

CANFOR PULP INCOME FUND

CANFOR PULP LIMITED PARTNERSHIP

Consolidated Financial Statements

For the periods ended December 31, 2006

MANAGEMENT'S RESPONSIBILITY

The information and representations in the financial statements and Management's Discussion and Analysis (MD&A) are the responsibility of Management and have been approved by the Board of Directors of Canfor Pulp Holding Inc. the general partner of Canfor Pulp Limited Partnership and by the Trustees of Canfor Pulp Income Fund. Management prepared the consolidated financial statements in accordance with accounting principles generally accepted in Canada and, where necessary, they reflect Management's best estimates and judgments at this time. It is reasonably possible that circumstances arise which cause actual results to differ. Management does not believe it is likely that any differences will be material. The financial information presented throughout this report is consistent with that contained in the consolidated financial statements.

The Partnership and the Fund maintain systems of internal accounting controls, policies and procedures to provide reasonable assurances as to the reliability of the financial records and the safeguarding of its assets. Canfor's Internal Audit Department performs independent reviews of the accounting records and related procedures. The Internal Audit Department reports its findings and recommendations both to Management and the Audit Committee.

The Board of Directors and the Trustees are responsible for ensuring that Management fulfills its responsibilities for financial reporting and are ultimately responsible for reviewing and approving the financial statements and Management's Discussion and Analysis. The Board and Trustees carry out these activities primarily through the Audit Committee.

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

The consolidated financial statements and Management's Discussion and Analysis have been reviewed by the Audit Committee, which recommended their approval by the Board of Directors and the Trustees. The consolidated financial statements have been audited by PricewaterhouseCoopers LLP, the external auditors, whose reports follow.

(signed) Paul Richards

Paul Richards
President and CEO
Canfor Pulp Holding Inc.

(signed) Thomas Sitar

Thomas Sitar
Chief Financial Officer and Secretary
Canfor Pulp Holding Inc.

Auditors' Report

To the Unitholders of
Canfor Pulp Income Fund

We have audited the consolidated balance sheet of Canfor Pulp Income Fund (the "Fund") as at December 31, 2006, and the consolidated statements of income and accumulated earnings and distributions and cash flows for the period from July 1, 2006 (commencement of commercial operations of the Fund) to December 31, 2006. These consolidated financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2006, and the results of its operations and its cash flows for the period ended December 31, 2006 in accordance with Canadian generally accepted accounting principles and as described in Note 1 to the consolidated financial statements.

(Signed) PricewaterhouseCoopers LLP

Chartered Accountants

Vancouver, BC
February 16, 2007

Canfor Pulp Income Fund
Consolidated Statement of Income and Accumulated Earnings and Distributions

<u>(thousands of dollars, except unit and per unit amounts)</u>	6 months ended December 31, 2006
Income	
Equity income in Canfor Pulp Limited Partnership	20,558
Expenses	
Operating Expenses (notes 4, 6)	-
<hr/>	
Net Income	20,558
Distributions declared (note 4)	30,419
<hr/>	
Accumulated distributions in excess of earnings, end of period	(9,861)
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Weighted average number of Units	17,947,838
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Net income per unit, basic and diluted	1.15

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

**Canfor Pulp Income Fund
Consolidated Cash Flow Statement**

(thousands of dollars)	6 months ended December 31, 2006
Cash generated from (used in)	
Operating activities	
Net income	20,558
Items not affecting cash:	
Equity income in Canfor Pulp Limited Partnership	(20,558)
Net Change in non-cash working capital	-
<hr/>	
Financing activities	
Distributions paid to Unitholders	(17,641)
<hr/>	
Investing activities	
Distributions received from Canfor Pulp Limited Partnership	17,641
<hr/>	
Beginning, change and ending balance in cash and cash equivalents	-

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

**Canfor Pulp Income Fund
Consolidated Balance Sheet**

As at

(thousands of dollars)

December 31, 2006

ASSETS	
Current Assets	
Distributions receivable from Canfor Pulp Limited Partnership	\$ 12,778
<hr/>	
Total current assets	12,778
<hr/>	
Equity Investment in Canfor Pulp Limited Partnership (note 3)	289,491
<hr/>	
	\$ 302,269
<hr/>	
LIABILITIES	
Current Liabilities	
Accounts payable (note 6)	1
Distribution payable (note 4)	12,778
<hr/>	
	12,779
<hr/>	
UNITHOLDERS' EQUITY	
Unitholders' Equity (note 5)	299,351
Accumulated distributions in excess of earnings – from inception July 1, 2006	(9,861)
<hr/>	
	289,490
<hr/>	
	\$ 302,269

Description of the fund and basis of presentation of financial statements (note 1)

Subsequent events (note 8)

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

Approved by the Trustees

(signed) Stan Bracken-Horrocks

Stan Bracken-Horrocks
Trustee

(signed) Charles Jago

Charles Jago
Trustee

Canfor Pulp Income Fund

Notes to the Consolidated Financial Statements as at December 31, 2006.

1. Description of the Fund and Basis of Presentation of Financial Statements

Canfor Pulp Income Fund (the Fund) is an unincorporated open-ended trust established under the laws of the Province of Ontario on April 21, 2006, pursuant to the Fund Declaration. The principal head office of the Fund is located at 1700 West 75th Avenue, Vancouver, BC, Canada. The Fund has been established to acquire and hold, through a wholly owned trust, the Canfor Pulp Trust (the Trust), investments in the Limited Partnership Units of the Canfor Pulp Limited Partnership (the Partnership), and such other investments as the Trustees of the Fund may determine. The General Partner of the Partnership is Canfor Pulp Holding Inc. (the General Partner) and each partner holds an ownership interest in the General Partner equal to its Partnership interest.

