financial Reporting Standards will replace Canada's current generally accepted accounting principles for publicly accountable profit-oriented enterprises for interim and annual financial statements effective January 1, 2011. The Company is presently considering the effect these standards will have on its financial statements.

## **4. 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 2008</b>	December 31 2007
Logs	\$ 10,882	\$ 21,124
Panel products	15,484	17,990
Materials and supplies	33,318	33,936
	<b>\$ 59,684</b>	<b>\$ 73,050</b>

# ***Ainsworth*** *Second Quarter 2008*

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## **AINSWORTH LUMBER CO. LTD.**

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

#### **Three and six month periods ended June 30, 2008 and 2007**

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

(Unaudited)

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#### **4. INVENTORIES (Continued)**

During the three-month period and the six-month period ended June 30, 2008, log inventory write-down recoveries of \$18,690 and \$11,189, and panel product inventory write-down recoveries of \$1,611 and \$1,086 were recorded, respectively.

The carrying amount of inventories pledged as security for loans was \$54,452 as at June 30, 2008 (December 31, 2007: \$73,050).

#### **5. COMMITMENTS AND GUARANTEES**

As part of the Grande Prairie expansion project, the Company has entered into agreements to purchase machinery, equipment, engineering and management support services which at June 30, 2008 totaled approximately \$5,366 (December 31, 2007: \$5,280). The terms of the contracts are varied and extend through 2009.

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.

#### **6. CONTINGENCIES**

In 2006, the Company, along with other North American OSB producers, was named as a defendant in several lawsuits which alleged violations of United States anti-trust laws in relation to the pricing and supply of OSB from mid-2002 to the present. In October 2007, the Company finalized a settlement agreement with the direct purchaser plaintiffs. Under the terms of the agreement, the Company paid \$8.6 million (U.S.\$8.6 million) into escrow to be distributed across the settlement class. In January 2008, the Company finalized a settlement agreement with the indirect purchaser plaintiffs. Under the terms of the agreement, the Company paid \$1.3 million (U.S.\$1.3 million) into escrow to be distributed across the settlement class. These settlement amounts, along with associated legal costs, were reflected in the Company's results as at December 31, 2007. The Company received preliminary court approval of these settlements in March 2008 and subsequently received final court approval of the settlement with the indirect plaintiffs on July 17, 2008. The Company continues to believe the allegations against it in these claims are entirely without merit. The decision to enter into the settlement agreements was to avoid prolonged litigation.

In the normal course of its business activities, the Company is subject to a number of 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, 2008 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.

#### **7. NON-CORE ASSET DISPOSALS**

On March 26, 2008, the Company completed the sale of an unused finger-joint lumber facility for net proceeds of \$3.4 million. The carrying value of the facility was \$650 and was previously included in Corporate assets for the purpose of segmented disclosures.

# ***Ainsworth*** Second Quarter 2008

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## **AINSWORTH LUMBER CO. LTD.**

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

#### **Three and six month periods ended June 30, 2008 and 2007**

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

(Unaudited)

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#### **7. NON-CORE ASSET DISPOSALS (Continued)**

On June 25, 2008, the Company completed the sale of an electricity transmission line for proceeds of \$2.8 million. The carrying value of the facility was \$2.7 million and was included in OSB assets for the purpose of segmented disclosures.

#### **8. TRANSACTION COSTS**

Transaction costs of \$9.6 million in the three months ended June 30, 2008 represent professional fees and filing fees associated with the proposed recapitalization transaction. In the six months ended June 30, 2008, transaction costs relate to the recapitalization as well as the exchange offer and consent solicitation, which expired in March 2008. Transaction costs of \$2.9 million in the three and six month periods ended June 30, 2007 were incurred on the issue of a U.S.\$102.6 million secured term loan.

#### **9. PENSION EXPENSE**

Pension expense related to the Company's defined benefit plans was \$1,654 for the three month period ended June 30, 2008 (2007: \$1,756) and is estimated using assumptions consistent with those applied in the Company's annual audited financial statements. For the six month period ended June 30, 2008, pension expense related to the Company's defined benefit plans was \$3,307 (2007: \$3,595). Amortization of past service cost and the net actuarial gain is calculated in a manner consistent with that disclosed in the annual audited financial statements and is not considered significant to disclose separately. The Company made contributions of \$1,028 in the three month period ended June 30, 2008 (2007: \$Nil) and \$2,718 in the six month period ended June 30, 2008 (2007: \$Nil).

#### **10. INCOME TAX RECOVERY**

In the second quarter of 2008 the Company refiled certain Canadian tax returns in order to recover provincial taxes previously paid. This resulted in the use of approximately \$70.7 million of Canadian tax losses for which a future tax benefit was previously recorded, and expiry of \$15.6 million of investment tax credits. As a result the Company recorded \$7.8 million of income taxes recoverable and a provision for the realization of previously benefited future tax assets of \$21.3 million. The income tax expense in the period resulted from the difference between the tax rate at which these losses were previously benefited and the tax rate at which they were realized.

In the first quarter of 2008 the Company determined that, in light of poor OSB market conditions, continued operating losses and a bleak market outlook for 2008 and 2009, the future income tax benefit of Canadian tax losses and U.S. tax losses incurred since the first quarter of 2008 and the fourth quarter of 2007 respectively should not be recognized. This, along with certain permanent differences, such as the non-taxable portion of the foreign exchange loss on the Company's U.S. debt, had a further impact on the effective tax rate.

#### **11. RELATED PARTY TRANSACTIONS**

During the quarter, the Company paid \$42 (2007: \$30) to a company owned by officers of the Company for rental charges relating to mobile forestry and transportation equipment. The Company paid \$84 in the six months ending June 30, 2008 (2007: \$60). During the quarter, the Company sold two vehicles and two trailers to a director and officer of the company for \$28. The Company also sold plywood and a laptop computer totaling \$7 to an officer of the Company. These transactions were conducted on normal commercial terms and prices. At June 30, 2008 \$7 was due from an officer of the Company.

# **Ainsworth® Second Quarter 2008**

## **AINSWORTH LUMBER CO. LTD.**

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

#### **Three and six month periods ended June 30, 2008 and 2007**

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

(Unaudited)

#### **12. CHANGE IN NON-CASH OPERATING WORKING CAPITAL**

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Accounts receivable	\$ (6,670)	\$ 4,022	\$ (9,361)	\$ (2,413)
Inventories	7,217	38,226	4,882	15,057
Income taxes receivable/payable	(7,094)	3,552	(7,450)	420
Prepaid expenses	(2,229)	(38)	(834)	1,048
Accounts payable and accrued liabilities	15,707	43	24,121	17,185
	<b>\$ 6,931</b>	<b>\$ 45,805</b>	<b>\$ 11,358</b>	<b>\$ 31,297</b>

#### **13. SETTLEMENT OF WARRANTY HOLDBACK**

On April 10, 2008, the Company finalized a settlement of a claim under a warranty holdback relating to the Company's purchase of Voyageur Panel Ltd. in May 2004. Under the terms of the settlement agreement, the Company received cash proceeds of \$2.9 million. The settlement was recorded as a reduction of the related capital assets.

#### **14. SEGMENTED INFORMATION**

	OSB	Plywood	Corporate	Consolidated
<b>Three months ended June 30, 2008</b>				
Sales to external customers	\$ 90,278	\$ 21,150	\$ -	\$ 111,428
Operating earnings (loss)	10,561	(1,078)	(8,668)	815
<b>Three months ended June 30, 2007</b>				
Sales to external customers	\$ 132,010	\$ 25,521	\$ -	\$ 157,531
Operating loss	(25,986)	(157)	(11,650)	(37,793)
<b>Six months ended June 30, 2008</b>				
Sales to external customers	\$ 160,560	\$ 39,376	\$ -	\$ 199,936
Operating loss	(21,038)	(1,316)	(14,829)	(37,183)
<b>Six months ended June 30, 2007</b>				
Sales to external customers	\$ 241,543	\$ 51,023	\$ -	\$ 292,566
Operating loss	(45,106)	(720)	(22,718)	(68,544)