These consolidated financial statements include the accounts of the Fund and the Trust. From the date of its establishment on April 21, 2006 to June 30, 2006, the Fund was inactive. As a result, there are no comparative figures in the financial statements for any periods prior to the six months ended December 31, 2006.

On July 1, 2006, the Fund completed the indirect acquisition of 20% of the Prince George, B.C. based NBSK pulp and paper business of Canfor Corporation (Canfor). Canfor exchanged 14,254,005 Class A Limited Partnership Units for an equal number of Fund Units and these units were then distributed by Canfor to its shareholders. As a result of these transactions, on July 1, 2006, Canfor shareholders owned all of the issued and outstanding Fund Units, and the Fund held all issued and outstanding Class A Limited Partnership Units representing a 20% indirect interest in the Partnership.

On November 30, 2006, Canfor exchanged 21,239,537 Class B Exchangeable Limited Partnership units of the Partnership for the same number of newly issued Fund Units and immediately distributed these Fund Units to its shareholders as an in-kind taxable dividend of 1.49 units for every 10 Canfor shares held. Following completion of this exchange, there are a total of 35,493,542 Fund Units issued and outstanding, and the Fund indirectly holds a total of 35,493,542 units of the Partnership, representing 49.8% of the Partnership. Canfor, through its ownership of Class B Exchangeable Limited Partnership Units, which are indirectly exchangeable for Fund Units, owns the remaining 50.2% interest in the Partnership. As a result of the transaction, and the Fund's method of accounting for its investment in the Partnership, the Fund recognized its 20% pro-rata earning of the Partnership's November income, however, based on the distribution declared by the Partnership on November 30, 2006, the Fund received 49.8% of the total November cash distribution. The Fund has recognized the distribution received in excess of its pro-rata share of the Partnership's income (\$5.1 million or 29.8% of the distribution) as a permanent contribution by Canfor through its ownership in the Partnership.

Each unitholder participates pro rata in any distributions from the Fund.

The Fund is entirely dependent on distributions from the Partnership to make its own distributions.

2. Significant Accounting Policies

Principles of consolidation

These consolidated financial statements include the accounts of the Fund and Canfor Pulp Trust (the "Trust"), its wholly owned holding trust. All significant inter-company transactions have been eliminated.

Investment in Canfor Pulp Limited Partnership

The Fund accounts for its investment in the Partnership using the equity method. Under the equity method the Fund records its pro rata share of the Partnership's income as an increase in investment. Any distributions declared by the Partnership and accruing to the Fund reduce the carrying value of the Fund's investment in the Partnership.

Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. It is reasonably possible that circumstances may arise that cause actual results to differ from management estimates; however, management does not believe it is likely that such differences will materially affect the Fund's financial position. The valuation of the Fund's investment in the Partnership relative to its market value is the only significant estimate in these financial statements.

Net Income per Unit

Basic net income per Fund unit is based on the weighted average number of Fund units outstanding during the period. At December 31, 2006 the Partnership has 35,776,483 Class B Exchangeable Limited Partnership Units outstanding which can be exchanged for Fund Units at the option of the holder (Canfor). Any issuance of new Fund Units would be accompanied with a corresponding increase in the Fund's investment in the Partnership through the acquisition of Class B Exchangeable Limited Partnership Units. As a result, this potential conversion would not result in any dilution of the Fund's net income per unit.

Income Taxes

The Fund is a unit trust for income tax purposes. As such, the Fund is only taxable on any taxable income not allocated to the Unitholders. For the six months ended December 31, 2006, all taxable income of the Fund will be allocated to the Unitholders. Income tax obligations relating to distributions from the Fund are the obligations of the Unitholders.

3. Equity Investment in Canfor Pulp Limited Partnership

The Fund's equity investment in the Partnership is as follows:

(thousands of dollars)

Initial investment in the Partnership on July 1, 2006 – 14,254,005 Fund units	\$	116,560
Issuance of Fund units for exchangeable Partnership units (November 30, 2006) – 21,239,537 Fund units		182,792
Cumulative equity in income of the Partnership		20,558
Cumulative distributions received and receivable		(30,419)
Equity investment in the Partnership as at December 31, 2006	\$	289,491

The Fund's investment in the Partnership units is recorded using the equity method. The Fund's initial investment in the Partnership on July 1, 2006 represented the Fund's 20% ownership in the transfer of the Pulp and Paper business from Canfor to the Partnership. On November 30, 2006 Canfor exchanged 21,239,537 Class B Exchangeable Limited Partnership Units for the same number of newly issued Fund Units for a total value of \$182.8 million (\$8.61 per unit), representing the Fund's pro rata share of the carrying value of the Partnership units received on the date of the exchange.

4. Distributions

The Fund declared distributions in its first six months of operation as follows:

(thousands of dollars, except per unit amounts)

Record Date	Payable Date	Amount per Fund Unit			Amount
		Monthly	Supplemental	Total	
		\$	\$	\$	\$
August 2, 2006	August 15, 2006	0.12	-	0.12	1,710.5
August 31, 2006	September 15, 2006	0.12	-	0.12	1,710.5
September 29, 2006	October 13, 2006	0.12	0.08	0.20	2,850.8
October 31, 2006	November 15, 2006	0.12	0.08	0.20	2,850.8
November 30, 2006	December 15, 2006	0.12	0.12	0.24	8,518.3
December 29, 2006	January 15, 2007	0.14	0.22	0.36	12,777.6
Total		0.74	0.50	1.24	30,418.5

The Fund's monthly distributions are based on the Partnership's monthly distributions. To December 31, 2006, distributions declared by the Fund equaled those declared by the Partnership with the exception of an expense distribution declared by the Partnership totaling \$142,000 payable to the Fund. The expense distribution is accounted for as a recovery of operating expenses and presented on a net basis in the consolidated statement of income and accumulated earnings and distributions. This amount represents the Partnership's commitment to cover the Fund's operating expenses pursuant to the Partnership agreement.

Monthly cash distributions from the Partnership are not directly equal to the Fund's pro rata share of the Partnership's income under the equity method.

5. Unitholders' Equity

The Fund may issue an unlimited number of Fund units for consideration, and on the terms and conditions, determined by the Trustees. Each Fund unit is transferable and represents an equal and undivided beneficial interest in any distributions from the Fund. All Fund units are of the same class and have equal rights and privileges.

On initial distribution on July 1, 2006, the total number of Fund units issued was 14,254,005, equal to the number of Class A Limited Partnership Units for which they were exchanged.

On November 30, 2006 the Fund completed the issuance of 21,239,537 Fund units for a total value of \$182.8 million (\$8.61 per unit) representing the Fund's pro rata share of the carrying value of the Partnership units received on the date of the exchange. Following completion of this exchange, there are a total of 35,493,542 Fund units issued and outstanding.

Redemption Rights

Fund units are redeemable at any time on demand by the holders thereof upon delivery to the Fund of a duly completed and properly executed notice requesting redemption in a form approved by the Fund Trustees. Upon receipt of the redemption notice by the Fund, all rights with respect to the Fund units tendered for redemption, including the right to receive any distributions which are declared payable to the Unitholders of record on a date subsequent to the date of receipt by the Fund of such notice, will be surrendered and the Unitholder will be entitled to receive a price per Fund unit equal to the lesser of 90% of the market price of the Fund Units as of the date on which the Fund units are surrendered for redemption (Redemption Date); and 100% of the closing market price on the Redemption Date.

Exchange Rights

Canfor holds all remaining (35,776,483) Class B Exchangeable Limited Partnership Units, and it has the ability to indirectly exchange them on a one-for-one basis into Fund units.

6. Related Party Transactions

All accounting, treasury, legal and administrative functions for the Fund are performed on its behalf by the Partnership pursuant to a support agreement. For the six months ended December 31, 2006, the Fund had incurred operating expenses with third parties of \$142,000. During the fourth quarter, the Partnership declared an expense distribution to cover the operating expenses of the Fund as provided for in the Partnership agreement. The expense distribution is accounted for as a recovery of operating expenses and presented on a net basis in the consolidated statement of income and accumulated earnings and distributions.

7. Taxation of Publicly Traded Income Trusts

Income tax obligations related to the distributions of the Fund are the obligations of the Unitholders.

On October 31, 2006, the Canadian Federal Government announced proposed plans to apply a tax on distributions from publicly traded income trusts, such as the Fund. For existing income trusts the government is proposing a four-year transition period until their 2011 taxation year before the tax would be applicable. The impact to the Fund is unknown at this time and may be material.

8. Subsequent Events

On January 24, 2007 the Fund declared a distribution of \$0.14 per unit or \$5.0 million, payable on February 15, 2007 to unitholders of record on January 31, 2007. On February 16, 2007, the Fund declared a distribution of \$0.14 per unit or \$5.0 million, payable on March 15, 2007 to unit holders of record on February 28, 2007.

Auditors' Report

To the Partners of
Canfor Pulp Limited Partnership

We have audited the consolidated balance sheets of Canfor Pulp Limited Partnership (the "Partnership") as at December 31, 2006 and December 31, 2005, and the consolidated statements of income and Partners' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Partnership as at December 31, 2006 and December 31, 2005, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles and as described in Note 1 to the consolidated financial statements.

(Signed) PricewaterhouseCoopers LLP

Chartered Accountants

Vancouver, BC
February 16, 2007

Canfor Pulp Limited Partnership
Consolidated Statements of Income and Partners' Equity

(millions of dollars)	Year ended December 31,	
	2006	2005
Sales	\$ 834.4	771.2
Costs and expenses		
Manufacturing and product costs	512.7	569.6
Freight and other distribution costs	114.1	116.0
Amortization	49.0	47.2
Selling and administration costs	23.5	21.7
	699.3	754.5
Operating income	135.1	16.7
Business acquisition costs (note 3)	(5.9)	-
Interest expense, net	(3.8)	-
Foreign exchange loss on long-term debt	(2.5)	-
Other income (expenses)	0.1	(0.2)
	(12.1)	(0.2)
Net income	\$ 123.0	16.5
Net income per Partnership unit (in dollars) (note 10)		
Basic and diluted	1.73	0.23
Weighted average Partnership units outstanding	71,270,025	71,270,025
Partners' equity, beginning of period	\$ 728.7	740.0
Issuance of promissory note on acquisition (notes 3 & 4)	(125.0)	-
Net transactions with Canfor (note 1)	(57.2)	(27.8)
Net income for the period	123.0	16.5
Distributions to partners (notes 13 & 16)	(88.5)	-
Partners' equity, end of period	\$ 581.0	728.7

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

Canfor Pulp Limited Partnership
Consolidated Statements of Cash Flows

(millions of dollars)	Year ended December 31,	
	2006	2005
Cash and cash equivalents generated from (used in)		
Operating activities		
Net income	\$ 123.0	16.5
Items not affecting cash:		
Amortization	49.0	47.2
Unrealized foreign exchange loss on long term debt	2.5	-
Employee future benefits	7.5	4.2
Other	(3.3)	-
Cash flow from operations before working capital changes	178.7	67.9
Changes in non-cash working capital (note 12)	(10.5)	2.1
	168.2	70.0
Financing activities		
Repayment of promissory note	(125.0)	-
Proceeds of long-term debt	125.7	-
Financing costs	(1.6)	-
Net transactions with Canfor	(57.2)	(27.8)
	(58.1)	(27.8)
Investing activities		
Property, plant and equipment, net	(19.6)	(43.0)
Distributions paid to partners (note 13)	(62.7)	-
	(82.3)	(43.0)
Increase (decrease) in cash and cash equivalents	27.8	(0.8)
Cash and cash equivalents, beginning of period	0.6	1.4
Cash and cash equivalents, end of period	\$ 28.4	0.6
Cash payments in the period		
Interest, net	\$ 2.4	-