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

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
United States	\$ 79,600	\$ 124,413	\$ 142,415	\$ 227,084
Canada	14,427	15,987	24,744	32,790
Overseas	17,401	17,131	32,777	32,692
	<b>\$ 111,428</b>	<b>\$ 157,531</b>	<b>\$ 199,936</b>	<b>\$ 292,566</b>

# **Ainsworth® Second Quarter 2008**

## **AINSWORTH LUMBER CO. LTD.**

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

#### **Three and six month periods ended June 30, 2008 and 2007**

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

(Unaudited)

#### **14. SEGMENTED INFORMATION (Continued)**

Capital assets attributed to countries based on location are as follows:

	<b>June 30</b>	December 31
	<b>2008</b>	2007
Canada	<b>\$ 598,174</b>	\$ 620,412
United States	<b>213,006</b>	209,690
	<b>\$ 811,180</b>	\$ 830,102

Goodwill of \$51,970 (2007: \$51,970) is attributable to the acquisition of Voyageur Panel Canada Limited which is located in Canada.

#### **15. MANAGEMENT OF CAPITAL**

The Company defines capital 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, 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.

#### **16. FINANCIAL INSTRUMENTS AND RISKS**

The Company undertakes transactions in a range of financial instruments including cash, short-term investments, trade and other receivables, trade and other payables and various forms of borrowings, including senior unsecured notes, 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 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, 2008, the amount of accounts receivable past due was nominal.

Credit risk associated with short-term investments is minimized by ensuring that commercial paper investments have the highest rating obtainable and that certificates of deposit are placed with well-capitalized financial institutions and other creditworthy counterparties. Concentration of 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.

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

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(Unaudited)

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

### **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.

On March 26, 2008, as a result of cash balances falling below U.S.\$75.0 million, under the terms of the U.S.\$42.3 million equipment financing facility the Company received a prepayment notification from the lender requiring prepayment of interest for a period of twelve months, which was paid on April 2, 2008.

Under the Company's existing long-term and current indebtedness, over the remainder of 2008 the Company must provide for interest payments of approximately \$57.8 million and principal payments of \$5.3 million. The Company did not make scheduled interest payments of \$25.0 million at June 30, 2008. Pursuant to the terms of the related indenture, the Company has up to 30 days after such interest payment is due to make such payment. Under the terms of the proposed recapitalization (Note 17), such interest obligations are to be settled.

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.

	<b>Less than 1 month</b>	<b>1 to 3 months</b>	<b>4 to 12 months</b>	<b>1 to 5 years</b>
6.75% Senior Unsecured Notes	\$ 11,013	\$ -	\$ 22,026	\$ 88,102
7.25% Senior Unsecured Notes	10,165	-	20,330	346,505
LIBOR plus 3.75% Floating Rate Senior Unsecured Notes	2,560	2,560	7,681	169,626
LIBOR plus 4.00% Floating Rate Senior Unsecured Notes	1,298	1,298	3,895	95,954
Senior Secured Term Loan	498	1,013	4,567	24,161
Equipment loan	685	1,371	6,655	36,035
Deutsche Bank equipment loan	-	-	2,904	10,483
Capital lease obligations	82	164	740	3,946
Operating lease obligations	317	609	2,134	2,271
Accounts payable and accrued liabilities	33,205	785	3,001	-
Reforestation obligation	-	-	-	4,187
Purchase commitments	897	1,152	7,103	20,824
	<b>\$ 60,721</b>	<b>\$ 8,953</b>	<b>\$ 81,036</b>	<b>\$ 802,094</b>

To help reduce liquidity risks the Company is seeking approval of a recapitalization, which is intended to significantly reduce long-term debt and annual interest expense, and inject additional cash into the Company (Note 17). Management believes that the debt reduction and capital infusion will improve the Company's ability to manage its liquidity and mitigate the effects of the ongoing downturn in the U.S. housing market.