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

**Canfor Pulp Limited Partnership
Consolidated Balance Sheets**

(millions of dollars)	As at December 31, 2006	As at December 31, 2005
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 28.4	\$ 0.6
Accounts receivable (note 9)		
Trade	130.9	127.9
Other	6.7	10.0
Inventories (note 6)	111.0	107.0
Prepaid expenses	13.1	4.9
Total current assets	290.1	250.4
Property, plant and equipment (note 8)	598.6	627.9
Deferred charges	4.7	0.1
	\$ 893.4	\$ 878.4
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities (note 9)	\$ 125.5	\$ 124.0
Distributions payable (note 13)	25.8	-
Total current liabilities	151.3	124.0
Long-term debt (note 4)	128.2	-
Long-term accruals and liabilities (note 5)	32.9	25.7
	\$ 312.4	\$ 149.7
PARTNERS' EQUITY		
Capital – 14,254,005 Class A Limited Partnership Units and 57,016,020 Class B Limited Partnership Units (notes 1 & 3)	581.0	728.7
Total Partners' Equity	581.0	728.7
	\$ 893.4	\$ 878.4

Commitments and contingencies (note 14)

Subsequent events (note 16)

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

Approved on behalf of Canfor Pulp Limited Partnership by
its General Partner, Canfor Pulp Holding Inc.

(signed) Stan Bracken-Horrocks

Stan Bracken-Horrocks
Director

(signed) Paul Richards

Paul Richards
Director

Canfor Pulp Limited Partnership

Notes to the Consolidated Financial Statements as at December 31, 2006 and 2005

1. Business Description and Basis of Presentation

Canfor Pulp Limited Partnership (the Partnership) is a limited partnership formed on April 21, 2006, under the laws of Manitoba, to acquire and carry on the NBSK pulp and paper business of Canadian Forest Products Ltd., a subsidiary of Canfor Corporation (collectively Canfor). The business consists of two NBSK pulp mills and one NBSK pulp and paper mill located in Prince George, British Columbia and a marketing group based in Vancouver, British Columbia (the Pulp Business).

On July 1, 2006, Canfor transferred the Pulp Business to the Partnership in exchange for a \$125 million promissory note, 14,254,005 Class A Limited Partnership Units and 57,016,020 Class B Exchangeable Limited Partnership Units (the Spinout). Canfor then exchanged its Class A Limited Partnership Units for equal number of Units of Canfor Pulp Income Fund (the Fund). Finally Canfor distributed to its shareholders, for each Canfor share held by them, one New Common Share of Canfor and 0.1 of a unit of the Fund (Fund unit), with the distribution of the Fund units being structured as a return of capital on the Canfor shares. As a result, on the date of the spinout, Canfor shareholders owned all of the issued and outstanding Fund units, with the outstanding Fund units representing a 20% indirect interest in the Partnership and thus the Pulp Business. On November 30, 2006, Canfor exercised its right to exchange Class B Exchangeable Limited Partnership Units for Fund units and 21,239,537 units were exchanged. The exchange was made in order to provide Canfor with the Fund units necessary to enable it to pay a dividend-in-kind to its shareholders. Following completion of this exchange Canfor owns 50.2% and the Fund indirectly owns 49.8% of the issued and outstanding units of the Partnership.

The general partner of the Partnership is Canfor Pulp Holding Inc. (the General Partner), which holds an interest of 0.001% of the Partnership.

All pulp produced by the Pulp Business is sold by the Pulp Business' sales and marketing group to customers primarily in North America, Europe and Asia. The kraft paper produced by the Pulp Business is sold by a 50% owned general partnership to customers in North America and Europe.

For all periods ending prior to July 1, 2006, these financial statements present the financial position, results of operations, and cash flows of the Pulp Business on a carve out basis from Canfor as if operated as a stand-alone partnership entity subject to Canfor control. As a result, the transaction has been accounted for as a continuity of interests. The accompanying financial statements include allocations of certain of Canfor's assets, liabilities and costs. The financial condition, results of operations, and cash flows of the Pulp Business for these comparative periods are not necessarily indicative of the financial condition, results of operations or cash flows that would have been incurred if the Pulp Business was a separate legal entity. Prior to July 1, 2006, the Pulp Business did not operate bank accounts independent or separate from Canfor (other than for marketing subsidiaries) and, as a result and for purposes of prior periods, the combined effect of all transactions is reflected in the net transactions with Canfor line in the Partners' equity.

The statements of income for all periods prior to July 1, 2006, include selling and administration expenses of the Pulp Business, as historically reported in Canfor's financial statements, that have been allocated to the Pulp Business based on specific identification and, where specific identification has been deemed impractical, on a basis which management believes reasonably reflects the cost of services provided. Employee benefits, consisting of such costs as pension, health and welfare and payroll taxes are based on a percentage of actual payroll or allocated payroll charges to the Pulp Business. Amortization is based upon specific identification of the assets utilized in the Pulp Business. Allocated corporate expenses have been charged to the Pulp Business based on specific identification or, when this is deemed impractical, on a basis that management believes reasonably reflects the cost of services provided. Management believes these expense allocations adequately reflect the estimated cost of services provided but may not necessarily be indicative of actual costs that would have been incurred if Canfor had not provided these services.

The balance sheet at December 31, 2005, includes all assets and liabilities directly attributable to the Pulp Business including an allocation of certain of Canfor's corporate assets and liabilities. Employee future benefit liabilities include the obligations for health care and other non-pension benefits for the active salaried employees and active and retired hourly employees of the Pulp Business. The Pulp Business participated in the centralized cash management systems of Canfor, and as a result, did not have separate bank accounts, except for cash held in international marketing operations.

These financial statements are those of the Partnership and do not include the assets, liabilities, revenues and expenses of its partners. The Partnership, other than its incorporated subsidiaries, is not subject to income taxes as its income is allocated for tax purposes to its partners. Accordingly, no recognition has been made for income taxes related to Partnership income in these financial statements. The tax attributes of the Partnership's net assets flow directly to the partners.

Economic Dependence

The Partnership depends on Canfor to provide approximately 65% of its fibre supply as well as to provide certain key business and administrative services as described in note 9. As a result of these relationships as well as other relationships described throughout these financial statements, the Partnership considers its operations to be dependent on its ongoing relationship with Canfor.

2. Significant Accounting Policies

Principles of Consolidation

These consolidated financial statements include the accounts of the Partnership, its wholly owned subsidiaries and its 50% interests in Premium One Papers (a partnership) and Canfor April Corporation (a joint venture). The 50% interests in the partnership and joint venture are accounted for using proportionate consolidation. All significant inter-company transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. It is reasonably possible that circumstances may arise that cause actual results to differ from management estimates; however, management does not believe it is likely that such differences will materially affect the Partnership's financial position.

Significant areas requiring the use of management estimates are, inventory valuations, amortization rates, employee benefit plan assumptions, and environmental obligations.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with an original maturity date of 90 days or less.

Valuation of Inventories

Inventories of pulp and paper products are valued at the lower of average cost and net realizable value. Wood chips are valued at the lower of: a) average cost or b) the greater of net realizable value and replacement cost. Processing materials and supplies are valued at the lower of average cost and replacement cost.

Property, Plant and Equipment

The Partnership capitalizes the costs of major replacements, extensions and improvements to plant and equipment.

Assets are amortized over the following estimated productive lives:

Buildings	10 to 50 years
Pulp and paper machinery and equipment	20 years

Amortization of manufacturing assets is calculated on a straight line basis. Assets under construction are not amortized.

Employee Future Benefits

The Partnership provides certain health care benefits and pension bridge plans to eligible retired employees. The Partnership accrues the costs and related obligations of the pension bridge plan and other retirement benefit plans using the projected benefit actuarial method prorated on service and management's best estimates of salary escalation and other relevant factors. Actuarial gains (losses) arise from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net accumulated actuarial gain or loss over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of the active employees, which is 16 years for the pension bridge plan and 14 years for the other benefit plans. Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the average remaining service period of employees active at the date of the amendment. On January 1, 2000, the Pulp Business (Canfor) adopted the new recommendations of the Canadian Institute of Chartered Accountants relating to the accounting for pensions and other post employment benefits using the prospective application method. The Partnership is amortizing the transitional obligation on a straight-line basis over 16 years, which was the average remaining service period of employees expected to receive benefits under the benefit plan as of January 1, 2000.

The Partnership participates, together with Canfor, in a group defined benefit plan (Group Plan) providing pension benefits to most of its salaried employees. The assets of the Group Plan are not segregated for each participating entity and are used to provide pensions to all members of this plan. As a result, the Partnership is required to account for the Group Plan as a multi-employer plan whereby contributions are expensed as paid. Certain offshore marketing entities provide pension benefits for salaried employees and these obligations are recorded in the liabilities of the Partnership.

For hourly employees covered by industry union defined benefit pension plans, earnings are charged with the Partnership's contributions required under the collective agreements.

Revenue Recognition

Revenues are derived from the following major product lines: pulp, paper, wood chips and sales commissions. Revenue is recognized from product sales when persuasive evidence of a sale exists, the sales price is fixed and determinable, goods have been delivered or title has transferred and collectibility is reasonably assured. Sales are reported net of discounts, allowances and vendor rebates. Amounts charged to customers for shipping and handling are recognized as revenue, and shipping and handling costs incurred by the company are reported as cost of sales.

Foreign Currency Translation

The majority of sales are denominated in foreign currencies. Foreign currencies are translated into Canadian dollars using the temporal method as follows: monetary assets and liabilities at period end exchange rates; and revenues and expenses at exchange rates prevailing at the time the transaction occurs. Exchange gains and losses are reflected in income as incurred.

Derivative Financial Instruments

The Partnership utilizes derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange and commodity price risk. For example, from time to time, it purchases foreign exchange forward contracts to hedge anticipated sales to customers in the United States and the related accounts receivable and also enters into swap transactions to reduce its exposure to fluctuating natural gas prices. The Partnership policy is not to utilize derivative financial instruments for trading or speculative purposes.

The Partnership formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities or to specific firm commitments or forecasted transactions. The Partnership also formally assesses, both at the inception of the hedge and on an ongoing basis, whether the

derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items.

Gains and losses on forward foreign exchange contracts which qualify as a hedge of US dollar denominated sales are recognized as an adjustment to revenue at the time that the contracts are settled. Gains and losses on natural gas swaps which qualify as a hedge and are recognized as an adjustment to manufacturing costs when the contracts are settled.

Impairment of Long-lived Assets

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

Income Taxes

The Partnership is not directly subject to federal or provincial income taxes. The taxable income or loss of the partnership is required to be allocated to the Partnership's partners. Management is of the opinion that any income tax liability arising from the activities of the wholly owned subsidiaries will not be material.

Change in accounting policy – Major maintenance costs

The Partnership adopted the deferral method of accounting for major maintenance costs. Under this method an asset is recorded when expenditures for maintenance costs related to major maintenance are incurred. This asset is then amortized over the period to which the maintenance relates. The amounts in prior periods are not considered material for restatement.