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

### **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 reduce its exposure to interest rate risk.

At June 30, 2008, 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 increase/decrease by approximately \$1.9 million on an annual basis (December 31, 2007: \$1.3 million). Other comprehensive loss would decrease/increase by \$Nil (December 31, 2007: \$Nil). The increased sensitivity of after-tax net loss to interest rate changes in 2008 is due to the Company's decision to stop recording the benefit of currently incurred tax losses.

#### *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.

Foreign currency risk also arises on translation of the net assets of the Company's self-sustaining U.S. subsidiary. This foreign currency translation risk exposure is partially offset by sales contracts and borrowings denominated in U.S. dollars. The U.S. dollar is the only foreign currency to which the Company has significant exposure. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

At June 30, 2008, 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 \$8.9 million higher/lower on an annual basis (December 31, 2007: \$5.3 million), and the change in other comprehensive income would have been \$Nil (December 31, 2007: \$Nil). The increased sensitivity of after-tax net loss to foreign currency rate changes in 2008 is due to the Company's decision to stop recording the benefit of currently incurred tax losses.

#### *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 actively manage its exposure to commodity price risk.

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(Unaudited)

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

### **b) Fair Values**

The fair value of financial instruments, with the exception of long-term debt, is estimated to approximate their carrying value at June 30, 2008 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. 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:

	<b>June 30, 2008</b>		<b>December 31, 2007</b>	
	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Carrying Value</b>	<b>Fair Value</b>
Senior notes	\$ 830,194	\$ 369,495	\$ 806,350	\$ 534,164
Term loan	104,659	104,659	101,744	101,744
Equipment financing	56,657	56,658	59,510	59,510
Capital leases	9,893	9,893	9,768	9,768
	<b>\$ 1,001,403</b>	<b>\$ 540,705</b>	<b>\$ 977,372</b>	<b>\$ 705,186</b>

The term loan is secured by accounts receivable and inventory having a carrying value of \$88,823. Equipment financing of U.S.\$39,673 is secured by certain capital assets.

## **17. RECAPITALIZATION**

The following is the summary of the key elements for the recapitalization transaction (the "Recapitalization") proposed by the Company:

All of the current outstanding common shares of Ainsworth (the "Existing Common Shares") will be cancelled and new common shares in the recapitalized Ainsworth will be issued (the "New Common Shares"), as described below.

### **Treatment of Existing Unsecured Notes**

All of the senior unsecured notes issued by Ainsworth and listed below (the "Existing Notes") will be affected by the Recapitalization:

Senior Unsecured Floating Rate Notes due October 1, 2010  
7.25% Senior Unsecured Notes due October 1, 2012  
Senior Unsecured Floating Rate Notes due April 1, 2013  
6.75% Senior Unsecured Notes due March 15, 2014  
6.75% Senior Unsecured Notes due March 15, 2014

Each holder of Existing Notes (the "Noteholders") will receive, in full and complete satisfaction of its Existing Notes, the following:

- Such Noteholder's pro rata share (based on the face amount of Existing Notes it holds) of U.S.\$150 million aggregate principal amount of new 11% senior unsecured notes due 2015 (the "New Rollover Notes");

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## **AINSWORTH LUMBER CO. LTD.**

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#### **17. RECAPITALIZATION (Continued)**

- b) For those Noteholders that are eligible under applicable securities laws, the right to subscribe to an offering of U.S.\$200 million aggregate principal amount of new senior unsecured notes (the "New Notes"). HBK Master Fund L.P., Tricap Partners II L.P. and Barclays Bank PLC (the "Initial Backstop Parties") and certain additional holders of Existing Notes have agreed to backstop (the "Backstop") the offering of the New Notes. The right to participate in the Backstop will be open to all Existing Noteholders that are eligible under applicable securities laws to purchase New Notes.