3. Business Acquisition Costs and Partners' Equity

The Partnership incurred costs related to its initial organization and the acquisition of the Pulp Business from Canfor principally comprised of legal, accounting, audit and consulting fees.

Prior to the transfer the net value of the Pulp Business is reflected in Partners' Equity. On July 1, 2006 the Pulp Business was transferred to the Partnership at Canfor's book value as follows:

Net assets transferred

(millions of dollars)

Non cash working capital	124.7
Property plant and equipment	612.9
Other accruals and liabilities	(29.8)
	707.8

Consideration provided

Promissory note	125.0
Partners' equity	582.8
	707.8

4. Credit Facilities and Long-term Debt

On November 30, 2006, the Partnership completed a debt financing by private placement of US\$110 million (Cdn\$125.7 million) of unsecured notes (the Notes). The Notes bear interest at 6.41% and are repayable in full on

their maturity date of November 30, 2013. The proceeds from the issuance of the Notes were used to repay the \$125 million Canfor promissory note.

The Partnership also entered into a 3-year \$75 million syndicated unsecured revolving bank credit facility (the Revolving Facility) with \$30.6 million of the Revolving Facility reserved for a standby letter of credit issued to BC Hydro (note 14). The Revolving Facility bears interest and fees at rates that vary depending on the ratio of net debt to operating earnings before interest, taxes, depreciation and amortization (EBITDA) and which may, at the Partnership's option, be based on lenders' Canadian prime rate, bankers acceptances, US base rate or US LIBOR rate.

Each agreement relative to the Notes and Revolving Facility contains the same covenants with respect to certain financial ratios and at December 31, 2006 the Partnership was in compliance with all covenants.

The fair value of long-term debt at December 31, 2006 was \$ 127.4 million (US\$109.3 million).

5. Long-term Accruals and Liabilities

(millions of dollars)	December 31, 2006	December 31, 2005
Accrued pension obligations	2.7	0.9
Post employment benefits	30.2	24.8
	32.9	25.7

6. Inventories

(millions of dollars)	December 31, 2006	December 31, 2005
Pulp	48.9	42.2
Paper	11.6	11.4
Wood chips	5.4	9.0
Processing materials and supplies	45.1	44.4
	111.0	107.0

7. Employee Future Benefits

The Partnership, in participation with Canfor, has funded and unfunded defined benefit plans, as well as a defined contribution plan, that provide pension, other retirement and post-employment benefits to substantially all salaried employees and for its hourly employees covered under collective agreements. The defined benefit plans are based on years of service and final average salary. The post-employment benefit plans are non-contributory and include a range of health care and other benefits.

The expense recognized in the year for providing the pension and post-employment benefits was as follows:

(millions of dollars)	2006	2005
Pension plans	4.4	4.7
Other employee future benefit plans	6.1	4.9
Contributions to forest industry union plans	6.2	6.3
	16.7	15.9

The assets of the salaried employees defined benefit plan are combined with those of Canfor (a multi-employer plan) and are not segregated for each participating entity. Accordingly, the assets and benefit obligations are not recorded on the balance sheet of the Partnership and contributions are expensed as paid. In the event that the Partnership ceased to participate in the multi-employer plan, the funded status of the pension obligations would be dependent on

the amount of assets transferred to the Partnership at the time of segregation, and therefore cannot be determined at this time.

Benefit Plans

The Partnership measures its accrued benefit obligations for accounting purposes as at September 30 of each year. The most recent actuarial valuations for the post employment benefit plan and the pension bridge plan were on September 30, 2004 and September 30, 2005, respectively.

Information about the Partnership's non-pension retirement benefits is as follows:

Benefit Plan Obligations

(millions of dollars)	2006		2005	
	Post Employment Benefit Plan	Pension Bridge Plan	Post Employment Benefit Plan	Pension Bridge Plan
Accrued benefit obligation				
Beginning of year	\$ 53.2	\$ 4.7	\$ 39.4	\$ 3.8
Current service cost	1.4	0.2	1.1	0.2
Interest cost	2.9	0.3	2.6	0.2
Benefit payments	(0.6)	-	(0.6)	-
Plan amendments	-	1.4	-	-
Actuarial loss (gain)	(1.1)	3.0	10.7	0.5
End of year	\$ 55.8	\$ 9.6	\$ 53.2	\$ 4.7

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

(millions of dollars)	2006		2005	
	Post Employment Benefit Plan	Pension Bridge Plan	Post Employment Benefit Plan	Pension Bridge Plan
Fair market value of plan assets	\$ -	\$ -	\$ -	\$ -
Accrued benefit obligation	55.8	9.6	53.2	4.7
Funded status of plans – deficit	(55.8)	(9.6)	(53.2)	(4.7)
Employer contributions after measurement date	0.2	-	0.2	-
Unamortized transitional obligation	7.1	1.8	7.8	1.9
Unamortized past service costs	-	1.4	-	-
Unamortized net actuarial loss	18.3	4.3	20.4	1.4
Accrued benefit liability	\$ (30.2)	\$ (2.1)	\$ (24.8)	\$ (1.4)

The Pension Bridge Plan is a benefit plan for hourly employees as a result of provisions in collective agreements. Under the terms of the agreements this is an unfunded obligation of the employer. Prior to July 1, 2006, obligations under this plan rested with Canfor and the 2005 comparative amounts above are shown for information purposes only.

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

(millions of dollars)	2006		2005	
Post Employment Benefit Plan				
Current service cost, net of employee contributions	\$	1.4	\$	1.1
Interest cost		2.9		2.6
Actuarial loss		1.0		0.4
Amortization of transitional obligation		0.8		0.8
	\$	6.1	\$	4.9
Pension Bridge Plan				
Current service cost, net of employee contributions	\$	0.2	\$	0.2
Interest cost		0.2		0.2
Actuarial loss (gain)		0.1		-
Amortization of transitional obligation		0.2		0.2
	\$	0.7	\$	0.6

Note: Amounts for Pension Bridge Plan in table above exclude amounts for employees who retired prior to July 1, 2006, as those are obligations of Canfor.

Significant Assumptions

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

(weighted average assumptions)	2006		2005	
	Post Employment Benefit Plan	Pension Bridge Plan	Post Employment Benefit Plan	Pension Bridge Plan
Accrued benefit obligation as of December 31:				
Discount rate	5.25%	5.25%	5.25 %	5.25 %
Rate of compensation increase	3.0%	N/A	3.0 %	N/A
Benefit costs for year ended December 31:				
Discount rate	5.25%	5.25%	6.5 %	6.25%
Rate of compensation increase	3.0%	N/A	3.5 %	N/A

Assumed health care cost trend rates

(weighted average assumptions)	2006	2005
Initial health care cost trend rate	5.87%	6.10%
Ultimate health care trend rate	4.27%	4.28%
Year ultimate rate is reached	2011	2011

Sensitivity Analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the post employment benefit plan. A one-percentage-point change in assumed health care cost trend rates would have the following effects for 2006:

(millions of dollars)	1% Increase	1% Decrease
Accrued benefit obligation	\$12.2	\$(9.5)
Total of service and interest cost	\$0.5	\$(0.4)

Defined Contribution and Other plans

The total cost recognized in 2006 for the Partnership's defined contribution plan was \$0.2 million (2005 – nil).

The Partnership contributes to forest industry union defined benefit pension plans providing both pension and other retirement benefits. These plans are accounted for as defined contribution plans. Contributions to these plans, not included in the cost recognized for defined contribution plans above, amounted to \$6.2 million in 2006 (2005 – \$6.3 million).

8. Property Plant and Equipment

(millions of dollars)	December 31, 2006		
	Cost	Accumulated amortization	Net
Land	5.4	-	5.4
Buildings, machinery and equipment	1,272.6	684.5	588.1
Construction in progress	5.1	-	5.1
	1,283.1	684.5	598.6

(millions of dollars)	December 31, 2005		
	Cost	Accumulated amortization	Net
Land	5.2	-	5.2
Buildings, machinery and equipment	1,248.7	629.3	619.4
Construction in progress	3.3	-	3.3
	1,257.2	629.3	627.9

9. Related Party Transactions

The Partnership's transactions with related parties are based on agreed upon amounts, unless otherwise noted below.

The Partnership purchased wood chips and hog fuel from Canfor sawmills in the amount of \$83.3 million in 2006 (2005 — \$106.2 million). The Partnership also purchased wood chips from Lakeland Mills Ltd. and Winton Global Lumber Ltd., in which Canfor owns a one-third interest. Purchases from these entities in 2006 were \$8.6 million (2005 — \$11.1 million).

Effective July 1, 2006, the Partnership entered into a services agreement under which Canfor provides certain business and administrative services to the Partnership. Total value of the services provided in 2006 was \$8.5 million (2005— \$11.6 million). The corporate costs in comparative periods prior to the acquisition were based on estimates of the Pulp Business' share of Canfor's corporate costs (Note 1).

Effective July 1, 2006, the Partnership entered into an incidental services agreement with Canfor, under which the Partnership provides certain business and administrative services to Canfor. Total value of the services provided in 2006 was \$1.5 million (2005— \$1.5 million).

The Partnership markets bleached chemi-thermo mechanical pulp production from Canfor's Taylor Pulp Mill for which it earned commissions totaling \$2.3 million in 2006 (2005 — \$2.8 million). The Partnership also purchased chemi-thermo mechanical pulp from the Canfor Taylor Pulp Mill for resale totaling \$10.1 million in 2006 (2005 — \$8.0 million). In respect of the products marketed and services provided for the Canfor Taylor Pulp Mill, the Partnership held balances of \$6.3 million in accounts receivable - trade and \$6.6 million in accounts payable to Canfor at December 31, 2006 (2005 — \$8.8 million accounts receivable - trade and \$9.8 million in accounts payable to Canfor).

The Partnership markets the NBSK pulp produced by Howe Sound Pulp and Paper Limited Partnership (HSLP), a partnership 50% owned by Canfor, for which it earned commissions totaling \$4.7 million in 2006 (2005 — \$6.0 million). In respect of the products marketed and service provided for HSLP, the Partnership held balances of \$31.9 million in accounts receivable - trade and \$23.1 million in accounts payable to HSLP at December 31, 2006 (2005 — \$32.3 million in accounts receivable - trade and \$35.6 million in accounts payable to HSLP).

On July 1, 2006, Canfor transferred the Pulp Business to the Partnership in exchange for a \$125 million promissory note, 14.254 million Class A Limited Partnership Units and 57.016 million Class B Exchangeable Limited Partnership Units. This Partnership paid the debt in full on November 30, 2006. Total interest paid or payable to Canfor was \$3.7 million in 2006.

At December 31, 2006, a total of \$14.3 million was outstanding as accounts payable to Canfor in respect of purchases of wood chips, hog fuel, services and amounts paid on behalf of the Partnership. At December 31, 2006 a total of \$0.8 million was payable to Lakeland Mills Ltd. and Winton Global Lumber Ltd. for wood chips (2005 - \$0.7 million).

During 2006, the Partnership declared distributions totaling \$88.5 million to its limited partners. Distributions to Canfor were \$57.9 million, of which \$45.0 million was paid, with the balance of \$12.9 million payable on December 31, 2006. Distributions to the Fund were \$30.6 million, of which \$17.7 million was paid, with the balance of \$12.9 million payable on December 31, 2006.