The New Notes and the New Rollover Notes will contain identical economic terms, including that interest thereon will be payable 6% in cash, plus 5% payment-in-kind.

- c) Payment in cash of all unpaid but accrued interest in respect of the Existing Notes as at March 31, 2008, to the extent not already paid; and
- d) Such Noteholder's pro rata share of up to 96% of the New Common Shares (based on the face amount of Existing Notes it holds), on a fully diluted basis: 46% will be allocated pro rata, based on the amount of Existing Notes held, to all Noteholders; 35% will be allocated pro rata, based on the number of New Notes subscribed for, to Noteholders that have acquired New Notes; 10% will be allocated to those Noteholders that have agreed to participate in the Backstop; and 5% will be allocated to the Initial Backstop Parties.

Accordingly, pursuant to the Recapitalization, for every U.S.\$1,000,000 of face value of Existing Notes held by a Noteholder, such Noteholder will be entitled to receive (i) approximately U.S.\$182,000 in principal amount of New Rollover Notes and (ii) its pro rata share of up to 96% of the New Common Shares, as described above. In addition, if such Noteholder qualifies under applicable securities laws, they will also be able to (i) purchase no more than approximately U.S.\$242,700 in principal amount of New Notes and (ii) subject to participation in the Backstop, purchase a pro rata share of any unsubscribed New Notes.

As at July 18, 2008, U.S.\$200 million of New Notes had been subscribed for.

#### **Support Agreements**

HBK Master Fund L.P., Tricap Partners II L.P. and Barclays Bank PLC and certain other Existing Noteholders (the "Consenting Noteholders") have executed a support agreement (the "Noteholder Support Agreement") with Ainsworth whereby they have agreed to vote in favor of and support the Recapitalization. The Consenting Noteholders hold in excess of U.S.\$655 million of Existing Notes. The Company has also entered into support agreements ("Shareholder Support Agreements") with the holders of a majority of the Existing Common Shares of the Company (the "Shareholders") under which they have agreed to vote in favour of and support the Recapitalization. Ainsworth will continue to solicit and obtain additional Noteholder and Shareholder support for the Recapitalization.

In addition, the Company has reached an agreement with the holders of a majority in aggregate principal amount of the Company's 2007 secured term loan facility to amend and restate the terms of such facility in connection with the Recapitalization.

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**AINSWORTH LUMBER CO. LTD.**

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## **17. RECAPITALIZATION (Continued)**

### **Treatment of Existing Common Shares**

All Existing Common Shares will be cancelled. Holders of Existing Common Shares will receive their pro rata share of:

- a) 4% of New Common Shares; and
- b) cashless warrants to receive additional New Common Shares representing 8% of the New Common Shares, on a fully diluted basis, if the Company's equity market capitalization exceeds U.S.\$1.2 billion within five years of the date of the Recapitalization or, if such market capitalization is not met within the five-year period, additional New Common Shares representing 0.02% of the New Common Shares on a Fully Diluted Basis.

### **Implementation Process**

Ainsworth will hold separate Noteholder and shareholder meetings on July 24, 2008 in Vancouver, British Columbia to obtain the required approvals for certain steps necessary to implement the Recapitalization transaction, including approval by the Noteholders of a Plan of Arrangement under the Canada Business Corporations Act (the "CBCA"). Details of the Recapitalization were provided in an information circular dated June 24, 2008 distributed to Noteholders and existing shareholders. In addition to Noteholder and shareholder approvals, implementation of the Plan of Arrangement is subject to final approval of the Court and receipt of all necessary regulatory and stock exchange approvals.

The proposed Recapitalization is expected to result in a substantial realignment of the Company's equity and non-equity interests, such that virtually all of the equity interests are acquired by non-equity interests. For financial accounting purposes, this reorganization creates, in substance, a "new reporting entity" and a need for "fresh start" accounting, establishing a new cost basis for the continuing entity. Under fresh start accounting, Ainsworth is required to assess the fair value of identifiable assets and liabilities, whether or not previously recorded.