10. Income per Partnership Unit

Basic income per Partnership unit is based on the weighted average number of limited Partnership units outstanding during the period. All outstanding Partnership units were issued on July 1, 2006, and there was no change in the number of outstanding Partnership units during the quarter. For purposes of comparative amounts for periods prior to July 1, 2006, it was assumed that the same number of units was outstanding throughout the comparative periods. There were no other securities with rights to conversion into Partnership units outstanding.

11. Financial Instruments

The Partnership uses a variety of financial instruments to reduce its exposure to risks associated with fluctuations in foreign currency exchange rates, pulp prices and energy costs.

At December 31, 2006, the Partnership had outstanding pulp swaps to hedge 7,500 tonnes (2,500 tonnes per month to March 2007) of future pulp sales at an average price of US\$683 per tonne, along with matching US dollar forward contracts for the exchange of US\$5.1 million at an average rate of 1.1092. There was a combined unrealized loss of \$1.0 million on the pulp swaps and forward contracts at the end of the period.

At December 31, 2006, the Partnership had outstanding commodity swaps hedging future natural gas purchases of 3.6 million gigajoules extending to October 2009 with an unrealized loss of \$0.8 million.

12. Changes in Non-Cash Working Capital

(millions of dollars)	Year ended December 31,	
	2006	2005
Accounts receivable	0.3	2.1
Inventories	(4.0)	7.3
Prepaid expenses	(8.2)	1.3
Accounts payable and accrued liabilities	1.4	(8.6)
	(10.5)	2.1

13. Distributions

The Partnership declared distributions in its first six months of operation as follows:

(millions of dollars, except per unit amounts)

Record Date	Payable Date	Amount per Partnership Unit			Amount
		Monthly	Supplemental	Total	
		\$	\$	\$	\$
August 2, 2006	August 15, 2006	0.12	-	0.12	8.5
August 31, 2006	September 15, 2006	0.12	-	0.12	8.5
September 29, 2006	October 13, 2006	0.12	0.08	0.20	14.3
October 31, 2006	November 15, 2006	0.12	0.08	0.20	14.3
November 30, 2006	December 15, 2006	0.12	0.12	0.24	17.1
December 29, 2006	January 15, 2007	0.14	0.22	0.36	25.8
Total		0.74	0.50	1.24	88.5

14. Commitments and Contingencies

The Partnership has committed to the following operating leases for property, plant and equipment. As at December 31, 2006, the future minimum lease payments under these operating leases were as follows:

(millions of dollars)	
2007	3.0
2008	1.5
2009	0.7
Thereafter	0.5
Total minimum lease payments	5.7

In 2003, Canfor entered into an agreement with BC Hydro to build an electrical cogeneration facility at the Prince George Pulp and Paper Mill. Under the agreement, BC Hydro contributed \$45.8 million of the project costs, with Canfor contributing the balance. The agreement was assigned to the Partnership effective July 1, 2006, with incentive payments totaling \$11.4 million outstanding. The final incentive payment of \$11.4 million was received August 9, 2006, and transferred to Canfor. The total incentive payments of \$45.8 million were accounted for as a credit to property, plant and equipment of the Partnership. The project was completed in the second quarter of 2005 at a net cost to the Pulp Business of \$69.6 million. The agreement entails a 15 year commitment with BC Hydro for power displacement at the cogeneration facility, whereby a proportionate repayment is required should the facility not

generate the minimum of 390 gigawatt hours of electricity per year. Under the agreement, the Partnership is required to post a letter of credit as security in annually decreasing amounts as minimum required amount of electricity is generated.

As of December 31, 2006, the Partnership has no repayment obligation under the terms of the agreement and a standby letter of credit in the amount \$30.6 million was issued to BC Hydro.

15. Segmented Information ^(a)

(millions of dollars)	Pulp	Paper	Unallocated Costs ^(d)	Total
Year ended December 31, 2006				
Sales to external customers ^(b)	720.9	113.5	-	834.4
Sales of pulp to paper segment ^(c)	71.4	(71.4)	-	-
Operating income (loss)	146.3	3.2	(14.4)	135.1
Amortization	45.0	3.8	0.2	49.0
Capital expenditures	16.9	0.8	1.9	19.6
Identifiable assets	784.2	70.8	38.4	893.4
Year ended December 31, 2005				
Sales to external customers ^(b)	653.8	117.4	-	771.2
Sales to other segments ^(c)	65.6	(65.6)	-	-
Operating income (loss)	26.7	3.6	(13.6)	16.7
Amortization	43.4	3.8	-	47.2
Capital expenditures	42.1	0.3	0.6	43.0
Identifiable assets	797.6	77.9	2.9	878.4

(a) Operations are presented by product lines. Operations are considered to be in one geographic area since all production facilities are in Canada. Substantially all sales are exported outside Canada, with sales to United States representing 43% (2005 – 40%).

(b) Sales to two largest customers represented approximately 34% of pulp segment sales (2005 – 37%).

(c) Sales of slush pulp to the paper segment are accounted for at approximate market value. The sales are transacted as a cost transfer and are not reflected in Pulp sales.

(d) Unallocated costs represent actual head office administrative costs in the third and fourth quarters of 2006. For all periods prior to July 1, 2006, head office administrative costs were based on allocated Canfor corporate expenses as described in Note 1.

16. Subsequent Events

On January 24, 2007 the Partnership declared a distribution of \$0.14 per unit or \$10.0 million, payable on February 15, 2007 to unitholders of record on January 31, 2007. On February 16, 2007, the Partnership declared a distribution of \$0.14 per unit or \$10.0 million, payable on March 15, 2007, to unitholders of record on February 28, 2007.